

The global COVID-19 crisis: An opportunity to rethink global supply chains of our companies?

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Introduction:

Only 2 months ago nobody heard of them, but since then they occupy the global news headlines... Wuhan and the COVID-19 virus. Wuhan a medium sized Chinese city of 12 million inhabitants in the south east of China and also the city where the COVID-19 virus at the end of 2019 started. It coincided exactly at the moment of the important and popular Lunar Celebration in China, one of the biggest festivals where millions of people travel from their resident city, back to their birth places to celebrate Chinese New Year with their family. It caused the Chinese government a serious headache to contain the virus and limit its further spread. They issued far going regulations regarding isolation of areas, limiting social contacts, the extension of the holidays and even the temporary closure of thousands of companies.

Hardly one month later the COVID-19 virus is causing severe health and sanitary problems in most of the countries, with even total lock downs in Europe. So, it comes as no surprise that it also affects the global economy. Due to the slowdown of the economy of several countries, China included, global growth is also slowing. We even see companies closing down and some of our products we daily use are becoming scarce or even unavailable... Unbelievably, but there is a link between Wuhan, China, COVID-19 and the shutdown of companies, job losses and scarcity of products on the shelves of the shops just near you....

When China, the world's workshop, closes for a short moment....

Everybody knows by now that most of our products and services have a link with China. The countries' almost continuous double-digit growth path of the last 30 years and its fast and full integration in the world economy and in the global supply chains of most of our companies made of China the world's workshop or the global factory.

Few people ever thought of what may happen if this global production motor would start stuttering, would have problems or even shut down for a moment Well the COVID-19 virus made it stutter and shut down for weeks, as we speak.

The measures the Chinese government took to contain the COVID-19 virus from spreading, included amongst others an extension of the New year holidays and a 3-week factory close down. At the end of February, Xi Jinping instructed the 170.000 Chinese Communist Party officials that the country's priority should be the recovery of the production and the restart of leading enterprises with a key function in the global.

Already under normal circumstances the return of the migrant workers after their holidays causes a serious labour shortage. Many look for jobs closer to home, instead of going back thousands of kilometres to the industrialised areas on the Chinese South Coast and the Pearl river Delta. The return this year was a huge nightmare for the companies in the coastal areas. At the end of February, more than 100 million migrant workers did not turn up. They stayed absent due to fear of being put in quarantine after the long travel from their hometown back to their workplace. The new start of the year was difficult, and that is an understatement. Nevertheless, the Chinese media published half of March that the companies in 11 provinces of the south eastern coastal area resumed work at a rate of more than 90%. These companies are the large state-owned enterprises and to achieve this some of the local governments, like Guangdong, chartered trains and planes or provided extra financial incentives for the workers to return. However, most the small and medium size enterprises

are still struggling with the huge labour shortage. Officials stated only 43% of these SME's had resumed normal operations.

China's role in the global economy and in the global supply chains of this world

Suddenly the world starts to be worried about China's role and influence in the global economy! China's contribution to global economic growth in 2018 was 33.43 %. China is the largest trading country, the world's second largest economy, the second largest consumer country and the second largest manufacturing country in the world. China has 110 companies in the Fortune 500 enterprises, it is the world's largest logistics and e-commerce market.

The current position of China in the world economy and the role it plays in the supply of parts and services across the global supply chains of major brands and China's own demand for products and services influences hugely the state of the global economy, but also those of individual countries and even companies. The production stop in China, due to COVID-19 crisis, will have an enormous impact on the economy.

The OECD published a worst-case scenario in which the global economic growth would be halved from 2,9% to 1,5%. Other voices are less apocalyptic and refer to the wrong prediction of the impact of the 2003 SARS virus on the economy. Some estimated that its effect would be huge, but finally it turned out to be only a small blip on the global economic radar. The situation in 2020 is different! In 2003 China contributed only 4,3% of the world GDP, while now it represents more than 17%. Since then China doubled its trade share with the rest of the world. The impact could be enormous.

A publication of the think tank ODI¹ predicted that if the Chinese demand would fall by 1% due to the COVID-19 virus outbreak, low- and middle- income countries would lose €4 billion worth of exports and €0.6 billion of revenues from tourism. The economic impact of the COVID-19 virus outbreak will be mostly felt by countries with close links to China. Some countries export up to 90% their total exports to China. More than 20% of total tourist arrivals in Myanmar, Thailand, Mongolia, Cambodia and Vietnam come from mainland China.

