Global Value Chains and the Information Asymmetry Problem

An Overarching Challenge of Sustainable Economic Governance

Long Abstract

Today, more than two-thirds of total international trade is embedded in global value chains (GVC). A GVC is the agglomeration of the manufacturing and distribution processes involved in the production cycle of a good or service, from its design to its delivery to the final consumer. In a GVC, the different steps of the overall process are carried out by hyperspecialized firms located in different parts of the world. Because of the high operational complexity of GVC structures, the exercise of organisational control and governance over the chain is a challenging task. This is particularly the case when it comes to the relationship between GVCs and sustainability.

The past two decades have witnessed a surge in the public interest for sustainable development. Sustainability has cemented itself as a policy priority on a global scale, leading to the proliferation of several initiatives aimed at tackling today's environmental, social, and economic global challenges. Because of the way in which GVCs are embedded into the fabric of the economy, sustainable GVC governance has become one of the most relevant topics in this context and this new field has been marked by key innovations both in the private governance and the public governance spheres. Private governance initiatives aimed at increasing sustainability in GVC structures have taken the form of industry self-regulation mechanisms such as codes of conduct, supplier management strategies, and voluntary sustainability disclosure practices. In the sphere of public governance, the trend is rapidly moving from reliance on international soft law tools towards the development of hard law-based regulatory initiatives, doctrinal innovations and new legal strategies aimed at introducing new boundaries for corporate behaviour. The developments in the field of sustainable GVC governance at all levels are plagued by many challenges. However, this paper seeks to shed light on one overarching and pervasive issue, that intrinsically complicates GVC sustainable governance and enforcement strategies in several different ways: information asymmetry.

Information asymmetry refers to a situation in which different parties to a transaction possess different levels of information relevant to the object of the exchange. In law and economics literature, asymmetric information is one of the primary market failures. This paper explores the way in which information problems manifest in GVC structures and how they affect both their private and public

governance. Information asymmetry is a material issue in GVC governance and information problems are exacerbated by the nature of the economic relationships between value chain partners. Understanding the incentive structures that underlie the flow of information in GVCs can shed light on the opportunities and limitations of private governance mechanisms and inform the way in which regulators can design effective legal interventions.

1. Global Value Chains and Information Loss

A GVC may be under the coordination of a “chain leader”, able to enact organisational control over the overall process. The chain leader is the actor in a GVC with the prerogative of enacting private governance strategies over the chain. It is also the primary target of the legislative interventions aimed at eliciting better sustainable performance of GVCs.

This section lays out how the role of chain leader comes with strong incentives to gather information on the sustainability performance of GVCs. The two main drivers are *reputation* and *liability risks*. Value chain partners (suppliers, contractors, distributors) may not have optimal incentives to share sull information with the leader, for a variety of reasons – e.g. fear of the termination of the business relationship; wanting to keep a competitive price by avoiding heightened compliance costs; fear of losing bargaining power, etc. The misalignment of incentives entails heightened monitoring costs for chain leaders and enables information loss along the value chain.

2. The Dimensions of Information Asymmetry in GVC Governance

This section displays some of the ways in which information asymmetry manifests in GVC structures, and how it affects control systems and enforcement mechanisms.

Private Governance

Private governance mechanisms for sustainability in value chains have increased in popularity and relevance in the business management sphere. A pertinent example is the voluntary practice of sustainable supply chain management (SSCM).

Asymmetric information inhibits sustainable private governance in two ways. First, it hinders the primary drivers behind why a corporation would want to have a more sustainable GVC. Assume that companies are incentivised to adopt strategies like SSCM because of positive feedback from activist investors and conscious consumers. If so, companies are only incentivised based on the strength of the consumers' and investors' preferences, and to the extent that investors and consumers have access to information on the sustainability performance of a company's GVC. Less access to information leads to less pressure put on companies to enact optimal levels of care. Secondly, even assuming that optimal care is employed GVC partners could still withhold relevant information that may lead to high-profile scandals, similar to the Rana Plaza incident. Thereby, reputational spillover risks are also heightened. Here chain leaders face a trade-off between monitoring costs and reputational spillover costs. However, because of the information loss, it might be difficult to quantify the trade-off in monetary value.

Public Governance

Public governance initiatives for sustainable GVC practices are generally enacted in jurisdictions with developed human rights and environmental protection frameworks – like the European Union. Legal strategies in this sense include mandatory human rights due diligence (mHRDD) laws, vicarious liability regimes for company groups and supply chains, transparency obligations, administrative enforcement regimes etc. These initiatives are often targeted at chain leaders incorporated in that jurisdiction, who are then obliged to become aware, monitor, prevent, mitigate and/or disclose information regarding human rights and environmental abuses that are linked to their GVC's business activities. Policymakers are especially concerned with companies incorporated in their territory outsourcing parts of their production process to high-risk countries. In this sense, public governance strategies for sustainable GVC governance seek to overcome the limitations of a government's jurisdictional reach, by relying on the chain leader's ability to exercise its influence transnationally – through their network of economic relationships.

Public governance strategies are divided into two main categories, based on the enforcement mechanism, which is either public enforcement – i.e. administrative sanctions, taxation and criminal persecution; or private enforcement – i.e. civil liability. Information loss in GVCs negatively affects the effectiveness of both of these enforcement regimes.

3. Informed Legal Strategies

The paper concludes by elaborating on the fact that private governance mechanisms for sustainable GVCs are intrinsically limited by the information asymmetry problem. As evidence shows, voluntary initiatives are less than effective in leading to an adequate level of internalisation of sustainability-based externalities. Public governance strategies risk incurring the same complications. Thus, policymakers should approach the design of their legal instruments in this regard by paying attention to disclosure incentives and the minimisation of the information problem.

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