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EXPERT GROUP MEETING ON INDUSTRIAL SUBCONTRACTING EXCHANGES AND POLICIES

Vienna, 22-24 May 1991

Report
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INTRODUCTION

1. The Expert Group Meeting on Industrial Subcontracting Exchanges and Policies met from 22 to 24 May 1991, at the Vienna International Centre. The purpose of the Expert Group Meeting was to review new and existing policies, programmes, mechanisms and instruments in the field of industrial subcontracting and to make recommendations for extending and reinforcing the mandate and guidelines of UNIDO in the implementation of its programme for the promotion of industrial subcontracting. The agenda for the Expert Group Meeting is given in annex I.

2. The Director of the Industrial Institutions and Services Division, Mr. M. Hamdy, chaired the Expert Group, Mr. A. de Crombrugghe was the Moderator and Mr. R. Bernardis was the Rapporteur. The Expert Group was attended by 14 experts (see annex II).

3. The Expert Group drew on the experience of (a) a small representative group of high-level experts, involved with effective approaches and techniques that had been successfully applied to implement industrial subcontracting policies and programmes in developed and developing countries; and of (b) managers of well-established subcontracting and partnership exchanges set up in selected countries with the assistance of UNIDO. The participants presented position papers and selected case studies on the topics.
RECOMMENDATIONS

4. The Expert Group Meeting on Industrial Subcontracting Exchanges and Policies, on Friday afternoon, 24 May 1991, considered and revised the draft recommendations. The recommendations adopted are given below.

**Recommendation 1.** UNIDO should establish an advisory committee on its programme on the promotion of industrial subcontracting and partnership that would continue the work begun by the Expert Group Meeting on Industrial Subcontracting Exchanges and Policies to be composed of senior experts, well-established counterpart institutions, including the presidents of national committees and managers of subcontracting and partnership exchanges, and of those donor countries that contribute to this programme.

**Recommendation 2.** UNIDO should search for financing, independent of ad hoc technical assistance projects, either from its regular budget or in the form of a global project to be financed by donor countries, to design and develop methodology and instruments related to its programmes, manuals, software development and consultative meetings.

**Recommendation 3.** UNIDO and Governments should establish subcontracting and partnership exchanges as useful institutions and instruments for industrial development, especially of small- and medium-scale industries, import substitution, export promotion, transfer of technology and national integration.

**Recommendation 4.** UNIDO and Governments should promote international subcontracting and partnership agreements by the launching of North-South and South-South industrial cooperation programmes, and by the establishment of national, regional and interregional networks.

**Recommendation 5.** UNIDO should publish a manual on the methodology, operational procedures and organizational aspects of subcontracting and partnership exchanges. If possible, audiovisual cassettes should be prepared in connection with the manual.

**Recommendation 6.** UNIDO should publish a manual listing the instruments it has designed or developed, including standard questionnaires, industrial subcontracting nomenclatures, organizational charts, guidelines on establishing subcontracting agreements (and model contracts), a guide on the organization of fairs and a user's guide on the subcontracting software of UNIDO.

**Recommendation 7.** UNIDO should take steps to legally protect the subcontracting system (UNIDOSS) it has developed.

**Recommendation 8.** UNIDO should increase the number of experts in industrial subcontracting and partnership and clarify the role of its chief technical advisers. UNIDO should also initiate advanced training programmes for trainers, including experts and managers of industrial subcontracting and partnership exchanges, at the national, regional and international levels.

**Recommendation 9.** UNIDO, before launching a technical assistance project for the establishment of a subcontracting and partnership exchange, should, if possible, carry out a preparatory assistance phase to examine the feasibility of establishing such an exchange and to propose its institutional set up.
Recommendation 10. UNIDO should implement a technical assistance project for subcontracting and partnership exchange only when authorized representatives of both the public and private sectors have made a firm commitment to such an exchange.

Recommendation 11. The first phase of the project should involve the establishment of a national tripartite committee as well as of an autonomous subcontracting and partnership exchange, according to the proposed statutes of UNIDO.

Recommendation 12. The counterpart institutions to UNIDO projects of technical assistance should establish minimum staff requirements for the subcontracting and partnership exchange, according to UNIDO terms of reference.

Recommendation 13. UNIDO should, when possible, coordinate its programme on industrial subcontracting and partnership with its programme on quality control and standardization and UNIDO should consider launching projects involving both programmes.

Recommendation 14. UNIDO should contribute to efforts to harmonize national systems of certification complying with ISO standards on quality assurance (ISO-9000) and establish certification procedures that could be applied in developing countries in accordance with those applied in the European Communities (EC) and in other areas.

Recommendation 15. UNIDO and Governments, in view of the increasing proportion of industrial subcontracting in international trade, should provide assistance to improve the competitiveness and flexibility of subcontracting enterprises, especially by upgrading their technologies and quality.

Recommendation 16. UNIDO and Governments, in view of the essential role and contribution of professional associations, especially those representing small- and medium-scale industries, should encourage the establishment and reinforcement of such associations and encourage them to undertake support services for their affiliated enterprises.

Recommendation 17. UNIDO should cooperate with the United Nations Conference on Trade and Development (UNCTAD) in research and surveys on international subcontracting as a component of international trade, its barriers and incentives, and in the formulation of policies conducive to the development of national and international subcontracting and, if possible, specific technical assistance activities at the field level.

Recommendation 18. UNCTAD, in cooperation with UNIDO, should undertake a survey on the impact of liberalization and deregulation policies on industrial subcontracting compared to self-reliance policies by import substitution, national integration and licensing policies, and preferential treatment for local industries, especially small- and medium-scale industries.

Recommendation 19. UNIDO should cooperate with the Commission of the European Communities (CEC) (especially with its DG-XXIII but also with DG-I, DG-III and DG-VIII) in relation to the promotion of industrial subcontracting, in the following ways:

(a) By using and disseminating the instruments and methods developed by the European Communities, such as subcontracting nomenclatures and terminologies, and guidelines for legal contracts;
(b) By encouraging the subcontracting and partnership exchanges benefitting from UNIDO assistance to enter into cooperation with the Business Cooperation Network (BC-NET) and to participate in European subcontracting fairs;

(c) By investigating and possibly launching joint financing of UNIDO technical assistance projects and calling on special financial facilities such as the EC International Investment Partners.

Recommendation 20. UNIDO should cooperate closely with the International Network of Subcontracting, Industrial Cooperation and Partnership Organizations (RIOST, which is the French acronym):

(a) By undertaking joint activities, such as technical assistance, training, research and compiling directories;

(b) By calling upon its sources of information on expertise, training institutes and publications;

(c) By encouraging those subcontracting and partnership exchanges benefitting from UNIDO assistance to join RIOST with preferential conditions.

