A.T. Kearney

Cautious Investors Feed a Tentative Recovery

The 2012 A.T. Kearney Foreign Direct Investment Confidence Index® finds that while FDI flows have picked up slightly in the past two years, this modest optimism could quickly revert to retrenchment.

The 2012 A.T. Kearney FDI Confidence Index® examines future prospects for FDI flows as the world seeks to recover from the global recession and continued economic uncertainty in Europe and the United States. The Index, which first appeared in 1998, assesses the impact of political, economic, and regulatory changes on the FDI intentions and preferences of the leaders of top companies around the world.

It's little surprise, considering the economic turbulence in the developed world, that emerging markets fare well in the rankings. China, India, and Brazil take the top three positions, and Southeast Asia, with its large and growing consumer base, makes a strong showing: Indonesia, Malaysia, Singapore, Thailand, and Vietnam all hold high rankings. South Africa, which was unranked in 2010, rebounds to 11th place, while Russia and Turkey make large gains, especially in comparison to neighboring countries in Europe (see figure 1).

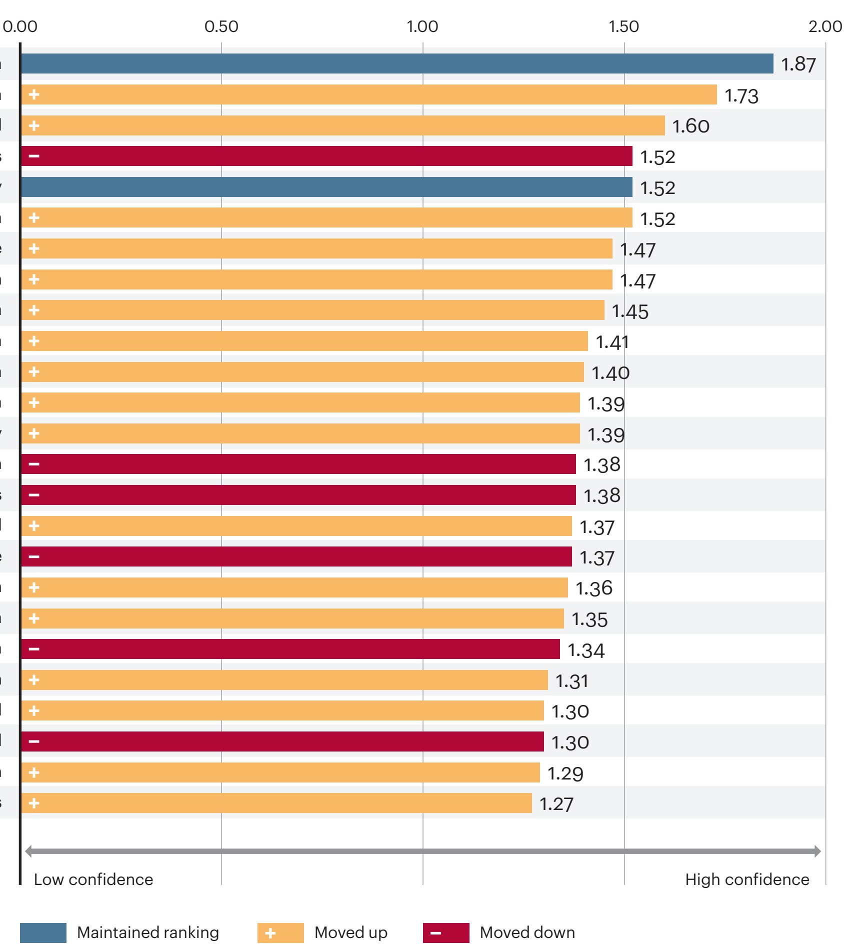
The United States remains the highest-ranked developed country in the Index, but it falls two spots in the rankings to 4th place. No doubt, the political gridlock on fiscal policy and continued uncertainty about the economic outlook weigh heavily on investor sentiment. For similar reasons, Europe also suffers from poor investor morale.

