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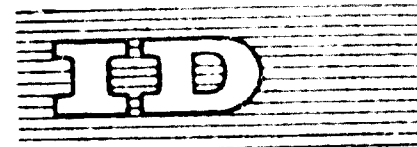
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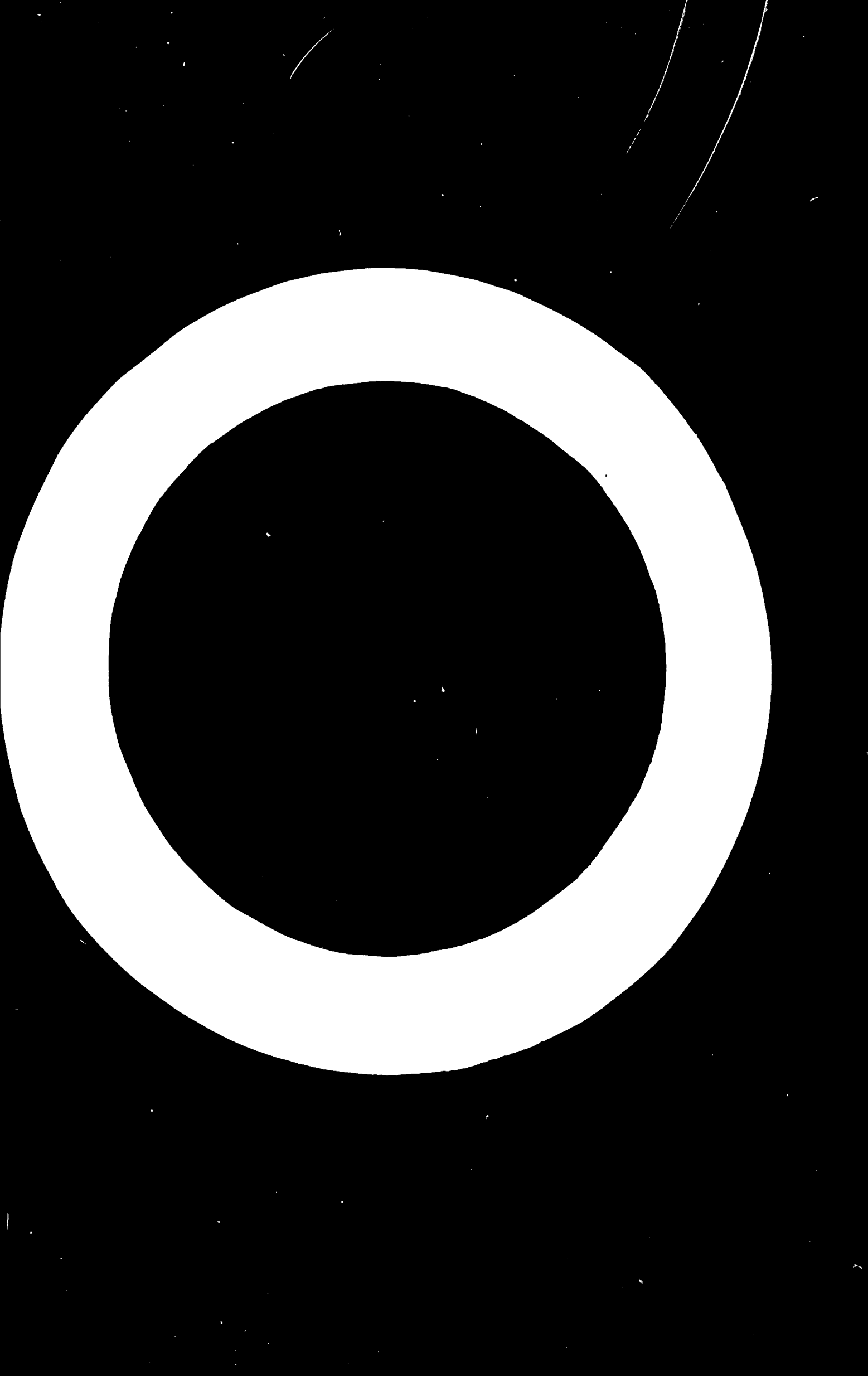
Expert Group Meeting on the Role and Promotion
of Subcontracting in Industrial Development

Paris, France, 6-11 October 1969

GENERAL CONCLUSIONS OF THE EXPERT GROUP ^{1/}

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Introduction

Organization and attendance

1. The Expert Group on the Role and Promotion of Subcontracting in Industrial Development met in Paris from 6 to 11 October 1969. The Expert Group was sponsored jointly by the United Nations Industrial Development Organization (UNIDO) and by the Development Centre of the Organisation for Economic Co-operation and Development (OECD).
2. The Group was attended by 24 participants from 23 countries - Argentina, Belgium, Brazil, Chile, France, Germany (Federal Republic of), Greece, India, Ireland, Israel, Italy, the Ivory Coast, Japan, Luxembourg, the Netherlands, Poland, Spain, Sweden, Tunisia, Turkey, the United Kingdom, the United Arab Republic and the United States of America; by staff members and consultants of UNIDO and of the Development Centre of OECD; by observers from the United Nations Economic Commission for Asia and the Far East (ECAFE) and the Economic Commission for Europe (ECE), and by 15 observers from national and international organizations having their Headquarters in 11 countries. A list of participants is given in Annex I.
3. Mr. André Philip, President, Development Centre, OECD and Mr. Igor Krestovsky, Chief, Small-scale Industry Section, Industrial Services and Institutions Division, UNIDO, welcomed the participants in the course of their opening addresses. Mr. R. Donn, Principal Division Chief, Information and Transfers of Experience Division, Development Centre, OECD and Mr. I. Krestovsky served as Co-chairmen of the Expert Group. Several country participants and staff members and consultants of UNIDO and OECD introduced the agenda items, led the discussion and drafted the corresponding part of the General Conclusions. A Drafting Committee consisting of the discussion leaders reviewed the first draft of the Conclusions.
4. The Meeting closed on 11 October 1969 with a motion of thanks to the Co-chairmen, staff and consultants of the Expert Group.

Opening statements

5. Mr. A. Philip opened the Meeting. He recalled that, in September 1967, the Development Centre of OECD had convened a Symposium on Assistance to Small and Medium-sized Firms through Collective Actions which was followed by expert missions to developing countries for the promotion of small-scale industry, including the development of subcontracting relationships between large and small industrial enterprises.