This shows once more that China is key to most of the supply chains, but at the same time its growing demand for products provides a huge potential for the same companies. It is scary but a lot of our products lives are starting and/or ending in China.

The decent infrastructure, services, flexibility of labour and the low labour costs made China attractive to be integrated in the global supply chain of most companies. The development of China and the urge of companies to reduce supply chain costs motivated them to pursue strategies such as lean manufacturing, offshoring, and outsourcing. These type of cost-cutting measures cause that when there is a supply-chain disruption, manufacturing will stop quickly due to the lack of parts. Indeed, companies with large supply chains, including in China, take a risk. But they take this risk knowingly because cutting costs is more important to them than anything else. In addition, many companies are unable to assess this risk since they have no overview of their entire supply chain. Research shows that a multinational company like as Volkswagen can have up to 5.000 tier-one suppliers, each with an average of some 250 tier-two suppliers, thus such a multinational would have more than 1 million suppliers across its entire production chain.

More than 51.000 companies have in their supply chain suppliers that are situated in Wuhan and at least 5 million companies around the world have one or more tier-two suppliers in the Wuhan region, the COVID-19's epicentre. The proof that China's factory shutdown really touches the central nerve of the global system!

¹ <https://www.odi.org/blogs/16639-economic-vulnerabilities-coronavirus-top-countries-risk>

The new business models used by companies on their supply chain work with highly calculated supply lead times (delivery periods for their products). This makes it possible to keep a reserve of spare parts limited to a minimum period, mostly one to 2 weeks. International brands like Tesla, Jaguar, Fiat-Chrysler, Apple, Hyundai, already announced possible disruptions of their production, even SME's in European and Asian countries are announcing the same type of problems. Consequently the worst supply chain disruptions still have to come, seen the delivery and transport times of products shipped by boat from China to Europe are minimum 3 weeks to one month, and the production in China only restarted at the beginning in March.

Even the Chinese Dream – their “Belt and Road Initiative”- slows down...

Also, the Chinese investments and projects abroad, in the context of the Chinese President's Belt and Road initiative, are undergoing delays, slowdowns and even stoppages due to failing delivery of parts or delayed return of the Chinese workers to these projects abroad. Some examples:

- The 6 billion China railway project to build a high-speed railway between Jakarta and the textile hub of Bandung will be delayed due to the late return of 300 Chinese workers.
- The Batang Toru hydropower project in Indonesia with more than 2 months.
- Bangladesh stopped issuing visas for Chinese visitors and consequently blocked several projects like the Bangladesh china power company or the construction of the Padma multipurpose bridge.
- Same story for the East Coast rail link from Wuhan to Malaysia, the building of the Colombo Port in Sri Lanka and construction projects in Pakistan and several African countries

Company closure impacts workers income

The closure of companies due to lack of raw materials or spare parts do have direct consequences on the jobs of workers! Temporary company closures mean in the best scenario no salary, in the worst job loss... Workers in several European countries can count on their social protection system. In Belgium for example the government, employers and the 3 main trade unions agreed that all affected workers can access the temporary unemployment programme, meaning they will receive an unemployment benefit during the period their companies stop their production.

But in most countries in Asia or Africa, where social protection systems are weak or non-existent, workers will be without salary or compensation. In case they are laid off, they will have to start looking for a new job.

Many companies in the garment sector in Cambodia, Vietnam, Myanmar undergo already temporary closures due to supply chain disruption caused by China's shutdown. The garment industry in these countries is extremely dependent on the import of raw materials, zippers, buttons etc from companies in China. China provides for example 60% of the raw materials of Cambodia's garment industry. This industry provides jobs to more than 800.000 workers, mainly women workers. The Cambodia Ministry of Labour declared that if the shortage of raw materials would still drag on this would have consequences for the jobs of 90.000 workers. These workers have few savings and cannot bridge the gap of temporary loss of wages. In support of these workers the ministry announced a scheme in which the garment workers victim of such a temporary company closure will receive 60% of the minimum wage (current minimum wage is 190\$ monthly – so 115\$), 40% from the factory and 60% from the government. Trade unions observe that this scheme cannot last long, since the companies won't pay forever the 40%.

