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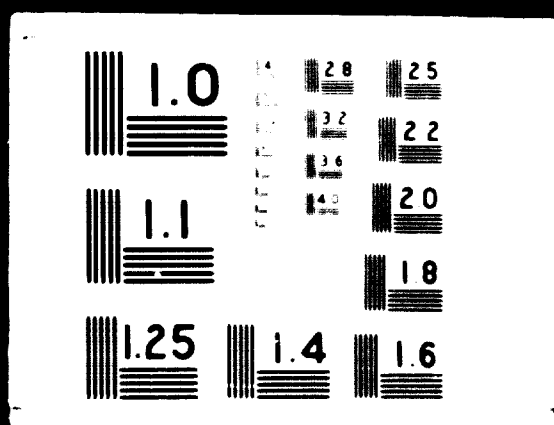
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FINANCING OF EXPORTS OF SMALL INDUSTRY PRODUCTS:
THE EXPERIENCE OF JAPAN ^{1/}

by

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FINANCING OF EXPORTS OF SMALL INDUSTRY PRODUCTS:
THE EXPERIENCE OF JAPAN

Introduction

Any account of the financing of the exports of the products of the smaller Japanese industries should include not only the measures for financing and the encouragement of exports, and the institutions and facilities created for the purpose by the Government, but also a background of the problems of small enterprises, their present status, their growth potential and export potential.

A glimpse of post-war developments

Immediately after World War II, the relaxation of the war-time controls of the economy, the weakening of the big financial trusts, the prohibition of indirect family monopolies and the reduction of the centralization of economic power, were the measures taken for achieving economic democracy. With the release of the tight grip of certain powerful groups, small enterprises showed great initiative and resourcefulness and began playing a part in the production of consumption goods urgently required in the post-war period. However, small industries suffered from the disadvantages of shortage of funds and inefficient management, while large industries were able to reorganize their operation and re-orient their approach to national economic development.

The economic stabilization policy introduced in 1949 was intended to stabilize the currency value by counteracting inflationary trends, increasing exports and softening domestic demand. Multiple exchange rates for different types of goods were virtually abolished and a fixed exchange rate of ¥ 360.00 to the dollar was established. The general deflationary policy, the restraint of wage increases and flexibility in the official price system and the goods distribution system were some aspects of the stabilization policy. These measures forced the Japanese industry to improve its efficiency. Small enterprises were naturally affected by these measures, which resulted in a number of failures.

Financial institutions and measures

In order to remedy the situation, the Government of Japan introduced a series of measures to create special financial organizations for small enterprises, including a credit insurance system. The Japanese Finance Corporation was established in 1949 and the Bank of Japan increased the allotment of funds for small enterprises. The execution of the Smaller Enterprises Loan system with US/AID counterpart funds, instead of rehabilitation finance funds, was also a part of this attempt to strengthen the financial viability of small industries. In 1951, the Government enacted the "Law on Special Measures on Taxation", and in 1952 the "Law on Promotion of Enterprise Rationalization". Two other laws which indicated the active interest of the Government in strengthening the small industries were the "Enterprise Rationalization Promotion Law" and the "Commerce Industry Co-operative Law".

In the nineteen fifties, the method of government financing of small industries underwent a change. The former system of direct financing was abandoned and special financial agencies for small enterprises were established. The Shoko Chukin Bank (Central Bank for Commercial and Industrial Co-operatives) was revitalized. In 1951, the "Law on Mutual Loans and Savings Bank" was enacted. This act enabled the Savings Bank to handle the financing and purchase of bills at a discount, besides facilitating mutual financing operations. Another law, the "Credit Association Law", facilitated the formation of co-operatives as credit associations.

Each of these agencies had its own individual character. The Shoko Chukin Bank was financing co-operatives. The People's Finance Corporation was advancing small loans to businessmen in general. The Mutual Loans and Savings Bank and Credit Associations were financing short-term loans to small enterprises. None of them, however, extended long-term loans for machinery and equipment. In order to meet this need, a Smaller Enterprise Finance Corporation was established in 1953. The next step in the financing of small industries was the legalization of the Credit Guarantee Associations. The latter were established in many prefectures even before the war, but became important only subsequently.

The Korean War gave a great stimulus to small industries in Japan. The "Smaller Enterprise Stabilization Law" and the "Law Pertaining to the Prevention of Private Monopoly and the Maintenance of Fair Trade" introduced a measure of stability and facilitated expansion in the small industry sector. Small industries were still at

some disadvantage under the latter law, which was revised subsequently. The revisions of the "Smaller Enterprise Stabilization Law" met the difficulties of the small industrialists in regard to purchase prices for raw materials, sales prices of products, methods of selling products and so on.

This paper is not concerned with the numerous measures and facilities adopted under the modernisation laws, and which are part of the development programmes that gave strength to the smaller industries and enabled them to play a greater role in industrial growth. The review relates mainly to governmental measures in the early postwar period, which made it possible for small industries to expand continuously the export of their products.

The importance of small industry in Japan

The place of small industries in the industrial structure of Japan should be considered before discussing the export potential of this sector. In 1960 the number of small enterprises accounted for 99 per cent of the total number of establishments. In 1962, about 40 per cent of the total number of employees in manufacturing industries were in small enterprises. In the forestry and marine products industries, 78 per cent were in this sector. Based on the statistics of 1960, the position may be seen in table 1.

Table 1 NUMBER OF ENTERPRISES AND NUMBER OF EMPLOYEES, 1960

	Number of enterprises			Number of employees (thousands)		
	Total	Large enter-prises	Smaller enter-prises	Total	Large enter-prises	Smaller enter-prises
All industries (percentage)	3,561,695 (100.0)	15,196 (0.4)	3,546,499 (89.6)	23,158 (100.0)	4,929 (21.3)	18,229 (78.7)
Mining industry (percentage)	9,874 (100.0)	321 (3.3)	9,553 (96.7)	506 (100.0)	330 (65.2)	176 (34.8)
Construction (percentage)	195,661 (100.0)	441 (0.3)	195,220 (99.7)	1,701 (100.0)	278 (16.3)	1,423 (83.7)
Manufacturing (percentage)	552,845 (100.0)	3,067 (0.5)	549,778 (99.5)	8,906 (100.0)	2,642 (29.7)	6,264 (70.3)
Dealers/Retailers (percentage)	1,849,151 (100.0)	6,688 (0.4)	1,842,463 (99.6)	6,790 (100.0)	776 (11.4)	6,014 (88.6)
Banking and Insurance (percentage)	51,301 (100.0)	182 (0.4)	51,119 (99.6)	763 (100.0)	113 (14.9)	650 (85.1)
Real estate (percentage)	38,481 (100.0)	9 (0.1)	38,472 (99.9)	93 (100.0)	4 (4.6)	89 (95.4)
Transportation and communications (percentage)	66,590 (100.0)	489 (0.8)	66,101 (99.2)	1,242 (100.0)	298 (24.0)	944 (76.0)
Electricity, gas, water supply (percentage)	7,658 (100.0)	95 (1.2)	7,563 (98.8)	166 (100.0)	50 (30.1)	116 (69.9)
Service industries (percentage)	790,134 (100.0)	3,904 (0.5)	786,230 (99.5)	2,990 (100.0)	437 (14.6)	2,553 (85.4)

Source: Based on Enterprise Statistics 1960 of Prime Minister's Office.

Note: Enterprises with less than 300 employees are counted as smaller enterprises except in the case of dealers, retailers and service industries, where the upper limit is 50 persons.

The smaller enterprises accounted for approximately 60 per cent of the total value of Japanese exports. This percentage has recently come down to 50.

Recent developments

As small industry grew, its structure gradually changed. Such traditional activities as cottage industry production of silk, soy and textile products, and some artisan undertakings were transformed into modern manufacturing industries with regular production lines. The share of traditional industries in exports to developing countries has been decreasing. Exports mainly consist of durable consumer goods and chemical products, besides heavy industrial products like steel, ships and machinery and equipment.

