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PRODUCTION CONTRACTS AND SUB-CONTRACTING IN ECONOMIC
CO-OPERATION BETWEEN THE USSR AND DEVELOPING COUNTRIES ^{1/}

by

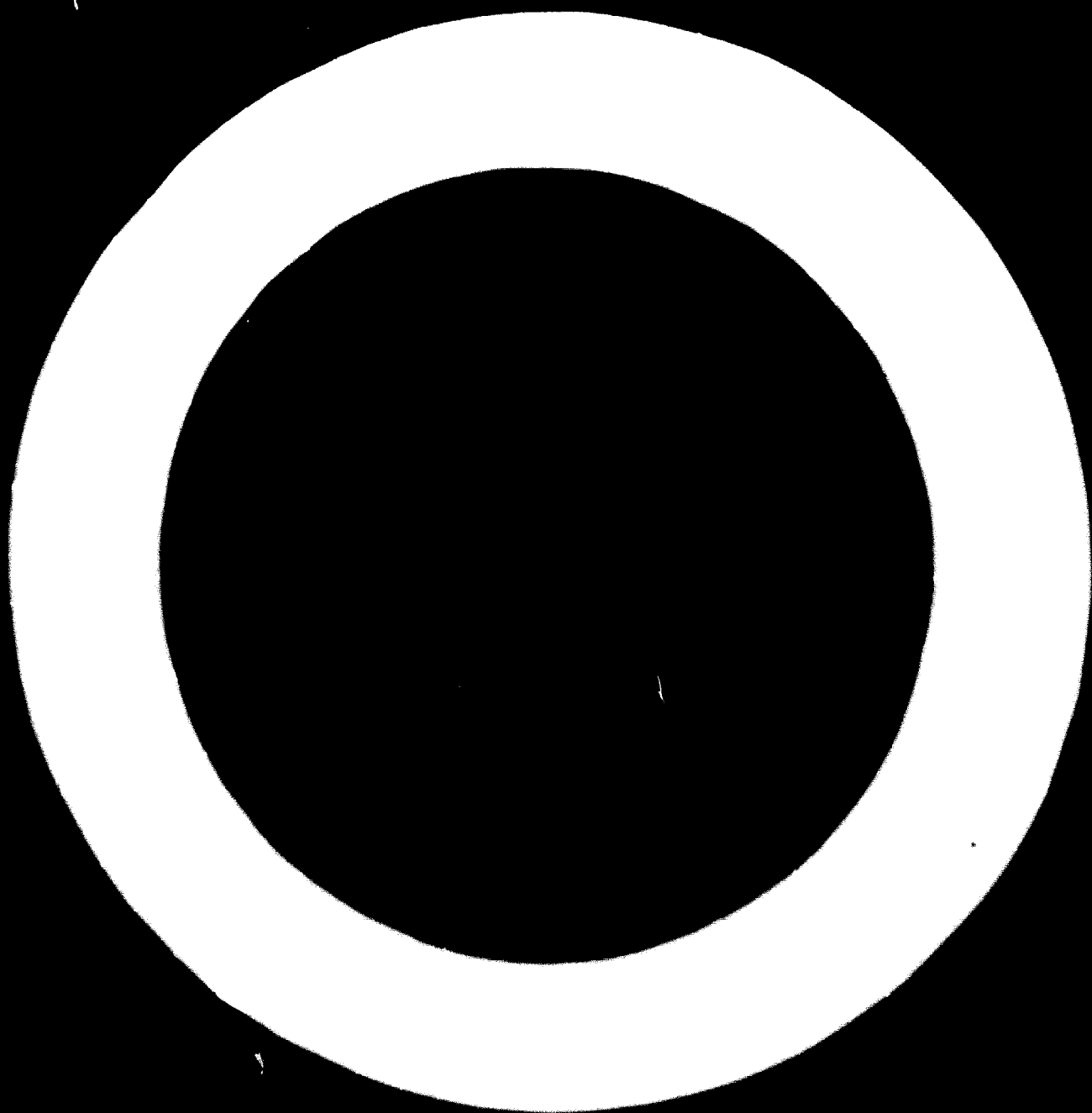
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1. MAIN FORMS OF ECONOMIC CO-OPERATION BETWEEN THE USSR AND DEVELOPING COUNTRIES

1. Economic co-operation with developing countries occupies an important place in the Soviet Union's overall system of foreign economic relations. More than 70 developing countries are permanent trading partners of the Soviet Union. In 1970 these countries took 16 per cent (by value) of all Soviet exports,^{1/} including a considerable proportion of machinery, equipment and materials for the construction and operation of industrial enterprises. The developing countries are the main source of many of the USSR's essential imports. Long-term credits to developing countries represent about one-third of the total credits granted by the Soviet Union to foreign countries. Trade with developing countries has become the most dynamic sector of the USSR's foreign trade. Over the past five years (1966-1970) it has increased by more than 70 per cent, at an average annual rate of 11.3 per cent.^{2/} More than 700 industrial, power, agricultural and other projects and enterprises are being built in developing countries with the economic and technical assistance of the USSR and more than half of them are already in operation.^{3/}

2. Trade and other forms of economic co-operation between the USSR and many developing countries are reaching a stage where permanent economic ties of benefit to both sides can be said to have been established. Co-operation between the Soviet Union and these countries, which is based on the principles of equality, non-interference in internal affairs and respect for sovereignty and each other's interests, is taking on the nature of a permanent division of labour. The Soviet Union's basic aims in such co-operation are to promote the economic and social progress of friendly peoples, the establishment of developed national economic systems, particularly industry, the dynamic growth of these economies and the strengthening of economic independence, and at the same time to secure fuller and more efficient exploitation of the advantages of an international division of labour in order to solve the problems of the USSR and the partners with which it co-operates.

1/ Vneshnyaya torgovlya SSSR za 1970 god. Statistichesky otkaz, pp. 10, 51, 52.

2/ Vneshnyaya torgovlya, 1971, No. 6, p. 41.

3/ Vneshnyaya torgovlya, 1971, No. 7, p. 4; 1971, No. 11, p. 33.

3. By expanding its co-operation with developing countries, the Soviet Union is able to meet the needs of its own economy for raw materials and finished goods more fully. Existing conditions for the production of goods of common interest create a basis for mutually beneficial trade between the Soviet Union and developing countries. With its great economic capacity, the Soviet Union can produce for export to developing countries a wide range of goods which they need for economic construction and the needs of the population, and at the same time has a growing demand for raw materials and industrial goods exported by these countries. Because the USSR has a planned economy, it can offer a stable market for the developing countries' goods, which is of no little importance for them at a time when they are experiencing increasing difficulties in selling their raw materials, and even more so the finished goods produced by their national industries, on foreign markets.

Naturally, it is easier for the USSR to establish and develop economic ties with developing countries which themselves show a desire to co-operate with it and make the necessary efforts to do so.

An analysis of the potential export resources and import needs of the Soviet Union and its economic partners among the developing countries gives grounds for thinking that there are still great opportunities for the development of economic co-operation between them which have not been exploited. This is shown, in particular, by the rapid growth in trade and other forms of economic co-operation in the last few years. The USSR's latest five-year plan for the development of the economy, covering the years 1971-1975, provides for a considerable development of economic ties with countries in Asia, Africa and Latin America.