6. He observed that, in the developed countries, an industrial revolution was taking place, not only in technology but also in industrial organization. While there was an increase in technical and financial concentration, this did not result in the disappearance of small-scale and medium-sized enterprises. There was, on the contrary, a strengthening of such enterprises, both through the undertaking of collective actions and through the development of subcontracting with large firms.
7. In the developing countries, there was a problem of accelerating the transition from an agricultural to an industrial economy. In many countries, there was scope for creating both large and small industries and for establishing complementary relations between them.
8. Much remained to be learned about subcontracting, both in the industrial and the developing countries, and Mr. Philip expressed the hope that the Expert Group would contribute to pooling and transferring knowledge and experience in that field.
9. Mr. I. Krestovsky extended to the Group the greetings of Mr. I. H. Abdel-Rahman, Executive Director, UNIDO. In his message, Mr. Abdel-Rahman expressed his satisfaction that the meeting had been convened under the joint sponsorship of OECD and UNIDO, thus representing a further example of partnership between the two organizations.
10. Mr. Krestovsky pointed out that the Expert Group meeting was one in a series of international symposia and seminars organized, over a period of nearly ten years by UNIDO and its predecessor - the Centre for Industrial Development of the United Nations - in the fields of small industry development, industrial estates and technical services and facilities for small-scale industries. Owing to the co-operation of OECD, the Expert Group was bringing together participants from some of the most highly industrialized countries as well as from certain developing countries of all regions. It was in the former countries that subcontracting had reached maximum development. In the developing countries, even in those where large enterprises were established in industries lending themselves to subcontracting, there were hardly any such relationships between them and small-scale industries. It was felt, however, that there was scope, in some of the developing countries, especially in those participating to the Expert Group, for the promotion of subcontracting as a means of strengthening and broadening industrial development.

11. The purpose of the Expert Group was to gain better knowledge of this form of industrial organization and, in the light of experience in the countries of the participants, to evolve guidelines for orienting action by Governments of developing countries, including measures for promoting and regulating subcontracting, and to pave the way for technical co-operation projects in this area.

12. Mr. Krestovsky stressed the need to focus the discussions on the role and promotion of subcontracting in the developing countries; he felt that, at the same time, the discussions would be of value for the industrial countries, in many of which the subcontracting market, even when widespread, appeared to be inadequately organized and in need of improvement.

Adoption of the agenda

13. The provisional agenda was adopted. The agenda is given in Annex II.

I. SCOPE AND NATURE OF SUBCONTRACTING POLICIES AND PROGRAMMES
IN DEVELOPED AND DEVELOPING COUNTRIES

Definition of subcontracting

14. Many speakers referred to the definition of subcontracting presented by UNIDO in the document entitled "Subcontracting - its Role in Industrial Development" (ID/WG.41/2 - CD/PME(69)7). This definition is as follows:

"Subcontracting is a contractual arrangement between a primary company (contractor) and a secondary company (subcontractor) for:

- (a) the supply, by the subcontractor, on order from the primary company, of parts, components, sub-assemblies and assemblies that are then incorporated in a product sold by the primary company, both companies being involved in manufacturing;
- (b) the processing of materials for the primary company - whether the materials are provided by it or not - and the processing or finishing of parts provided by, and returned to, the primary company."

15. According to this definition, subcontracting covers all forms of processing carried out by one company on the order of another one. It excludes the more usual forms of procurement of "shelf items", as well as services. Thus, the term subcontracting would not be used in the case of government purchasing from industry, where no further processing, assembly or other manufacturing operations are involved, even though the term subcontracting is often used in that sense, in particular in the United States. Also excluded from its scope would be all activities related to non-industrial sectors such as construction. However, it was felt that the above definition was broad enough to include all forms of contractual arrangements between a primary company and a secondary company whereby the latter supplies parts, components, etc. which are incorporated in the final product marketed by the primary company.

16. Most participants were of the view that this definition was adequate for the needs of the discussion at the meeting. Some of them also felt that there was no need to spend too much time in achieving a precise definition. Participants who had worked in subcontracting for many years pointed out that they had never been troubled with the need for a strict definition of the subject. However, it was pointed out that, in the case of the United States, the term subcontracting was defined in such a way as to fit the provisions of a special law enacted in

that country, aimed at ensuring a "fair share" of public contracts for small business. Also, in the United States the ordering of parts or sub-assemblies by large corporations would not necessarily be considered as subcontracting but might often be viewed as a normal purchasing operation of these companies.

17. Most of the participants felt that the definition given to the term subcontracting in the United States was too restricted for the purposes of the discussion, especially as regards the role of subcontracting in the industrialization of the developing countries. Some participants thought that subcontracting should be given a wider definition so as to encompass not only manufacturing but also construction, and provision of services, research and technical know-how. Others were of the view that the definition should spell out in greater detail the types of operations and activities that could be included in subcontracting, especially those relating to the processing of basic materials.

18. After discussion, it was agreed to correlate the various views and the following definition was agreed upon by the Expert Group:

"A subcontracting relationship exists when a company (called a contractor) places an order with another company (called the subcontractor, for the production of parts, components, sub-assemblies or assemblies to be incorporated into a product to be sold by the contractor. Such orders may include the processing, transformation or finishing of materials or parts by the subcontractor at the request of the contractor."

Types of subcontracting

19. The Group discussed the three main forms of subcontracting distinguished in the paper "Types of Subcontracting" (ID/MG.41/4 - CD/PPL(69)9): economic or cost-saving subcontracting, specialized subcontracting and capacity subcontracting. The inquiry made by UNIDO in a few industrial countries of Western Europe - Austria, France, the Netherlands and the United Kingdom - indicated that much subcontracting in these countries was of the specialized and capacity types, rather than of a purely economic (cost-saving) type. Specialized subcontracting involved frequently a steady and long-term relationship between large and small industries. On the other hand, capacity (or peak-load) subcontracting was usually short-term and intermittent, though it was sometimes highly remunerative for the small firms.

20. Some participants felt that all subcontracting had to be economic or it would not take place. There were therefore only two types: specialized and capacity subcontracting. Other participants pointed out that there were cases where subcontracting, especially short-term, was practised for reasons other than gaining a cost advantage, for instance when there was a need to fulfil an order in time or to benefit from the specialized or high-quality production of outside manufacturers.

21. There were different ways of assessing the economic advantages of subcontracting. For example, some large firms in the United States used return on capital rather than a mere cost comparison as a criterion for deciding whether to subcontract or not. In other countries, it could be argued that it was the lower costs and lower profit margins of small enterprises that made it economic to subcontract work to them.

22. It was felt that, since the purpose of the meeting was to find ways of increasing all forms of subcontracting in developing countries, it was useful to distinguish the different types of subcontracting while recognizing that there might be some overlapping between them. Most participants considered that in the developing countries, subcontracting should principally take the form which would result in relatively stable relationships between large and small industries rather than that of intermittent relationships that arose out of special market conditions which could change rapidly and suddenly. Particularly in the developing countries, subcontracting tended to be mainly based on such temporary situations, thus resulting in a feeling of insecurity by the small firms engaged in it. For that reason, particular attention should be given to the promotion of specialized subcontracting which, given adequate standards of technical competence and mutual trust, could result in more permanent and secure relationships between large and small industries and could make a more substantial contribution to industrial development. At the same time, it was pointed out that there were many cases when subcontracting started for capacity reasons, on a temporary basis, and later developed into a more permanent specialized type. The promotion of capacity subcontracting should therefore not be neglected.

Role of Subcontracting in industrial development

23. In some developing countries, for instance in India, an important objective of government policy in the field of subcontracting is the promotion of modern

small industries, in particular of those able to undertake specialized work. In that country, subcontracting small industries (which are referred to as "ancillary industries") receive considerable technical and financial support from the Government, over and above that given to non-subcontracting small-scale industries. In other countries subcontracting is promoted in connexion with the development of the automobile, machine and appliance industries with a view to extending the participation of national enterprises in the production of these goods. Another purpose is to spread employment through the expansion of subcontracting either between national and/or foreign-owned industries producing for the local market or, whenever possible, between such industries producing for a sub-regional or even broader international market.

