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ARTICLES

EASTERN GERMANY REPORT: INVESTMENT INCENTIVES IN THE NEW LÄNDER

by Alexander Reus¹

INVESTMENTS IN GERMANY

This comment attempts to provide a comprehensive overview and insight into the various investment incentives offered by the reunited Germany for investments in the territory of the former German Democratic Republic ("GDR"). The introduction presents the legal, political, and economic status quo which render Eastern Germany an appealing investment object. It is followed by the historical background and significant changes, which culminated in the current position of the former GDR as the central focus of international investment. In Part II of this comment the author introduces the international investor to the various investment schemes provided by the Federal Republic of Germany ("FRG"), its new states, the European Community ("EC"), and various investment banks. This Part ends with two sample investment plans for small and large businesses and a critical analysis of investment impediments. Part III presents the attractiveness of the European market as framework and expansion potential for investors having secured a domestic market position in Eastern Germany. Part IV deals with special investment incentives and competitive advantages of U.S. investors, as well as, U.S. support and tax credits for such investments. Part V concludes with a positive perspective for both the recovery of the Eastern German economy and the potential returns for committed investor.

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I. INTRODUCTION

The former GDR presents one of the world's most promising markets and opportunities for foreign investments during the 1990's.² After the economic unification on July 3, 1990, and the political unification on October 3, 1990, the newly enlarged FRG offers the necessary prerequisites for a favorable investment climate: a hard currency, a predictable legal system, a western style banking system, excellent supply of capital, developing and expanding markets, large numbers of skilled and trainable workers at low labor costs, extensive scientific and technical facilities at universities and research institutes, and group and individual motivation.³

As the FRG, inclusive of its Eastern part, approaches the EC 1992 target date⁴, and with respect to the recent and projected developments in Eastern Europe,⁵ investments in Europe "change their face" and gain increased significance and attractiveness. Germany is a major part of the "EC-scheme" and presents the ideal gate to a broader, mainly Eastern oriented, European market.⁶

The reunification has increased the German population to 79 million, rendering Germany's internal market Europe's largest and richest.⁷ Additionally, in its rebuilding stage, the Eastern part of Germany has an enormous appetite for high-quality goods and services, as well as know-how and management.⁸ This presents oppor-

² John E. Blyth, *Incentives and Impediments to U.S. Investment in the Former German Democratic Republic*, 63 *NY St. B. J.* 8 (Mar.- Apr. 1991).

³ *Id.*

⁴ The target date refers to the formation of the Common Market.

⁵ Christian Hoenig, *Investing in Eastern Europe Through an Austrian Holding Company*, 26 *INT'L LAW.* 303, 305 (1992).

⁶ *Investment In Eastern Germany Opens The Door To European Community, Rest Of East Europe*, *INT'L TRADE REP. (BNA)*, June 12, 1991, at 907.

⁷ Michael E. Murphy et al., *New Access to Europe: Investing in Eastern Germany*, 48 *THE BENCH & BAR OF MINN.* 19 (July 1991).

⁸ *East Germany Offers Investment Opportunity Despite Economic Problems, Official Says*, *INT'L TRADE REP. (BNA)*, January 30, 1991, at 168 (Germany as an excellent market because of the growing demand for goods); *Eagleburger Urges U.S. Companies Not To Give Up On Eastern Germany*, *Int'l Trade Rep. (BNA)*, October 10, 1990, at 1553 (Deputy Secretary of State Lawrence S. Eagleburger says, U.S. companies have a "real advantage" over European and Japanese firms in management techniques and technological development).

tunities for both domestic and international investors to “step in” and secure long-term market positions.

Eastern Germany is located in the heart of Europe and opens the door not only to existing Western European markets, such as the EC and the European Free Trade Association (EFTA)⁹, but also to newly accessible and increasingly growing Eastern European markets which extend far beyond Poland, Czechoslovakia, and the Balkan States.¹⁰ Germany has already become the bridgehead for U.S. companies such as GM, Proctor & Gamble, Philip Morris, IBM, and Coca-Cola into Eastern Europe and the former Soviet Union.¹¹ This is due to its central location as well as the language capabilities and know-how of many Germans experienced in doing business in the Eastern European market.¹²

Despite the general potential for investments in Germany and Europe, there are additional incentives rendering Eastern Germany the main focus for such investments. Tax incentives, investment funds and grants, assumptions of debts by the “Treuhandanstalt”, exemptions from environmental liabilities, and loans at preferential rates can provide assistance for up to 60% of the total investment.¹³

The author suggests that, as a result of high investment levels and high economic potential, a rebuilt Eastern Germany will possess the world’s most modern infrastructure and sustain a robust growth. Nevertheless, the “tickets” for participating in this development are now on sale at a wholesale price.

⁹ Current members of the EFTA are Austria, Finland, Iceland, Norway, Sweden, and Switzerland.

¹⁰ *cf.* Hoenig, *supra* note 4, at 303 (attractiveness of Austria for direct investments in Eastern Europe through an Austrian holding company); *see also Eagleburger Urges U.S. Companies Not To Give Up On Eastern Germany*, INT’L TRADE REP. (BNA), October 10, 1990, at 1553 (German Commerce Secretary Robert Mosbacher about good business opportunities in all the countries of Eastern Europe, particularly Poland, Hungary and Czechoslovakia, as well as the former Soviet Union).

¹¹ Mark Trumbull, *Eastern Germany Seeks U.S. Capital*, CHRISTIAN SCI. MONITOR, September 13, 1991, at 8.

¹² Michael E. Murphy et al., *supra* note 6, at 20; *Investment In Eastern Germany Opens Door To European Community, Rest Of East Europe*, INT’L TRADE REP. (BNA), June 12, 1991, at 907.

¹³ *Infra*, see main text under II. Investment Incentives and examples under II. 5) Examples of Small and Large Investments.