4. The Soviet Union's imports from the developing countries of raw materials and foodstuffs, which are as yet their main export items, increase from year to year. Thus, imports of raw cotton increased from 144,200 tonnes in 1960 to 247,100 in 1970, jute from 19,900 tonnes to 41,200 and natural rubber from 184,000 to 316,000 tonnes.^{1/} But the most important feature is the change in the pattern of imports from developing countries in the direction of greater purchases of finished and semi-finished goods. They include rolled iron and steel, instruments, motor tyres and accumulators, cotton thread and cloth, jute fabrics, outer-wear and knit-wear, leather footwear and fancy goods, cleansing agents and other goods.

^{1/} Vnesnyaya torgovlya SSSR, statistical yearbooks, and Vnesnyaya torgovlya, 1971, No. 8, pp. 21-2.

5. Another important aspect of economic relations between the Soviet Union and developing countries is economic and technical co-operation in the construction of enterprises and in research and other work. Bearing in mind the aims mentioned above and the needs of the developing countries, it is possible to determine more correctly the main lines of policy to be pursued in co-operation between the USSR and the developing countries in developing their national economies. The main aim is economic and technical co-operation in the establishment of modern industry, which is in accordance with the policy of industrialization adopted by many developing countries. More than 70 per cent of all the commitments entered into by the Soviet Union with regard to economic and technical assistance to its partners in developing countries are connected with the development of this sector of the economy.

Among the various branches of industry, iron and steel has come to occupy first place as a field for co-operation. It is followed, in terms of the volume of goods and technical services supplied, by power, non-ferrous metallurgy, mechanical engineering and metalworking. Oil extraction and processing also plays a prominent role. In these branches, many large and technically advanced plants have been or are being built. They include metallurgical works in India (Bhilai and Bokaro), the Arab Republic of Egypt, Algeria, Iran, Turkey and Ceylon. The output of ferrous and non-ferrous metallurgical works built with the assistance of the USSR will not only help to replace imports on the developing countries' internal markets, but will also help to swell industrial exports to external markets. Steel and rolled metal from the Bhilai plant already figure among India's exports to both developing and developed countries. Part of the output of the Helwan plant in Egypt will also, of course, be exported.

Metal production forms the basis for the actual process of mechanical engineering. Plants have been built or are being completed with Soviet assistance in this sector in India, the Arab Republic of Egypt, Iraq and Iran. Oil refineries have been established in India, the Arab Republic of Egypt, Syria and Ethiopia and large power stations in a number of countries. The activities of these enterprises add directly or indirectly to the developing countries' export capacity.

Other branches of the developing countries' economies, although they absorb a relatively smaller proportion of the equipment and technical services supplied by the Soviet Union, still give rise to a great deal of co-operation.

Textile and knitwear factories, canning plants, elevators and other food industry plants built with USSR assistance are already playing an important part in the economic life of a number of developing countries and their output, particularly that of textile mills and canning plants, has added to the industrial export resources of the countries concerned.

6. Great importance is attached in co-operation between the USSR and developing countries to the training of national cadres of specialists and skilled workers. Quite rightly so, because in many countries the lack of skilled personnel is today the greatest obstacle to economic growth, hindering the use both of the countries' own resources and of those they receive in the form of foreign aid. About 200,000 specialists and skilled workers in the most varied fields of the construction and operation of industrial, agricultural, transport and other enterprises have been trained with the assistance of Soviet instructors and specialists in the developing countries themselves (at construction sites and at educational institutions and centres) and in the Soviet Union at its own enterprises and educational institutions.

Training qualified specialists and skilled workers for the developing countries is one of the essential prerequisites for expanding their industrial exports, because the quality of the output, and hence its ability to compete on the foreign market, depends to a large extent on the level of skill of the production personnel.

7. Assistance in the organization and execution of prospecting and geological survey operations for oil, gas, coal, metal ores and other mining resources is one of the most important aspects of co-operation between the USSR and developing countries. The discovery of new deposits has substantially increased the fuel and raw materials supplies of many developing countries, including the Arab Republic of Egypt, Afghanistan, India, Syria and others. At a number of such deposits, industrial extraction of underground resources has already been organized, including oil in India, Egypt and Syria and gas in Afghanistan. As far as Afghanistan is concerned, gas has already become an important export product. When construction of a nitrogen fertilizer plant based on the gas deposits discovered is completed, its output will represent a new addition to Afghan exports.

8. By helping to create an industrial structure, to provide education, to fund initial investments and to assist in construction and to train engineering, technical, administrative and production personnel, co-operation with the USSR has become an active growth factor in the economies of many developing countries. The extent to which such co-operation has a positive influence on the economies of the partner countries depends not only on the volume and conditions of aid and trade but also on the form in which co-operation takes place. Obviously, the form of co-operation cannot be uniform for all countries. One of the main reasons for this is the differences in the economic level of the Soviet Union's partners in co-operation, which determines the extent to which they have capital investment resources and qualified personnel of their own. The form of co-operation also changes in accordance with the sphere or sector in which it is to take place.

9. The choice of the form of co-operation is made on the basis of a thorough consideration of all the partner countries' possibilities and interests. Under the most common variant, Soviet organizations undertake to carry out design and research work, to supply construction and technological equipment and some materials not available in the recipient country, to direct or supervise the technical aspects of construction and assembly operations and to help start up production and train the personnel necessary for operation of the enterprise. Machinery, equipment and materials supplied by the USSR are usually paid for out of long-term or commercial loans granted by the Soviet Union for the purpose. In such cases the Soviet foreign trade organizations act as suppliers of goods and technical services at all stages in the establishment of new enterprises and operation of existing ones.

The Government of the country receiving assistance, or an organization duly authorized by it, undertakes to provide the construction site, to organize and direct the administrative aspects of construction operations, to hire local personnel, to supply local materials, to transport supplies in its territory, to supply electricity and water, to provide everyday services, to finance all expenditure in local currency and to make itself responsible for all matters which need to be dealt with in the partner country. In co-operation between the Soviet Union and more highly developed countries, the latter sometimes undertake to design and install, to supply a certain proportion of construction components and equipment and to carry out construction and assembly work.

10. A considerably less common practice so far has been the form of co-operation in which Soviet organizations not only do the design and research work and supply equipment and materials, but also carry out all construction and assembly operations, either themselves or with the assistance of other - for the most part national - firms, and deliver the plant to the client fully complete, or, as it is sometimes called, on a "turn-key" basis.

In recent years an ever-increasing part has been played by various forms of scientific and technical co-operation, covering the transfer of technology and technical documentation, the training of scientific and technical personnel, assistance in the establishment of design organizations, etc. A relatively recent phenomenon in the USSR's economic relations with developing countries are contracts for the production of goods and sub-contracts for the execution of construction work.

As the economic, scientific and technical capacity of the developing countries increases, the form of co-operation chosen necessarily changes, with greater emphasis on the part played by the developing countries themselves. To ensure the fullest and most rational use of national resources is one of the most important aims to be achieved by foreign economic and technical aid.

