New Concerns in an Uncertain World

The 2007 A.T. Kearney FDI Confidence Index®
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Despite significant obstacles, foreign direct investment (FDI) continued to rise in 2007, and global investors are optimistic about opportunities in the developing world. China and India continue to rank at the top of the FDI Confidence Index. Six of the top 10 countries in this year’s FDI Confidence Index are emerging markets. A seventh, Hong Kong, represents an access point to the largest emerging market, China. Frontier markets such as Vietnam, the Gulf states and South Africa also broke into the top 25 as targets for foreign direct investment over the next one to three years, with multinationals tapping into growth opportunities in fresh target markets. Developing countries, which are expected to account for an increasing number of large FDI deals, display special interest in frontier markets as first-time investment destinations.

In the developed world, the United States maintains its lead in investor confidence. Europe’s economic recovery keeps Germany and the United Kingdom in the top 10, while France ranks 13th. Other European countries, however, fare less well. First-wave EU accession states such as Poland, the Czech Republic and Hungary all fell in the rankings after initial investor exuberance in 2005.

As investors decide how and where to allocate their capital, they weigh new considerations. Sustainability—economic, political, social and environmental—has become a significant worldwide issue. Following the lead of corporate giants such as General Electric, Wal-Mart and Toyota, survey respondents have adopted new policies and invested in sustainability projects, which are expected to benefit both the environment and the bottom line.

Another important development is the further emergence of private equity, hedge funds and state or government funds as new channels for global liquidity. Although respondents generally perceive them as favorable, these channels nevertheless compete with traditional FDI. Almost two-thirds of global investors view private equity as the greatest source of competition. Moreover, three-quarters of firms in the $1 billion to $5 billion revenue range consider private equity

As 2007 turned into 2008, investors were once again operating on unstable ground. Several years of bullish recovery from an early twenty-first century recession ended abruptly as the subprime market crisis pummeled the world’s leading financial markets. While the current account deficit of developed markets persists, emerging markets are enjoying a current account surplus. Persistently high oil prices are dampening hopes that the deficit might decline.
a particular threat to their own FDI plans. The clout of these new investment channels is expected to grow, while the number of large FDI-financed M&A deals over the next three years is expected to fall.

These are among the major findings of A.T. Kearney’s 2007 FDI Confidence Index® survey, which tracks the impact of likely political, economic and regulatory changes on the foreign direct investment intentions and preferences of the leaders of top companies around the world. With responses from global executives spanning six continents and 17 industry sectors, the survey represents a unique window into the present and future prospects for international investment flows (see figure 1).

Figure 1
2007 FDI Confidence Index®

Top 25

<table>
<thead>
<tr>
<th>Rank</th>
<th>Country</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>China</td>
<td>2.21</td>
</tr>
<tr>
<td>2</td>
<td>India</td>
<td>2.09</td>
</tr>
<tr>
<td>3</td>
<td>United States</td>
<td>1.86</td>
</tr>
<tr>
<td>4</td>
<td>United Kingdom</td>
<td>1.81</td>
</tr>
<tr>
<td>5</td>
<td>Hong Kong</td>
<td>1.78</td>
</tr>
<tr>
<td>6</td>
<td>Brazil</td>
<td>1.78</td>
</tr>
<tr>
<td>7</td>
<td>Singapore</td>
<td>1.75</td>
</tr>
<tr>
<td>8</td>
<td>United Arab Emirates</td>
<td>1.72</td>
</tr>
<tr>
<td>9</td>
<td>Russia</td>
<td>1.70</td>
</tr>
<tr>
<td>10</td>
<td>Germany</td>
<td>1.70</td>
</tr>
<tr>
<td>11</td>
<td>Australia</td>
<td>1.68</td>
</tr>
<tr>
<td>12</td>
<td>Vietnam</td>
<td>1.67</td>
</tr>
<tr>
<td>13</td>
<td>France</td>
<td>1.67</td>
</tr>
<tr>
<td>14</td>
<td>Canada</td>
<td>1.65</td>
</tr>
<tr>
<td>15</td>
<td>Japan</td>
<td>1.63</td>
</tr>
<tr>
<td>16</td>
<td>Malaysia</td>
<td>1.63</td>
</tr>
<tr>
<td>17</td>
<td>Other Gulf states</td>
<td>1.62</td>
</tr>
<tr>
<td>18</td>
<td>South Africa</td>
<td>1.61</td>
</tr>
<tr>
<td>19</td>
<td>Mexico</td>
<td>1.59</td>
</tr>
<tr>
<td>20</td>
<td>Turkey</td>
<td>1.59</td>
</tr>
<tr>
<td>21</td>
<td>Indonesia</td>
<td>1.58</td>
</tr>
<tr>
<td>22</td>
<td>Poland</td>
<td>1.58</td>
</tr>
<tr>
<td>23</td>
<td>Central Asia</td>
<td>1.57</td>
</tr>
<tr>
<td>24</td>
<td>South Korea</td>
<td>1.57</td>
</tr>
<tr>
<td>25</td>
<td>Czech Republic</td>
<td>1.56</td>
</tr>
</tbody>
</table>

Source: A.T. Kearney

1 Foreign direct investment includes investment in physical assets, such as plants and equipment, in a foreign country. Holdings of 10 percent or more equity in a foreign enterprise is the commonly accepted threshold between direct and portfolio investment as it demonstrates an intent to influence management of the foreign entity. The main types of FDI are acquisition of a subsidiary or production facility, participation in a joint venture, licensing and establishment of a greenfield operation. The last is defined as a direct investment in new facilities or the expansion of existing facilities.
Major Findings

Global FDI continues to recover from a low point in 2003. According to the United Nations Conference on Trade and Development (UNCTAD), global FDI inflows in 2006 reached their second-highest level in recorded history at $1.3 trillion. Preliminary UNCTAD estimates of global FDI inflows for 2007 amounted to $1.5 trillion, surpassing the 2000 peak of $1.4 trillion. Developing nations, which accumulate foreign capital as the developed world runs up its trade deficits, are increasingly active as global investors and will likely account for a growing share of outbound FDI.

Despite a Global FDI Recovery, Investors Are Concerned about the United States’ Economic Health

As the U.S. subprime mortgage turmoil has spread to the broader U.S. housing market and asset-backed securities markets around the world, and tightening credit conditions and high oil prices exert pressures on global economic growth, global investors are uneasy. Their top concerns in making FDI decisions are the slowdown in the U.S. economy (55 percent of investors), volatility of the U.S. dollar (45 percent) and rising interest rates (39 percent). Also on the list are increased government regulation (38 percent) and energy price volatility (37 percent) (see figure 2). Global investors see risks in the United States stemming from policy choices such as the cost of the Iraq war (30 percent) and looming protectionism (15 percent), as well as from structural problems. They worry about high consumer indebtedness (18 percent), declines in the highly skilled workforce (15 percent), and persistent budget and trade deficits (15 percent) (see figure 3).

Nevertheless, the United States retains its status as the third most attractive FDI destination in the world, just behind the large emerging markets of China and India. As a first-time investment destination, the United States is more attractive to developed market investors than developing market investors.

The 52 percent of respondents who plan to increase their U.S. investments over the next three
years are encouraged by the country’s continued stable macroeconomic environment, the large consumer market and robust economic growth, along with access to cutting-edge technology or research (see figure 4). Investors who plan to decrease or hold constant their level of U.S. investment (48 percent) are driven by better overseas investment options, concerns over a major dollar devaluation and a slowing of the U.S. economy. This group is also deterred by increased R&D regulation and uncertainty surrounding the 2008 presidential election.

**China and India Top FDI Rankings**
China and India remain the top two countries in the Index. China leads the Index rankings for the fifth consecutive year. China ranks first among Asian investors and second among European and North American investors. Both developed and developing country investors cite China as their preferred destination for first-time investments. China holds its appeal across sectors, topping the list for financial and nonfinancial services, light and heavy manufacturing, and primary sectors. It is only surpassed by India in telecommunications and utilities.

Global investors remain optimistic about China, with 35 percent of investors viewing China’s investment environment more positively than they did one year ago. However, investors also report a number of concerns over China’s investment environment. They are primarily concerned about rule of law issues in China over...
the next five years, with threats to intellectual property (50 percent of investors) and uncertainties over the political and legal environment (44 percent) topping the list (see figure 5). Next are concerns over macroeconomic stability, specifically dangers of a real estate and stock market bubble (32 percent) and an overheating economy (31 percent). In addition, 30 percent of investors fear a global protectionist backlash against China-manufactured goods. Recent controversies over food safety and toy quality may represent only the tip of the iceberg.

Forty-three percent of global investors in China prefer to put their money in wholly owned enterprises that they can control. Equity and contractual joint ventures are favored by 26 and 23 percent of investors respectively (see figure 6). These arrangements allow investors less control but spread the risks and leverage domestic market knowledge.

India retains second place in the Index, a position it has held since displacing the United States in 2005. FDI inflows increased 250 percent, from $6.7 billion in 2005 to $16.9 billion in 2006. Preliminary UNCTAD estimates of 2007 inflows are at $15.3 billion. India continues to attract investors in the high value-added services industry sectors, particularly financial services and information technology. Multinationals seek economies of scale and productivity gains in their IT and business process outsourcing (BPO) functions in established cities such as Bangalore, Mumbai and Delhi. They are also diversifying to lower-cost cities such as Pune and Kolkata amid attrition and wage inflation pressures in the first-tier cities. In addition, companies are locating more sophisticated functions such as equity research and high-end analytics in India, tapping into its vast pool of educated and increasingly experienced talent. In addition, India appeals to investors across all
other sectors, reflecting the country’s potential to attract more diverse investments.

While China is the chosen investment location of Asian investors (out of all investors with a high likelihood of investing in China, 34 percent are Asian) in the near future, India attracts a broader set of global investors, gaining recent interest from companies such as IBM, General Motors and Nokia. Three-quarters of respondents highly likely to invest in India over the next few years are from outside Asia. India also tops the list for positive investment outlook among all destinations, with 36 percent of global investors indicating more positive views compared to the previous year (see figure 7).

Proven Destinations Remain Strong, but Frontier Markets Attract Interest, Especially from Developing Country Investors

Twenty of the top 25 investment destinations on the Index are returning from the last survey, confirming investors’ continued confidence in destinations that have delivered results. Seven of the G-8 nations are represented, as are the BRIC countries (Brazil, Russia, India and China). Of the 10 countries with the greatest uptick in investor outlook compared to last year, eight are well-known investment targets: China, India, Brazil, Hong Kong, the United States, the United Kingdom, Russia and Germany. The other two are the United Arab Emirates, which broke into

Figure 7
Changes in investor outlook compared to a year ago

Percentage of respondents

<table>
<thead>
<tr>
<th>Country</th>
<th>Positive change in outlook</th>
<th>Negative change in outlook</th>
</tr>
</thead>
<tbody>
<tr>
<td>India</td>
<td>36%</td>
<td>-6%</td>
</tr>
<tr>
<td>China</td>
<td>35%</td>
<td>-9%</td>
</tr>
<tr>
<td>Brazil</td>
<td>30%</td>
<td>-5%</td>
</tr>
<tr>
<td>United Arab Emirates</td>
<td>29%</td>
<td>-6%</td>
</tr>
<tr>
<td>Vietnam</td>
<td>28%</td>
<td>-5%</td>
</tr>
<tr>
<td>Hong Kong</td>
<td>24%</td>
<td>-4%</td>
</tr>
<tr>
<td>United States</td>
<td>23%</td>
<td>-14%</td>
</tr>
<tr>
<td>Russia</td>
<td>23%</td>
<td>-7%</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>23%</td>
<td>-5%</td>
</tr>
<tr>
<td>Germany</td>
<td>22%</td>
<td>-5%</td>
</tr>
</tbody>
</table>

Source: A.T. Kearney
the list in 2005, and Vietnam, which returned to the list for the first time since 2003.

Indeed, Vietnam occupies the 12th spot in the Index this year, its highest ranking ever. Having joined the World Trade Organization (WTO) in 2007, Vietnam has been named a leading candidate for first-time investments by both developed and developing country investors. Manufacturing is the main attraction for developed country investors. U.S. chipmaker Intel is building a $1 billion microprocessor production base in Ho Chi Minh City—the largest U.S. FDI project in Vietnam. Japanese companies such as Canon and Honda are interested in Vietnam as a low-cost production base for exports.

Other countries are joining the top 25. Other Gulf states arrive at number 17, as increased petrodollar liquidity gives rise to new investment opportunities in petrochemical downstream industries, construction and real estate, and financial services. South Africa, ranked 18th, has relative political and economic stability and a concentration of key companies to attract developing country investors. Industrial and Commercial Bank of China’s (ICBC) acquisition of a 20 percent stake in Standard Bank, South Africa’s largest bank, will allow China to facilitate future energy and commodity investments on the African continent. Indian conglomerate Tata Group has also invested in multiple sectors from IT services to cars to hotels. Elsewhere on the Index, Malaysia and Indonesia return to the top 25, thanks mainly to interest from Asian investors.