The history of "two Germanies"

After the Second World War, the allied forces divided the "German Reich" into several zones, with the former USSR controlling what had been known as the GDR for more than 40 years. Although each part of the separated Germany established their own constitution soon thereafter, the West German post-war Constitution provided in its "Präambel", that it was meant to be only a temporary solution until the reunification of both parts of Germany.¹⁴ With the Unification Treaty of August 31, 1990 ("Einigungsvertrag")¹⁵, and the accession of the five new states ("Neue Länder")¹⁶ to the FRG, pursuant to article 23 of the German Basic Law ("Grundgesetz"), this constitutional premise has been realized.¹⁷

Legal, political, and economical changes due to the unification

Although the public law aspects of the transition from split to united Germany culminated in the reunification, many legal and economic problems remained. These problems concerned the monetary union, the applicable law in the new states, labor laws, and the as-

¹⁴ PRAEAMBEL, GRUNDGESETZ VOM 23. MAI 1949 [German Basic Law], BGBl. I 1.

¹⁵ Vertrag zwischen der Bundesrepublik Deutschland und der Deutschen Demokratischen Republik über die Herstellung der Einheit Deutschlands - Einigungsvertrag [hereinafter Unification Treaty]-ratifiziert in der Bundesrepublik Deutschland durch Gesetz vom 23. September 1990 zu dem Vertrag vom 31. August 1990 zwischen der Bundesrepublik Deutschland und der Deutschen Demokratischen Republik über die Herstellung der Einheit Deutschlands - Einigungsvertragsgesetz - und der Vereinbarung vom 18. September 1990 (BGBl. II at 885) [hereinafter Unification Treaty Act].

Treaty Between the Federal Republic of Germany and the German Democratic Republic on the Establishment of German Unity, BGBl. II at 889 (dated Aug. 31, 1990) ("Unification Treaty") and Agreement between the Federal Republic of Germany and the German Democratic Republic on the Implementation and Interpretation of the Unification Treaty, BGBl. II at 1239 (dated Sept. 18, 1990), both ratified through the Act of September 23, 1990, BGBl. II at 885 ("Unification Treaty Act").

¹⁶ These five new states are Thuringen, Sachsen-Anhalt, Sachsen, Mecklenburg-Vorpommern, and Brandenburg. Eastern Berlin became a part of the already existing Western German city-state Berlin; Praeambel, Grundgesetz vom 31. August 1990 [German Basic Law] 1990 BGBl. II 889, 890.

¹⁷ Präambel, Grundgesetz vom 23. Mai 1949 [German Basic Law], modified by Einigungsvertrag vom 31. August 1990 [Unification Treaty], 1990 BGBl. II 889, 890; for further legal and historical details of the reunification, see, Oliver Passavant & Gerhard Noesser, *The German Reunification - Legal Implications for Investment in East Germany*, 25 INT'L LAW. 875 (1991)

sumption of debts, contractual as well as other legal obligations of the former GDR.¹⁸ Furthermore, substantial uncertainty existed with respect to conversions of existing businesses, corporate liabilities and capitalization, environmental liabilities and regulations, and the restitution of property to victims of expropriations under the Third Reich and the GDR.¹⁹

While in the socialist system of the former GDR, the majority of businesses were government-owned enterprises, in the FRG the Western system of a free market economy had been successfully in existence for more than 40 years. In order to close the gap between the two parts of Germany, the introduction of a market economy to the former Eastern part was mandatory and necessary. In order to do so, government-owned enterprises had to be restructured and reprivatized.²⁰ Hence, the Public Trust Institution ("Treuhandaanstalt"), established in March 1990,²¹ and reorganized by the Trust Law ("Treuhandgesetz") of June 17, 1990,²² provided that effective July 1, 1990, all companies owned by the state would be transformed by statute into either a GmbH²³ or AG²⁴.

The most significant problem in restructuring and reprivatizing the new federal states was the uncertainty and complexity of the property situation created by the restitutionary claims of formerly

¹⁸ cf. Passavant & Noesser, *supra* note 16, at 875.

¹⁹ This article focuses on the legal and economic problems related to investments in the territories and businesses of the former German Democratic Republic. Most "other" legal problems have been resolved. For a discussion of these "other" legal implications of the German reunification, see, Michael Gruson & Georg F. Thoma, *Investments in the Territory of the Former German Democratic Republic* (pts. 1 & 2), 14 *FORDHAM INT'L L.J.* 540 & 1139 (1991).

²⁰ The process of restructuring the Eastern German economy originated in the former GDR after the peaceful revolution of November 9, 1989. Substantial political pressure led to the implementation of the Joint Venture Ordinance [Verordnung über die Gründung und Tätigkeit von Unternehmen mit ausländischer Beteiligung in der DDR vom 25. Januar 1990], 1990 GBl. I 15, which for the first time allowed the foundation of privately-owned corporations.

²¹ Beschluss zur Gründung der Anstalt zur treuhaendischen Verwaltung des Volkseigentums vom 1. März 1990, 1990 GBl. I 107.

²² Gesetz zur Privatisierung und Reorganisation des volkseigenen Vermögens (Treuhandgesetz) vom 17. Juni 1990, 1990 GBl. I 300.

²³ Gesellschaft mit beschränkter Haftung ("GmbH") [limited liability company].

²⁴ Aktiengesellschaft ("AG") [stock corporation].

expropriated families.²⁵ Eventually, on March 22, 1991, the German Parliament ("Bundestag") passed the Law On The Elimination Of Obstacles To Privatization And On The Promotion Of Investments²⁶ which created the legal basis for the settlement of property matters and the break-through for investments.²⁷

II. INVESTMENT INCENTIVES

The legal and economic order of Eastern Germany offers sufficient certainty for investment activities in the new states.²⁸ Additionally, the statutory obligation of the Treuhandanstalt, to sell, restructure, and privatize companies owned by the former Eastern German government presents a unique, temporary investment opportunity for the business community.²⁹ The federal government of the FRG encourages private investment in the new states through a broad range of incentive programs, which provide assistance on investments of close to 60% and ensure a high degree of liquidity and substantial return.³⁰ These investment incentives exist in the form of direct and indirect assistance. The direct investment assistance is available in the form of tax-exempt investment allowances and tax-

²⁵ For a thorough discussion of this now moot matter, see, Gruson & Thoma, *supra* note 18, at 552-565; Volker B. Triebel & Graham J.C. Vincent, *Buying Businesses in the Former GDR*, INT'L FIN. L. REV., February 1991, at 35, 37.