11. The legal basis for economic and technical co-operation between the USSR and developing countries is usually inter-governmental agreements. Such agreements are most often concluded for a period of four to five years (in the case of trade agreements, three to five years). When it is necessary to amplify and clarify the agreements, protocols may be signed, sometimes several of them. Before any agreement (or protocol) is signed, a great deal of work is done in order to determine the capacity of the partners to co-operate in carrying out this or that project or developing this or that branch of the economy and the practical justification for building this or that enterprise.

The first practical step in co-operation on the construction of an industrial enterprise, power station or other project is usually to prepare a technico-economic study of the feasibility of constructing such a project, given the conditions prevailing in the partner country. The justification for the project is set forth in the form of a report containing an analysis and recommendations. Where necessary, preliminary studies are made to investigate resources of minerals, hydrocarbons, and water and any other relevant conditions.

The report estimates and analyses such indicators as the country's demand for the proposed plant's output, the available resources of raw materials, the desirable capacity of the plant, its specialisation, the range of output, the organization of the plant (departments and shops), transport conditions, the sequence and duration of construction operations, the manpower needed, including workers and specialists, arrangements for collaboration with other enterprises, the extent to which the output is expected to be competitive and production efficiency. The feasibility report is the basis for the decisions taken by the competent bodies in the USSR and the partner country with regard to co-operation in the construction of the project. Whatever understanding is reached is embodied in an agreement or protocol.

II. PRACTICE WITH REGARD TO PRODUCTION CONTRACTS AND SUB-CONTRACTING IN RELATIONS BETWEEN SOVIET ORGANIZATIONS AND ORGANIZATIONS AND FIRMS IN DEVELOPING COUNTRIES

12. Intergovernmental agreements (protocols) on trade or economic and technical co-operation are the primary legal basis for commercial, production and other economic relations between Soviet organizations and organizations and firms in the developing countries. These relations are legally formalized as contracts, and in some cases, sub-contracts. Contracts, as a rule, are concluded in pursuance of and within the context of the agreements and protocols mentioned above, spelling out their precise application with regard to specific operations.

13. The subject of a contract relating to export-import operations is, as a rule, the purchase or sale of specified goods and their delivery by stated times. Under a contract relating to assistance in the construction of industrial enterprises or other projects, or the other hand, the obligations of the Soviet organizations include, as a rule, the execution of design and research work, the preparation of technical and working plans, the delivery of construction and technological equipment, and technical assistance in the execution of construction work, assembly, starting-up operations and training.

The organizations or firms of the partner country (the client) undertake in their turn such commitments as the receipt of goods (machinery, equipment, etc.) addressed to them at a frontier station or port, the transport of such goods within the country to the construction site, prompt payment for goods and services, the provision of suitable living conditions for specialists sent to give technical assistance, etc.

The contract may cover the whole range of operations connected with the construction of the plant or specific objects of these operations. The latter is most common, because it is usually possible in one document to go into the details of all the mutual obligations of the parties and the conditions governing their fulfillment in the construction of an entire enterprise. Contracts for the supply of goods, including goods for export, are concluded either for one year or for a longer period, during which fixed prices are maintained. Sub-contracts for the execution of operations are concluded for the period necessary for the completion of the work in question.

14. Under the laws on foreign economic relations which are in force in the Soviet Union, all operations connected with the export of Soviet goods to foreign markets, the import of goods from other countries and the export and import of services, including technical assistance, are undertaken by duly authorized foreign-trade organizations, known as "all-union corporations". Their right to conduct foreign economic operations and to conclude all kinds of agreements and deals with institutions, organizations, enterprises and individuals in the USSR and abroad is fixed by their articles. The corporations are as a rule established on an industry basis, although there are some which deal with a wider range of goods and others which deal with the countries in a particular region.

Most of them both export and import the goods in their field. Thus, for example, the Eksportlen All-Union Corporation exports cotton, flax, hemp, wool, yarn and thread, and cotton and other fabrics, and also imports cotton, wool, jute and jute products, artificial fibres and various fabrics.

15. Some corporations undertake to export machinery and equipment and to give technical assistance in the construction or reconstruction of enterprises and other projects. One such corporation is Tekhnoekspert, which gives assistance in the construction and reconstruction of roads and railways, bridges, ports, construction materials factories, textile, knitwear and clothes factories and plants producing antibiotics, chemicals and pharmaceuticals and in geological survey operations for certain mineral resources. Another, the Elektromekhprom All-Union Corporation is concerned with exporting from the USSR electric motor equipment, electrical engineering and electrical industrial equipment, electric power itself and complete sets of equipment for hydroelectric, thermal and atomic power stations, and also gives technical assistance in fitting out water plants.

We give below a list of just a few of the all-union corporations which are actively engaged in dealing with the developing countries:

Vostokimport is responsible for export and import operations in trade with Afghanistan, Iran, Turkey and Yemen (this is an example of a corporation organized on a regional basis);

Tsvetmetpromeksport gives technical assistance in the construction in other countries of nonferrous metallurgical works, coal and gas plants, gas and oil pipelines and other projects;

Soyuzpromeksport exports and imports solid mineral fuel, iron ore, mineral fertilizers, non-ore extractive resources and some kinds of finished industrial goods;

Raznoimport exports and imports nonferrous metals, ores, concentrates and rolled products, and natural and synthetic rubber;

Raznoeksport exports and imports cement, glass, tobacco and tobacco products, leather goods, footwear, china, sewn goods and knitwear, toys and household electrical appliances;

Soyuzplodoimport exports and imports fruit, tinned fruit and vegetables, tea, coffee, cocoa beans, starch, pasta and confectionery;

Solkhozpromeksport gives technical assistance in the organization and construction of agricultural and irrigation projects and plants processing and preserving agricultural produce.

The administrative organs of all the all-union foreign-trade corporations are in Moscow.

16. Every all-union corporation is an independent economic organization with its own legal personality and operates on a profit-and-loss accounting basis. It is answerable for its operations and obligations with its property, which under the law in force in the Soviet Union is liable to distraint. Neither the State nor its organs or other organizations are liable for the corporations' operations and obligations. At the same time, the corporation is not liable for claims against the State or its organs or other organizations. The articles of each corporation fix its basic capital.

In exercise of the right granted them under their policies, all-union corporations conclude contracts with organizations and firms in the developing countries under which they act as suppliers of Soviet goods and services or purchasers of developing countries' goods and services. In some cases a contract for the supply of a set of equipment and the granting of technical assistance is signed, not only by the authorized representatives of the all-union corporation, but also by representatives of the Soviet economic organization which will directly effect delivery and provide technical assistance. Business relations between the foreign-trade organizations (all-union corporations) and the industrial enterprises producing for export and economic organizations using exports are governed by law.

17. Soviet industrial corporations and enterprises do not sell their output directly on the foreign market. Nor do they buy the machinery, equipment and raw materials they need directly from foreign suppliers. These functions, as has already been said, are performed by the Soviet foreign-trade organizations (all-union corporations). The all-union corporations also act as intermediaries in organizing industrial (production) collaboration between enterprises in the Soviet Union and manufacturing firms in the developing, industrially developed and socialist countries.