Both developed and developing country investors are interested in making first-time investments in established emerging markets such as China and India and in frontier destinations such as Vietnam and the United Arab Emirates. Otherwise, developed country investors are turning to large and popular FDI destinations such as Russia and Turkey in the developing world and the United States and Western European destinations in the developed world. These investors also consider Saudi Arabia primarily as a site to serve the region’s large corporations and high net worth customers.

By contrast, developing country investors cite up-and-coming destinations for first-time investment over the next three years. These investors are interested in locations such as Nigeria, South Africa and Egypt in Africa and the Middle East; Thailand, Cambodia and Indonesia in Asia; and Chile in the Americas. As first-time FDI locations, these countries offer cost advantages, labor availability and an increasingly favorable investment and business climate.

Chinese investors have started to offshore within East Asia to destinations such as Vietnam and Cambodia. Anticipating growing trade ties along the shared border, Chinese producers have invested in physical infrastructure as well as factories in Vietnam to produce for both domestic sale and export. Chinese firms have invested in Cambodian raw materials such as iron ore and silk. China has also been active in Africa. Its financial commitments of $20 billion over the next few years have eclipsed funding by the continent’s traditional global aid agency donors.2

Developing country investors now compete for investment targets with developed country investors. Is this a sign of larger changes to come? To be sure, developing countries contributed only about 15 percent of global FDI outflows in 2006. Developing Asian economies have seen dramatic increases in outflows since 2003, with their share of world FDI outflows rising from 4 to 9 percent. Sustained economic growth over

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2 See A.T. Kearney research on “CHIMEA”—the growing strategic alignment of China, India, the Middle East and Africa.
the past decade has allowed countries to build up huge capital pools, much of which has funded internal investments or the accumulation of foreign currency reserves. China alone has parked hundreds of billions of dollars in U.S. Treasury bonds, in part to maintain its currency peg. Developing countries now hold more than 70 percent of world currency reserves, according to the latest IMF data, up from about 50 percent in 1996. The problem is that countries accumulating reserves so quickly are exposed to significant currency risk. In the event of a major depreciation of the U.S. dollar, these countries’ central banks would suffer substantial capital losses. If China and other developing economies that have been accumulating reserves move to buying real assets rather than portfolio assets, the FDI numbers are likely to shift rapidly.

Non-Western governments looking to diversify beyond sovereign debt instruments have mainly targeted investments in their home regions. For instance, the Singapore state investor Temasek Holdings, with its $80 billion-plus portfolio, has concentrated on Asian investment targets. However, there is anecdotal evidence that Singaporean capital has begun to move abroad. The Temasek Review 2006 reports that 44 percent of its assets are invested in Singapore, down from 52 percent in 2004. Temasek and the Chinese government helped underwrite Barclays’s hostile bid for Dutch bank ABN Amro.

Temasek is not alone. The Chinese government has acquired a 9.9 percent stake in both the Blackstone Group and Morgan Stanley. Borse Dubai concluded a bid for 20 percent of Nasdaq Stock Market and is pursuing shares in the London Stock Exchange. The Abu Dhabi Investment Authority is estimated to have nearly $875 billion for investment. Following recent subprime-related write-downs, Citigroup received a $7.5 billion investment from the Abu Dhabi Investment Authority and $6.88 billion from the Government of Singapore Investment Corporation. Merrill Lynch raised capital from Singapore’s Temasek Holdings, the Kuwait Investment Authority and the Korea Investment Corporation. Bear Stearns and UBS received capital injections from the China Investment Corporation and the Government of Singapore Investment Corporation respectively. Further expansion of the investment horizons of sovereign wealth funds should be expected.

But not all countries have resorted to state-owned funds to increase their overseas investment portfolio. Notably, India has become a major player in FDI through the actions of its private firms. The acquisition of specialty steel producer Arcelor by Mittal Steel made the newly formed ArcelorMittal the world’s largest steel producer. Tata Steel has responded in kind,
buying the Anglo-Dutch Corus Group, Singapore-based producer NatSteel Asia, and a 40 percent stake in Millennium Steel, a Thai steel company. Aluminum manufacturer Hindalco bought Novels, a U.S. aluminum rolling firm, for $6 billion in 2007, creating the world’s largest aluminum rolling company. The Economist reports that total foreign acquisitions by Indian firms totaled $23 billion in 2006, a new record.3

Such major deals are likely to continue. According to survey responses, developing country investors plan to make more than half (54 percent) of the $500 million-plus FDI deals over the next three years. These large deals are expected to be channeled to other developing country markets and to some extent Europe. In the United States, however, political resistance may well contain the size of such FDI investments, as evidenced by China’s recent strategic investments in Blackstone and Bear Stearns via government-controlled CITIC Securities. Both shares are small enough to avoid congressional review.

Near-Shore Destinations Draw Asian and European Investors

Regionally, investors in Asia and Europe prefer the “near abroad” for their investments, while North American investors tend to look outside the Western Hemisphere. Nine of the top 15 preferred investment destinations for Asian investors are in Asia. Eight of the top 15 preferred investment destinations for European investors are in Europe. Data also suggests that investment flows to the EU-15 (the 15 countries in the European Union prior to the accession of 10 candidate countries in May 2004) increasingly come from within the EU-15. In 1994, 64 percent of all FDI in the EU-15 came from other EU-15 states. By 2005, that number was 79 percent.

Among the top 10 FDI destinations, China and Russia generate the most confidence among home region investors. Asian investor interest in China spans across manufacturing and service sectors, as the country expands its domestic market demand and deepens its know-how as an export platform. Russia attracts significant interest from European investors, who are also much more likely to select Russia as a first-time investment destination than are North American investors.

On the other hand, North American investors have not shown a similar tendency to invest within the region. Rather, they have a strong preference for markets outside the Western Hemisphere. U.S. FDI flows to Latin America were up 123 percent over the 1996 to 2006 period. During the same time period, flows to Canada rose 200 percent and those to Europe increased by 318 percent. FDI in Asia grew by 300 percent, and in the Middle East it increased 1000 percent. The character of investment for North American firms also varies by region: Developed country investment occurs via reinvestment of profits earned by foreign affiliates, whereas developing country investment uses capital earned outside the target country.

According to the Bureau of Economic Analysis (BEA), the United States’ outward foreign direct investment position at year-end 2006 increased substantially compared to 2005, helped by outward capital flows of $216 billion. However, net outflows were still $41 billion below the post-2000 record level of 2004.4 The Netherlands led recipients of U.S. FDI at 15 percent of the total. The United Kingdom (9 percent), Luxembourg (7 percent), Canada (7 percent) and Ireland

4 The 2005 to 2006 comparison of U.S. FDI outflows would indicate much higher FDI outflow volume than the 2004 to 2006 comparison. However, 2005 is a poor benchmark due to tax provisions in the American Jobs Creation Act of 2004, which permitted foreign earnings repatriation at reduced tax rates for FY2005. The FDI outflow numbers for 2005 are therefore artificially weak due to repatriation of foreign earnings, and 2004 represents a better benchmark year.
(6 percent) completed the top five recipients. Together with Mexico (5 percent), these countries accounted for nearly 50 percent of U.S. FDI outflows in 2006. In Asia, Japan was again the largest target for U.S. investment, taking in 27 percent of the $45 billion total in that region. This doubled Japan’s relative share of 14 percent in 2004.

Although Europe, South and Central America, Africa and the Middle East saw increases in U.S. FDI from the benchmark year of 2004, Asia, North America and the remaining states in the Western Hemisphere experienced decreases. Also according to the BEA, compared with 2004, overseas investments fell in bank and nonbank financial services, nonbank financial holding companies, professional services and manufacturing.

FDI Faces Increased Competition from New Investment Channels

Recent high-profile investments of hedge funds, private equity firms and sovereign wealth funds have not gone unnoticed by global investors, almost 80 percent of whom consider the growth of these nontraditional sources to be benign or positive. Only 13 percent think they are a negative force (see figure 8). Among the three investment channels, private equity is considered by 62 percent of investors as the greatest competition to traditional FDI. Firms in the $1 billion to $5 billion range view private equity more negatively than their larger or smaller counterparts.

Investors remain divided on how best to enter new markets, with M&A, greenfield investment and joint ventures ranked more or less equally. M&A is expected to be the primary mode of entry for smaller deals, but fewer investors are planning $1 billion-plus M&A deals.

As private equity’s acquisitions spree winds down in response to banks’ reduced appetite for risk, sovereign investment funds, backed by huge foreign exchange reserves, will likely play a more prominent role in overseas investment. To date, private equity firms have relied on cheap and

![Figure 8](Image)

New investment channels are competing with FDI
abundant credit to structure highly leveraged deals. Recently, however, private equity has found fundraising more difficult. Cerberus Capital met with resistance in financing the final elements of its Chrysler buyout. The Carlyle Group’s bids for Virgin Media are reportedly running into financing difficulty. Corporate M&A is gaining some advantages in bidding against private equity, owing to its ability to use financing mechanisms other than leveraged debt. If the debt markets continue their deterioration, or interest rates in the United States or Europe rise over inflation concerns, the private equity market will likely cool further, diminishing the sector’s role in overseas investment and acquisition.

**Sustainability in Global Investments**

Investors from different regions, sectors and firm sizes are all concerned about the sustainability of the global economic order. The greatest single challenge, cited by 66 percent of respondents, is global competition for scarce energy reserves. Climate change follows closely behind, mentioned by 55 percent of respondents. Other top concerns include global competition for non-energy natural resources (47 percent) and increasing pollution from developing countries (44 percent). Beyond environmental sustainability, the leading issue for investors is the wealth and income gap between the developed and developing worlds (38 percent) (see figure 9).

Corporations are taking note. Fifty-three percent of investors have programs in place that enhance eco- and energy-efficient practices, products and technologies (see figure 10 on page 12). Companies are also adopting formal, written sustainability codes to guide corporate practices. Some of the world’s largest enterprises, including BP and Wal-Mart, are implementing corporate strategies that address critical challenges to a sustainable future. Wal-Mart estimates that investing in energy-efficient building and shipping practices will quickly and substantially reduce overall costs, along with supporting sustainability. At the same time, its corporate image will benefit. Wal-Mart plans to demand similar sustainable practices of its suppliers.

**Figure 9**

Most important challenges to the sustainability of the global economic order over the next 20 years
Consumers are also driving environmentalism. Whole Foods Market, focusing on organic and sustainable products, enjoys healthy profits in an industry of historically tight margins. General Electric has built a significant presence in the wind power sector, which now enjoys a boom as governments and private companies worldwide demand wind turbines; in turn, General Electric’s suppliers have benefited as well. Meanwhile, activist shareholders from large pension funds are pressuring firms to uphold higher standards in their business practices. Such shareholders are driven both by concern for the long-term environmental and social impact of their investments, and by good business sense.

Furthermore, global corporations are looking outside their own organizations for solutions. Thirty-three percent have joined industry bodies to lobby for sustainable practices, such as swift regulation to combat climate change. Twenty-five percent report that they have tightened selection criteria for suppliers and switched to those that demonstrate sustainable business practices. In addition, 20 percent of investors have adopted industrywide sustainability codes.

One example is the Leadership in Energy and Environmental Design (LEED) Green Building Rating System, developed by the U.S. Green Building Council. This system provides benchmarks for environmentally friendly design and building practices, and is used to certify new and existing construction. Approximately 1,200 projects are already certified, and 9,000 more have registered with the building council to collaborate with its members and achieve certification. Another example is the ISO-14001, an environmental audit standard that offers comprehensive guidelines for environmental management and third-party certification and verification. Europe and Asia-Pacific (particularly Japan) together accounted for 87 percent of total ISO-14001 enterprise certifications as of 2005, according to the International Organization for Standardization.

Investor enthusiasm notwithstanding, only 25 percent of global investors indicated that their firms tracked the return on investment (ROI) of their sustainability initiatives. Of that group, 70 percent expect returns of 10 to 40 percent. While only 19 percent of North American investors track the ROI from such initiatives, they found substantially greater returns than investors from Europe and Asia. Also, larger firms ($10 billion-plus in annual revenues) reported better ROI on their sustainability investments than smaller firms.

Although developing country investors share the same sustainability concerns and priorities, voluntary standards have generally lagged behind government enforcement in responding to environmental challenges. But recent private sector innovations in India offer cause for optimism. In 2007, Wipro Infotech—the India, Middle East and Asia-Pacific IT business unit of Wipro Limited—became the first Indian manufacturer

Figure 10
Most common firm responses to sustainability risks

<table>
<thead>
<tr>
<th>Percentage of respondents</th>
</tr>
</thead>
<tbody>
<tr>
<td>Invest in eco-efficient practices, products or technologies</td>
</tr>
<tr>
<td>Adopt formal sustainability code</td>
</tr>
<tr>
<td>Join industry bodies to promote sustainability efforts</td>
</tr>
<tr>
<td>Tighten supplier selection criteria and switch to suppliers with sustainable practices</td>
</tr>
<tr>
<td>Adopt industrywide codes on sustainable products and business practices</td>
</tr>
</tbody>
</table>

Source: A.T. Kearney
to launch a range of environmentally friendly “GreenWare” desktops. These desktops are fully compliant with EU standards on the use of hazardous materials in manufacturing, and the company eventually plans to adhere to these standards across its entire computer line. In the utilities sector, Tata BP Solar, a joint venture between Tata Power Company and BP Solar, ranks among the world’s leading producers of solar-powered home solutions. Its projects include the installation of 1,000 solar-powered water pumps in the state of Punjab, allowing farmers to get water without requiring time- and resource-intensive routing of power lines to the region. It also brought in-home lighting to remote regions of the Himalayas using solar lantern technology.

