BACKGROUND REPORT

INSTITUTIONAL SET-UP FOR SME POLICY DESIGN AND IMPLEMENTATION
CASE STUDY JAPAN

MANGARA TAMBUNAN
WOLFGANG HILLEBRAND

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<tr>
<td>ADB</td>
<td>Asian Development Bank</td>
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<tr>
<td>GDP</td>
<td>Gross Domestic Product</td>
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<td>HRD</td>
<td>Human Resource Development</td>
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<td>IT</td>
<td>Information Technology</td>
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<td>MEITI</td>
<td>Ministry of Economy, International Trade and Industry</td>
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<td>MITI</td>
<td>Ministry of International Trade and Industry</td>
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<td>OECD</td>
<td>Overseas Economic Cooperation Development</td>
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<td>R and D</td>
<td>Research and Development</td>
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<td>SME</td>
<td>Small and Medium Enterprises</td>
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V. EXECUTIVE SUMMARY

Role of SME in the Japanese Economy

SME, largely defined as enterprises having less than 300 employees in manufacturing or less than 100 employees in wholesale and services, account for more than 99% of all enterprises, 72% of employment, 42% of turnover across all economic sectors, and 52% of turnover in manufacturing.

The share of SME in total exports is, however, only around 28% but would be higher if indirect exports (no reliable estimates available) were included. Labor productivity of SME is also low, i.e. only 50% of large enterprises. Even worse, since the late 1980s, more small companies are going out of business than are being established one of the reasons being a decade of low or no growth of the Japanese economy.

New understanding and objectives of SME policy

For decades, government viewed SME as weak economic actors. According to the ‘dual-economy concept’ large enterprises were seen to be modern and efficient with great managerial and financial resources, while small firms were thought to be unproductive entities lacking sufficient management skills and financial backing to compete in the modern economy.

In line with this, the main objective of the SME Basic Law of 1963 was to close the productivity gap between small and large enterprises and correct the differences between SME and large enterprises. To this end, a complex mix of financial and non-financial instruments was developed to support the modernization of facilities, improvement of technology and business management, optimization of corporate scale as well as the development of intensive subcontracting relationships between large companies and SME. At the same time, in order to improve their chances of survival, a complex policy for protecting SME was introduced, namely a bankruptcy-prevention policy and a policy to protect SME from unfair business practices by large enterprises.

In the 1990s, as a reaction to the prolonged economic crisis and the new challenges posed by the globalization of the economy, a new understanding of the role of SME in the Japanese economy emerged. As is reflected in the 1999 revision of the SME Basic Law of 1963, the main objective of SME policy has become to develop a wide range of independent SME for greater economic vitality and as a source of dynamism.

Main policies are aiming at promoting business start-ups, business innovation and management, supporting self-help efforts of businesses and strengthening the role of SME as part of regional economies. At the same time, more emphasis will be placed on promoting market competition, deregulation and creating a conducive environment for SME and the private sector development in general. Also, increased efforts will be undertaken to evaluate the effectiveness of SME policies and programs.

Regulatory reforms have in fact been prominent on Japan’s political agenda since the mid-1990s. The goals are ambitious: to move from a model of state-led growth to a model characterized by a more efficient and flexible economy in which the role of the government is diminished and structural change driven by market forces. Although progress has been made, success was mainly achieved in areas in which consensus could easily be reached. Vested interests and resistance to reform in key areas are still very strong. Accordingly, an enormous amount of work has still to be done to achieve a fundamental revision of the regulatory system.
Strong legal base for SME development: There are more than 30 SME-related laws reflecting the tendency of the government to codify nearly all aspects of SME development: There are laws that establish the ‘rules of the game’, define the roles of different stakeholders in SME development, and laws that provide the basis for both financial and non-financial support programs.

**Institutional set-up for SME policy design and implementation**

Japan’s institutional set-up is characterized by a clear division of authorities between the central and local governments as defined in the Constitution.

The central government plays a dominant role in both SME policy design and implementation. Private sector participation in policy design is, however, institutionalized and intensive. Private sector organizations have a strong role on their own as well.

The key body of the central government is the Ministry of Economy, Trade and Industry (METI), i.e. the former MITI.

- METI’s mandate covers a broad range of areas, namely international trade / global environment, industry, SME, information technology, consumer protection, natural resources and energy. To ensure public participation in policy design, numerous councils have been set up as advisory bodies to the ministry.

- SME policies are mainly formulated by the Small and Medium Enterprise Agency under METI. For example, the Agency, assisted by the attached Small and Medium Enterprise Policy Making Council, was responsible for reviewing the 1963 SME Basic Law and the drafting of the new law.

The various policies are mainly implemented through special corporations, SME organizations and local administrations leading to a highly decentralized system of SME promotion.

To implement policies and programs at regional level, METI’s is operating regional bureaus in eight locations that cooperate closely with both public and private bodies at the regional and local levels. Specific SME support programs are implemented or overseen, in addition, by a number of government-affiliated institutions. Among the key institutions or schemes are

- the Japan Small and Medium Enterprise Corporation (JASMEC) that is running both financial and non-financial support schemes. These comprise among others: (i) management guidance, (ii) promotion of business start-ups, (iii) management training, (iv) information services, (y) support of internationalization of SME, and (vi) schemes for credit insurance and the prevention of bankruptcies,

- the National Association for Promotion of Subcontracting Enterprises which has been established in each prefecture to ensure smooth subcontracting operations,

- the SME Evaluation System (SHINDAN) which analyses the performance of SME, and presents concrete measures to improve business performance,

- the Japan External Trade Organization (JETRO). Operating under the general supervision of METI, the primary functions of JETRO are to (i) provide information on foreign economies, (ii) promote imports into Japan, (iii) assist regional economies and SME to internationalize, and (iv) to promote domestic and foreign direct investments.

- some six major institutions or schemes set up to meet the financing needs of SME in such fields as investment financing, R&D financing, and credit insurance and guarantees.
**Strong role of private sector organizations**

Private sector organizations with their strong roots at the local level play an important role in SME development: Key institutions are:

The **Japan Chamber of Commerce and Industry** (JCCI) groups some 560 local chambers many of which having a tradition of more than hundred years. About 5,500 business consultants have been placed at the local chambers.

The **National Federation of Small Business Associations** with its 47 branches operates on its own initiative and under the guidance of the central government. Activities of the associations are wide-ranging involving about a thousand guidance officers stationed around the nation.

**Commerce and Industry Trade Associations** group companies in the same business and engage, among others in the following activities: proposing improved regulations, coordinating management rationalization programs and providing guidance and training.

**J-SMECA**, the Japan Small and Medium Enterprise Management Consultants Association: It has 47 branches with about 7,000 members that are providing advisory services for a broad range of business fields. J-SMECA cooperates closely with the central and municipal governments. Its main mission is to assist members in sharing their knowledge and expertise by building a consulting support system. To become a certified member, applicants must pass an examination that includes field consultancy. Registration has to be renewed every 5 years and depends on the consultant's performance.

In addition, almost every profession has a national association. However, of the more than 12,000 associations, only a limited number can be regarded as professional organizations. Even so, all major industries have at least one highly professional association such as the Japan Electronics and Information Technology Industries Association, the Japan Machinery Federation or the Japanese Apparel Industry Council. All of them provide a wide range of services to their members and also play an important role in shaping sectoral policies of the government. While these associations are clearly dominated by large enterprises, many of their services are also relevant for SME, namely the on-line information services.

**Reforms of local governance**

Regional and local autonomy is clearly defined in the Constitution and the Local Autonomy Law. Major authorities include (1) the local police, (2) social welfare, health, (3) local development including city planning and water supply; (4) local business development, (5) basic education, and (6) environmental protection.

The Local Autonomy Law requires every Japanese municipality to draw up a series of development plans with different time horizons including an annual ‘implementation plan’. **Stakeholder participation** in the planning process is extensive.

Although, in principle, regional and local governments have wide discretion over their development, local autonomy is greatly constrained because of limited local taxation rights resulting in a weak financial base. Of the total tax income available to prefectures and municipalities, nearly 70% are financed by the central government that links most of the transfers to the execution of national programs. As this practice has led to a fairly uniform and centralized system that stifles local vitality and individuality, a process of reforming the current system has been initiated from the mid-1990s. However, progress is very slow and implementation of major reforms cannot be expected in the near future.
**Substantial changes of the Japanese development model under way**

The perceived Japanese development model has two main parts. On the government side, Japanese industrial policy was long viewed as a new best practice to the management of the economy. On the corporate side, the Japanese management system was seen as a new and better way of managing companies and business networks. However, both parts of the development model - that served Japan so well until the late 1980s or so - have become under close scrutiny both internally and externally.

In view of the weaknesses of the first part of the development model that became apparent in the early 1990s at the latest, Japan is placing increased emphasis on both regulatory reforms (stronger role of market forces to drive structural change) and decentralization reforms that focus on giving more authorities to the regions. However, progress in both areas is fairly slow as vested interests and resistance to reform are strong.

As regards the second part of the model, there are clear indications that major components of the model of industrial organization, namely the tightly knit subcontracting (keiretsu) networks between large firms and SME are undergoing drastic market- and technology-driven changes. For example, a study by the Small and Medium-Size Enterprise Agency of 1996 reported that the share of companies strengthening ties with current suppliers had dropped to half of previous levels.

As main reasons have been identified: (i) intensification of global competition that forced a fundamental re-evaluation of the role of parts procurement, (ii) growing use of information technology that placed limits on the traditional practice of fostering technology development within the traditional supplier-manufacturer relationships, and (iii) the difficulties to pursue distinctive corporate strategies given the pressures to serve highly diverse needs of a large number of inter-related companies. Accordingly, continuation of the ongoing transformation of the Japanese economy from one based on ‘Keiretsu closed network organization’ to a more ‘open network of firms’ will be essential to revitalize the Japanese economy and industry.

**Issues for Indonesia**

As would apply to any other country study, the institutional arrangements, basic and specific policies and instruments of Japan for promoting SME development cannot be transferred one to one to Indonesia. This is the more so as there cannot be just one ‘correct’ interpretation given the complexity of the Japanese model. Therefore, the systemic changes of the Japanese development model under way need further careful study. But it is perhaps fair to list the following issues that deserve special attention:

(1) In line with the trends within developed and most developing economies, deregulation, as a means to enhance market forces to drive structural change, and decentralization as a means to empower local economies rank high on the political agenda. However, a broader consensus among key stakeholders with regard to scope and speed of the necessary reforms still needs to be developed.

(2) Weaknesses in overall economic management and delayed regulatory and structural reforms cannot be compensated through even the most comprehensive financial and non-financial support structures for SME.

(3) The move from a SME development concept that long viewed SME as weak economic actors and contained many protective policies and instruments to a concept that views SME a source of dynamism and aims at a more market-friendly and focused approach of direct support to SME through public and private organizations is well in line with recent international trends. Combined with increased efforts to improve the evaluation of the effectiveness of support programs, a leaner and more effective concept of SME development could emerge over time.
(4) **Participation of private sector and other stakeholders** in SME policy design and implementation is institutionalized and strong both at the national and local level, and complemented by many informal communication channels. Moreover, private sector organizations with their strong roots at the local level play a very important role in the delivery of support services to SME.

(5) To revitalize the SME sector, traditional business partnership and linkage and cluster development concepts are being adjusted to reflect new economic realities resulting from increased competition in both the domestic and international markets, and rapid technological advances.
V. RINGKASAN EKSEKUTIF

Peran UKM dalam Ekonomi Jepang

Pada umumnya, UKM didefinisikan sebagai perusahaan yang mempunyai kurang dari 300 pekerja di sektor manufaktur atau kurang dari 100 pekerja di sektor perdagangan grosir dan jasa. Jumlah perusahaan UKM mencakup lebih dari 99% semua perusahaan; menyerap 72% lapangan kerja dengan omzet 42% dari seluruh sektor ekonomi atau omzet 52% di sektor manufaktur.

Namun demikian, kontribusi UKM hanya sekitar 28% dari total ekspor tetapi dapat lebih tinggi, apabila ekspor tidak-langsung ikut diperhitungkan (tidak tersedia data yang dapat diandalkan). Produktivitas tenaga kerja UKM juga rendah, yaitu hanya sekitar 50% dari perusahaan besar. Keadaan ini semakin parah dengan kondisi ekonomi Jepang yang menurun sejak akhir 1980-an, dalam dasawarsa terakhir bahkan makin rendah dan berhenti tumbuh dengan akibat lebih banyak perusahaan yang tutup daripada pendirian yang baru.

Pemahaman baru dan sasaran kebijakan UKM

Selama puluhan tahun, pemerintah melihat UKM sebagai pelaku ekonomi lemah. Menurut ‘konsep ekonomi-ganda’, perusahaan besar tampak modern dan efisien dengan sumberdaya manajemen dan finansial sedangkan perusahaan kecil dianggap sebagai usaha yang tidak produktif, kekurangan ketrampilan manajerial dan sumberdaya finansial untuk bersaing di ekonomi yang modern.

Berdasarkan hal-hal diatas, tujuan utama Undang-undang UKM tahun 1963 (SME Basic Law) ialah untuk mengurangi kesenjangan produktivitas dan memperbaiki perbedaan antara perusahaan besar dan UKM. Untuk mencapai tujuan ini, sejumlah instrumen campuran finansial dan non-finansial yang rumit dikembangkan untuk mendukung modernisasi fasilitas, perbaikan teknologi dan manajemen bisnis, optimasi pada skala korporasi maupun pengembangan hubungan sub-kontrak yang intensif antara perusahaan besar dan UKM. Pada saat bersamaan, untuk memperbesar kemungkinan daya-hidup perusahaan UKM, dibuat suatu kebijakan yang kompleks untuk melindungi UKM, yaitu kebijakan untuk menghindari UKM jatuh pailit dan suatu kebijakan perlindungan UKM terhadap praktik bisnis tidak sehat oleh perusahaan besar.


Kebijakan-kebijakan utama bertujuan untuk promosi pendirian usaha-usaha baru, inovasi usaha dan manajemen, mendukung usaha kemandirian, dan penguatan peran UKM sebagai bagian dari ekonomi regional. Pada saat bersamaan, diutamakan promosi persaingan pasar, deregulasi dan penciptaan lingkungan yang kondusif untuk pengembangan UKM dan sektor swasta secara umum. Demikian pula akan dilakukan peningkatan upaya untuk menilai efektivitas kebijakan dan program UKM.