The system of plan targets and schedule orders and other kinds of business arrangements ensure co-ordination between the producing enterprises and foreign-trade organizations in the USSR, and also between the foreign-trade organizations and consumers outside the production sphere, whose interests are represented by the Ministry of Trade and other economic organs. Soviet enterprises' obligations with regard to the supply of goods to consumers are determined by a production programme within the context of plan targets. Many kinds of goods are produced in collaboration with other Soviet industrial enterprises. A growing number of goods are produced in collaboration with enterprises in other countries belonging to the Council for Mutual Economic Assistance. Experience has shown beyond question that the establishment of economic relations, including collaborative arrangements, with foreign partners through the foreign-trade corporations is no hindrance to mutually beneficial co-operation.

18. It follows from what has been said that Soviet industrial enterprises and firms in the developing countries do not have direct relations of the kind which in UNIDO documents have come to be described as "subcontracting".

In such cases the producing firm in the developed country (the main contractor) farms out to a firm in the developing country (the subcontractor) the production of certain goods or parts in accordance with the contractor's specifications and for delivery in accordance with its instructions. Goods needed to meet production needs and consumer demand in the Soviet Union are purchased in the developing countries by Soviet foreign-trade organizations under contracts with State organizations and corporations, industrialists' associations or the producing firms themselves (State, mixed or private). The contract may be either for the delivery of goods from the suppliers' normal range of output or for goods specifically intended for delivery to the USSR in accordance with the special needs of its consumers or adapted for use under certain conditions prevailing in the Soviet Union. Thus, for example, under contracts with Soviet foreign-trade organizations, Iranian firms produce and deliver to the USSR knitted outer and underwear, leather and rubber footwear and cleaning agents (labelled in Russian). Certain firms in India, the Arab Republic of Egypt, Algeria and Syria do the same. In these cases the relationship is essentially on a production contract basis.

19. Apart from this, there are arrangements which combine features of the production contract and of production collaboration. In these the Soviet foreign-trade organizations act as the contractor purchasing the goods produced and supplying (wholly or partly) the raw materials and technical documentation needed to produce them. Thus, for example, under a contract between the Soviet foreign-trade organization Eksportlen and the Indian State textile promotion board, the latter undertook to process cotton supplied by the Eksportlen corporation. All the goods produced, in the form of finished cotton fabrics, are exported to the Soviet Union and Eksportlen pays for the cost of processing at rates agreed between the partners.

Another example of relations based on production contracts combined with collaboration is the arrangement for co-operation between the Soviet Union and the Arab Republic of Egypt. On the basis of orders from Soviet foreign-trade organizations, Egyptian enterprises produce ships, pressed automobile and tractor parts and sheet metal. The Soviet organizations supply the metal, equipment, accessories and technical documentation (drawings etc.) needed for the purpose. The goods produced under the contract are intended for delivery to the USSR.

In Algeria a brandy distillery is being set up in collaboration with Soviet organizations. Part of the output will be exported to the Soviet Union in payment for the technical assistance received in the construction of this and other projects in Algeria.

20. Co-operation based on production contracts and industrial collaboration enables firms in the developing countries to the following:

To make fuller use of existing production capacity or to expand it if it is insufficient to carry out the orders received;

To employ the existing work force more fully and to recruit additional labour for the expansion of production;

To have a reliable market for the sale of the goods produced under contract;

To make wider use of the technical experience and the services of specialists from Soviet organizations and to obtain from the organizations materials and documentation in order to execute the orders given under the contract.

This form of co-operation gives the Soviet foreign-trade organizations a more reliable source of the goods they need, with the knowledge that their requirements have been taken into account in the process of production. It increases their chances of establishing permanent economic relations and of exporting Soviet goods in return.

Co-operation based on production contracts and collaborative arrangements, however, can only be successfully established and developed when it is beneficial to both sides. In many cases the partners are able to derive additional benefits in the form of technical progress in production, improved supplies of raw materials and lower expenditure on the sale (or purchase) of the goods.

21. In view of the above-mentioned and other advantages of co-operation based on production contracts and collaboration, Soviet foreign-trade organizations endeavour to make use of these arrangements in all cases when the necessary pre-conditions are met (this aspect is dealt with in section 3 of this paper). In addition, the expansion of the developing countries' industrial exports can be actively promoted by the system under which the Soviet organizations buy part of the output of the enterprises built in the developing countries with their assistance. Operations of this kind are already being undertaken. As examples we may cite the deliveries to the USSR of steel and rolled products produced at the Bhilai Works in India and of tinned meat products produced by the meat plant at Chibouche in the Somali Democratic Republic.

22. Questions relating to international cooperation between a socialist developing country and the USSR, including the work of the consulates on the basis of production contracts and deliveries, trade missions, and deliveries between the countries as a whole, are usually dealt with in commercial and economic departments of the consulates and representatives of the consulates or of trade departments concerned with foreign economic relations. The agreements reached in such negotiations (or in correspondence) are embodied in contracts between trade organizations and firms. Of great importance in obtaining information on what the partners can offer, and in making contacts and conducting negotiations are the USSR trade missions and embassy advisers on economic affairs to be found in many developing countries.

23. Subcontracting between Soviet organizations and firms or organizations in the developing countries, in the strict sense of the word, is to be found in the construction of projects on a turn-key basis. The essence of this form of co-operation is that the Soviet organization, acting as the contractor under the basic contract with the client, subcontracts for the execution of the work with an organization or firm in the partner developing country or in other countries. These firms then act as subcontractors.

The following types of subcontracts are possible, depending on the organizations taking part:

1. Between a Soviet foreign-trade corporation and national State organizations and companies or private firms in the client country;
2. Between a Soviet foreign-trade organization acting in conjunction with a Soviet economic organization and national organizations or firms in the client country;
3. Between a Soviet supplier (foreign-trade organization) and organizations or firms in other developing countries, socialist countries or industrially developed capitalist countries, and also with international specialized agencies taking part in aid programmes.

In actual practice, however, there can be other variations: the role of subcontractor can be played jointly by organizations from two or three socialist countries, or one socialist country acting together with firms from developing countries or industrially developed capitalist countries.

Soviet foreign-trade organizations can regard subcontracting as a form of co-operation which affords the developing countries a real opportunity to raise the level and increase the efficiency of their own efforts, increase their productive capacity for development purposes and as a natural result of working together to solve the developing countries' problems by promoting the establishment of national construction and assembly organizations.

24. The basic principles governing contracting and subcontracting between Soviet organizations and organizations, companies and firms in the developing countries are in essence as follows:

1. The relationship of the partners is one of equality and is embodied as such in their respective rights and obligations;
2. The subcontractor enjoys administrative and operational independence in carrying out deliveries, operations and other commitments under the contract or subcontract;
3. The subcontractor bears material responsibility for ensuring that the goods supplied and the work carried out meet the requirements with regard to quality, deadlines and other conditions laid down in the contract or subcontract up to the end of the guarantee period;
4. The Soviet contractor has the right to check in order to ensure that the subcontractor meets the deadlines for delivery and completion of work and complies with technical and other specifications.

25. The favourable attitude of Soviet organizations to subcontracting, as described above, is also based on an analysis of the experience accumulated so far and the basis established for a further expansion of this form of co-operation. There follow a few examples of the experience of Soviet organizations in this field.