Projects such as these suggest ways for India to continue to move toward Western standards of living—regular running water and indoor lighting, for example—without the infrastructure and pollution footprint required by Western models. Continued development will require substantial investment, but there are signs that India’s booming economy will support it. For example, New Ventures India has announced a $25 million venture fund targeted at green technologies and hopes to use this as a seed to attract foreign investment. The non-governmental sector has also attempted to fill the gap. Programs such as the Green Rating Project provide company-level ratings by sector of environmental performance, and publicize both the best and the worst companies in each sector.

Due in part to its heavy emphasis on manufacturing, China faces even more acute problems that threaten sustainable economic growth. Rapid industrialization and development, coupled with ingrained attitudes about land and water resource exploitation, have made it among the most polluted countries in the world. Domestic and international pressure to improve environmental performance has been intense. Recent outrage in the United States, Canada and Europe over pet food contaminated with industrial chemicals has led to greater scrutiny of Chinese food imports in general. Beijing also faces creeping desertification that, if left unchecked, may overtake the city and make it uninhabitable. Blinding dust storms are already a reality during the summer months.

Fortunately, China has shown increasing interest in greener development. Top government officials seek to stem rising domestic unrest from negative reaction to the effects of rampant pollution. Still, key government initiatives, such as green GDP accounting (an economic growth index which attempts to factor in environmental consequences), have not yet been successfully implemented. By contrast, the private sector has leapt to capture business opportunities associated

The greatest single challenge to global sustainability, cited by 66 percent of respondents, is global competition for scarce energy resources, followed closely by climate change.
with environmental degradation, with venture capital targeted at clean technology in China increasing 147 percent from 2005 to 2006. As in India, the utilities sector has realized the effectiveness of solar power in a country with an underdeveloped power infrastructure. In 2006, $2.6 billion worth of solar-powered water heaters were installed, compensating for both the lack of power infrastructure and China’s dependence on coal-fired power plants.

China’s booming construction industry has also begun to adapt clean technologies to its purposes. The Shanghai Green Building Council was established in 2004 to help the city prepare for the World Expo 2010. It is now adapting LEED standards to the demands of the Chinese climate. Green buildings, including shopping malls, office complexes and municipal buildings, are being planned for Beijing, Shanghai, Harbin and other cities. Among the most ambitious is Shui On Properties’ Xihu Tiandi development project in the city of Hangzhou—a mixed-use location featuring shops, restaurants and other cultural activities. Built in cooperation with U.K.-based engineering firm Arup, it received a best-in-class LEED Platinum rating from the U.S. Green Building Council.

If India and China continue and expand their major sustainability initiatives, global markets will certainly feel the effects. Companies locating operations in these countries would face the higher costs of complying with more stringent regulations. Furthermore, increased demand for sustainability products could lead to shortages, such as today’s worldwide windmill shortage which is driven by the popularity of the wind energy industry. On the other hand, these initiatives might also dramatically alter the profitability of goods and services targeted at sustainable markets, and lead to significant economies of scale.

Regional Findings

The Americas

The United States continues to rank third among global investment destinations, but it attracts more interest from developed—rather than developing—country investors. As the backlash against China National Offshore Oil Corporation and Dubai Ports for their attempted acquisitions of U.S. strategic assets illustrates, security and political concerns are becoming more prominent factors in investment decisions. The expansion of the review process for foreign acquisitions run by the U.S. Treasury under the Committee on Foreign Investment in the United States (CFIUS) will increase the regulatory burden for foreign investors. Indeed, regulation is very much on investors’ minds: Thirty-eight percent cite increased government regulation as one of the top five developments affecting their investment decisions. Twenty-nine percent credit a less burdensome regulatory environment as a reason for increasing investment in the United States, and 23 percent will maintain or decrease investment because of greater regulation of R&D.

Despite macro concerns, the U.S. economy still exerts a powerful pull on FDI. Investors planning increases to their U.S. investment positions in the next three years cite the size of the market, the overall stability of the macroeconomic environment and robust economic growth as primary considerations. These responses were recorded during a period of 2007 when the financial fallout from the housing market decline repeatedly roiled markets and created doubts about future consumer demand.

Although Mexico and Brazil recorded similar FDI receipts in 2006, global investors are more optimistic about Brazil as an investment destination in the future, according to investors surveyed. Out of the $19 billion of FDI inflows into
Mexico in 2006, 61 percent went to manufacturing investments, mostly by foreign firms seeking to produce for the U.S. market within the NAFTA trading area. Brazil followed at a close second with $18.8 billion in inflows, of which 55 percent went to the service sector, in particular financial services and utilities. The United States, the Netherlands and Switzerland accounted for the majority of these flows. For the first time, FDI outflows exceeded inflows for Brazil, owing to the acquisition of Inco, a Canadian mining concern, by the Brazilian firm Companhia Vale do Rio Doce (or Vale, as it is now referred to after a recent corporate rebranding).  

More than half of the global investors surveyed consider rising populism in Latin America as negative, with 55 percent indicating that it deters their investments in the region. FDI flows into countries where populism is a concern have been volatile. After a 43 percent drop in 2004, Venezuela’s FDI receipts rose 95 percent to $2.6 billion in 2005, but then fell to minus $543 million in 2006. The United Nations credits this downturn to the distribution of profits from state-run oil giant PDVSA to foreign shareholders, which the government had held up since 2003. Bolivia’s FDI intake fell 66 percent from 2003 to 2004, and turned negative in 2005 before finally rising to $237 million in 2006.  

More recently, both ExxonMobil and ConocoPhilips refused ultimatums to enter into joint ventures with PDVSA in order to keep pumping oil in Venezuela. With the country dependent on oil for 90 percent of its export revenue, the exit of major Western firms and their technology will certainly have repercussions. The volatility of these flows suggests that investors are responding to short-term political and economic moves by the ruling governments while they attempt to discern what the long term holds for both countries.

Investors planning to increase their U.S. investment positions in the next three years are considering market size, overall macroeconomic stability and robust economic growth.

Finally, with trade negotiations around the Doha Development Agenda stalled, the United States has taken to negotiating separate trade deals with many of its major Latin American trading partners. In the current Washington climate, Congress has forced these deals to include conditions on labor and environmental standards—as reflected in the United States-Peru Trade Promotion Agreement (signed in 2006) and the United States-Panama Trade Promotion Agreement (signed in 2007). Thirty-nine percent of respondents viewed these standards positively, while only 7 percent thought they would erode investment attractiveness.

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1 United Nations Economic Commission for Latin America and the Caribbean, Foreign Investment in Latin America and the Caribbean, 2006.
2 Ibid.
**United States.** In addition to holding third place in the overall Index, the United States also ranks third for first-time investments from developed country investors. However, developing country investors place it 13th. Regionally, North American investors are the most optimistic about prospects for American investment, ranking the United States first, while European and Asian investors rate it fourth and seventh respectively.

The growth in FDI inflows to the United States—from $101 billion in 2005 to $175 billion in 2006, and to an estimated $192.9 billion in 2007—reflects investor optimism. Investors in light manufacturing sectors (including technology and health care products), telecom and utilities are the most bullish on the U.S. market. For example, France’s Vivendi has announced plans to buy the video games maker Activision. GlaxoSmithKline has agreed to buy Reliant Pharmaceuticals, a privately held drug company specializing in heart therapies, for $1.65 billion. In the utilities sector, the U.K. firm National Grid acquired the U.S. gas and electricity group KeySpan for $11.8 billion, boosting National Grid to become the second-largest utility group in the United States. Investors in the heavy manufacturing and the primary sectors are also upbeat about the U.S. economy. For example, Saudi Basic Industries Corporation recently paid $11.6 billion in cash for General Electric’s plastics business.

Ranking lower, but still upbeat, are investment prospects in the financial services and non-financial services sectors. The recent perfect storm of a devalued U.S. dollar and the subprime mortgage debacle is prompting investments in financial services firms. One example is the $7.5 billion stake in U.S. banking giant Citigroup that the Abu Dhabi Investment Authority acquired in late 2007. In the nonfinancial services arena, Dubai World reportedly plans to invest up to $5.2 billion in the hotels and casino operator MGM Mirage by buying shares and half of a major Las Vegas project.

Short-term investment prospects in the United States appear to be mixed. Compared to a year ago, 23 percent of investors report a more positive outlook, whereas 23 percent report a more negative outlook. On the one hand, a slowdown in the economy coupled with concerns about exposure to the U.S. subprime market should mean a less favorable climate for investment. However, a countervailing trend is the depreciated value of the dollar compared to the euro and Canadian dollar, making mergers and acquisitions by companies in those countries less expensive and thus more tempting.

**Brazil.** Brazil continues to be a favorite of international investors in this year’s Index, rising one place in the FDI Confidence Index from seventh in 2005 to sixth in 2007. FDI inflows rose 25 percent, from $15 billion in 2005 to $18.8 billion in 2006 and further to an estimated $37.4 billion in 2007.

Investors in the primary, manufacturing, telecom and utilities sectors are especially confident about investment in Brazil. Regionally, Asian investors are most interested, ranking Brazil fourth behind China, India and Vietnam as a favored FDI destination, while European and North American investors rank the country eighth and seventh respectively. In addition, 30 percent of investors hold a more positive outlook on Brazil in 2007 than in 2006, compared to 25 percent who felt more positive in 2005 than in 2004.

The United States and Europe remain the largest sources of FDI in Brazil, but that lead is narrowing as Asian investors play a larger role. In 2007, the Indian steelmaker ArcelorMittal bought out minority shareholders in its Arcelor Brasil arm in a deal reaching more than $3 billion, and Nippon Steel Corporation unveiled an $8.4
billion capacity expansion plan at its Brazilian affiliate Usiminas to narrow the production gap with ArcelorMittal. Other recent investments in the manufacturing sector include Fiat’s $2.8 billion expansion of its assembly plant in Betim, which will make it the firm’s largest assembly facility.

High commodity and energy prices have boosted investor interest in the energy and commodities sector. Brazil has a comparative advantage in biofuels, and foreign investors are optimistic about increasing production there. Norwegian energy group Statoil and Petrobras recently signed an agreement to look for joint biofuel ventures and to enhance their existing cooperation in oil and gas exploration and production. The service sector also remains an important destination for FDI. The Irish firm Experian, for example, agreed to pay $1.2 billion for a 65 percent stake in the corporate credit consultancy Serasa.

President Luiz Inácio Lula da Silva’s re-election, macroeconomic stability, buoyant growth and the success of the central bank in controlling inflation are driving Brazil’s continued FDI attractiveness.

Canada. Canada is rising in the FDI Confidence Index this year, moving from 21st in 2005 to 14th place in 2007. Canada’s booming economy attracted FDI inflows of $69 billion in 2006, up 140 percent from 2005.

Primary sector investors show the greatest confidence in Canada. In the face of strong demand and tight commodities markets, they are increasing investments and riding the boom. High oil prices have made extracting oil from the tar sands in Alberta province economically viable, leading to an influx in oil exploration money and rising fortunes in Calgary. These deposits are expected to contain an estimated 180 billion barrels of oil, the largest oil reserves in the world after Saudi Arabia’s. Canada’s National Energy Board has forecast that by 2015, Canada’s total oil output will be 4.1 million barrels of crude oil a day, 61 percent more than in 2005. Foreign investments in sectors such as mining also remain important. As stated earlier, the Brazilian mining company Vale recently purchased Canadian nickel producer Inco for $17 billion, the largest acquisition ever undertaken by a Latin American company.

The new government’s focus on continuing reforms by lowering taxes, maintaining fiscal surpluses and continuing debt reduction has contributed to investor optimism. Tight commodity markets, federal budget surpluses and a current account surplus combined with the subprime mortgage meltdown in the United States have pushed the Canadian dollar above parity with the U.S. dollar. This gain creates favorable conditions for Canadian firms to acquire assets in the United States, but its potential to decrease exporters’ competitiveness is already causing concern in Canada.

Mexico. Mexico’s overall ranking of 19th is three places below its spot in 2005. FDI inflows into the country declined slightly to $19 billion in 2006 from $19.7 billion in 2005, but reached a new high of $36.7 billion in 2007 according to the latest UNCTAD estimates. North American investors rank Mexico as the 10th most favorable destination for FDI.

It is not surprising that North American investors are most confident about Mexico, because almost two-thirds of FDI inflows come from the United States and Canada. North American investors are especially interested in manufacturing, which accounts for almost one-half of all Mexican FDI inflows. One example is investment in auto manufacturing, which has continued to develop since NAFTA was signed. Mexico’s five top automakers are General Motors, Ford, DaimlerChrysler, Nissan and Volkswagen, all of which produce for the American market. Located in Mexico allows auto companies to integrate production, easily shipping cars and parts northward...
by truck and rail. Analysts predict the continuing integration of Mexico’s manufacturing industry into the U.S. production chain.