Table 2 shows the composition of Japanese exports in 1966. Small industries contribute to exports by meeting the need for parts, components and semi-processed goods of the larger enterprises. The subcontracting system in Japan developed rapidly, accompanying the increase in exports. Its success was due to the availability of high-grade equipment for small industries, quality control, good design and standardization. The small enterprises remained independent but became increasingly specialized, and are now an indispensable part of the industrial organization. This pattern developed largely through the initiative of the small industries themselves.

It has often been stated that this relationship between small and large industries has turned small industries into "captive" enterprises. It is true that the "dual structure" of industry in Japan still puts small industry in serious difficulty. The productivity of small industries is much lower than that of large industries. The wage rates show disparity, but with the increase in wages in small industries, their advantage of lower operational costs has diminished. However, adjustments and remedial measures are constantly adopted to maintain the balance between the two sectors.

Table 2Composition of Japan's Exports, 1966

(in millions of US dollars)

<u>Fish</u>	268.2
<u>Fruits and others</u>	55.7
<u>Textiles and textile products</u>	
Raw silk	8.6
Synthetic and regenerated fibres	113.2
Cotton yarn	23.7
Yarn, thread and synthetic fibres	110.6
Cotton fabrics	285.7
Silk fabrics	31.9
Woollen fabrics	76.4
Synthetic fibre fabrics	271.9
Spun rayon fabrics	87.5
Clothing	340.4
<u>Chemicals</u>	
Chemical fertilizers	183.1
<u>Non-metallic mineral products</u>	
Cement	22.8
Pottery	89.5
<u>Iron and Steel</u>	1293.1
<u>Machinery</u>	
Textile machinery and parts	100.1
Sewing machines	92.2
Radio receivers	278.2
Passenger cars	176.1
Trucks	113.3
Vessels	823.1
<u>Others</u>	
Scientific and optical equipment	271.6
Toys	108.3
Plywood	73.9

It is common knowledge that the number of bankruptcies in 1967 was a record for the post-war period; this was due to some extent to the tight money policy. The number of enterprises going bankrupt with debts of ¥ 10 million or more was about 936 in December 1967. The total number of bankruptcies for the year rose to 9,496 exceeding the figure of 1966 by about 43 per cent. The amount of liabilities involved in the bankruptcies totalled ¥ 516,909 million showing an increase of 30 per cent over that of 1966. Some other estimates made by commercial inquiry agencies in 1967 place the total number of bankruptcies at 8,192 and the debts involved at ¥ 485,433 million. The bankruptcies were mainly in the small industry sector. Some of them were not entirely due to the depression and the financial situation, but also to certain structural changes in the manufacturing sector; this was particularly the case in the construction and food industries.

Generally, the financial situation is under a very careful watch. Banking and government agencies are taking precautionary steps: for instance, at the end of 1967, the Bankers Federation earmarked nearly ¥ 500,000 million for small business loans and the mutual banks, credit depositaries and governmental agencies took similar steps. However, the financing policy and the general attitude of the Bank of Japan is stricter and credit is restricted to financing firms in sound shape. This attitude causes worry to small industries. The other special difficulties of small industries are the shortage of labour and the increase in personnel expenses.

I - EXPORT FINANCING

In view of the importance of foreign trade to the Japanese economy, the spectacular economic growth of the post-war period has often created complex problems of foreign exchange reserves. Even in recent years, the frequent drainage of reserves compelled the Government to adopt from time to time tight monetary measures aimed at curbing economic growth and redressing an adverse balance of international payments.

The policy of the Government of Japan at present is to increase the international competitive power of Japanese industries and towards this end every effort is made to accelerate technological modernization and management development. The role of small and medium industries in export promotion is great indeed, as is their role in economic development in general. However, their share in total exports has been declining gradually since the end of the last world war and is now estimated at about 50 per cent of the total.

The keynote of government policy for developing small industries is to strengthen their competitive power with a view to increasing exports. Some difficulties have been experienced in recent years by the smaller export goods producers. They no longer have the advantage of a lower level of wages at home. In some cases there has been a decline in their competitive power vis-à-vis their counterparts in developed countries. To help small producers tide over these difficulties, the Government has enacted the Small Enterprise Modernization Promotion Law and other legislation and taken some other measures.

Among these measures are preferential arrangements by the Government and the Bank of Japan for financing smaller industries engaged in exports. The general structure of export financing (import financing is also shown for purposes of analogy) is as follows:

Chart 1. Export and Import Finance Systems

Export Finance System

Finance in Yen	<u>Before shipment</u>	Short-term operating fund	Export trade bill system (Advance bill for export) Joint sales; Export finance
		Medium-term operating fund	The Export-Import Bank of Japan
		equipment fund	Export finance for specified small- and medium-sized enterprises
	<u>After shipment</u>		
		Short term usance	Loan facilities for foreign exchange funds
			Export trade bill system (Yen Usance Bill)
		Medium and long-term deferred payment	The Export-Import Bank of Japan
			The Overseas Economic Corporation Fund
Finance in foreign currency		After shipment, short term finance in foreign countries	Loan in foreign countries Stand-by credit Foreign exchange holding by trading houses

Export Finance System by Stage

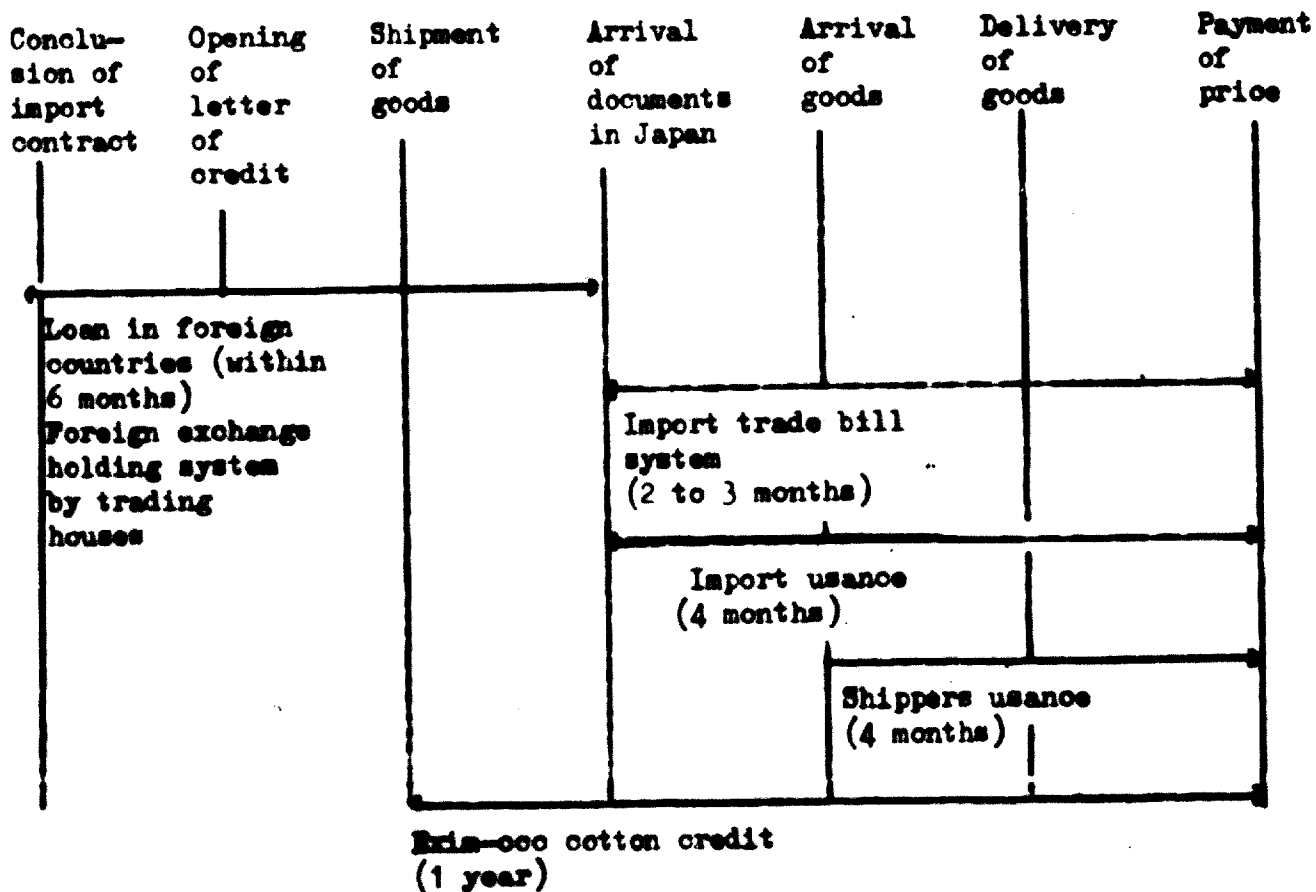
Production by estimate	Conclusion of export contract	Arrival of letter of credit	Shipment of goods	Arrival of documents	Arrival of goods
	Export trade bill system			Mail credit	
Joint sales export finance	Bills suitable for col- lateral security (not more than 6 months)	Bills suitable for re- discount- ing (not more than 3 months)			Finance in foreign countries (within 6 months)
			Loan facilities for foreign ex- change funds (within 6 months)		