The largest project built by Soviet organizations in a developing country on a subcontracting basis is the northern section of the trans-Iranian gas pipeline, the total length of which is 1,100 km. About 600 km of pipeline were laid and 6 pumping and compression stations were built with the economic and technical assistance of the USSR (the southern part of the pipeline was laid with the assistance of French and United Kingdom firms). The client placing the general order for the pipeline was the Iranian national oil company and the supplier was

a Soviet foreign-trade organization which entered into a contract with a Soviet economic organization specializing in civil engineering in order to carry out the work planned and taken to do.

The construction and assembly work was subcontracted to an Iranian firm, which assumed the responsibility for meeting the subcontract specifications with regard to completion dates, quality and other conditions. This firm in its turn subcontracted a number of operations to other Iranian firms. Payment for deliveries and work carried out by the subcontractors was made in the Iranian national currency out of the funds received under the original contract. The client's expenditure in foreign currency to pay for deliveries of equipment and the services of specialists despatched from the USSR was met from a Soviet long-term loan. Part of the construction equipment which the subcontractors could not find in the country was obtained from the Soviet supplier and paid for at cost. At the request of the client, the general contractor sent the Soviet specialists whose services were needed for the construction and assembly work. The combined efforts and co-ordinated action of the Soviet and Iranian technical and production personnel and the mutual understanding they showed in the process of construction helped to ensure the successful completion of this unique pipeline within a short period in very difficult climatic and natural conditions.

26. The subcontracting form of co-operation has been used in the construction with the assistance of Soviet organizations of an oil pipeline in Iraq (from the northern Rumaila oil deposit to the port of Al Faw). The Iraqi national state construction company acts as sub-contractor in the construction work. The supplier who signed the original contract with the Iraqi authorities, as in the previous example, is one of the Soviet foreign-trade corporations and the client is the Iraqi ministry responsible for oil affairs.

A special feature of the contract and subcontract for this project is that provision is made for an arbitrator to check on the quality of the equipment supplied for the pipeline and on the execution of the construction work. By agreement between the parties the USSR All-Union Chamber of Commerce was invited to act as arbitrator. In addition, representatives of the client supervise and check the work. Thus, in this case, the subcontracting arrangement was organized fully within the State sector.

27. Sub-contracting has also been agreed to in the State sector between Soviet organizations and local firms in the execution of operations connected with the assembly of equipment for one of the workshops at the Annaba metallurgical works in Algeria. The sub-contractor for this work is the Algerian national construction organization. The supplier (the Soviet foreign-trade organization) is responsible for foreign work and deliveries of equipment under a separate contract.

28. Co-operation between Soviet organizations and national firms on a sub-contracting basis has been adopted to a greater or lesser extent in the construction of projects in a number of other developing countries, including Morocco and Turkey. There are a considerable number of developing countries, which prefer this form of co-operation in the construction of industrial enterprises. So far sub-contracts between Soviet organizations and sub-contracting firms in developing countries have been mainly for construction work, but they could obviously cover other matters which the developing countries' organizations and firms agreed to undertake, and this would be in the interest of both sides.

29. An analysis of experience in sub-contracting between Soviet organizations and enterprises acting as suppliers or contractors and organizations or firms in the developing countries acting as sub-contractors reveals both the favourable aspects of this form of co-operation and the factors hindering its further expansion.

For the developing country, it means greater use of the country's own productive capacity and labour resources, increases employment, leads to certain savings in the expenditure of resources, particularly foreign currency, because of differences in the rates for local personnel and foreign technical specialists, and makes it possible to replace imported equipment partly by equipment of national manufacture. Working together with qualified Soviet specialists broadens the knowledge and experience of local engineering and technical personnel and helps to train local skilled workers. All this has a favourable effect on the formation and strengthening of national construction organizations and other industrial enterprises.

For the Soviet organizations engaged in industrial construction, it means that they do not have to assign their own resources to the work which can be done by local firms, that they can reduce the number of specialists sent to provide technical guidance and supervision and that they can depend on the experience of national construction and assembly firms and their familiarity with local conditions.

Subcontracting increases the opportunities for economic and technical co-operation between the USSR and the developing countries, and particularly for collaboration in production. This in its turn can encourage the growth of industrial exports from the developing countries to the socialist market. In general, this form of co-operation means that fuller use can be made of the joint efforts of countries to solve the economic construction problems of the developing countries.

30. At the same time, the obstacles and difficulties in the way of subcontracting must not be underestimated. Among them should be mentioned first of all the fact that national organizations and firms capable of undertaking modern industrial construction at the required technical level are few in number, or in some developing countries, completely lacking. National firms tend to be ill-equipped with machinery and appliances, and this creates difficulties in the transport and assembly of large and heavy equipment. One of the factors holding up the development of co-operation on a sub-contracting basis is the greater risk for Soviet suppliers (contractors) of failure to meet deadlines and technical specifications. Some of these failures may only become apparent after the guarantee period has elapsed. But even if they are discovered within that period, payment of the corresponding penalty cannot fully compensate for the material and moral loss suffered.

31. Subcontracting between Soviet organizations and firms in the developing countries can help to give national firms in those countries a greater share in the supply of materials, constructional engineering parts and various kinds of equipment and to encourage the independent execution by them of operations at projects being constructed with the economic and technical assistance of the Soviet Union. One example is the participation by Indian firms in the construction of the metallurgical works at Bhilai and Bokaro.

The tendency for a greater proportion of supplies to come from the developing countries themselves is a perfectly proper one. This tendency actively encourages the mobilization and rational use of the developing countries' own resources and efforts, which have a decisive role to play in the achievement of economic growth. But in order to engage in this form of co-operation the national organization or firm must have engineering and technical personnel who are qualified to provide the right kind of technical direction.

32. Apart from the developing countries' own firms, organizations and enterprises in other socialist countries also enter into subcontracting arrangements for the supply of equipment and services. In such cases the matters covered by the subcontract between the Soviet organizations furnishing economic and technical assistance and the organizations or firms in other socialist countries are usually the followings:

- Execution of design and research work for a particular part of a project or installation;
- Delivery of certain types of construction equipment, particularly special-purpose equipment;
- Delivery of part of the technological equipment or individual pieces of machinery and units in the production of which the subcontractor is technically advanced;
- Dispatch of specialists by the subcontractor to assemble and adjust equipment supplied by him under the subcontract;
- Training of local personnel to work with this equipment;
- Supply of certain materials and parts necessary for the construction of the enterprise (project);
- Supply of spare parts for construction and technological equipment.

An example of subcontracting with organizations in socialist countries is co-operation in the construction of the Baghdad-Basra railway in Iraq. The supplier under the basic contract is the Soviet foreign trade organization.

but under subcontracts Polish organizations have undertaken to carry out a considerable part of the design work and to supply rolling stock (goods wagons), Czechoslovak organizations are supplying locomotives and Hungarian organizations are helping to construct a shipyard factory and to install communications systems.