24. A number of problems are encountered in trying to increase the volume of subcontracting given out to local manufacturers by foreign firms established in developing countries to produce such items as vehicles, appliances, machinery and electronic equipment. The large manufacturers insist, with varying degrees of justification, that the local small industries are not able to produce at the level of quality required. The price aspect is also relevant. The case was quoted of a country in which the integration of locally-manufactured parts in the assembly of trucks had had the effect of raising the price of the finished vehicle very considerably in relation to the price of the imported truck.

25. Many participants felt that an important reason for a comparatively limited volume of subcontracting in several countries was the lack of information in these countries on the available capacities and capabilities of potential subcontractors - a situation which was also prevalent, though to a smaller extent, in some industrial countries. There was general agreement that the engineering industries afforded the best opportunities for subcontracting but it was incorrect to consider that subcontracting was necessarily restricted to these industries.

26. In Asia and the Far East subcontracting had not yet taken hold significantly except in Japan and to a lesser extent in China (Taiwan), India and Pakistan. In Japan, the development of subcontracting has played a vital role in industrial growth. After years of looking on subcontracting as a means whereby the large companies reduced the price of their products by using the cheaper labour and lower profit margins of the small enterprises, the Japanese industry was now resorting increasingly to specialized subcontracting.

27. In Africa, a preliminary survey undertaken by the Afro-Asian Organisation for Economic Co-operation (AFROSEC) indicated that there was hardly any subcontracting in most countries of the continent; where it did exist it was of an irregular and unsteady nature and involved few enterprises. The survey reported that in some African countries subcontracting was handled to a great extent through intermediaries whose sole function was to bring the contractors and subcontractors together. The survey also suggested that most subcontracting such as existed in Africa was of a very simple nature requiring no specialized competence. This was particularly true in the subcontracting practised in the export textile industry. A role appeared to be played by large retail stores which generated a relatively significant volume of subcontracting among their suppliers.

28. One participant from an African country at a very early stage of industrial development stressed that in such countries the first steps, before one could talk of subcontracting, were to develop local indigenous enterprises. In some of these countries the governments faced great difficulties in reconciling their desire to encourage foreign investments through a liberal investment code and their need to press foreign firms to subcontract work locally.

29. In Latin America, the more industrialized countries had already developed to the stage where a considerable volume of subcontracting was being practised in certain industries. However, in the region as a whole, lack of mutual trust between the large and small industries still hampered the further development of subcontracting. Yet many countries of the region recognized that subcontracting was potentially an important development instrument, especially for deflecting industrialization away from the capital cities, and some steps were being taken to promote it.

30. It was generally agreed that subcontracting was an aspect of economic growth. In the early stages of economic development there were little opportunities for subcontracting. The phases of the artisan and agricultural economy were generally followed by a phase of industrial development through import substitution which provided possibilities for a limited amount of subcontracting. However it was only when the industry reached a certain level of maturity that it became possible to expand considerably the volume of subcontracting. As the general level of industrial development was raised and standards of technology and management improved, then special measures of promotion should be taken. The process could be facilitated and accelerated if a suitable machinery existed, such as

institutes for setting standards, systems of financial assistance and extension services for subcontractors providing help in technology, management and marketing.

31. In some countries subcontracting had played an important role in decentralizing industrial growth by giving an impetus to the growth of enterprises, both large and small, and employment away from the metropolitan areas. It introduced a measures of flexibility in industrial growth and of diversification in the industrial structure which helped developing countries to face changes in the economic cycle. If subcontracting were promoted in several industrial sectors, rather than remaining limited to a few industries, as was generally the case today, the economy as a whole, and in particular the small-scale industries could withstand better the effects of recessions.

32. There was general agreement that while the volume of subcontracting would vary with the degree of industrial development, a start could be made to promote subcontracting even in countries at early stages of industrialization by assisting the establishment of small industries supplying parts and services to the new large enterprises. In a general way, the Expert Group considered that subcontracting should be taken into account in the over-all industrial development plans and programmes of the developing countries.

II. MEASURES OF PROMOTION, REGULATION AND PROTECTION OF SUBCONTRACTING IN DEVELOPING COUNTRIES

The role of public policy and institutions in subcontracting

33. The Expert Group recognized that, in market-oriented economies, the decision to subcontract or not was normally taken by large companies only. Yet, the government could, in such economies, play an important role in promoting or regulating subcontracting.

34. In one country with a socialist economy - Poland - subcontracting arrangements between the centrally-planned (or "key") industries and small-scale industries are usually concluded at the level of industrial ministries and co-ordinated by inter-ministerial commissions. In some cases, such arrangements are made at the level of associations of enterprises and, more seldom, by the enterprises themselves. Thus, most of the subcontracting is programmed, though some non-programmed and casual subcontracting is also practised.

35. In the market-oriented economies, public policy can exert a very important influence on subcontracting through taxation. The Expert Group recognized that, in general, the system of tax on value added was not unfavourable to subcontracting and could even encourage it in some cases. It noted that most of the countries which are still using a system of indirect taxation resulting in cumulative imposition had to ease the implementation of the fiscal legislation through special administrative measures, so as not to penalise excessively subcontracting operations.

36. The Group recognized that the government may use accelerated depreciation allowances on new equipment and machinery as a powerful instrument to induce enterprises to require producers' goods. However, this measure has only an indirect influence on subcontracting relationships. A similar remark may be made regarding the effects of a reduction from import duties on machinery needed by contractors and subcontractors.

37. In general, most of the measures of promotion of small-scale industry benefit subcontractors as well as non-subcontractors. This is true in particular of measures of financing at liberal conditions for the procurement of machinery and for working capital. Several participants stressed the need to allocate scarce raw materials to subcontractors with the same priority as for the contractors. The Expert Group noted that, in India, "ancillary" industries remained entitled to benefits such as admission to industrial estates, hire-purchase of machinery,

technical assistance, etc., even when their investment in fixed capital exceeded the ceiling; applying to small-scale industries in general, and felt that a special definition of subcontracting industries could be useful in many countries.

38. The participants discussed the problems of compulsory subcontracting and were in agreement that government action in this area should be very cautious. It was desirable that subcontracting relationships should not be made rigid by legislation. The measures adopted should not impose excessive constraints on the contractors, nor should they give contractors excessive privileges vis-à-vis the subcontractors. Some participants were doubtful that legislation alone could lead to an expansion in the volume of subcontracting. However, others were of the view that pressure could be applied on large industry in certain cases; for example, government orders may provide that a given percentage of the value of the orders should be subcontracted. It was pointed out in this connexion that in the United States, the Small Business Administration applies pressure on government purchasing offices to include in their major contracts provisions that prime contractors will subcontract a fair share of their output to small-scale industries. Systems of licences for the establishment of industries or for import of materials could also be used towards that end. The establishment of bodies bringing together those who participate to the rational organization of subcontracting could be particularly useful in the case of compulsory subcontracting.