Export finance by the Export-Import Bank of Japan
(more than 6 months, up to 5 years)

Import Finance System

Before shipment	In foreign currency short-term	Loan in foreign countries Stand-by credit Foreign exchange holding-system by trading houses
After shipment	Credit extended by bank	
	At sight yen short-term	Import trade bill system
	Usance yen short-term	Import trade bill system
	foreign currency short-term	Import usance
	foreign currency medium and long-term	Credit by the Export-Import Bank of Washington
	Credit extended by shipper	
	foreign currency medium and long-term	Shippers' usance Maker's credit

Import Finance System by Stage



The Small and Medium Enterprise Finance Corporation and the Small and Medium Enterprise Credit Insurance Corporation

Small and medium enterprises can be financed by the Small and Medium Enterprise Finance Corporation (SMEF) (Chusho Kigyo Kinyu Koko) or the Small and Medium Enterprise Credit Insurance Corporation (Chusho Kigyo Shinyo Hoken Koko) under specified conditions, for exporting their goods.

A. Export Financing by the SMEF Corporation

(1) Long-term export contracts

Under this system, the Corporation finances any small or medium enterprise (an exporter or a manufacturer of goods) under specified conditions when it has concluded a long-term export contract with an overseas importer of durable consumer articles, machine parts or parts of small-sized industrial machines and requires a considerable amount of money for equipment investment to carry out the original transaction.

- (i) The long-term contracts to be financed under this system are those meeting the following conditions and contributing to the cultivation and maintenance of export market as deemed by the authorities concerned.
 - (a) The term of the contract will exceed one year, as a rule, and renewal of the original contract will be expected.
 - (b) The orderer and the goods ordered will be confirmed in specific details and the value to be received, or volume to be bought, will be exactly announced.
- (ii) The enterprises financed under this system will be the exporters or manufacturers specified by the law concerned and which will meet the following conditions:
 - (a) The applicant will have received orders of the overseas importer (in the case of an exporter) or of the exporter in Japan (in the case of a manufacturer), under proper terms as deemed by the authorities concerned.
 - (b) The amount of orders received will represent 20 per cent or more of the whole amount (value or volume) of the goods in question produced or sold by the enterprise in question in the latest fiscal years (about 3 years, as a rule).

(iii) The funds, under this system, will be employed for providing machines, equipment and facilities necessary for carrying out the long-term contracts. The applicants are financed directly by the Corporation at a specified rate.

(2) Financing of Specified Industries

Those industries related to export trade which have a good export record and which are deemed to require further improvement in the quality of their products are also financed by the Corporation for machinery, equipment and facilities. Such industries include pottery, table hardware, artificial pearls, metallic toys, artificial flowers, smokers' supplies, metallic watch bands, celluloid and plastic goods, umbrellas and ribs, pencils, textiles, knitted goods, sewn goods, dyestuff preparations and industrial tools.

(i) Enterprises financed under this system are small or medium enterprises specified by the law and meeting the following conditions:

- (a) Any enterprise (an exporter or a manufacturer) whose annual export record reaches 20 per cent of his annual production or sale.
- (b) The new equipment is expected to lead to a 10 per cent or more increase in exports.

(ii) The Corporation specifies the equipment required by each industry for its modernization. The funds are used to purchase machines specified as to model, capacity and size; the interest rates are also specified according to the terms of loans.

B. Financing of Export by the Insurance Corporation

This system was established by the Smaller Enterprises Agency, Chusho Kigyo Cho, and the International Trade Department of the Ministry for International Trade and Industry (MITI) conferring with the Ministry of Finance and is operated by regional public bodies, authorized foreign exchange banks, the Insurance Corporation, and the Credit Guarantee Association of each district, on the basis of the Special Guarantee System for the Promotion of Small and Medium Enterprise Export Trade.

Under this system, the Insurance Corporation gives the loan of special funds to the Association which is executing the aforesaid Special Guarantee System. The Credit Guarantee Association deposits the funds given by the Insurance Corporation together with the funds borrowed from the regional public body in the authorized

foreign exchange bank concerned. The bank, adding a certain amount to the deposited funds, lends the amount to the exporters or manufacturers under the guarantee of the Association. Thus the Insurance Corporation finances the exporters and manufacturers indirectly through the Association and the authorized foreign exchange bank concerned.

Enterprises coming under this system are:

- (1) Exporters, or
- (2) Manufacturers who are manufacturing or processing the goods for export and are meeting the following conditions:
 - (a) A manufacturer who is dealing in export trade by himself, or has received orders of an exporter;
 - (b) A manufacturer whose export record for the previous year reached 20 per cent of his annual proceeds of the goods in question.

Under this system the funds are used for the following purposes:

- (1) Manufacture of goods (including the manufacture of goods in anticipation of export);
- (2) Collection of goods for export.

The applicant for financing obtains the guarantee of the Association. The interest rate and the guarantee fee are lower than the normal rates.

The assistance programme and the participation of organizations established by the government banks, trading firms and others can be more clearly seen in an analysis of the short-term, long-term and other facilities granted.

Short-term loans granted to smaller industries for export promotion

The smaller enterprises in Japan engaged in the production of export goods seldom conduct direct business transactions with foreign clients. Usually they sign a sale contract with a Japanese trading firm which, in turn, concludes an export contract with a foreign importer. Such a sale contract of the small industrialist is completed as soon as the goods covered by the contract are delivered ex-warehouse at a specified Japanese port. Hence, the transaction conducted between a smaller enterprise and a trading firm is of "inland nature" and settled in cash generally within two weeks after shipment. Apart from the question of prices in general, the payment terms under such a contract are far more advantageous than in the case of a purely inland transaction.

Four trading houses - C. Itoh, Marubeni-Iida, Mitsui and Co., and Mitsubishi Shoji - are well known outside Japan as the "Big Four". There are, however, many other trading firms, who deal in sizable quantities of small industry products. C. Itoh's annual turnover is US\$ 3,200 million, Marubeni-Iida's US\$ 3,400 million, Mitsui's US\$ 4,500 million and Mitsubishi Shoji's US\$ 4,300 million. The turnover of each of the Big Four may exceed or approach one-quarter of Japan's National Budget which amounts to about US\$ 14,000 million a year.

The major reasons for this concentration of trading business are the massive financial outlays, complex organizational arrangements and efficient management operations required for promoting exports. The "Big Four" finance other companies, enter into joint ventures, assist manufacturers by telling them what to make and how to go about it, enter the insurance and real estate business and often influence to a noticeable degree the policy and production of those firms with whom they do business.