Trade agreements with the EU, Asia and Latin American countries also underpin investment in Mexico. Although Mexico competes with China for manufacturing investments, its proximity to U.S. markets will likely keep it competitive for investment in heavy goods, such as vehicles, transport equipment and large consumer durables.

The commodity boom has also benefited Mexico, as government officials predict that $15 billion will be invested in mining over the next five years. Canada’s Goldcorp, for example, expects to invest $1.2 billion in its Peñasquito project in the Mexican state of Zacatecas, where it has proven reserves of 13 million ounces of gold and 864 million ounces of silver, among other precious mineral deposits. Mexico’s tourism industry also has significant potential for further development and investment.

The contentious 2006 presidential election caused some concern among investors, but President Felipe Calderón’s acceptance by the electorate and his ability to garner approval for pension and fiscal reforms this year, against expectations, have eased investor concern.

Argentina. Argentina has not ranked among the Index’s top 25 countries since its 2002 financial crisis and debt default. Its reputation does appear to be recovering somewhat, however, and North American investors rate it 15th as an investment destination.

FDI inflows remained nearly constant at $5 billion in 2005 versus $4.8 billion in 2006, before lowering to an estimated $2.9 billion in 2007. This is still up from $1.6 billion in 2003, but FDI remains below the 1990 to 2000 average of more than $7 billion a year.

One reason for North American investors’ optimism is Argentina’s growth rates of at least 8.5 percent a year since the crisis. A measure of stability has returned to the country, and, as of this writing, President Cristina Fernández de Kirchner is expected to restructure $6.3 billion in defaulted debt—a barrier to investor confidence—owed to the Paris Club group of creditor nations. As part of the deal, Argentina will probably revisit its 2005 debt restructuring and try to improve relations with the International Monetary Fund (IMF). Despite that progress, inflation, export bans, price controls and electricity shortages still limit Argentina’s potential for investment, and will have to be tackled if Argentina is to attract the levels of investment it attained before the crisis.

Chile. While not among the top 25 FDI destinations, Chile ranks 14th among developing country investors as a destination for first-time investments. Inflows to Chile rose 14 percent from 2005 to 2006, reaching nearly $8 billion. 2007 estimates are even higher, at $15.3 billion.
In addition to free trade and economic agreements with countries in the region, Chile has also signed economic agreements with China and India, and is in negotiations with Malaysia. These agreements promise to boost future trade and investment activity. Apart from commodities, Chile can also act as a regional production and service platform for adjacent markets in North and South America.

**Andean Region.** At the time of the 2005 Index, analysts speculated that forthcoming bilateral trade deals with Andean countries such as Peru would boost U.S. interest in the region. However, the recent United States-Peru Trade Promotion Agreement was held up in Congress until environmental and labor standards were added to the terms. At the time, many analysts assumed that these standards would make investors less likely to move to Peru (or Panama, where similar restrictions were required). But the 2007 survey suggests otherwise. A majority of respondents indicated that the inclusion of environmental and labor standards had either improved the investment attractiveness of these states (39 percent), or had no effect (29 percent).

**Asia-Pacific**

Global investors indicate strong confidence in the Asia-Pacific region, with such countries representing 11 of the top 25 most attractive investment destinations. Not only do established markets such as China and India remain at the top, but Singapore, Hong Kong, Vietnam, Malaysia and Indonesia are also on the rise. Inbound FDI to Asia-Pacific reached a new high in 2006 and is expected to climb to more than $270 billion in 2007. China and Hong Kong continue to dominate the investment landscape, accounting for $120 billion of the total. Singapore comes in third at an estimated $36.9 billion, Japan fourth at $28.8 billion, and India fifth at $15.3 billion. Overall, the region continues its recovery from the 1997 financial crisis, with many of the countries most implicated in that crisis—Indonesia, Thailand, Singapore and the Philippines—seeing positive growth in FDI receipts.

Investors in Asia-Pacific generally report improved views of its headline economies. More than 25 percent of respondents indicate more positive views of China's, India's and Vietnam's investment environments than a year ago. Their concerns are primarily economic. Rising energy costs top the list, with 59 percent of investors concerned that such costs would negatively affect the economy. Beyond energy, the prospects of slowdown in the major economic growth engines for Asia—China and the United States—are of similar magnitude, mentioned by 46 percent and 44 percent of respondents respectively. Global protectionism—damaging to the export-based growth model of so much of Asia—is fifth in the list of concerns, cited by 43 percent of respondents.

**China.** Despite topping the charts in FDI attractiveness, China's FDI inflows fell slightly from $72.4 billion in 2005 to $69.5 billion in 2006. Estimated inflows for 2007 are at $67.3 billion. Starting in February 2006, China's Ministry of Commerce stopped reporting deal values, hoping to keep officials from inflating deal sizes to reap bonuses. The decline, or apparent decline, in inflows may be an unintended consequence of this effort.

In the longer term, however, the government in Beijing has taken steps that should encourage future FDI. Past restrictions on foreign participation in Chinese capital and investment markets, as well as on foreign ownership of large enterprises, have loosened. The new enterprise income tax law, which took effect on January 1, 2008, replaces the different tax rates for foreign and domestic companies with one common rate of 25 percent. Tax incentives for venture capital and social investment were also announced in
2007. These changes will likely help to reduce the “round-tripping,” or double-counting, of domestic Chinese capital—which refers to “FDI” first sent through tax havens such as Hong Kong and later reintroduced back into the country as FDI—inflating Chinese investment figures. Beijing has also instituted new rules that should allow greater access for foreign banks to operate in its capital markets. UNCTAD, in its Investment Brief No. 2, published in 2007, estimates that FDI inflows to the financial sector grew nearly fourfold from 2004 to 2005, and that FDI in real estate was nearly $8.8 billion, or more than 10 percent of total inflows and an estimated 15 percent of the total Chinese real estate market. Major financial institutions such as Citigroup have begun acquiring assets in the prime markets of Shanghai, Guangzhou and Beijing. Merrill Lynch targeted $30 million for a residential project in Nanjing, and Hutchison Whampoa shifted $5 billion into investments in several major Chinese cities.

This flurry of investments has raised fears of an asset bubble. To dampen such fears, the government began in 2006 to restrict foreign investment in Chinese real estate markets, part of a broader series of moves designed to rein in the overheating credit market. Whether it can maintain these restrictions in the face of regional pressures from Shanghai and other cities to attract foreign direct investment is unclear. Shanghai announced in May 2007 that it would loosen some of Beijing’s restrictions on foreign property ownership to avoid discouraging foreign investors.

The effects of China’s changing banking regulations, stemming from its commitment under the WTO to liberalize the banking sector, are already visible. Financial services sector investors rank China as their top FDI destination. Indeed, 2006 marked significant foreign investment in the Chinese financial services sector, even as investment in traditional manufacturing and textiles sectors remained flat. Among the investors were HSBC and Citigroup. Each received permission from the government to incorporate domestically and tap into Chinese savings. ABN Amro, Bank of East Asia and Hang Seng Bank have also entered the market. As China continues to open its domestic financial markets to foreign firms, investment in the financial sector should accelerate.

Of the respondents whose firms are invested in Asia, nearly two-thirds include Chinese assets in their FDI portfolio. Wholly owned enterprises in China are preferred by a nearly two-to-one ratio over either equity or contractual joint ventures with Chinese firms. Greenfield investment is less common, however, and is the favored mode of entry of only 7 percent of respondents.

While investors’ attitudes toward China are generally positive, several drawbacks were noted. Intellectual property rights remain a concern for 50 percent of investors in China. The political and legal regime, in a state of flux as it attempts to adapt to China’s rapidly changing economy, concerns 44 percent of respondents. Meanwhile, the symptoms of an overheating economy—a real estate bubble and a tight market for high-skilled labor—concern 32 percent and 31 percent of respondents respectively. Thirty percent of respondents with investments in China noted the foreign protectionist backlash against Chinese manufactures, and troubles with adulterated raw materials have received wide publicity.

India. India retains its number two position in this year’s Index. India is also ranked second by both developed and developing country investors for first-time investment. Regionally, European investors rank India first, while Asian and North American investors place it second and third respectively. That optimism was complemented by a jump in inward FDI from $6.7 billion in 2005 to $16.9 billion in 2006. Preliminary UNCTAD
estimates put 2007 inflows at a slightly lower but still strong figure of $15.3 billion.

Investors from across all sectors show confidence in India. Telecom and utilities investors are the most optimistic. According to India’s Planning Commission, the country needs to invest $500 billion in road, port, housing, railway, airport and telecommunications infrastructure over the next five years. The government is seeking public-private partnerships to meet this backlog of investment. Recent interest in the telecom sector includes AT&T’s announcement that it is considering a major wireless acquisition in India.

Both heavy manufacturing and primary sector firms are looking at major projects. In addition to interest from companies such as IBM, General Motors and Nokia, Kuwait Petroleum Corporation is in talks with Indian firms, including Reliance Industries Limited, to build a large refinery and petrochemical plant in India, Asia’s third-largest oil consumer. Bolstering the trend toward increasing research and development investments, U.S. chemical maker DuPont plans to double its previously announced investment in an R&D center in Hyderabad to $51 million.

Investors in the financial and nonfinancial services sectors are also bullish on investment in India. Besides the high value-added services sectors, where India has gained a global reputation, the real estate sector is gaining investor interest. United Arab Emirates-based property development company Rakeen has formed a joint venture with the Indian firm Trimex Group, to be called Rakindo Developers. It plans to spend $5 billion over five years to develop 50 million square feet of residential and commercial space. American International Group, the world’s largest insurer, has agreed to buy Indian mortgage lender Weizmann Homes to get a stronger toehold in India’s growing market.

Investors are drawn to India for a variety of reasons. The Indian economy is booming, and, according to the IMF, that growth appears to be on a solid footing. Strong investment and productivity gains have translated to higher potential growth. While investors welcome these developments, potential bottlenecks remain. Political resistance to privatization remains high, the labor market is relatively inflexible, and poor infrastructure will impede FDI inflows. Restrictions on FDI also dampen its potential. Carrefour and Wal-Mart have both run into roadblocks in planned investments. The Indian government is responding to such concerns, however. In April 2009, the government will review restrictions on foreign banks’ ability to compete with their domestic rivals. Foreign banks seek a more open market and fewer limits, such as a cap on the number of branches they can open.

**Hong Kong.** Hong Kong ranks fifth on the Index, up from 10th in 2005. About one-quarter of investors indicate a positive outlook toward Hong Kong, with only 4 percent holding negative views. Hong Kong ranks 10th among Asian investors, 14th among European investors, and fifth among North American investors. Developed country investors rate Hong Kong 13th as a first-time investment destination.

Hong Kong’s FDI success continues to be shaped by its relationship with the mainland’s booming economy. International investors looking to get a piece of the China pie see Hong Kong’s familiar regulatory environment as an attractive staging ground for mainland operations. Hong Kong’s unique position as an FDI conduit to China no doubt helped its overall FDI receipts rise 28 percent from 2005 to 2006, to $43 billion. Estimated 2007 figures are even higher, at $54.4 billion. On the other hand, mainland companies wishing to test international waters use Hong Kong, with its recognizable
Rising energy costs top investors’ concerns about Asia, followed by the prospects that Asia’s major economic growth engines — China and the United States — will experience a slowdown. 

or removes geographical, financial and ownership restraints for companies in 28 service sectors—including legal, accounting, medical, construction, transport and information technology—wishing to access China. Supplement III to CEPA, which took effect in January 2006, allows Hong Kong service suppliers access to the mainland ahead of China’s WTO timetable. CEPA was further expanded in 2007, with Supplement IV granting access to 11 new service areas including environmental services and public utilities. Forty more liberalization measures were introduced across additional service sectors. In the banking sector, for instance, the minimum total asset requirement for a Hong Kong bank acquiring a shareholding in a mainland bank was lowered from $10 billion to $6 billion. A foreign company can take advantage of CEPA if it is incorporated in Hong Kong, has operated for three to five years, is liable to pay Hong Kong profits taxes and employs 50 percent of its staff locally.

The territory intends to maintain its financial center status through closer ties with the mainland. The “1-3-5 financial development blueprint,” drafted by the Hong Kong Monetary Authority in response to China’s 11th Five-Year Plan (spanning the years 2006 to 2010), plots out how Hong Kong’s efficient financial system can help spur improvements in the mainland and strengthen the links between savers and investors on both sides of the causeway. Banking in renminbi, the Chinese national currency, is now offered by 38 banks, and in January 2007 mainland financial institutions were granted the right to issue renminbi-denominated bonds in Hong Kong. Major Chinese companies are turning to Hong Kong to raise funds. For example, ICBC set records in October 2006 when it reaped $21.9 billion from its IPO. China Construction Bank also acquired Hong Kong’s Bank of America (Asia) Limited in 2006, to the tune of $1.2 billion. The Qualified Domestic Institutional Investor Program, launched in 2006, further liberalized foreign exchange regulations, with Hong Kong well positioned to take advantage of the market. Under the system, commercial banks are allowed to sell financial products denominated in renminbi to domestic customers and
pool the funds to buy foreign exchange and invest in offshore fixed income products. Additionally, qualified securities agencies are allowed to issue foreign currency investment products in the mainland and use their clients’ foreign currency to invest in overseas securities. According to the Economist Intelligence Unit, $16 billion has been raised under the scheme since September 2007, with the majority of the capital thought to be headed to Hong Kong.

