

Bailing out the Supply Chain

COVID-19 and the impacts for workers in supply chains

April 2020

As the coronavirus continues to spread, affecting almost every area of our lives, the attention of companies and policymakers is focused not just on how to fight the pandemic, but also how to minimise the damage to people’s livelihoods. In this paper, we explore the impact on supply chains using the specific case of the hard-hit garment supply chain.

This paper proposes a way forward for brands, retailers and policymakers to mitigate the impact of the crisis and to strengthen resilience moving forward. This would include brands and retailers honouring their contracts to their suppliers and working with suppliers to ensure workers who don’t benefit from social protection coverage have the means to survive during this crisis. Secondly, it requires donor governments and international organisations to come together and establish social protection floors in production countries, as well as regulatory reform in countries where brands and retailers are domiciled.

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COVID-19 and the impacts for workers in supply chains

The coronavirus has hugely disrupted world trade. A few essential industries remain stable. Some even benefit from the increased demand that widespread lockdown and quarantine has brought, such as medical supplies, toilet paper, and food in supermarket supply chains. Other sectors are profoundly affected, demonstrating the precariousness of our global systems of production and consumption.

The case of the garment sector

The garment industry is a case study of fragility. The main consumer markets are not major producers, relying on complex international supply chains. Workers are typically on low wages and have few savings. Production countries have limited-to-non-existent social security systems to provide unemployment benefits, employment injury insurance and healthcare. Factory owners are not always obliged to contribute to social security systems. And the brands and retailers in Europe and North America have designed a sector with low prices and flexibility in mind.

COVID-19 has brought deep disruption to this model, driving the garment industry into crisis. On the one hand, two major production countries – namely China and Italy – are two of the most affected countries, contributing to a reduction in supply. Similarly, on the demand side, sweeping government measures have led to the closure of clothing stores, stopping people from shopping for clothes and leading to a collapse of global demand.

As a consequence, H&M's share price has plummeted by about half over the past month while Inditex has lost one third. As a response, brands are seeking to shift risk onto their suppliers. In one week, garment brands have cancelled about \$1.5bn worth of clothes orders from Bangladesh alone¹, casting at least 1 million workers into unemployment.² Many global brands and retailers have asked suppliers to be “flexible” and have “understanding”, and have made the following demands:

- Cancelling orders for goods that workers had already made.
- Cancelling orders for goods that workers were in the process of making.
- Delaying payment terms.
- Requiring / discounts back to retailers and brands.

These demands have devastating consequences for textile workers worldwide. Most suppliers suddenly lost contracts which were in-process, without any form of compensation. 72% of surveyed suppliers said they were unable to provide their workers with some income when furloughed (sent home temporarily), and 80% said they were unable to provide severance pay when order cancellations resulted in worker dismissals, with over 90% reporting no support from brands to cover these costs.

¹ <https://www.bloomberg.com/news/articles/2020-03-23/europe-retailers-cancel-1-billion-of-bangladesh-garment-orders>

² <https://qz.com/1828541/covid-19-leads-to-one-million-garment-workers-unemployed/>

Over 95% of suppliers indicated that brands and retailers refused to contribute to the cost of partial wages for workers who were suspended or severance payments for those dismissed.³

These developments underscore the massive power imbalances between Western brands and workers in the global garment industry. Companies can set the terms of trade unilaterally, with grave consequences for workers and suppliers.

At the same time, the legality of these cancellations is debatable. As discussed below, Force Majeure provisions in contracts have been widely invoked, although these often have their limits. Suppliers may lack the legal support to dispute the interpretation of Force Majeure.

A crisis compounded with non-existing or weak national health and social protection systems in production countries

Cancellation of orders, and the likelihood that future orders will be smaller than forecast, has left many workers without any income.⁴ Over 1 million garment workers are reportedly out of work in Bangladesh alone since the beginning of the crisis, with millions more at risk globally as the measures take root and more orders are cancelled. In factories where production continues, workers don't always have the necessary protective equipment and guidance regarding distancing is not always observed.

At the same time, national institutions in production countries are not all equipped to deal with the enormous rise of unemployed people and people in medical need. Several production countries also lack the capacity to provide sufficient stimulus to their economies.