In regard to financial transactions, it has been customary for an export-goods-producer to make payments for procured materials not in cash but in promissory notes, which is another advantage for him. There are no serious problems involved in his transactions with a trading firm or in the sale of export bills, on letter of credit basis, to an established foreign exchange bank.

In regard to export bills on a basis other than a letter of credit, which usually take the form of documents against payment (D/P) or documents against acceptance (D/A), the Government has since 1954 enforced an insurance system enabling a foreign exchange bank to cover 80 per cent of the risk involved in the purchase of such a document. An additional 15 per cent risk coverage can be made with the authority of a local self-governing body. In this case, the foreign exchange bank buys a D/P or D/A by charging margin money at the rate of about 5 per cent as security against the remaining uncovered risk.

Further, a trading firm which has signed an export contract, and an export-goods manufacturing firm, which can fulfil certain credit conditions, are eligible for a loan from a financial agency for the purposes of collecting and manufacturing or processing export goods. According to the system which has been adopted by the Bank of Japan since 1962, an export advance bill drawn on an irrevocable letter of credit basis or a time export bill on usance letter of credit basis, can be rediscounted at a rate lower than the official money rate. The rediscount rate is 4.09 per cent which is

lower than the discount rate for commercial bills of 5.84 per cent. The maturity of bills, to which this system is applicable, is a period up to 6 months. The bills to be rediscounted by the Bank of Japan are those once discounted by a commercial bank (maintaining business affiliations with the Bank of Japan), the Central Bank for Agriculture and Forestry, the Central Bank for Commercial and Industrial Associations, and a mutual savings bank which meets the financial needs of smaller industries. Should a bill drawn by a smaller enterprise be guaranteed by the Central Bank for Commercial and Industrial Associations or a credit guarantee association, it would be eligible for rediscount by the Bank of Japan. The system enables a trading firm and an export-goods-producer to obtain the necessary funds from a financial agency at a low rate of interest.

Only smaller industries with a high credit rating can benefit from the rediscount system of the Bank of Japan. However, other smaller enterprises can benefit from the guarantee of a credit guarantee association.

The credit guarantee associations (totalling 42 in Japan) guarantee bills drawn by smaller enterprises at a low rate of interest for export promotion. For this purpose, they can obtain loans from the Small Business Credit Insurance Bank. These loans amounted to ¥ 800,000,000 as of 1966.

According to this system, a loan can be granted to a smaller industry producing or processing and dealing in export goods, when a bill drawn by it is guaranteed by a credit guarantee association. The rate of interest is below 6.21 per cent, the rate of guarantee money charged is ¥ 0.0025 per diem, the maturity of a bill guaranteed is a period up to 3 months, and the amount of a loan provided is below ¥ 3,000,000 and within 85 per cent f.o.b. of the price indicated on the export contract or written order involved.

As already stated, the types of bills eligible for rediscount by the Bank of Japan are the export advance bill on irrevocable credit basis and the time export bill on usance credit basis. As regards export advance bills on non-irrevocable credit basis, these are also eligible for a loan by the Bank of Japan, if backed by security. The rate of interest on such loans is 4.38 per cent.

Long-Term Loans to Smaller Export-Goods Producers:

The primary difficulty felt by smaller Japanese industries in the export markets is the low level of their international competitive power. To raise this level,

various financial and tax measures have been evolved with an eye on export promotion.

Among these are the provision of long-term loans for smaller export-goods producers. A major arrangement which has been effected by the Small Business Finance Corporation since 1962 is the grant of loans for export promotion to specified smaller industries. Those covered by the arrangement are:

- 1) A small enterprise which has concluded a long-term export contract for a period of one year or more, directly or indirectly, with a foreign importer, the amount of the orders received for a certain export item in the latest year exceeding 30 per cent of the enterprise's annual output or sales of the said item.
- 2) A small enterprise which belongs to any of the designated industrial groups, the amount of whose exports in the latest year exceeds 20 per cent of its annual output or sales, and whose business achievements are appraised as promising enough to enable an increase in its exports by more than 10 per cent through the replacement of machinery and equipment with a loan granted to it. The designated groups, totalling 15, are: ceramics, metal cutlery, cultured pearls, metal toys, artificial flowers, pipes and other smoking tools, metal watch bands, celluloid and plastics products, umbrellas and parts, pencils, textiles, knit goods, ready-made garments, dyeing and adjustment, and machine tools.

A. enterprise, as specified above, is eligible for a loan of up to ¥ 80,000,000 over a period of 2 to 7 years. The annual rate of interest on a loan of up to ¥ 50,000,000 is 7.5 per cent and on a loan exceeding this amount 8.2 per cent. (The latter rate is the same as that on a loan provided by the Small Business Finance Corporation through normal procedure). The loan is repayable in instalments of less than six months with a grace period of one year.

The Corporation also provides a non-export-goods producer with a loan for a period of 1 to 5 years to the maximum amount of ¥ 1,000,000 at the annual interest rate of 8.2 per cent. Such a loan may be granted for replacement of machinery and equipment and for long-term operating capital.

The Small Business Finance Corporation is the main financial agency for small industries in Japan, while the Japan Export-Import Bank, also a semi-government

financial agency, caters to large industries.

Tax Prerogatives for Export Promotion

The Government of Japan grants small industries various prerogatives to reduce the incidence of taxation and even to exempt part of their income from taxation for export promotion purposes. These prerogatives are indicated below:

(1) Extra Depreciation System on Foreign Transactions

A system of extraordinary depreciation for income tax reduction has been enforced by the Government in order to enable a smaller corporation or an individual to obtain the advantage of its or his depreciable assets, in addition to those depreciated through normal procedure in any one year, during the period 1 April 1964 to 31 March 1969, if foreign transactions including those on technology were involved in the total income earned in that year.

This system is not applicable when any other extra depreciation system is applied except for the extra depreciation of works and plant by the Small Business Modernization Promotion Law.

The computation formula of annual extra depreciation costs by the system is as follows:

$$\begin{array}{r} \text{Annual extra} \\ \text{depreciation cost} = \end{array} \quad \begin{array}{l} \text{Normal annual depreciation cost} + \\ \text{(normal depreciation cost} \times \\ \text{standard foreign transaction ratio)} \end{array}$$
$$\begin{array}{r} \text{standard foreign} \\ \text{transaction ratio} = \end{array} \quad \frac{\text{Total amount of foreign trans-} \\ \text{actions in standard year}}{\text{Total income in standard year}}$$

(2) Tax Reduction from Income on Technological Exports

Part of the annual income earned by a smaller corporation or an individual from 1 April 1964 to 31 March 1969 can be exempted from taxation when technological exports are involved in the income. In this case, 70 per cent of the earnings derived from such exports (or 20 per cent of the consulting service fees earned) can be computed as loss eligible for tax exemption, provided that the earnings (or fees) do not exceed 50 per cent of the annual income. When foreign transport and other foreign transactions are involved in the annual income, 3 per cent of the earnings from them can be computed as loss, provided that the total amount computed as loss does not exceed 80 per cent of the earnings from the transport transactions made in the year.

(3) Reserves for Foreign Market Development.

A corporation or an individual is entitled in any one year from 1 April 1964 to 31 March 1969 to exempt from taxation part of its or his earnings derived from the foreign transactions conducted in the preceding year as reserves for foreign market development. In this case, 0.5 per cent of the annual earnings from the foreign transactions made by a large trading firm, 1 per cent of those from the transactions made by an individual or a smaller trading firm capitalized at less than ¥ 100,000,000 and 1.5 per cent of those from the transactions made by a manufacturer can be computed as loss, and the amounts thus computed are carried forward to the following term as tax-free reserves for foreign market development. They are following term as tax-free reserves for foreign market development. They are computed by adding $1/5$ of the reserves made in each year before the current term.