Figure 1
2012 FDI Confidence Index®

Ranking

Values calculated on a 0 to 3 scale

2007	2010	**2012**		
1	1	**1**	China	1.87
2	3	**2**	India	+ 1.73
6	4	**3**	Brazil	+ 1.60
3	2	**4**	United States	– 1.52
10	5	**5**	Germany	1.52
11	7	**6**	Australia	+ 1.52
7	24	**7**	Singapore	+ 1.47
4	10	**8**	United Kingdom	+ 1.47
21	19	**9**	Indonesia	+ 1.45
16	20	**10**	Malaysia	+ 1.41
18	–	**11**	South Africa	+ 1.40
9	18	**12**	Russia	+ 1.39
20	23	**13**	Turkey	+ 1.39
12	12	**14**	Vietnam	– 1.38
8	11	**15**	United Arab Emirates	– 1.38
–	–	**16**	Thailand	+ 1.37
13	13	**17**	France	– 1.37
–	–	**18**	Taiwan	+ 1.36
24	–	**19**	South Korea	+ 1.35
14	9	**20**	Canada	– 1.34
15	–	**21**	Japan	+ 1.31
–	–	**22**	Switzerland	+ 1.30
22	6	**23**	Poland	– 1.30
–	–	**24**	Spain	+ 1.29
–	–	**25**	The Netherlands	+ 1.27



Source: A.T. Kearney Foreign Direct Investment Confidence Index®, 2012

Following are findings of the 2012 FDI Confidence Index, which are based primarily on a proprietary survey of more than 200 executives from 27 countries and 17 industry sectors (see sidebar: About the Study).[1]

Slow Recovery in Investment Flows

Just five years ago, the global economy and cross-border investment flows reached unprecedented levels. Riding the wave of strong economic performance across the globe, foreign investors generated an all-time high of $2 trillion in 2007 as international corporations executed ambitious growth strategies to seize new market opportunities.

As we are all now painfully aware, the situation deteriorated quickly. Seemingly overnight, unprecedented turmoil turned economic conditions upside down. A housing market collapse, a major banking crisis, profound economic contraction leading to rising unemployment, and falling sales forced companies to tighten their belts. In 2008, investment inflows dropped almost 20 percent to $1.7 trillion as the global economic crisis took hold, punishing firms with falling profits and market expectations, tighter credit conditions, and reduced asset values. In 2009, inflows plunged even further to $1.1 trillion as companies hunkered down, fearing risks of additional financial shocks, a further deterioration of the global economic situation, the potential for a double-dip recession, and the possibility of a rise in predatory trade policies and blatant protectionism.

About the Study

The FDI Confidence Index® is constructed using primary data from a proprietary survey of senior executives of the world's leading corporations. Respondents include C-level executives and regional and business heads. Participating companies represent 27 countries and span 17 industry sectors. Together, the companies comprise more than $1 trillion in annual global sales. The survey was conducted between July and October 2011.

The Index is 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 50 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. There is an even stronger correlation between the Index ratings and future brick-and-mortar FDI, especially after correcting for anomalies, such as those stemming from tax havens.

While the FDI Confidence Index provides readers with a sense of investor attitudes about the future, it is not designed to reveal specific reasons for the results. This study reflects upon likely causes for upward or downward changes, but the conclusions must be regarded only as considered judgment on the part of A.T. Kearney's Global Business Policy Council.

