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German Investment in Developing Countries

by Awni-Al-Ani, Hamburg

The Pros and Cons of direct investment promotion measures in overseas countries have recently become the subject of fierce controversy in all industrialised countries, including the Federal Republic of Germany. Advocates and opponents of such measures, however, almost exclusively try to analyse the desirability and effects of such investments in the industrialised countries only, virtually disregarding the problem of direct investment in developing countries. The Department on Development Policies of the Hamburg Institute for International Economics has therefore recently begun to investigate the volume, the motivation, and the success of German investments in the "Third World". The following report discusses the first results of this study.

Though both public and private sectors of the German economy agree that increased overseas investments are required, there is disagreement over the methods of promoting such investment activities which, relatively to other industrialised nations, are on a low level in the Federal Republic (see Table 1).

However, the indispensable basis for making proposals on the ways and means by which to increase direct German investments in developing countries would be an empirical investigation, long overdue, into the motivation, the prospects, and the problems of development investments which have been made in the past. The discussion in this article is based on the results of direct questioning by the Institute of 53 German industrial concerns from a multitude of different branches of production and of varying sizes of the companies involved, which have made themselves responsible for a total of 95 investment projects in 25 developing countries (31 of the

projects are in Asia, 7 in Africa, 47 in Latin America, and 9 in Europe¹.

Multiple Motivation

By far the most important motive for investing abroad is the intention of securing sales outlets. In 83 p.c. of all the cases under review, parent companies have named, among their objectives, protection and consolidation of their market positions. This desire was motivated as follows:

Exports have declined because former client countries have substituted products of their own for former imports;

Exports have gone down through import restrictions imposed by governments of former client countries;

¹ The Hamburgisches Welt-Wirtschafts-Archiv (the Hamburg Institute for International Economics) is at present engaged in a study of German investments in developing countries, comprising about 600 different projects, for which 200 German investors are responsible. The results of this enquiry will be published by about the middle of 1969. The present article uses preliminary results from the material that is available now.

Table 1
State of West German Direct Investments in Developing Countries
(DM million)

Continent	up to and including 1961	1962	1963	1964	1965	1966	1967	1968
Europe	147.7	190.2	256.2	328.9	424.6	522.7	632.1	736.8
Africa	141.8	228.4	295.8	341.0	395.5	490.2	594.4	729.9
America	1,099.3	1,356.9	1,476.5	1,514.5	1,579.1	1,736.1	1,925.8	2,376.4
Asia	122.8	151.0	167.8	200.8	241.7	287.6	319.7	347.0
Total Developing Countries	1,511.6	1,926.5	2,196.3	2,385.2	2,640.9	3,036.8	3,472.0	4,190.4
Total Industrialised Countries	2,330.9	3,029.2	3,874.5	4,819.9	5,676.1	6,958.7	8,584.0	10,158.6
Grand Total	3,842.5	4,955.7	6,070.8	7,205.1	8,317.0	9,995.5	12,056.0	14,349.0

Source: Bundesminister für Wirtschaft: Runderlass – Außenwirtschaft, betreffend IV/I: Vermögensanlagen Gebietsansässiger in fremden Wirtschaftsgebieten (Circular Decree of the Federal Minister of Economics on Foreign Trade, reference IV/I: Capital Investments by Residents in Foreign Trading Areas).

- Keener competition in Europe;
- Changed structure of demand in Europe;
- Patent protection (numerous developing countries will recognise foreign patents only on condition that the patented products and/or processes are used in local production);
- To secure foreign orders (some developing countries tend to award export orders only to such firms which invest on their home territory).

This goes to show that the prevalent motives of German companies investing in developing countries are created by state imposed measures. The former Chairman of Volkswagen, Professor Nordhoff, once declared—and thus spoke for many German investors—that his company was not inclined to increase its overseas output without being forced to do so. Setting up production plants abroad was only one of the suitable means to overcome obstacles which hinder exports. All foreign production plants (of German companies) were operating at much higher costs than home facilities, and producing abroad was always a burden².

As the second major reason for engaging in foreign investments there appears the wish to open up new markets (in 61 p.c. of the answers received), but it was not possible to find out whether or not this desire had been caused by a threat to the market position of the company concerned.

Both the Federal Republic of Germany and developing countries are full of praise for the measures of tax remission and financial support

Table 2
Breakdown of Motivation for German Investments in Developing Countries by Reasons Given

Reasons given	in p.c. of total number of projects *
Securing of market shares and other motives based on constraint	83
Opening up of new markets	61
Tax remission and financial advantages	29
Building up and/or maintaining good will	18
Low wage levels	13
Private reasons	10
Safeguarding raw material supplies	8
Opening up additional outlets for other products of company	4
Shortage of labour in West Germany	3
Cheap raw materials and other requirements	2

* Percentages given in this column add up to more than 100, since more than one reply was received in individual cases.

for direct investments, but only in one third of the cases under review did such measures contribute materially to the decision to invest in a developing country.

The low wage levels prevalent in developing countries are of importance only for investments in processes with a high labour content. This motivation appears only as the fifth most im-

² cf. Die Welt, No. 104, May 5, 1964.

portant one, which indicates that ostensibly low labour costs in developing countries must not be overrated as a major attraction for investors. Training expenditure, the costs for sending German skilled staff to the country where investment is desired, and relatively low productivity of local labour all tend to absorb the advantages of low wage rates. However, this may change in future, and wage advantages may then make a bigger impact on investment decisions in line with the progressive improvement in labour skills and productivity that is under way in developing countries.