(4) Foreign Market Development Reserves by the Designated Business Association

Another measure enforced by the Government as applicable from 1 April 1964 to 31 March 1969, is to omit from taxation part of the annual income earned by the smaller business association, which is designated by the State Minister concerned, for foreign market research and development purposes, when the foreign transactions conducted by it in the past two years amount to 20 per cent of the total income earned in the same period. In this case, the association collects dues from its members at the rate of less than 1 per cent of the earnings from foreign transactions made by each of them, and the sum of them should not exceed an amount computed at the rate of less than 2.5 per cent of those from transactions conducted by the association itself. The dues thus collected when posted to the foreign market development reserves account of the association can be recognized as loss which is eligible for tax exemption.

Each member of the association is, besides, individually entitled to make his own reserves for foreign market development at the rate of less than 1.5 per cent of the earnings derived from his foreign transactions.

The amount computed by adding $1/5$ of the reserves made in each year before the current term is considered as loss eligible for tax exemption.

II - EXPORTERS' ASSOCIATIONS

In surveying export promotion financing in Japan, the role of the associations should also be considered. To establish orderly export trading it was felt desirable to form exporters' associations which are authorized by law.

An exporters' association is a non-profit juridical person. Membership is voluntary and all members have equal rights in voting or in the adoption of resolutions. Both exporters and exporters' organizations are qualified to become members of an association.

The establishment of an exporters' association is, however, subject to approval by the Ministry of International Trade and Industry. Approval is given when the procedures for organizing the association and other matters do not violate the Cabinet ordinances concerned, and when the association is recognized as genuinely contributing to the establishment of orderly export trading.

The functions of an exporters' association are:

- (a) The prevention of unfair export trading practices by members;
- (b) the establishment of facilities for promoting the common interests of members (such as maintaining and developing of overseas markets; improving price, quality, designs etc. and handling complaints and disputes regarding export trade); and
- (c) instituting rules to be observed by members.

As regards item (c), there are two types of rules to be observed by members:

1. Rules concerning price, quality, design and other export trading matters. These rules must be reported to the Minister of International Trade and Industry not later than 10 days before their scheduled enforcement.
2. Rules concerning price, quality, design and other matters of domestic trading in export goods, and collective contracts between members of an association and producers or suppliers. The Minister's approval is required.

Rules intended to govern association members must not have adverse effects either at home or abroad (as in the case of exporters' agreements). Modification or cancellation of these rules, or withdrawal of approval, can occur in certain circumstances (as in the case of exporters' agreements).

In certain cases the Ministry of International Trade and Industry can entrust administrative business to exporters' associations. An association given this

authority can collect the necessary funds from all other exporters concerned with the approval of the Government.

The case of the Japan General Merchandise Exporters' Association is elaborated below as an illustration of activities of exporters' associations.

Japan General Merchandise Exporters' Association

1. Characteristics of the Association:

This Association was established by sanction of the Ministry of International Trade and Industry in September 1954, based upon the Import and Export Business Law. It is a non-profit-making, special corporation, whose membership is open voluntarily to any exporter. It is one of 33 associations which are established, each for a different line of merchandise. This Association is concerned with the so-called miscellaneous goods.

The Association is constituted into divisions and sub-committees and specialized committees (by products) and functions as an organ for deciding upon solutions to various problems arising in each case, by calling together the specialized members concerned to deliberate on the points in question. The membership of the association is 850 and includes almost all the exporters of miscellaneous goods in Japan.

2. Activities of the Association:

These can be divided principally into the following two:

- (1) To promote the mutual interests of the members.
- (2) To formulate provisions to be observed by the members in regard to price, quality, amount, design, terms of transactions, etc. when going into contract for export.

At the initial stage of its establishment the Association dealt mostly with the first objective, but following the expansion in exports it has become largely involved in the second category of activities. On the one hand the rapid expansion of Japanese exports to overseas markets has resulted in increasing import restrictions in foreign countries against Japanese products. On the other hand, excessive competition among the exporters of Japan has tended to lower the export price. To cope with the first problem, the Association took measures overseas for preventing import restrictions against Japan, by co-operating with embassies and legislative bodies abroad, the Japan Export Trade Organization (JETRO) and so forth; and also through meetings

arranged with importers overseas or their associations for promoting understanding between them and for concluding agreements acceptable to both sides. Measures taken within the country by the Association were the instituting of "a self-controlling system" to regulate exports based upon the Import and Export Business Law.

The principal programmes implemented by this Association today are as follows:

(1) Those classifiable within the first group of activities:

- (a) Activities of overseas staffs - as a joint project with JETRO: a few staff members of the Association work in New York and Hamburg, collecting information and assessing the actual condition of markets for each type of miscellaneous goods in America and Europe.
- (b) Gathering and collecting statistics and data related to miscellaneous goods by product and import statistics and customs rates on miscellaneous goods in principal countries of the world.
- (c) Employment of a permanent legal adviser to cope with such problems as import restrictions against Japan and customs duties on miscellaneous goods in the market of the United States.
- (d) Participation in overseas trade fairs.
- (e) Survey of an overseas market - dispatching of representatives of members or secretariat staff abroad to survey the actual situation of miscellaneous goods in overseas markets.
- (f) Publication of the Association news - editing and distributing among the members news relating to the government's decisions on exports of miscellaneous goods, proceedings of various meetings held within the association, reports of surveys implemented by overseas staff and so forth.
- (g) Proposition and petition - in order to promote exports of miscellaneous goods the Association approaches the government and other related agencies, presenting propositions and petitions for enforcement of appropriate measures.

(2) Those classifiable under the second type of activities:

Agreements on export volume and terms of transaction for:

- (a) metal tableware
- (b) umbrella and umbrella beams
- (c) sponge-footwear

- (d) cloth-made and water-proof shoes
- (e) electric tubes used for Christmas trees
- (f) baseball gloves
- (g) badminton rackets
- (h) melamin resin ornament board
- (i) leather cloth made of non-rigid vinyl chloride
- (j) kitchenware and folding knives
- (k) agreement on design, new model for practical use and trade mark of equipment for smokers
- (l) agreement on method of settlement
- (m) agreement on method of settlement of footwear
- (n) agreement on export amount of fishing-reel

Examples:

(1) In April 1957, the American makers of metal tableware made a plea to the Tariff Commission of the United States to impose import restriction measures against Japanese products on the ground that increase in the imports of Japanese tableware would cause great harm to American (domestic) manufacturers. With the final arbitration of the President of the United States, a tariff quota system limiting the imports up to 5,750,000 dozens in a year was instituted from 1 November 1958. A higher rate of tariff would be applied if exports to the United States exceeded the quota. The Japan General Merchandise Exporters' Association, in co-operation with the Association of the makers of metal tableware, endeavoured with the American makers as well as in public hearings to present the stand of the Japanese side and also took every opportunity to have the present quota enlarged. On the other hand, to prevent an abnormal increase in the exports, self-control measures were adopted by allocating export quotas to each Japanese manufacturer or dealer.

(2) Since 1958, the Canadian Government began expressing its desire to the Japanese Government for having self-restraint measures established among Japanese industries for protecting Canadian domestic industries. Since then the annual export volume of Japanese goods is decided every year through a liaison meeting held between the two Governments and by taking this amount as a standard. Self-restraint measures are taken by the Association in compliance with the established agreement.

(3) As it was observed from 1962 that the industrial circles in The Federal Republic of Germany desired to restrict imports of Japanese goods, the Japanese industrial circles began to take self-restraint measures from the following year on exporting merchandise to that country. Also, a meeting was held between the representatives of the German makers and the Japanese makers and, as a result of arbitration by both Governments, the export volume for three years was determined. The Japanese side voluntarily decided in the later part of 1966 to continue the self-restraint measures on the export of its products. Measures were also taken to restrict exports to the markets of the other countries of the European Economic Community (EEC) in order to prevent the flow of Japanese merchandise into the German market from these countries. Furthermore, to maintain an order in transactions with the EEC countries, including the Federal Republic of Germany, the exporters were invited to register the names of buyers.