Recommendation 21. Subcontracting and partnership exchanges should be co-financed by Governments, professional associations and industrial companies. Certain services, such as registration in international fairs and participation in training seminars, provided by the exchanges, could be charged separately; however, the exchanges should not charge commissions on contracts awarded.

Recommendation 22. Subcontracting and partnership exchanges should encourage subcontractors to comply with the standards of quality set by national standards bureaux and testing institutes.

Recommendation 23. Subcontracting and partnership exchanges should, among other things, provide to subcontractors technical consultancy, training, information and advice on financial facilities, financial incentives and legal issues.

Recommendation 24. Subcontracting and partnership exchanges, with the assistance of UNIDO, should promote the use of national subcontracting codes of conduct and guidelines on legal contracts covering subcontracting relations, and should provide advice, training and awareness seminars to subcontracting enterprises.

Recommendation 25. Subcontracting and partnership exchanges should advise subcontractors to diversify their clients, as far as possible, in order to avoid becoming too dependent on one contractor.

Recommendation 26. Subcontracting and partnership exchanges should, with the assistance of UNIDO, initiate a strategy on industrial promotion, including market analysis, participation in international subcontracting fairs, and business meetings with purchasing managers and buyers from large companies.

Recommendation 27. Subcontracting and partnership exchanges should organize fairs with the joint participation as exhibitors of subcontractors, main contractors and other partners.
Recommendation 28. National tripartite committees on subcontracting should interact on an ongoing basis with their Governments and should propose governmental incentives and measures to facilitate national and international subcontracting operations.

Recommendation 29. National tripartite committees on subcontracting should establish a mechanism to provide legal advice to the contracting parties and for the reconciliation and settlement of disputes between them.

Recommendation 30. Governments, when applying national integration policies and import substitution policies, should proceed gradually, and with flexibility, on a case-by-case basis.

Recommendation 31. Governments, in taking account of their development objectives, should apply policies to attract foreign investment, the relocation of foreign manufacturing facilities and joint-ventures.

Recommendation 32. Governments should apply de-licensing and decentralization policies, and to that end, State-owned companies should be encouraged to subcontract (contract out) to small- and medium-scale industries.

Recommendation 33. Governments should provide incentives to domestic subcontractors such as fiscal incentives, special customs and excise tariffs, soft export credit, credit guarantees and concessional financing.

Recommendation 34. Governments should support subcontracting operations by applying regulations appropriate to a specific national context and addressing specific problems such as inter-enterprise credit and payment terms.

Recommendation 35. Governments should reinforce national organizations providing assistance, in cooperation with subcontracting and partnership exchanges, to small- and medium-scale subcontracting enterprises on matters related to quality, testing, design, technology, marketing, training, financing, and research and development.

I. PRESENTATION BY THE UNIDO REPRESENTATIVES

5. On behalf of UNIDO, the Chairperson welcomed the participants to the Expert Group Meeting. He explained that the Industrial Institutions and Services Division had devised and successfully applied an integrated, comprehensive and modular approach to the development of small- and medium-scale industries and the private sector. The approach consisted of innovative programmes such as enterprise-to-enterprise cooperation, promotion of industrial subcontracting, development of small- and medium-scale industries, private sector development, entrepreneurship development and privatization strategies. Those programmes focused on the entrepreneur as the main agent for development and also on his/her environment, which had to be made equally entrepreneurial. As a result of their success, the programmes had been financed mainly by donor countries by financial contributions to the UNIDO Industrial Development Fund. They had been extended to Eastern European countries, including the Union of Soviet Socialist Republics, which had requested UNIDO to assist them in their efforts to convert their centrally planned economies to market economies.
6. The UNIDO programme for the promotion of industrial subcontracting was one form of enterprise-to-enterprise cooperation, based on the recognition that cooperation between enterprises from developed and developing countries and between those in developing countries was an effective means of achieving rapid and well-structured industrial development. The impact of industrial subcontracting on the integrated development of a country's industrial sector was well recognized.

7. The UNIDO programme for the promotion of industrial subcontracting was an integrated approach with two dimensions. At the national level, UNIDO assisted (a) Governments in establishing policy frameworks and environmental and policy instruments conducive to the promotion and development of industrial subcontracting; (b) industrial institutions or associations in establishing and strengthening subcontracting and partnership exchanges to provide a broad range of services to both prime contractors and subcontractors; and (c) industrial enterprises in concluding partnership agreements in areas such as product development, manufacturing, management and quality control in order that partnership agreements could be adequately implemented.

8. At the international level, the UNIDO programme dealt with three major aspects: (a) the development of regional or international networks of subcontracting and partnership exchanges; (b) the promotion of subcontracting and partnership agreements between enterprises/entrepreneurs in North/South and South/South contexts; and (c) cooperation agreements with international institutions, international subcontracting fairs and international subcontracting networks.

9. The Moderator introduced the participants and requested them to contribute to the UNIDO programme for the promotion of industrial subcontracting by addressing themselves to some of the problems involved. In particular, each expert was requested to formulate recommendations on (a) any changes thought to be necessary to the UNIDO programme; (b) whether and how it should be expanded; (c) how to attract clients; and (d) how to mobilize financial support.

II. SUBCONTRACTING AND PARTNERSHIP EXCHANGES AND INTERNATIONAL COOPERATION NETWORKS

A. Institutional and financial arrangements

10. Mr. Balana began his presentation by stressing that subcontracting was not only a relation between a contractor and a subcontractor but a strategic element of any national industrial policy. Therefore, a programme for the promotion of subcontracting should be developed jointly by private- and public-sector institutions such as chambers of commerce and industry, industrial associations, export promotion centres, small industries' development organizations, investment promotion agencies, development banks and others, depending on the institutional framework.

11. Based on the successful experience in several Latin America countries, he suggested that the most appropriate way to launch a subcontracting programme at national and regional levels was to set up a committee for the coordination of subcontracting operations on which private- and public-sector institutions would be jointly and actively represented. The committee for the coordination of subcontracting should elect a president and vice-president and appoint a secretary, most probably the manager of the national subcontracting and
partnership exchange. He found that the most suitable legal structure for the establishment of such exchanges in developing countries was in a form of a non-profit association or foundation.

12. He said that the minimum staff requirements were one manager (an engineer or an economist), one or two technical staff (engineers) and one secretary, and possibly a computer programmer for the period required to set-up the computerized database for the exchange. He emphasized the importance of recruiting qualified and highly motivated staff to ensure the effective operation of the exchange, who should be paid salaries equivalent to those paid in the private sector.

