



WIRTSCHAFTSFÖRDERUNG  
SACHSEN

The Saxony Economic Development Corporation

# Invest in Saxony

2004/1

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# Wirtschaftsförderung Sachsen GmbH

## The Saxony Economic Development Corporation

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# 1 Saxony in Germany

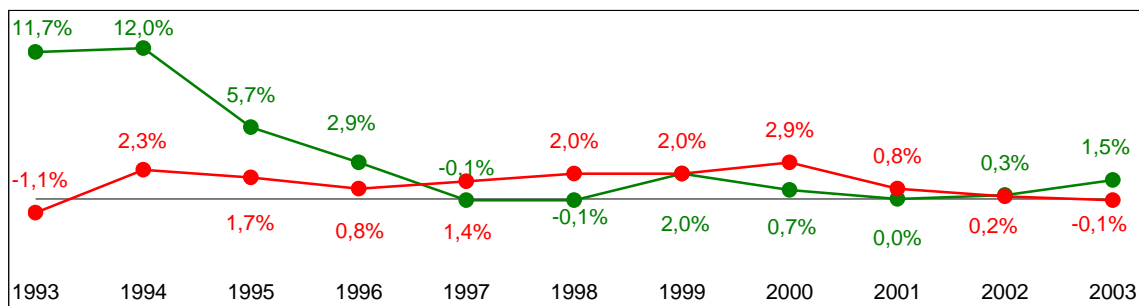
## 1.1 Facts and Figures of Saxony

### 1.1.1 Population

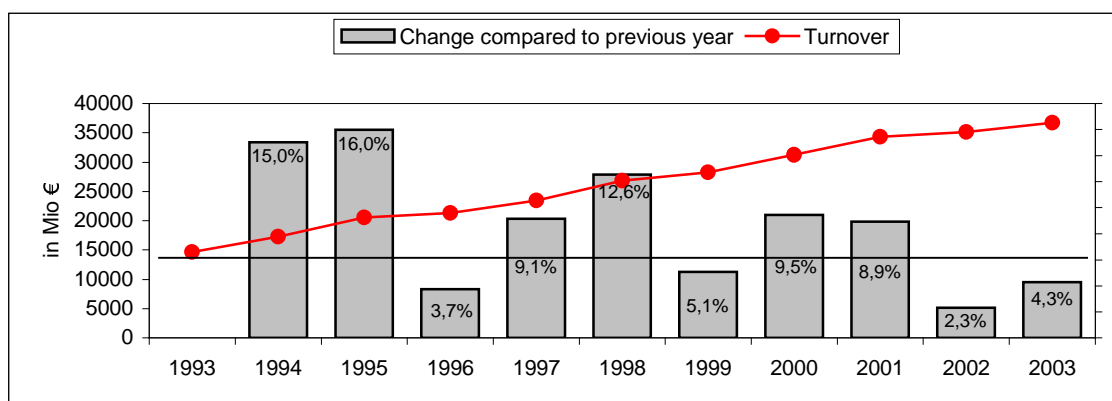
With about 4.35 million inhabitants, Saxony is the most densely populated region in Eastern Germany. Its area encompasses 18,413 sq km, that is 236 inhabitants per sq km compared to 230 inhabitants per sq km in Germany. Dresden city has 481,308 inhabitants. In Leipzig city and Chemnitz live 495,609 and 251,829 persons respectively. In 2003, the buying power per Saxon inhabitant amounted to 13,101 EUR and to 16,606 EUR in Germany.<sup>1)</sup>

### 1.1.2 The Evolution of the Real Gross Domestic Product

This figure shows the development of the *real* gross domestic product of **Saxony** and **Germany** in percentage changes compared with the previous year.<sup>2)</sup>



Even more expressive is the development of the annual turnover<sup>3)</sup> in the Saxon industry, excluding construction, which is shrinking in order to decrease excessive capacities developed immediately after development process.



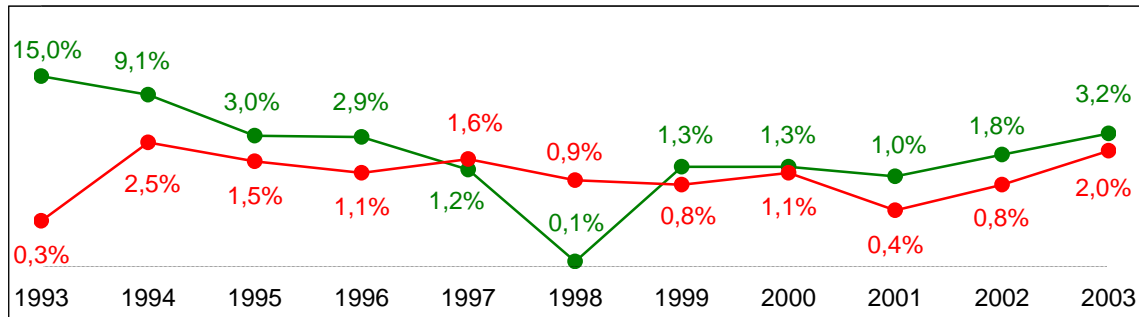
<sup>1)</sup> Source: GfK Marktforschung GmbH Nürnberg.

<sup>2)</sup> Source: Arbeitskreis "Volkswirtschaftliche Gesamtrechnung der Länder" Statistical Office of Baden-Wuerttemberg.

<sup>3)</sup> Source: Statistical Office of the Free State of Saxony, Saxony State Ministry for Economic Affairs and Labour (Wirtschaftstelegramm 03/2003)

### 1.1.3 The Productivity of the Overall Economy

This figure shows the development of the *real* gross domestic product per employee of **Saxony** and **Germany** in percentage changes compared with the previous year.<sup>4)</sup>

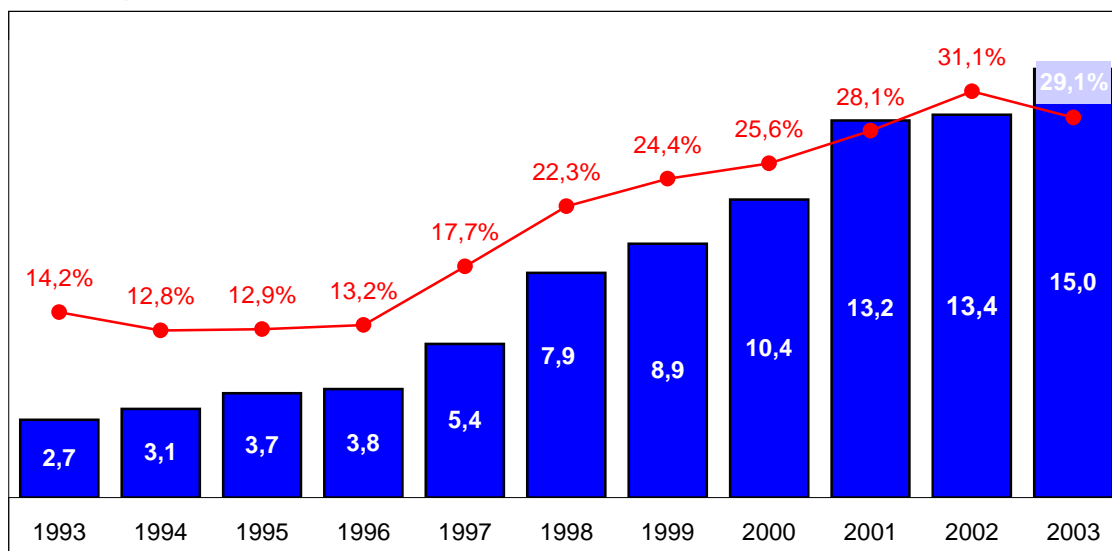


### 1.1.4 Exports

In the European Union, exports and imports as such refer only to extra-Community trade. Nevertheless, exports and imports on a national or regional basis are still important indicators of economic power. The problem is that national and in particular regional numbers are not exact since there is no reliable registration of these figures. During the last years some export numbers could be rectified by including e.g. Volkswagen Mosel's exports that had been registered before in favour of Lower-Saxony where the head office of Volkswagen is.

There is no such corrective possibility for import numbers that reflect more direct imports which is only a small portion of really imported goods. In this respect, it makes no sense to compare Saxony's imports to its exports.

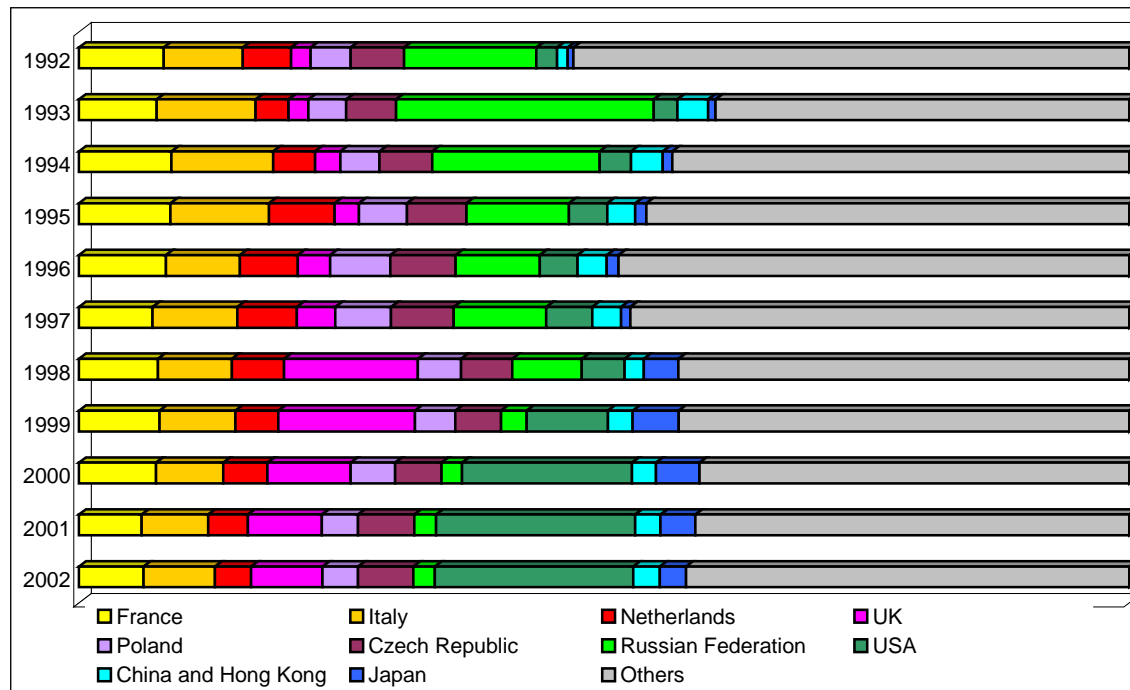
This figure shows the evolution of the **exports (special trade)** in billions of EUR and the **export rate** as ratio of the turnover of foreign trade to the overall industrial turnover.<sup>5)</sup>



<sup>4)</sup> Source: Arbeitskreis "Volkswirtschaftliche Gesamtrechnung der Länder" Statistical Office of Baden-Wuerttemberg.