In Indonesia trade unions are working on the inclusion of an unemployment scheme in the social protection system. Such a scheme can absorb this type of risks, in addition to the consequences caused by the transitions in the context of digitalisation or climate change.

What are the problems in the global supply chain?

The blind logic for profit steers the remodelling and the management of supply chains. These cost reducing models have a direct consequence on the workforce in the lower levels of these chains (the lower tiers), they are exposed to severe violations of national and international labour laws and regulations. The outsourcing practice in the supply chain increased fast. Many supply chains even end, or start, in the informal economy where workers are outside the legislation and even child labour is not an exception.

Some examples from companies in the supply chain in Indonesia:

- PT. Inalum aluminium is a large company that outsources its work to 900 companies with a total workforce of 12.000 people. Some workers work already 20 years for the aluminium factory, but never built up any work seniority considering they change every 2 years from outsourcing company.
- In Freeport Mac Moran, a US gold mine company multiplied its subcontractors from 10 in the year 2010 to hundreds nowadays. At the beginning, this process aimed at sharing the responsibility of the operations, but then they started to share also the responsibilities of their workers and now they are all independent companies. Again, workers are shifted between the companies which allows them to keep the workers on short term contracts. As a result, these workers don't build up rights. The same model is practiced by Vale, a Brazilian mining company, or Chevron....
- Wilmar, the biggest palm oil plantation in Southeast Asia, set up a business group, which includes the mother company, daughter companies, partnerships and many other types of cooperation between the different business entities. Their chain is totally untransparent, they can change their structure at any time they want. And when labour rights violations occur in this chain, the mother company declares not to be responsible for that level of the chain.

But work in the global supply chain can and will become decent...

In 2016 the ILO began the discussions on how to improve decent work in the global supply chain. This reflection could lead to a new set of instruments of the ILO on the global supply chain. Unfortunately, the employers group in the ILO does not want any enforceable regulation, according to them the problem of the declining quality of decent work in the global supply chain is the weakness of governments to enforce legislation and not the lack of responsibility of the companies.

Currently negotiations and discussions are ongoing within the UN and the EU, but also in individual countries, like Germany, Switzerland,... to draft enforceable legal frameworks based on the UN Guidelines on Business and Human rights² (Ruggie framework, 2011) which put forward the responsibility of companies to conduct Human Rights Due Diligence across their supply chains.

The Accord on Fire and Building safety in Bangladesh, or the Better Work programs of the ILO in Indonesia, Cambodia and Myanmar are already investing in better working conditions in the supply chains.

Initiatives of trade unions contribute also extensively to the improvement of decent work in the global supply chain, like the Global Framework Agreements between a Global Union Federation and a brand; the Indonesian Freedom of Association protocol in the garment sector in which several brands, suppliers and trade unions agree to respect the freedom of association in the companies; or a program on networking in multinational companies in Asia with unions in Cambodia, Indonesia, Myanmar etc.

² <https://www.business-humanrights.org/en/un-guiding-principles>

“But will a virus crisis push the multinational companies to alter their supply chain model and or leave China?”

Over the last few years several companies already left China for neighbouring countries like Myanmar, Cambodia, Bangladesh, Vietnam. Mostly those with highly polluting production processes or those producing goods with a low added value. But changing the production to other countries is costly and time consuming. Most companies do this on the base of long-term predictions. Will such a crisis caused by a virus be enough? The combination of increasing labour costs, trade tensions, pressure from CSOs to make supply chains more sustainable, degrowth discussions and this virus might push companies to diversify their production bases and suppliers. They might investigate new types of production models, like short economic cycles, recycling and reusing of materials...

The shifting of supply chains or production sites from one country to another due to an earthquake or floods seems to be a real possibility, but in a situation of a global pandemic, where many countries will be hit, it seems more difficult.

Many companies will start up reflections to review their supply chain model on the long term, maybe looking into the possibilities of having less suppliers, or having them closer to the main markets or to the home base of the brands. At the same time, we need to be aware that these global supply chains create employment in the South and by extreme remodelling workers in these regions will lose their income.

Hopefully government, international institutions supported by civil society, including trade unions, can use this period to set up a global legal framework that will guarantee human and trade union rights as well as the environment across the supply chains of the future.