39. The Group considered the measures for protecting subcontractors against abusive practices on the part of contractors, and felt that arbitration should be the responsibility of professional bodies rather than that of public judicial authorities. Subcontracting is essentially a professional problem and conflicts should be solved among professionals. An effective assistance could be given to subcontractors by providing them with model subcontracting contracts, on the grounds that well prepared contracts offer the best possible protection in this field. Some countries have already evolved model contracts and procedures for professional arbitration.

40. The problem of the influence of anti-trust legislation on subcontracting may be very important for developing countries which endeavour to protect local industry. If, in a given activity, there is only one production unit of relatively large size, it may enjoy a monopoly position which may hamper economic development and, in particular, impede the development of subcontracting.

41. There was a consensus that the government's intervention should be aimed at creating environmental conditions which would foster the development of subcontracting and at maintaining a balance between large enterprises and small and medium-sized ones.

The role of industrial extension centres and other promotional and assistance agencies

42. There was agreement that, in general, the existence of developmental institutions was not a pre-condition to economic development. In a number of developing countries, some development of industry took place in the absence of such institutions. However, some institutional infrastructure was necessary to facilitate and accelerate industrialization. This was particularly needed for the promotion of small-scale industries which required assistance at all stages of establishment and operation of their enterprises. Desirable as self-help measures were, these could be encouraged only after the small-scale industry sector had achieved a certain level of proficiency. In most developing countries, new entrepreneurship could be effectively stimulated and modernization of existing enterprises could be successfully achieved only if some "industrial extension" agency - small industry service institutes, small industry department of a ministry or of a development corporation - was in existence. In view of the importance of quality production and efficient management for small industries engaged in subcontracting, the existence of industrial extension centres or the provision of extension services by other institutions were of particular importance.

43. In this connexion, some participants considered that it was not always necessary to wait for the establishment of industrial extension centres to assist small industries and to promote subcontracting. In view of the shortage of financial and human resources, recourse for this purpose could in many cases be made to existing institutions such as productivity centres, chambers of commerce and industry and other professional organizations. Attention was drawn to the need to avoid a proliferation of institutions having overlapping functions. The organization responsible for small industry development should be staffed with technicians familiar with industry, should provide practical assistance, and should avoid bureaucratic methods.

44. There was agreement that, if the scope of subcontracting work in a country did not justify the establishment of subcontracting exchanges, it was both appropriate

and desirable for an extension centre to carry out clearing-house functions aimed at relating supply and demand for subcontracting operations. This could be done by collecting information on the available capacity, the specialization and the proficiency of small establishments. The Group stressed in this connexion that while registration of small industries, resort to questionnaires and other such methods were useful, personal knowledge through regular visits to small industrialists was essential. The centre could draw up and circulate lists of parts, components and processing operations needed by large industries, and bring together contractors and subcontractors. In areas of concentration of subcontractors in similar lines of business, the centres could assist in setting up common service facilities, such as tool rooms, testing laboratories, design centres and specialized machinery. The existence of the industrial extension centres should be well publicized and inducements provided to the small industrialists to avail themselves of their services and facilities; it was suggested, for example, that all other conditions being equal, preference be given to suppliers supported by the extension services, when tendering for subcontracting operations.

45. A number of participants felt that clearing-house services should be extended against a fee, on the grounds that such services represented an operational cost to the beneficiaries; a further reason was that, as a rule, services were appreciated only when paid for. In principle, services should be provided at cost or at subsidized rates. It was recognized that in certain circumstances, for instance where the subcontracting programme was at early stages, services could initially be provided free of charge and fees introduced later on.

46. It was felt that the services extended to sub-contractors were not substantially different from those provided to other small-scale industries. They could, therefore, be given by the regular staff of an extension centre; if the volume of such work increased, full-time "ancillary" officers might need to be appointed. Foreign experts attached to the centres should assist more by training local staff than by providing themselves services to small-scale industries.

The role of large industry

47. The analysis of the motives which justify the development of subcontracting in the more industrialized countries shows that the conditions found in a large number of developing countries are likely to hamper the development of that system of industrial organization. Both in countries which are only at the first stages of industrialization and in countries which are relatively more developed, the large enterprises have no spontaneous incentives to promote subcontracting activities. The large industrial enterprises - private and public - prefer to do all their manufacturing under their own roof partly through concern for security, that is to say, lack of confidence in the capacities of the small industries to produce quality articles in the desired time limits, and partly through the wish to keep their technical responsibilities to themselves.

48. However, the Group noted that in a fairly appreciable number of developing countries and, particularly, in a certain number of countries represented at the meeting, some progressive large industries were adopting wider and longer-term views and were promoting, sometimes spontaneously and sometimes prompted by the State, subcontracting relations. Thus a large international computer firm prepared itself, with a view to its establishment in India, lists of parts and components used in its manufacturing and organized exhibitions of these articles so as to encourage offers from small industries capable of producing these articles. In the same country, Hindustan Machine Tools - a public sector company - instigated, in the orbit of its various factories, the creation of small subcontracting firms to which it gave technical assistance.

49. A participant mentioned the TOP (Technique, Organization, Productivity) experience carried out in France, a country where, in a less developed region, a certain number of large firms agreed to give, free of charge, their technical assistance to the small firms located in the region. They were later surprised to note that this technical assistance was favourable both to the development of their subcontractors and to the training of their own technical personnel. This example suggests that, particularly in the developing countries, the large enterprises can be encouraged to give technical assistance.

50. Certain participants pointed out the danger to which the subcontractors expose themselves when they depend too closely on their contractors in a period of economic

depression. In such times, the contractors tend to pass on some of their difficulties to the subcontractors. The Group agreed that the subcontractors should, as far as possible, work for several contractors as well as on their own behalf.

51. As far as the administration of subcontracting in the large enterprises is concerned, the importance of having recourse to very qualified engineers was pointed out, both for the drawing up of contracts as well as for the negotiations with subcontractors. Orders should be as clear and precise as possible. The commercial and legal services should only be called in for the formalities of contracts.

The role of small-scale industry

52. It was agreed that small-scale industry could play only a limited role in the development of subcontracting, since it was the passive partner in this relationship, which depended usually on the initiative of the contractor. However, there were certain actions that could be undertaken by the subcontractors in addition to the initiatives of the large enterprises and of government.

53. The nature of the actions to be undertaken by small industry and by organizations on behalf of small industry would differ from country to country. These would depend on the degree of development of the industry of the country and especially on the situation in those sectors of industry lending themselves particularly well to subcontracting.

54. Several examples were given by participants of activities conducted by organizations and groups of industrialists to increase the role and share of small industries in subcontracting work. In some countries, despite the very high percentage of small industries in the total number of industrial firms, subcontracting still had not developed to any appreciable extent, mainly because of lack of confidence in the abilities of the small enterprises to carry out work reliably. In these countries, the major effort on behalf of small industries was to raise their technical competence so as to enable them to meet the demands of the large contracting industries. Where industry was dominated by large state-owned enterprises, the government had more opportunities for influencing the establishment and development of subcontracting relationships.