²⁶ Gesetz zur Beseitigung von Hemmnissen bei der Privatisierung von Unternehmen und zur Förderung von Investitionen vom 22. März 1991, 1991 BGBl. I 766, *amended by*, Gesetz zur Änderung des Vermögensgesetzes und anderen Vorschriften vom 14. Juni 1992 (Zweites Vermögensrechtsänderungsgesetz), art. 7, 1992 BGBl. I 1275.

²⁷ Peter-Andreas Brandt, *Tax Perks in Eastern Germany*, INT'L FIN. L. REV., October 1991, at 35.

²⁸ Gruson & Thoma, *supra* note 18, at 577.

²⁹ See, Detlef Rahmann, *Investing in Eastern Germany*, 18 INT'L BUS. LAW. 507, 510 (1990); *Investment In Eastern Germany Opens Door To European Community, Rest Of East Europe*, INT'L TRADE REP. (BNA), June 12, 1991, at 907 (1,600 companies had been sold by mid-1991 already, with about 10% of the purchases going to non-German firms; meanwhile there are only about 200 companies left).

³⁰ BUNDESWIRTSCHAFTSMINISTERIUM [hereinafter BMWi][Federal Ministry of Economics of the F.R.G.], *INVESTING IN THE FUTURE - GERMANY'S NEW FEDERAL STATES* (March 1992) at 20.

ble investment grants.³¹ Indirect investment assistance is granted in the form of local infrastructure development.³²

In addition to the federal assistance programs, regional incentive programs have been established by each of the new states.³³ All assistance programs, federal and regional, as well as the sale of former government-owned companies through the Treuhandanstalt are open to German and foreign investors alike.³⁴

So far, the federal support programs have encouraged investments of DM 72 billion³⁵ in the new states, a figure expected to grow by 25% to 35% by the end of 1992.³⁶ Overall German investment in the former East Germany ranges at \$143 billion in 1991, while private investment in Central and Eastern Europe was at only \$7 billion, and merely \$570 million in the former USSR.³⁷

As a result of these high investment levels in Eastern Germany, the German Federal Ministry of Economics expects the former GDR's gross national product to grow by about 10% before the end of 1992.³⁸

Tax incentives

Although Germany is generally regarded as a high-tax country, due to the high German income tax rates of up to 53% combined with significant capital taxes,³⁹ the German Government has provided for a variety of tax incentives in the new states, such as amortization of intangibles and goodwill, selective investment grants and allowances, as well as a suspension of the trade tax on capital and

³¹ BMWi, *supra* note 29, at 24.

³² *Id.*

³³ *Id.* at 20.

³⁴ Except for tax allowances, which can only be claimed by an entity with German income tax liabilities, the relevant statutes and regulations do not contain discriminatory provisions based on citizenship or country of incorporation.

³⁵ Equal to \$ 45 billion at an exchange rate of 1.6:1.

³⁶ BMWi, *supra* note 29, at 20.

³⁷ *EBRD Head Criticizes EC Treatment Of Eastern Europe As Trade Rivals*, INT'L TRADE REP. (BNA), September 16, 1992, at 1609.

³⁸ BMWi, *supra* note 29, at 21.

³⁹ *Tax Considerations for U.S. Corporate Investors Planning a German Business Venture*, 92 TAX NOTES INTERNATIONAL 47-4 (October 9, 1992).

the net assets tax.⁴⁰ While these incentives were originally intended to expire after December 31, 1994, the German Finance Minister, Theo Waigel, has proposed and supported an extension until after December 31, 1995.⁴¹ Of further significance, particularly for U.S. investors, is the applicability of the U.S.-German income tax treaty to the territory of the former GDR, providing for a reduction in the withholding rate on direct investment dividends.⁴² This treaty applies after the tax laws of Western Germany entered into force in the five new states on January 1, 1991.⁴³

Investment Allowances

Investment allowances⁴⁴ are available for the acquisition or production of new and movable capital goods in the new federal states.⁴⁵ For an entity taxable under Germany's personal and corporate income tax laws, individual investment allowances amounted to 12% of the acquisition or production costs incurred after June 30,

⁴⁰ *Summaries of this week's important tax items*, 92 TAX NOTES INTERNATIONAL 47-H (October 9, 1992).

⁴¹ *Id.*

⁴² *Senate Foreign Relations Committee Official Transcript of Hearing on Tax Treaties with Spain, Finland, Germany, Tunisia, India, Indonesia, and the OECD Multilateral Convention (Tax Treaties - Doc 91-6105)*, 91 TAX NOTES INTERNATIONAL 35-38 (August 28, 1991); particularly important is the reduction in the withholding rate on direct investment dividends from 15 to 5 per cent. Yet, the treaty will only apply as far as the tax laws in Eastern Germany are "identical in substance" to those applicable to the rest of the country. *Year-End Sees Expansion of U.S. Tax Treaty Network*, 91 TAX NOTES INTERNATIONAL 3-9 (January 16, 1991) (The U.S. Treasury hinted that the department would not consider the existing cash and other investment incentives as contravening the "identical in substance" mandate).

⁴³ *German Digest*, 91 TAX NOTES INTERNATIONAL 10-30 (March 6, 1991).

⁴⁴ As the tax-exempt form of direct investment assistance.