Companies continue to have confidence in Hong Kong as a destination for light manufacturing FDI, ranking it eighth despite the gradual migration of factories northward. Textiles, printing and food processing are the key manufacturing subsectors within Hong Kong. Targeted R&D efforts are underway to support the development of high-value electronics and promote the sector’s synergies with telecommunications, biotechnology and precision engineering. For instance, the Hong Kong Science and Technology Park is set to double in size later this year. However, the enthusiasm on the part of light manufacturing companies again may reflect Hong Kong’s unique position as a channel for “re-exports” from China, whereby goods produced in China are marketed, financed and shipped through the territory.

**Singapore.** Singapore’s challenge as competition from neighboring countries heats up is to maintain its role as a regional hub. This year’s Index suggests that in the near term, the foreign-investor friendly nation has accomplished just that. Global investors are bullish about Singapore, ranking it seventh, up from 18th previously. FDI inflows rose from $24.2 billion in 2006 to an estimated $36.9 billion in 2007. Asian investors are particularly interested, ranking Singapore sixth among all destinations and first among developing countries, just above the United States and the United Kingdom. Singapore is popular as a first-time investment destination among developed and developing country investors, who both rank the country 14th, evidence that Singapore’s geographic diversification efforts have yielded dividends. Singapore’s Economic Development Board has launched a concerted effort to draw Asian and Middle Eastern companies to the country. Over the past five years, the number of companies from the two regions investing in Singapore has doubled to 13,000. Major investments last year include Kuwaiti-based Proclad’s establishment of an oil equipment manufacturing facility, the Indonesian company Pan Sino’s new cocoa processing plant, and a manufacturing and R&D center opened up by India’s Bahar Industries.

An accommodating business environment and foreigner-friendly investment rules make Singapore the distribution hub and financial center of Southeast Asia. Among nonfinancial services companies and financial services companies surveyed this year, Singapore scores seventh and fourth, respectively, as a top FDI destination. Tax holidays for companies that locate regional or international headquarters in the country and strong intellectual property regulations are among the incentives that fuel FDI flows. Corporations stand to benefit further through investor-friendly measures outlined in the 2007 budget. The corporate tax rate is slated for a reduction from 20 percent to 18 percent (by comparison, Hong Kong’s rate is 17.5 percent), and a change to the partial tax exemption regulations enables 80 percent of companies to pay an effective tax rate of less than 10 percent.

Singapore has leveraged its strategic position between China and India and its stellar infrastructure to attract professional services companies ranging from consulting firms, IT services companies and logistics and supply-chain management firms. DHL underscored the importance
of these assets in 2007 by relocating the regional headquarters of its two logistics divisions—DHL Global Forwarding and DHL Excel Supply Chain—to Singapore. PayPal just opened its new international headquarters and technology development center in Singapore, taking advantage of the country’s headquarters promotion and hoping to tap into its highly educated pool of local professionals.

Financial services FDI has long streamed into the country. Twenty-four foreign banks had centralized their regional and global processing operations in Singapore by the end of 2006. The trend should continue, as the financial services sector in Singapore grows unabated, led by the emerging wealth management industry which has surged by 9.5 percent annually for the past six years. An expanding pool of high net worth individuals and increasingly sophisticated domestic and regional investors underpin the growth of wealth management, private equity, philanthropy and trust foundations.

Singapore’s manufacturing sector has continued to be a magnet for FDI: Fully 81 percent of investment commitments in manufacturing came from abroad in 2006. Light manufacturing companies rank the country as the sixth most attractive destination in this year’s Index. Electronic products and components and chemicals and chemical product sectors are the main recipients of FDI, but the government has launched plans to diversify this mix further, singling out pharmaceuticals and biomedical products for development. Singapore currently hosts six of the top 10 pharmaceutical conglomerates, key industry players and a growing base of medical technology companies within the Tuas Biomedical Park. Recent years have seen a flurry of funds committed to economic-driven R&D, with the goal of spurring growth through innovation. In 2006, the Ministry of Trade and Industry unveiled its Science and Technology Plan 2010, which commits $4.9 billion to R&D in select industry clusters. In 2007, Prime Minister Lee Hsien Loong granted additional financial support to the National Research Fund, which channels support to projects in electronics, chemicals, marine engineering and biomedical sciences. According to the Economic Development Board, Singapore also attracted 158 R&D projects from abroad in 2006, worth a total of $1 billion.

Building on its strong history as a base for oil refining, Singapore continues to attract multi-billion dollar contracts in the energy sector. Shell Eastern Petroleum’s plans for a combined ethylene cracker and mono-ethylene glycol (MEG) plant will increase Singapore’s ethylene output by about 800 kilotons per year and bolster developments in the petrochemical sector. In 2006, Singapore carved out a new space in the alternative energy sector by securing the Danish company Vestas Wind System’s Asia-Pacific headquarters and R&D center. Additionally, in 2006 global renewable energy group Natural Fuel Limited of Australia began construction on what will be the world’s largest biodiesel production plant.

**Australia.** Australia remains in the FDICI top 25 at 11th place, but it dropped from eighth place in 2005. North American investors are most bullish on Australia, ranking it eighth overall. Australian FDI receipts recovered from the net $35 billion outflow in 2005, reaching $24 billion in 2006. Nevertheless, that sum is below the 2004 record level of $36 billion.

Investors in the primary sector are the most optimistic. The Australian extractive industries are a primary source of foreign direct investment.
and have fueled investor confidence. Steel companies Tata Steel and POSCO of South Korea have both expressed interest in buying Australian assets or forming joint ventures to secure additional materials sources. Other investments in the sector include Chevron’s Gorgon natural gas project off of Western Australia, estimated to be worth more than $10 billion. High commodity prices have also meant Australian mining firms are bullish about outward investment. BHP Billiton, for example, jointly listed in the United Kingdom and Australia, made a $150 billion all-share takeover proposal to acquire its smaller mining rival Rio Tinto. Rio rejected the offer, but BHP is still pursuing the deal.

Investors in the nonfinancial services sector are also optimistic about Australia’s prospects. Mexico’s Cemex, the world’s top building materials company by revenue, recently acquired its Australian rival Rinker for $16 billion. Another recent example is the Japanese group Kirin Holdings’s acquisition of the Australian dairy and fruit juice producer National Foods for $1 billion.

Australia’s high ranking is a result of world demand for its commodities and its strong macroeconomic and economic policy performance over the last decade. Labor candidate Kevin Rudd’s victory over John Howard of the Liberal Party is not expected to change that. While economic policy may be tweaked, in the labor market for example, early indications point to consistency. Rudd’s plan for tax cuts was only slightly less generous than Howard’s. However, these cuts, coupled with new spending, strong domestic demand and tight labor markets, could be inflationary. Still, the fundamentals of the economy are strong, the fiscal position is good, and it seems likely that Australia will maintain its commitment to free trade, so the election has been met with equanimity by investors.

**Vietnam.** Vietnam’s Index ranking has climbed sharply since 2005, reaching 12th in 2007 from below the top 25 in 2005. In particular, Asian investors are most bullish, ranking Vietnam just behind China and India. Twenty-eight percent of global investors indicate a more positive outlook toward Vietnam compared to a year ago, behind only India, China, Brazil and the United Arab Emirates. Both developed and developing country investors favor Vietnam as a first-time investment destination, ranking it seventh and third respectively.

Vietnam’s accession to the World Trade Organization in 2007 and its robust economy—GDP growth has increased from 6.8 percent in 2000 to more than 8 percent in 2005 and 2006—are driving investor optimism. Inward FDI flows reached $2.3 billion in 2006, up from $2 billion in 2005 and $1.6 billion in 2004. Early indicators suggest that 2007 FDI inflows will be substantially higher. The Vietnamese Ministry of Planning and Investment estimates that Vietnam attracted more than $15 billion of FDI in the first 11 months of the year.

Investors in the heavy manufacturing, nonfinancial services, telecom and utilities sectors are the most optimistic about investment in Vietnam. Manufacturing has been an especially important sector for investment. Vietnam’s share of GDP from industry has grown from around 23 percent in the early 1990s to 41 percent in 2006. Beyond Intel’s planned $1 billion investment cited earlier, Asian, European and developing country investors have also showed interest in manufacturing. Examples include Thailand’s Siam Cement’s plans to build a $3.7 billion petrochemical complex in Vietnam, and the Italian firm Piaggio will invest $30 million in a plant to produce scooters for the Vietnamese market. Japan’s Hitachi Construction Machinery Company is also considering investing in a manufacturing plant.
Recent announcements indicate that foreign investors are also showing interest in Vietnam's financial services sector. HSBC plans to pay roughly $255 million for 10 percent of Bao Viet, becoming the sole foreign investor in Vietnam's largest insurer. Deutsche Bank recently bought a 10 percent stake in the Vietnamese lender Hanoi Building Commercial Joint Stock Bank.

Along with membership in the WTO, recent reforms in legislation governing private enterprise and investment should improve the investment climate. Other drivers fueling investment include two decades of economic reform, a stable political situation and proximity to other booming economies. Despite these efforts and high growth, however, inflation may prove troubling. Vietnam also needs to continue to strengthen the financial sector, reform state-owned enterprises and reduce bottlenecks in infrastructure.

Japan. Japan retains the 15th spot in the Index from the previous survey. Developed country investors consider Japan the 14th most attractive first-time investment destination. North American investors are more bullish about Japan than are Asian investors.

FDI inflows to Japan are expected to rebound in 2007 to $28.8 billion, from a net outflow of $6.5 billion in 2006. It is speculated that the yen carry trade—borrowing in yen to purchase higher-yielding assets in other currencies—has been a factor behind at least some of the 2006 outflow.

The sector most bullish on Japan is light manufacturing, which includes health care and pharmaceuticals. One influential factor is a large and growing elderly population with ample disposable income. Pfizer Inc. has announced that it wants to expand its research and development activities in Asia, including Japan. On a related note, the Carlyle Group is looking to tap the growing demand for senior housing among a fast-aging population by forming a joint venture with a unit of Tokio Marine & Nichido Fire Insurance Company to buy and refurbish buildings for seniors.

The financial services sector was active in 2007. Citigroup’s $7.9 billion buyout of the brokerage firm Nikko Cordial was the biggest deal. Another notable effort was the bid of $1.8 billion for up to 32.6 percent of Shinsei Bank by a group of investors led by U.S. buyout firm J.C. Flowers & Co.

Japan’s policies and economic growth offer a mixed bag for investors. Japan has pushed through reforms to attract foreign investment, including a recent move to allow so-called triangular mergers, in which a foreign company’s

Investors in both developed and developing countries favor Vietnam as a first-time investment destination, ranking it seventh and third respectively.
Japanese subsidiary can use its parent company’s shares to buy a local company. Japan’s keiretsu system of interlinked business relationships and shareholdings, however, still can act as a practical barrier to foreign investment. Japan’s fundamentals are good and it is paying down the debt it accumulated in the 1990s. Compared to the rest of Asia, Japan’s economic growth is relatively low and is expected to remain so for the foreseeable future. But the Japanese economy has recovered from its slump in the 1990s, consistently reaching growth of more than 1.5 percent since 2003 (and up to 2.7 percent in 2004), which has reawakened investor interest.

**Malaysia.** Malaysia’s ranking rose to 16th place on the 2007 Index after falling below the top 25 in the last survey. Asian investors are most interested, ranking it ninth. In 2006, FDI inflows to Malaysia rose to $6.1 billion, the highest level since the Asian financial crisis. Estimated inflows in 2007 are an all-time high of $9.4 billion. According to the Malaysian Industrial Development Authority, Japan and the Netherlands led the pack of investor countries, with the Asian region as a whole accounting for close to half of the total investment.

The electronics sector has been a principal recipient of flows (40 percent in 2006). One attraction for electronics manufacturers is the availability of quality manpower at costs 40 percent lower than in Singapore and Hong Kong. Sony, Samsung, Dell and Motorola all have operations in the country. Under the Third Industrial Master Plan, released in 2006, electronics and other key sectors such as petrochemicals, pharmaceuticals, transport machinery and wood-based products are targeted for further development and promotion. In the past, foreign investment in certain sectors has been limited or subject to affirmative action rules requiring 30 percent Bumiputra, or indigenous, ownership. These regulations are gradually being eased in the face of capital migration and rising competition in the region. Rules pertaining to foreign ownership of manufacturing have been flexible since 2003. In 2007, affirmative action requirements were dropped for six service industries in the Iskandar Development Region (IDR). Foreign businesses that operate in this zone are also offered a 10-year tax exemption and no restrictions in the hiring of foreign employees. Recently, four Gulf-based investment funds committed $1.2 billion in the IDR.