<sup>5)</sup> Source: Statistical Office of the Free State of Saxony.

The main export countries<sup>6)</sup> for Saxony are:



## 1.2 Infrastructure

Saxony 200 years ago, was the cradle of the German industrialization process. Entrepreneurship has had a long tradition and developed into modern industry as to the machinery industry, and from the beginning of the 20<sup>th</sup> century the automotive industry. This led to the fact that Saxony, before World War II, had the highest per capita income on the European Continent.

Even the socialist regime could not destroy the capacity for entrepreneurship in Saxony, because after reunification in 1990, Saxony developed new signs of entrepreneurship very fast. Due to its location, Saxony is predestined to become a pan European player again and catalyst in the expansion of the European Union, that is why Saxony will have realized the biggest infrastructure programme in the economic history of Europe in 2012. Its main target is the extension of the traffic and telecommunication network throughout the state. The efficiency of Saxony's traffic infrastructure is strengthened by a budget amounting to 40.3 billion EUR.

But infrastructure is also the network of existing industrial production. A great variety of small and medium sized firms provide all kind of intermediate products and services, since the transformation process from socialist to market economy has been completed on the contrary to what has happened in the neighbouring countries. There are e.g. more than 500 small and medium sized firms providing all sort of parts and services to the automotive industry.

<sup>6)</sup> Source: Statistical Office of the Free State of Saxony.

## 1.2.1 Transport

The motorways are being upgraded and integrated into the national and international road systems. The density of the network of federal motorways in Saxony now almost equals the national average. The completion of the A4 autobahn between Dresden and Görlitz, at the German-Polish border, and the current construction of the autobahn heading for the Czech Republic once more show, to what extent Saxony lives up to its importance as a cross-roads for East-West trade.

In addition, Saxony possesses more than 177 km of federal waterways which are all part of Saxony's largest river, the Elbe. The Saxon inland ports in Dresden, Riesa and Torgau trans-shipped in the year 2002 1,690,850 tonnes<sup>7)</sup>. These harbours are completely modernised.

Traditionally, Saxony stands out for its railway network. Since 1839, when the first long distance railway from Dresden to Leipzig was put into operation, Saxony has developed into the state with the highest railway density in Germany. Aiming at Saxony's inclusion into the European infrastructure network, existing railroads are being modernised.

The Dresden airport, the Leipzig-Halle international airport, and seventeen other regional airstrips provide Saxony's air services. The Leipzig-Halle airport has been connected with the logistics centre of Leipzig, currently the traffic intersection in Saxony with the highest potential. Its new runways were opened for international air traffic in spring 2000, breaking away from restrictions upon payload and range or night traffic. A new central terminal, an integrated railway station including an Inter-City-Express (ICE) connection as well as a new motorway approach to the motorways A9/A14 at Schkeuditz teleport are being built. Likewise, the Dresden airport has a new terminal since 2002, an integrated railway station for direct transport to the city center and is situated at the motorway crossing of A4/A13.

## 1.2.2 Telecommunication

Schkeuditz teleport, one of Europe's largest network nodes, was established in 1997. Due to a unique historical process, Saxony benefits from technological progress of several generations. Saxony's telecommunication network undoubtedly ranks alongside the premier state-of-the-art developments worldwide. Deutsche Telekom alone has invested 7.3 billion EUR so far. ISDN and DSL, a data highway, allowing for 12 times top speed of ISDN, are standard and available throughout the state as well as GSM-technology, covering the whole Saxon area. UMTS service is under construction and will start by the end of 2002.

In July 2000, the most modern television broadcasting station in Europe featuring completely digitalised image and sound equipment was officially opened in Leipzig. Almost 700 access lines capable of transmitting data up to 64 times faster than previously link Saxony's universities and research centres with the newly launched 2.5 gigabit science network "Internet 2".

In Saxony, providers of network access and electronic data processing and communication services are constantly introducing new products into the market. The number of commercial providers is also growing rapidly.

Worldwide renowned providers are operating their own access nodes in Saxony. Saxony is easily accessible to and connected with the entire world.

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<sup>7)</sup> Source: Sächsische Binnenhäfen Oberelbe GmbH, Dresden.

### **1.2.3 Growth**

Japan and the former West Germany are two success stories of economic growth. At the end of World War II, the economies of both countries were in shambles. In the decades after the war, these two countries experienced some of the most rapid growth rates on record. This high growth occurred because, at a lowered capital stock, investment exceeded depreciation. This led to the “miracle” of rapid growth. The same principle also applies to Saxony.

## **1.3 Basic Economic Sectors**

The cradle of German mechanical engineering has stood for roughly 170 years in Saxony. Not only traditional sectors like the electronics and automotive industries, but especially the new technologies, including microelectronics, telematics, biotechnology, new materials, and processing engineering once more verify the state’s exceptional innovative power compared to its competitors. The tertiary sector, which encompasses financial and business services, trade, hotels and restaurants, transport, as well as public and private services, is markedly growing in importance and remains the economic pillar in Saxony.

### **1.3.1 Manufacturing**

The processing industry is the core industry in this sector, contributing one-sixth to the domestic gross output in Saxony compared to one-fourth in Germany as a whole. It has constantly gained ground and narrowed the gap compared to Germany from 13 to 7 percentage points since 1991. The building trade’s contribution to the domestic gross output remains twice higher than the German average. Excluding building the manufacturing industry in Saxony is growing yearly with a rate of two digits. Even the minor but noteworthy contribution by mining, energy, and water supply is one percentage point higher than in Germany. Saxony’s manufacturing sector overall has, since 1998, consistently beaten Germany’s average.

### **1.3.2 Services**

Financial and business services have advanced to number one in Saxony’s service sector by doubling their contribution to the gross domestic output. The real growth in this sector has, since 1992, always been above Saxony’s real growth of gross domestic product. As for trade, hotels, restaurants, and transport, this sector has steadily lost ground since 1991, but still achieves a higher real growth than Saxony as a whole. The state sector has lost its leading role and its contribution to the gross output has been shrinking since 1991. Finally, Saxony’s service sector has been able to keep up with Germany and its contribution of 67.9 percent to the gross output stays slightly behind the overall German average of 68.9 percent.

## 1.4 Research and Development

Education and research play a crucial role. With its five state universities, one private university in Leipzig and five state universities of applied sciences, Saxony's education structure offers one of the broadest spectrum of faculties in Germany and most of them are top ranking.

Furthermore, Technical Universities in Saxony have a tradition of intimate cooperation with industry. To a certain extent, they act as suppliers of young professionals in particular for IT and semiconductor industry.

Apart from the research institutes of the universities, Saxony has more than 50 top-level non-university R&D institutions carry out research, among them 11 Fraunhofer-Institutes, 6 Max-Planck-Institutes and 7 institutes of the "Leibniz-Association".

### 1.4.1 Biotechnology

Saxony is committed to the growing biotechnology market. The Dresden University of Technology covers 16 biotechnological faculties in which research is done, ranging from foodstuff biotechnology to medical technology. Twenty research institutions in Saxony are occupied with environmental biotechnology and eighteen research institutions lay stress upon medical biotechnology.

In July 2000, the Saxon parliament agreed to invest about 18.9 billion EUR over a period of five years in personnel and equipment for the university's share of the Biotechnological-Biomedical Centre Leipzig (BBZ), as well as to finance the construction of a building with a size of 14,000 m<sup>2</sup> (75% for industrial use, with the remaining quarter being assigned to the University of Leipzig).

The scientific part of the BBZ will be occupied by new biotechnological and biomedical fields to be set up at the University of Leipzig, for which practically focused basic research is already underway at the relevant faculties. These new areas will not only aid the development of new, marketable products, but may also promote the spin-off of new biotechnology firms by scientists. Moreover, it will provide an attractive, innovative environment encouraging existing biotechnology and biomedicine companies to move there.

### 1.4.2 New Materials

Practically unique in Germany is the combination of fluid dynamics and material research by means of electromagnetic forces. Research is carried out within the "Innovationskolleg Magnetfluiddynamik", founded in 1995 at the Dresden University of Technology. According to experts of the Deutsche Forschungsgemeinschaft (DFG), this combination occupies another white spot on the scientific map.

### 1.4.3 Microelectronic Industry

The Dresden University of Technology and in particular, the Chemnitz University of Technology, both are established high-performance training and research institutions, providing a steady flow of highly qualified personnel. In co-operation with the industry, they carry out research and development services ranging from pure research to practically orientated applications in their own facilities. Twenty research institutions throughout Saxony emphasise product and process research, and material research.

## 1.4.4 Production Engineering

Due to its historically strong development as an industrial region, Saxony lives up for the fertile combination of concentrated technical knowledge and its rapid transfer into real production. Mechanical engineering has been offered at the Dresden University of Technology since its foundation in 1828. The highest stress in this research field is laid upon process engineering.

## 1.4.5 Telematics

The Dresden University of Technology stands out for being Germany's top institute for training IT-specialists. Seven further Saxon institutes have devoted themselves to computer science. Together with the local chambers of commerce and industry, private and public training centres are providing a wide range of training in the field of telematics throughout Saxony.

## 1.5 Education in Saxony

Education is compulsory. Beneath state owned schools, there are forty-three officially recognised private schools and two international schools in Dresden and Leipzig.

After four years elementary school (*Grundschule*), a pupil is, based on selection and willingness, sent to a further 5 year elementary school (*Hauptschule*), or to the middle school (*Realschule*) for 6 years or to the high school for secondary education (*Gymnasium*) for 8 years.

### 1.5.1 High School for Secondary Education

The high school prepares young people for higher education at a university or polytechnic school. In Saxony, it is possible to reach university access after twelve years compared to thirteen years in most of the other states in Germany.