⁴⁵ These allowances provide direct assistance for goods that:

- are not low-value goods (*i.e.* cost more than DM 800);
- are not passenger cars or aircraft;
- will remain a fixed asset of the company or plant in the New Federal States for at least three years from the date of purchase;
- and
- will be used for private purposes no more than 10% of the time during each year for at least three years from the date of purchase

BMW, *supra* note 29, at 38; §§ 1,2 Fördergebietsgesetz (Artikel 6 Steueränderungsgesetz vom 27. Juni 1991), 1991 BGBl. I 1331.

1990, and before July 1, 1992.⁴⁶ These allowances remain at 8% of these costs incurred after June 30, 1992, and before January 1, 1995.⁴⁷

Accelerated Depreciation Allowances

In addition to these investment allowances, the German fiscus offers special accelerated depreciation allowances for the acquisition or production of fixed assets, the modernization and/or expansion of buildings, and subsequent production costs of movable assets.⁴⁸ Section 4 of the "Foerdergebietsgesetz" (Artikel 6 Steueraenderungsgesetz 1991) provides that the investor may set off up to 50% of the purchase, manufacturing, or additional construction costs against taxable profits.⁴⁹ While generally the allowance may be used in the fiscal year of the purchase, manufacture, or construction, and the ensuing four years, special amortization for fixed assets is not available beyond the fiscal year ending December 30, 1994.⁵⁰

Cumulative Straight-Line Depreciation Allowance

After the expiration of the special depreciation period, § 7 IV "Einkommenssteuergesetz" (Income Tax Act) permits a 2% per annum straight-line depreciation allowances.⁵¹

⁴⁶ The member working on this edit suggests that there should be a footnote here. Please, advise author to provide.

⁴⁷ BMWi, *supra* note 29, at 38; yet, assets purchased after December 31, 1992 are only eligible if the qualifying enterprise ordered the product or started its production before January 1, 1993; Brandt, *supra* note 26, at 35.

⁴⁸ Investors may also claim the accelerated depreciation allowances for down payments on purchase costs or partial production costs; § 4(2) Foerdergebietsgesetz (Artikel 6 Steueränderungsgesetz vom 27. Juni 1991), 1991 BGBl. I 1331.

⁴⁹ Brandt, *supra* note 26, at 35. (This is a footnote that we added. Check with the author if it is the authority that he would have cited to.)

⁵⁰ *Id.* Yet, debates in Congress ("Bundestag") in September contemplated an extension of this deadline.

⁵¹ BMWi, *supra* note 29, at 39.

Exemptions From Municipal Taxes

Until December 31, 1994, an exemption from net worth taxes is available for assets of corporations located in the New Federal States. Persons who established residence in Eastern Germany before January 1, 1991 also enjoy this exemption.⁵²

Local authorities ordinarily levy municipal trade taxes on the basis of the total invested capital of an industrial or trade enterprise and its annual income. However, these taxes will not be levied until December 31, 1994.⁵³ Additionally, lower levels of municipal trade earning taxes have been introduced to small and medium-sized enterprises.⁵⁴

Income Tax Incentives

As a general exemption from income taxes, 12% of the income, up to DM 2.1 million, is tax free, with a guaranteed tax exemption of DM 10,000.00 for small businesses.⁵⁵ Furthermore, "a tax free appropriation of revenue is offered in an amount of 20% of the annual income up to DM 50,000.00."⁵⁶

Investment Grants

The new states and East Berlin are eligible for assistance under the "Improvement of the Regional Economies Act" (IRE Act) until the end of 1995.⁵⁷ This is a joint federal and state program supporting investment in trade, industry, and industry-related infrastructure.⁵⁸ The annual volume of this program is over DM 3 billion, with 50% contributions by both the Federal Government and the individual state governments.⁵⁹

⁵² *Id.* at 40.

⁵³ *Id.*

⁵⁴ *Id.*

⁵⁵ Blyth, *supra* note 1, at 15.

⁵⁶ *Id.*

⁵⁷ BMWi, ECONOMIC ASSISTANCE IN THE NEW GERMAN LÄNDER (May 1991) at 13; BMWi, *supra* note 29, at 41.

⁵⁸ *Id.*

⁵⁹ *Id.*

The EC's regional fund (ERDF) supplements these regional promotional measures by supporting investments in the new states and East Berlin with an annual contribution of DM 1 billion from 1991-1993.⁶⁰ Furthermore, the EC has decided to make another DM 30 billion available for regional investments in the steel sector.⁶¹ Additionally, the "Eastern Upswing" project, a DM 1.2 billion fund provided by both the federal and state governments, offers assistance for districts particularly affected by structural changes.⁶² Investment projects in the industrial and commercial sectors, and investment projects improving the regional infrastructure are eligible under these discretionary regional programs.⁶³

Investment Projects in the Industrial and Trade Sector

New ("greenfield") investment projects qualify for grants of up to 23% of the initial investment, a rate which also applies to additional investments in the course of the acquisition of failed or failing enterprises.⁶⁴ Costs for the expansion of an existing enterprise qualify for grants of up to 20%, while the maximum assistance for costs of an enterprise's conversion or modernization is 15%.⁶⁵

Other forms of assistance exist in the form of ERP-funds, equity capital support programs, and accelerated depreciation allowances, may be utilized.⁶⁶ However, the non-regional investment assistance may not exceed the maximum rate of 23% by more than 12%.⁶⁷ Hence, an overall support of up to 35% is possible. Another limitation on the regional support is that it is only available for a project producing goods or providing services for regular sale outside the region.⁶⁸

⁶⁰ *Competition*, EC COMMENTARIES, October 29, 1992, at 19; BMWi, ECONOMIC ASSISTANCE IN THE NEW GERMAN LÄNDER (May 1991) at 13; BMWi, *supra* note 29, at 41.

⁶¹ *Competition*, EC COMMENTARIES, October 29, 1992, at 19.

⁶² *Id.*

⁶³ BMWi, *supra* note 29, at 41.

⁶⁴ *Id.* at 42.

⁶⁵ *Id.*

⁶⁶ *Id.*

⁶⁷ *Id.*

⁶⁸ *Id.*; i.e. beyond a 20 miles radius from the municipality in which the applicant company is located.