**Indonesia.** Indonesia reenters the Index’s top rankings in 21st place, with Asian investors ranking it 11th. Developing country investors consider it the 15th most attractive destination for first-time investments. Realized foreign direct investment in the first half of 2007 rose to $3.5 billion, up by 17 percent in a year-on-year comparison according to the Investment Coordinating Board. The upsurge in confidence over the past few years may be the result of President Susilo Bambang Yudhoyono’s active courting of the international business community, an outreach effort that marks a departure from past practice. In February 2006, the Presidential Instruction No. 3/2006 outlined a plan to improve the investment climate through targeted enhancements in five areas: general provisions, customs, labor, taxation and small and medium-sized enterprises. The new investment law of March 2007 strengthened foreigners’ property rights, restructured the bureaucratic process for investment applications, streamlined the tax regime and clarified the range of industries open to foreign investment. Although the law was greeted with praise, implementation will be critical to the continued successful attraction of FDI.

Rich in natural resources, Indonesia ranks high on the list for primary sector investors. Foreign investment has been encouraged in the country due to the technical sophistication required in its extractive industries. However, an uncertain
regulatory environment has kept foreign enthusiasm in check. The recent acquittal of the U.S. mining company Newmont Mining and its president of polluting a bay near its mine improved confidence in the country’s operating environment. The Japan-Indonesia Economic Partnership Agreement concluded in August of 2007 provided a boost to Japanese involvement in the energy sphere. For example, Mitsubishi invested in a gas-refining project involving two energy firms in exchange for Indonesia’s commitment to export the final product to energy-scarce Japan.

**Central Asia.** Central Asia as a region moves up a notch from 24th to 23rd place on the Index, with Kazakhstan ranking 22nd as a first-time investment destination. Kazakhstan is the clear leader, with FDI inflows that total more than all the other Central Asian countries’ inflows combined. According to UNCTAD, net inflows grew from $1.9 billion in 2005 to $6.1 billion in 2006 and an estimated $8.3 billion in 2007. Turkmenistan, with its gas resources, is the second-highest recipient of FDI in the region with $731 million in 2006. FDI grew from 2005 to 2006 in all Central Asian countries.

Much of the interest in the region stems from its energy resources. Oil production remains a major source of FDI for Kazakhstan, and production is expected to triple over the next decade. Beyond oil, companies are also investing in mining. China National Nuclear Corporation, for example, is forming a joint venture with Kazakhstan’s state-owned nuclear energy company Kazatomprom to invest in uranium production in Kazakhstan.

Turkmenistan’s energy resources have become an even bigger lure for investors than in the past, because the death of former President Saparmurat Niyazov has meant that the country has tentatively opened up. Already the biggest gas producer in Central Asia, the country is revising its energy legislation in order to attract foreign partners in addition to Gazprom—such as ConocoPhillips, Chevron, PETRONAS, Royal Dutch Shell and BP, many of which are already established in the region. China is also interested in the country’s gas resources, and has set 2009 as the completion date for a 7,000 kilometer pipeline it is financing and building that will stretch from Turkmenistan to Shanghai in the east and Guangzhou in the south.

In the finance sector, the Italian bank UniCredit acquired Kazakhstan’s ATF Bank for $2.1 billion, the biggest foreign investment to date outside the oil sector. UniCredit hopes the acquisition will provide a hub to expand in Central Asia.

To expand beyond exploiting its energy supplies, the region is attempting to improve its infrastructure. One such plan is the preliminary agreement among China and seven countries in Central Asia—Afghanistan, Azerbaijan, Kazakhstan, Kyrgyzstan, Tajikistan, Uzbekistan and Mongolia—to invest in a $19.2 billion infrastructure development described as a modern Silk Road trade route. The plan calls for investment over the next decade in six new transport corridors, mainly roads and rail links, to connect the region better to China, Russia and the rest of Europe.

**South Korea.** South Korea remains in the top 25 for 2007 at 24th place, only a slight decline from 23rd in 2005. FDI inflows were down nearly 30 percent, at $5 billion in 2006 compared to $7 billion in 2005. North American investors are most bullish about South Korea, ranking it 14th. The United States is the largest source of Korea’s FDI, and ratification of the United States-Korea Free Trade Agreement—the largest trade deal for the United States since the North American Free Trade Agreement (NAFTA) with Mexico and Canada—will no doubt increase investor interest in the future. However, uncertainty still exists over ratification due to opposition in particular
sectors such as beef and auto, as well as protectionist voices within both legislatures. Additionally, free trade talks with the EU and Canada promise future investment into South Korea.

However, free trade negotiations cannot mask the increasing threat that South Korean exports, particularly in the key economic sectors of heavy and light manufacturing, face from large emerging economies such as China. But South Korea does not only face cost competition. Investment in the manufacturing of high-end products such as mobile handsets and flat-panel TVs also faces vigorous competition from China, Japan and Singapore. The South Korean government has been actively positioning its free economic zones (FEZs)—Incheon, Busan-Jinhae and Gwangyang—as business hubs of Asia. These efforts are paying off: Incheon, for example, has attracted companies such as GM Daewoo, DHL and New York-Presbyterian Hospital to expand operations there. The upcoming World City Expo 2009 in Incheon also promises to showcase Korea’s vision of a future “ubiquitous” city and related innovations, including robots, high-speed trains, multimedia networks and biomedical technologies, in the hope of drawing more global investment. The event is expected to attract more than 10 million people over three months.

**Thailand.** Thailand has dropped off the 2007 Index, due in part to investor concerns over political stability following the military coup in September 2006. But Thailand ranks 11th as a first-time investment destination among developing country investors. Asian investors maintained their interest, ranking the country 12th as an investment destination. FDI inflows continue to recover since the financial crisis in the 1990s. Inflows to Thailand grew 9 percent from 2005 to 2006, reaching $9.7 billion.

Despite investor concerns about political stability, recent investment decisions continue to show that there is strong interest in Thailand. ICBC and Malaysia’s CIMB Group are competing to buy a 19.3 percent share in the Thai bank ACL. The Dutch financial group ING recently acquired a 24.9 percent stake in TMB Bank. Dubai World’s real estate firm Nakheel Group also announced it would pursue projects in Thailand.

A decade after the Asian financial crisis, Thailand seems to have recovered in investors’ perceptions, especially those of Asian investors. Over time, the financial sector has been significantly strengthened, but the IMF continues to recommend further reforms to address remaining vulnerabilities, improve regulatory oversight and broaden and deepen capital markets.

**Europe**

Boosted by Europe’s economic recovery, Western Europe continues to be a major FDI target, even as regional investors eye new destinations further east. Its share of world FDI inflows held steady at 45 percent from 2005 to 2006. The United Kingdom retains fourth place on the Index, while Germany and France rank 10th and 13th respectively. Nearly half of total FDI inflows to Europe, or $263.4 billion, went to these three core European economies. The investment in these three countries alone is greater than the FDI flowing to all of Asia in 2006.

FDI inflows to the EU-15 have declined since their zenith at the end of the dot-com boom, as they have in developed economies elsewhere. Despite a post-2003 recovery, overall inflows in 2006 fell 12 percent below their 2000 levels. But prospects for recovery in FDI inflows remain strong. For example, union wage restraint during the past several years has made Germany among the most competitive advanced industrial economies. German unemployment, formerly more than 10 percent, was projected to fall to 8.3 percent in 2007. Furthermore, political trends
seem poised to continue this recovery. President Nicolas Sarkozy in France and Prime Minister Gordon Brown in the United Kingdom both profess to be economic reformers, though it remains to be seen how far Sarkozy will be able to push the reform-averse French.

The 2004 entrants to the European Union (collectively known as the EU-10) continue to attract investors, although they may soon be eclipsed by the new 2007 members, Bulgaria and Romania. From 2000 to 2006, FDI inflows to the 10 states that joined in 2004 increased by 78 percent to about $39 billion. While Poland and the Czech Republic remain in the top 25, Poland slipped 17 spots from fifth to 22nd, and the Czech Republic slipped from 12th to 25th. These countries continue to enjoy advantages as production centers for goods destined for markets inside the Common Market, and wages remain far below Western European labor market standards. Indeed, 48 percent of respondents cite low labor costs as a factor in pursuing investments in Central and Eastern Europe. Another attraction is the EU-10’s flat-tax regimes: The average implicit tax burden in the EU-10 is approximately 19.4 percent, compared with almost 27.6 percent in the EU-15.8 With this investment, however, have come rising living standards and wages. Between 2000 and 2006, average labor costs rose 173 percent in the Czech Republic, 128.9 percent in Hungary, 123 percent in Lithuania, 110 percent in Latvia, 103 percent in Slovenia and 87.5 percent in Poland. By comparison, the average increase for the entire EU-27 over the same period was only 60 percent. That said, average wage costs in the new member states remain low in comparison to the European average: For example, labor costs are 31 percent of the average in the Czech Republic, 27 percent in Slovenia, 25 percent in Poland and Hungary, 22 percent in Slovakia and 17 percent in Lithuania.9

However, these states now face new competition from further east. The accession of Romania and Bulgaria introduced two new low-wage locales into the EU customs union. European investors list Romania sixth and Bulgaria 13th in their top FDI destinations in the future, closely trailing Poland at fifth place and the Czech Republic at 12th place respectively. With Romanian wages at 12 percent and Bulgarian wages at 7 percent of the EU average, investors have begun to seek out these regions as new production centers. Romania, building on its car manufacturing history, is now the heir apparent to Slovakia as the auto production capital of Eastern Europe. Investors are also interested in access to markets on Europe’s periphery (43 percent), the region’s highly skilled workforce (40 percent) and the ability to “offshore” while remaining within the EU (34 percent). These factors point to Romania’s and Bulgaria’s potential as both customer markets and supply hubs. In addition, investors appreciate these countries’ improving infrastructure. The EU’s Trans-European Transport Networks program will further encourage this shift of production eastward. Within the next decade, high-speed rail and motorway links will tie the new member states to the major consumer markets of Western Europe via the capitals of Central Europe. The rapid increase in logistical capacity promised by these infrastructure improvements should make Romania and Bulgaria even more attractive investment destinations in the future.

Europe has waded into the international M&A boom, with $413 billion in deals occurring in 2005, an increase of more than 200 percent

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8 Tax data taken from Eurostat.
9 All calculations based on labor cost per hour data from the Economist Intelligence Unit.
from the market’s 2003 nadir. This activity, however, was highly concentrated in the advanced economies of Western Europe, with France, Germany, the Netherlands and the United Kingdom accounting for two-thirds of the overall transaction value.

Finally, it should be noted that most European FDI comes from within Europe—and that this contribution has steadily risen over the past 30 years. Internal EU-15 investment flows now account for nearly 80 percent of gross FDI inflows to EU-15 countries. Private equity continues to play a substantial role in these investment flows. Across Europe, private equity and venture capital accounted for $70 billion in investment for 2005, 27 percent over the 2004 figure. From 2004 to 2005, the latest year in which data is publicly available, private equity funds raised for use in Central and Eastern Europe tripled, from $625 million to $1.9 billion.10 The market remains volatile, however. About $317 million was invested in Bulgaria in 2004, but nothing in 2005. By contrast, investment in the Czech Republic increased more than sixfold, from $23 million in 2004 to $160 million a year later.

**United Kingdom.** The United Kingdom retains fourth place in the Index. It received $140 billion in FDI in 2006, making it the leading recipient of foreign investment in Europe by a margin of nearly two to one over France at $81 billion. Estimated 2007 inflows amount to $171.1 billion. Twenty-three percent of investors report a more positive outlook over the past year, more than for any other Western European country. The United Kingdom ranks highly as an investment destination for both Asian and North American investors, at sixth and eighth place respectively. It is also the top developed country destination for developing country investors making first-time investments. Both financial and nonfinancial services sector firms indicate high interest in the United Kingdom. The higher transaction costs imposed on U.S. markets by the Sarbanes-Oxley Act of 2002 have made London a more attractive financial services hub. U.S. politicians looking across the Atlantic have cited London as the world’s premier financial center, both for its consolidated regulatory environment and its ability to attract top-quality people and skills. Record profits in 2006 were rumored to have yielded $17.3 billion in bonuses to London bankers. Furthermore, high oil prices have enlarged one of the traditionally large streams of money flowing to the city—namely, petrodollars from the Middle East looking for reinvestment.

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Private equity also had a banner year in 2006, with British private equity firms investing $41 billion, almost twice the 2005 level and up more than threefold since 2001. Moreover, while nearly half went to investments in the United Kingdom, the same share was directed at continental Europe. Industrial and consumer goods firms received 60 percent of the total investment funds.\(^{11}\)

Several uncertainties affect the future investment environment. What the power transition at No. 10 Downing Street will mean for the British economy remains to be seen.

**Russia.** Russia falls three places in the Index from 2005, coming in at ninth place in 2007. Russia received $28.7 billion in FDI in 2006, more than double the $12.8 billion from 2005. Estimates for 2007 reach $48.9 billion, reflecting continued investor interest in the country’s resource extraction and resource-dependent industries. Despite this increase, tightening resource extraction regulations may affect investors’ future confidence. Russia attracts mostly European investors, securing third place after India and China, while ranking 14th among Asian investors and below the top 15 for North American investors. As a first-time investment destination, Russia interests both developed and developing country investors, ranking fourth and fifth respectively. Investors are most interested in Russia’s primary sector, ranking it just below China for investments in the sector. Investors in heavy manufacturing are also bullish. Oil wealth has given a generation of Russians purchasing power not seen in recent memory, leading foreign firms to set up shop in Russia despite the risks. One example is the auto industry. Toyota, Nissan and Renault all either opened plants in 2007 or have plants under construction.