### 1.5.2 Elementary School and Middle School

After having attended elementary school for four years, the pupil may follow another five years elementary school or six years middle school. Both types create the requirements for a more rapid entering on a practical career.

### 1.5.3 Vocational Education and Training

Vocational education and training (VET) in Germany continues the tradition of medieval guild training, as it was then practised all over Europe. This combined system of practical and theoretical learning was adapted for the purposes of industry in the nineteenth century. In the course of the twentieth century, practices across different industrial sectors were brought together into a modern vocational training system, and were codified in the 1969 Vocational Training Act (*Berufsbildungsgesetz*) and Education Acts for Vocational Education and Training in the federal states.

Saxony was unknown territory for us. Today we know that we could not have found better qualified or more committed employees for our "greenfield" factory. That is the basis for our success."

**Juichiro Takada,**  
CEO, Takata  
Corporation, Tokyo

The system, also called Dual Training System, is founded on close links between public and private training organisations, between statutory provision and provision governed by collective agreements, and between public training policy and private training investment.

Significant characteristics are

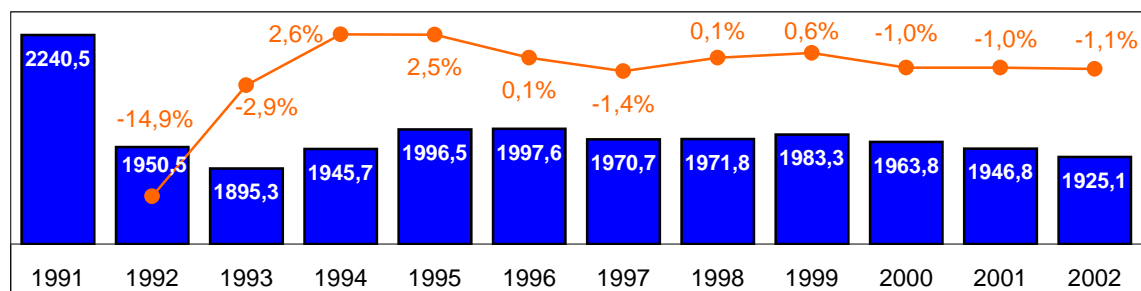
- The participation of companies is voluntary
- Standards and content of two or three year training are agreed upon by employers and trade unions and then legally codified
- Independence of the system is preserved through corporate bodies (chambers of commerce and industry)
- The system is financed mainly by corporate training providers, with supplementary funding coming from government
- The provision of further education includes both general and occupation-related theoretical study
- The young people get a training subsidy from the company where they learn and work. Visit of vocational training school is compulsory but free of charge.

#### 1.5.4 *Berufsschule* in the Dual Vocational Training System

The *Berufsschule* (equivalent to further education colleges for initial vocational craft/ technician level education) works in tandem with companies in three-year programmes of VET for young people in the Dual System. They operate under the jurisdiction of the federal states and, with schools, are within the portfolio of their Minister of Education.

## 1.6 Employment and Labour Market

This graph shows the number of the **employed [1,000]** in Saxony and its **change [%]** compared to the previous year.<sup>8)</sup>



In 2002, the age group capable of work, i.e. from 18 to 65 years of age, amounted to about 2.8 million persons, of whom 49 percent were female.<sup>9)</sup> In 2002, the unemployment rate in Saxony was 17,8 percent compared to 9,8 percent in Germany.<sup>10)</sup>

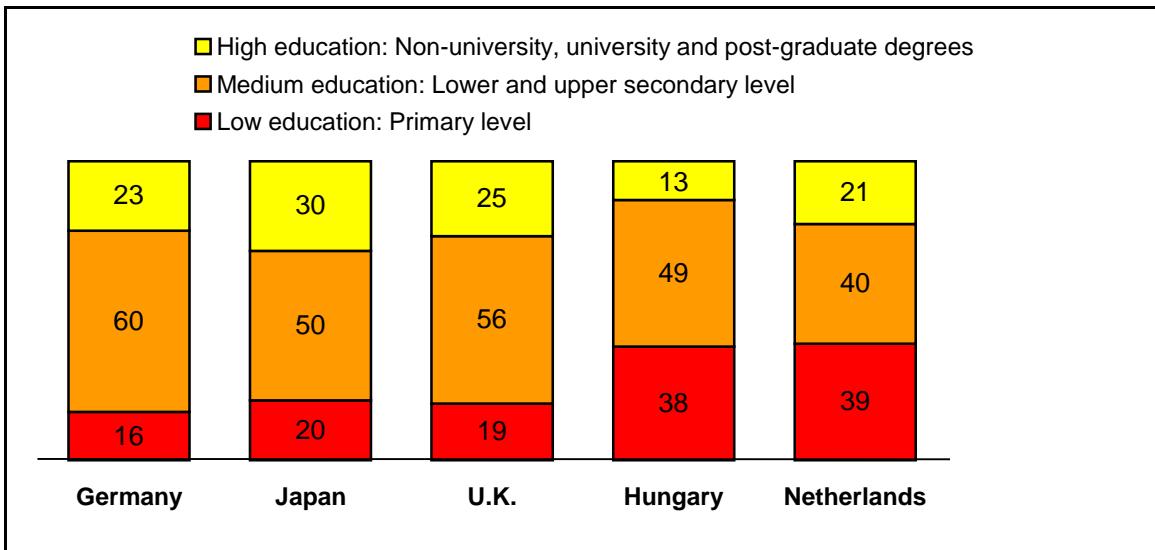
<sup>8)</sup> Source: Statistical Office of the Free State of Saxony.

<sup>9)</sup> Source: Arbeitskreis "Erwerbstätigenrechnung des Bundes und der Länder", Statistical Office of the Free State of Saxony.

<sup>10)</sup> Source: Federal Statistical Office Germany, Wiesbaden.

### 1.6.1 Best Qualified Labour Force

The following figure<sup>11)</sup> shows an international comparison of the qualifications:



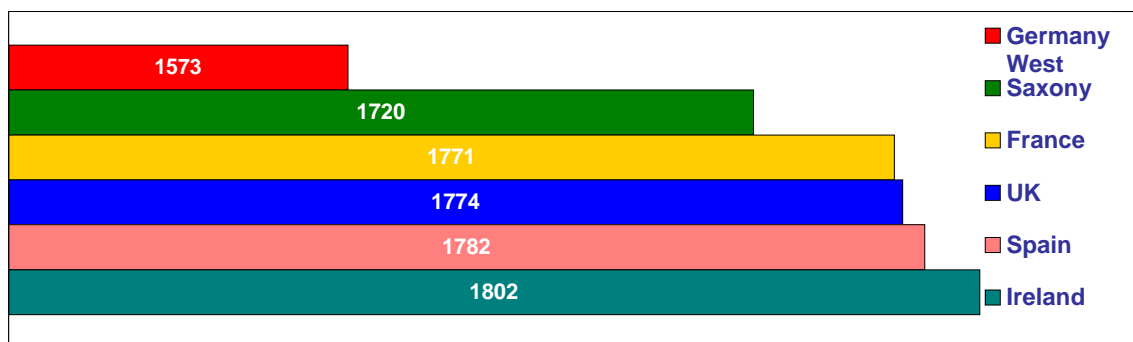
Compared to other nations, a relatively high percentage of Germans have either a medium or high level of education.

And within Germany itself, the eastern region boasts a much higher percentage of skilled labour, with only 11 percent unskilled labour, compared to 23 percent in its western counterpart.<sup>12)</sup>

In Saxony, 28 percent of the work force have a diploma from a vocational school, a vocational college, or a science college or have completed training as a master in their field. Approximately 61 percent have educational or practical education and only 11 percent of Saxony's work force has no degree.<sup>13)</sup>

### 1.6.2 Annual Working Hours

Compared to West Germany, Saxony's labour force works about ten percent more per year as the following graph shows:



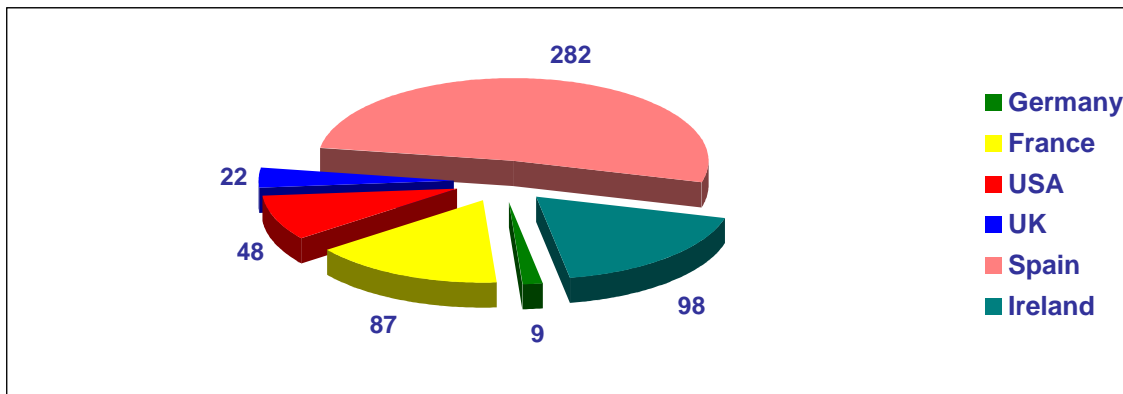
<sup>11)</sup> Source: Federal Ministry of Education and Research Germany, 2002.

<sup>12)</sup> Source: IAB (08/2001).

<sup>13)</sup> Source: Microcensus, 2002.

### 1.6.3 Strikes in Saxony

The number of working days lost through strikes (yearly average 1992 - 2001, per 1,000 employees) in Germany amounts to nine days, a situation, which compares favourably with its principal worldwide competitors.



### 1.6.4 Average Monthly Salary in Saxony

Despite higher qualification, the average monthly salary in Saxony is up to thirty percent lower than in West Germany. Male industrial workers resp. administrative personnel earn seventy resp. seventy-four percent of what is paid in West Germany. Female industrial workers resp. administrative personnel are with seventy-six resp. eighty-one percent better off. In absolute terms, women earn less than men (See table with monthly salaries below in point 1.6.6).

### 1.6.5 Productivity of Saxony's Labour Force

In Saxony, the real gross domestic product per employed person increased at an average rate of 12.3 percent between 1995 and 2003. Because of a weaker economic growth since the mid 1990s and the shrinking of the building industry, the productivity has slowed down, but the average annual increase still remains above the average growth rate of Germany as a whole ( Compare to table in point 1.1.3 on page 5).