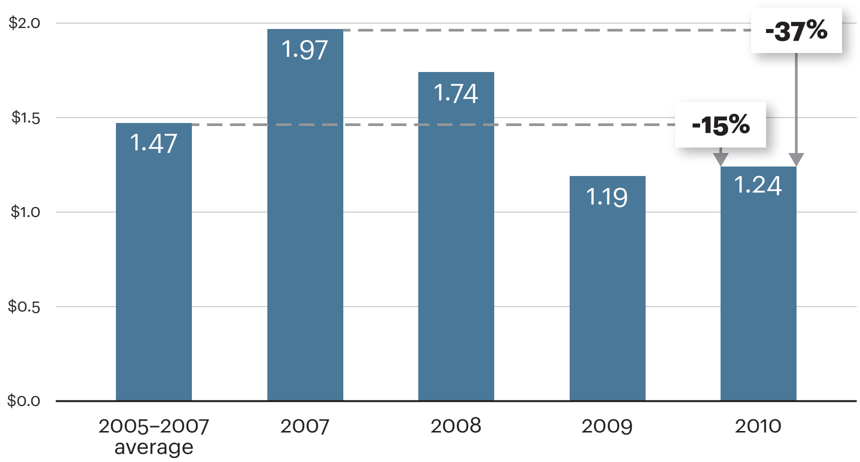
FDI flow figures are the latest statistics available from the United Nations Conference on Trade and Development (UNCTAD). Other secondary sources used in this year's FDI Confidence Index come from investment promotion agencies, central banks, ministries of finance and trade, and major periodicals.

[1] All monetary figures are in U.S. dollars.

FDI flows recovered slightly in 2010 as the world economy began its rebound. FDI flows rose 5 percent to $1.2 trillion as businesses improved profits, rationalized corporate structures, and increased efficiencies, often by relocating business functions (see figure 2). Still, the evidence suggests that many remain cautious about their foreign expansion plans. In the first half of 2011, FDI inflows continued to rise, but by only a marginal 2 percent. While volumes are nowhere near their peaks, these minor gains nevertheless do signal some cautious optimism on the part of investors.

Figure 2
FDI inflows rose 5 percent in 2010 to reach $1.24 trillion

Global FDI inflows (US$ trillions)



Source: United Nations Conference on Trade and Development (UNCTAD)

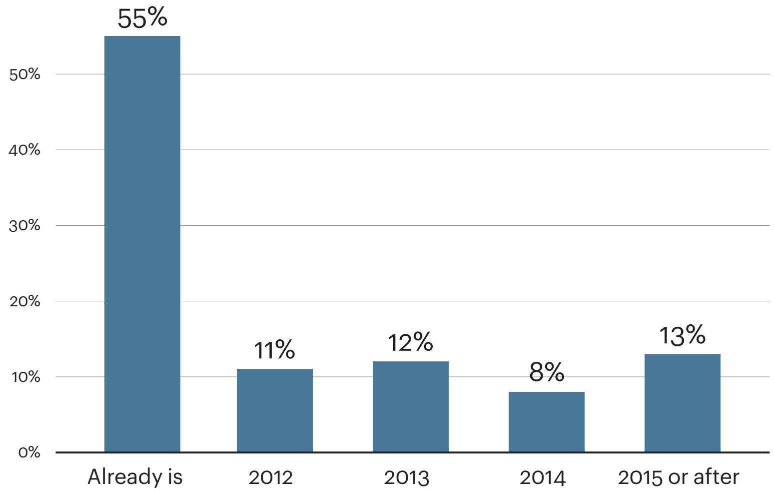
At this point, investors are uncertain about whether to invest or wait for more encouraging economic conditions. The future global economic landscape will be defined by when and where executives finally choose to place their investments. If the economic crisis continues to ease and corporations again become more comfortable pursuing internationalization of their operations, global investment flows could recover to between $1.4 trillion and $1.6 trillion in 2011, according to United Nations Conference on Trade and Development (UNCTAD) projections, and approach its 2007 peak of $2 trillion in 2013. However, that optimism, no matter how welcome, may be premature. Many of the signs of turnaround evident in early 2011 have evaporated, and growth expectations have subsequently been revised downward.

Our findings on FDI budgets indicate that near-term FDI recovery is far from certain. Only one-half of FDI budgets are back to pre-crisis levels, and 21 percent of respondents do not anticipate that their budgets will reach those levels until 2014 or later (see figure 3). The scattered outlook over the next half-decade indicates an ambiguous future. Even if their budgets have been restored, investors may continue building their "rainy-day" funds rather than making bets on an increasingly risky economic future. On the other hand, some may see this period as a great buying opportunity, with prices, particularly in Europe, significantly depressed.