Reformasi pengaturan ternyata merupakan hal yang menonjol dalam agenda politik Jepang sejak pertengahan tahun 1990-an. Tujuannya ambisius: membuat perubahan dari suatu model pertumbuhan yang dikendalikan pemerintah menuju suatu model ekonomi yang bersifat lebih efisien dan lentur dimana peran pemerintah berkurang dan perubahan

**Dasar hukum yang kuat untuk pengembangan UKM:** terdapat lebih dari 30 undang-undang yang berkaitan dengan UKM dengan kecenderungan pemerintah untuk mengkodifikasi hampir semua aspek pengembangan UKM, yaitu undang-undang yang menentukan 'aturan bermain', mendefinisikan peran para stakeholder yang berbeda dalam rangka pengembangan UKM, dan undang-undang yang menjadi dasar program-program dukungan finansial dan non-finansial.

**Penataan kelembagaan untuk perumusan dan pelaksanaan kebijakan UKM**

Sesuai ketentuan Konstitusi Jepang, penataan kelembagaan menunjukkan secara jelas pembagian wewenang antara pemerintah pusat dan daerah.

**Pemerintah pusat** mempunyai peran yang dominan baik dalam perumusan maupun pelaksanaan kebijakan UKM. Namun demikian, partisipasi sektor swasta dalam perumusan kebijakan telah dilembagakan dan intensif. Organisasi sektor swasta memang mempunyai peran yang kuat.

Lembaga kunci pemerintah pusat ialah Menteri Ekonomi, Perdagangan dan Industry (METI), dahulu disebut MITI.

- Mandat METI mencakup bidang yang luas, yaitu perdagangan internasional / lingkungan global; industri; UKM; teknologi informasi; perlindungan konsumen, sumberdaya alam dan energi. Untuk menjamin partisipasi publik dalam perumusan kebijakan, berbagai dewan dibentuk sebagai penasihat untuk kementerian tersebut.
- Kebijakan UKM terutama dirumuskan oleh Lembaga Perusahaan Kecil dan Menengah (Small and Medium Enterprise Agency) dibawah METI. Misalnya, dengan bantuan Dewan Perumus Kebijakan UKM (yang berada dibawah lembaga), maka lembaga tersebut bertanggung jawab atas pengkajian ulang Undang-Undang UKM thn 1963 dan perumusan Rancangan Undang-Undang yang baru.

Berbagai kebijakan tersebut diatas dilaksanakan terutama oleh perusahaan-perusahaan khusus, organisasi UKM dan pemerintah daerah yang menunjukkan adanya suatu sistem desentralisasi yang kuat untuk promosi UKM:

Untuk pelaksanaan kebijakan dan program pada tingkat regional, METI mengoperasikan biro-biro di delapan lokasi yang bekerja-sama erat dengan badan-badan pemerintah maupun organisasi swasta pada tingkat regional dan daerah. Disamping itu, program-program khusus dukungan UKM dilaksanakan atau diawasi oleh sejumlah lembaga yang terkait dengan pemerintah. Lembaga-lembaga atau skema kunci tersebut, antara lain, ialah:

- The Japan Small and Medium Enterprise Corporation (JASMEC) yang melaksanakan skema dukungan finansial maupun non-finansial. Hal ini terdiri, antara lain: (i) pedoman manajemen; (ii) promosi usaha baru; (iii) pelatihan manajemen; (iv) jasa informasi; (v) dukungan internationalisasi UKM; dan (vi) skema asuransi kredit dan pencegahan pailit.
- The National Association for Promotion of Subcontracting Enterprises yang didirikan di setiap provinsi (prefecture) untuk menjamin kelancaran pelaksanaan subkontrak.
The SME Evaluation System (SHINDANI) yang membuat analisa kinerja UKM dan menawarkan langkah-langkah konkret untuk memperbaiki kinerja berusaha.

The Japan External Trade Organization (JETRO). Bekerja dibawah pengawasan umum METI, maka fungsi utama JETRO ialah (i) menyediakan informasi tentang ekonomi luar negeri; (ii) promosi import ke Jepang; (iii) membantu ekonomi regional dan internasionalisasi UKM; dan (iv) promosi investasi langsung domestik dan asing.

Pendirian enam lembaga atau skema utama untuk memenuhi kebutuhan pembiayaan UKM antara lain, dalam bidang-bidang: pembiayaan untuk investasi, pembiayaan untuk Litbang, asuransi kredit dan jaminan kredit.

Peran kuat organisasi sektor swasta
Organisasi sektor swasta yang mengakar kuat di daerah mempunyai peran penting dalam pengembangan UKM. Lembaga-lembaga kunci ialah:

**The Japan Chamber of Commerce and Industry (JCCI)** dengan sekitar 560 cabang di daerah, banyak diantaranya dengan tradisi lebih dari satu abad. Sekitar 5.500 konsultan usaha ditempatkan di JCCI daerah.

**The National Federation of Small Business Association** dengan 47 cabang bekerja atas initiated sendiri dengan pedoman pemerintah pusat. Aktivitas asosiasi-asosiasi ini sangat luas, melibatkan sekitar seribu pendamping diseluruh negeri.

**Commerce and Industry Trade Association** yang mengelompokkan perusahaan-perusahaan sejenis dan mempunyai kegiatan sebagai berikut: mengusulkan perbaikan peraturan; mengkoordinasi program-program rasionalisasi manajemen dan menyediakan pedoman dan pelatihan.


**Reformasi pemerintahan daerah**
Konstitusi dan Undang-undang Otonomi Daerah secara jelas telah mendefinisikan otonomi regional dan daerah. Otoritas utama meliputi (1) kepolisian daerah; (2) kesejahteraan sosial dan kesehatan; (3) pengembangan daerah termasuk perencanaan tata kota dan penyediaan air minum; (4) pengembangan usaha daerah; (5) pendidikan dasar, dan (6) perlindungan lingkungan.
Undang-undang Otonomi Daerah mewajibkan setiap kotamadya untuk menyusun perencanaan pengembangan kota dengan berbagai batasan waktu termasuk suatu 'rencana pelaksanaan' tahunan. Partisipasi stakeholder dalam proses perencanaan sangat luas.

Walaupun secara prinsipil pemerintah regional dan daerah mempunyai wewenang luas dalam pengembangan daerah, otonomi daerah mempunyai hambatan besar karena pembatasan dalam hak penentuan pajak lokal dengan akibat pada sumber anggaran daerah yang lemah. Dari seluruh penghasilan pajak yang tersedia untuk semua provinsi dan kotamadya, hampir 70% dibaiayai oleh pemerintah pusat yang mengkaitkan alokasi dana dengan pelaksanaan program-program nasional. Sementara prosedur ini telah mengakibatkan pembentukan suatu sistem standar dan terpusat yang melumpuhkan kemampuan dan hal-hal khas daerah, suatu proses untuk reformasi sistem tersebut telah dimulai sejak pertengahan tahun 1990. Namun demikian, kemajuan proses tersebut sangat lambat dan pelaksanaan reformasi besar tidak dapat diharapkan terjadi dalam waktu yang singkat.

Proses pengembangan perubahan mendasar model pembangunan Jepang


Menarik kelemahan-kelemahan bagian pertama dari model pembangunan yang mulai tampak pada awal tahun 1990-an, Jepang telah mengutamakan dua reformasi pengaturan (peran lebih kuat kekuatan pasar untuk mendorong perubahan struktural) dan reformasi desentralisasi dengan fokus pada pelimpahan lebih banyak wewenang ke daerah. Namun demikian, kemajuan di kedua bidang tersebut sangat lambat karena hambatan yang kuat dari kepentingan yang tertanam dan perlawanan terhadap perubahan.

Menarik bagian kedua dari model diatas, terdapat indikasi jelas bahwa komponen-komponen utama model organisasi industri, yaitu jaringan subkontrak yang ketat (keiretsu) antara perusahaan besar dan UKM mengalami perubahan yang drastis akibat tekanan teknologi dan pasar. Misalnya, suatu studi oleh Small and Medium-Size Enterprise Agency tahun 1996 melaporkan bahwa jumlah perusahaan yang menguatkan hubungan-kerja dengan para pemasok telah menurun hingga separuh dibandingkan dengan tingkat sebelumnya.

Alasan-alasan utama yang sudah dikenali, yaitu: (i) intensifikasi persaingan global yang memaksa pengkajian-ulang mendasar tentang peran pembelian komponen produksi; (ii) pemanfaatan teknologi informasi yang membatasi praktik tradisional dengan teknologi dukungan pengembangan dalam hubungan tradisionil pemasok-pabrikan; dan (iii) kesulitan yang dialami untuk mengikuti strategi korporasi akibat tekanan untuk melayani kebutuhan yang sangat beragam sejumlah besar perusahaan yang saling terkait. Dengan demikian adalah sangat esensial untuk meneruskan proses transformasi ekonomi Jepang dari suatu model berdasarkan 'Keiretsu organisasi jaringan tertutup' menjadi lebih terbuka dengan 'jaringan perusahaan terbuka' untuk menggairahkan kembali ekonomi dan industri Jepang.

Hal-hal yang penting bagi Indonesia

Sebagaimana juga berlaku untuk setiap studi negara manapun, penataan kelembagaan, kebijakan dan instrumen yang mendasar dan khusus Jepang untuk promosi
pengembangan UKM tidak dapat serta merta ditrapkan secara satu per satu di Indonesia. Hal ini lebih menonjol apabila diingat bahwasanya tidak ada hanya satu interpretasi yang ‘benar’ dapat memahami kompleksitas model pembangunan Jepang. Oleh karena itu perubahan-perubahan sistemik model pembangunan Jepang yang sedang berjalan perlu dipelajari dengan cermat sekali. Mungkin dapat dikatakan cukup masuk akal untuk membuat suatu daftar hal-hal yang perlu diperhatikan secara khusus:

1. Sejalan dengan kecenderungan yang terjadi di kebanyakan negara-negara ekonomi yang sudah dan sedang berkembang, deregulasi sebagai alat untuk meningkatkan kekuatan pasar mendorong perubahan struktural, dan desentralisasi sebagai alat untuk memberdayakan ekonomi daerah, memperoleh tempat paling atas dalam agenda politik. Namun demikian, masih harus dikembangkan suatu konsensus luas di antara para stakeholder kunci tentang lingkup dan kecepatan reformasi yang diperlukan.

2. Kelemahan dalam manajemen ekonomi secara keseluruhan dan keterlambatan reformasi pengaturan dan struktural tidak dapat di-imbangi dengan dukungan struktural dan non-finansial yang paling komprehensif sekalipun bagi UKM.

3. Perpindahan dari suatu konsep pengembangan UKM yang sejak lama memandang UKM sebagai pelaku ekonomi lemah dan memuat banyak kebijakan dan instrumen perlindungan ke konsep yang memandang UKM sebagai suatu sumber daya-gerak dinamis dengan tujuan pendekatan yang lebih ramah-pasar dan memfokus dukungan langsung kepada UKM melalui organisasi-organisasi publik dan swasta, memang sudah sejalan dengan kecenderungan internasional saat ini. Digabung dengan peningkatan upaya untuk memperbaiki evaluasi efektivitas program-program dukungan, suatu konsep pengembangan UKM yang lebih ramping dan efektif dapat timbul pada suatu waktu.

4. Partisipasi sektor swasta dan stakeholder lainnya dalam rangka perumusan dan pelaksanaan kebijakan UKM dilengkapi serta berakar kuat pada tingkat nasional dan daerah, yang dilengkapi dengan banyak saluran komunikasi informal. Terlebih pula, organisasi sektor swasta dengan akar kuat di daerah mempunyai peran yang sangat penting dalam penyediaan jasa dukungan bagi UKM.

5. Untuk mengairahkan kembali sektor UKM, konsep-konsep kemitraan usaha tradisional, keterkaitan dan pengembangan kластer perlu disesuaikan kepada realita situasi ekonomi baru sebagai akibat peningkatan persaingan baik di pasar domestik maupun internasional serta kemajuan teknologi yang deras.
1 INTRODUCTION

1.1 Objectives and structure of the case study

The purpose of the case study is to examine the governance structure of Japan, focusing in particular on those aspects of government dealing with SME and private sector development and how the nature of governance has changed over the past two decades. In doing so, the case study seeks to identify major points of interest for Indonesia with respect to the role of government and the private sector in the formulation of national and regional policies for economic development and the promotion of SME.

Structure of the case study

The case is structured in six main sections, of which this introductory section is the first. Section 2 briefly outlines the role and characteristics of SMEs in the Japanese economy. The general nature of SME policy and Japan's initiatives in the field of deregulation are examined in Section 3. Section 4 looks at the structure and functions of the Japanese government at national and local levels, and provides an overview of government support to SMEs as well as the role of the private sector in SME development. In Section 5, the experience of regional development is considered, looking in particular at recent trends in industry cluster development. Major points of interest for Indonesia are presented in Section 6.

Country comparisons

Japan has a population of 127 million and with a gross national income of US$ 4.1 trillion it is the second largest economy in the world. Contrary to widespread belief, Japan's economy largely depends on its domestic market. International trade accounts for only 23% of gross domestic product (GDP). Japan is one of the most densely populated countries in the world and highly urbanized with a particularly strong concentration of economic activity in the greater Tokyo metropolitan area.