13. He estimated that the total average cost for running an exchange was $US 50,000 a year. Exchanges should be co-financed by Governments, professional associations and industrial companies through cash and in-kind contributions. Certain services provided by the exchanges, such as registration in international fairs and participation in training seminars, could be charged to member companies separately. He suggested that the promotion of income-generating activities should be mandatory for that type of institution after two years of operation.

14. Mr. Balagna observed that the criteria to evaluate the performance of an exchange should not be measured only in terms of the sophisticated software and hardware available, number of official members, catalogues and other publications issued by the exchange, but also in terms of the number of interventions and estimated business value of subcontracting opportunities promoted by the exchange, since an exchange was far more than a data bank or an information centre.

15. Mr. Souhaité mentioned that affiliated subcontractors should pay a membership fee (at prorata of the turnover, fixed assets or number of employees).

B. Standard instruments and methodology

16. Mr. Cuny reviewed methods and standard instruments that had been adopted by UNIDO in promoting and implementing industrial subcontracting programmes in developing countries, and made suggestions on how to facilitate their application and increase their impact that were incorporated into the Recommendations, above.

17. He stressed that the financing of a subcontracting and partnership exchange should be tripartite: public institutions, in view of the national interest of promoting industrial subcontracting; private professional associations and chambers, in view of the benefits of this mechanism to their industrial sectors; and individual affiliated enterprises, in view of the direct advantages provided to their economic growth.

18. He mentioned that the forms of industrial subcontracting had been progressively changing since the Second World War. At first, subcontracting had been based on spare manufacturing capacities, then on the specialization of industrial processes, equipment and know-how. Lately, it had been based on the ability to produce with zero defaults, zero delays and zero stock, and progressively included more sophisticated and stable industrial collaborations or partnerships. However, all those forms continued to co-exist and he suggested that UNIDO should endeavour to promote and secure the establishment of
exchanges capable of performing all those forms. Those exchanges could also provide other related or complementary services to affiliated enterprises such as information and advice on second-hand machinery and raw materials.

19. He suggested that the UNIDO Subcontracting System (UNIDOSS) should include enterprise selection, follow-up, data analysis and accounting procedures, and should be subject to legal protection.

20. He also suggested the preparation by UNIDO of two manuals (see Recommendations 5 and 6).

21. He underlined that UNIDO expertise was the main instrument in establishing exchanges in developing countries. In that respect, he strongly urged UNIDO to increase the number of its experts in that specialized field and to provide them with advanced and permanent training or briefing on UNIDO applied methodologies. He stressed the necessity of clarifying the role and responsibility of UNIDO Chief Technical Advisers or senior experts in the field towards government authorities, the counterpart institutions and the United Nations Development Programme (UNDP) with regard to the successful achievement of the objectives of the project, the counterpart obligations and national institutional and financial arrangements. He said that training of counterpart personnel was crucial for the successful operation of subcontracting projects in developing countries and that UNIDO should continue to organize advanced training programmes for managers and technical staff of exchanges at national, regional and international levels.

C. Technical aspects closely related to industrial subcontracting

22. Mr. Schicchi presented the "just-in-time" practices and total quality systems derived from the Japanese experience, which were increasingly being applied by other industrialized countries, and spoke of their impact on subcontracting practices and relationships. He noted that the main consequences for the subcontractors when supplying a purchaser just-in-time were as follows:

(a) The subcontractor had increased responsibility to avoid any problem related to delays in the delivery of items, while the warehouses for parts and components supplied were at the purchaser's location;

(b) Quality control of subcontracted parts was no longer performed by the purchaser. The parts should be free of defect, and it was the responsibility of the subcontractor to certify the quality of its production and to adjust to a zero-defect production system;

(c) Communications between purchasers and subcontractors must be efficient and immediate since just-in-time practices did not allow delays in the adjustment of the supply to variations in the production schedules of the purchasing plant.

23. As a consequence of the above-mentioned considerations, the trend in Japan and other industrialized countries was to reduce the number of subcontractors for the same group of components or sub-assemblies to a single one (called "first rank" subcontractors). That clearly originated from the need to enter into a solid and stable partnership relation allowing stock reduction and production flexibility, typical of the just-in-time practices.
24. As a general result of the just-in-time and zero-stock practices, the overall responsibility was increasingly shifting from the main contractors to the subcontractors, while the main contractors were still imposing their standard contracts and legal terms, including terms of payment that extended up to six months after delivery, on the subcontractors.

25. He mentioned that in industrialized countries, the criteria for the selection of subcontractors were, in order of priority: quality, flexibility of production and cost.

26. As far as quality was concerned, to obtain satisfactory quality of subcontracted components and maintain it at the same level during the whole period of supply, strict cooperation was required between the main contractor and subcontractors. For many sophisticated products, team-work started at the stage of designing, engineering and making a prototype. That resulted in a partnership relation rather than a simple buyer-seller relation.

27. New production management methods had transformed subcontracting practices and relationships in developing countries where the improvement of the quality of subcontracted products had become a major concern. He strongly urged UNIDO to intensify its programmes aimed at upgrading the quality of subcontracted products manufactured by small- and medium-scale industries in developing countries, before considering promoting their exports.

28. He found that exchanges not only should provide technical consultancies and training to their affiliates, but also were the most appropriate institutions to encourage subcontractors to comply with the standards and quality set by national standards bureaux and testing institutes. In addition, he believed that exchanges should provide technical consultancy, training, information and advice to subcontractors on financial schemes, fiscal incentives and legal issues.

29. He concluded by noting that he was in full agreement with the necessity of obtaining the commitment of all parties involved in the establishment of an exchange, before initiating a technical assistance project and of providing advance training.

D. Selected implementation issues

30. Mr. Montes discussed selected implementation aspects related to counterpart obligations, staffing and financing of a subcontracting and partnership exchange. Through his work experience in Colombia and in other Latin American countries, he could identify common difficulties in operating exchanges deriving from the inappropriate training of staff and lack of financial resources.

31. He stressed the need to provide comprehensive training to the managers and technical staff of subcontracting and partnership exchanges, as well as to trainers and experts, on (a) operational aspects of the exchanges, including technical matters closely related to subcontracting, such as quality, testing and design; and (b) promotional aspects of international subcontracting. Training was considered a major element for the effective operation of exchanges and should be encouraged by the organization of seminars, publication of manuals, study tours, participation in international fairs, business meetings with the main contractors and purchase managers of large enterprises, marketing studies on subcontracting opportunities etc. Appropriate training
and salary schemes and incentives for the staff of exchanges would ensure efficiency and continuity of operations and a proper transfer of know-how.