(4) A licensing system for importing Japanese goods was in force in the United Kingdom until recently, but, after the liaison conference held between the two Governments, this system was abolished and exports were liberalized in 1965. However, despite such changes in the United Kingdom, the industrial circles of the country have expressed their desire to the Japanese side through their Government for the imposition of a self-restraint system. A meeting was held between the traders of the two countries in May 1966 and as a result, the Japanese established a framework of restraint measures from July 1966.

Table 3 **Export Clearance Record of General Merchandise**

Items	Calendar Year	1965 Jan.- Dec.	1965 Jan.-Nov.	1966 Jan.-Nov.	Ratio of increase and decrease as com- pared to preceding year
(In thousands of US dollars)					
1. Construction materials		17,379	15,944	24,207	+ 52
2. Stationery		31,076	28,430	31,423	+ 11
3. Musical instruments, records, sports goods		55,180	49,477	60,445	+ 22
4. Metal products for daily use		114,802	105,289	126,258	+ 20
5. Wooden and bamboo goods		67,937	62,344	71,483	+ 15
6. Toys		134,751	127,249	136,066	+ 7
7. Rubber goods		207,908	189,981	182,825	- 2
8. Leather goods		35,852	32,572	32,845	+ 1
9. Smoking instruments		16,171	14,887	18,283	+ 23
10. Celluloid and plastic goods		64,811	60,676	65,346	+ 8
11. Miscellaneous goods for personal use		83,112	76,184	88,097	+ 21
12. Electric bulbs for Christmas use		15,788	14,989	25,766	+ 72
13. Chemical synthesis goods		16,362	14,576	17,532	+ 20
Sub-total		861,129	792,598	880,576	+ 11

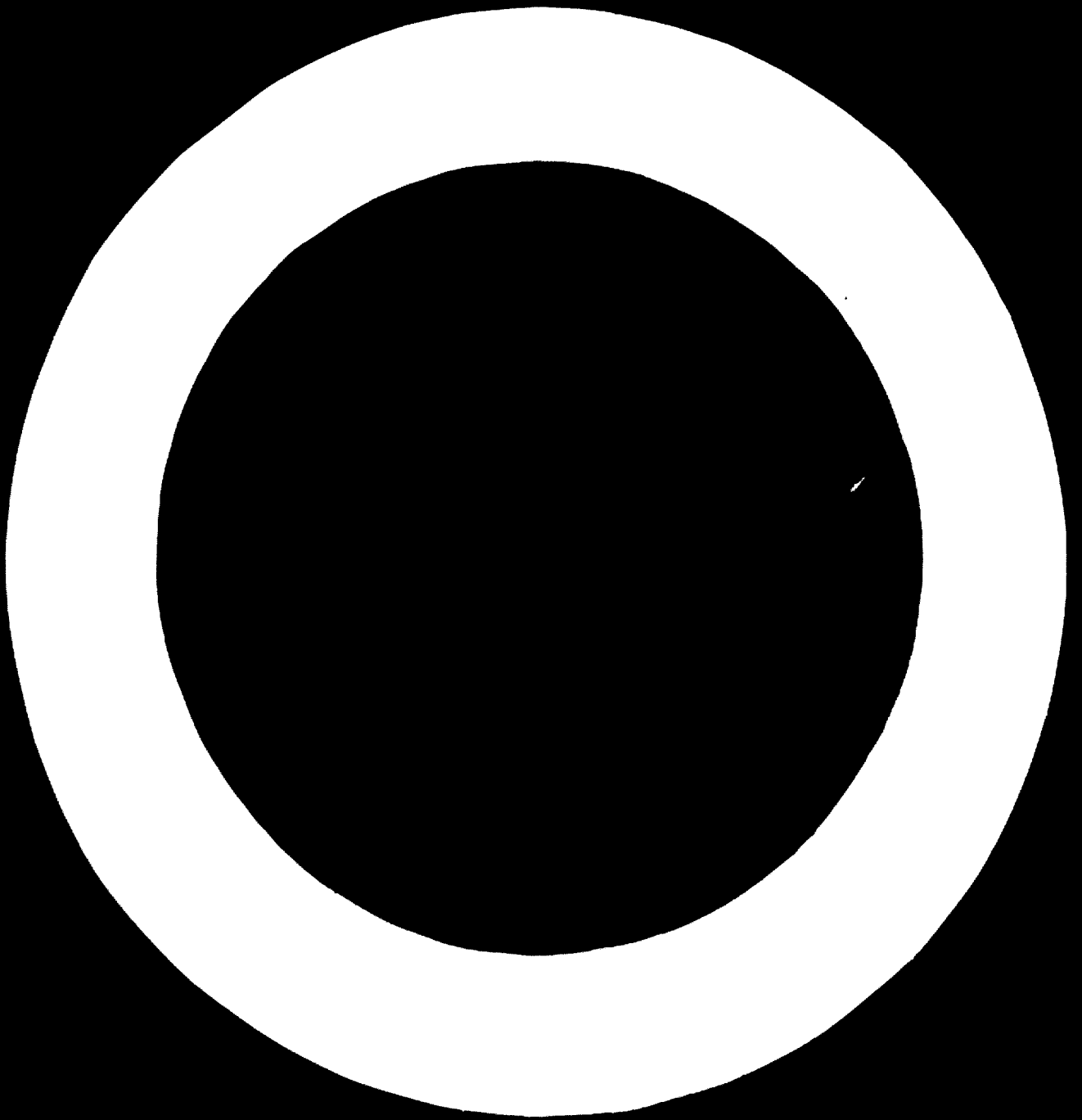
Table 3 - continued

Items	Calendar	1965 Jan.- Dec.	1965 Jan.-Nov.	1966 Jan.-Nov.	Ratio of increase and decrease as com- pared to preceding year
	Year				
(In thousands of US dollars)					
14. Pottery		147,095	135,470	144,262	+ 6
15. Cement		21,444	20,046	20,475	+ 2
16. Glass		43,622	39,952	46,498	+ 16
17. Artificial pearls		7,506	6,952	5,274	- 24
18. Ceramic goods for industrial use		26,262	22,778	28,982	+ 27
Sub-total		245,929	225,198	245,491	+ 9
19. Tobacco		8,667	8,140	10,548	+ 30
Total		1,115,725	1,025,936	1,136,615	+ 11

Source: Clearance Statistics of the Ministry of Finance.

Notes:

- The total amount of exports during the months from January to November 1965 was 87,601,350, and the proportion of general merchandise to the total was 13 per cent.
- The total amount of exports during the months from January to November 1966 was 88,688,694, and the proportion of general merchandise to the total was 13 per cent.
- The proportion of increase or decrease of exports during the period between January and November as compared to the preceding year was + 14 per cent.
- The kinds of products listed as "general merchandise" (exporters) are those listed from No. 1 to No. 13 of the above table.



Appendix

CASE ILLUSTRATION: EXPORT PROMOTION IN THE OSAKA PREFECTURE

The analysis of export activities in the Osaka Prefecture will help to illustrate the Japanese export promotion drive and the many indirect promotional activities involving financing of small industries. This case underlines the importance of an integrated approach to facilitate export by combining promotional measures and financing.

Of the total industrial exports of Osaka, 60 per cent is accounted for by light industrial goods and 40 per cent by heavy industry goods. In this Prefecture, light industry goods are mainly manufactured by small industries. The measures in operation are:

Direct measures:

- (1) Export loans at low rates of interest to small business (agencies and types of loans already described);
- (2) Full utilization of overseas facilities, such as the technical consulting offices of the Osaka Prefecture maintained in some foreign countries;
- (3) Guidance in research and development;
- (4) Guidance in design improvement;
- (5) Public relations and advertising in foreign markets for the goods manufactured in Osaka Prefecture;
- (6) Guidance and assistance to the export trade association and the manufacturers' association concerned with exports;
- (7) Overseas trade fairs and exhibitions.