Promotion of Economic Infrastructure Projects

Assistance under the IRE Act is provided for improving the infrastructure in the following areas:⁶⁹

-preparation or renovation of property for industrial or commercial use;

-construction or expansion of educational, training, and retraining facilities;

-construction or expansion of the transportation infrastructure for the development of industrial and commercial zones;

-creation and expansion of commercial centers, including the purchase of existing buildings;

-construction or expansion of energy and water supply networks and distribution facilities;

-construction or expansion of plants for the collection and treatment of sewage and waste;

-creation of tourist facilities, including public recreational facilities designed to attract tourism; and

-building or expanding research parks and other facilities that encourage innovation, such as research and development centers.

Traditionally these measures are implemented by the public sector. As an additional disincentive for the private investor, grants are only available if the private entity bears a reasonable share of the costs.⁷⁰ Consequently, private sector involvement in these projects is limited, and will rarely receive regional assistance.

Assumption of Debts and Release from Environmental Liabilities by the Treuhandanstalt

The currency conversion of the Treaty on Economic, Monetary and Social Union has reduced all existing liabilities of private corporations at the rate of 1:2.⁷¹

⁶⁹ BMWi, *supra* note 29, at 43.

⁷⁰ *Id.* (excluding the costs of real estate purchases).

⁷¹ Vertrag über die Schaffung einer Währungs-, Wirtschafts- und Sozialunion zwischen der Bundesrepublik Deutschland und der Deutschen Demokratischen Republik vom 18. Mai 1990 [Treaty Regarding the Creation of a Currency, Economic and Social Union Between the Federal Republic of Germany and the German Democratic Republic, May 18,

Pursuant to §§ 2(4), 4(1) of the Regulation Concerning Discharge of Old Indebtedness of Previously State-Owned Enterprises (“Verordnung des Ministerrats vom 5. September 1990 über Massnahmen zur Entschuldung bisher volkseigener Unternehmen von Altkrediten - Entschuldungsverordnung”), the Treuhandanstalt can assume all or part of the obligation to repay principal and interest and thereby discharge the debtor company.⁷² Although no mandatory assumption of debts by the Treuhandanstalt exists, opening balances of the companies it sells usually contain remaining debts. This makes these debts a part of the sales negotiations and purchase price.⁷³

Article I, § 4(3) of the former GDR's Environmental Law (“Umweltrahmengesetz”), permits release of the purchaser of a facility serving commercial purposes from liability for environmental damages caused by the facility before July 1, 1990.⁷⁴ Pursuant to the Unification Treaty the former GDR's Environmental Law retains continued validity.⁷⁵ The Law On The Elimination Of Obstacles To Privatization And On The Promotion Of Investments even extends its scope by permitting owners, purchasers, lessees, and tenants equally to apply for an exemption from environmental liabilities.⁷⁶

Furthermore, the Treuhandanstalt may offer individual financing to purchasers of formerly state-owned businesses, through the issuance of bonds, special loans, and loan guarantees.⁷⁷ The government set aside DM 7 billion in 1990, and DM 10 billion in 1991 for these special Treuhandanstalt incentives.⁷⁸ The nature and conditions of these incentives demonstrate the Treuhandanstalt's main

1990], F.R.G.-G.D.R., arts. 1(2), 10(5), 1990 BGBl. II 537; BMWi, ECONOMIC ASSISTANCE IN THE NEW GERMAN LÄNDER (May 1991) at 112.

⁷² Entschuldungsverordnung, 1990 GBl. I 1435; for further detail, see Gruson & Thoma, *supra* note 18, at 549.

⁷³ Rahmann, *supra* note 28, at 509; BMWi, *supra* note 29, at 26.

⁷⁴ Umweltrahmengesetz vom 29. Juni 1990, 1990 GBl. I 649.

⁷⁵ Unification Treaty, *supra* note 14, annex ii, ch. XII, subdiv. III, no. 1(b).

⁷⁶ Gesetz zur Beseitigung von Hemmnissen bei der Privatisierung von Unternehmen und zur Förderung von Investitionen vom 22. März 1991, *supra* note 25, article 12.

⁷⁷ Blyth, *supra* note 1, at 15.

⁷⁸ *Id.*

concerns, stimulation of the economy and promotion of employment.⁷⁹

Preferential Loans

Equity Capital Assistance

The Equity Capital Assistance (ECA) program offers long-term personal loans (20 years) with equity capital characteristics at preferential interest rates.⁸⁰ The purpose of this program is to permit the individual applicant to expand his equity base for the establishment of a private enterprise, business, or practice.⁸¹ Thus, it mainly concerns small and medium-sized entities.⁸²

Without requiring any collateral, ECA loans may provide up to 40% of financing needs, with a maximum loan amount of DM 350.000,00 (DM 1 million with approval of the Federal Economics Ministry).⁸³ Loans generally carry a 20-year maturity with a 10-year redemption-free grace period for repayments. They also enjoy a three-year interest free period, before interest rates gradually increase from two per cent (2%) in the fourth year to five per cent (5%) in the sixth year.⁸⁴ Applications for these loans must be made before January 1, 1994.⁸⁵

European Recovery Program

Loans from the Marshall-Plan-funded European Recovery Program (ERP) are available for investments in the new states, regardless of the national origin or incorporation of the investor.⁸⁶ The purpose of these loans is to rebuild and strengthen small and medium-sized enterprises in the new states. Their focus is on the areas

⁷⁹ *Id.*

⁸⁰ Passavant & Noesser, *supra* note 16, at 900; BMWi, *supra* note 29, at 44; BMWi, ECONOMIC ASSISTANCE IN THE NEW GERMAN LÄNDER (May 1991) at 21.

⁸¹ Passavant & Noesser, *supra* note 16, at 900.

⁸² *Id.*

⁸³ BMWi, ECONOMIC ASSISTANCE IN THE NEW GERMAN LÄNDER (May 1991) at 23.