32. He said that the lack of financial support had always been a major constraint to the development of exchanges in Latin America. But the role those institutions could play in facilitating major ongoing restructuring efforts within the region was increasingly recognized, and the required financial resources could be mobilized from the public and private sectors by providing good quality services to the business community. The capacity to respond effectively to the needs of the subcontractors and main contractors by offering a complete range of information and advisory services with a competent and motivated staff was the key factor in attracting financial contributions for the activities of the exchanges with a long-term perspective.

E. International promotion and networks

33. Mr. Germano began by discussing three types of subcontracting network at the institutional level. The first one, for example as used in the United Kingdom of Great Britain and Northern Ireland, was informal relations between professional organizations, consisting mainly of an exchange of information and contacts with the used directories.

34. The second type, for example as used in Mediterranean countries, was characterized by the existence of formal networks for the promotion of national and international subcontracting operating within chambers of commerce and industry, industrial associations and other professional organizations.

35. The third type, as used in Japan, was one in which the main contractors had their own network of selected subcontractors who worked almost exclusively for them.

36. The possibility of promoting national, international and interregional subcontracting networks depended largely on the institutional set-up of a given country or region. Special effort was needed to gather information on subcontracting agencies in industrialized and developing countries, and to develop links and cooperation between them.

37. He emphasized the importance of specific promotional instruments, such as participation in international subcontracting fairs and the organization of business missions with purchase managers in selected target-market countries, which should be developed to facilitate the creation of industrial subcontracting networks.

38. He felt that the organization of specialized fairs with the joint participation as exhibitors of subcontractors, main contractors and other partners was the most appropriate and effective formula.

39. Several participants agreed that UNIDO should encourage the collective participation of developing countries in specialized subcontracting fairs and the organization of business meetings with purchase managers and buyers from large companies in selected countries. They also suggested that UNIDO should continue to promote and assist in the establishment of national, regional and international networks of subcontracting and partnership exchanges. Mr. Rodriguez mentioned, as a case in point, the experience of the Peruvian Exchange, which had participated in many sessions of the Hannover Fair in
Germany. As a result, subcontracting agreements with Peruvian subcontractors had been concluded, and that was the proof that Peruvian small- and medium-scale industries could export to Europe.

40. On the same subject of the international promotion of networks, Mr. Holtz reviewed the overall favourable political and economic environment and trends towards market-oriented economies, liberalization, internationalization, negotiation mechanisms with and between Governments that had been instrumental in promotions.

41. He suggested that, in view of the essential role and contribution of professional associations, especially those representing small- and medium-scale industries, in promoting national and international industrial cooperation agreements, UNIDO and Governments should encourage the establishment and reinforcement of such associations and encourage them to undertake support services for their affiliated enterprises and to establish networks among them.

III. ENVIRONMENT CONducIVE TO THE DEVELOPMENT OF INDUSTRIAL SUBCONTRACTING

A. The role of the Government

42. Mr. Altersohn first presented the experiences of the United States of America, and then those of Japan and France in promoting and creating environments conducive to the development of industrial subcontracting practices and relationships.

43. He described the steps the United States Small Business Administration (SBA) took to promote federal purchasing and procurement for small- and medium-scale enterprises, within the general framework of its anti-trust policy. In 1987, a new law had been enacted to facilitate a higher level of integration between national main contractors and subcontractors. Under this law, main contractors should make every effort to contract out to small-scale enterprises.

44. In practice, all purchase contracts of more than $US 10,000 had a provision to resort to small subcontractors. For contracts of more than $US 500,000, the main contractor should submit a detailed plan of the subcontracting arrangements to be implemented. That plan should be discussed with the Procurement Center Representative of SBA and, when approved, should be attached to the contract and fully complied with, otherwise the contract could be voided and a penalty imposed.

45. SBA also had Commercial Market Representatives, operating at national level, to assist small subcontractors in seeking business opportunities with main contractors and to assist the latter in complying with the provisions of the law.

46. The results achieved by that system had been quite remarkable. In 1987, purchasing and procurement brought about by the federal Government amounted to $US 197.3 billion; $US 35.4 billion was the estimated value of purchasing orders to small subcontractors, particularly in the defence and energy sectors.

47. In Japan, the Agency for the Development of Small- and Medium-scale Enterprises, which was a specialized body of the Ministry of Trade and
Industry, had the responsibility of coordinating subcontracting activities in three major areas.

48. First, 30 inspectors of the Agency, in connection with the Loyal Business Practice Commission, monitored the application of the 1956 law that prohibited delays in paying subcontractors and other unfair or unilateral practices. Secondly, the Agency, in the framework of a 1970 law, facilitated the development and modernization of small- and medium-scale subcontractors. But, in the implementation of the second law, an essential role was played by the Association for the Promotion of Subcontractors. That Association had 100,000 members and acted as an exchange with branch offices covering the entire Japanese peninsula. The 1970 law also provided norms and codes of conduct for subcontracting. Thirdly, the Agency promoted and regulated Government purchasing and procurement for small- and medium-scale enterprises, according to a 1966 law.

49. Mr. Altersohn mentioned specific features of the French system. He described the 1975 law which clearly defined a subcontracting relation and protected subcontractors, especially in cases of problems of payment. He also mentioned the special effort made by the French Government to promote a national network of subcontracting and partnership exchanges. Prior to 1975, 15 regional exchanges had been established, mainly within Chambers of Commerce and Industry, with a substantial financial contribution from the State. He also mentioned other institutions such as the Institut pour la Sous-Traitance et l'Assistance Technique (INSTAT)* and the Centre National de la Sous-Traitance (CENAST).**

50. He described the activities undertaken by the National Technical Commission for Subcontracting. That Commission, set up in 1976, was composed of representatives of the Government, professional and vocational bodies, main contractors and subcontractors. It dealt with a number of extremely varied matters, such as the legal environment conducive to subcontracting, institutional support to facilitate subcontracting operations, insurance and export aspects related to subcontracting, model contracts and specific research on how to improve the 1975 law, including the stability conventions. Furthermore, the Commission undertook research work on the application of new technologies in the context of subcontracting activities, and had promoted the preparation of a guide for export-oriented subcontractors and the establishment of two promotional offices abroad to assist French subcontractors operating in Germany and the United Kingdom of Great Britain and Northern Ireland.

51. He mentioned that other European countries also had avoided taking excessive legislative measures in favour of subcontractors, since the general industrial legislation in Europe penalized monopolistic practices, and thus limited the possible abuses of the main contracting enterprises.