55. Some participants referred to actions undertaken by institutes, extension services and associations of small industrialists to raise the managerial and techni-

cal level of the small enterprises. Among the various methods that had proved successful were the "self-organization" groups and operations such as EOP, both of which started in France. The former was a method whereby small industrialists helped each other through a frank exchange of experiences, while in the latter the large industries helped the small industries to overcome their managerial problems. Other methods referred to included the preparation of pilot projects within specific groups of small enterprises to demonstrate how management could be improved, and different forms of training programmes to raise the managerial standards of the small industrialists.

56. The meeting recognized the need for the small subcontractor to promote himself by convincing large industries that subcontracting could in the long run be mutually advantageous.

57. A further conclusion was that there was no single method of overcoming the apathy of the small industrialist, his tendency to immerse himself in his own problems and his unwillingness to seek and accept the advice of outside bodies. In some cases this could be done through a prolonged process of winning over the small industrialist through personal contact, with demonstration and training in his own factory. The personal relationship of the extension officer or adviser acting on behalf of a service, trade or business association with the small businessman was considered to be fundamental for achieving success in improving the operation of the small enterprise.

58. It was stressed that quality was a most important subject in connexion with subcontracting. Inadequate quality was very often given as the reason for the reluctance of large factories to subcontract work to small industries. A service for ensuring quality control was essential if these doubts of the large industrialists were to be overcome.

59. Another method, which had been successful in certain countries, in particular in Japan and in socialist countries, was to encourage the establishment of co-operatives of small-scale industries in general and of co-operatives of subcontractors in particular. Such co-operatives could assist their members in procurement of raw materials, financing, legal problems, and other aspects of production and management

The role of private groups

60. Besides the action of special organizations of subcontractors, a role in the development of subcontracting is also played by trade unions and trade and professional associations.

61. It was the experience of a number of participants that, as a rule, trade unions were not favouring subcontracting. Some trade unions in certain countries felt that it was an anti-recessionary weapon in the hands of the contractors, the first victims of which are the small-scale industries. In other countries, some trade unions are so rigidly organized in guild-like systems that subcontracting is hampered, and workers oppose it in labour negotiations. A few unions have a more flexible attitude and accept subcontracting as an employment-generating system.

62. The Expert Group felt that the attitude of trade unions might be influenced by improvements in the organization of subcontracting, and by better knowledge of its operation. Some participants thought that an effective way of achieving a better understanding by all concerned of the mechanisms and implications of subcontracting was to include, in the committee of a subcontracting exchange, representatives of trade unions, side by side with representatives of employer organizations and, where they exist, of small industry promotion and extension agencies.

63. As regards the professional associations such as chambers of commerce and industry and federations and confederations of industries, the Group felt that they could be of definite help in improving the organization of the subcontracting market. They could provide considerable assistance to their members, in particular to those who operate small-scale industries, by preparing model subcontracting agreements or by drawing up the rules for a professional "deontology code" regulating relationships between contractor and subcontractors. They should also be encouraged to provide the smaller enterprises with assistance in technique and management.

Deontology of subcontracting-Practices and rules of action

64. The Expert Group noted that, in all countries, side by side with the beneficial effects of co-operation between large and small industries, many regrettable practices developed.

65. Contractors complain that subcontractors do not adhere to specifications, are unable to meet delivery dates, are often unable to calculate costs correctly and

complain about pricing, and even engage in unethical practices, e.g., violating industrial secrets, misusing tools and dies provided by the contractor, etc. Systems of penalties, "black lists", and other such measures are sometimes adopted by contractors. General prejudice and lack of trust in respect of the subcontractors are not uncommon. Paternalistic policies may ensure security through subservience. In some developing and even in some industrial countries, subcontracting may be in the hands of middlemen, and the small industries may be exploited.

66. Subcontractors complain that because of the disparate bargaining strength between them and the large companies, the latter impose drastic conditions in terms of price, specifications, time of delivery, etc.; delay payments, reject supplied items unreasonably, change specifications without adequate notice, cancel orders in progress, and sometimes reduce subcontractors to subservience, "captivity" and even "peonage".

67. Small-scale industries - whether subcontractors or not - are sometimes charged with evasions of statutory requirements regarding social security, workers' legislation, guaranteed minimum wages and other legal benefits for industrial workers. Such practices may sometimes be condoned by contractors with a view to keeping the subcontractors' manufacturing costs at the lowest possible level.

68. From the standpoint of the economy as a whole, the above practices result in waste, hamper progress and often have undesirable social effects.

69. The Group agreed that the formulation of a common code of business behaviour was an essential element in the organization and promotion of subcontracting. The respect of the code, however, is not so much a matter of legislation as one of business ethics. The development of business ethics anywhere is an evolutionary process. An ethical approach is all the more necessary as a country industrializes.

70. It is axiomatic that the contractor and the subcontractor must come to a meeting of minds on the work to be performed, price, delivery, progress payments and so on. Much care should be taken in drawing up the contract so that both parties will have a record of the anticipated relationship and a solid base for discussion should disagreements arise. For a subcontract of large size it would be prudent and good business practice to include a clause in the contract providing for arbitration of conflicts.

71. More important than the legal relationship as reflected by the contract, however, is the personal relationship between the two parties. Contractors, usually big

businesses, study candidate subcontractors carefully before entering into relationships with them. The reputation of the firm, its financial position, the quality of its products are checked in considerable detail. For their part, subcontractors would be well-advised to find out at least as much about prospective contractors. There is no doubt that some contractors engage in sharp practices while others take great care in upgrading the management and technical capabilities of the subcontractor.

72. Subcontractors should keep in mind some possible developments in their relationship with the contractor. There is sometimes a risk that the relationship might finally end in the take-over of the small firm by the large. Potential subcontractors would be well-advised to think carefully about these matters before proceeding.

73. Experience in the most advanced countries indicates that many large firms are very helpful to their subcontractors and that this is usually of mutual benefit. A spirit of co-operation, a genuine rapport between the two parties, is good business and improves the effectiveness and profitability of those concerned. Several examples were given of assistance extended to the subcontractor by the contractor, such as advice on procurement; financial counselling and assistance; the judicious and sympathetic scheduling of progress payments; management assistance; engineering assistance in many forms; practical advice on quality control; modification of delivery schedules if conditions require such modification; training of purchasing and technical personnel; and the provision of information material needed by the subcontractor.

74. Business ethics reflect in general the values of the society as a whole. Other than setting a good example in its business operations, the government can do little in setting the tone or plane of business behaviour. A code of business behaviour is the hallmark of professionalism and the role of trade associations is particularly important in this connexion; in some countries, they have drafted, and continually revise, codes of behaviour for business firms.

75. There are many examples of sharp practices in the world today and it is everybody's responsibility - the firms, the government, the unions - to improve the business climate. The role of the trade unions may be particularly important in seeing to it that subcontracting does not lead to the exploitation of cheap labour in small firms.

76. Some participants pointed out that inflationary conditions and repeated deval-

uations of currencies in some developing countries made good business relations between contractor and subcontractor difficult unless such conditions were provided for in the agreement between them.

III. SPECIAL INSTRUMENTS OF PROMOTION (OF SUBCONTRACTING)

Subcontracting exchanges and clearing-houses (public or private)

77. Several experiences relating to the creation and operation of subcontracting exchanges were described to the participants. The exchanges may extend the following services:

- facilitate subcontracting, that is bring together supply and demand;
- obtain information on the number of machine-hours available and other facilities; such information makes it possible to find out under-equipments and over-equipments and enables therefore the exchange to provide advice in the field of investment;
- provide information focused on technical questions.

