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It's High Time for a Change

Research-based companies receive tax incentives all over the world—but not in Germany. We can no longer afford this competitive disadvantage

by Thomas Wessel

There are only a few industrialized countries in the world that do not grant tax incentives for corporate research and development activities. Unfortunately, Germany—which is often praised as the land of tinkerers, inventors, and engineers—is one of them. Apart from the promotion of individual projects, Germany provides no tax-related support for research and development, or R&D for short—and definitely not for R&D conducted by major companies. That diminishes the innovative power of German companies and holds them back in global competition.

OTHER COUNTRIES ARE SETTING THE PACE

If we take a look beyond our borders, we can see that the countries that invest most heavily in their innovative power are among the most economically successful. Most of the OECD countries and half of the EU member states use funding such as "input promotion" to support their research sectors. For example, France introduced research promotion policies over three decades ago. So did the Netherlands more than 20 years ago. Ireland as well as Norway, which cooperates closely with the EU, have been promoting research through tax incentives in their respective economic systems for almost 15 years.

These investments are paying off. Six years ago Austria restructured its tax-incentive system, which it had introduced in 1988. Since then, its gross domestic expenditure for R&D has grown significantly compared to its national income. This instrument has also had positive effects on Austria's national budget.

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The payroll taxes of the scientists additionally hired by companies can in themselves cover almost half of the costs of Austria's research funding. Offsetting against the payroll tax has a direct effect on the cash flow.

SIZE IS UNIMPORTANT

In Germany, it's not only the domestic companies that are disadvantaged by the lack of such instruments. The German branches of foreign companies are also negatively affected, because they are at a disadvantage when they compete with branches in other countries for corporate research projects. In the long run, this is a burden on Germany's economy as a whole.

Let's not close our eyes to the fact that the relative weights within the global economy are rapidly shifting, especially to the advantage of Asian countries, which are attracting research and development activities—and more—by offering sizable tax advantages. In Germany, the focus of the political debate concerning tax incentives for R&D is not so much on the competition for real investments but rather on accusations that multinationally operating companies are avoiding taxes.

Of course it's legitimate to ask whether German industry even needs tax incentives, in view of its economic success. After all, it also reliably produces and delivers innovations on the basis of its own economic strength. However, general tax benefits are playing a growing role in the global competition between countries to attract companies. We can see that if we simply look at the drastic reduction of corporate taxes in the USA.

Germany cannot completely withdraw from this global competition, especially in the future-oriented area of R&D. That's because research and development, as well as intangible assets such as patents and trademark rights, play an outstanding role in the world's increasingly knowledge-based national economies. It's high time for a change! Germany should no longer be handicapping itself with its taxation policy when innovative companies are looking for new locations to set up shop and invest their capital.

That's why I challenge the German federal government to use tax reform to lay the foundation for an even playing field where we can operate at eye level with our neighboring countries and trade partners. Germany's passive and cautious behavior must end. Above all, we need tax incentives for research, right now, and they must be available to all companies and all technologies.

The goal must be a general tax credit for R&D expenditures for all research-based companies, and this tax credit must include expenditures for commissioned research. It must also be independent of the size of the company, because small and medium-sized companies are just as relevant to innovation as major industrial groups. In many cases, the latter are the system leaders in innovation partnerships and the principal clients commissioning research from small and medium-sized companies.

A pragmatic, manageable variant for initiating tax incentives for R&D in Germany, which would result in little loss of tax income, would be a policy limiting the tax credit to R&D staff salaries. That should not, however, be the ultimate goal—at most it would be a milestone on the road to Germany's status as a country that is "open to all companies and all technologies."

In general, it's important for the support mechanism to be simple and transparent so that the costs of administering it are kept low, not only for the state but also for the companies involved. In addition, like all support schemes, it should be plannable and reliable, and must offer companies legal security and investment protection. All of this is common practice outside Germany and within the boundaries of Europe. The German variant of R&D promotion must also provide all of these benefits.

At long last, Germany's standstill on this issue seemed to be ending. The introduction of a tax incentive for R&D for small and medium-sized companies was finally included in the coalition agreement. The Federal Ministry of Education and Research and the Federal Ministry for Economic Affairs had already submitted a list of shared key points last fall. However, the constructive participation of the Federal Ministry of Finance is of crucial importance. This means that joint draft legislation could be presented by the German federal government by Easter. It would be very welcome if legislative action were to quickly follow these excellent ideas regarding innovation policy.

NEW INSIGHTS

This legislation would result in far more winners than "only" Germany's status as a business location. An increase in the research conducted in Germany would intensify the transfer of knowledge between science and business. Simultaneously, tax incentives would offer opportunities to gain new insights into the national economy. For example, they would make it easier to calculate an index of innovators—in other words, the number of innovative companies by comparison with the total number of companies.

Such an index could even be differentiated according to sectors. It could, for instance, create transparency if there is a concentration of ever fewer economic actors operating in increasingly concentrated markets with higher barriers to market entry—that could enable companies to counteract this trend.

It would also provide a clearer view of relocations of innovation centers that are having a negative impact on the local labor market and causing an emigration of know-how. This effect is especially relevant for Germany. That's because Germany, a country of tinkerers and inventors that is poor in raw materials, has been living for decades on the fact that it's a leader rather than a laggard when it comes to research and development.