52. As a result of his analysis of the American, Japanese and French experiences and efforts to create a conducive environment for the development of industrial subcontracting, he believed that the State should limit its role to encouraging, regulating and coordinating efforts in favour of subcontracting,

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*Institute for Subcontracting and Technical Assistance.

**National Centre for Subcontracting.
but should not substitute or intervene directly in subcontracting practices and relationships. It should also encourage public procurement, but without imposing minimal quotas, for small- and medium-scale enterprises that had always been the most dynamic and flexible part of the private sector.

B. The contribution of the public sector

53. Mr. Mathur presented the Indian public sector's contribution to the promotion of industrial subcontracting and the establishment of subcontracting and partnership exchanges. In the case of India, these exchanges were part of and operated by a government department with the Ministry of Industry under a Development Commissioner for Small-scale Industries. That Department also ran a series of institutions and facilities such as the small industries service institutes and the regional testing centres.

54. In addition, he described the activities of the National Small Industries Corporation (NSIC), which provided complementary support to small-scale industries through three major programmes: the Hire Purchase Programme, the Marketing Programme, and the Prototype Development and Training Centres Programme. Particularly, the NSIC Marketing Programme sought (a) to ensure a fair price to small manufacturers by enhancing their negotiating strength; (b) to ensure standardization and quality control across specific segments of industry; and (c) to facilitate advertising and projection of a product/brand image.

55. It achieved these objectives by enabling participating manufacturing units to register under a single point registration scheme. Thereafter, NSIC formed appropriate consortia and made bids on behalf of the consortia for large orders. To facilitate the above-mentioned programme, NSIC had set up a number of Market Development Centres and also assisted small units in exporting.

56. Mr. Mathur believed that the public sector subcontracting and partnership exchanges had a major function that tended to be overlooked or inadequately projected. That function was the feedback on Government's fiscal and industrial policy, channelled through the exchanges' national committees. In India, the identification of policy initiatives to correct structural and economic imbalances was a function that had not been adequately covered. Subcontracting and partnership exchanges must be regularly involved in consultations with the Government and must keep suggesting changes in the operations and norms relating to lending by banks and financial institutions in order to optimize their functioning. Other key areas where a subcontracting and partnership exchange must interact with Government were import-export policy, methodology and amounts of Government subsidies, if any, Government taxation policy and labour legislation.

57. The development of strong, well-organized industry associations was another key area of activity to be undertaken by the public sector exchange. While the constituents of such associations would all be in the private sector, the Government exchange would function as a clearing-house and for feedback on Government policy.

58. In conclusion, he suggested that UNIDO refrain from recommending that Governments should strengthen their direct involvement in, or to over-legislate on, industrial subcontracting operations, and avoid politically sensitive issues such as privatization. Instead, its recommendations on Government contributions should be tailor-made to specific countries, focusing
on specific topics, and should be made on a case-by-case basis. He also suggested that countries envisage establishing national institutions to provide technical advice, service and back-up to the subcontractors and to enlarge the role of the subcontracting and partnership exchanges to include the promotion of the small industries credibility, quality and stability in the field of subcontracting, as well as the negotiation of reasonable prices and availability of raw materials.

C. National integration and licensing policies

59. Mr. Bhaskarudu in his presentation raised some issues of concern that must be addressed to make subcontracting policies and strategies truly effective.

60. The first issue was the policy framework to support national subcontracting and supply development. In India, the Government made clear policies to encourage the growth, development and viability of small-scale and ancillary units. This encouragement was provided in the form of differential excise duties, special infrastructural support, preferential financial treatment, reservation of items for exclusive manufacture in the small-scale sector etc. This policy had certainly helped India and scores of industrial units to develop.

61. The second issue related to determining the optimum rates or levels of national integration or what is known as "indigenization". Clearly that would depend - apart from Government policy requirements - on the technical, managerial and organizational capabilities of the subcontractors and the existing infrastructure of the economy. In India, many of the contracting enterprises or parent units provided a comprehensive range of raw materials, technical and financial support to the subcontractors to ensure high levels of indigenization and performance. The sincerity of a prime contracting or a licensor company to help the subcontractor or the licensee in absorbing technology largely determined the rate of indigenization. Each country would have to find its own appropriate level of support and indigenization depending on the overall capabilities of the subcontractors. Any localization programme should be negotiated on a case-by-case basis and implemented step-by-step through a yearly plan.

62. The third issue was the one relating to research and development and technological innovation among the subcontractors. It must be accepted that very often the subcontractors operated at low volumes that did not justify major investments in research and development and technological innovation. He believed the main contractors or parent units would have to play a key role in ensuring technological competitiveness in the supply units. UNIDO programmes of assistance could also be usefully launched at that level.

63. The fourth issue related to the role of Government de-licensing policies. He quoted the example of the Indian auto-component industry which was de-licensed to encourage new entrants to come into the field and effectively cater to the needs of the vehicle manufacturers. One example was the experience of Maruti Udyog Ltd., which showed that the policy of the Government of India of de-licensing the auto-component sector enabled that company to effectively use new units that were set up to support the project. The main objective of de-licensing was to create quickly new capacities to produce items of mass consumption in larger quantities. That resulted in a spate of new foreign collaborations. In the automotive sector alone the number of foreign collaborations went up from 90 to 418 between 1984 and 1989.
In that respect, he suggested that Governments should enact legislation on appropriate duty structures or facilities for imported capital equipment and raw materials not available in the country. He stated that in any country, liberalization measures in regard to the industrial policy would have to be dictated by national priorities. At the same time, liberalization should be viewed as a dynamic process and, depending on the increasing maturity levels, bolder liberalization steps might be taken.

The fifth issue was of quality and reliability. Indigenization did not automatically ensure international levels of quality and competitiveness. A partnership approach between the parent unit and the subcontractors was essential to sustain high levels of quality and performance. Export of automobiles entailed conformance to strict international standards and certification requirements. The subcontractors had to work continuously to upgrade quality and thereby ensure acceptance in international markets. Technology could not be transferred solely through software, machinery and equipment. The local unit might have to adopt not only the technology but also the management philosophy and ethos of the parent company or partner.

The sixth issue pertained to the role of foreign investment in encouraging subcontracting. A recent and highly successful example of subcontracting through overseas investment was that of Texas Instruments, which had set up a dedicated software development facility in India using Indian software specialists for use by the parent company in the United States. In that respect, he suggested encouraging foreign investments and international partnership agreements (licensing, subcontracting, marketing, technology).