⁸⁴ BMWi, *supra* note 29, at 44; BMWi, ECONOMIC ASSISTANCE IN THE NEW GERMAN LÄNDER (May 1991) at 21.

⁸⁵ BMWi, ECONOMIC ASSISTANCE IN THE NEW GERMAN LÄNDER (May 1991) at 23.

⁸⁶ Blyth, *supra* note 1, at 15.

of tourism, new businesses, environmental protection, and modernization.⁸⁷

ERP loans may provide a maximum of 50% of the investment costs, with a cap at DM 1 million per loan, for businesses with annual sales of up to DM 50 million. This limit is extended to DM 500 million for investments in environmental protection.⁸⁸ ERP loans are fixed rate loans, without prepayment penalties, at preferential rates, which are set by the ERP Special Fund according to capital market conditions.⁸⁹

Investment Loans from the Kreditanstalt

As a supplement and expansion of ERP and ECA loans, the Credit Institute for Reconstruction ("Kreditanstalt fuer Wiederaufbau - KfW") offers low-interest long-term loans of up to ten years to small and medium-sized industrial enterprises and to self-employed individuals with annual sales of less than DM 500 million.⁹⁰ The purpose of these loans is to help establish, preserve, or expand businesses in the new states and East Berlin.⁹¹ KfW loans are available to a maximum of DM 10 million, at preferential, fixed interest rates.⁹² They provide financing of up to 75% of the total investment.⁹³

⁸⁷ Passavant & Noesser, *supra* note 16, at 901; BMWi, *supra* note 29, at 45; BMWi, ECONOMIC ASSISTANCE IN THE NEW GERMAN LÄNDER (May 1991) at 26-29.

⁸⁸ BMWi, *supra* note 29, at 45; BMWi, ECONOMIC ASSISTANCE IN THE NEW GERMAN LÄNDER (May 1991) at 28.

⁸⁹ BMWi, *supra* note 29, at 45; BMWi, ECONOMIC ASSISTANCE IN THE NEW GERMAN LÄNDER (May 1991) at 26,27.

⁹⁰ Passavant & Noesser, *supra* note 16, at 900-901; BMWi, *supra* note 29, at 45-46; BMWi, ECONOMIC ASSISTANCE IN THE NEW GERMAN LÄNDER (May 1991) at 31-35.

⁹¹ BMWi, *supra* note 29, at 45-46; BMWi, ECONOMIC ASSISTANCE IN THE NEW GERMAN LÄNDER (May 1991) at 31-35.

⁹² (We need to tell author that *Id.* can only be used when referring to the previous authority with only one cite in it. Since we do not have the Treaty, we do not know to which authority he is referring to.)

⁹³ (same comment as the preceding footnote).

Additional Loan Guarantee Programs

Additional loans may be obtained from various institutions, such as the European Investment Bank, the Berliner Industriebank AG, the Deutsche Ausgleichsbank, and other privately-owned or federal guarantee banks.⁹⁴ Depending upon the bank and the investment objective, these fixed rate loans run from 10 to 23 years.⁹⁵

Examples of Small and Large Investments

The subsequent examples of investment plans for a small and large business investment serve to better illustrate the aforementioned opportunities.

Investment Plan of a Large Business

TOTAL INVESTMENT DM 100.0 MILLION

Components: Equipment DM 70.0 MILLION

with an operating life of 10 years

Buildings DM 30.0 MILLION

INCENTIVES AND TAX CREDITS

- General Incentive (23%) DM 23.0 MILLION

- Equipment Incentive (12%) DM 8.4 MILLION

Special Depreciation - 50%

Straight Line Depreciation for Equipment - 10%

Straight Line Depreciation for Building - 4%

- Investment in Equipment: DM 70.0 MILLION

- Less 23% incentive DM 16.1 MILLION

- Basis for Tax Assessment DM 53.9 MILLION

- Depreciation at 60% DM 32.3 MILLION

- Tax Savings at 50% Rate DM 16.15 MILLION

- Investment in Buildings: DM 30.0 MILLION

- Less 23% incentive DM 6.9 MILLION

- Basis for Tax Assessment DM 23.1 MILLION

⁹⁴ BMWi, *supra* note 29, at 47,48; BMWi, ECONOMIC ASSISTANCE IN THE NEW GERMAN LÄNDER (May 1991) at 36-44; Passavant & Noesser, *supra* note 16, at 901.

⁹⁵ BMWi, ECONOMIC ASSISTANCE IN THE NEW GERMAN LÄNDER (May 1991) at 36-44 (The fixed interest rates are temporarily at 8%).

- Depreciation at 54% DM 12.5 MILLION
- Tax Savings at 50% Rate DM 6.2 MILLION

-
- Total Incentives and Tax Savings DM 53.75 MILLION

With first-year incentives and tax relief amounting to 53.7% of the total investment, only 46.3% would require financing through loans and assistance programs. Thus, the investment incentives exceed the tax relief impact of an immediate 100% write-off, which would amount to DM 50 million, or 50%.

Investment Plan of a Small or Medium-Sized Business

TOTAL INVESTMENT DM 1,000.00

Components: Equipment DM 700.00

with an operating life of 10 years

Buildings DM 300.00

INCENTIVES AND TAX CREDITS

- General Incentive (23%) DM 230.00
- Equipment Incentive (12%) DM 84.00
 - Special Depreciation - 50%
 - Straight Line Depreciation for Equipment - 10%
 - Straight Line Depreciation for Building - 4%
- Investment in Equipment: DM 700.00
- Less 23% incentive DM 161.00

-
- Basis for Tax Assessment DM 539.00
 - Depreciation at 60% DM 323.40
 - Tax Savings at 35% Rate DM 113.20
 - Investment in Buildings: DM 300.00
 - Less 23% incentive DM 69.00

-
- Basis for Tax Assessment DM 231.00
 - Depreciation at 54% DM 124.70
 - Tax Savings at 50% Rate DM 43.70

-
- Total Incentives and Tax Savings DM 470.80

Here the total investment incentive package, including tax relief, amounts to 47%. This exceeds the tax relief impact of an immediate 100% write-off at a 35% rate.