This kind of collaboration brings economic benefits to all those taking part - the client, the supplier and the subcontractor. It enables the client to obtain equipment in the production of which other socialist countries are experienced and technically advanced, and also to secure the services of qualified specialists from those countries. It frees the supplier (the Soviet organization) from the need to concern itself with deliveries of those types of machinery and equipment for which it does not have facilities but which other socialist countries are equipped or better equipped to produce. Finally, it enables the subcontractor to expand exports of goods and services to the developing countries. Time is saved, which benefits everybody. But this kind of arrangement also creates problems which have to be solved. They concern both the necessity for strict compliance with delivery dates and specifications and the willingness of the subcontractor to undertake obligations with regard to the provision of goods and services (including the granting of credits) on the same conditions as in the original contract between the client and the supplier.

33. There are also opportunities for subcontracting between Soviet foreign trade organizations giving assistance to developing countries, firms in industrialized Western countries and international agencies taking part in United Nations aid programmes. However, the capacity of Soviet organization and enterprises in this area is still not being made full use of by international organizations.

III. CONDITIONS AND OPPORTUNITIES FOR THE DEVELOPMENT OF
CO-OPERATION BETWEEN SOVIET ORGANIZATIONS AND FIRMS
IN THE DEVELOPING COUNTRIES ON THE BASIS OF
PRODUCTION CONTRACTS AND SUBCONTRACTING ARRANGEMENTS

34. Among the conditions necessary for the establishment and development of co-operation based on production contracts or subcontracting arrangements between Soviet foreign trade organizations and firms in the developing countries, the first requirement is the very fact of the existence of intergovernmental agreements (on trade and technical co-operation) determining the nature and framework of co-operation and creating the basis for commercial and production relations between the organizations and firms.

In addition, there must be a wish and a desire on the part of the organs in the partner countries responsible for foreign economic relations to make use of such arrangements as production contracts and subcontracting in co-operative undertakings. They can give assistance in this connexion by helping to select firms, providing facilities for the transport of goods, arranging power and water supplies, giving firms credit and other measures.

After the signature of the agreement on co-operation and the basic contract on technical assistance in the construction of an enterprise, a number of operations have to be carried out before it is possible to arrange subcontracts with national firms. They include geological and other surveying work, the preparation of technical designs and working drawings for the whole enterprise, the drawing up of specifications for equipment, and so on. Without such preliminary work, not one subcontract can be awarded. The terms of the original contract between the client and the Soviet supplier serve as the legal framework which to a large extent determines the terms of the subcontracts for the execution of the commitments entered into under the main contract.

It goes without saying that relations based on production contracts and on subcontracts can only come into being and develop successfully if they have a subject. The subjects of such arrangements are, firstly, goods which Soviet organizations are interested in obtaining on economically advantageous terms and which industrial firms in the developing countries can undertake to produce. Secondly, they are industrial enterprises and other projects which are to be built under the co-operation agreement.

A list of goods which in the author's opinion could be the subject of contracts for production and export to the USSR will be given below. We shall here just note that they must meet the standards and technical specifications in force in the USSR.

35. For co-operation on the basis of a production contract or a subcontract, it is necessary to have partners, the agents in the relationship. On the Soviet side, as already noted, the agents are the foreign-trade organizations, the all-union corporations. In order to carry out the commitments entered into under contracts, they make wide use of the technical and productive capacity of the economic organizations, with which they have smooth working relations.

The developing country which is the Soviet Union's partner in co-operation should accordingly have its own organizations, companies or firms having the necessary industrial capacity and cadres of specialists and workers to carry out the work required under the production contract or the subcontract. Such partners can be State organizations and companies (from the Soviet corporations' standpoint this is preferable), mixed firms or private ones.

36. The question arises whether the developing countries have firms which are capable of producing industrial goods for export to the markets of the developed countries. Documents and publications put out on this question, including those published by UNIDO, together with the author's personal observations, convince him that these countries already have a considerable number of enterprises with the technical equipment and experience to produce goods of a quality which meets the necessary requirements (as yet there are mostly consumer goods). Many of these enterprises, however, are either branches of foreign firms, or mixed companies in which the foreign firms have a share and which work under contracts and subcontracts with them.

As far as national industrial firms are concerned, they often either do not have the necessary facilities or the cost of production is too high and their output is not competitive. Hence it is no easy matter to select national firms as partners for Soviet organizations under contracts for the production of goods for export to the USSR. Similar difficulties arise in the selection of a partner as subcontractor. His technical capacity and experience will, after all, determine the results of the subcontracting arrangement, and may affect co-operation between the countries as a whole.

A serious obstacle to such production arrangements, particularly for goods for use in production, is differences in standards and technical specifications. Since imports of industrial goods from developing countries are merely a supplement to the USSR's own production of the same goods, Soviet foreign-trade organizations are fully justified in insisting that goods produced to their order by foreign firms should meet the State standards and technical specifications in force in the USSR. If they do not, some goods intended for use in production (spare parts, for example) cannot be used at all, while other goods (household appliances, for example) require additional expenditure on adjustment and maintenance.

All this shows the need to establish the necessary technical, organizational and production pre-conditions in the developing countries for the development of relations based on production contracts and subcontracts. The Soviet organizations can, we believe, undertake to deliver the necessary equipment and raw materials for these purposes on commercial terms, to supply technical documentation and to supply information on the requirements set for output by Soviet State standards and technical specifications.

37. The success of the work done by any particular firm in a developing country under a production contract or a subcontract depends to a large extent on the training and experience of the engineering, technical and administrative personnel and the skill of the workers. Even when production capacity exists, this to what largely determines the quality of the output and work and the amount of time taken. The absence or shortage of qualified engineering, technical and other personnel in the developing countries' own organizations and firms is one of the reasons holding up the further development of contractual and subcontractual relations between them and Soviet organizations.

In these circumstances, an important means of preparing for co-operation in the form of production contracts and subcontracting would be a substantial increase in the training of national specialists in the USSR, and also in their own countries with the assistance of Soviet instructors, given the existence of the necessary educational institutions and centres. When citizens of the developing countries (specialists, students and workers) study in the USSR, they not only get vocational training of a high standard, but also become familiar with Soviet equipment and technical specifications, which is of considerable assistance to them in their future work for national organizations and firms acting as suppliers and subcontractors in co-operative arrangements with Soviet organizations.

38. The further development of production contracts and of subcontracts, as well as production contracts and of subcontracts, is encouraged by various forms of collaboration in production, which includes, for example, the sending of Soviet specialists to assist in the work, the extension to local personnel, and this in its turn contributes to increasing the number of national specialists (engineers and administrators) who can make themselves responsible for the management of production and of construction and assembly operations. The converse must also be mentioned, i.e. the development of subcontracting encourages the development of collaborative arrangements. The latter, in their turn, lead to an increase in the developing countries' industrial exports. This is mainly due to the fact that on a collaborative basis it is possible to organize the production of goods which are of higher quality and better suited to modern requirements, particularly those of the partner country, which is interested both in the production and in the sale of the goods.

39. Another necessary condition for the development of production contracts and of subcontracts, and one of special importance, is the existence of an economic incentive. Neither the Soviet foreign-trade organizations, operating on a profit-and-loss basis, nor their foreign partners will want to enter into such an arrangement if it is less attractive for them from the economic standpoint, if the resources and efforts they expend will be less effective on this basis and possibly result in a loss.