His own company, Maruti Udyod Ltd. — which was a joint-venture between the licensor, Suzuki Motor Company of Japan, and the Government of India — was yet another example where a partnership type of cooperation with a foreign investor had strongly encouraged and reinforced subcontracting local capacities. After seven years, 90 per cent of the parts and components were supplied locally by Indian subcontractors. Out of 400 local subcontractors and suppliers, 200 were small units and 50 per cent supplied exclusively for Maruti.

On the same topic, Mr. Dhemaied reviewed the recent history of economic policies related to international subcontracting. The rapid development of international subcontracting in the 1960s, aiming at increasing the volume of production and reducing production costs, did not properly transfer the benefits to the subcontracting units in the developing countries. Therefore, those countries had launched industrial policies based on import substitution and national integration or localization.

The main instruments of the import substitution policies were:

(a) Custom protection of new national industries against foreign competition;

(b) Incentives to attract foreign investors to establish manufacturing units in the country;

(c) State participation in the equity of large manufacturing units jointly with foreign or local private entrepreneurs.
70. In order to ensure that the benefits of new production lines established in the country by foreign investors would spread to the local manufacturing industry - and thus create new employment, allow transfer of foreign technology and foreign exchange earnings, favouring overall national economic integration and development - national integration or localization policies were applied by those countries. They consisted in establishing rates (percentages in value, volume or weight) for the parts and components of final products to be manufactured by local feeding units. Those rates of integration or localization were determined either by bilateral negotiations or by decree. Increasing percentages of locally manufactured components to be incorporated in the final products were progressively imposed on the foreign partners according to given plans or timetables, thus gradually substituting imported components by local components.

71. The policies on import-substitution by localization, however, had not yielded the expected results. There were three categories of country:
(a) those that progressively achieved a 100 per cent local integration;
(b) those where the integration process had been purposely limited due to the high cost of local manufacturing; and (c) those where the integration process had been limited by technical (level of quality) or economic (market size) factors.

72. Therefore, as of the 1970s, that industrialization strategy was frequently supplemented by an export promotion policy. In that context, the foreign partners were required to compensate for the foreign exchange invested by the State in a joint-venture by buy-back arrangements for exports; local purchase of industrial products or raw materials and exports on foreign markets; and investing in a local manufacturing unit (related or not to the main joint-venture) intended for export. Thus, this system aimed at compensating the loss of foreign exchange by earning the equivalent amount through exports.

73. In conclusion, Mr. Dhemaied suggested that the United Nations should study and recommend a balanced industrial strategy for developing countries, as some international organizations were encouraging liberalization policies while others were encouraging national self-reliance policies.

D. Import substitution and export promotion policies

74. Mr. Supper presented a number of export promotion instruments and incentives that had influenced positively international subcontracting in certain developing countries.

75. He mentioned that the promotion of subcontracting by developing countries had traditionally played a major role in policies to substitute imports by domestic production and to expand exports. Foreign exchange considerations were one of the primary concerns either in the form of hard currency savings, or in the form of increased export earnings. A second major consideration consisted of employment creation. A major portion of subcontracting operations consisted of domestic subcontracting, mainly between assembly firms of vehicles, electric appliances, machines, instruments or other metal products and suppliers of parts and components. International subcontracting took, to a large extent, the form of working with or processing materials, such as clothing and textiles for re-export in the finished form, while industries manufacturing components for foreign partners had been rapidly increasing over the past decade. The main policy emphasis had in the past been on traditional foreign trade instruments for protection and export promotion.
76. He mentioned that the main trade policy instruments used traditionally for stimulating domestic production to replace imports included heavy protection by means of tariffs, import licensing or prohibitions and exchange controls. Various industrial regulations had similar effects to promote import substitution, in particular the national contents rules previously mentioned.

77. He said that in recent years there had been big changes in the trade policies and import regimes of many developing countries. The emphasis had switched from import substitution strategies to export-oriented development policies and greater reliance on market mechanism. Comprehensive structural adjustment programmes comprised liberalization of quantitative restrictions, tariff reforms and the adoption of market-oriented exchange rates. In addition, several countries had proceeded to industrial deregulation, privatization and substantial liberalization of foreign investment.

78. Those changes implied for many import substituting subcontracting industries the end of long-lasting high levels of protection. Foreign competition increased along with free access to establishment of new enterprises in domestic markets. In many cases, domestic suppliers of components or manufacturing services therefore had been under substantially increased pressure to reduce costs, rationalize their production and upgrade quality. Most developing countries had shifted their policy emphasis towards promoting exports. Initially, several South-East Asian countries had achieved substantial success with pronounced export-oriented policies as a strategy for fostering industrial development. The more recent trade-policy reforms of other developing countries within structural adjustment programmes implied a shift in intensive structures from production for domestic markets to production for export: they aimed at neutralizing the negative bias resulting from import substitution policies for exports.

79. International subcontracting had played an important role in achieving rapid export expansion. Thus, subcontracting constituted an important proportion of total exports of such countries as Malaysia, Mauritius, Mexico, Morocco, Tunisia, Turkey, Yugoslavia and some Central American and Caribbean States, where it might reach between 20 and 25 per cent of overall exports, or even more. Subcontracting operations had also been valuable complements to exports in other developing countries.

80. Export-oriented subcontracting had initially developed in the form of simple, labour-intensive operations: the motivation of the foreign subcontractor consisted mainly of taking advantage of low labour costs in developing countries. Local economies had benefited from increased employment and increased foreign exchange earnings.

81. More recently, international subcontracting of parts and components had become increasingly important, as the pressure of foreign competition forced multinational corporations to abandon former tendencies to maintain the entire production process within one enterprise. Most subcontracting relationships were made with producers in developed countries.

82. A number of instruments seemed to have influenced positively international subcontracting in certain developing countries: (a) special customs rules for outward processing of major developed countries (such as the United States and the European Economic Community); (b) the negotiation of separate import quotas
for the subcontracting of clothing and textiles within preferential arrangements; (c) export processing zones; (d) customs rules of the developing countries (such as the temporary admission of imported inputs before re-export); (e) trade financing; (f) firm-specific industrial incentives; and (g) market-oriented exchange rates.

83. As in the case of import policies, the liberalization and deregulation of the economies would eliminate many specific export-policy measures and subsidies, or reduce their impact. Conversely, the role of general, functional and macro-economic incentives was rising. The question, however, remained whether the private sector, on its own, would be able to continue the drive towards more exports, and fulfill expectations to increase vertical integration; to advance from subcontracting towards production; and to strengthen its technological capabilities. With the change of strategies, the requirement for orienting government policies towards the enterprises themselves, had become as important for enhancing domestic competitiveness as for fostering export competitiveness.