1.2 Overview of economic performance

From the mid-1950s until the early 1970s, Japan experienced very high growth rates of GDP and exports, accompanied by low levels of inflation and unemployment and large external surpluses. However, by 1973 domestic macroeconomic policy had resulted in a rapid increase in the money supply, which led to extensive speculation in the real-estate and domestic commodity markets. Japan was already suffering from double-digit inflation when, in October 1973, the outbreak of war in the Middle East led to an oil crisis. Energy costs rose steeply. The consequent recession lowered expectations of future growth resulting in reduced private investment. Economic growth slowed from the 10% level to an average of 3.6% during the period 1974-1979, and 4.4% during the decade of the 1980s. However, by the early 1980s, Japan had caught up already with other OECD countries in terms of per capita GDP.
Figure 1: Comparative national statistics

<table>
<thead>
<tr>
<th>Country</th>
<th>Gross National Income (GNI) (Trillion USD)</th>
<th>Population (Millions) and Population Density (Persons / km²)</th>
</tr>
</thead>
<tbody>
<tr>
<td>USA (1)</td>
<td>8,880</td>
<td>300</td>
</tr>
<tr>
<td>Japan (2)</td>
<td>4,055</td>
<td>12</td>
</tr>
<tr>
<td>Germany (3)</td>
<td>2,104</td>
<td>17</td>
</tr>
<tr>
<td>France (4)</td>
<td>1,453</td>
<td>17</td>
</tr>
<tr>
<td>UK (5)</td>
<td>1,404</td>
<td>17</td>
</tr>
<tr>
<td>Italy (6)</td>
<td>1,163</td>
<td>17</td>
</tr>
<tr>
<td>Indonesia (31)</td>
<td>125</td>
<td>17</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>GDP per capita (USD, Atlas Method)</th>
<th>Surface Area ('000 km²)</th>
</tr>
</thead>
<tbody>
<tr>
<td>USA (8)</td>
<td>31,910</td>
</tr>
<tr>
<td>Japan (7)</td>
<td>32,030</td>
</tr>
<tr>
<td>Germany (13)</td>
<td>25,624</td>
</tr>
<tr>
<td>France (21)</td>
<td>24,170</td>
</tr>
<tr>
<td>UK (23)</td>
<td>23,590</td>
</tr>
<tr>
<td>Italy (29)</td>
<td>20,170</td>
</tr>
<tr>
<td>Indonesia (150)</td>
<td>1,905</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>International Trade (% GDP)</th>
<th>Urbanisation (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>USA</td>
<td>20%</td>
</tr>
<tr>
<td>Japan</td>
<td>23%</td>
</tr>
<tr>
<td>Germany</td>
<td>44%</td>
</tr>
<tr>
<td>France</td>
<td>45%</td>
</tr>
<tr>
<td>UK</td>
<td>35%</td>
</tr>
<tr>
<td>Italy</td>
<td>12%</td>
</tr>
<tr>
<td>Indonesia</td>
<td>12%</td>
</tr>
</tbody>
</table>
From the early 1990s to the present, the Japanese has gone through a decade of very slow growth with dramatic declines in investments and huge budget deficits and growing public debt.

Figure 2:  

Japan - GDP Growth Rates, 1956 - 2000

Source: METI

While some observers still see the decline of the Japanese economy as a kind of prolonged negative business cycle, most analysts agree that Japan's economic problems are more deeply rooted, the collapse of the so-called bubble economy being the symptom rather than the cause. The main reasons are seen to be poor management of monetary, financial, banking and social security institutions, over-regulation and delayed regulatory reforms, and slow adjustments of corporate strategies of both large and small and medium scale enterprises to changing economic and technological framework conditions (Porter 2000.)
2 CHARACTERISTICS OF SME

2.1 Tracing the roots of SME development

Japan’s economic development can roughly be divided into two phases: the period of pre-modern transition under the feudal Tokugawa rule from 1603 to 1868, and the Meiji restoration era from 1868 to 1911, a period characterized by the opening up of the economy and the start of industrial development supported by technology imports from western nations.

SME were an important part of Japan's economic development almost from the start of the modern period. While small retail shops were quite numerous in the Meiji era (1868-1911), their manufacturing counterparts only began to emerge in large numbers in the period following World War I. These firms processed raw materials into finished consumer goods for sale domestically and for export. They often were part of production networks known as the old tonya system. Tonya were mercantile capitalists who outsourced processing to less skilled labor in the poorer districts of big cities or to part-time farmers, even sometimes to master craftsmen working with apprentices in what primarily were craft industries. The tonya also began to organize the production of machinery and other manufactured goods by small subcontractors. The "new tonya" type of manufacturer often owned factories that would handle more sophisticated production processes and then assemble the final product. Like the large industrial firms that emerged in the postwar period, these producers frequently provided credit, technical advice, tools and other machinery to their subcontractors (Cole 1958).

The modern industry of Japan did not develop before the 1930s, the leading sector initially being not large heavy industries but labor-intensive textile industries (especially silks). The production units were rather small, private capital was dominant, and interestingly, the role of government and banks modest and mostly indirect (Smith 1988). Thus, in this period it was the market mechanism that led SME development.

This is not to say, however that large enterprises were not important in the early phases of Japan’s economic development. Quite to the contrary, in particular after the Meiji restoration (1868), large family-controlled banking and industrial groups emerged known as ‘Zaibatsu’ (literally "financial cliques"). Supported by subsidies and a favorable tax policy, the new government granted them a privileged position. Among the most important Zaibatsu were Mitsui, Mitsubishi, Dai Ichi Kangyo, Sumitomo, Sanwa, and Fuyo. Later they helped finance strategic semi-public enterprises in Japan and abroad, particularly in Taiwan and Korea. By 1937, the four leading Zaibatsu controlled directly one third of all bank deposits, one third of all foreign trade, one half of Japan's shipbuilding and maritime shipping, and most of the heavy industries.

After Japan's surrender in 1945, the US ordered the break-up of the Zaibatsu. But from the mid-1950s, the same groups re-emerged as Keiretsu, i.e. large groups bound together by webs of cross-shareholdings, preferential lending, supply, distribution and close intra-group transactions including intensive long-term sub-contractor relationships with hundreds and sometime thousands of small and medium-sized ‘Keiretsu Suppliers’ which became the core group within Japanese SME.
2.2 Definitions

Japan adopted a legal SME definition in 1963. The definition, included in the Basic SME Law of 1963 used two criteria - employment and capital size - and varied according to sectors. In 1999, the SME definition was slightly changed to reflect changes in the economic environment.

Figure 3: *Definition of SME in the new SME Basic Law of 1999*

<table>
<thead>
<tr>
<th>New Law</th>
<th>Manufacturing</th>
<th>Wholesale</th>
<th>Retail</th>
<th>Service</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Below 300 workers</td>
<td>Below 100 workers</td>
<td>Below 50 workers</td>
<td>Below 100 workers</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Old Law</th>
<th>Manufacturing</th>
<th>Wholesale</th>
<th>Retail</th>
<th>Service</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Below 300 workers</td>
<td>Below 100 workers</td>
<td>Below 50 workers</td>
<td>Below 50 workers</td>
</tr>
</tbody>
</table>

C: capitalization

Source: Small and Medium Enterprise Agency, METI

The definition of small enterprises uses the employment criterion only and has been taken over unchanged from the previous SME Basic Law. In manufacturing, the upper limit is 20 employees, and in commerce and services 5 employees.

2.3 Role of SME in the Japanese economy

Over the last 50 years (1947 - 1996), the number of establishments has increased by nearly 4 million from 2.7 million to 6.5 million.

Figure 4: *Number of Establishments, 1947 -1996*

Notes: 1. SMEs are defined as establishments employing fewer than 300 people (fewer than 100 in wholesale and 50 in retail and service sectors), 2. Data represent all non-primary industries, excluding agriculture, forestry, and fisheries. The same applies in all tables below.

Source: Management and Coordination Agency, "Census of Japanese Establishments"

Today, SME account for 99.7% of all enterprises, 72% of employment, 42% of turnover across all economic sectors, and 52% of turnover in manufacturing. The share of SME in total exports is, however, only around 28% but would be higher if indirect exports (no reliable estimates available) were included. Labor productivity of SME is also low, i.e. only 50% of large enterprises.
Since the late 1980s, the number of enterprises has ceased to grow one of the reasons being a decade of low or no growth of the Japanese economy.

Figure 5:  *Japan - Number of Establishments in Non-primary Industries, 1963 - 1996*

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>SME</td>
<td>3,883,573 (99.6%)</td>
<td>5,083,270 (99.4%)</td>
<td>6,229,572 (99.4%)</td>
<td>6,448,123 (99.3%)</td>
<td>6,571,942 (99.2%)</td>
<td>6,484,296 (99.1%)</td>
<td>6,470,532 (99.1%)</td>
<td>6,433,942 (98.9%)</td>
</tr>
<tr>
<td>Large enterprises</td>
<td>16,605 (0.4%)</td>
<td>30,453 (0.6%)</td>
<td>39,499 (0.6%)</td>
<td>46,218 (0.7%)</td>
<td>50,304 (0.8%)</td>
<td>57,445 (0.9%)</td>
<td>61,448 (0.9%)</td>
<td>69,367 (1.1%)</td>
</tr>
<tr>
<td>Total</td>
<td>3,900,178</td>
<td>5,113,723</td>
<td>6,269,071</td>
<td>6,622,246</td>
<td>6,541,741</td>
<td>6,531,980</td>
<td>6,502,924</td>
<td></td>
</tr>
</tbody>
</table>

Source: Small and Medium Enterprise Agency, METI

Figure 6:  *Number of Enterprises and Employees by Enterprise Scale and Sectors, 1996*

<table>
<thead>
<tr>
<th></th>
<th>No. of SME</th>
<th>%</th>
<th>No. of LE</th>
<th>SME Employees</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Construction</td>
<td>646,954</td>
<td>99.9</td>
<td>402</td>
<td>5,527,373</td>
<td>95.7</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>767,542</td>
<td>99.4</td>
<td>4,249</td>
<td>9,575,970</td>
<td>74.1</td>
</tr>
<tr>
<td>Wholesale and retailing</td>
<td>2,804,551</td>
<td>99.1</td>
<td>24,046</td>
<td>15,146,015</td>
<td>83.2</td>
</tr>
<tr>
<td>Services</td>
<td>1,640,228</td>
<td>97.2</td>
<td>39,323</td>
<td>8,449,050</td>
<td>61.2</td>
</tr>
<tr>
<td>Other</td>
<td>574,282</td>
<td>99.8</td>
<td>1,347</td>
<td>5,794,168</td>
<td>87.3</td>
</tr>
<tr>
<td>Non-primary industries, total</td>
<td>6,433,557</td>
<td>98.8</td>
<td>69,367</td>
<td>44,492,576</td>
<td>77.6</td>
</tr>
</tbody>
</table>

(1) Establishments with a work force of less than 300 employees (or less than 100 employees in wholesale and less than 50 employees in retail and service trades) are classified as SME.

(2) Source: Management and Coordination Agency, Business Establishment Census of Japan

According to data provided by the Small and Medium Enterprise Agency, business closure rates have exceeded start-up rates already since 1986, a development that has been particularly pronounced in the manufacturing sector. These data clearly indicate that the SME sector is in a difficult situation that is further aggravated by the fact that investment by SME in the manufacturing sector has drastically been reduced since the early 1990s.
Figure 7:  Change in Start-up and Closure Rates (non-primary industries), 1969-1996

Figure 8:  Change in Start-up and Closure Rates in Manufacturing, 1969 - 1996

Figure 9:  Annual Change in Investment by Small & Medium Manufacturers, 1980 - 1998
According to a survey carried out by the National Federation of Small Business Associations in December 1997, the main problems of SME in the manufacturing sector are decrease of demand, competition among small and medium enterprises, shortage of human resources, high labor cost, difficulties to charge adequate prices for finished goods, strict transaction conditions for subcontractors, and low levels of technology and marketing skills.

Figure 10: Problems of SME in Manufacturing

<table>
<thead>
<tr>
<th>No.</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Decrease of demands or poor sales</td>
</tr>
<tr>
<td>2</td>
<td>Competition among small and medium enterprises</td>
</tr>
<tr>
<td>3</td>
<td>Shortage of human resources</td>
</tr>
<tr>
<td>4</td>
<td>High labor cost</td>
</tr>
<tr>
<td>5</td>
<td>Difficulty in higher quotation for finished goods and selling price</td>
</tr>
<tr>
<td>6</td>
<td>Strict transaction conditions for subcontractor</td>
</tr>
<tr>
<td>7</td>
<td>Low levels of technology and selling</td>
</tr>
<tr>
<td>8</td>
<td>High rises in raw materials and stock in trade</td>
</tr>
<tr>
<td>9</td>
<td>Labor shortage</td>
</tr>
<tr>
<td>10</td>
<td>Competition with large enterprises</td>
</tr>
<tr>
<td>11</td>
<td>Deregulation</td>
</tr>
<tr>
<td>12</td>
<td>Stringency in the money market</td>
</tr>
<tr>
<td>13</td>
<td>Overseas shift of business connection</td>
</tr>
<tr>
<td>14</td>
<td>Superfluous personnel</td>
</tr>
<tr>
<td>15</td>
<td>Exchange loss</td>
</tr>
</tbody>
</table>

Note: Number of surveyed firms: 22,216
Source: National Federation of Small Business Associations, December 1997

Even so, it must not be overlooked that Japanese SME are not a homogenous group. For example, there is a large number of SME engaged in R&D (MITI 2000). As of 1997, 37% of SME (LE: 74%) in the manufacturing sector carried out R&D activities, i.e. 28% of the SME with less than 100 employees and 44% of the SME with 100 and less than 300 employees. And as a share of turnover, innovative SME on average spent around 1.7% on R&D (LE: 2.4%).
3 GENERAL UNDERSTANDING OF SME POLICY

3.1 Emerging new understanding and focus of SME policy

For decades, government viewed SME as weak economic actors. According to the ‘dual-economy concept’ large enterprises were seen to be modern and efficient with great managerial and financial resources, while small firms were thought to be unproductive entities lacking sufficient management skills and financial backing to compete in the modern economy.

In line with this, the main objective of the SME Basic Law of 1963 was to close the productivity gap between small and large enterprises and correct the differences between SME and large enterprises. To this end, a complex mix of financial and non-financial instruments was developed to support the modernization of facilities, improvement of technology and business management, optimization of corporate scale as well as the development of intensive subcontracting relationships between large companies and SME. At the same time, in order to improve their chances of survival, a complex policy for protecting SME was introduced, namely a bankruptcy-prevention policy and a policy to protect SME from unfair business practices by large enterprises.

In parallel, the government implemented its income-doubling plan designed in December 1960 which set a goal of 7.8% annual growth during the decade 1961-1970. Major objectives of this plan were to broaden and deepen the industrial base, improve the distribution of wealth between large and small firms, and reduce regional disparities. Major policy fields were infrastructure development, export promotion, human resource and technology development. In terms of its quantitative target, the plan proved exceedingly successful: by 1968, national income had doubled, achieving an average annual growth rate of 10%.