What makes Saxony's work force highly productive is their will to work. Men and women are eager to work, they are willing to get qualified and trained for new jobs. They commute to daily work even over larger distances. Men and women are willing to work in shifts, and even on weekends and on public holidays.

Personal time accounts make labour supply flexible according to the needs of the employer.

### 1.6.6 Labour Costs per Hour in Manufacturing Industries

Labour costs do depend on wages and productivity. In general economic terms, East Germany is for some economic reasons still being considered less productive than West Germany. But in business terms this is not correct.

„The success of our operation in Eastern Germany would have been inconceivable without the consequence, flexibility and initiative demonstrated by the indigenous work force.“

**Neal Blue,  
CEO General  
Atomics,  
Electronics**

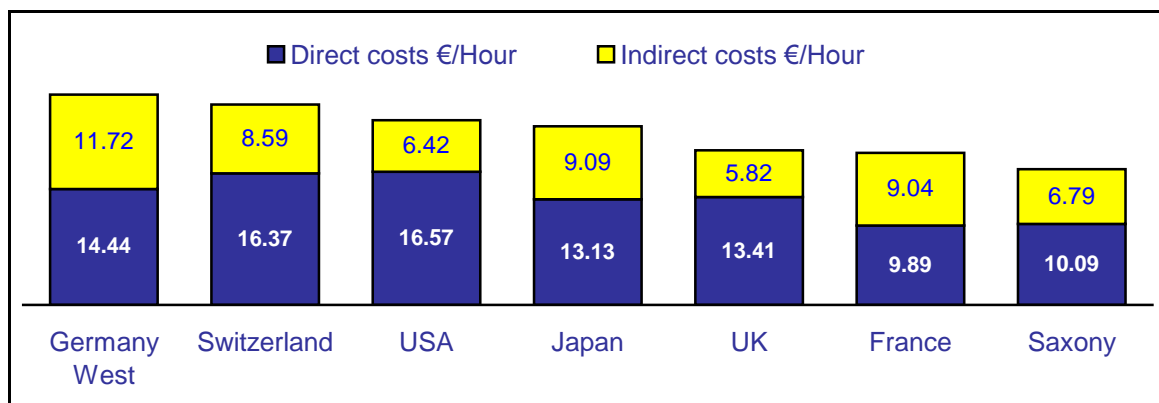
Due to the eagerness of the working force as outlined above and combined with modern management methods, productivity is much higher than in West Germany.

	Industrial workers		Adm. Personnel	
	Men	Women	Men	Women
<b>Saxony</b>	1,900	1,429	3,098	2,238
<b>West Germany</b>	2,601	1,924	4,056	2,903

In the table<sup>14)</sup> above mentioned, the indicated average values refer to monthly values paid in EUR generally 12 times a year.

Labour wages and salaries in Saxony are 25 to 30 % lower than in West Germany.

The following table<sup>15)</sup> shows the direct and indirect labour costs per hour in Saxony compared to Germany West, Switzerland, the USA, Japan and France.



Labour wages and salaries are in Saxony slightly higher than in the neighbouring Eastern European countries like Poland or the Czech Republic. Yet what counts after all is productivity based on quality and qualification of the labour force.

Some Saxon manufacturing companies are already cooperating with cheap labour companies in the Czech Republic, but they do so only for some parts of their production process which is specially labour intensive. The option for technologically qualified production with labour cost of 20 percent or less will always be a location in Saxony.

<sup>14)</sup> Source: Federal Statistical Office Germany, Wiesbaden.

<sup>15)</sup> Source: Institut der deutschen Wirtschaft, Cologne.

## 1.7 Quality of Life

### 1.7.1 Entertainment in Saxony

In Saxony, there are 15 theatres, attracting about 1.9 million visitors each year. In the season between 2001 and 2002, Saxony's six *Kulturorchester* gave about 1,530 concerts, pleasing 507,500 listeners.<sup>16)</sup> The Dresden Semper Opera has a tradition going back as much as 350 years, and many works by Richard Strauss, Carl Maria von Weber and Richard Wagner premiered there. The International Dixieland Festival in early May and the Music Festival in May/June are part of Dresden's annual events calendar as well as the *Filmnächte* at the river Elbe during summer. Saxony possesses 103 cinemas with 264 stationary screens and 51,433 seats.<sup>17)</sup> Foreign films in Germany are generally doubled into the German language. Furthermore, there are countless restaurants with German or foreign kitchen, pubs and cafés where people can get together and enjoy themselves.

### 1.7.2 Culture in Saxony, Some Aspects

Saxony's public libraries amount to 699, in which 7.5 million medias are available and 17 million are taken out per year.<sup>18)</sup> The *Deutsche Bücherei* in Leipzig and its sister library in Frankfurt are the largest German language libraries. With its 370 museums and galleries, Saxony attracts about 7.1 million visitors each year.<sup>19)</sup> The Dresden *Zwinger* houses five museums. The most important are the Old Mastery Gallery, which features masterpieces including Raphael's Sistine Madonna and paintings from the Italian painter Canaletto who depicted the era's rich architecture in many paintings, and the Historical Museum, with its superb collection of ceremonial weapons. The baroque New Town Hall in Leipzig with its impressive interior is one of the finest municipal buildings in Germany.

### 1.7.3 Shopping Possibilities

Apart from fully developed retail commerce throughout Saxony, Leipzig's impressive 26 platform train station is not just the largest passenger terminus in Europe, it houses a fabulous three storey shopping mall with more than 150 shops.

In the food departments and specialized Delicatessen you get food and materials from all over the world.

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<sup>16)</sup> Source: Statistical Office of the Free State of Saxony, 2004

<sup>17)</sup> Source: Statistical Office of the Free State of Saxony, 2004

<sup>18)</sup> Source: Statistical Office of the Free State of Saxony, 2004, Deutsche Bibliotheksstatistik (DBS).

<sup>19)</sup> Source: Institut für Museumskunde der Staatlichen Museen, Preußischer Kulturbesitz Berlin.

### **1.7.4 Health, Sport and Nature**

Currently, Saxony possesses 88 hospitals with 29,300 beds, i.e. 671 beds per 100,000 inhabitants.<sup>20)</sup> Medical treatment is as good as anywhere in Germany or Western Europe.

In Saxony, there are 3,956 sport clubs with 503,536 members, of whom 50 % are younger than 27.<sup>21)</sup> Various disciplines like golf, tennis, riding, swimming or sailing as well as skiing can be practised. As for bikers, they can ride along the Elbe. The *Sächsische Schweiz* is a national park 50 km south of Dresden near the Czech border. Its wonderfully wild, craggy country is dotted with castles and tiny towns alongside the mighty Elbe. The landscape varies unexpectedly and radically. Its forests can look deceptively tropical, while the worn cliffs and plateau recall the parched expanses of New Mexico or central Spain. Highlights include the Bastei lookout and the border resort of Bad Schandau.

### **1.7.5 Inner Security**

As one may expect in any highly developed western European country, Saxony has reliable authorities and few criminals.

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<sup>20)</sup> Source: Statistical Office of the Free State of Saxony.

<sup>21)</sup> Source: Landessportbund Sachsen e.V., Leipzig.

## 2. Federal Regulations

### 2.1 Residence and Labour Permit

Every foreign national wishing to reside and work in Germany must apply for a residence permit (*Aufenthaltserlaubnis*) and a work permit (*Arbeitserlaubnis*). The rules differ between citizens of EU member states who are entitled to get these permits, and those of other states.

Employers who employ foreign nationals without the necessary work permits commit a criminal offence. The construction industry is under particular scrutiny in this respect.

#### 2.1.1 EU Nationals

EU nationals must apply for a residence permit, but the process is a formality as they are entitled to a permit. The first permit will be granted for five years, after which EU nationals can apply for a permit with unlimited duration provided they satisfy authorities that they fulfil certain conditions. If these conditions are met, the residence permit will be extended for five years.

EU nationals do not require a work permit. Restrictions will only apply if the EU national wants to work in a profession where special qualifications are required for everybody. Obstacles, such as the non-recognition of diplomas from other member states, are being removed by EU legislation.

#### 2.1.2 Other Nationals

Individuals not from the EU member states will require both a residence permit and a work permit. Usually application for these permits must be made before entering the country and will only be granted if the individual already has a fixed job offer. Management specially qualified personnel nominated by the foreign investor receive in Saxony a priority treatment.

Special rules apply to citizens of certain states, often based on bilateral agreements. In some cases the citizens of certain states, say those of the United States, Canada, Japan and Australia can travel to Germany without a visa and apply for a residence and work permit after arrival. Swiss citizens are treated similarly to EU citizens.

## 2.2 Freedom of Trade and Business Formation

Individuals and corporations planning to carry out a business activity in Germany must cope with a number of formal requirements as set forth by administrative, civil and tax laws.

### 2.2.1 What is a Business (*Gewerbe*)?

The term “business” normally includes any engagement in trade or business that is aimed to recognise gain, is conducted not just incidentally and goes beyond the scope of a mere administration of property.

## 2.2.2 The General Trade Permit (*Gewerbeschein*)

Before engaging in such a business, natural persons both foreign and domestic need to obtain a general trade permit, which is issued on application by the local trade agency (*Gewerbeamt*) for a small fee.

## 2.2.3 The Public or Commercial Trade Register (*Handelsregister*)

Any enterprise with a business activity in Germany must register with the commercial trade register. Those registers are kept for each municipality by the appropriate district court (*Amtsgericht*).

## 2.2.4 The Name of the Company or the Trade Name (*Firma*)

The German Commercial Code (*Handelsgesetzbuch – HGB*) restricts the choice of the name of the company. The name must be capable of identifying the company and must be distinguishable. The name must not be misleading, that is a company only operating in Germany may not call itself “European”. The name must not be the same as or confusingly similar to the name of an existing company at the place of registration. However, the German registration system operates locally, not nationwide.

## 2.2.5 Forms of Business (*Unternehmensformen*)

An investor has the choice among varieties of organisational forms. The most common are briefly outlined. Foreign investors generally decide for a limited liability company or a stock corporation (see 2.2.5.3).

### 2.2.5.1 Sole Proprietor (*Einzelunternehmer*)

A sole proprietor operates a business or trade on his own. A sole proprietor assumes full responsibility for all liabilities of the business, and of all his assets, both business and personal, can be called upon to meet payment or business debts.