Impediments to Investments in the New Länder

For the domestic or foreign investor there remain significant problems and uncertainties to consider before entering the Eastern German market. These problems concern the applicable law in the new states, labor laws, the environment, the status of the legal profession, the property issue, the world economy, the infrastructure and unemployment in Eastern Germany, as well as the East German mentality.

Applicable Law

With the political reunification on October 3, 1990, West German and European Community laws were imposed on the former GDR on a national level, thus relegating GDR law to state law status.⁹⁶ As GDR law applies on state law level to the extent it is not inconsistent with the new laws, uncertainties have arisen in the areas of intellectual property, labor, and international law, as well as with respect to the abortion issue.⁹⁷ As a result, a potential foreign investor is encouraged to consult with legal experts, in order to determine the legal parameters and applicable standards and laws for the contemplated investment.

Status of the Legal Profession

Before the reunification, Eastern Germany had a mere 600 attorneys admitted to practice law, thus the legal profession was basically non-existent.⁹⁸ As a result, there is a significant shortage of experienced and well-skilled lawyers in the former GDR. Moreover, both attorneys and judges were mostly politically trained to promote the goals of the Communist Party, as opposed to the interests of individual clients.⁹⁹ Consequently, investors in need of legal assistance may encounter a critical lack of manpower and experience concerning legal issues accompanying the investment process.

⁹⁶ Blyth, *supra* note 1, at 9.

⁹⁷ *Id.*

⁹⁸ Blyth, *supra* note 1, at 9-10.

⁹⁹ *Id.*

Property Issues

Although the property issue seemed resolved after the expiration of the March 31, 1991 deadline for filing restitutionary claims, the chaotic status of the land records of the former GDR continues to cause uncertainty and problems in settling property claims.¹⁰⁰ There are some commentators who believe that it will take until the turn of the century, before land records will be corrected and property claims will be settled.¹⁰¹

Environmental Problems

With respect to the environment, and notwithstanding issues of liability, there is significant pollution in the air and rivers of the former GDR, caused by the notorious ignorance of Eastern bloc countries towards the environment.¹⁰² On the advent of EC laws of the Common Market, these environmental problems must be addressed in a territory which still draws its energy largely from lignite (brown coal).¹⁰³

Status of Old Factories and Work Mentality

Lastly, although all formerly state-owned companies are for sale by the Treuhandanstalt, many of these businesses or factories are outdated, unproductive, and useless.¹⁰⁴ They need retooling and their workers need retraining.¹⁰⁵ A sophisticated supplier network must be established and psychological, unproductive habits of formerly demotivated East Germans have to be changed.¹⁰⁶ Yet, it is commonly acknowledged that East Germans have learned to adapt to changed circumstances.¹⁰⁷ These skills are required in East Ger-

¹⁰⁰ Blyth, *supra* note 1, at 11; Gruson & Thoma, *supra* note 18, at 552-565.

¹⁰¹ INT'L HERALD TRIB., December 13, 1990, at 13, col. 3.

¹⁰² Blyth, *supra* note 1, at 14.

¹⁰³ *Id.*

¹⁰⁴ *Id.*

¹⁰⁵ *Id.*

¹⁰⁶ *Id.*

¹⁰⁷ *Id.*

many's new environment of expansion and dynamic force.¹⁰⁸ Additionally, the German government will retrain East German professionals to meet western demands, which is particularly important in the service sector, a sector offering tremendous opportunities.¹⁰⁹

World Economy and Finance

In times of global recession and slow growth rates in all Western European countries, there are difficulties in finding able and willing investors for Eastern Germany.¹¹⁰ Furthermore, many investors want to see short-term returns and profits, an impossible goal in a basically "newborn" economy.¹¹¹

The productivity level of East Germany is estimated at about 30% of West Germany's, requiring about \$1.33 trillion to close the gap completely by the year 2001.¹¹² Net transfers from West to East Germany have already amounted to DM 143 billion in 1991, a figure expected for 1992 again and only slightly lower for 1993.¹¹³ The German Central Bank ("Bundesbank") has repeatedly expressed its concern about this excessive spending in the form of large subsidies, requesting a step-by-step reduction of subsidies for investments in the east.¹¹⁴ Holding that investments incentives are no panacea for East Germany's economic problems, the Bundesbank has also complained about the stoking effect of large subsidies on inflation.¹¹⁵ Hence, there is considerable concern on part of financial experts about the impact of the large German investment scheme.

¹⁰⁸ *Id.*

¹⁰⁹ *East Germany Offers Investment Opportunity Despite Economic Problems, Official Says*, INT'L TRADE REP. (BNA), January 30, 1991, at 168.

¹¹⁰ *Investment In Eastern Germany Opens Door To European Community, Rest Of East Europe*, INT'L TRADE REP. (BNA), June 12, 1991, at 907.

¹¹¹ *Id.*

¹¹² *IMF Paper Sees Export Opportunities Resulting From Unification Of Germany*, INT'L TRADE REP. (BNA), January 23, 1991, at 125.

¹¹³ David Waller, *Bundesbank Criticises East German Subsidies*, Financial Times, August 19, 1992, at 14.