In the 1990s, as a reaction to the prolonged economic crisis and the new challenges posed by the globalization of the economy, a new understanding of the role of SME in the Japanese economy emerged. As is reflected in the 1999 revision of the SME Basic Law of 1963, the main objective of SME policy has become to develop a wide range of independent SME for greater economic vitality and as a source of dynamism. In other words, there is a recognition that the ‘dual structure theory’ no longer applies and that SME are able to play an important role as a seed-bed of market competition, and as players in innovation, in the generation of attractive employment opportunities and in the development of local economies.

Main policies are aiming at promoting business start-ups, business innovation and management, supporting self-help efforts of businesses and strengthening the role of SME as part of regional economies. At the same time, more emphasis will be placed on promoting market competition, deregulation and creating a conducive environment for SME and the private sector development in general.

3.2 Increased emphasis on deregulation

The economic malaise of the 1990s has revealed fundamental structural problems of the Japanese economy and the need for regulatory reform. In fact, regulatory reform has been prominent on Japan’s political agenda since the government promoted deregulation as key to economic recovery in 1994, and has been a central element in the broad economic structural reform program underway since December 1996. The goals of regulatory reform are ambitious: to complete the move from a model of state-led growth -- in which interventionist styles of regulation were used for decades to manage high economic growth, carry out deep structural reform, and promote producer interests - to a
model of market-led growth characterized by a more efficient and flexible economy in which the role of the government is diminished. The government has described such a society as one in which personal choice and initiative increase, consumer interests take higher priority, structural change is driven by market pressures, and domestic markets are more open to international competition (OECD 1999).

To promote deregulation, an Administrative Reform Commission was set up in December 1994 and a Deregulation Subcommittee (DC) in April 1995. In April 1999, DC was reinforced and reorganized into the Regulatory Reform Committee (RRC) under the Cabinet Headquarters for the Promotion of Administrative Reform (HQPAR).

Figure 11: Regulatory Reform in Japan

<table>
<thead>
<tr>
<th>Date</th>
<th>Event Description</th>
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</thead>
<tbody>
<tr>
<td>December 19, 1994</td>
<td>Administrative Reform Commission (ARC) inaugurated. (ARC’s Deregulation Subcommittee inaugurated on April 19, 1995.)</td>
</tr>
<tr>
<td>March 31, 1995</td>
<td>Cabinet decided &quot;Programme for Promoting Deregulation&quot; (addressing 1,091 measures in 11 areas).</td>
</tr>
<tr>
<td>December 14, 1995</td>
<td>ARC submitted its &quot;First Report on Deregulation&quot;.</td>
</tr>
<tr>
<td>March 29, 1996</td>
<td>Cabinet decided &quot;Programme for Promoting Deregulation (revised)&quot; (addressing 1,797 measures in 11 areas).</td>
</tr>
<tr>
<td>December 16, 1996</td>
<td>ARC submitted its &quot;Second Report on Deregulation&quot;.</td>
</tr>
<tr>
<td>March 28, 1997</td>
<td>Cabinet decided &quot;Programme for Promoting Deregulation (further revised)&quot; (addressing 2,823 measures in 12 areas).</td>
</tr>
<tr>
<td>December 12, 1997</td>
<td>ARC submitted its &quot;Final Report&quot;.</td>
</tr>
<tr>
<td>December 18, 1997</td>
<td>ARC’s term of office ended.</td>
</tr>
<tr>
<td>December 20, 1997</td>
<td>Cabinet decided &quot;On the Promotion of Deregulation&quot;.</td>
</tr>
<tr>
<td>February 5, 1998</td>
<td>Deregulation Committee (DC) of the Cabinet Headquarters for the Promotion of Administrative Reform (HQPAR) inaugurated.</td>
</tr>
<tr>
<td>March 31, 1998</td>
<td>Cabinet decided &quot;Three-Year Programme for Promoting Deregulation &quot; (addressing 624 measures in 15 areas).</td>
</tr>
<tr>
<td>December 15, 1998</td>
<td>DC submitted its &quot;First Report on Deregulation&quot;.</td>
</tr>
<tr>
<td>December 18, 1998</td>
<td>HQPAR decided &quot;to incorporate the contents of DC’s First Report in the coming revision of the Three-Year Programme&quot;.</td>
</tr>
<tr>
<td>March 30, 1999</td>
<td>Cabinet decided &quot;Three-Year Programme for Promoting Deregulation (revised) &quot; (addressing 917 measures in 15 areas)</td>
</tr>
<tr>
<td>April 6, 1999</td>
<td>Deregulation Committee (DC) reinforced and reorganised into Regulatory Reform Committee (RRC).</td>
</tr>
<tr>
<td>December 14, 1999</td>
<td>RRC submitted its &quot;Second Report on Regulatory Reform&quot;.</td>
</tr>
<tr>
<td>December 14, 1998</td>
<td>HQPAR decided &quot;to incorporate the contents of RRC’s Second Report in the coming further revision of the Three-Year Programme&quot;.</td>
</tr>
<tr>
<td>March 31, 2000</td>
<td>Cabinet decided &quot;Three-Year Programme for Promoting Deregulation (further revised) &quot; (addressing 1,268 measures in 16 areas).</td>
</tr>
</tbody>
</table>

Source: Regulatory Reform Committee

The latest program, the ‘Three-Year Program for Promoting Deregulation’ of March 2000 was revised in early 2001 and covers now 554 deregulatory items in 15 areas such as
information technology, education and the environment but still avoids the proposed dismantling of Nippon Telegraph & Telephone Corp, the holding-company structure of telecommunications giant.

Meanwhile, the progress of regulatory reforms is being constantly monitored. According to a report released by the Economic Planning Agency in January 2000, deregulation in eight areas - including telecommunications, civil aviation, vehicle inspections, electricity, gasoline and stock trading brokerage fees -- has already resulted in 8.6 trillion yen (around US$ 70 billion) in consumer surplus. The Management and Coordination Agency also reported in November 2000 that by October of that year, 58.7% of the proposals in the Committee's revised "Three-Year Program for Promoting Deregulation" (fiscal year 1998-2000) had been fully implemented and 29.2% had been partially implemented.

These figures indicate that progress in deregulation has been made over the last few years. But as been stressed by the Chairman of the Regulatory Reform Committee, much of the success in regulatory reform was achieved in areas in which a consensus was fairly easy to reach. These were primarily regulations that are considered in Japan purely "economic" or "business" activities. Even in these areas, however, there are some major hurdles that still need to be overcome. For example, the government-run postal savings system continues to distort the financial markets in Japan, and the monopoly power of the Nippon Telegraph and Telephone Corporation (NTT) will have to be reduced to allow more competition in the telecommunications market.

The Chairman of the Regulatory Reform Committee also emphasized that "in addition to the unfinished business in the financial and telecommunications industries, much larger obstacles exist in fields like agriculture, education, health care, welfare and employment, which many people in Japan still believe to be primarily 'social' activities that should involve a great deal of governmental involvement. The vested interests and resistance to reform in these areas are still very strong. Accordingly, an enormous amount of work has still to be done to achieve a fundamental revision of the regulatory system. A great deal of political will and public understanding will be necessary to attain such a transformation of the Japanese socio-economic structure. Without such reforms, Japan is destined to continue its decade-long progression down the road to economic mediocrity". Given the initial extremely negative reaction of key ministries to the deregulation and privatization program prepared under the new Basic Law for Reforming Public Corporations of June 2001 by Prime Minister Koizumi, it is clear that the resistance from the central bureaucracy to deregulation and privatization will continue to be a major problem.

### 3.3 Strong legal basis for SME development

There are certainly more than 30 SME-related laws (see Annex 4) reflecting the tendency of the government to codify nearly all aspects of SME development. Accordingly, there are laws that establish the ‘rules of the game’, define the roles of different stakeholders in SME development, and laws that are provide the base for both financial and non-financial support programs. Apart from the SME Basic Law of 1999 that defines the new overall objectives and priorities of SME development, important laws that define the role of the different stakeholders and relationships between SME and large enterprises comprise:

- **SME Guidance Law**: The Law stipulates planned and effective implementation of small and medium enterprise activities by the national government, local governments and the Small Business Corporations for the purpose of streamlining corporate management of such enterprises and improvement of their skills.

- **Law concerning the Organization of SME Organizations**: The Law stipulates establishment, organization, management and coordination of the Cooperative Associations, the Commerce and Industry Associations and the Federation of the
Commerce and Industry Associations. It also stipulates the Small and Medium Enterprise Stabilization Council.

- **Law on the Cooperative Association of SME:** The Law stipulates establishment, organization and management of the Cooperative Associations of Small and Medium Enterprises (Business Cooperative Associations, Business Cooperative Small Associations, Cooperative Associations for Fires Mutual Relief, Credit Cooperative Associations, Federations of Cooperative Associations and Unions) and the Centers of Small and Medium Enterprise Organizations (Prefectural Centers of Small and Medium Enterprise Organizations and National Centers of Small and Medium Enterprise Organizations).

- **SME Modernization Promotion Law:** The Law aims to assist structural improvement activities carried out by industry associations and others in accordance with industry-by-industry modernization plans in order to promote modernization of SME.

- **Law on Financial and Other Assistance for Small Business Modernization:** The Law requests the national government to assist prefectural governments in necessary loans for modernization of facilities of small and medium enterprises.

- **Law on the Promotion of Subcontracting of SME:** The Law aims to promote subcontracting small and medium enterprises. It stipulates measures to promote their effective modernization and to introduce subcontracting business opportunities through the Association of the Promotion of Subcontracting Small and Medium Enterprises.

- **Law on the Prevention of Delay in the Payment of Subcontracting Charges and Related Matters:** The Law aims at fair trade toward subcontractors by preventing delay in the payment of subcontracting charges.

The enforcement of the laws for promoting SME is considered credible given a strong judiciary system and the readiness of the key players to comply with the laws. However, perhaps more importantly, economic activities - given Japanese culture and values - rely heavily on personal relationships and less on stipulated laws and regulations (Hayami 1997).
4 INSTITUTIONAL SET-UP

Japan is a democratic parliamentary monarchy and a unitary state, which means all authority rests with the central government. Prefectural and local governments have only those powers given to them by the central government.

4.1 Governance structure at the central level

The Japanese unitary and centralized government system was initially adopted from China but subsequently modernized taking into account European and American experiences. As laid down in the Constitution of 1947, the national government is made up of three branches: the legislative, the executive, and the judiciary (see also Annex 1). The Emperor of Japan is serving as the ceremonial head of state.

**Legislative branch:** The Japanese Diet (Kokkai) is a bicameral legislature that consists of the 252 seat upper chamber - House of Councilors (Sangi-in) and the 500 seat lower chamber - House of Representatives (Shungi-in). Elections to the Lower House, the more powerful of the Diet's two chambers, are held every four years. Upper House elections are held every three years, at which time half of the membership is up for election.

**Executive branch:** The head of government is the Prime Minister. The Prime Minister is elected by the Diet and appointed by the emperor. The Prime Minister appoints his cabinet. At present, there are 10 ministries: (1) Finance, (2) Economy, Trade and Industry, (3) Public Management, Home Affairs, Posts and Telecommunications, (4) Foreign Affairs, (5) Justice, (6) Education, Culture, Sports, Science and Technology, (7) Health, Labour and Welfare, (8) Agriculture, Forestry and Fisheries, (9) Land, Infrastructure and Transport and (10) Environment, and five Ministers of State.

The judicial system is modeled after the European civil law system with English-American influence. In contrast to the pre-war system, in which executive bodies had much control over the courts, the new constitution guarantees that "all judges shall be independent in the exercise of their conscience and shall be bound only by the constitution and the laws" (Article 76). The Chief Justice is appointed by the Emperor after designation by the cabinet, all other justices are appointed by the cabinet.

**Central government at sub-national levels:** Local branch offices are established by law when it is necessary to divide-up the administrative affairs of national bodies such as the Prime Minister's Office, ministries, commissions, or agencies. Fundamental jurisdictional areas are “regional”, which divide the nation into 8 to 10 regions, and “prefectural” or “municipal” which roughly correspond to the local governments' jurisdictions. The national bodies which have both regional and prefectural or municipal offices include the Management and Co-ordination Agency, Ministry of Justice, Ministry of Finance, National Tax Administration Agency, Ministry of Agriculture, Forestry and Fisheries, Ministry of Construction and Ministry of Public Management, Home Affairs, Posts and Telecommunications.

The administrative responsibilities and authorities of the ministries and agencies that are allocated to these local branch offices are executed by them in the areas under their jurisdiction. Many other organizations (experimental laboratories, educational facilities, etc.) of ministries and agencies are also established in local areas. These are sometimes called "local administrative bodies".

On January 6, 2001, an administrative reform of the central government including the reorganization of a number of ministries became effective. The previous number of 22 ministries was reduced to 12 (and again to 10 when the new administration under Prime Minister Koizumi took office in April 2001). The four main objectives of this reform are (1) establishing a system with more effective political leadership, (2) restructuring of national...
administrative organs, (3) more transparent administration, and (4) drastic streamlining of the central government including a reduction of the number of government officials by 25% over the next 10 years.

4.2 Local Governance

The New Constitution of 1947 included for the first time a chapter on local government. The Constitution states that “local public entities shall have the right to manage their property, affairs and administration and to enact their own regulations within law.”

The Local Autonomy Law was enacted at the same time. It defined a two-tier structure of prefectures and municipalities. It further defined, in accordance with the principles of the Constitution, the structure, composition and powers of local elected legislative bodies and of chief executives at both levels.

**Territorial organization**

Japan is divided into a total of 47 prefectures (including the metropolis of Tokyo, and the prefectures of Osaka, Kyoto and Hokkaido). Prefectures are further divided into municipalities that consist of cities, towns and villages. Cities have a population of 50,000 or more, and towns and villages have a population of under 50,000. There are around 660 cities and 2,600 towns and villages.

Each local unit (prefecture, municipality) has a popularly elected chief executive (called ‘governor’ in a prefecture, and ‘mayor’ in a municipality), and a unicameral legislative body (Assembly). The Assembly is composed of members elected by direct popular vote. The number of assembly members is defined by the Local Autonomy Law according to the population of the local area. This number can be reduced by a by-law. The term of office of an assembly member is four years.