For many shell-shocked investors, the continued economic volatility has prompted investment in strategic planning tools. With the United States and Europe, two former bastions of stability, facing continued financial turmoil and slow growth, the formerly intuitive "safe bet" rules no

Figure 3
Half of FDI budgets are back to pre-crisis levels

When do you expect your FDI budget to be back to its level prior to the economic crisis?

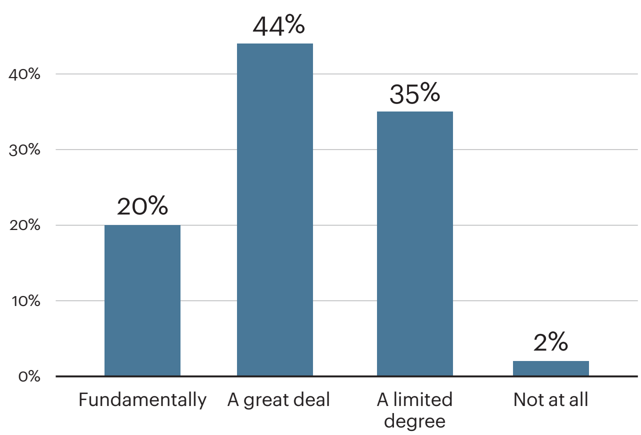


Source: A.T. Kearney Foreign Direct Investment Confidence Index®, 2012

longer apply. About 64 percent of respondents feel that the recession has fundamentally or significantly changed global business conditions (see figure 4). This implies that businesses must adjust rapidly to a new reality, though it remains unclear precisely what shape this new reality will take. With more cash on hand but facing considerable uncertainties, business executives are increasingly using strategic planning tools to determine where the best bets can and should be made. More than half report that they are enhancing their strategic planning processes in the wake of the economic crisis to increase foresight and peripheral vision—capabilities they believe are crucial for navigating today's highly uncertain business environment (see figure 5).

Figure 4
Investors believe that the recession has significantly changed business conditions

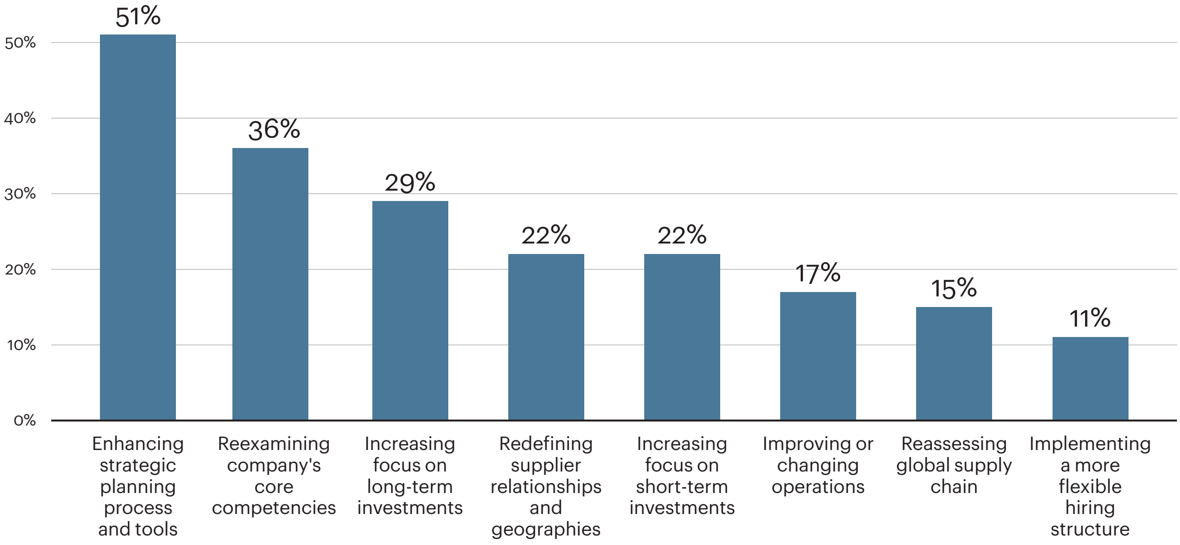
To what degree has the Great Recession changed global business conditions going forward?