### 2.2.5.2 Partnerships

For a trade or business, the German civil laws offer two different partnership versions the general partnership (*Offene Handelsgesellschaft – OHG*) and the limited partnership (*Kommanditgesellschaft – KG*). A general partnership is an association for business purposes formed by two or more general partners. These partners can be either individuals or corporations and either domestic or foreign. A limited partnership has at least one general partner and one limited partner. A general partner will be held personally liable with the entire business and private property. Those kinds of partnerships are vehicles often used by craftspeople and small to medium sized family business.

### 2.2.5.3 Companies

The German limited liability company (*Gesellschaft mit beschränkter Haftung – GmbH*) and the stock corporation (*Aktiengesellschaft – AG*) are the most important business corporations. While a *GmbH* must have a minimum nominal share capital (*Stammkapital*) of 25,000 EUR of which 12,500 EUR shall be paid in upon registration, the equity of a standard *AG* (*Grundkapital*) must amount to at least 50,000 EUR.

The *GmbH* represents the most popular form doing business in Germany, because it is a highly flexible and rather informal type of corporation. Transactions such as the assignment of shares and certain amendments to the articles may require notarial form but are easy to accomplish. The *GmbH* is frequently used as both operating entity and holding company and, in general, grants the foreign investor the lowest possible tax burden.

## 2.3 Business Taxation

This paragraph only briefly outlines taxation issues that affect all businesses, regardless of their legal status. The second section deals with the tax reform and some of its main implications for companies.

### 2.3.1 General Information

Any taxpayer that engages in a trade or business with the intention of generating earnings and profits derives business income. The excess of revenues generated by the trade or business over all deductible expenses is, on a recurring basis, subject to

- Income tax for natural persons (*Einkommensteuer*) or
- Corporate tax (*Körperschaftsteuer*) for business corporations
- Temporary solidarity surcharge (*Solidaritätszuschlag*)
- Trade tax (*Gewerbesteuer*)

and, where applicable

- Capital yields tax (*Kapitalertragsteuer*)
- Church tax (*Kirchensteuer*) only for natural persons belonging to one of the recognised churches

Other important taxes include

- Value added tax (*Umsatzsteuer*)
- Real property transfer tax (*Gründerwerbssteuer*)
- Real property tax (*Grundsteuer*)

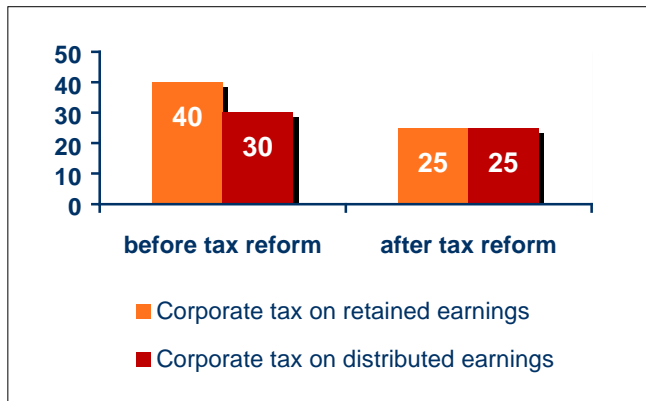
### 2.3.2 Tax Reform

The major tax reform contains numerous changes. The following changes took place

- The corporate tax rate on retained earnings: reduced from 40% to 25%
- The corporate tax on distributed earnings: reduced from 30% to 25%.

As for the taxation of dividends, the full imputation system (*Körperschaftsteuer-anrechnungsverfahren*) was applicable in 2001 for the last time. There are specifics regarding financial years differing from the calendar year. As from 2002, the so-called half-income system (*Halbeinkünfteverfahren*) is going to apply to make cross-border investment within Europe more attractive.

Under this new system, only half of the distributed profits of a corporation will be included in the shareholder's personal income tax base. In return, it will be no longer



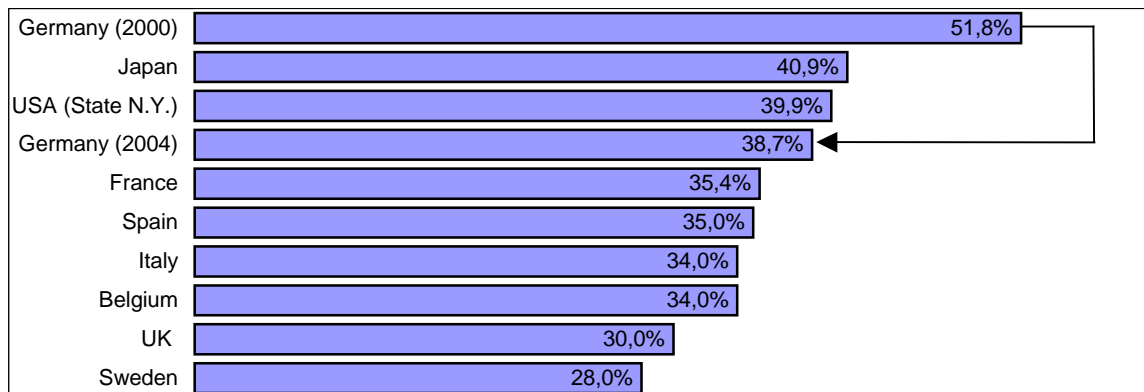
necessary to credit the corporation tax paid by the company against the shareholder's income tax.

Capital gains from the sale of shareholdings between corporations will generally be exempted from tax. In order to prevent abuse, various restrictions will be imposed, among them a minimum holding period of one year. The new rules entered into effect as from the tax year 2002.

### 2.3.3 International Comparison

The German government had already slashed corporate tax in 2002. Further income tax cuts planned for January 2005 have been brought forward to January 1, 2004. The new rate makes Germany an competitive tax location within the industrialized world.

This figure depicts the change in corporate taxation<sup>22)</sup>.



### 2.3.4 PAYE (Lohnsteuerabzugsverfahren)

In Germany, the employer is under an legal obligation to deduct tax from the gross wages and pay it to the tax authorities (*Finanzamt*). Accordingly, the employer must notify the *Finanzamt* of any employment commenced or terminated.

<sup>22)</sup> Source: Federal Ministry of Finance Germany

## **2.4 Labour Law and Social Security**

### **2.4.1 Labour Law**

In Germany there is no single law governing the individual or collective aspects of employment conditions. The following is a summary of the most important aspects of German labour law, which apply to every employment in Germany.

#### **2.4.1.1 Obligations of Employers and Employees**

The basic obligations of the parties are the employee's obligation to offer his services and to work diligently in the performance of his duties during his working hours, the employer's obligation to provide safe and healthy working conditions, and to pay the salary and other agreed emoluments.

#### **2.4.1.2 Termination of Employment**

Notice of termination given by one party to the other is an unilateral declaration of the intent to cancel the employment relationship from a certain date. The statutory period of notice ranges from a regular period of notice for both employer and employee of four weeks to the 15<sup>th</sup> or end of a month, to seven months notice, always at the end of the month, after 20 years employment, where notice is given by the employer. During a maximum six month probationary period, the employment can be terminated with two weeks notice.

The Law Concerning Protection Against Unfair Dismissal (*Kündigungsschutzgesetz – KSchG*) applies to businesses with more than five regular employees. The basic rule is that giving notice to an employee who has worked in the same business for more than six months is legally ineffective if it is socially unjustified.

The Mother Protection Law (*Mutterschutzgesetz – MuSchG*) and the Federal Law on Financial Education Aid (*Bundeserziehungsgeldgesetz – BerzGG*) protect pregnant women and new mothers. Notice of termination given during pregnancy and up to four months after giving birth will be null and void, provided the employer is aware of the pregnancy or birth, or is notified within two weeks of the termination of employment.

#### **2.4.1.3 Disability and Equality**

The Law on the Disabled (*Schwerbehindertengesetz – SchwbG*) provides for two safeguards, first that in the case employers with 16 or more employees at least 6 % of the workforce must consist of disabled persons, otherwise a small tax has to be paid, and second the dismissal of disabled persons requires the prior consent of the Principal Welfare Office (*Hauptfürsorgestelle*). Employers must treat male and female employees equally, with specific regard to hiring and dismissing, working conditions and promotion.

#### **2.4.1.4 Remuneration**

An employee's remuneration, in cash or kind, is payable after the work is completed. The employer is under statutory obligation to withhold income tax and social security levies from wages and salaries and to pay the employee a net wage (*Netto-Lohn*) or net salary (*Netto-Gehalt*). Unless expressly stipulated otherwise, the parties to an employment agreement agree on the gross remuneration (*Brutto-Vergütung*), in the knowledge that the above statutory deductions must be made from the gross amount.

#### **2.4.1.5 Custom and Practice (*Betriebliche Übung*)**

Occasionally, custom and practice within the employer organisation can create rights in favour of employees even if the employer did not intend to create any such rights. For example, if an employer repeatedly pays a Christmas bonus for a number of years, three years suffice, without stating that the bonus is discretionary, the employees may well acquire an enforceable right to such a bonus in future days. Newcomers cannot be excluded because of the requirement of equal treatment.

#### **2.4.1.6 Sickness**

Under the Sick Pay Act (*Entgeltfortzahlungsgesetz*) every employee is entitled to sick pay amounting to the normal salary or wage for the first six weeks of sickness to be paid by the employer, provided one month service has been completed. After six weeks, if eligible, the employee receives benefits from the state health insurance scheme.

#### **2.4.1.7 Working Hours**

There are statutory provisions on maximum working hours in the Working Time Act (*Arbeitszeitgesetz – ArbZG*). These apply to most employees. The most noticeable exception concerns managers and other “leading employees” (*Leitende Angestellte*). Usually, their working hours are much higher than the statutory working hours. In West Germany, working hours approach merely 35 hours a week, while in Saxony a 40 hours week is considered normal.

#### **2.4.1.8 Holiday**

The Holiday Act (*Bundesurlaubsgesetz – BurlG*) entitles all employees to a minimum paid annual vacation of 24 working days based on a six-day week, the equivalent of 20 days on five-day week. The full vacation entitlement begins after completing six months of service and will be pro-rated if the employment is terminated within this period.