78. In view of the numerous contacts with entrepreneurs which take place on the occasion of the services provided by a subcontracting exchange, an exchange can be relied upon to advise managers on the improvement of productivity, to facilitate the formation of groups of enterprises for collective action, to provide managerial training and so on. It is extremely important, in particular, that an exchange should provide technical assistance in addition to its normal functions, especially in developing countries.

79. The Group emphasized that exchanges could not and should not be a planning instrument, even at the regional level, since they are not in contact with all the enterprises located in a given area. They should not operate as a procurement office nor as a commercial agency. In particular, they should not act as an intermediary in the commercial sense of the word; they should not become involved in the commercial negotiations between large and small industries. Needless to say, they should not limit or suppress free competition.

80. It was essential that an exchange should enjoy the confidence and respect of both big and small industrialists. For that reason, sponsorship by a chamber of commerce and industry was very desirable, provided the chamber grouped all types of industries and was not dominated by the large ones. However, it was noted that, in most developing countries, the chambers and other professional associations were usually reluctant to add promotional functions to their normal functions of protection. Yet the Group felt that it was worthwhile to attempt to steer them towards promotional activities. The industrial extension centres

also present all the conditions required for sponsoring a subcontracting exchange, and the Group felt that it would be easier to set up exchanges under their sponsorship than under that of chambers of commerce. The fact that industrial extension centres have, as a basic assignment, to provide small-scale industries with assistance in technique and management was a further reason for doing so, in view of the special importance of technical assistance for the subcontractors. Organization in the form of a foundation was recommended by one participant. The Group strongly advised against the organization, in the developing countries, of public or private exchanges on a commercial basis.

81. In developing countries, the exchanges should preferably serve a rather limited geographical area where the following conditions would be met: industrial potential, communications, and support by large industries. The scope of action of an exchange will usually be more restricted than in industrial countries where it may encompass 150 to 200 kilometres. Proximity between large and small industries is indeed desirable, especially in developing countries, in order to make it possible for the large industries to check the efficiency of their subcontractors and to give them technical assistance more easily. The distance between the contractor and the subcontractors should necessarily be relatively small when subcontracting is of the capacity type. It may be greater in the case of specialized subcontracting.

82. The Group considered that, in most developing countries, the services of a subcontracting exchange should, at any rate in the early stages, be provided free of charge. Different systems of payment could be introduced later on, with Government subsidies if need be. Among the systems are annual subscriptions based on company size, without commissions for individual services; and small registration fees by all users, with commissions for services, on a fixed or sliding-scale basis.

83. Many participants stressed that the exchanges should be autonomous if they were to be dynamic and efficient. An exchange should be financed, leaving aside the contributions of the industrialists, by the sponsoring organization, by the professional associations for services extended to the sector as a whole, and by the Government for the contribution made by the exchange to actions of global interest, in particular to the increase in productivity.

84. The opinion expressed in a document submitted to the Group ("Subcontracting - its Role in Industrial Development" - ID/IG.41/2 - CD/PML(69)7) that an exchange was a self-destroying instrument was correct only with respect to specialized subcontracting, but not in regard to capacity subcontracting. The latter was, in industrial countries, the main activity of subcontracting exchanges. In developing countries, the exchange would be expected to serve the promotion of subcontracting in all its forms, and if both large and small industries grew, the disappearance of the exchange would not be likely to take place.

85. The Group emphasized strongly the importance of selecting, as the director of an exchange, an engineer, preferably a mechanical engineer, having not merely a high technical competence and widespread experience, but also human qualities and "public relations" talent which would win him the trust of the entrepreneurs, both big and small. The importance of trust in the field of subcontracting could not be under-estimated.

Subcontracting in the industrial estates

86. The Group noted that "ancillary" industrial estates had been set up in India and in Japan. In India, such estates have been established by a few public industrial corporations, and one estate has been developed as a co-operative undertaking of subcontractors with the assistance of the contractor, a private company. In Japan, ancillary estates are set up by subcontractors' co-operatives, with government assistance.

87. It was considered that the establishment of subcontractors' industrial estates was a desirable but not an essential measure. Moreover, it was pointed out in many developing countries, there would be great difficulties in developing such specialized industrial estates. Most of these countries attached greater priority to the establishment of general-purpose estates and the construction of specialized estates could be effectively undertaken only after the former had been developed on a sufficient scale and had proved their worth. One participant pointed out, in this connexion, that the development of small-scale industries on general-purpose industrial estates could be accelerated if subcontracting opportunities existed in the surrounding area.

88. Some participants felt that, where ancillary estates were feasible, they might be developed by co-operatives of subcontractors, with some assistance from the contractor and the government (for instance for obtaining credit, land, building and machinery). It was doubtful that contractors would be willing to

bear the costs of such projects. Some doubts were also expressed regarding the chances of forming co-operatives or other associations of subcontractors for the construction of industrial estates, since even the ordinary forms of co-operative associations had not met, so far, with great success in a majority of the developing countries.

89. It was important that small industries established in an ancillary industrial estate should be entitled to using their surplus capacity to manufacture for the open market. This would reduce their dependence on a single prime contractor, an especially important consideration in times of economic recession.

Subcontracting and integrated area development: local, national, regional and international networks

90. Subcontracting is encouraged and facilitated when large and small industries are not too far remote from each other. As stated earlier, in the case of capacity subcontracting vicinity is most important; in the case of specialized subcontracting, it is less important, but it still facilitates transactions. In the developing countries, it was likely that most subcontracting would be given out locally, at any rate at early stages.

91. It was pointed out that industrial decentralization was a policy objective in most developing countries, and it was considered that subcontracting could be promoted with a view to encouraging regional development. Whenever a large industry lending itself to subcontracting was set up in a decentralized location, the establishment of small-scale industries able to cater to some of its needs should be promoted. Such small industries would also produce for the local market. It might sometimes be possible to orient enterprises already established in such locations towards subcontracting activities, rather than to create new enterprises to that end. Schemes of this type should preferably be worked out within the context of regional economic and physical planning.

92. The creation of subcontracting exchanges was justified only in regions where industry was concentrated to the point that it was difficult to obtain information on available capacity or specialization of potential subcontractors. In small countries, a central exchange could serve the whole territory and even, as was the case in Sweden, promote subcontracting among several countries. Where subcontracting exchanges could not be set up economically, clearing-house services should be provided, at the local and if possible the regional or national levels, by professional associations or industrial extension centres.

Fairs and exhibitions

93. There was agreement that fairs and exhibitions of parts and components were of great value in the promotion of subcontracting activities. They should be held at locations where representatives of those engaged in subcontracting gather or frequent. Permanent exhibitions might be held at convenient centres such as the show-rooms of big contractors, the premises of trade associations, chambers of commerce and industry and of industrial extension centres.

94. Even in countries where subcontracting is at early stages, fairs and exhibitions could be an important promotion means. One participant mentioned that the Standing Committee on African Trade Fairs and Exhibitions intended to stage in 1970 a technological exhibition and symposium on small industries, and thought that the occasion may well provide an excellent opportunity to organize a special exhibition on subcontracting with the help of international agencies and firms interested in the promotion of exports from developing countries.