Note: Due to rounding, percentages add up to 101.
Source: A.T. Kearney Foreign Direct Investment Confidence Index®, 2012

Figure 5
Half of investors are improving strategic planning capabilities in the wake of the crisis

What are you doing differently post-crisis?



Source: A.T. Kearney Foreign Direct Investment Confidence Index®, 2012

Protectionism Fears Ebb, But Regulation Rises

In the wake of the economic crisis, many feared that countries would impose tariff barriers, quotas, subsidies, and other protectionist measures in an effort to support national industries, rolling back the gains generated in recent decades by open trade. At the height of the crisis, political leaders across the world warned about a repeat of the 1930s, when measures enacted following the Great Depression spiraled into a tit-for-tat war of beggar-thy-neighbor policies such as the U.S. Smoot-Hawley Tariff Act, which exacerbated the crisis and took decades to dismantle.

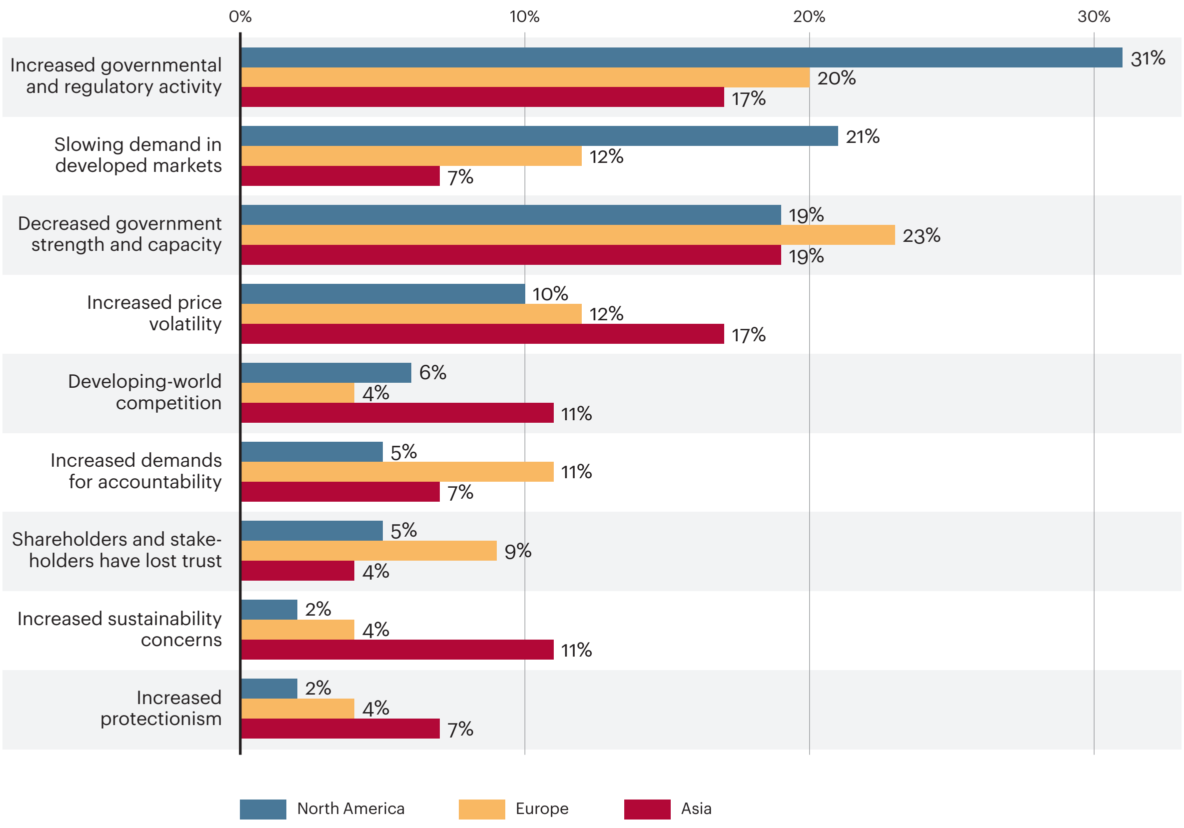
However, of all the changes that could mark the post-recession global economy, according to the 2012 FDI Confidence Index respondents, regardless of region, protectionism is not a major concern (see figure 6). Recent data supports their assessment. Of the 102 new national policy measures affecting foreign investment in 2009 tracked by UNCTAD, 71 encouraged the further liberalization and promotion of foreign investment. In 2010, of the 149 policy measures affecting foreign investment, 101 were related to investment liberalization, promotion, and facilitation. However, the number of measures restricting or regulating FDI increased from 31 in 2009 to 48 in 2010—leading to a new high of 32 percent. Many of these measures pertain to the financial sector in G20 countries, some of which have tightened existing rules in order to prevent future financial crises. As such, although many policies aim to address gaps in regulatory frameworks, the number of restrictive investment regulations and administrative practices has accumulated over the past few years, posing the risk of potential protectionism relating to investment in the future.