However, investors in Russia are split as to its future prospects. The 45 percent who indicated they would increase investment in Russia did so for economic reasons: Russia’s recently improved economic performance, its large consumer market, its energy reserves and its skilled labor force. Of those looking to increase investments, 35 percent cite Russia’s economic growth and 31 percent its growing consumer markets as primary drivers.

Eight percent of investors have decided to decrease investments and 48 percent to hold constant, for explicitly political concerns: Seventeen percent are motivated by the threat of nationalization of their assets by the Russian government. Sixteen percent cite the erosion of the rule of law, 14 percent the political uncertainty surrounding the upcoming retirement of Putin, and 13 percent the threat posed by organized crime. Nearly 14 percent of respondents said their assessment of Russia’s economic outlook had worsened in the last year. Investor ambivalence about Russia should not be surprising. As Royal Dutch Shell, Chevron and BP have all experienced in their energy operations in Siberia, the Kremlin under Putin has become a force in the economy, setting the terms under which firms may participate in major industries.

Russia faces significant challenges in diversifying its economy, improving the health of its citizens, addressing serious environmental problems and achieving peaceful relations with its neighbors. The country’s dependence on oil revenues to provide rising standards of living and fund the government has made the energy industry of paramount importance. However, Russian Finance Minister Alexei Kudrin has estimated that, without additional investment and imported Western technology, Russia will be unable to meet its contractual commitments to deliver energy in a

five-year timeframe. Reflecting concern about this issue, Turkmenistan is routing a gas pipeline to Russia through Kazakhstan rather than along a shorter trans-Caucasus route.

**Germany.** Germany falls one place in the Index rankings from 2005, but still secures 10th place. At least one significant foreign divestment shook German FDI in 2006: that of Wal-Mart, following disappointing sales figures at its German stores. The 85 stores were sold to domestic rival Metro at a loss speculated to be in the $100 million range on top of an additional $1 billion hit to Wal-Mart’s bottom line.12

Still, investors are bullish about Germany, with 22 percent indicating a more positive outlook compared to the previous year. While European investors rank Germany 11th among their top investment locations, Asian and North American investors rate the country 15th and 13th respectively. FDI inflows rose 20 percent from $35.9 billion in 2005 to $42.9 billion in 2006, and further to $44.8 billion in 2007.

Investors in heavy and light manufacturing sectors are most bullish about Germany, ranking it among their top 10 investment locations over the next three years. Anecdotal evidence suggests a vibrant FDI market. UPS opened a major new logistics hub in the region around Cologne and Bonn at a price tag of $135 million. Dell launched a new customer service hub supplying 1,500 jobs at an undisclosed cost. Italian chemicals producer Menarini, after years of high growth in its German operations through its subsidiary Berlin Chemie, is expanding operations in the eastern parts of Germany. Verisign spent $273 million to acquire Jamba!, a leading provider of wireless services in Germany. Data from the Bundesbank—Germany’s central bank—mirrors this anecdotal evidence, with the chemicals, transport, and the media, television and communications industries being the top three recipients of foreign investment in 2006.

Some of this improvement may be due to ongoing economic reform. In July 2007, the Bundestag approved legislation to cut the German corporate tax rate from 39 to 30 percent, placing Germany in the middle of the tax range in Europe and well below the 35 to 40 percent range prevailing in the United States. This should generate significant investment interest from overseas companies and continue the impact of reforms begun in former Chancellor Gerhard Schröder’s government. Whether such reform continues, however, is less clear. The governing Grand Coalition under Chancellor Angela Merkel, having reached the halfway mark between elections, may be destined for a period of relative inaction. Labor market reforms beyond the Hartz IV measures of the Schröder government appear unlikely due to fundamental disagreements between the main coalition partners—the Christian Democratic Union and Christian Social Union on the one side, and the Social Democratic Party on the other. In contrast, the success of private industry and company-level wage moderation measures agreed to by both management and unions has had a much larger impact, significantly improving German competitiveness.

**France.** France places 13th in the 2007 Index, up from 14th in 2005. The $81 billion in FDI flows to France in 2006 were roughly equal to their 2005 level. 2007 estimates are higher, at $123.3 billion. With $40 billion in international M&A transactions, France accounted for 8.8 percent of the European total. Among European investors, France ranks as the ninth most attractive destination. It is also a popular destination for North American investors. According to the Invest

in France Agency, a quarter of the 40,000 new jobs generated by foreign companies in France in 2006 came from American businesses. France also ranks 11th as a first-time investment destination among developed country investors.

The election of President Nicolas Sarkozy has promised some liberalizing reforms for the French economy: labor laws skirting the 35-hour work week, greater labor flexibility for French firms and an improved education system. However, Sarkozy has also revived protectionist talk about national champions and said he would reopen questions concerning how the European Central Bank sets monetary policy. Financial commitments made during the election might well widen the budget deficit, possibly putting France in violation of the limits it agreed to under the Stability and Growth Pact—a treaty framework for coordinating the economic policies of countries in the European Economic and Monetary Union.

Telecom and utilities sector investors are most confident in France as an FDI destination. The 2005 FDI study predicted that privatization of Electricité de France might presage a new era of openness in the French energy market. But since then, French state activism has manifested itself, with the creation of a French mega-utility through the government-sponsored merger of Gaz de France and SUEZ.

**Turkey.** Turkey ranks 20th among global investors in the FDI Confidence Index. FDI inflows to Turkey more than doubled from 2005, reaching $20 billion in 2006 and an estimated $19.4 billion in 2007. UNCTAD reports that motor vehicles-related investment accounted for 13 percent of Turkey’s inward FDI flow in 2006. Among major investors, Robert Bosch invested $240 million in 2005 to build auto parts and other manufactures, and plans to invest millions more in its Turkish operations. In other industries, Indian Oil has applied for a permit to build a $6 billion refinery at the oil port of Ceyhan, and Austrian refiner OMV bought a $1.1 billion stake in Turkish oil and gas concern Petrol Ofisi. Cross-border M&A deals included the $1.6 billion purchase of telecommunications firm Turkcell Iletisim Hizmetleri by CTF Holdings, and Vodafone’s purchase of Telsim Mobil for $4.6 billion.

Nonetheless, uncertainties about Turkey persist. Turkey’s prospects for EU accession remain questionable at best, with French President Nicolas Sarkozy stating that he would not allow Turkey to accede during his presidency, which will last until at least 2012. In 2005 and 2006, Turkey and Brussels continued to disagree over the Cyprus question and internal human rights issues.
Poland. After rising in the Index rankings in 2005, Poland falls from fifth to 22nd place in 2007. This drop can be attributed in part to the last two years of significant economic and political turmoil, which raised investor concerns about the future of economic reform in Poland. Under the Law and Justice Party, the government was openly antagonistic both toward Russia and the European Union over issues such as trade, security and political representation in the European Commission. Former Prime Minister Jarosław Kaczyński indicated a desire to reopen the privatization process that had concluded in the mid-1990s, on the grounds that many who benefited had tainted legacies from the Communist era. After the liberal Civic Platform’s parliamentary victory over the Law and Justice Party in October 2007, however, the government signaled it would follow a less populist path.

Still, Poland leads Central and Eastern Europe in FDI inflows, with net inflows of $13.9 billion in 2006 and an estimated $18.1 billion in 2007. It is the top-ranked EU destination among European investors, at fifth place overall. Investment in the real estate sector has boomed, especially in retail and office properties. Telecom and utilities firms continue to capitalize on market liberalization opportunities. The question is whether Poland can hold on to European investment in the face of new, low-cost competitors further east as well as other 2004 accession states such as the Czech Republic and Slovakia. Poland’s staying power will depend on continued progress in infrastructure improvements, upgrading of human capital and the sustained growth of consumer markets to fuel domestic demand.

Czech Republic. The Czech Republic drops to 25th place in the rankings, 13 spots below its 2005 ranking. Nevertheless, it is still the 12th most attractive destination for European investors. FDI inflows to the Czech Republic fell $6 billion from 2005 to 2006, slipping to $5.9 billion (a figure which was nevertheless 20 percent higher than its 2004 intake). Estimated 2007 inflows are slightly higher, at $7.6 billion.

As with its neighbor Slovakia, the Czech Republic continues to attract auto manufacturing investment from Western Europe. Major recent investments include a $74 million plant for French auto parts manufacturer Faurecia. In the IT arena, Hitachi and the LCD display maker IPS Alpha Technology recently announced plans to invest $89 million and $166 million respectively in twin display factories in the former Czech airbase at Žatec. Indian software giant Infosys opened a 400-seat BPO delivery center in Brno to provide services to European clients. Finally, a wide range of U.S. companies, from high-tech giants Hewlett-Packard and Microsoft to consumer products leader Procter & Gamble and industrial goods firm Ingersoll-Rand, established R&D facilities in the Czech Republic in 2006. The Czech government is encouraging investment, having recently lowered the corporate tax rate from 28 to 24 percent.

Hungary. Hungary, which had been 11th place in 2005, does not rank in the 2007 Index’s top 25. FDI inflows fell from $7.6 billion in 2005 to $6 billion in 2006. In that year, Hungary experienced significant political turmoil after newly elected Prime Minister Ferenc Gyurcsány admitted to misleading voters during the election campaign. Though several days of massive demonstrations in Budapest did not overturn the government, it did remind Hungarians and investors alike that political reforms have some way to go before full political stability is achieved.

Hungary’s wage and cost advantages over Western European production areas have been eroded by the entry of Romania and Bulgaria into the EU. While Hungarian wages are 25 percent of the EU average, Romanian wages are 12 percent of the average and Bulgarian wages 7 percent.
Spain. Spain falls from 17th place in 2005 out of the top 25 in 2007. European investors are particularly negative about Spain’s prospects. FDI flows to Spain dropped 20 percent, from $25 billion in 2005 to $20 billion in 2006. Some of this decline was due to the reduced level of private equity activity after a record year in 2005, when two U.K. private equity firms—BC Partners and Cinven—bought the IT company Amadeus for $5.7 billion, and the telecommunications firm Auna sold its cable subsidiary to Spanish rival Ono for $3.4 billion, much of which was provided through a consortium of U.S. private equity firms. Also in 2006, the Spanish real estate bubble, in which housing prices nearly doubled between 1997 and 2005, began to deflate. The bubble burst amid structural concerns for Spanish competitiveness, while rising inflation reduced prospects for Spanish economic growth in the near term. Nevertheless, Spain remains one of the faster-growing economies in the Eurozone.

Italy. Italy drops from 19th place in 2005 to below the top 25 in the 2007 Index. However, European investors rank it 22nd and North Americans 18th as an investment destination. With $39.2 billion in FDI receipts, Italy was the fifth-largest recipient of FDI in Europe in 2006. Nearly one-third of this came from the acquisition of Banco Nazionale del Lavoro by BNP Paribas for $11 billion, part of a wave of Italian banking consolidations. Foreign interest in Italian banks continued into 2007, with Danske Bank spending $5 billion for Cassa di Risparmio di Parma. These cross-border banking deals represent a shift from Italian policy in 2005, when the Berlusconi government intervened to prevent foreign acquisition of UniCredit. Following both the scandal that accompanied that policy and the election of Prime Minister Romano Prodi’s administration, Italy’s attitude toward foreign entry into its banking market seems to have drawn closer to that of the EU. Brussels has actively encouraged European banking consolidation within the Common Market.

Ukraine. While Ukraine is not ranked among the top 25, it is the seventh most attractive investment destination among European investors. FDI inflows in 2006 fell by one-third from 2005, to $5.2 billion. Some of this decline no doubt stems from Ukraine’s ongoing political instability and associated concerns about the pace and direction of economic reform. Elections in October 2007 were followed by more than a month of delay as the leading parties proved unable to form a governing coalition. Previously, the 2004 Orange Revolution led to two years of governmental instability. Meanwhile, tensions with Russia have persisted since January 2006, when Russia abruptly shut off oil flows to Ukraine.

Nevertheless, foreign investment has continued in certain sectors. Czech manufacturer Škoda Auto now produces 19,000 cars annually in Ukraine, and has announced further plant investment for the future. Škoda’s parent company, Volkswagen, has also moved some production capacity to Ukraine. Future prospects for FDI in the banking sector should improve with Ukraine’s 2006 opening of its banking sector to foreign firms, under the auspices of WTO negotiations. UniCredit has already taken advantage of this change, acquiring Ukrsotsbank for $2.1 billion in July 2007. Russian oil money is rumored to be involved in significant purchases in Ukraine, though offshore banking intermediaries make verification difficult.