Prefectures stand midway between the national government and the municipalities and their functions are divided into two categories: (1) intermediation between national government and municipal governments, and (2) area-wide administration. They are responsible for matters that affect broad geographical areas within their jurisdiction or for which a single standard needs to be maintained throughout the prefecture; for large-scale jobs that municipalities cannot handle on their own, for liaison between the national government and municipalities and for providing advice and guidance to municipalities.

4.2.1 Distribution of responsibilities between central and local government

The Local Autonomy Law stipulates that authority is distributed between local governments and central government according to the premise that local governments do not deal with the following: (1) juridical affairs; (2) criminal punishment; (3) transportation and communication at the national level; (4) postal services; (5) national institutions of education and research; (6) national hospitals and sanatoriums; (7) facilities for navigation, meteorology, and sea channels; and (8) national museums and libraries.

The authorities of local governments are divided into two categories: “inherent functions” and “delegated functions”. Inherent functions are those that are supposed to be carried out by local governments according to the principle of local autonomy, while

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1 In this Section, we draw heavily from the study of OECD: Japan - Managing Across Levels of Government, Paris 1997 and the study of the Japan Local Government Center, Sydney: Local Government in Japan Today, 1999.

2 Tokyo has a unique function as the capital of Japan, and its central area is therefore divided into 23 special wards that are similar in character to cities but with several distinguishing features.
delegated functions are the activities of central government that have been delegated to local governments for implementation.

**Inherent functions** include: (1) the local police and fire fighting system, (2) social welfare, health, management of public hospitals; (3) local development including city planning and water supply; (4) local business development; (5) youth policy and basic education including management of primary, junior high and senior high schools; (6), and environmental protection including pollution prevention.

Central government, however, also exerts influence over local governments in these fields through mechanisms such as subsidies and due to the precedence of national laws over local by-laws.

**Delegated functions** are sub-divided into “mandated functions” and “agency delegated functions”.

- Mandated functions are those entrusted to local government by central government, public corporations and other bodies by statutes and Cabinet ordinances. Local governments have some degree of discretion in carrying them out, e.g. in designing programs, and local assemblies can deal with these functions in the same way as the inherent functions. Examples of these functions include the construction of primary and secondary schools and the establishment of hospitals for infectious diseases.

- The agency delegated functions are different from mandated functions in that local governments have virtually no discretion with respect to the former. They are not entrusted to the local government as a whole, but to the chief executives or other executive bodies of local government. In implementing these functions, the chief executives and other executive bodies are regarded as “agencies” of central government and must comply with the directions and orders received from the relevant minister. In principle, local assemblies do not have the right to discuss and decide on issues relating to the “agency delegated functions”. There are currently 379 agency-delegated functions for prefectures and 182 for municipalities which represent approximately 80% and 30-40% of their respective workloads. Agency delegated functions include organization of national elections, recruitment of national defense forces, collection of statistics, some infrastructure projects such as rivers and roads, and some welfare projects such as assistance to the elderly. Most functions are either financed fully by the central government or co-financed with local governments.

There is evidence of a trend towards a decrease in local government autonomy through the growth in the number of both mandated functions and agency delegated functions.

### 4.2.2 Participatory planning by local governments

The Local Autonomy Law requires every Japanese municipality to draw up a 'Basic Vision'. This document presents the major long-term policy goals (usually spanning twenty years) of the municipality. A municipality also prepares a 'Basic Plan', a document which sets out medium-term (usually 10 year) targets and projects to achieve them, as well as an 'Implementation Plan', which specifies projects for the next three to five years, and, if available, their associated costs. (Prefectures - regional level local governments - also produce these management plans, although this is not a statutory requirement.)

These plans ensure that municipalities administer their areas and undertake various projects and programs in a coordinated and consistent manner. The plans are reflected in a municipality's actual operations, most importantly in the budget-making process. Any project that cannot be found in the Basic Vision and Basic Plan, is unlikely to be funded.
The process of drafting a Basic Vision usually involves: resident surveys; public hearings; expert demographic and economic forecasts and consideration by a Basic Vision Consultative Committee. A municipality usually prepares its Basic Plan concurrently with its Basic Vision and submits this to the council for approval. Of course, Basic Visions and Basic Plans are occasionally reviewed, and, if necessary, amended during their lifetime. On the other hand, since it contains practical programs, an Implementation Plan is prepared annually based on interdepartmental discussions and coordination and considering the financial outlook.

4.2.3 Internationalization of local governments

In December 1955, Nagasaki became the first Japanese city to establish an overseas link, when it signed a sister city agreement with Saint Paul in Minnesota, the United States. Over almost half a century since, Japanese local communities’ international links have steadily increased, especially throughout the 1980’s and 90's. In the decade from 1986, the number of international affiliations established by Japanese local governments almost doubled from 600 to nearly 1,200, i.e. of Japan's 3,200 municipalities, approximately one-in-four has at least one sister city agreement. Over the years, these international programs have flourished to encompass a spectrum of economic, social, cultural, educational and citizenry activities.

More recently, new strategies have been introduced to prepare communities for, and to capitalize on, new trends in globalization. A case in point is the development of a ‘globalization strategy’ by the Gifu Prefecture. The prefecture is located in the centre of Japan's largest main island, Honshu, and is made up of 99 municipalities. Gifu City is the prefectural capital and has a population of 400,000.

A current major strategy, titled 'Global Village', aims to expand and consolidate Gifu's international networks in information technology, and other areas that have strategic importance for the prefecture’s industrial and economic development. To this end, in 1999, a number of overseas delegations were dispatched. They included delegations to Hungary, Singapore, and a study visit to Germany to examine the textile industry, which has traditionally been a strong contributor to Gifu's economy.

The rapid growth in grassroots international activities has, in particular been triggered by changing economic circumstances and the resulting government responses.

- The drastically strengthened yen (from around 1985) severely exposed Japanese industries to international competition, especially from Asian industrializing nations. As a result, numbers of Japanese factories moved offshore to China and other Asian countries in a bid to remain cost-competitive. Japan's rural areas experienced particular hardship, losing local industries and failing to lure factories from major urban centers. This trend, often referred to in Japan as 'the hollowing out of manufacturing', hit virtually all parts of Japan. These events alerted Japanese people to the fact that local economies were not immune to global trends.

- In view of these challenges, governments at the national and local level agreed that some initiatives should be introduced to better prepare Japanese people and their communities for the rapidly 'globalizing' Japan. The economic and social changes were so massive and significant that a new word entered the Japanese lexicon to describe the trend, namely 'kokusaika', often translated as the 'globalization' or 'internationalization' of Japan.

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3 This Section is based on the study of the Japan Local Government Center, Sydney: Local Government's Role in the Globalization of Japan - Emerging Trends and Strategies, Sydney 2000.
In the late 1980s, the national government introduced a number of programs to stimulate local government interest in developing international relations programs. For example, since 1986, the national government has allocated grants to local governments for their international exchange programs. And the traditionally very domestic-minded Ministry of Home Affairs, which oversees local government operations, established an International Affairs Office to manage the grant allocation process. Within just a few years, every prefecture and large city had established an international affairs division. Furthermore, non-profit international exchange organizations began appearing in many local communities, through the joint efforts of local governments, the private sector and residents.

Japanese local governments’ sponsorship of international programs is perhaps unrivalled, in terms of both financial and personnel commitments. Spending by Japanese municipalities on international activities totalled approximately US$ 40 million in 1997. This averages out to approximately US$ 35,000 per municipality per link.

4.2.4 Vertical policy coordination

According to OECD (1997), “the issue of vertical policy co-ordination is perhaps less problematic in Japan than in many OECD countries due to the strong and extensive role of the central government. In the major policy fields, the typical relationship between central government and local governments is one where central government, as the senior authority, decides on policies, sets directions and gives guidance which chief executives of local governments follow and implement as agents of individual ministries. In this sense, there is less necessity for mechanisms to secure policy coherence in Japan”.

However, it is precisely the overarching role of the central government that lies at the heart of many of the problems faced by local governments. Therefore, in May 1995, the National Parliament (Diet) passed the Decentralization Promotion Law to create a diversified and decentralized administrative system, one that respects local conditions and diversity. The law was enacted on the premise that the existing uniform and centralized system stifled local vitality and individuality.

In addition to the problem of overly centralization, the Japanese administration is facing a different kind of problem regarding policy co-ordination. Individual ministries tend to set up regulations, directions, and guidance and to impose them on local chief executives that act as their agents without sufficient policy co-ordination internal to the central level. As a result they may be duplicative or even contradictory. Critics claim that the lack of effective policy co-ordination at the central level leads to inefficiency in local governments.

4.3 Slow progress of local governance reforms

‘Decentralization’ in the Japanese context does not mean any more the relocation of national government departments and/or agencies to regional cities. Nor does it simply mean the devolution of national government services and functions to local government. Decentralization, in fact, involves the whole restructuring of administrative and financial intergovernmental relations, as well as managerial reform and improved accountability mechanisms.

Current decentralization reforms focus on a new demarcation of powers and responsibilities. Progress is, however, extremely slow. The Committee for the Promotion of Decentralization, established under the Decentralization Promotion Law in 1995 for a

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5 ibid, p. 297.
five-year period to advise the prime minister, has submitted its final report only by June 2001. And the signs are that no swift action will be taken although the Decentralization Promotion Law (Art. 11) dictates that the Prime Minister must draw up a Local Decentralization Promotion Plan (Art. 8) based on the Committee's recommendations. The Plan is to include details of the legislative amendments necessary to promote decentralization and should also detail the government's plans to improve the fiscal autonomy of local authorities by revising the systems of grants and subsidies (Art. 8). However, rather than moving ahead with decentralization based on the Committee's recommendations, a new body, the Council for the Promotion of Decentralization Reform has been set up under the Cabinet Office of the prime minister for a three year period. The Council, that held its first meeting in July 2001 will - like his predecessor - carry out studies and deliberate on the modalities of duties and business in accordance with the role sharing of central government and local governments, methods of allocating tax and financial resources, the promotion of local governments' administrative and financial reforms, and other important matters concerning regional systems development.

4.4 Financing patterns of local government

Significantly, Japan's local public finance system offers financial security to local authorities. Shortfalls in local revenue are made up with enormous transfers from the national to local governments in the forms of a Local Allocation Tax grant (a general purpose grant, explained below) and a Specific Purpose (or tied) grant. The size of the national government transfers is based on the Local Public Finance Plan (see Box below) and is equivalent to approximately 34% of local revenue.

Local government expenditure in Japan is high. In fiscal year 1996, local public finances comprised 13.4% of GDP and 64.6% of the joint net expenditure of the national and local governments. On the other hand, income from local taxes was in the order of 39% only, while the difference (61%) was covered by tax and other transfers from the central government.

Box: The Local Public Finance Plan of the Central Government

The Local Public Finance Plan is prepared annually to coordinate the fair and equitable allocation of national government funds to local authorities. Its implementation reflects the high dependence of local governments on financial transfers from the national government and the value placed on a local government finance equalisation system which guarantees a minimum national standard of local administrative services.

The fiscal year in Japan starts in April, but as early as late August of the previous year, all Ministries and Agencies are required to submit their budget estimates to the Ministry of Finance and to report to the Ministry of Home Affairs with their estimates of local government expenditure.

The Ministry of Home Affairs uses these reports to estimate the revenue and expenditure of local authorities as a whole for the following fiscal year. At the same time, the Ministry of Finance estimates the national government revenues based on economic forecasts and agreed tax policies. Negotiations are then held between the Ministries of Finance and Home Affairs to establish the necessary financial measures to make up any shortfall in the estimated revenue and expenditure of local authorities. Options to boost revenue include amending intergovernmental financial rules, a one-off increase in the total amount of general purpose grants, and approval for local authorities to undertake supplementary borrowings.

Once these local finance measures are agreed on, they are incorporated in the national government's official estimate of Local Government Finance, which becomes the next fiscal year's Local Public Finance Plan submitted to the Diet (National Parliament) for approval.

The Plan is integral to the Diet's consideration of the national budget, since as much as 40% of its total general account expenditure is made up of general and specific purpose grants paid to prefectures and municipalities.

The Minister of Home Affairs may also permit additional borrowing by a local authority (either a prefecture or a municipality) as required, in the form of local bonds.

It is estimated about four fifth of the budget transfers from the central government are linked to programs of the sectoral ministries and their agencies. As result, there is a built-in disincentive for reducing the financial dependence of prefectures and cities on central government financing.

In Japan, the Local Tax Law provides the framework for levying and collecting local taxes. Tax rates are established by local by-laws. The main prefectural taxes are the enterprise tax, the prefectural income tax and the motor vehicle tax. The municipal inhabitant tax and the 'fixed asset tax' (or tax on real property value) are the major sources of municipal tax revenue. Major local government expenditure is on public works, education, welfare, administration and debt servicing.

With local finances likely to be extremely tight in the future, Japanese local authorities have embarked on drastic cost reduction programs. For example, Osaka Prefectural Government plans to reduce its workforce by 7,000 over ten years and to hold off pay increases for two years, while Kanagawa Prefectural Government is selling some of its property and leasing it back for ongoing use by the government. Many other local authorities have also taken, or are considering, such measures as ‘rationalization’ of their workforce and salaries, a thorough review of their service delivery systems (contracting out is a major option), the more efficient implementation of public works and improved tax collection efforts.

### 4.5 Key institutions for SME policy design and implementation

The central government plays a dominant role in both SME policy design and implementation. The key body is the Ministry of Economy, Trade and Industry (METI), i.e. the former MITI. Along with METI, there are other government agencies that are involved in, or related to SME policy in one form or another. For example, taxes and finance are under the jurisdiction of the Ministry of Finance, labor issues under the jurisdiction of the Ministry of Labor, and social security and social welfare are under the jurisdiction of the Ministry of Health and Welfare. Housing for workers and urban problems are under the jurisdiction of the Ministry of Construction, food industry is under the jurisdiction of the Ministry of Agriculture, Forestry and Fisheries, and shipbuilding and transportation industries are under the jurisdiction of the Ministry of Land, Infrastructure and Transport.