It should be noted in this connexion that in evaluating the return on resources and effort expended in co-operation with foreign partners, Soviet organizations do not only consider their own commercial interests as a firm, but also the interests of the economy as a whole and those of their partners.

Production contracts guarantee that both partners will benefit because they ensure rational exploitation of favourable conditions for the production of various goods in the developing countries, increase the rate of utilization of productive capacity and raise employment. Subcontracting ensures that they both benefit mainly through the achievement of high production indicators in the execution of operations and other work under the subcontract. Full equality, a common economic interest and mutual support enable each of the partners to apply and utilize their resources and efforts in a rational manner in order to achieve their production aims and secure their commercial interests, i.e. to expand their scale of operation and hence increase their income.

These most general pre-conditions, as outlined above, determine in large measure the opportunities for the further development of co-operation between Soviet organizations and firms in the developing countries on the basis of production contracts and sub-contracting in the construction of industrial and other projects. In addition, there may be special factors constituting a basis for enlisting the services of firms in particular developing countries, e.g. wide experience in the construction of installations from some particular local building material or in the use of primitive machinery in construction when the dispatch of large construction machinery is not economically justified.

40. On the basis of the targets set in the five-year plan for 1971-1975 for fuller satisfaction of the growing demand for goods by the USSR economy and population, recent trends in the pattern of Soviet imports and the developing countries' proposals for the diversification of their exports, it can be assumed that the volume of goods purchased by Soviet foreign-trade organizations in developing countries on the basis of production contracts will increase considerably. In addition to cotton, silk and woollen fabrics, footwear, clothing and knitwear, it would seem that orders can be placed for such goods as rolled steel products and pipes, spare parts for tractors and motor cars, inner and outer tubes for motor cars, non-ferrous metals and products made from them, accumulators, refrigerators, conditioners and other household appliances, low-capacity electric motors, electric lighting apparatus, sanitary engineering products, furniture, tinned meat, tinned fruit and juices, and various leather products. In determining the actual list of goods whose production is to be entrusted to firms in developing countries, special attention will of course be given to labour-intensive goods, i.e. those whose production requires a great expenditure of labour, which at the present stage is in the interests of both the developing countries and the USSR. It goes without saying that only goods of the necessary quality, meeting the demands of the modern world market and the specific requirements for their use in the USSR can be the subject of contracts for the production of goods for export to the USSR.

41. As regards subcontracting in the construction of projects under agreements for economic and technical co-operation, considering the agreements and contracts that have been concluded and the trends that are evident in this field, it would seem that if the necessary pre-conditions exist, such arrangements could be entered into and developed in connexion with the construction

of metallurgical work, thermal and hydroelectric stations, oil and gas pipelines, oil extraction plants, oil refineries, and machine tool works, cement factories and housing construction concerns, elevators, spinning and sugar factories, railways and harbours, with the arrangement of mechanized agricultural enterprises (farms) and with the construction of educational institutions and centres. The list of possible branches and projects will vary depending on the particular country concerned. It is of course true that subcontracting can only be a supplement to the main form of co-operation now adopted in the construction of industrial enterprises and other projects, which is based on a division of responsibility with regard to supplies and other matters between the supplier and the client (see section 9 of this report).

42. Considering the advantages of the subcontracting form of co-operation, and at the same time the fact that practical experience of it is limited, it seems advisable to follow a policy of establishing subcontractual relations with the developing countries' national firms gradually (stage by stage). Beginning with less complicated operations and gradually moving on to those which require greater experience and technical equipment, national firms, with adequate assistance from the government organs and qualified specialists of the supplier (contractor), can within a relatively short period substantially increase their production capacity and assume the functions of subcontractor for a wide range of operations of varying degrees of complexity. Practical activity directed towards a specific purpose is a very efficient and reliable way of forming a body of production workers.

A good example of this is the experience of Soviet organizations in the construction of an oil refinery at Assab, Ethiopia. To start with, the Soviet organizations could not find a national organization capable of carrying out operations on a subcontractual basis, and they were obliged to hire workers individually. That, however, did not prove satisfactory. They then proceeded to select the most capable and interested workers and set up teams under their leadership with which they concluded contracts for jobs to be paid for as a whole on the basis of piece rates. Everything then went well. Some of these teams, having received training during their work with the Soviet specialists, then set up their own small construction and production contracting firms and started working at other sites in Ethiopia.

43. The necessary conditions for the development of relations based on production contracts and subcontracting, some of which have been mentioned above, are also to some extent the prerequisites for the development of collaborative arrangements. But additional conditions are necessary in this field. The selection of a reliable partner capable of fulfilling all his obligations in time while maintaining the required level of quality is one of the most difficult problems in organizing co-operation based on collaboration. Any departure from the conditions agreed upon by the parties inevitably leads to unnecessary expense and other losses for the other side. Active support by administrative organs and banks for national firms entering into collaborative arrangements with foreign partners has therefore become an important requirement for the development of this form of co-operation.

Among the effective means of promoting collaboration in production are favourable credit terms, all kinds of exemptions from customs, currency and financial regulations and assistance in establishing production facilities.

44. Since production contract and subcontracting arrangements between Soviet organizations and firms in the developing countries are organized within the framework of intergovernmental commercial and economic agreements, the possible development of these arrangements should obviously be borne in mind at the stage of negotiations on co-operation and the signing of agreements and contracts. Hence when selecting projects for co-operation, in addition to such criteria as the country's ability to supply basic raw materials from its own resources, the existence of a domestic market for the output or at least part of it, and the economic importance and profitability of the enterprise, it is also necessary to take into account the possibility of exporting output to the USSR, including deliveries based on production contracts and collaborative arrangements, and the possibility of subcontracting part of the work to national firms in the developing countries.

Accordingly, in the process of economic and technical co-operation, when creating plant production capacity and the other material and technical elements of production and when training specialists and workers, it is advisable to plan not only for meeting domestic demand, but also for export, particularly to the country giving assistance. Thus experience suggests the desirability of adopting a form of co-operation in which the action taken now will broaden the basis for

the further development of co-operation in the future and the adoption of such arrangements as the partner countries consider to answer most closely to their particular conditions and capabilities.

45. While recognizing the potential of subcontracting arrangements, it would be wrong to ignore the difficulties and obstacles in the way of their development. Such difficulties are largely due to the gap between the technical and technological levels of production in industrialized and developing countries and differences in the organization of production and marketing. A consequence of the technical and technological gap is variations in national standards and technical specifications, which also in turn hold up the development of subcontracting.

An important factor hindering the adoption of this kind of arrangement is the fact that the developing countries' industrial capacity is scattered over tens of thousands of small and medium-sized enterprises. The establishment and development of subcontractual and collaborative relations with such a large number of partners is far from an easy matter. The scattered nature of production also creates additional difficulties with regard to the flow of goods transport in both directions. With the world market in its present state, when for many goods supply exceeds demand, special importance attaches to the seller's willingness and ability to seek out a purchaser (client). When the potential sellers (exporters) are scattered all over the country, this aspect becomes still more of a problem.