For decades, several of these countries have sought to develop their economies through the adoption of reforms to attract foreign investment or export. This supply-side model has not been compatible with the establishment of deep and wide social protection coverage. Instead, these countries have, under pressure from International Financial Institutions, followed a race to the bottom through wage suppression, deregulation and privatisation. Faced with a collapse of orders combined with the effect of the COVID-19 virus, these countries are ill-equipped to provide support to the increasing numbers of sick people, workers at risk of exposure, and families without income.

In conclusion

The global garment industry employs 50 million workers who are now facing a difficult and uncertain future. This is not an accident. Large garment businesses have deliberately established themselves in countries with low wages and low levels of regulation and continue to scan the world to find the cheapest places to produce. Meanwhile, workers won't have savings to carry them through hard

³ Anner M., Abandoned? The Impact of Covid-19 on Workers and Businesses at the Bottom of Global Garment Supply Chains, March 2020

⁴ As a first estimate, the International Labour Organization estimates that 35 million people are at risk of working poverty as a result of the COVID-19 crisis: https://www.ilo.org/wcmsp5/groups/public/---dgreports/---dcomm/documents/briefingnote/wcms_738753.pdf

times. Their employers are working on extremely tight margins. Their national governments are not able or willing to develop an adequate social protection mechanism. The necessary institutions to protect workers from the consequences of insolvency are often lacking. Workers, farmers, suppliers and sourcing countries are not responsible for EU, US or UK businesses having adopted precarious business models. Yet they are bearing the brunt of the consequences.⁵

Moving forward

Immediate term - The responsibility of brands and retailers

Honouring contracts and prompt payment.

Everybody agrees that these are exceptional times, and nobody denies the extraordinary economic impacts of the crisis on the world economy. However, this hardship extends to all companies including suppliers. Hence, as an absolute minimum, brands and retailers need to honour existing contracts that they have already signed. Some brands are seeking to evade this responsibility by invoking Force Majeure. The legality of this approach varies depending on the specifics of the contract. In several cases, Force Majeure seems to have been used for economic reasons, to terminate contracts where the continuation would have been merely impractical. Brands and retailers should avoid misusing Force Majeure provisions in contracts to evade their contractual responsibilities.

In addition, brands and retailers which benefit from European consumer markets need to pay their suppliers promptly, widely recognised across Europe and in the UK as being 60 days after the receipt of an invoice.⁶ The current situation makes prompt payment even more urgent. Similarly, brands also need to work with their suppliers to ensure that workers continue to receive salary payments to bridge the time of technical unemployment.

The ETI has already called for such measures.⁷ So far, some ACT brands⁸ such as the H&M Group⁹ appear to have in principle taken steps in the right direction.

Other **brands and retailers should** follow this example and

a) pay for finished products

b) pay for committed cost on unfinished products to cover the material and salaries of workers

c) do so within agreed (or mandated) payment terms.

⁵ As a first estimate, the International Labour Organization estimates that 35 million people are at risk of working poverty as a result of the COVID-19 crisis: https://www.ilo.org/wcmsp5/groups/public/---dgreports/---dcomm/documents/briefingnote/wcms_738753.pdf

⁶ See https://ec.europa.eu/growth/smes/support/late-payment_en

⁷ <https://www.ethicaltrade.org/blog/eti-during-coronavirus-outbreak>

⁸ <http://www.industriall-union.org/act-brands-commit-to-responsible-business-practices-in-bangladesh>

⁹ <https://assetsds.cdnedge.bluemix.net/business/news/hm-comes-its-garment-suppliers-rescue-1887454>

Minimising negative impacts on workers

The international consensus on Responsible Business Conduct¹⁰ is clear that any company should assess the potential negative impact of any business decision. Once such an impact is identified, brands need to prevent and mitigate any negative impact if they pursue such a decision.

In cases where production is currently happening, brands therefore need to collaborate with suppliers to assess whether production can take place in such a way that complies with World Health Organisation guidelines to protect workers from COVID-19. Where it is impossible to guarantee the necessary protection, brands should not ask their suppliers to put the health of workers, their families, and the wider society, at risk.