High Costs of Production

The results of the present enquiry have led to the conclusion that the frequent belief that production costs in developing countries are lower than in West Germany, because of their low

Table 3
The Structure of Costs

Type of Costs	In p.c. of the Cases Under Review		
	lower than in West Germany	higher than in West Germany	same level as in West Germany
Overall costs	25	71	4
Labour costs	79	8	13
Cost of materials used	12	85	3

wage levels, the cheaper raw material supply, and the tax remissions and lower financial burdens, is a fallacy. Only 25 p.c. of the projects reviewed showed overall costs which were lower than in the Federal Republic of Germany, whilst, in 71 p.c. of the total, costs were higher than in West Germany by between 10 and 30 p.c. Costs of materials used were more expensive than in Germany in no less than 85 p.c. of all cases, and only labour outlay showed a prevalence of lower costs, as is shown in Table 3.

Products which are to be produced by the plant that is the object of an investment project will be marketed in the country where the investment takes place in 91 p.c. of all cases reviewed, and in 5 p.c. of these cases the products are intended only for marketing in industrialised countries.

Differences in Earnings

The projects under review showed big differences between the earnings recorded in the past and their prospective yields. For investments made

Table 4
Marketing Outlets

Type of Market	for p.c. of total number of projects
Only the country where investment has been made	60
Country of investment and other developing countries	23
Country of investment, other developing countries, and industrialised countries	8
Industrialised countries only	5
Not indicated	4

before 1965, assessments of present yield positions can be broken down as follows: "Good" yields are being earned by 22 p.c. of all projects, 38 p.c. show "sufficient" profits, and 35 p.c. "poor" yields. On the other hand, assessments of prospects are more hopeful—in 36 p.c. of all cases, "good" earnings are expected, and in 50 p.c. "sufficient" ones.

Investments made after 1965 showed a present-day yield assessment of 36 p.c. "sufficient" and 50 p.c. "poor".

The good results of investments which were made before 1965, as against the poorer ones of all later projects, may be explained by the fact that earlier investors have had sufficient time to gain a foothold in the markets of the developing countries, whereas later ones have still not yet fully overcome their initial difficulties.

Table 5
Assessment of Earnings

Assessment	Interest acquired up to 1965 in p.c. of cases		Interest acquired since 1965 in p.c. of cases	
	Past results	Future trend	Past results	Future trend
very good	5	4	—	—
good	22	36	13	40
sufficient	38	50	44	50
poor	35	10	43	10

It is interesting how differently future prospects are being judged. The trend is for all investors without exception whose profits have hitherto been very good to predict the likelihood of declining profit margins, whilst the remaining businessmen expect their results to improve to between "sufficient" and "good".

With certain reservations, this enables us to conclude that prospective earnings of German investments in developing countries are judged to be, in the long run, between "sufficient" and "good".

Profits which have been earned on investments in developing countries have, in the main, been reinvested (in 45 p.c. of all the cases under study), whilst in 32 p.c. of all cases, only part of the earnings were reinvested, the balance having been remitted home.

A Host of Obstacles to Investment

Investment activities in developing countries are beset with a multitude of problems: 75 p.c. of all projects reviewed encountered red tape and administrative delays in the country which was designed to benefit from them. The obstacles are mainly time-wasting official procedures (the need to obtain permits, licences, proof of registration, etc.) for all business projects and decisions on company policy. In addition, many developing countries have legislated, in the spirit of their socialist economic policies, for restrict-

ing managerial and entrepreneurial discretion in the making of decisions, e.g. on fixing output capacities, on sales prices, on the employment regulations, on the use made of the profits earned, etc.

Table 6
Obstacles Encountered by Investment Projects

Type of Obstacle	In p.c. of all cases reviewed *
Administrative problems in the country where investments are planned	74
Import restrictions because of lack of foreign currency	50
Poor quality and irrational moods of local labour	28
Poor quality of raw and other materials and of production facilities	26
Delayed deliveries of spare parts, and of raw and other materials	26
Weak infrastructure in the developing country	16
Restrictions on remitting profits home	14
Obstruction by local partners	12

* Adding up the percentages given will result in more than 100, since more than one problem encountered was named by companies.

A second major hindrance (50 p.c. of all cases) are import restrictions on foreign machinery, raw and other materials, spare parts, etc., because of the developing countries' shortage of foreign currency. In 16 p.c. of all cases, a weak and insufficiently developed "infrastructure" of the country of investment was found problematical, but the difficulties in the way of making remittances of profits home have been quoted as obnoxious only in 14 p.c. of all cases.

Support Measures to Be Desired

The companies who have answered the Institute's questionnaires also brought forward a number of proposals and suggestions which they thought suitable for making it easier and more profitable to invest in developing countries, in this order of frequency with which the proposals were made:

- Tax remission through higher depreciation allowances on fixed assets and operating capital, and through permission to set off losses incurred overseas against profits earned at home;
- Guarantees for managerial discretion in developing free and unhindered initiatives and decision-making in running any business;
- Better support to be extended by West German diplomatic missions abroad;
- The conclusion of investment pacts and of agreements on avoiding double taxation;
- Dismantling the obstacles placed in the way of making profit transfers.

Legislators would be well advised to study this list of proposals and suggestions most carefully when preparing for future measures to aid and assist materially development investments in the future, and pay to them more heed than they have done in the past.