Romania. Romania falls out of the Index in 2007 after debuting at 25th place in 2005. However, European investors rank Romania sixth among investment destinations, second only to Poland among member states that have joined the EU since 2004.
After a small decline in 2005, FDI inflows to Romania grew from $6.5 billion to $11.4 billion in 2006. In particular, its auto industry has become a magnet for investment. Among the major players was automobile firm Renault, which spent nearly $750 million to upgrade an old Dacia plant to produce its $7,000 Logan car. In the process, Renault convinced its suppliers to set up operations in Romania. As a result, Romania now has a substantial auto industry with well-established networks of foreign parts suppliers, as well as geographic proximity to Western European markets. Further investments are to be expected, particularly given Romania’s much lower wage structure compared with Central European counterparts such as the Czech Republic or Hungary.

**Bulgaria.** European investors rank Bulgaria as the 13th most attractive investment target in the world. Foreign direct investment to Bulgaria rose 34 percent from 2005 to 2006, reaching a total of $5.2 billion. Much of this improvement is probably due to Bulgaria’s accession to the EU. After years of negotiations, Bulgaria and Romania finally entered the European Union on January 1, 2007. Shortly before accession, the government boosted Bulgaria’s attractiveness to investors by cutting the corporate tax rate to 10 percent to match that of Cyprus as the lowest in the EU.

Foreign investors appear to have responded. The real estate market has attracted interest in the Black Sea resort areas and in the capital, Sofia. Foreign investment in real estate doubled between 2005 and 2006 to $1.6 billion. Retail giant Carrefour spent $120 million to anchor its Boulevard Tsarigradsko Shosse project in downtown Sofia. Outside retail, the Italian cement firm Italcementi committed $271 million to upgrade the facilities at its Bulgarian subsidiary Devnya Cement. Belgian firm Solvay invested $105 million to upgrade thermal power facilities through its Bulgarian subsidiary Deven AD.

**Middle East**

The Middle East attracted a total of $59.9 billion in foreign direct investment in 2006, up from $41.6 billion in 2005. Two countries, the United Arab Emirates ($8.4 billion) and Saudi Arabia ($18.3 billion), account for almost half of this total.

The region remains of concern to investors because of chronic geopolitical challenges. Investors cite the continued instability in Iraq (74 percent), the possible outbreak of war with Iran (70 percent), the risk of terrorism (57 percent), anti-Western bias (48 percent), and ethnic conflicts in the region (35 percent) as deterrents to foreign investment. However, investors also see access to the wealthy regional market as a top opportunity for investment (78 percent), followed by the availability of services industry hubs such as Dubai (65 percent). A fast-growing population (61 percent) and access to capital (61 percent) are also among the top assets for the region. Interestingly, a substantially smaller share of investors (39 percent) considers access to energy reserves as a major asset.

**United Arab Emirates.** The United Arab Emirates has risen from 22nd on the 2005 Index to eighth in 2007. Among Asian investors, the United Arab Emirates ranks fifth, and among European investors it ranks 10th. The relative lack of interest from North American investors may partly be attributable to corporate concerns over potential political backlash at home. Compared with a year ago, 29 percent of investors report a more positive outlook toward the United Arab Emirates—behind only India, China and Brazil.

The United Arab Emirates ranks favorably among financial services and nonfinancial services firms, owing in part to continued progress in reforms and attractive incentives at the Dubai International Financial Centre (DIFC), including permission for 100 percent foreign ownership.
and zero tax on profits and income. In addition, the country ranks favorably among primary and heavy manufacturing investors. Dubai continues to attract major foreign corporations interested in setting up Middle Eastern headquarters. For example, Halliburton, the energy firm and services provider, decided in May 2007 to move its corporate headquarters to Dubai from Houston. Keen investor interest translated into FDI inflows of $8.4 billion in 2006, down from a record high of $10.4 billion in 2005.

In the last two years, the United Arab Emirates has become a major investor and not simply a target for foreign investment. As a result of the petrodollar boom, the state-owned Abu Dhabi National Energy Company, in the largest-ever North American takeover by a UAE company, agreed in September 2007 to buy Canada’s PrimeWest Energy Trust for $5 billion in cash and assumed debt. The government of Abu Dhabi also bought a 7.5 percent stake in the Carlyle Group for $1.35 billion. In an effort to diversify from oil to financial services, Borse Dubai is buying a 20 percent stake in Nasdaq Stock Market. Istithmar, one of Dubai World’s real estate investment firms, has just opened its first office overseas in Shanghai.

**Other Gulf states.** The Gulf region, rich in capital from elevated oil prices, has followed Dubai’s model of diversifying its economic base, investing in infrastructure and reforming institutions to attract foreign FDI. As a result, the other Gulf states debut in 17th place in the 2007 Index.

FDI flows tell the same story. According to UNCTAD, inward FDI to Bahrain was $1 billion in 2005 but jumped to $2.9 billion in 2006, a 177 percent increase in one year. Oman’s inward FDI grew from $900 million to $952 million in the same period, and Qatar’s increased from $1.2 billion to $1.8 billion. Conversely, Kuwait, which has focused less on reform and diversification, brought in only $110 million in 2006, down from $250 million in 2005.

Investors from the heavy manufacturing sectors, in particular, hold positive views of the region. Chemicals are a growing sector, with much of the capital flow in chemicals being regional. Leading world firms are also investing: Dow, Total, ExxonMobil and Royal Dutch Shell all have stakes in chemical joint ventures throughout the region and are planning further investment in Qatar.

Investors from the financial services sector are also optimistic about the region’s prospects. In November 2007, Deutsche Bank officially opened its first branch in Qatar to offer investment banking and private wealth management
services. Aon applied for a license to operate from the Qatar Financial Centre and plans to open there next year. In Bahrain, Allianz launched an Islamic insurance operation, Allianz Takaful (Bahrain), and is establishing a central office to monitor its regional operations.

As a region, the Gulf states have been opening markets and increasingly using public-private partnerships to invest in infrastructure. According to the IMF, the Gulf Cooperation Council (GCC) countries have made “significant advances” in legislative and financial sector reforms. They are also modernizing the supervisory and regulatory frameworks governing the financial markets. Both Bahrain and Qatar are creating the infrastructure and regulatory framework needed to excel in financial services.

Saudi Arabia. Saudi Arabia is the 10th most popular first-time investment destination for developed countries. Saudi Arabia was the largest single recipient of FDI in the Middle East, drawing in $18.3 billion in 2006, up 51 percent from 2005.

The increase in FDI is fueled in part by Saudi Arabia’s attempts to diversify the economy with planned investments through public-private partnerships in infrastructure and real estate. This is in addition to reforms in the 1990s encouraging growth in the broader economy. According to the IMF, the reforms have had results, with non-oil exports increasing by more than 20 percent per year from 2000 to 2006. These changes are improving investors’ confidence in the country.

Investments—often through joint ventures—in the oil, gas and chemicals sectors constitute a large portion of Saudi Arabian FDI. Saudi Arabia accounted for nearly 63 percent of total GCC investment in petrochemical projects in 2006. Japan’s Sumitomo Chemical Company and Saudi Aramco recently announced plans to expand Petro Rabigh, their petrochemical joint venture, with additional investment of at least $1.8 billion.

In our survey, investors from the financial services sector are most positive about Saudi Arabia. This is borne out by recent announcements from major players in the sector. Morgan Stanley plans to form a banking venture with the Saudi firm the Capital Group, and Goldman Sachs is forming an investment banking venture with the state-owned National Commercial Bank.

Egypt. Although Egypt did not make it into the top 25 in the 2007 Index, developing country investors ranked the country 12th among first-time investment destinations. FDI inflows also demonstrate rising interest on the part of investors in the country. FDI inflows of $10 billion in 2006 and an estimated $10.2 billion in 2007 represent almost double the 2005 figure of $5.4 billion. For example, Thailand’s PTT International signed a contract to buy a 25 percent stake in Egypt’s East Mediterranean Gas for $487 million.

In 2006, Egypt’s FDI flowed mostly from the United States ($4.6 billion) and the European Union ($2.9 billion). The United Kingdom accounted for more than 50 percent of net EU outflows to Egypt, although the French cement company Lafarge’s 2007 agreement to buy Orascom Cement for $12.9 billion shows that the rest of Europe is noticing recent improvements in the Egyptian economy. Middle Eastern countries invested $554 million in financial year 2005-2006.

Africa

Africa’s year-on-year FDI performance was positive, with overall investment inflows rising 22 percent in 2006, after a 78 percent increase in 2005. But the continent still attracted only $36 billion in total investment, less than the island territory of Hong Kong.

Despite Africa’s traditional dependence on primary industries, investors are most interested
in Africa for services investment. Sixty-nine percent of respondents indicate that services provide the greatest investment opportunities, compared to 38 percent for agribusiness, 35 percent each for raw materials (excluding energy) and retail, and 23 percent for traditional energy. The Index suggests that the bulk of this interest is directed at South Africa, which ranks 18th in investor confidence.

Despite emerging opportunities in the oil-rich African states, Africa continues to lag behind the rest of the developing world in terms of visibility to global investors. When asked about the greatest risks to investing in Africa generally, investors place political instability at the top of the list (77 percent of respondents), followed by insufficient public infrastructure (69 percent), low workforce skill level (58 percent), poor IT infrastructure (58 percent) and bureaucratic overhead (54 percent). When asked what steps would improve the investment environment, one response stands out: the streamlining of government bureaucracy (92 percent of respondents). This answer is well ahead of financial and tax incentives (69 percent), public-private investment partnerships or partnerships with local firms (46 percent each), or better vocational training (27 percent). Firms have long been used to operating in areas where they must develop their own networks or train their own workers. But the perceived bureaucratic overhead of operating in Africa is considered outside firm control.

South Africa. South Africa debuts in the FDI Confidence Index at 18th place. Among developing country investors, South Africa ranks sixth as a first-time investment destination. FDI inflows to South Africa fell dramatically between 2005 and 2006, from a record high of $6.3 billion to a net outflow of $323 million. This was due largely to sales of foreign equity shares to local firms. FDI inflows are expected to rebound to an estimated $5 billion in 2007.

European Union firms remain the largest investors in South Africa. German firm Bilfinger Berger announced plans in June 2007 for a $14 million plant to make boiler parts. Engine and auto manufacturer Rolls-Royce purchased a 15 percent stake in specialty alloys manufacturer Avalloy. German optics maker Carl Zeiss has purchased 70 percent of Denel Optronics, the opto-electronics arm of state-owned defense contractor Denel. And the DaimlerChrysler plant in the auto-producing city of East London has attracted foreign parts makers, including Johnson Controls and Feltex Fuhrer. In short, companies across the industrial spectrum have found South Africa to be an attractive target.

Nigeria. Nigeria ranks 10th among developing country investors as a first-time investment destination. Recent FDI data confirms investor activity in the country. The oil economy made Nigeria the continent’s top destination in 2006, with $5.4 billion in inflows, a substantial rise from $3.4 billion in 2005.

Conclusion
As developed markets feel the effects of financial turmoil and emerging markets draw growing numbers of investors, the locus of power in FDI may be shifting. While still dominating the majority of outward FDI flows, developed markets also face unprecedented competition from emerging market capital. At the same time, as investment targets, many developed markets are at a crossroads. They recognize the need for fundamental reforms to help their countries regain global competitiveness and attract investment. Yet their electorates are pressing strongly to preserve national interests and domestic jobs.

Emerging markets, amid investor exuberance, face a variety of new global challenges. Investors are increasingly concerned about the progress of
reform and the stability of the macroeconomic and political environment. Furthermore, there is a growing worldwide focus on environmentally and socially sustainable development.

In an increasingly uncertain global investment environment, will the geographical shift of FDI continue? The answer depends not only on the fundamental attributes that attract global investors. It depends very much on policymakers’ ability to address investor concerns and distinguish their countries among the crowded, competitive field of investment destinations.

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Methodology

The FDI Confidence Index® was constructed using primary data from a proprietary survey administered to senior executives of the world’s leading corporations. The respondents were selected from the Global 1,000 population as determined by 2006 revenues, as well as the largest corporations in emerging economies. Participating companies represent 60 countries and span 17 industry sectors across all six inhabited continents. Together, the companies comprise more than $3.8 trillion in annual global sales and more than $35 trillion in global assets. They are responsible for more than 75 percent of global FDI flows. Respondents included not only C-level executives, but also regional and business heads. The survey was conducted in July and August 2007, just as the subprime market crisis was beginning to unfold.

The index was calculated as a weighted average of the number of high, medium and low responses to questions about the likelihood of direct investment in a market over the next three years. Index values are based on non-source country responses. For example, the Index value for the United States was calculated without responses from investors based in the United States. Higher index values indicate more attractive investment targets.

Since the inception of the FDI Confidence Index in 1998, the 10 most attractive FDI destinations have consistently received 40 percent or more of global FDI inflows roughly one year after the survey. Over the same period, on average, the top five countries captured 35 percent of global FDI inflows, and the top 25 countries more than 70 percent of global inflows. There is an even stronger correlation between the Index rankings and future bricks-and-mortar FDI, especially after correcting for anomalies, such as those stemming from tax havens.

FDI flow figures are the latest statistics available from the United Nations Conference on Trade and Development (UNCTAD). Other secondary sources of information used in this year’s FDI Confidence Index include the International Monetary Fund, the European Statistics Agency (Eurostat), the Economist Intelligence Unit and the U.S. Green Building Council. Additional sources of information include country investment promotion agencies, central banks, ministries of finance and trade, and major periodicals.