Indirect measures:

- (1) Equipment-modernization loan for small business;
- (2) Group loans for small business (mainly to co-operatives);
- (3) Utilization of the instalment payment system for machines supplied for "rationalization" of small business;

- (4) Development of industrial estates (linked to re-development of metropolitan cities);
- (5) Other measures for the modernization and rationalization of small business.

Promoting change in export structure

In order to meet changes in the demand structure in the world market and taking into account the increasingly capital-intensive trend in the structure of domestic industry, the pattern of exports from the Osaka area was expected to change gradually from light industry products such as textiles and sundry goods, to heavy industry products, such as machinery, steel and chemical products. Further, the quality of light industry products would need to be improved.

Maintenance and enlargement of the share in foreign markets

Osaka had close relationships with the neighbouring markets in South-East Asia even before the last war, enjoying a favourable position in regard to freight and packaging costs. It goes without saying that Japan has not only to keep its share of this market but also to enlarge it. It has also to try and increase exports to highly developed countries in Europe and America. The following measures were considered necessary to achieve these objectives:

- (1) Improved operation of overseas technical consulting offices;
- (2) Dispatching of market research personnel to overseas markets;
- (3) Positive participation in the overseas trade fairs;
- (4) More active advertising of exportable goods;
- (5) Dispatching of engineers to the developing countries and acceptance of trainees from there. This will also help develop the economy of the other countries.

In order to encourage the production of exportable goods which are good in quality, price, design, packaging, and therefore have competitive power in international market, the following measures were considered important:

- (1) Development of industrial estates for small business;
- (2) Equipment modernization loan for small business;
- (3) ~~Guidance~~ for improvement of design, packaging and so forth;
- (4) Export loans;
- (5) Training of sales engineers capable of marketing the heavy industry goods.

Improvement of facilities

To facilitate the increase in the number of foreign buyers visiting Osaka, the following measures have been adopted. Though they are not strictly speaking export financing measures, they are necessary for stimulating exports:

- (1) Facilitating the availability of suitable hotel accommodation for foreign buyers;
- (2) Construction of Foreign Trade Centres locating in one place the export trade associations, an information centre for overseas markets and other agencies;
- (3) Construction of permanent trade fair buildings for periodic trade fairs;
- (4) Strengthening of the Research Institute to collect accurate information on foreign markets and extend suitable guidance to small business;
- (5) Transportation facilities such as roads, ports and airports should be systematically improved, to cope with the increased traffic resulting from continuously increasing trade transactions;
- (6) Similarly, communication facilities, such as telephone and telegraph facilities and mailing systems, should be continuously improved.

Financing of activities

The financial figures for the export drive will be of interest.

Table 4 Budget for Export Promotion and Related Activities in the
Osaka Prefecture, 1965

<u>Activity</u>	<u>Budget allocated at the beginning of 1965</u>
	(in US dollars)
1. Expenses for guidance of export trade association	79,833
2. Foreign market development expenses for Osaka products	15,350
3. Subsidies for loss of export finance and export bill	111,914
4. Small business export promotion expenses	28,458
5. Funds for export promotion loan for small business	695,494
6. Expenses for guidance in improving export goods	5,569
7. Allotted amount for international trade fair	83,333
8. Overseas office operating expenses	220,900
9. Expenses for participation in overseas trade fairs and exhibitions	65,289
10. Expenses for dispatching marketing research group	18,300
11. Expenses for guidance of small business in export	23,095
12. Trade consulting expenses	22,222
13. Expenses for participation in domestic trade fair and exhibition	3,695
14. Advertising expenses for the export industry	22,906
15. Expenses for advanced training institute for foreign trade	4,514
16. Foreign trade institute expenses	<u>21,028</u>
Total	US dollars 1,421,900

The Osaka Prefectural Export Promotion Centre - Programme for 1965-66

1. Finance:

(1) Special Financing System of Export Promotion Loan for Small Business.

This system was first introduced in 1961 to finance small business in the Osaka prefecture. In 1966, the Osaka prefectural government deposited 300 million yen at the foreign exchange bank which, in turn, will finance the small businesses guaranteed through the Osaka Prefecture Small Business Credit Guarantee Association. The export transaction need not necessarily be backed with a letter of credit.

- Total annual loans 4 billion yen
- Maximum loan for one firm 10 million yen

- Mortgage

Loan less than 3 million yen: not necessary

Loan more than 3 million yen: necessary

- Interest rate 1.7 sen per diem for ¥ 100
($0.017 \times 365 = 6.205\%$ per annum)
- Guarantee fee 0.0025 yen per diem for ¥ 100
($0.0025 \times 365 = 0.91\%$ per annum)
- Term of loan Usually 3 months (if permitted, can be prolonged to within the limit of 6 months)

(2) Subsidising for Export Finance Loss and Export Bill Loss

This is an additional compensating system for export bill insurance and export finance insurance by the national Government. When a bank contracted with the prefectural government suffers the loss of purchased export bill of exchange without L/C or advance loan for export by some accident, 15 per cent of the loss are compensated by the prefectural government.

2. Guidance for Export Trade Associations:

This is intended to promote exports through assistance in business activities by export trade association. In 1966, subsidies were given to JETRO, the Japan Export Sundry Goods Centre and other various export trade associations.

3. Activity to Promote Exports by Small Business:

Those small businesses of the Osaka prefecture who wish to display their products at the standing exhibition hall (in the Osaka International Trade Centre) are given a subsidy up to half of the exhibition fee. This is to help the advertisement of the exportable products manufactured by small businesses.

4. Overseas Activities:

(1) Overseas Offices

(a) Technical consulting office

In order to promote the exports of machinery and to co-operate in the industrialization of the developing countries, the Osaka prefectural government has organized the Overseas Machinery Export Promotion Commission (its head office is in the Osaka Foreign Trade Centre) and has established technical consulting offices in China (Taiwan), Hong Kong, India and Thailand with staff from the Osaka prefectural government, which renders technical consultancy service on machinery, plant layout, and information service.

(b) As a member of the Japan Small Plant Commission, the Overseas Machinery Export Promotion Commission promotes full utilisation of the amounts of small plant loans given to other countries and allocated and granted to the Osaka manufacturers. The Commission keeps close contact with the Plant Association and the Japan Overseas Technical Co-operation Association (located in the Nagoya City Chamber of Commerce, Aichi Prefecture).

(c) Japan Trade Centre

In collaboration with JETRO, the Osaka prefectural government established trade centres in Hong Kong and in New Orleans, U.S.A.

(2) Participation in overseas trade fairs

The Osaka Foreign Trade Centre has participated in international trade fairs, has engaged in advertising of exportable goods and has rendered information service concerning Osaka products. A subsidy for exhibit rent is expected to be allocated, in principle, to the extent of one-third for small business and one-fourth for big business. Consideration is being given to subsidising the full expenses for very good export products.

(3) Utilization of JETRO Trade Centres

JETRO has set up Machinery Centres and Light Machinery Centres in many countries in addition to 14 trade centres. The opportunity for using the services of these trade centres is given to businesses in the Osaka prefecture.

(a) Countermeasures for overseas markets

In order to maintain and develop overseas markets for Osaka products, subsidy is given for overseas market research and public relations through printing of publications for overseas markets.

(b) The Osaka Foreign Trade Centre has dispatched several marketing research groups since 1964 with satisfactory results. The importance of this activity can be seen from the following market research groups dispatched to different areas.

- Plastic machinery (South East Asia, Middle and Near East)
- Screws (USA)
- Cutlery (Europe)
- Hardware (USA and Europe)
- Textile machinery (South East Asia, Middle and Near East).

5. Sundry Goods Export Promotion Activities

(Small business guidance activity)

Hong Kong and other developing countries have succeeded in establishing industries exporting sundry goods not only to South-East Asian countries but also to the Japanese domestic markets. Since sundry goods in Osaka are mainly manufactured by small business, they need improvements on the quality side both to meet the competition from Hong Kong and to develop markets for high quality products in Europe and America.