IV. INTERNATIONAL SUBCONTRACTING

Scope for international subcontracting

95. The Expert Group considered briefly certain problems relating to international subcontracting, defined as an arrangement between a foreign contractor (usually a large international concern set up in an industrial country) and small subcontractors in developing countries. It noted that the replies to the UNIDO questionnaire ("Subcontracting - An Analysis of International Experience" - II/EG.41/3 - CD/PNE(69)39) indicated that some subcontracting of this type was taking place, but in fewer countries and in fewer industries than domestic subcontracting. The replies reflected a promising trend for the development of international subcontracting in the future. The Expert Group felt that this problem deserved further study, especially on the part of international organizations. Research should be concerned with the different flows of subcontracting -- among industrial countries, from industrial country (contractor) to developing country (subcontractor) and vice versa, and among developing countries.

96. In most cases, international subcontracting as defined in paragraph 95 was restricted to the production, in a developing country, of items with a high labour content and the economics of the transaction required that reduced labour costs should not be offset by high transport costs.

97. The Group recognized that the existence of common markets, free trade areas or monetary blocks was not a pre-condition for international subcontracting. However, the existence of such arrangements improved trade relations between countries and helped in the development of international subcontracting.

98. It was the view of the Expert Group that the development of subcontracting between contractors in the industrial countries and subcontractors in the developing countries should be encouraged since it would stimulate the establishment of modern small-scale industries in the latter countries. There were some prospects for increasing subcontracting between the developing countries themselves, but considerable difficulties would need to be overcome, owing to the fact that until now industries in these countries were usually competing rather than complementing the activities of each other. The Expert Group expressed its support of efforts to develop industry on a regional or sub-regional basis, as was being endeavoured, in particular, in Africa.

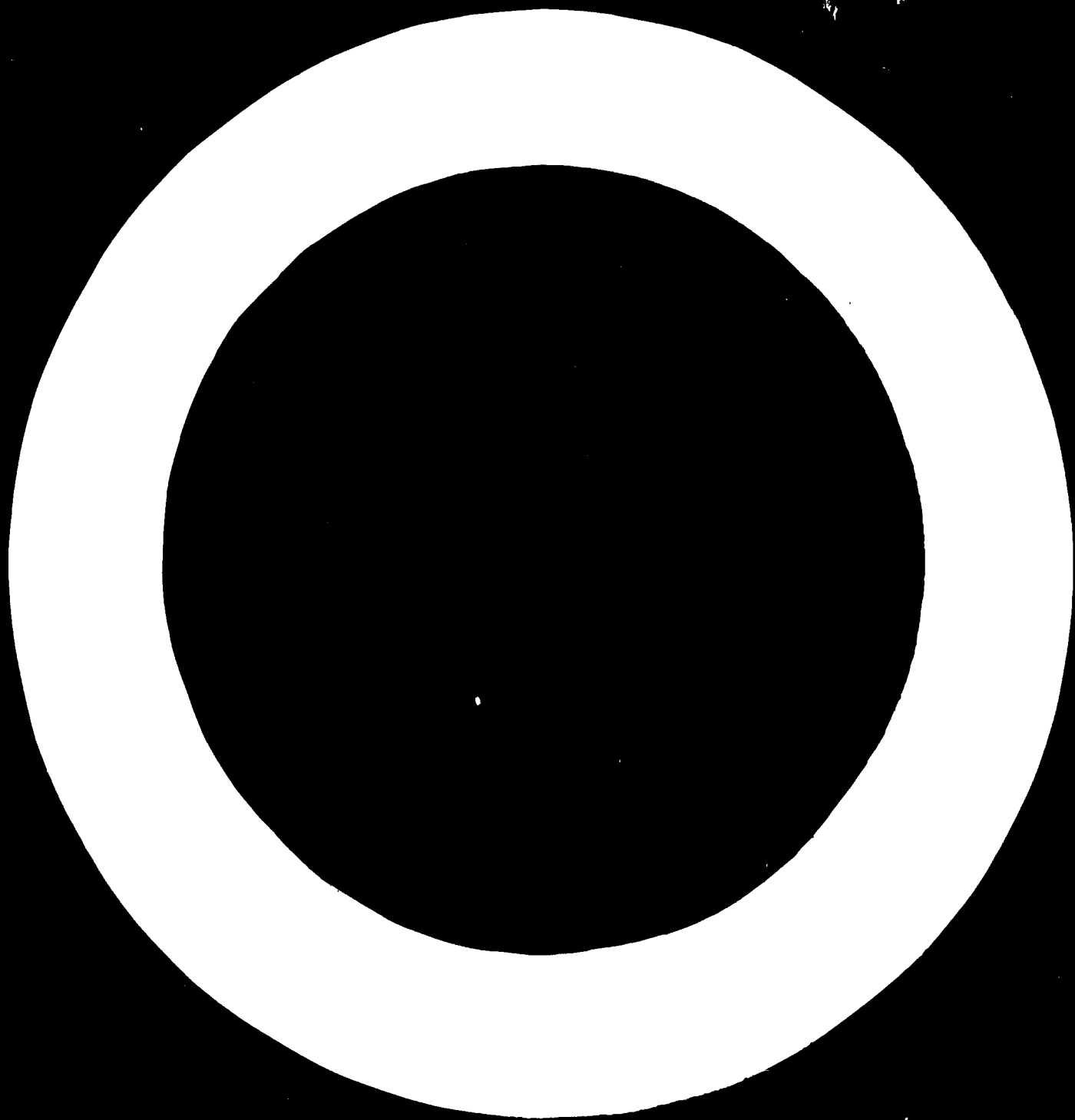
Facilities and methods for promoting international subcontracting

99. The promotion of international subcontracting raised administrative, technical, financial, legal and fiscal problems, some of which had to be solved within the context of international treaties or trade agreements, while some others lent themselves to the adoption of national measures.
100. Measures of international character to promote subcontracting related, among other things, to trade preferences, protection of foreign investment (a provision regarding subcontracting might be introduced in the International Convention for the Protection of Investments), and creation of international subcontracting exchanges or clearing house systems. One participant suggested that an International Convention on subcontracting, be drawn up: the Convention would define the mutual obligations of the parties concerned and would provide for arbitration in case of conflict. The adoption of a common terminology, in particular of technical terms used in industry, and of international standards, would facilitate international subcontracting. National measures might include, among others, tax and tariff concessions, export premiums, special financing (with special collateral systems for subcontractors and special schemes of government and bank guarantees for subcontracting operations), special allocations of foreign exchange, preferential allocation of scarce raw materials, special training, etc., for domestic subcontractors. Free customs zones, including industrial areas and industrial estates for export industries, might serve to promote not only exports but also international subcontracting.