Where brands have ceased orders, they need to assess how that decision places workers at risk. Brands can reasonably assume that any cancellation of orders or delay in payment terms will directly negatively impact thousands, if not millions, of the workers are involved in making their products. Hence, brands should consider the impact that such decisions (like cancelling or suspending orders) have on workers' rights, including the immediate risk of unemployment.¹¹

Brands hold a responsibility for the welfare of workers who have been working in their supply chains. Brands should ensure that workers being made temporarily redundant owing to lack of orders continue to receive a salary. A salary obviously includes the monthly take-home pay. Any contributions (or lack thereof) for a social protection system should equally be considered an integral part of the salary. Such contributions vary by country, with Pakistan and Cambodia having established some systems which cover workers to a certain extent. Countries like Bangladesh have not done so, resulting in lower prices for brands. This choice for low salary sourcing destinations now comes back to haunt the brands and suppliers in relation to the consequences now faced by their workers living in countries without robust social protection systems.

Brands are particularly responsible for ensuring workers continue to receive a salary where they have failed to collaborate with their suppliers to foresee and finance private insurance against the risk of unemployment. In cases where there is limited state-based or private unemployment insurance, brands need to work with their suppliers to ensure income for workers during the time that there is no production. Special attention should be given to migrant workers and home-based workers.

Brands and retailers should work with their suppliers to minimise the impact on workers by

- a) **ensuring safe working conditions** where production continues
- b) **ensuring immediate salaries and termination benefits are properly paid;**

¹⁰ UN Guiding Principles on Business and Human Rights, the OECD Guidelines on Multinational Enterprises, the OECD Due Diligence Guidance on Responsible Supply Chains in the Garment and Footwear Sector and the OECD General Guidance on Due Diligence for Responsible Business Conduct.

¹¹ See especially articles 23(1), 23(3) and 25 of the Universal Declaration on Human Rights (UDHR) and article 9 of the International Covenant on Economic, Social and Cultural Rights (ICESCR).

c) ensure payment of salaries in the interim until production restarts, even for workers whose employment has been terminated since mid-April (since there is no prospect of future work in the short term).

A longer-term responsibility for the international community

The need for international institutions to step in

In order to protect workers from both the pandemic and the economic effects of disrupted supply chains, International Financial Institutions should come to the assistance of sourcing countries that don't have the necessary economic or financial strength for stimulus and/or lack the necessary social protection regimes. Donor governments (including EU, G7 and G20 countries) and International Financial Institutions (IFIs) including Multilateral Development Banks (MDBs) should:

- Temporarily suspend loan repayments from sourcing countries that are hardest hit, and work to restructure such debt including relieving debt.¹²
- The donors, IFIs, and MDBs should also work together with the International Labour Organisation (ILO) and World Health Organisation (WHO) to quickly establish an appropriate aid and finance package to disburse to workers who have lost jobs in the garment sector and where brands have been unable to step in. It is anticipated that this package would have to amount to multiple billions of dollars.¹³

Such a global social protection fund should be aimed at increasing vulnerable countries' resilience in the context of volatile and globalised supply chains, by:

- Requiring detailed, specific, and time-bound commitments from recipient governments to get money quickly, securely and transparently to affected workers and their families.
- Building on the existing labour safeguards within IFIs, recipients should be obliged to develop the necessary institutions in the medium term including the development of a robust national social protection system post-crisis, which would include employment injury, paid sick leave and unemployment benefits. While the immediate aid and finance package can serve as seed-funding for such a system, a long-term finance mechanism needs to be developed which includes a contribution system as outlined in relevant ILO Conventions, and supplemented by a finance mechanism which includes international buyers when sourcing resumes. The package should also contain a strong pillar dedicated to strengthening domestic regulation, which includes:

¹² See also <https://jubileedebt.org.uk/actions/stop-coronavirus-debt-disaster>

¹³ UNCTAD has estimated that a broader relief package would amount to 2,5 trillion USD <https://unctad.org/en/pages/newsdetails.aspx?OriginalVersionID=2315>

