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Incentives for Private Investment Abroad

Development policy is once again the subject of lively discussions in the Federal Republic of Germany. Interest in it has been stimulated by the *Entwicklungshilfe-Steuer-gesetz* (Development Aid Taxation Act) which serves the purpose of encouraging capital investment by German firms in developing countries through tax concessions. The present act will expire at the end of this year, and the issue in the current debate is whether it should be retained and extended in its present form or subjected to fundamental changes.

The main objections raised against the act as at present are that the concessions depend on the amount of capital invested and thereby discriminate against labour-intensive investments in developing countries, that it does not permit selective or variegated aid for different countries and regions, and that the choice of investment projects cannot be influenced. These objections are being raised primarily by the Ministry for Economic Cooperation, the Ministry of Finance and some scientific institutes whereas economic organisations such as the Federal Association of German Industry have expressed the view that there are no grounds of substance to justify altering the scope of the act and that, certain necessary amendments apart, it has proved its value in its present form.

The debate is taking place against a background of certain basic ideas on the purpose and usefulness of direct private investment in developing countries and the efficacy of tax concessions as aid instruments. An *a priori* intention that labour-intensive investments and undertakings in especially poor regions only should benefit from the tax concessions, rests on the assumption that in the first place other investments in developing countries would either be made without this kind of aid and/or are undesirable from the point of development policy, secondly that applicable, practicable and operational criteria for differentiation and starting points for appropriate aid measures are available, and thirdly that taxation provides suitable devices for such a policy.

All experience concerning the forms, regional distribution and motivation of investments abroad

suggests that tax concessions in whatever form they are given play only a secondary role in investment decisions. That despite special tax concessions direct investments in developing countries account for only a very modest part of the total German investment abroad is symptomatic. According to spokesmen of German firms this kind of assistance has so far at best balanced the special risks involved in capital investment in developing countries as compared with industrial countries. Seeing that even in the most favourable cases the conditions on the side of supply are no more than equal, this means that the investment decision will in fact be in favour of the industrial countries with their better marketing conditions. The conclusion to be drawn from this however is that the concessions which have been granted hitherto should be retained, apart from insignificant modifications, if a downturn in the volume of direct investment in developing countries is to be avoided.

Additional concessions for certain projects in defined regions would be conceivable on this basis, but whether they ought to be granted within the framework of this act, i.e. through tax measures, is doubtful as they may overburden and unnecessarily complicate the act by including provisions of questionable efficacy.

In this context it should be borne in mind that tax measures are only one among many other available instruments of development policy and the desired effects could probably be secured more easily by other means. Labour-intensive projects in developing countries could, for instance, be helped by defraying the expenses of investing firms for training local labour from technical assistance funds of Germany. Investments in especially poor countries could be supported by providing for the requisite infrastructure facilities through capital aid. Other examples could be given for such an aid policy. No more importance should therefore be attached to tax measures for the encouragement of capital investment in developing countries than is justified by their efficacy. They will be most effective if they are used as an integral part of an overall concept for the encouragement of investments in developing countries. *Otto G. Mayer*