METI’s mandate covers a broad range of areas, namely international trade / global environment, industry, SME, information technology, consumer protection, natural resources and energy. To ensure public participation in policy design, numerous councils have been set up as advisory bodies to the ministry.

SME policies - both structural and operational - are mainly formulated by the Small and Medium Enterprise Agency under METI. For example, the Agency, assisted by the attached Small and Medium Enterprise Policy Making Council, was responsible for reviewing the 1963 SME Basic Law and the drafting of the new law.

#### 4.5.1 Highly decentralized system for SME policy implementation

In close collaboration with the SME Agency and METI’s eight regional offices, the various policies in such fields as development of regional industries, promotion of R&D, internationalization and the introduction of information technology in the regions are

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6 See Japan Local Government Center, Sydney: Local Government in Japan Today, Chapter 3, Sydney 2000, also for the remainder of this section.
mainly implemented through special corporations, financial intermediaries, SME organizations and local administrations (see Figure 12).

**Key government affiliated organizations and public support schemes**

Specific SME support programs are implemented or overseen by a number of government-affiliated institutions. Among the key institutions and schemes are:

- the Japan Small and Medium Enterprise Corporation (JASMEC), an integrated SME policy implementation body with a staff of around 1,000. The Corporation was founded in July 1999 after the merger of the Japan Small Business Credit Insurance Corporation, the Japan Small Business Corporation and the Textile Industry Restructuring Agency. JASMEC has offices in major cities, and in New York, Bangkok and Shanghai (linked to the offices of JETRO). JASMEC is running both financial and non-financial support schemes comprising namely: (1) management guidance and financing for upgrading of projects, (2) promotion of business start-ups, (3) management training, (4) information services, (5) support of internationalization of SME, and (6) schemes for credit insurance and the prevention of bankruptcies. JASMEC is also running 9 ‘Institutes for Small Business Management and Technology’ that offer a variety of training programs for SME executives, managers, technical experts and prefectural government personnel who provide guidance to SMEs. Annual trainees number about 14 000.

- Business management advice is furthermore provided through two special support schemes:
  - the SME Evaluation System (SHINDAN) which analyses the performance of SMEs, and presents concrete measures to improve business performance. Each prefecture and the administrations of 12 major cities evaluate the management conditions of SMEs, make detailed recommendations and provide guidance. Skilled personnel are located in each prefecture and in each of the 12 major cities, and provide management consultancy advisory services in cooperation with private SME consultants, as required. The central government has responsibility for the selection criteria and choices associated with these consultancy and technical guidance services.
  - Another program manages the dispatching of private management consultants to firms. By June 1998, approximately 15 000 consultants had been used and around 12 000 companies benefited from 34 000 consultant-years through the prefectures and JASMEC by FY1997.

- the National Association for Promotion of Subcontracting Enterprises, a public interest corporation involving representatives of both the public and private sector. The association has been established in each prefecture to ensure smooth subcontracting operations with full support from the central and local governments.

- the Japan External Trade Organization (JETRO), a non-profit organization with some 36 domestic and 80 overseas’ offices. Financed largely by and operating under the general supervision of METI, the primary functions of JETRO are to (1) gather, analyze, and distribute information on foreign economies, (2) facilitate international transactions, (3) promote imports into Japan and market opening, (4) cooperate in promoting the trade and industries of developing nations, (5) assist regional economies and SME to internationalize, and (6) promote internal and external direct investment.

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7 see OECD Small and Medium Enterprise Outlook 2000, Paris 2000, p. 144
Figure 12: **Major Implementing Institution of Policies for Small and Medium Enterprises**

- **Human resource development and information service etc.**
  - Institute for Small Business Management and Technology
    - (Tokyo, Kansai, Nogata, Asahikawa, Hiroshima, Seto, Sendai, Sanjo, Hitoyoshi)
    - (About 241 consultants)

- **Information**
  - National Center for Promotion of Information for Small and Medium Enterprise
  - Regional Information Centers (47)

- **Finance**
  - Japan Finance Corporation for Small Business (59 branches)
  - People’s Finance Corporation (152 branches)
  - The Shoko Chukin Bank (104 branches)

- **Credit insurance**
  - Small Business Credit Insurance Corporation
  - Prefecture Credit Insurance Association (52)

- **Investment**
  - Small and Medium Business Investment & Consultation Co., Ltd. (Tokyo, Osaka, Nagoya)

- **Subcontracting**
  - National Association for Subcontracting Enterprise Promotion
  - Prefecture Association for Promotion of Subcontracting Enterprises

- **Guidance**
  - Japan Chamber of Commerce and Industry, National Federation of Commerce-Industry Trade Associations
    - (about 9,000 consultants)
  - Chambers of Commerce and Industry (515), Prefecture federation of commerce-industry Trade associations (47), Societies of Commerce and Industry (2,818)

- **Organization**
  - National Federation of Small Business Associations
    - Prefecture Federation of Small Business Associations
    - (about 982 consultants)
  - National Federation of Shopping Districts Promotional Associations
    - Prefecture Federation of Shopping Districts Promotion Associations

**Source:** JASMEC
Financing measures for SMEs (activities of JASMEC excluded) are arranged through a number of government financial institutions and government-supported schemes\(^8\) to include, among others, the Small Business Finance Corporation, the Central Cooperative Bank for Commerce and Industry (Shoko Chukin Bank) and the National Life Finance Corporation. Assistance can be in the form of ordinary loans at the basic rate or special loans to which preferential terms and conditions are applied in accordance with policy goals (e.g. loans for management enhancement, improvement of small-scale enterprises, new business development funds). Relevant other financing institutions and schemes are:

- The Loans for Managerial Improvement of Small-Scale Enterprise (“Marukei Loan”) scheme is implemented for small-scale enterprises which have no collateral or guarantees combined with SME evaluation under the SHINDAN schemes,

- The Credit Supplementation System facilitates funding for SMEs that would otherwise have insufficient credit or security to obtain funding through the Japan Small and Medium Enterprise Corporation and Credit Guarantee Association. The Credit Guarantee System provides credit guarantees for loans by private financial institutions to supplement the credit-worthiness of SMEs.

- The Credit Guarantee Association, comprising 52 offices throughout the country, extends supplementary credit or guarantees so that enterprises may obtain loans from financial institutions on the usual criteria. These guarantees are insured by the Japan Small and Medium Enterprise Corporation.

- The Small and Medium Business Investment and Consultation Co. Ltd (SBIC), established in 1963, implements various investment schemes and programs for SMEs to raise equity capital, particularly for start-up business investment, initial investment for R&D corporations and fledging companies. SBIC provides capital through underwriting new stock, convertible bonds and bonds with warrant.

Little is known as regards the effectiveness of the Japanese system for SME promotion. Since 1999 however, MITI has stepped up its efforts to introduce a monitoring and evaluation system not just for SME promotion policies and programs but for MITI’s policies in general (MITI 1999).

**Strong private sector organizations**

As is shown in Figure 12, private sector organizations with their strong roots at local level play an important role in SME development:

The Japan Chamber of Commerce and Industry (JCCI) is the central organization to which all of the some 560 local chambers of commerce belong. About 5,500 business consultants have been placed at local chambers of commerce to offer advice and direction to SME with regard to management improvements, financial issues and tax matters.

As an opinion leader in economic circles, JCCI represents the various local chambers in presenting their concerns and suggestions to the government and other bodies, and at the same time plays a role in efforts to implement them. JCCI also has a central position in the dissemination of information concerning government policies and programs, and the promotion of nationwide projects.

The National Federation of Small Business Associations has been established in 1956 under the Law on Cooperatives of Small and Medium Enterprises. The Federation operates on its own initiative and under the guidance of the central government. Members are (a) Prefectural Federations of Small Business Associations, (b) Federations of

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nationwide cooperatives Associations, and (c) Federations of Nationwide Trade Associations and others.

The Federation plays a vital role in promoting and implementing measures for small business on a nationwide scale. It also acts as an intermediary between the small business associations in each prefecture and various SME cooperatives.

There are forty-seven associations (one for each prefecture), with the National Federation of Small Business Associations at the top, providing various kinds of guidance to SME cooperatives. Activities of the associations are wide-ranging. They extend guidance namely to SME cooperatives through visits by about a thousand guidance officers stationed around the nation. They also conduct studies and training sessions, seminars and conventions, plus the publication of newsletters. Also, in response to advice from the Government and other entities, they prepare diverse plans for small business promotion and help implement them by making various proposals and petitions to the legislature.

Commerce and Industry Trade Associations group companies in the same business that seek to promote and stabilize the general conditions of the industry. To establish such a body, it must encompass at least one prefecture and include more than half of the companies in that business. The associations engage, among others in the following activities: formulating regulatory measures to overcome the ill effects of excess competition, coordinating management rationalization programs, providing guidance and education, collecting and supplying data, and drawing up research and survey plans for members.

J-SMECA, the Japan Small and Medium Enterprise Management Consultants Association was established in October 1954 as a non-profit membership organization under the guidance of the Small and Medium Enterprise Agency and authorized by MITI. With its headquarter in Tokyo, J-SMECA is the only business consultants organization in Japan that has 47 branches (i.e. a branch in each prefecture) with a total of about 7,000 members providing advisory services for a broad range of industries and business areas such as manufacturing, distribution and commerce, information, finance and others. Furthermore, there are about 600 consultants with special international experiences in around 30 countries.

J-SMECA cooperates closely with the central and municipal governments, the SME Regional Information Centers, the Japan Small and Medium Business Corporation and other public organizations.

J-SMECA assists members in sharing their knowledge and expertise by building a consulting support system. To become a member of J-SMECA, applicants must pass examinations divided in 3 stages: the first examination (1 day) comprises a written test on eight subjects and the second examination (2 days) a written test on selected problem areas with four subjects each. Applicants that succeeded in the earlier examinations pass on to stage 3 (15 days) consisting of class room learning and field consulting (in 2 companies). After successful completion of stage 3, applicants can apply for registration to become a certified SME Consultant registered with METI. Registration is for 5 years to be renewed every 5 years. To renew registration, consultants either need to complete successfully mandated yearly seminars or pass examinations on specific subjects required or submit records on specified consulting work for government projects.

In addition, almost every profession has a national association the most important of which with some local and overseas' branches. Each association is registered with its relevant ministry. The number of associations is more than 12,000. However, it is hard to know exactly how many of them can be regarded as professional groups. Even so, all major industries have associations that are highly professional such as the Japan Electronics and Information Technology Industries Association, the Japan Machinery Federation or the Japanese Apparel Industry Council. All of them provide a wide range of services to their members including comprehensive and up-to-date information on sector
trends, organization of trade missions and study tours. They also play an important role in shaping sectoral policies of the government. While these associations are clearly dominated by large enterprises and have no explicit SME focus, many of their services are also relevant for SME, namely the on-line information services.

4.5.2 Market- and technology-induced changes in industrial organization

“The received Japanese model has two parts. On the government side, Japanese industrial policy was viewed as a new approach to management of the economy. On the corporate side, the Japanese management system was seen as a new and better way of managing companies (Porter 2001).” Indeed, one of the core features of the Japanese model of industrial organization is the subcontracting networks between large firms and SME. According to a survey carried out by the Small and Medium Enterprise Agency in November 1998, 55% of SME and even 41% of large firms in manufacturing were involved in subcontracting businesses with prime contractors.

This subcontracting system developed over a long period starting on a larger scale after World War I (see Chapter 2.1). It has continuously been adjusted and became an essential element in Japan's growth period after World War II, and developed into the highly efficient modern Keiretsu subcontracting system, popularized by the Toyota model of corporate organization.

Parent firms’ efficiency was improved through a division of labor with suppliers which allowed each firm to specialize in their most efficient activities, reduced cost of production especially for small batch specialized parts and improved flexibility through an enhanced capacity to respond quickly to changes in output and the avoidance of overly large, hierarchical organizational structures. The subcontractors gained technology, market information, training, access to specialized equipment, managerial support and research and development at relatively low cost from the parent company.

These networks are typically organized into a multi-tier system where the parent firm (assembler or trading house) has direct relationships only with a limited number of first-tier, mostly medium-sized subcontractors. These first-tier firms have direct relationships with the second-tier sub-contractors, these second-tier firms again with the third-tier subcontractors, etc.

Collaborative strategic arrangements between parent firms and first tier suppliers allowed Japanese firms to undertake continuous product and process innovations which maintained their role as leading world producers of sophisticated consumer durables. Both types of firms had significant internal R&D capacities aimed at developing new materials and products. They also engaged in reverse engineering, joint technology development, design and collaborative arrangements with other sources of technology such as equipment suppliers and public research institutions. Small second and third tier suppliers, however, had much lower technical capacities and predominantly focused on achieving cost cutting production improvements (Hodgkinson 2000).

Keiretsu supplier system undergoing major changes

Both parent firms and suppliers have been reevaluating their traditional relationships already since the mid-1980s. Not only fewer manufacturers strengthened existing ties, but more and more were working to build new ties with other suppliers, both foreign and domestic.

Most of the more technically advanced higher tier suppliers have been able to cut costs, develop new markets, expand sales to non-Keiretsu clients and to shift production abroad. Lower tier suppliers lacking capital and managerial resources, however, have often not
been in a position to meet increased demands of parent firms or higher tier firms to lower costs. As a result, many lower tier suppliers were forced to close down.

From the early 1990s, the restructuring process of the subcontracting system became even more pronounced showing clear signs of major change (JETRO 1996, Sugita 2001). A study by the Small and Medium-Size Enterprise Agency of 1996 reported that the percentage of companies strengthening ties with current suppliers had dropped to half of previous levels.

The 1996 Economic White Paper indicated three key factors behind the ongoing changes in supplier relationships.

- First, the intensification of global ‘mega-competition’ that forced a fundamental reevaluation of the role of parts procurement.
- Second, the growing use of information technology has placed limits on the traditional practice of fostering technology development within the traditional supplier-manufacturer relationship.
- Finally, it became increasingly difficult to maintain business practices that appeared exclusive to foreign observers.