46. In the circumstances, there is a quite obvious need for developing countries to have national government organs and non-governmental organizations (industrial associations, chambers of commerce, etc.) which will be responsible for assisting the development of subcontracting, collaboration and other arrangements for expanding industrial exports and co-operation as a whole. Only such organs and organizations can have a chance of success in carrying out such difficult tasks as identifying the potential capacity of producers in developing countries and bringing them together with potential clients in developed countries. The achievement of positive results in the development of subcontracting arrangements and collaboration on the basis of production contracts will depend primarily on the initiative and persistence of the developing countries themselves. That does not, of course, detract from the role of the developed countries and international organizations, particularly UNIDO, in this important matter.

47. The contracting institutions and organizations in developed countries can, in response to requests from governmental and non-governmental organizations in the developing countries, use their own institutions, help to find firms in their own countries which are interested in carrying out production to firms in developing countries and to help to establish contacts between potential partners.

There is every reason to suppose that UNIDO can make a positive contribution to the promotion of subcontracting arrangements between developing and industrialized countries. The main way in which UNIDO could do this, in our view, would be by drawing up well-considered recommendations on the strategy and policy to be followed by both developed and developing countries in this field, including measures to encourage subcontracting arrangements by easing credit and insurance terms, customs and tax regulations, etc.

Full use should be made of UNIDO's opportunities for giving developing countries practical assistance in setting up, principally in the State sector, production, construction and assembly firms capable of acting as partners in subcontracting or production contracts. To this end steps should be taken to reach agreement with the International Bank and other international financial agencies on the granting of credits to developing countries on favourable terms for the expansion of output under the subcontracting programme.

UNIDO could recommend developing countries to make fuller use of their governmental and non-governmental organizations and institutions as a centre for organizing the development of subcontracting arrangements.

48. With a view to the collection and general dissemination of information on the opportunities that potential contractors and subcontractors can offer and on their desire to take use of their capacity to expand the output of goods in which both sides are interested, it seems desirable to organize with UNIDO assistance the regular publication of information bulletins and directories, which could be distributed through national governmental and non-governmental agencies. Regular correspondence between UNIDO and these agencies can also provide important information.

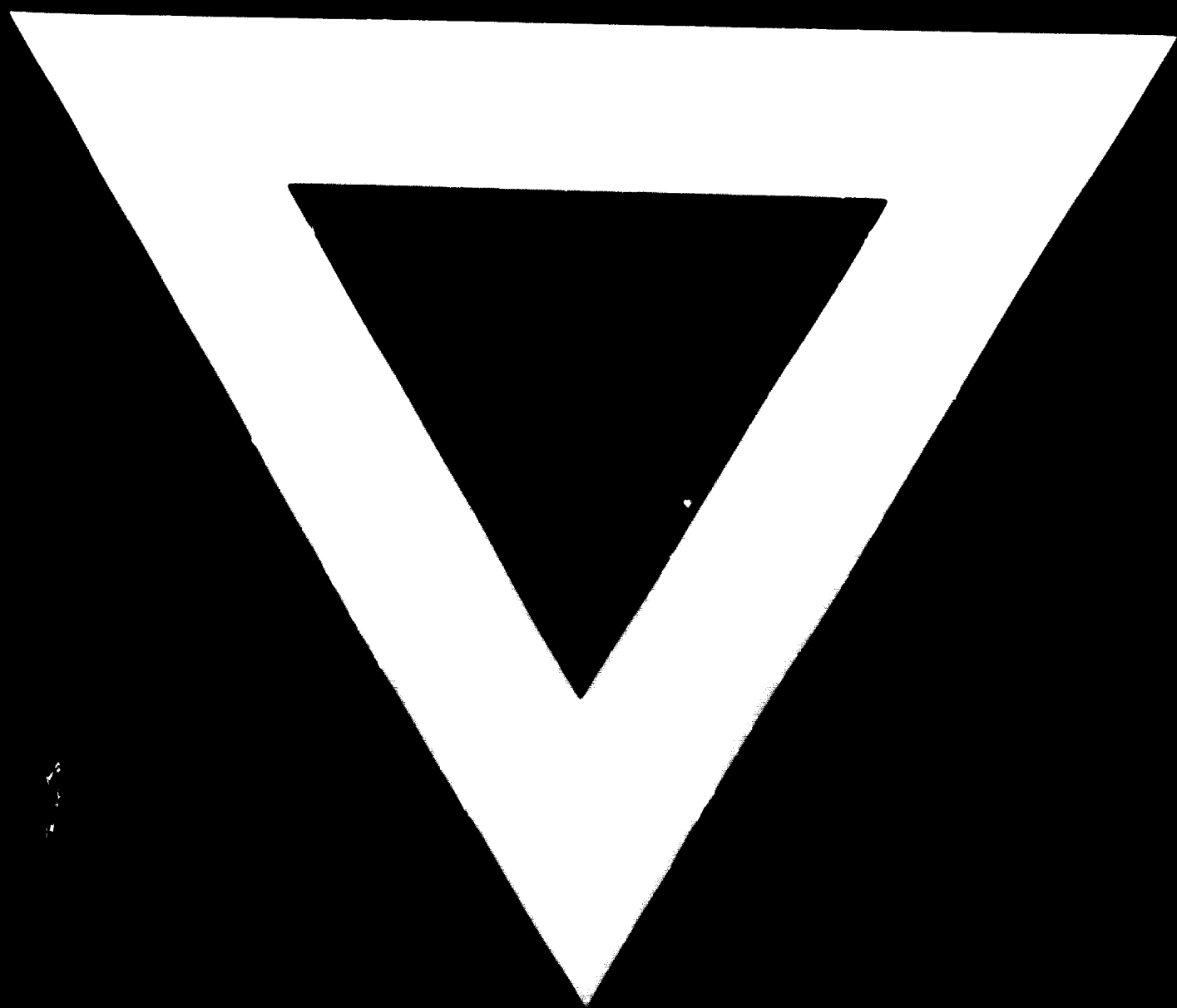
As regards the establishment of business contacts between contracting and subcontracting firms, that is, in the author's opinion, primarily the responsibility and concern of the firms themselves. UNIDO can effectively

assist the process, of course, particularly through the active participation of national institutions and organizations. Their programme does not exclude the possibility of the UNIDO secretariat exchanging information directly with potential partner firms with a view to suggesting cooperation and helping to promote subcontracting arrangements. A positive role can be played in this connexion by the various seminars and meetings of business representatives and specialists under the UNIDO programme.

49. The long-term outlook for the adoption of subcontracting arrangements, including production contracts, with firms in the developing countries depends closely on trends in these countries' industrial growth and the successes they achieve. Subcontracting in its turn can make an effective contribution to industrial development and to raising the technological and technical level of production in developing countries. The growing importance of this kind of inter-relationship seems quite evident. The development of subcontracting arrangements thus opens up an additional channel through which the industrialized countries can give the developing countries support in solving their industrialization problems.

In conclusion, it should be noted that a process as complex, difficult and many-sided as the development of subcontracting arrangements between firms in developed and developing countries requires a systematic (comprehensive) approach. Substantial results can only be achieved in this area if unremitting efforts are made by the developing countries themselves, by the socialist and industrialized Western countries and by international organizations. The programme for the promotion of subcontracting undertaken by UNIDO can and should be an important element in the over-all system of measures to promote the industrial development of the developing countries and the steady expansion of their industrial exports.





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