- Ratification and implementation of the ILO Core Conventions.
 - The strengthening of national Occupational Health and Safety systems.¹⁴
 - The development and/or extension of social protection coverage for all workers¹⁵ in case of sickness, employment injury, unemployment, suspended employment and insolvency.¹⁶
- The aid and financing need to be designed in such a manner to support the time-bound road map. Failure to comply should eventually lead to penalty rates for paid out loans and other financing instruments.
- Including within the governance of the package representation of the MDBs, donor governments and recipient governments, as well as international unions and representatives of employers. At the national level, it is important to develop a tripartite governance structure to oversee the country-specific implementation of the package.
 - Ensuring variation within the modalities of the repayment of the initial package as well as the future financing of the social protection systems. Repayment should involve brands, buyers, suppliers and as production countries. However, independent of the mix, the financial burden should not lie exclusively with beneficiary countries. Indeed, while brands and retailers might not be able to provide for financing currently, the package should be (partially) repaid by a price premium on future orders which is added on the Freight on Board price in cross-border trade.

Governments and International Institutions should quickly agree a significant financial and regulatory package to assist countries who are facing the combined challenges of massive cancellations of orders and subsequent lack of employment together with the scale of the COVID-19 pandemic.

¹⁴ This should at a minimum include the ratification and implementation of ILO C155 - Occupational Safety and Health Convention, 1981, (No 155) to the extent that a beneficiary country has not yet done so.

¹⁵ In the case of the example in the garment sector, it should not only cover factory workers and/or nationals but ensure that it also covers home workers and/or migrant workers. Therefore, the package should include the ratification and implementation of C097 - Migration for Employment Convention (Revised), 1949 (No. 97), C143 - Migrant Workers (Supplementary Provisions) Convention, 1975 (No. 143) and C177 - Home Work Convention, 1996 (No. 177). Also, the package should factor in Recommendation R204 - Transition from the Informal to the Formal Economy Recommendation, 2015 (No. 204).

¹⁶ This includes the ratification and implementation of C095 - Protection of Wages Convention, 1949 (No. 95), ILO C102 - Social Security (Minimum Standards) Convention, 1952 (No. 102) and C102 - Social Security (Minimum Standards) Convention, 1952 (No. 102) to the extent that a country has not yet done so.

The need for regulatory reform for more robust supply chains

- Host countries, where brands and retailers are domiciled, should support this package through regulatory reform to support fairer commercial practices in sourcing relationships. Such reform should ban or limit certain unfair commercial and trade practices such as late payments, late order changes, post-hoc discounts and unilateral cancellations. Such reform should counter the power asymmetry between brands/retailers and their suppliers, ensuring that contracts are fairer on the weaker contracting party (typically the suppliers in poorer countries).
- Given the power asymmetry between brands and retailers and their suppliers, and the subsequent reluctance on the part of the weaker party to even complain when contractual terms are breached, it is important that such reform is coupled with a system of robust enforcement. This should include the establishment and/or strengthening of a regulatory mechanism where suppliers can raise anonymous complaints.
- Such legislation already exists within the EU in the agri-food sector, in the recently adopted Directive on Unfair Trading Practices¹⁷ which stops food/agricultural buyers applying abusive purchasing practices to their suppliers and provides an anonymous method for suppliers to complain. In the UK there is the Groceries Code Adjudicator¹⁸ which is a watchdog on the relationships between the 13 largest food retailers and their suppliers. Both the UK and EU mechanisms can be used by suppliers all over the world. To support more robust supply chains, similar regulation to the European Unfair Trading Practices Directive could be developed to cover garments.
- Finally, host countries should legislate to place an obligation on companies to respect human rights in their operations and supply chains. Such laws should do two things. One, they should require companies to conduct due diligence on their human rights and environmental risks and take appropriate steps to prevent or mitigate those risks. This would extend to supporting workers (including in their supply chains) whose rights are jeopardised as a result of a business decision. Two, they should hold companies accountable in the courts if they abuse human rights.

In order to make Global Value Chains more resilient towards the future, governments need to **ban Unfair Trading Practices** in the Textile, Leather, Garment and Shoe sector as well as adopt **mandatory Human Rights Due Diligence legislation**.

¹⁷ https://ec.europa.eu/info/sites/info/files/food-farming-fisheries/key_policies/documents/brochure-utp-directive_en.pdf

¹⁸ <https://www.gov.uk/government/organisations/groceries-code-adjudicator>