¹¹⁴ *Id.*

¹¹⁵ *Id.*

East German Infrastructure and Unemployment

The Eastern part of Germany suffers severe economic hardship as a result of the reunification, which is reflected in the unemployment of more than 600,000 people and shortened working hours for another 1.8 million.¹¹⁶ Additionally, East German telephone lines and roads are in very bad shape and have to be replaced and upgraded before the infrastructure will be able to meet the demands of a modern industrial state.¹¹⁷ Yet, the German government has made this task a first priority in its attempt to rebuild East Germany.¹¹⁸ Consequently, the government has set aside DM 55 billion for a program to revamp the backward telecommunications system.¹¹⁹

III. EUROPE AS A MAIN MARKET

With the expectations concerning the growth potential of the former GDR, the new federal states emerge as an attractive market, especially within the framework and aspirations of the EC's "Common Market". The new states are strategically located in the center of Europe, in an expanding trade zone of EC, EFTA, and COMECON countries. They are functioning as a bridge between the EC and the awakening economies of Eastern Europe, and serving a market of 340 million consumers to the west and 400 million consumers to the east.¹²⁰ Hence, investment in Eastern Germany presents the opportunity to gain access to the world's largest consumer market.¹²¹

With respect to the Eastern European markets, the German government offers the most extensive package of export assistance of any other Western nation, in the form of investment credit and

¹¹⁶ *East Germany Offers Investment Opportunity Despite Economic Problems, Official Says*, INT'L TRADE REP. (BNA), January 30, 1991, at 168.

¹¹⁷ *Id.*

¹¹⁸ *Id.* (Statements by Andreas Siegel, Economic Consul at the German Consulate-General in Boston).

¹¹⁹ Mark Trumbull, *supra* note 10, at 8.

¹²⁰ BMWi, *supra* note 29, at 21.

¹²¹ Mark Trumbull, *supra* note 10, at 8

guarantee programs.¹²² The former USSR takes up the largest share of these programs with \$6 billion of available credit.¹²³

Nevertheless, there are some concerns by other EC members that, despite the minimal burden of an estimated ECU 500 million per year from 1991 to 1993 which East Germany will place on the Community budget, the after-effects of the German reunification will be far more significant.¹²⁴ The German Monetary Union and subsequent reunification have lead to rising unemployment and prices.¹²⁵ However, the opportunity costs of investments in the territories of the former Eastern Germany are suspected to have a much more significant impact on the other EC regions craving private investments.¹²⁶

IV. ATTRACTIVENESS FOR U.S. INVESTORS

The Eastern European, particularly Eastern German, market has substantial shortages in management techniques and technological development, as well as in investment capital.¹²⁷ While Germany has struggled to provide extensive investment incentives, lack of investment capital is not the determinative factor. A crucial deficiency exists with respect to know-how and management services, for the supply of which Eastern Germany predominantly calls upon U.S. companies and investors.¹²⁸ As a result U.S. companies such as GM, Proctor & Gamble, Philip Morris, IBM, and Coca-Cola have al-

¹²² INVESTMENT IN THE NEW STATES OF THE FEDERAL REPUBLIC OF GERMANY, Memorandum by George M. Rehm, former member of *Popham, Haik, Schnobrich & Kaufman, Ltd.*, to German American Trade Council Miami (September 23, 1992) (on file with author) at 4.

¹²³ *Id.*

¹²⁴ *Application of the EC Directives to Former East German States*, 90 TAX NOTES INT'L 49-4 (November 28, 1990).

¹²⁵ *East Germany Offers Investment Opportunities*, *supra* note 115 at 168.

¹²⁶ *Application of the EC Directives to Former East German States*, *supra* note 123 at 49-4.

¹²⁷ *Eagleburger Urges U.S. Companies Not To Give Up On Eastern Germany*, INT'L TRADE Rep. (BNA), October 10, 1990, at 1553.

¹²⁸ *Id.* (In 1990 the Commerce Department's Eastern Europe Business Center received 22,000 inquiries of U.S. companies interested in doing business in Eastern Germany).

ready entered the market, in order to provide necessary services and goods, and to secure a promising market position.¹²⁹

Furthermore, U.S. private investors can obtain financing from the Overseas Private Investment Corporation ("OPIC") through direct loans, loan guarantees, and political risk insurance for investments in countries eligible for OPIC support.¹³⁰ The OPIC is a self-sustaining U.S. government agency charged with encouraging private U.S. investment in about 120 developing countries.¹³¹ The Central and Eastern European Countries eligible for OPIC programs are Hungary, Poland, Czechoslovakia, Yugoslavia, and the former East German states of the reunified Germany.¹³²

In addition to subsidies originating in the U.S., Germany, and the EC, the U.S. investor can take advantage of the applicable U.S.-F.R.G. income tax treaty's reduction for withholding taxes on direct foreign investments.¹³³ Hence, the U.S. investor enjoys both domestic and European support when committing to an investment in Eastern Germany.

V. CONCLUSION

The new federal states of the FRG present unique and exciting opportunities for investors with management skills, capital, and know-how. There are some uncertainties and concerns, mostly resulting from the lack of exposure to the European economic, political, and legal system. Yet, diligent background research and information reveal that the prospects of lucrative investments and substantial returns far outweigh initial uneasiness about investing in the former GDR.

¹²⁹ Mark Trumbull, *supra* note 10, at 8.

¹³⁰ *OPIC Backed \$400 Million Of Investment In Central, Eastern Europe Last Year*, INT'L TRADE REP. (BNA), March 11, 1992, at 438.

¹³¹ *Poland Needs Foreign Capital To Meet Privatization Goals, Ambassador Says*, INT'L TRADE REP. (BNA), May 29, 1991, at 830. In addition to financial support the OPIC also provides preinvestment services, including information about particular countries and detailed data on investment opportunities, and sponsors investment missions to developing nations.

¹³² *Id.*

¹³³ Speak to the author b/c since we have none of these sources we can not rearrange into an appropriate cite.

The federal, state, and European investment incentives in the form of grants, allowances, or preferential loans render every project feasible with virtually no capital, thereby expressing the German governments concerns for management and know-how, rather than purely monetary investments. The new German states present an opportunity for every investor, who formerly had to surrender to the lack of sufficient capital or government support, to implement modern investment plans. Additionally, and significantly changing the aspects of any investor's involvement, immense support, only comparable to third world and underdeveloped countries, is available in a country at the heart of Europe, already the engine of the EC, and indispensable in a "discovery" of Eastern European markets. Furthermore, particularly the U.S. investor should consider its involvement in light of the strong demands for U.S. know-how and management, and the multi-faceted investment incentives from both sides of the Atlantic.