Such sundry goods exported have been of relatively low quality and sold at low prices. Therefore, the Osaka Foreign Trade Centre in co-operation with MITI and the Small Enterprise Agency spared no effort in seeking the best export goods and in giving guidance for improving the design of other export goods. The Osaka Foreign Trade Centre buys when necessary competitive products in European markets upon request by manufacturers in Osaka prefecture. The Centre studies the quality and composition of the product through various tests and exhibits all these data for the convenience of small industries in Osaka.

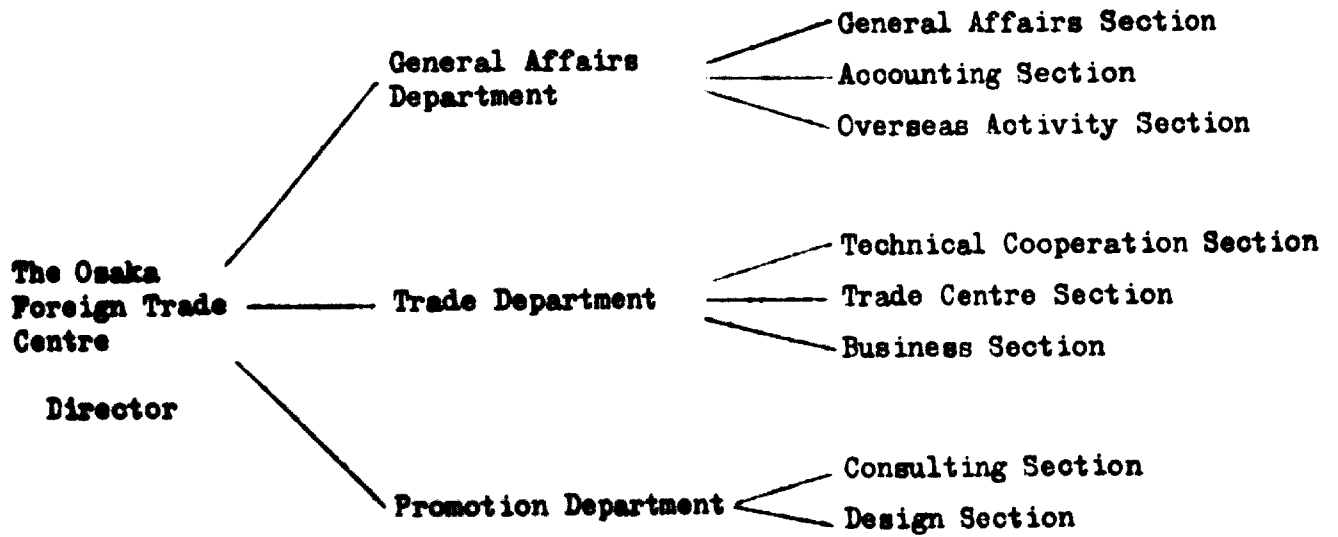
The Osaka Foreign Trade Centre renders consulting service to those companies which manufacture unique products and exports a certain amount of them. The consulting service develops exportable products with good design. These developed products are introduced overseas through exhibitions in New York, Hamburg and Paris. And also, the Centre invites foreign expert designers to provide advice for the improvement of export products. A part of the guidance fee for instruction in designing to small enterprises is shared by the Osaka Prefecture. This activity is carried out jointly with the Design House. Design contests are organized by the Osaka Foreign Trade Centre for encouraging new designs.

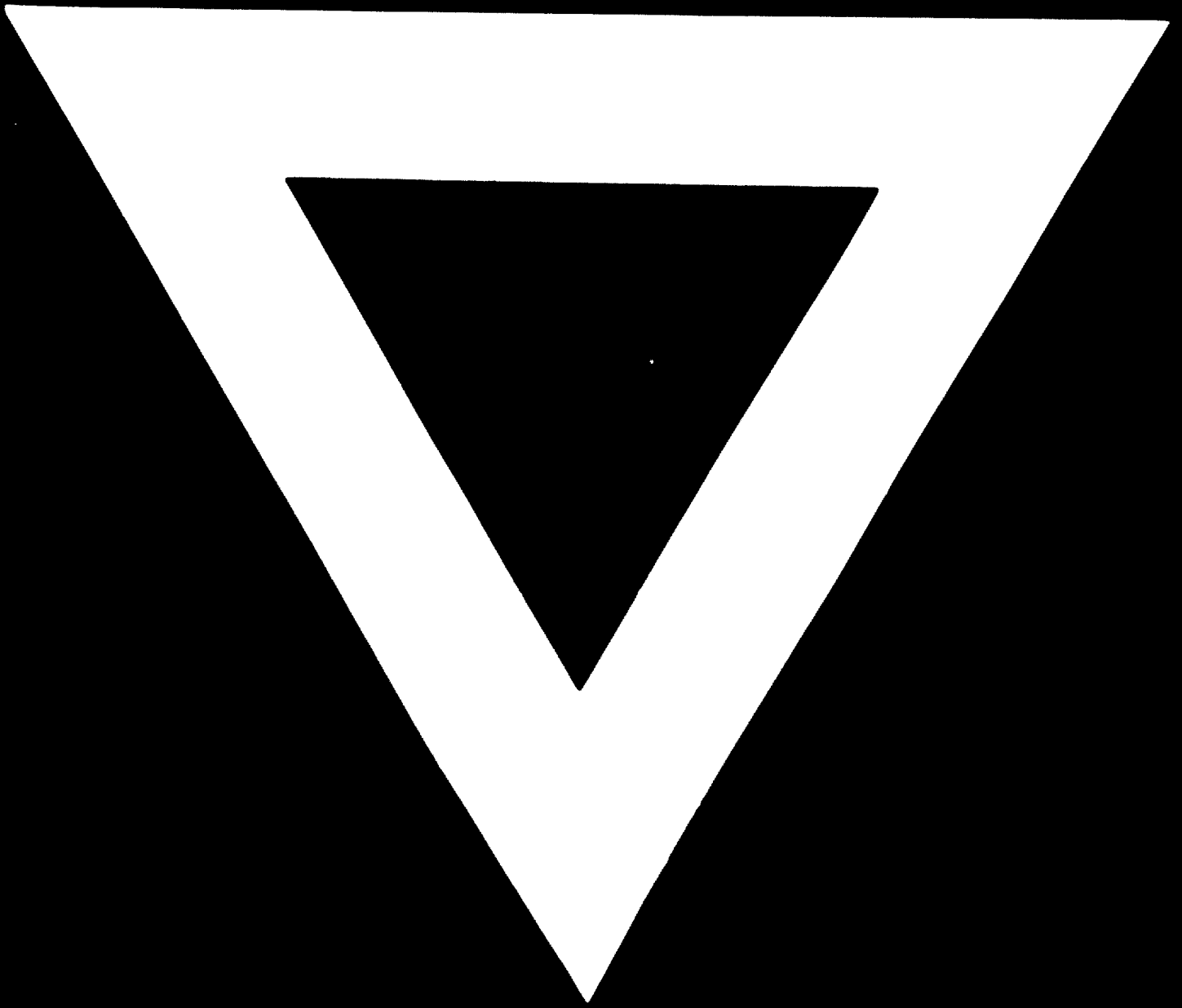
Participation in Domestic Trade Fairs, e.g. the Tokyo International Trade Fair and the all Japan Small Business Export Trade Fair enables the introduction and advertisement of Osaka products. Half of exhibition fee is subsidized for small business.

The Osaka Trade Centre has so far published 32 plant guidebooks which gives handy information on plant, equipment and machinery useful for setting up of new industry and factories in developing countries. The Centre has published "The Osaka Foreign Trade Centre Report" which covers activities by the Centre, report of foreign market trends and information concerning export promotion in each industry.

The prefecture has established an Advanced Training Institute for providing training in export-marketing.

Organization





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