#### **2.4.1.9 Workers’ Council (*Betriebsrat*)**

A workers’ council can be set up at the request of the employees in all businesses which regularly employ at least five employees over 18 years of age, three of whom have been employed by the business for at least six months. The workers’ council has rights in three areas: social, personnel, and economic matters. In the first two areas its rights are more extensive, going up to co-decision making or veto in some instances, whereas in economic issues the workers’ council is generally limited to rights of information. Of particular importance is the right to be heard before any dismissal is effected. Failure to hear the workers’ council will render the dismissal null and void. An agreement between the employer and a workers’ council (*Betriebsvereinbarung*) can regulate issues covered by the council’s authority.

This institution has contributed much to the famous social stability in Germany. If properly used by management, it is an excellent medium for transferring business policy to the working force.

#### **2.4.1.10 Trade Union Agreements (*Tarifverträge*)**

Trade union rights are recognised in the German constitution. Issues regulated by trade union agreements vary and usually include wages, holiday, extra payments, safety at work, and exclusion clauses. Most trade union agreements are regional rules. Association of workers is voluntary as well as association of the employers to their union. There is no legal minimum wage policy in Germany except for some special cases in the building industry.

In Saxony, trade unions are weak and most companies do not belong to the entrepreneurs union, so wages are freely set or negotiated with the employees.

### **2.4.2 Social Security**

In principle, the compulsory social security system includes all wage and salary earners working in Germany, as well as German employees who are temporarily assigned abroad. There are some exceptions for management and staff beyond a certain salary level. Temporary assignments to Germany by a foreign employer do not come within the scope of the social security regulations.

Employees and employers generally halve contributions. Employee contributions are withheld by the employer and accounted for to the relevant authorities together with the employer's contributions. Contributions represent a percentage of the gross wage or gross salary as well as on most additional payments. Social security payments are due in respect of four principal areas.

#### **2.4.2.1 Health Insurance**

Contributions to the health insurance scheme, about 13.5% depending on the insurance body, are shared equally between employer and employee and are due only up to a certain income ceiling.

#### **2.4.2.2 Unemployment Insurance**

The employer also withholds unemployment insurance and contributes 50 percent to the unemployment insurance contribution. The contribution amounts to 6.5% of the gross emolument.

#### **2.4.2.3 Social Security Pension Insurance**

The employer and the employee also share pension insurance contributions equally. The contribution equals actually about 19,5 % of the gross income.

#### **2.4.2.4 Accident Insurance**

The employer alone must pay contributions to the statutory accident insurance for each employee. The professional corporation relevant to the sector (*Berufsgenossenschaft*) collects the contributions. These contributions are not nearly as high as social security contributions and vary depending on the risks involved in jobs in the industry. The rules on the statutory accident insurance provide that in case of an accident the employee cannot sue the employer but also has to rely on the insurance.

## 2.5 Import Regulations and Customs

The customs legislation of the European Union is completely harmonized apart from a few minor procedural rules and binding for all EU member states in the form of a customs code. In this respect, Saxony's import regulations are liberalised.

### 2.5.1 Community Goods

Community goods are goods produced in the EU or regularly imported by one of the member states. They can be traded within the European Community without any further clearance by the customs authorities of the member states (in Germany: *Zollverwaltung, Bundesministerium der Finanzen*). This free circulation is no longer classified as an export or an import, but as an intra-Community supply or an intra-Community demand.

### 2.5.2 Imports from Third Countries

Non-community goods, which are imported into the customs territory of the European Union from non-EU countries, must be cleared by customs.

The import duties to be levied are based on the EU customs tariff or excise duty laws, – customs duty, import turnover tax, certain excise duties. Most of the customs duty rates in the Common Customs Tariff of the EU are ad valorem duty rates.

Agricultural produce in particular is subject to customs rates primarily based on the net weight of the goods. Levies may be charged instead of, or in addition to, customs duties.

Mixed duties are imposed on Consumer Ready Food Products, – bread, cakes, pastries, meat, and beer.

The import turnover tax corresponding to the VAT is charged according to the rate in practice by the importing member state. This applies also to the intra-Community trade.

The rate of tax for agricultural products in Germany is set at 7 per cent of the customs value and at 16 per cent for most industrially manufactured products.

Commercial samples and patterns, advertising material and temporarily imported goods, – trade fair exhibits –, are exempt from import turnover tax.

Excise duties (*Verbrauchssteuern*) are levied on mineral oils, alcohol and alcoholic drinks, tobacco products and roasted coffee.

## **2.6 Real Estate Issues**

### **2.6.1 Sales Agreement, Transfer of Title, Notarial Deed**

The purchase of real property is effected through the conclusion of a sales agreement. In addition, an agreement on the transfer of legal title must be concluded, – conveyance (*Auflassung*) –, and this has to be entered in the land register (*Grundbuch*). Ownership cannot be transferred to the buyer before the entry is made. Before the registration of transfer of title, the tax authorities must issue a clearance certificate (*Unbedenklichkeitsbescheinigung*) confirming payment of real estate transfer tax. Both agreements and all additional agreements legally relating thereto must be notarised, even if an assembly of business assets is acquired. The notarial fees are based on the purchase price. In Saxony, notarial offices are public offices. In some other German states, specially licensed lawyers or attorneys supply notarial services.

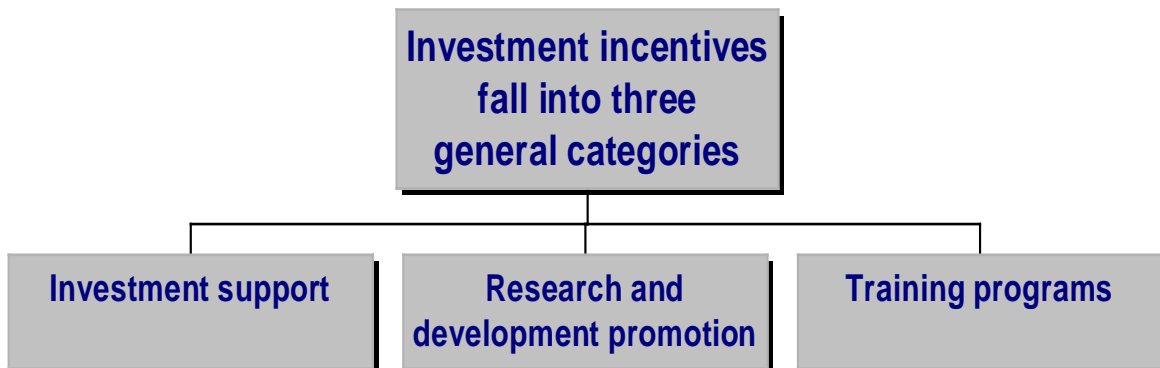
### **2.6.2 Building License (*Baugenehmigung*)**

Before the erection of a building in Germany commences, a prerequisite is to obtain the necessary permissions. The applicable rules relating to the planning permission can be briefly described as follows:

The erection of a building requires the obtaining of prior building permission from the municipal authorities. A building permit will be issued if the planned project complies with public law provisions. To save time, it is common practice to make a preliminary application for a building permit (*Bauvoranfrage*) to clarify specific questions and do further negotiations in case of doubt.

Saxony's authorities are business minded and do their best to grant the license in the shortest period possible. A small project should be authorized within a month, larger projects should not overpass three months.

### 3. Investment Incentives in Saxony



There is a variety of incentive schemes that may be used by the investor qualifying for the respective scheme:

#### 3.1 Financial Incentives

The European Union authorities supervise all financial incentives. Saxony belongs to those areas with the highest priority for incentives. Their application however is subject to the discretion of the Government of Saxony. There is no legal claim to these incentives.

Most manufacturing companies as well as specified industry-related services such as data processing, R & D, technical design, and call centres are eligible for financial incentives.

There is no „automatic“ fund attribution since funds are limited and their distribution is subject to economic and political priorities.

Incentive rates will be applied according to priority of region and economic policy of the Government of Saxony. The rates are scaled:

- First priority up to 35 %
- Second priority up to 28 % and
- Third priority up to 20 %.

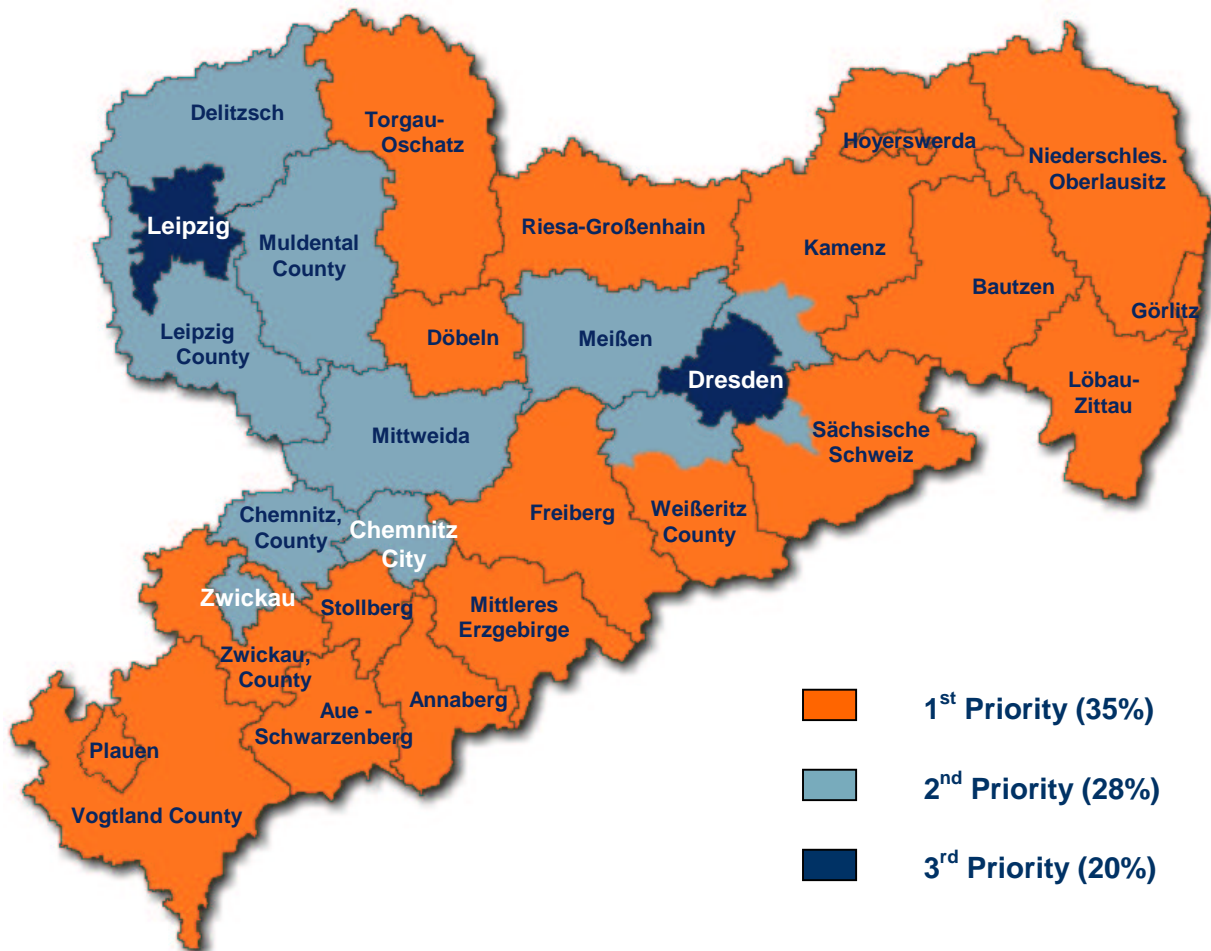
The incentive rate is calculated on the subsidizable investment expenditure that is on

- Buildings
- New industrial equipment and
- Intangible goods like software licenses.