84. Some questions arose specifically in the context of subcontracting: were the producers of components in developing countries in a position to follow the policy changes and to switch from production for domestic markets to exports? Could the relaxation of import controls and national integration policies lead to lower local content of production of multinationals? Might liberalization of foreign investment lead to bypassing local firms and the establishment of new foreign enterprises belonging to a subcontracting network of a single multinational corporation?

85. International subcontracting relied on the Governments of industrialized countries deregulating and relaxing import and investment controls and on the Governments of developing countries providing incentives to increase the attractiveness of their country as a location for foreign investment and on the proximity of modern and reliable transport and telecommunications systems.

86. Governments could strengthen the capabilities of domestic firms for subcontracting by assistance and advisory services for the upgrading of quality and quantity control, by special support programmes in favour of small- and medium-scale enterprises, by the promotion of foreign partnerships, by establishing subcontracting and partnership exchanges or other information systems on national capacities for subcontracting, by establishing industrial estates and Government-supported initiatives (financing, fiscal and training), and by increasing standardization.

87. International organizations, such as UNIDO and UNCTAD, could assist developing countries in efforts (a) to elaborate appropriate framework conditions for domestic and international subcontracting; (b) to promote partnerships through information and contact services (subcontracting and partnership exchanges); and (c) to provide technical assistance to small- and medium-scale subcontracting enterprises for quality control, standardization, technological and managerial advice.

E. Forms of inter-enterprise agreements

88. Mr. Souhaité discussed the legal forms of an inter-enterprise agreement.

89. Cooperation agreements between complementary enterprises could be horizontal (such as joint-venture, cooperation agreements, temporary consortia
of enterprises and agreements for joint production) or vertical (subcontracts). Subcontracting agreements were very different from horizontal cooperation agreements whereby each of the contracting parties were on an equal footing and were part of the same market; they generally acted in common and with solidarity, although remaining legally distinct and autonomous.

90. In industrial subcontracting, the relations between prime or main contracting and subcontracting enterprises were vertical and hierarchical. Subcontracting was an agreement by which an enterprise, the main contractor, entrusted another, the subcontractor, with the duty of producing for it, according to specific requirements, a part of the production process, for which it remained responsible to the final client. The subcontractor implemented the main contractor's instructions to produce a specific element of a given assembled product. That implied some form of economic dependence which made it necessary that the rights and obligations of each party should be clearly defined by a contract or at least by referring to a subcontracting code of conduct.

91. Subcontracting led the way to horizontal forms of industrial cooperation, such as industrial partnership, when the subcontractor was no longer subordinated to carry out a task but was a fully fledged partner. Cooperation implied autonomy (in know-how, equipment, finance etc.), which small- and medium-scale enterprises often did not have, at least initially.

92. Mr. Souhainté suggested that UNIDO assist Governments in establishing non-compulsory legislation and a legal framework conducive to clearly defining and encouraging subcontracting operations; and in promoting a more balanced and stable relationship between parties, such as partnership instead of only subcontracting in the strict sense.

93. He suggested that subcontracting and partnership exchanges and their national committees, with the assistance of UNIDO, should play a leading role in disseminating such subcontracting codes of conduct and guidelines; in providing realistic training or briefing and legal advice to subcontractors on the legal implications and constraints of subcontracts.

94. Mr. Altersohn suggested calling on professional associations to settle disputes, to encourage the general use of contracts, to publish guidelines on the legal clauses of subcontracts, and to promote the general development of partnerships.

IV. COMPLEMENTARY PRESENTATIONS

A. A case study: Peru

95. Mr. Rodriguez described the Peruvian experience in developing a national subcontracting and partnership exchange.

96. The national subcontracting and partnership exchange was established at Lima in December 1982 and started its operations first in the metal industry sector with the assistance of UNIDO and then gradually in the plastic, rubber, textile, wood, electric and electronic sectors, basically covering the entire industrial system in Peru. He said that the Lima Exchange was a non-profit service centre which involved both private and public-sector organizations. Large-, small- and medium-scale industries were very well represented in the
Exchange through the National Federation of Industries and the Association of Small- and Medium-scale Industries together with the Industrial Development Bank of Peru and the National Institute for Foreign Trade.

97. The Lima Exchange had a Board of Directors composed of senior representatives of the national institutions sponsoring the Exchange and of managers of affiliated enterprises. The staff of the Lima Exchange consisted of a general manager, a technical manager, two information brokers and one secretary.

98. The Exchange operated mostly in Lima where the largest number of national industries were based, but it also provided services to, and coordinated with, the two other exchanges within the country: Trujillo in the North and Arequipa in the South of Peru.

99. After six years of operations more than 2,000 contracting and subcontracting enterprises had already been visited and half of them had been registered by the Lima Exchange, using UNIDO methodology and standard tools. In 1989, the Lima Exchange reported more than 1,600 successful interventions which had led to the conclusion of contracts, of which around 1,300 were national contracts worth approximately $US 70 million, and around 300 were international contracts worth approximately $US 30 million.

100. An important service provided by the Lima Exchange was the organization of "Subcontrata" fairs in Lima and the organization of collective participation in specialized fairs abroad. Inspired by the MIDEST* fair in France, which Mr. Rodriguez had visited in the framework of a UNIDO programme in 1987, the Lima Exchange started organizing an annual national subcontracting fair in Lima, which had been very successful in terms of participation and number of subcontracting agreements established. In 1990, the Exchange organized the first Andean "Subcontrata" exhibit. Forty industrialists from Bolivia, Colombia, Ecuador and Venezuela participated in that event together with Peruvian enterprises. In 1991, it would organize the first subcontracting fair at the regional level, "Subcontrata Latina-Americana", with an expected participation of 13 Latin American countries.

101. Furthermore, the Lima Exchange had organized with the assistance of CEC the participation of Peruvian subcontracting enterprises in the Hannover Industrial Fair in 1990 and 1991, which had resulted in subcontracting agreements between Peruvian and European enterprises. Starting in 1991, Peru and other Andean countries would participate on a regular basis in the MIDEST and Hannover fairs with the financial support of CEC.

102. He concluded by saying that the promotion of subcontracting systems and practices in Peru had greatly contributed to the national industrial integration between small- and medium-sized enterprises and large industries as well as to substantive improvement of flexible specialization and export capacity.

B. The programme and experience of the Commission of the European Communities

103. Mr. Morosi presented the programme for the development of subcontracting designed by CEC which was the subject of an EC resolution in September 1989.