According to Porter et. al. (2000, p. 165), another major weakness of the Keiretsu system is that it undermined pursuit of distinctive corporate strategies given the pressures to serve sister-company needs. In a globalizing economy, competitive firms flexibly mobilize the best resources, and form strategic alliances of the strongest firms that are integrated by computer networks. The Keiretsu formulas of organizing an exclusive network of vendors and maintaining long-term relations within are being seriously challenged. And indeed, a transformation of the Japanese economy from one based on Keiretsu “closed network organization” to a more “open network of firms” seems to be well under way.
5 REGIONAL/LOCAL DEVELOPMENT

5.1 Increased role of regional governments in SME development

Despite their strong dependence on central government financing and limited own financial resources, regional and local governments have considerable possibilities to create a conducive business environment for SME and private sector development as well as to support SME development at prefectural and/or municipal level in more direct ways. All prefectures have either a commerce and industry section or a SME section in their offices that work to guide and implement SME policy in the cities, towns and villages located in the prefecture.

For example, a comprehensive development plan has recently been formulated by Chiba prefecture. The prefecture, where the economic situation in terms of industrial output, consumption, corporate bankruptcies and employment had deteriorated over the last years, decided in June 1998 to implement wide-ranging measures targeting SME development, employment promotion, human resource development and others.

The measures are financed under a special scheme and by using funds obtained under the regular central government budget allocations. The specific measures targeting SME comprise financial support, bankruptcy protection, improvement of public procurements, assistance to venture businesses to support prototype development in manufacturing, and measures to strengthen subcontracting. While these measures are still reflecting ‘old thinking’ to a certain extent, e.g. bankruptcy protection, there are a number of measures that have market enhancing functions (improvement of public procurement) or forward-looking components such as technology support provision.

5.2 Strong private sector organizations at local level

As has already been described in Chapter 4, private sector organizations play an important role in developing and shaping regional economies. Of particular importance are the more than 500 local Chambers of Commerce and Industry - many of which with a history of more than 100 years -, the Societies of Commerce and Industry (around 2,800), the Prefecture Associations for Promotion of Subcontracting Enterprises where representatives of both the public and private sector are involved, and the Japan Small and Medium Enterprise Management Consultants Association. These institutions are also involved in the implementation of central government SME programs in line with the stipulations of the SME Guidance Law. These private sector organizations often also provide feedback on central government programs or even propose new initiatives that should be taken up by the central government when designing new programs.

5.3 Revitalizing industry cluster development

Industry clusters have played and are playing an important role in the development of Japanese SME. According to the Japan Small Business Research Institute (JSBRI), Japan has 700 industrial clusters that can be divided into three categories:

- traditional production districts as locations of groups of enterprises involved in traditional local industries,
- castle towns-style industrial districts, where affiliated subcontractors gather around a large company,
- urban industrial districts where SME, namely in metal and machinery processing are supporting a wide range of industries in urban areas.
Among the most prominent examples are the Ohta Ward in Tokyo which houses the largest cluster of machine and metal industries in Japan, and Sakaki Town in Nagano Prefecture where a relatively small cluster of machine and metal industries is located. As described by S. Urata (2000), these clusters have developed involving both the public and private sectors and utilizing the vigor of the Chambers of Commerce and Industry and other private sector organizations (see Box below).

However, according to JSBRI, industry clusters have experienced a considerable decline in recent years and the trends are not encouraging: Both the number of businesses and employees continue to decline, hurt by falling numbers of business start-ups and growing failures among small businesses.

Based on a survey that analyzed the development of 106 industry clusters (out of a total of 700 clusters in Japan) during the period 1995 to 1998 (Kaibori 2000), it was found that most of the clusters had experienced declines in terms of value added and employment: 70 clusters (66%) declined in value added, and in 94 clusters (89%) the number of employees decreased. Small-sized enterprises with labor-intensive production technology and low productivity were particularly affected.

As general reasons for this decline were identified growing global competition, change of customer needs, and rapid progress of IT (Information Technology). More specifically, the reasons why cluster development declined were found to be the following ones:

- Most SME were part of a Keiretsu Supplier System and thus depended on doing business with their parent companies only under long-term contracts.
- Most SME have focused on process innovation and concentrated on QCD (Quality, Cost, Delivery) while product innovation was neglected.

**BOX: Examples of successful industry cluster development in Japan**

- **The Ohta Ward, Tokyo**, is home to the most representative cluster of machine and metal industries. More than 10,000 plants are concentrated in this ward and are engaged in the processing of various metal and plastic resins. This cluster was established when local large enterprises acting as leading enterprises attracted the relocation of SMEs around them to act as subcontractors. The SMEs in this cluster are involved in the subcontracted manufacture of mass production parts or in the manufacture of trial products and parts in small quantities for assembly makers. There is a close link between SMEs and the cluster which, in co-operation, perform such roles as (i) refinement, development and extension of special technologies and (ii) buffering fluctuating market needs in terms of labor and capital.

- **Sakaki Town, Nagano Prefecture**, is a small town of 17,000 people in Nagano Prefecture, has a cluster of 350 plants of the machine and metal industry and the plastics industry. The town was originally a farming area. Its industrialization began in 1941 when the town authorities successfully invited a machine tool maker producing files and other goods into the area. During the Second World War, many plants sought a safe haven in the town, forming the basis for the present local machine industry. One characteristic of the cluster in Sakaki is the high frequency of the opening of new businesses. There have been many cases of spin-offs and, at one time, former employees of other enterprises seeking to start their own business established more than 10 new businesses. These new enterprises receive technological assistance, leasing arrangements for equipment, financial assistance and job orders from their parent enterprises. The success of new enterprises further stimulates further spin-offs. Newly independent enterprises fully utilize their own technologies to ensure orders from multiple enterprises, including those in different industrial sectors, and they are not particularly dependent on a specific enterprise. Another characteristic is the establishment of high-tech groups, particularly in relation to parts processing. There are many societies, which consist of enterprises in the same type of business. The Sakaki Society of Engineering Firms is one example. These societies actively facilitate visits to excellent plants and exchanges of technology at technology workshops, etc. Through these activities, almost all of the enterprises specialize in a specific processing technology and the active introduction of state-of-the-art equipment and original processing methods ensure value-added processing and high productivity. Some enterprises now enjoy a top share of the world market in such fields as injection molding machines, construction machinery, typewriters and measuring instruments, etc.

Most SME were technology-driven and had weaknesses in marketing.

In addition, the merit of Industrial Clusters such as easily securing and fostering skilled engineers and a workforce had gradually been lost. Accordingly, SME had difficulties even in maintaining basic production functions.

However, it was also found that even in stagnating clusters viable and vital enterprises had emerged, typically SME that focused on their core competencies, product innovation and/or marketing. Among the successful companies were:

- R & D-oriented companies that outsourced manufacturing and marketing functions while focusing on the development of products and technologies;
- companies that had established their own core technology and capabilities as a result of many years of technical research in a specialized field;
- companies that had become independent by putting to work the expertise gained through subcontracting work for parent companies, developing their own products and diversifying their clients;
- companies with advanced specialized capabilities that developed products jointly in cooperation with other companies, universities or research institutes;
- companies that built joint order-reception frameworks and networks to make up for each others' weaknesses;
- companies that created new markets by establishing direct contacts with end users and uncovering latent needs.

Given the drastic changes in the economic environment and the weaknesses of the traditional Keiretsu supplier system, SME in industrial clusters are required to radically reform their business models and behavior, JSBRI concluded. SME need, in particular to

- focus on product innovation to open up new fields,
- make every effort to shape business from the former business style of depending on clients to the new business style of creating markets,
- investigate market needs and embody market needs in the shape of products and technology;
- establish effective network systems among enterprises (in particular horizontal networks) that have various technological and marketing capabilities and to combine their management resources.

In order that SME can come up with new products and services and develop international competitiveness, comprehensive measures should be taken to promote cooperation between industry, government and academia.
6 MAJOR POINTS OF INTEREST FOR INDONESIA

As would apply to any other country study, the institutional arrangements, basic and specific policies and instruments of Japan for promoting SME development cannot be transferred one to one to Indonesia. This is the more so as there cannot be just one ‘correct’ interpretation given the complexity of the Japanese model. Therefore, the systemic changes of the Japanese development model under way need further careful study. But it is perhaps fair to list the following issues that deserve special attention:

(1) In line with the trends within developed and most developing economies, deregulation, as a means to enhance market forces to drive structural change, and decentralization as a means to empower local economies rank high on the political agenda. However, a broader consensus among key stakeholders with regard to scope and speed of the necessary reforms still needs to be developed.

(2) Weaknesses in overall economic management and delayed regulatory and structural reforms cannot be compensated through even the most comprehensive financial and non-financial support structures for SME.

(3) The move from a SME development concept that long viewed SME as weak economic actors and contained many protective policies and instruments to a concept that views SME a source of dynamism and aims at a more market-friendly and focused approach of direct support to SME through public and private organizations is well in line with recent international trends. Combined with increased efforts to improve the evaluation of the effectiveness of support programs, a leaner and more effective concept of SME development could emerge over time.

(4) Participation of private sector and other stakeholders in SME policy design and implementation is institutionalized and strong both at the national and local level, and complemented by many informal communication channels. Moreover, private sector organizations with their strong roots at the local level play a very important role in the delivery of support services to SME.

(5) To revitalize the SME sector, traditional business partnership and linkage and cluster development concepts are being adjusted to reflect new economic realities resulting from increased competition in both the domestic and international markets, and rapid technological advances.
APPENDICES

Appendix 1: Structure of National Government
Appendix 2: Local Governments in Japan (1996)
Appendix 3: Local Self-Government in Japan
Appendix 4: SME-related Laws in Japan
Appendix 5: Small & Medium Enterprises in Japan’s Economy
Appendix 6: Map of Japan
Appendix 1: Structure of National Government
Appendix 2: Local Governments in Japan (1996)

Source: Japan Local Government Center, Sydney
Appendix 3: Local Self-Government in Japan

Japan's system of local self-government is founded on 2 main principles. Firstly, it provides for the right to establish autonomous local public entities based on a given geographical area that are, to a certain extent, independent of the national government. Secondly, it embraces the idea of "citizens' self-government," by which residents of these local areas participate in and handle, to varying degrees, activities of the local public entities. Japan's system of local self-government originates from the pre-World War period, primarily from the concept of autonomous local entities. After the war, the concept of citizens' self-government was incorporated to a greater extent.

Japan's fundamental principles of local self-government are set forth in the Local Autonomy Law (Chiho Jichi Ho), which gives specific legal validity to the principle of local autonomy as ensured by Chapter 8 of the Constitution of Japan. This Local Autonomy Law specifies the types and organizational framework of local public entities, as well as guidelines for their administration. It also specifies the basic relationships between these local entities and the central government. As of July 1996, Japan's local governments numbered as follows: 573 villages (mura), 1,993 towns (machi or cho), 23 special wards (tokubetsuku), 666 cities (shi) and 47 prefectures (43 of which are called ken, fu in the case of Osaka and Kyoto, to in the case of Tokyo, and do in the case of Hokkaido).

The organ of the central government that is in charge of local government-related administrative activities is the Ministry of Home Affairs. It is responsible for communication and exchange of views between the local and central government; it also establishes local self-government programs and tax systems.

After World War II, in accordance with the provisions of the Constitution and the Local Autonomy Law, Japan's local governments gained broad recognition of their autonomy and self-standing, both at the formal, structural, and at the operational level in terms of their actual dealings with the central government. Although they are considered autonomous entities, as the source of their funding and orientation comes from the central government, it is the central government that exercises control in various ways.

Further reflecting this situation, in May 1995, the Decentralization Promotion Law (Chiho Bunken Suishin Ho) was passed by the Diet. A specialized commission, set up in accordance with this law, has on 4 occasions (through October 1997) put forth specific proposals for the decentralization of authority from the national to the local level for a wide range of governmental functions.

Local Governments

As stated in the Local Autonomy Law, prefectures are administratively headed by governors (chiji), while cities, towns and villages are headed by mayors (cho). These officials represent the local governments in their external dealings and serve in an executive position vis-a-vis the elected local assemblies, the forums for discussion of local issues. Governors and mayors are elected for 4-year terms by direct popular vote and are responsible to the local citizenry.

The local assemblies (including those of the 23 special wards of Tokyo) are composed of members elected by the local voters. Among the functions of these assemblies are establishing or abolishing local ordinances, determining local government budgets, and approving settlements of accounts. They also check work undertaken by local bodies on their own initiative or when delegated to do so by organs of the central government. Like-wise, they request audits by the local governments' audit commissions and have a say in the selection of important local officials (vice governors, deputy mayors, etc.). Their work is carried out largely by standing committees (jonin iinkai).

The Large-City System

In response to the special characteristics of the administration of very large cities, the Local Autonomy Law designates for such cities a number of special regulations that differ from those affecting ordinary cities, towns, and villages.

First of all, there is the unique system currently in effect in Metropolitan Tokyo. The 23 wards that make up the most densely populated part of Tokyo Metropolis are designated as special wards (tokubetsuku), each of which has a status similar to that of cities, within certain limitations. They can elect ward mayors, for instance. Some of the responsibilities and services normally reserved
for cities are, in fact, in the hands of the Tokyo Metropolitan Government. Many are calling for further changes to make the ward administrations more closely approximate ordinary cities.

Secondly, in keeping with the Local Autonomy Law, a cabinet order was issued for large cities with more than 500,000 people that made special provisions for their administration and finances. This is now being applied to 12 cities, other than Tokyo, most of which have populations of more than 1 million. These are Osaka, Kyoto, Nagoya, Yokohama, Kobe, Kita Kyushu, Sapporo, Kawasaki, Fukuoka, Hiroshima, Sendai, and Chiba. In these government-designated cities, authority over 18 categories of public activities - including welfare, hygiene, and urban planning - that are ordinarily within the prefectures’ and governors’ spheres of competence is transferred to these cities' decision-making and administrative mechanisms. Additional legal authorizations transfer still other elements of prefectoral control and authority to these cities, with the result that they are treated, for all practical purposes, on a par with the prefectures. Each of these cities is divided into several wards to facilitate the work of city administration, and each geographical subdivision has a ward office that employs a ward head and other public servants.