V. INTERNATIONAL CO-OPERATION FOR THE PROMOTION OF
SUBCONTRACTING IN THE DEVELOPING COUNTRIES

101. The Expert Group noted with appreciation the work carried on by UNIDO and the Development Centre of ECN in the fields of small-scale industry and subcontracting through studies, meetings and technical co-operation activities. Two countries represented at the Expert Group - India and Turkey - were receiving technical co-operation from both organizations for the establishment of subcontracting exchanges. The other countries - Greece and Spain - had received assistance from the International Association of Credits and Small and Medium-sized Enterprises. The Group felt that there was much scope for increasing technical co-operation in the field of subcontracting in the developing countries.
102. Such co-operation might take the form of expert assistance to industrial extension centres in setting up "ancillary" industry departments; expert advice for the establishment and operation of subcontracting exchanges or clearing houses; training of ancillary extension officers, in particular through fellowships abroad -- this might include, in particular, training within existing subcontracting exchanges or in the purchasing departments of large corporations engaged in subcontracting; and advice to governments on the legal and administrative aspects of the promotion of subcontracting, both domestic and international.
103. In view of the considerable shortage of experts in subcontracting, the participants from the industrial countries were invited to submit to UNIDO and OECD the names and resumés of personnel suitable for expert missions in this field. Governments and other authorities of these countries were also invited to make available their subcontracting exchanges and other facilities, including those of private industries, to trainees from the developing countries. It was pointed out that expert missions for the establishment of subcontracting exchanges or clearing-house facilities would generally be of short duration, but that they would require, on the part of the recipient country, extensive advance surveys of small-scale industries able to serve as subcontractors; such surveys should cover their equipment, production capacity and specialization. In the short period of the missions, the experts would not be expected to carry out such surveys themselves, nor to draw up lists of parts, components or operations lending themselves to subcontracting. Such tasks were to be undertaken, and later continued, by national agencies.

104. There was also scope for international co-operation among national agencies involved in the promotion of subcontracting, such as industrial development corporations, credit institutions, industrial extension centres, subcontracting exchanges, chambers of commerce and industry and other professional associations in both the industrial and the developing countries. Such co-operation could take the usual forms of collection and dissemination of information, and organization of seminars, working parties and training programmes.



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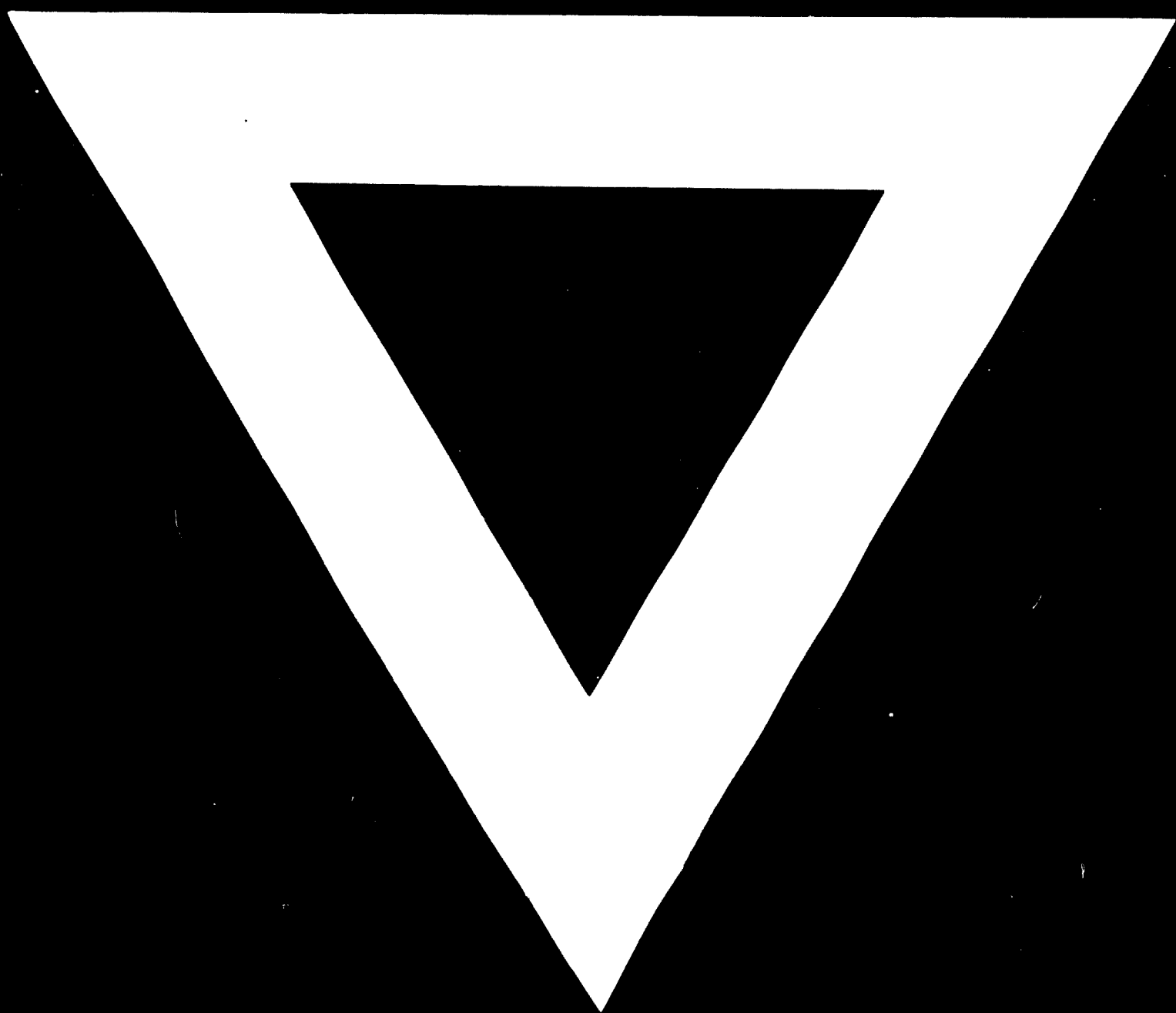
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ANNEX II

AGENDA

- Item I. Opening addresses and introductory statements
- Item II. Adoption of the agenda
- Item III. Scope and nature of subcontracting policies and programmes in developed and developing countries
- (a) Definition of subcontracting, its place in the economy in general. Its role in industrial development and particularly in the promotion of small-scale industry
 - (b) Review of present experience in a number of developed and developing countries
 - (c) Feasibility and desirability of subcontracting as a means of industrialization of developing countries.
- Item IV. Measures of promotion, regulation and protection of subcontracting in developing countries
- (a) The role of public policy and institutions in subcontracting
 - (b) The role of industrial extension centres and other promotion and assistance agencies
 - (c) The role of large industry
 - (d) The role of small-scale industry
 - (e) The role of private groups
 - (f) Deontology of subcontracting - practices and rules of action
- Item V. Special instruments of promotion
- 1. Subcontracting exchanges and clearing-houses (public or private)
 - 2. Subcontracting in the industrial estates
 - 3. Subcontracting and integrated area development: local, national, regional and international networks
 - 4. Fairs and exhibitions, etc.
- Item VI. International subcontracting
- (a) Scope for international subcontracting
 - (b) Facilities and methods for promoting international subcontracting
- Item VII. International co-operation for the promotion of subcontracting in the developing countries
- (a) Role of and co-operation among international organizations
 - (b) Co-operation among international agencies
- Item VIII. Adoption of conclusions of the meeting
- Closing addresses





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