The maximum investment expenditure taken into consideration is an amount of 500,000 EUR per job created.

The total incentive package consists of a bonus, being paid out after filing of tax returns, and a grant, which is paid out after expenditures. The bonus can cover up to 15% of new, depreciable equipment and new buildings. Grants can cover up to 35% minus the bonus percentage awarded.

The following map may help to identify the priorities of the different regions in Saxony:



Small and medium sized investor companies (SME) with less than 250 employees with a maximum annual turnover of 40 million EUR (with effect from 2005: 50 million EUR) or maximum balance sheet sum of 27 million EUR (with effect from 2005: 43 million EUR) may get financial incentives at better rates than what is outlined above.

This scheme is constantly under discussion by the EU authorities with a tendency of further restrictions.

There are special rules for large investments. According to the Multisectoral framework on regional aid for large investments<sup>23</sup> the maximum subsidy rates are scaled as follows:

Eligible investment costs	Reduced subsidy rates <sup>24</sup>
up to € 50 mio.	100 % of maximum regional subsidy rate
€ 50 mio. - € 100 mio.	50 % of maximum regional subsidy rate
> € 100 mio.	34 % of maximum regional subsidy rate

In the case of investment costs above 50 million EUR the allowable aid is calculated by splitting the eligible investment costs into portions as shown in the table above. The respective parts of the investment costs can only be supported at the regional subsidy rate reduced by the percentage shown above.

## 3.2 Labour-Related Incentives

The German Labour Administration provides support for the selection of qualified personal and determination of their occupational aptitude (profiling). In addition to that an investor can apply for all labour-related programs at the local employment offices. There are special schemes for training unemployed people and develop their skills according to the needs of the employer. Furthermore employers can receive employment subsidies to help integrate entitled workers that are currently unemployed. The amount and duration of the subsidy depends on the extent of the employee's unemployment period, the individual skills and the requirements of the job. On average the granted subsidy for new employees that have been unemployed for at least 3 months is 30% of regular wage costs up to 6 months.

Subsidiary to the benefits of the German Labour Administration the European Social Funds (ESF) provides European Union funding for actions which support developing both human resources and labour market policy. The main activities funded by the ESF are training measures (both pre and after hiring). The maximum funding rate of the eligible training costs are dependent on the size of the enterprise and the extent to which the training is customized to a specific enterprise.

	Large enterprises (Non-SME)	Small and medium sized enterprises (SME)
<b>Specific Training measures</b>	60%	80%
<b>Non-Specific Training measures</b>	35%	45%

<sup>23</sup> Official Journal of the European Communities Nr. C 70 of 19th March 2002, p. 8

<sup>24</sup> Currently 35% (in case of SME-investments a bonus of 15% may be granted). Depending on the individual case public aids may require a special approval by the European Commission!

In addition to the support for training measures, small and medium sized enterprises can apply for employment subsidies from the ESF.

Employment subsidies for	Granted amount	Duration of the subsidy
<ul style="list-style-type: none"> <li>- youths under 25 years of age</li> <li>- disabled people</li> <li>- single parents</li> <li>- recipients of social welfare</li> <li>- women (for occupations in which they are underrepresented)</li> </ul>	up to 650 € per months	up to 12 months

### 3.3 Incentives for R&D

The Free State of Saxony offers a variety of grants for companies with regard to Research and Development (R&D).

Precondition for all Technology Grants:

- The applicant must have a permanent location within the State of Saxony.
- R&D project must be carried out within the State of Saxony.
- Results of the projects must be innovative on EU-level.
- Outcoming results from the project have to be implemented into production of new innovative products in the State of Saxony.

The Saxony State Ministry for Economic Affairs and Labour offers grants for individual and joint R&D projects. Subsidies for R&D enterprises must always be based on a specific R&D project focussing on the development of new products and technologies.

According to the project type Saxony can offer technology grants for large companies that may cover up to 65 percent of the eligible costs for industrial R&D<sup>25</sup> (SME: 75 percent) and up to 40 percent of the eligible costs for precompetitive development activities<sup>26</sup> (SME: 50 percent). Subsidies can be awarded e.g. for personnel, consumables, depreciation (linked to investments being indispensable for the realization of the project) and costs for patent/licence investigation (the latter only applies to SME).

<sup>25</sup> By industrial research is meant planned research of critical investigation aimed at the acquisition of new knowledge, the objective being that such knowledge may be useful in developing new products, processes or services or in bringing about a significant improvement in existing products, processes or (*Community Framework for state aid for research and development, Official Journal of the European Communities Nr. C 45 p. 5*)

<sup>26</sup> By precompetitive development activity is meant the shaping of the results of industrial research into a plan, arrangement of design for new, altered or improved products, processes or services, whether they are intended to be sold or used, including the creation of an initial prototype which could not be used commercially. (...). It does not include the routine or periodic changes made to products, production lines, manufacturing processes, existing services and other operations in progress, even if such changes may represent improvements. (*Source: see footnote 3*)

The exact amount of all the subsidy programs is subject of bilateral discussions between the State of Saxony and the investor.

### **3.4 Other Incentives**

There are many more support programmes in Germany. It is recommended to contact the Saxony Economic Development Corporation in order to give the necessary advice about the financial support or combined programs.

The information given here is valid subject to the publication of new guidelines.

## 4. Comparison of Production Conditions in Saxony with Poland, the Czech Republic and Hungary

Some investors may have the impression that labour wages in these neighbouring countries are so low that that all other arguments as to legal and administrative framework conditions are losing weight.

This is mainly due to the fact that CzechInvest publishes information on its website about the wages of, for example, a skilled worker as being US \$ 377 per month, which, at a rate of approximately US-\$ 0.95, corresponds to 397 Euros. If the investor compares this rate with that of a skilled worker in (West) Germany - about 2,100 Euro - this gives a ratio of about 20 to 100, apparently an absolute "killer argument" against Germany as a location.

It is nevertheless worthwhile to examine the situation in a little more detail (see the table in the appendix). This shows that the wage of a skilled worker in the Czech Republic is just 38% lower than in Saxony. Under these conditions, it may be doubtful whether the quite different and undoubtedly more difficult framework conditions in the Czech Republic do really compensate this small advantage in labour wages.

The following comparison of production conditions is based on an investigation which was undertaken by the ifo-Institut Dresden on behalf of the Saxony Economic Development Corporation. The study evaluated the comprehensive literature and subsequently undertook a survey of the German companies in the three candidate countries and in Saxony.

### 4.1 Wages

First of all, it has to be taken into account that wages in Saxony are 25 to 30% lower than in West Germany.

The comparison between the statistical average wages of (West) Germany with Poland, the Czech Republic and Hungary is misleading. The most important reasons are:

- The low statistical average wage in the Czech Republic is determined by the large number of employees who are still occupied in the former state companies which are as yet largely unefficient and not far from conditions as in socialist times. These employees are not, however, available to foreign companies at these conditions. In the Czech Republic - and not only there - the wages paid by international companies are about 30% higher than those in the Czech private sector which is mainly foreign dominated.
- The gaps between high and low wages is very high in all three countries. While in comparison with Western standards, workers with low qualifications receive very low wages, salaries rise steeply in tandem with higher qualifications. The remuneration of management staff is rapidly approaching the West European level.

- According to information provided by the EBRD<sup>27</sup>), wage spread in the three Central and East European countries has increased "dramatically" since the beginning of transformation. In 1989 the salary of an academic in the Czech Republic was approx. 28% higher than the salary of a college junior graduate. By the middle of the 90s the difference had increased to 72%. Development in Hungary was quite similar, where the wage difference in 1996 was 78%. According to studies carried out by the EBRD, it appears that it is particularly "knowledge-based economic growth" which pushes up the wages of qualified workers in the countries undergoing economic regeneration.
- Wages and salaries display a relatively high degree of difference according to business area. They are highest in the area of financial services. In Poland they are approx. 50% above the average wage, and in Hungary and the Czech Republic even clearly more than 100%.
- Since the currency of a country undergoing economic regeneration appreciates in real terms according to the growth in productivity in the export sector (Balassa/Samuelson Effect), the real labour costs in the three Central and East European countries also usually display an increase (calculated in Euro) corresponding to the amount of the real appreciation. Between 1995 and 2000 the real exchange rate in the three countries increased by 20 - 30%.
- Besides the factors mentioned here, there are also other cost components which influence productivity, such as infrastructure, legal system, etc.

So far, only wages have been compared. There is another important factor that is the social contribution to be paid by the employer which in these Eastern States is much higher than in Germany: While in Germany about 20%, the rate in the Czech Republic is 35%.

A simple comparison of gross wages reveals little, since it is productivity per unit labour cost that is the decisive factor.

## 4.2 Productivity

As a result of a decades-long program of systematic vocational training, there are well trained **skilled workers** in Saxony. They are not available in Poland, Hungary and the Czech Republic. Specialists are given focussed trained in modern technological methods of production, including e.g. industrial electronics engineers or mechatronics engineers.

People in Saxony are **flexible** and are quite willing to relocate and to commute up to 50 km.