**Local Public Finance**

Each year, the Cabinet must put together a document giving the total estimated amount of revenue and expenditures of the local governments for the next fiscal year. This document must be made public and submitted to the Diet. Ordinarily called the local finance plan, it becomes the main guideline for the various local governments' financial operations. The scale of these local finances is enormous, as approximately 60% of the country's total public expenditures is channeled through local governments. In fiscal 1997, these local expenditures amounted to approximately 88 trillion yen (US$730 billion).

Local taxes (*chihozei*), which constitute an autonomous sort of revenue for local governments, are collected by these local administrations within the limits of their authority to levy taxes. There are both prefectural taxes and taxes levied by cities, towns, and villages. Both types of taxes are subcategorized into special-purpose taxes, to be used for certain designated ends, and ordinary taxes, whose use is not specifically designated.

Local taxes covered only about 33.2% of local governments' total expenditures in 1995. Thus the financial gap was supplemented by local government bonds (*chihosai*) 16.8%, and, budgetary transfer from the central government to the local governments: local allocation taxes (*chiho kofuzei*) 15.9%, and national treasury disbursements (*kokko shishutsukin*) 14.9%. From the financial point of view, local governments rely on the central government. Pointing out this circumstance, some criticize that a local government has only one third of its autonomy.

Local allocation taxes are used by the central government as a means of adjusting local financial administration with a view to ensuring a certain level of administrative equality throughout the country. The monies are allocated as general revenues that local governments can use as they see fit. These funds account for a large portion of several types of taxes levied at the national level, namely, 25% of tobacco taxes, 24% of general consumption taxes, and 32% of the combined revenue derived from liquor taxes, plus corporation and income taxes. On the other hand, national treasury disbursements are made to local public entities by the government to defray the cost of specific programs.

As a means of increasing local governments' financial resources for the purpose of promoting the local share on authority and improvement of local welfare undertakings, a system of local consumption taxes was instituted in 1997. The issuance of local government bonds is subject to various limitations imposed by the central government, including the need for formal permission granted by the Minister of Home Affairs. The commission on reforms, established under the Decentralization Promotion Law, is pressing for the abolishment of this permission system.

**Growing Citizens' Awareness**

Japan's local self-government, has provisions for direct democracy not seen at the national level. For example, after collecting signatures from 2% of registered voters in a given local area, residents may request that heads of government establish, change, or abolish a certain ordinance. Or, with the same percentage of signatures, local residents may demand that a local audit commission perform an audit of work carried out by a head or a local public entity. By collecting the signatures of one third or more of registered voters, petitions can be made to local election administration commissions to dissolve local assemblies or to dismiss a head or key local officials.
In addition to these types of direct petition, local residents are guaranteed by the Constitution (Article 95) the right to vote directly on special laws applicable only to one local public entity.

As a result of changes in residents' awareness and in the political environment, there are a growing number of local governments that are establishing voting ordinances allowing residents to vote yes or no on important local issues. This trend is not based on the Local Autonomy Law but on the constitutional right to establish local ordinances. At present, local ordinances have been established in this way with respect to such issues as the building of nuclear power stations, plans to fill in seaside marsh areas, the continued existence of U.S. military bases, and the building of waste disposal facilities.

Reflecting the need to respond to various residents' complaints about local governments, beginning in 1990 (in the city of Kawasaki, Kanagawa Prefecture), systems have been established for employing a local ombudsman charged with investigating aspects of local administration. The ombudsman has the necessary powers of investigation to resolve complaints, and in cases where it is judged that the reasons for complaints are grounded in systemic defects or administrative shortcomings, the ombudsman will make his or her views public and advise the local administrative head to correct the investigated problems.

Source: Japan Embassy, Singapore
Appendix 4: SME-related Laws in Japan

**Small and Medium Enterprise Basic Law:** The Law aims to provide new paths for small and medium enterprises and set forth goals of policies for those enterprises.

**Law on Supporting Business Innovation of SME:** This law stipulates measures to support business innovation by small and medium enterprises in response to changes in the economic environment. It also provides measures to strengthen operating bases that contribute to future business innovation among SME that have been markedly affected by major changes in the economic environment, and thereby promote innovative development by small and medium enterprises and contribute to the sound development of the national economy.

**Japan Small and Medium Enterprise Corporation Law:** Japan Small and Medium Enterprise Corporation provides necessary guidance, finance, investment and assistance to promote the advancement of small and medium enterprises and the development of new businesses. The Corporation also provides loans to insurance and credit guarantee associations in connection with the guarantee of credit for facilitating funding of the activities of Small and Medium Enterprises. At the same time, the Corporation provides training and for rationalizing management and improving the technology of Small and Medium Enterprises, while administering a relief system under the Small Enterprise Mutual Relief Project Law and the Law on Mutual Relief System for the Prevention of Bankruptcies of Small and Medium Enterprise.

**Temporary Law concerning Measures for the Promotion of Creative Business Activities of SME:** The Law stipulates rules of approval and others matters regarding research and development programs of SME, industries unions and others in order to enter into new business sectors.

**Temporary Law concerning Measures for Smooth Adaptation to Structural Changes in Economy by Advancement of Specific SME to New Fields, etc.:** The Law aims to assist small and medium enterprises affected by the economic structural changes. It supports those enterprises to enter new business sectors or facilitate the business expansion to overseas.

**SME Modernization Promotion Law:** The Law aims to assist structural improvement activities carried out by industry associations and others in accordance with industry-by-industry modernization plans in order to promote modernization of small and medium enterprises.

**Law on Financial and Other Assistance for Small Business Modernization:** The Law requests the national government to assist prefectural governments in necessary loans for modernization of facilities of small and medium enterprises.

**Small Business Corporation Law:** The Law stipulates the Small Business Corporation. The aim of the Corporation is to contribute to training and guidance for promoting advancement of small business structure and streamlining of corporate management. Its other duties include contributing to operation of mutual relief projects under the Small Enterprise Mutual Relief Projects Law and the Law on Mutual Relief System for the Prevention of Bankruptcies of Small and Medium Enterprises.

**Small Business Finance Corporation Law:** The Law stipulates the Small Business Finance Corporation. The Corporation’s aim is to extend long-term loans which are necessary for the promotion of businesses of smaller companies but difficult to obtain from ordinary financial institutes.

**Shoko Chukin Bank Law:** The Law stipulates the Shoko Chukin Bank. The Bank’s aim is to conduct necessary activities to facilitate financing toward the Cooperative Associations of SME and other organizations composed mainly of small and medium enterprises.

**SME Credit Insurance Law:** The Law sets small and medium enterprise credit insurance to facilitate financing of operation money for small and medium enterprises, aiming at their development.

**Small Business Credit Insurance Corporation Law:** The Law stipulates the Small Business Credit Insurance Corporation. The Corporation’s aim is to facilitate financing of operation money for small and medium enterprises by insuring for compensation of their debts and providing necessary money toward the Credit Guarantee Association.

**Credit Guarantee Association Law:** The Law sets the system of the Credit Guarantee Associations aiming at smooth financing for SME. The system’s main duties are to make guarantee for such debts when those enterprises are financed by other financial institutes.
Limited Partnership Act for Venture Capital Investment: This law stipulates a system of "venture capital investment limited partnership" to legally limit to capital invested the liability borne by limited partners with a view to promoting the provision of funds to venture business in Japan from various investors.

Small Business Investment Company Limited Law: The Law stipulates the Small Business Investment Company Limited. Its aims are to invest in and promote activities for small and medium enterprises to increase their shareholder's equity and healthy development of their businesses.

Law concerning the Promotion of Improvement of Employment Management in SME for Securing Manpower and Creating Quality Jobs: The Law stipulates support measures for SME that are members of the business cooperative associations or individual enterprises by the means of subsidies, loans, tax break and so forth. Enterprises are eligible to receive such supports when their business improvement plans are approved by local prefectural governments.

SME Guidance Law: The Law stipulates planned and effective implementation of small and medium enterprise activities by the national government, local governments and the Small Business Corporations for the purpose of streamlining corporate management of such enterprises and improvement of their skills.

Law concerning the Organization of SME Organizations: The Law stipulates establishment, organization, management and coordination of the Cooperative Associations, the Commerce and Industry Associations and the Federation of the Commerce and Industry Associations. It also stipulates the Small and Medium Enterprise Stabilization Council.

Law on the Cooperative Association of SME: The Law stipulates establishment, organization and management of the Cooperative Associations of Small and Medium Enterprises (Business Cooperative Associations, Business Cooperative Small Associations, Cooperative Associations for Fires Mutual Relief, Credit Cooperative Associations, Federations of Cooperative Associations and Unions) and the Centers of Small and Medium Enterprise Organizations (Prefectural Centers of Small and Medium Enterprise Organizations and National Centers of Small and Medium Enterprise Organizations).

Law on Supporting Small Industries: The Law stipulates measures by regional economic organizations such as chambers of commerce and industry or commerce and industry associations to assist small enterprises to improve and develop their businesses through "Management Improvement Popularization Activities" and "Basic Facilities Activities.

Commerce and Industry Association Law: The Law stipulates the objectives, activities, operation, supervision and other aspects of the commerce and industry associations.

Law on Securing Business Opportunities for SME by Adjusting the Business Activities of Large Enterprises: The Law aims to adjust start and enlargement of business activities of large enterprises which may have an extremely negative impact on the stability of the business operation of small and medium enterprises in accordance with the request of relevant small and medium enterprise associations. While paying attention to the protection of interests of consumers, adjustments are made by the competent minister in charge of the industries concerned. It also aims to guarantee proper business opportunities for small and medium enterprises through guidance to promote modernization and rationalization of their businesses.

Law concerning the Promotion of Efficient Distribution Systems in SME: The Law stipulates procedures, necessities, contents and other aspects regarding assistance to efforts by small and medium enterprises to improve their efficiencies in distribution by the means of financing and tax break and others.

Law on Ensuring the receipt of Orders from the Government and Other Public Agencies by SME: The Law aims to expand demand of materials supplied by small and medium enterprises. It stipulates measures to secure business opportunities for those enterprises regarding government's procurement contracts.

Law on the Promotion of Subcontracting of SME: The Law aims to promote subcontracting small and medium enterprises. It stipulates measures to promote their effective modernization and to introduce subcontracting business opportunities through the Association of the Promotion of Subcontracting Small and Medium Enterprises.
Law on the Prevention of Delay in the Payment of Subcontracting Charges and Related Matters: The Law aims at fair trade toward subcontractors by preventing delay in the payment of subcontracting charges.

Small Enterprise Mutual Relief Projects Law: The Law stipulates the system of mutual relief against retirement or bankruptcies of small enterprises and other incidents under the spirits of mutual assistance.

Law on Mutual Relief System for the Prevention of Bankruptcies of SME: The Law stipulates the system of mutual relief to prevent bankruptcies of small and medium enterprises caused by bankruptcies of their clients.

SME Retirement Allowance Cooperative Law: Aiming to contribute to enhancement of employees' rights in small and medium enterprises and promotion of such enterprises, the Law stipulates the retirement allowance cooperative system for such enterprises which are difficult to establish their own retirement allowance systems by the means of mutual relief and the governmental assistance.

Law on the Promotion of Small and Medium Retail Business: The Law stipulates measures to promote activities such as modernization of small retailers by improving local shopping districts and by encouraging concentration of stores and organization of joint stores.

Shopping District Promotion Association Law: By promoting environment improvement activities and joint business management in shopping districts with the participation of retailers, service businesses and other enterprises, the Law aims to contribute to healthy development of businesses in local districts and advancement of commonweal.

Law on Special Measures for the Adjustment of Retail Businesses: The Law stipulates the system for guaranteeing proper business opportunities for small retailers and for eliminating demand dampening factors against those retailers.

Law on Temporary Measures for Concerning Activation of Specific Small and Medium Enterprises: The Law stipulates measures to activate local area through diversification and adding value making use of techniques etc. specific to the area and tradition for the purpose of spontaneous development of small and medium enterprises.

Source: METI
## Appendix 5: Small & Medium Enterprises in Japan’s Economy

<table>
<thead>
<tr>
<th>Year</th>
<th>No. of Establishments</th>
<th>Employment</th>
<th>Value Added (billion yen)</th>
<th>Productivity of value added per employee (thousand yen)</th>
<th>Shipment value in small and medium manufacturing (Billion yen)</th>
<th>Export (Billion yen)</th>
<th>Nominal GDP (Trillion yen)</th>
<th>Growth (% of GDP)</th>
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<tbody>
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<tr>
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<td>99%</td>
<td>99%</td>
<td>99%</td>
<td>99%</td>
<td>99%</td>
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<tr>
<td>1990</td>
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<td>99%</td>
<td>99%</td>
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<tr>
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<td>99%</td>
<td>99%</td>
<td>99%</td>
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<tr>
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<td>99%</td>
<td>99%</td>
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<tr>
<td>1993</td>
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<td>99%</td>
<td>99%</td>
<td>99%</td>
<td>99%</td>
<td>99%</td>
<td>99%</td>
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</tbody>
</table>
   Notes:  a. SMEs are defined as establishments employing fewer than 300 people (fewer than 100 in wholesale and 50 in retail and service sectors).
   b. Data represent all nonprimary industries, i.e., excluding agriculture, forestry, and fisheries.

   Establishment and Enterprise Census of Japan.
   Notes : a. For all firms (non primary industries) SMEs are defined as enterprises capitalized at 300 million yen or less.
           (Wholesale:100 million yen or less / Retail:50 million yen or less.)

<table>
<thead>
<tr>
<th>Year</th>
<th>Number of Establishments</th>
<th>Employment</th>
<th>Capitalization</th>
<th>Capitalization</th>
<th>Capitalization</th>
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<td>98.9</td>
<td>31,243,768</td>
</tr>
<tr>
<td>1996</td>
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<td>98.9</td>
<td>31,662,394</td>
<td>98.9</td>
<td>31,662,394</td>
</tr>
</tbody>
</table>

| 1994 | 6,470,532                | 99.1       | 379,071        | 99.0           | 32,204,424     |
| 1995 | 6,463,450                | 99.0       | 381,019        | 98.3           | 31,787,503     |
| 1996 | 6,433,942                | 98.9       | 365,946        | 99.0           | 30,451,240     |
| 1997 | na                       | 98.9       | 31,243,768     | 98.9           | 31,243,768     |
| 1998 | na                       | 98.9       | 31,662,394     | 98.9           | 31,662,394     |
Appendix 6: Map of Japan