*Marché international de la sous-traitance.
104. The programme had three main aims:

(a) To create an environment conducive to the development of subcontracting, such as studies on terms and practices of payments, liability of subcontractors, and legislation related to public procurement, as well as on subcontracting relations and working conditions between enterprises from different member States of the Community, under the principle of freedom for subcontracting firms to provide services;

(b) To improve communications between main contractors and subcontractors. Eight multilingual sectoral terminologies on subcontracting had been established and published, as well as a practical guide on legal aspects of industrial subcontracting relations in the Community. A detailed preliminary investigation had also been carried out into ways of improving the supply of information on subcontracting opportunities at Community level;

(c) To promote the Community's international subcontracting potential and enhance its image among third-country investors. Following a fact-finding mission on subcontracting in Japan in November 1988, a conference had been held at Brussels in June 1990 on contract opportunities offered by Japanese investors in Europe.

105. Originally, in 1973, industrial subcontracting, as a major inter-EEC economic activity, was the responsibility of the Business Cooperation Centre, which was absorbed in the SMI Task Force in 1986, and incorporated into the new Directorate General XXIII on enterprise policies in 1989. Besides the DG-XXIII, the DG-VIII on development cooperation was implementing large technical assistance programmes in African, Caribbean and Pacific countries, whereas the DG-III (Industrial Affairs), and the DG-I (External Relations) were jointly implementing specific technical assistance projects in other regions.

106. He also mentioned other programmes related to the development of small- and medium-scale industries, such as the Business Cooperation Network (BC-Net), Europarteneriat and the EC International Investment Partners. The BC-Net, which had registered more than 30,000 enquiries, was currently being jointly evaluated.

C. The programme and experience of the United Nations Conference on Trade and Development

107. Mr. Supper presented a study programme conducted jointly by UNCTAD and the United Nations Centre on Transnational Corporations (UNCTC), which would emphasize two categories of export-oriented industrial collaboration: export-oriented joint-ventures and international subcontracting.

108. The objectives of this study programme were:

(a) To identify conditions that favoured the development of export-oriented industrial collaboration arrangements;

(b) To evaluate the effectiveness of governmental export-promotion policies and the development impact of such arrangements (i.e. sharing of responsibilities within joint-ventures, intensified linkages and vertical integration, and assistance to the development of local enterprise);
(c) To assess the contribution of foreign enterprises and of Governments to international cooperation;

(d) To evaluate future trends and the scope of industrial collaboration arrangements in the countries concerned.

109. About five case studies should be conducted in Chile, Mauritius, Morocco, Thailand and Yugoslavia, since all those countries had been successful in attracting export-oriented joint-ventures and subcontracting in the 1980s. The country case studies followed a common methodology and outline and a synthesis study would be prepared on the main policy conclusions. That synthesis would attempt to identify further scope for strengthening international industrial collaboration for the benefit of developing countries and to draw some generally applicable lessons regarding the efficiency of specific instruments. The convening of an expert group was envisaged at the end of the study to assess the results and consider policy proposals.

D. The International Network of Subcontracting, Industrial Cooperation and Partnership Organizations

110. Mr. Germano described the activities of the International Network of Subcontracting, Industrial Cooperation and Partnership Organizations (the French acronym is RIOST). RIOST is an international association of organizations (public, private and mixed) and individual experts concerned with the promotion, development or study of subcontracting. The overall purpose of RIOST is to promote and establish relations between subcontracting organizations and enterprises operating in Europe.

111. RIOST provides information services (list of organizations, calendar of events, studies, directories, guides, roster of experts and databanks) training services (organization of technical workshops and seminars) and undertakes research and studies on technical matters related to subcontracting. Regarding specific training activities, RIOST is planning to set up a programme to train subcontracting managers from Eastern countries.
Annex I

AGENDA OF THE EXPERT GROUP

22 May 1991

Opening session

Thematic area I

Topic I.1  Subcontracting and partnership exchanges and international cooperation networks

by A. Balaña

Topic I.2  Institutional and financial arrangements

by C. Cuny

General discussion

Topic I.3  Aspects closely related to industrial subcontracting

by N. Schicchi

Topic I.4  Selected implementation aspects

by J. Montes

Topic I.5  International promotion and networks

by J. Germano and R. Holtz

General discussion

23 May 1991

Thematic area II

Environment conducive to the development of industrial subcontracting

by C. Altersohn

Topic II.1  Government's role (legal and economic environment)

by V. K. Mathur

Topic II.2  Public sector's contribution

by R. Bhaskarudu and F. Dhemaied

General discussion

Topic II.4  Import substitution and export promotion policies

by E. Supper

Topic II.5  Forms of inter-enterprise agreement (ancillerization, partnership, affiliations etc.)

by M. Souhaité
General discussion

24 May 1991

Complementary presentations:

Peru case study (M. Rodriguez)
EEC programme and experience (T. Morosi)
UNCTAD programme and experience (E. Supper)
RIOST programme and experience (J. Germano)

Working groups to draw up the recommendations

Adoption of the final recommendations
### Annex II

**LIST OF PARTICIPANTS**

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<tr>
<th>Name</th>
<th>Title</th>
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<tbody>
<tr>
<td>C. Altersohn</td>
<td>General Inspector, French Ministry of Industry</td>
</tr>
<tr>
<td>A. Balaña</td>
<td>UNIDO Consultant</td>
</tr>
<tr>
<td>R. Bhaskarudu</td>
<td>Director, Maruti, Udyod Ltd., India</td>
</tr>
<tr>
<td>C. Cuny</td>
<td>UNIDO Consultant</td>
</tr>
<tr>
<td>F. Dhmaied</td>
<td>Director, National Subcontracting Exchange of Tunisia</td>
</tr>
<tr>
<td>J. Germano</td>
<td>International Network of Subcontracting, Industrial Cooperation and Partnership Organizations (RIOST)</td>
</tr>
<tr>
<td>R. Holtz</td>
<td>President of the Federation of Small- and Medium-scale Industries (IFSMI)</td>
</tr>
<tr>
<td>V. K. Mathur</td>
<td>Chairman, International Airports Authority of India</td>
</tr>
<tr>
<td>J. Montes</td>
<td>UNIDO Consultant</td>
</tr>
<tr>
<td>L. Morosi</td>
<td>UNIDO Consultant</td>
</tr>
<tr>
<td>M. Rodriguez</td>
<td>President of the Subcontracting Exchange of Lima</td>
</tr>
<tr>
<td>N. Schicchi</td>
<td>UNIDO Consultant</td>
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<tr>
<td>M. Souhaité</td>
<td>UNIDO Consultant</td>
</tr>
<tr>
<td>E. Supper</td>
<td>Chief, TEICS/ITP, UNCTAD</td>
</tr>
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