Relocation in Saxony is easy as housing facilities are available at any place. This is quite different in Poland and the Czech Republic since appropriate housing is not available, even less for expatriates. Furthermore, the bad condition of roads and public transport hinders travelling long distances. Relocation for native managers requires the company to provide accommodation.

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<sup>27</sup>) Source: European Bank for Reconstruction and Development.

Flexible working times, shift work and working on public holidays are all legally possible and accepted in Saxony, but they are not so readily accepted by the working force in Poland and the Czech Republic.

The **fluctuation** of the young and qualified employees in Poland, Hungary and the Czech Republic is very high. Even small wage differences tempt people to change jobs.

In the model calculation (see the table in the appendix) a moderate difference of productivity between Saxony and the Czech Republic of only 20% has been taken into account. It may be much higher in certain cases, but under extreme conditions some firms do realize a productivity scale comparable to Germany. So 20% is a rather conservative approach.

### 4.3 Infrastructure

The standard of the infrastructure in Poland, the Czech Republic and Hungary is quite lower than in Saxony. This applies particularly to the transport infrastructure.

- According to information provided by the EBRD, Poland is far worse than the Czech Republic and Hungary in this regard. Of the approx. 350,000 km of roads 79% are in bad condition, including 264 km of motorway and 263 km of fast roads. Only **1% of all roads conform to EU requirements**. A third of all roads require urgent repair. It will be a number of years before the Polish roads are fully integrated into the EU motorway system.
- The Czech Republic - and particularly Hungary - have modernized some of their main transport routes using **motorways**. Hungary is making great efforts to establish better access to the East, since the infrastructure has proven to be an obstacle for investment in the East, and the concentration of new companies around Budapest has led to a lack of qualified employees. On a pro capita basis, the Czech Republic has the most dense road network of the three Central and East European countries. Nonetheless, some secondary roads have still to be modernized.
- A general principle for all three Central and East European countries is that the infrastructure is worst in those regions which are least developed.
- Poland does have a rail network of 22,300 km. However, only half of this is electrified and 8,900 km are single-track only. More than half of the rail network requires urgent modernization. All in all, the rail system is in a very neglected condition. The situation is similar in the Czech Republic. Between 1990 and 2000 the productivity of the deeply indebted state rail company has decreased significantly. Some smaller lines are however run profitably by private firms.
- In all three countries the improvement of the transport infrastructure is not keeping pace with the rapidly growing haulage traffic, since the demand for private cars grows over-proportionately following the increasing economic growth.
- Air traffic functions relatively well. While the Czech Republic and Hungary each have only one single - but modern - airport, there are ten in Poland, in some of which more investment is badly needed.
- In neither Poland, the Czech Republic nor Hungary, there is a modern and functioning **industrial infrastructure**. To take the automotive suppliers

industry as an example, there are about 500 direct and indirect suppliers in Saxony in a highly developed network structure. There are indeed some very capable suppliers in Poland, Hungary and the Czech Republic, but these are mostly subsidiaries of German or other foreign suppliers, who produce certain wage-intensive products on an individual basis but are not networked with each other, or they are specially tailored to satisfy requirements of assembly plants of Volkswagen or other companies. In Hungary, where the process of privatisation is most developed, a study by the Hungarian Economic Ministry shows that foreign investors receive 10 – 20% of their primary products from abroad. Particularly in the case of Greenfield investments, where products are manufactured which were never produced in the country before, investors are forced to rely on their foreign supply network.

#### 4.4 Legal Security and Political and Administrative Risks

After the reunification of Germany, West German laws and administrative institutions as well as EU regulations were taken over in East Germany without compromise and without any transition period.

- There was no radical change of administration in Poland und the Czech Republic, including the courts. The laws are being adapted to conform to EU standards, but because of the low number of legal workers with a knowledge of the new laws, Poland and the Czech Republic are greatly overburdened. An additional uncertainty is to be found in the implementing regulations, which have been passed late or only partially, or else not at all. Both according to the letter of the law and also with regard to the administrative implementation of legal positions, **legal uncertainty** is therefore great. According to information provided by the EBRD, the implementation of existing laws in the Czech Republic in 2000 worsened distinctly in comparison with 1999 - a very unusual fact during the transformation process.
- Property law in Poland and the Czech Republic contains certain **obscurities** and uncertainties, particularly with regard to liability and lending against collateral security.
- Small and large "**useful contributions**" are usual in Poland, the Czech Republic und Hungary and were also found to be a source of complaint in the interviews with the German firms. According to surveys by the World Bank and by the EBRD, the situation in Hungary is worst on the **administrative level**. The interviews confirmed this.
- Although foreign trade has officially attained a high degree of liberalization, in all three countries there are still numerous problems because of differences in legal interpretation between EU law and national law with regard to the technical handling of foreign trade. Complicated **customs procedures** in import and export make the unhindered exchange of goods in all three countries more difficult. To a great extent, they are characteristic of non-tariff trade obstacles. Uncooperative behaviour in lower-level customs positions is widespread. This was repeatedly brought

up in the interviews. Rectification or replacement of wrong deliveries from abroad can lead to production delays lasting weeks.

- Some of the local companies operating in the Central and East European countries are de facto bankrupt, particularly in the Czech Republic, where, in the meantime, after warnings from the EU, the tenth **bankruptcy law** has been passed. However, hardly any bankruptcies take place de facto in the Czech Republic. According to sources compiled by the research department of the German Federal Bank, approx. 30% of local Czech firms are practically bankrupt.
- Many people in the Czech Republic and in Poland fear the sell-out of their domestic economies to Germany or other foreigners. They therefore boycott or consciously delay making many decisions. The population is divided, and it is predominantly the political parties with a leaning to the right that fear the loss of national identity because of “**EU dictates**”. Despite increasing affluence, the fact that foreign companies continuously produce a growing part of the GNP and of exports arouses great fears in many sections of society. In the meantime, the desire to join the EU has (with the exception of Hungary) diminished significantly in the Czech Republic, and even more so in Poland. Adherence to the time scale for membership in the EU for 2004 is not at all certain in these countries.
- The argument which is repeatedly brought up by the Americans in particular, that the three candidate countries make good "investment locations" because of the weak **trade unions**, has only limited application. Both the EU and the ILO<sup>28)</sup> are putting great pressure on the governments to introduce the social standards as codified in the White Book of 1995. These social standards apply as "minimum standards", of which functioning trade unions are also a part.

## 4.5 Policy of Investment Incentives

The efforts which have been made in the states of the former East Germany to set in motion a process of catching-up in terms of jobs and productivity have led to an extraordinarily varied and differentiated system of subsidization for the setting-up of companies in Saxony. Despite the restricted financial possibilities in Poland, the Czech Republic and Hungary, the instruments of subsidization in these states have also been supplemented - in addition to temporary tax incentives - by various regulations concerning investment grants or by grant regulations connected with job creation.

Many subsidization measures can be claimed only in the case of investment in a disadvantaged region. If the different measures for the subsidization of investment are grouped together then three categories of subsidization measures may be obtained, which

- apply independently of the investment location and the size of the company for investments of all size of companies (normal case);
- may be claimed by companies which invest in a certain (usually less developed) region (favoured region);

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<sup>28)</sup> Source: International Labour Office in Geneva.

- may be received only by certain companies, usually small-to-medium sized firms in the case of investment in a less developed region (extremely favoured).

With the exception of the subsidies available in the Czech Republic in the case of investment in a less developed region, the system of subsidization practiced in **Saxony** in the above-mentioned cases is also **more profitable** in commercial terms according to a comprehensive model calculated by the institute. The risks of the economic environment were taken into account in the ifo-Institut's comparison calculations only in a general way.

Decisions about subsidization policy in Saxony take place **quickly**. Saxony is always on the side of the companies in the event of conflicts with the EU authorities.

Companies located in Poland and, to a smaller extent, those in the Czech Republic, report that subsidization promised by the government **cannot** always be **relied upon**.

Many companies do not make any efforts at all to obtain subsidies, since a suitable grant is often dependent on filling out complicated documents, at the least, or depending on conditions not acceptable to the firms.

Since the resources are limited it may also happen that the resources are **exhausted** in the short-term. This has apparently already happened in the Czech Republic by mid 2002, after the resources have been used for the Toyota Peugeot project in Kollin.

Moreover, should it turn out that, at the time of joining the EU, the subsidy grants or tax exemptions are not conform to EU regulations, then **subsequent reductions** abolishments cannot be ruled out.

## 4.6 Quality of Life

The lack of **legal security** in Poland und the Czech Republic also has an effect on criminality. The crime rate is very high. In this regard, Poland ranks ahead of the Czech Republic, and far ahead of Hungary.

The **public health system** in Poland and the Czech Republic is quite underdeveloped. Even CzechInvest recommends going to Germany or Austria in case of sickness.

The limited **cultural life** is considered a further problem. According to the surveys, there is a relatively large amount of dissatisfaction among the investors with regard to the school system, particularly the international schools.

Due to the great **increase in traffic** in the three capitals, there is a large amount of air pollution there. Worst of all is Warsaw, followed by Prague and Budapest. While Budapest and Prague are already planning ring motorways around the capitals, Warsaw is still a long way far from this.

	<b>Saxony</b>		<b>Czech Republic*)</b>			<b>CzechInvest</b>
	Social Contribution	Labour cost	Social Contribution/ Productivity difference	Labour cost	Difference**) In favour of Czech Republic	Values***)
Unskilled workers						
Salary		1,380		456		260
Employers' social contribution	<b>20%</b>	276	35%	160		
Total gross salary		1,656		616		
Productivity difference			20%	123		
<b>Labour cost</b>		<b>1,656</b>		<b>739</b>	<b>55%</b>	
Skilled workers						
Salary		1,610		745		431
Employers' social contribution	<b>20%</b>	322	35%	261		
Total gross salary		1,932		1,006		
Productivity difference			20%	201		
<b>Labour cost</b>		<b>1,932</b>		<b>1,207</b>	<b>38%</b>	
Mechanical engineers						
Salary		2,636		1,259		1.159
Employers' social contribution	<b>20%</b>	527	35%	406		
Total gross salary		3,163		1,565		
Productivity difference			20%	313		
<b>Labour cost</b>		<b>3,163</b>		<b>1,878</b>	<b>41%</b>	
						1 \$=0.874 EUR

\*) Real values experienced by German firms in the Czech Republic,

\*\*) Difference in favour of Czech Republic,

\*\*\*) Values published on the internet sides of CzechInvest