Moreover, while free trade agreements (FTAs) no longer seem to be the norm, many countries are still pursuing them. In October 2011, for example, the U.S. Congress finally ratified the FTA with South Korea. While the treaty was not ratified for more than four years after it was signed, it did manage to pass Congress despite a decidedly difficult political journey. It is the largest trade agreement for the United States since it adopted the North American Free Trade Agreement in 1993.

Figure 6

North American respondents have noticed the most government and regulatory activity

Since the crisis began, which aspect of the global economy has changed most significantly?



Source: A.T. Kearney Foreign Direct Investment Confidence Index®, 2012

The most significant concern, particularly for respondents in the Americas, is regulatory activity within countries rather than protectionist measures among them. Turmoil in financial markets translated into greater state intervention in some cases, such as new limits on foreign participation in some industries and tightened procedures for investment screening and approval. The anticipated reversal of temporary nationalization in strategic sectors could result in governments pushing to have privatized companies remain under domestic control or pressuring investors to keep production and jobs at home.

Not surprisingly, European executives see decreased government capacity due to sovereign debt as the most significant change, and Asian investors concur. The phasing out of post-crisis emergency measures will need to be closely monitored, particularly given the anticipated decrease in government strength that such a transformation implies. While governments may wish to be more activist, they may not be able to promote the conditions the economy needs.

While Asian executives share their Western colleagues' expectations of increased regulatory activity and decreased government capacity, they are much more concerned about price volatility and competition from developing-world players—indicating that they operate in a different business reality. Moreover, they anticipate increased sustainability concerns and demands, reversing the idea that being "green" is predominantly a Western problem.

When it comes to expectations about the future role of government, the main concern, shared by almost 60 percent of our respondents, is greater taxation in developed economies. In the midst of raging debates on future taxation and ways to reduce mounting public debts, companies are calculating that public budgets will have to be brought back to balance through increases in government revenue—which means higher potential tax burdens for them.

Expectations are quite different in emerging markets, where increased labor regulations are regarded as the most likely development (see figure 7). As these economies mature and integrate with the global economy, their labor laws will tighten. In one of the most high-profile instances, a spate of worker suicides and news reports of poor working conditions at Taiwan-based Foxconn, one of Apple's major suppliers and the largest private employer in mainland China, compelled the company to raise wages at its Shenzhen production bases.

About one-third of executives expect higher barriers to trade in both developed and developing countries. This suggests that, although increased protectionism has not yet come to pass, concern over the future of trade remains.

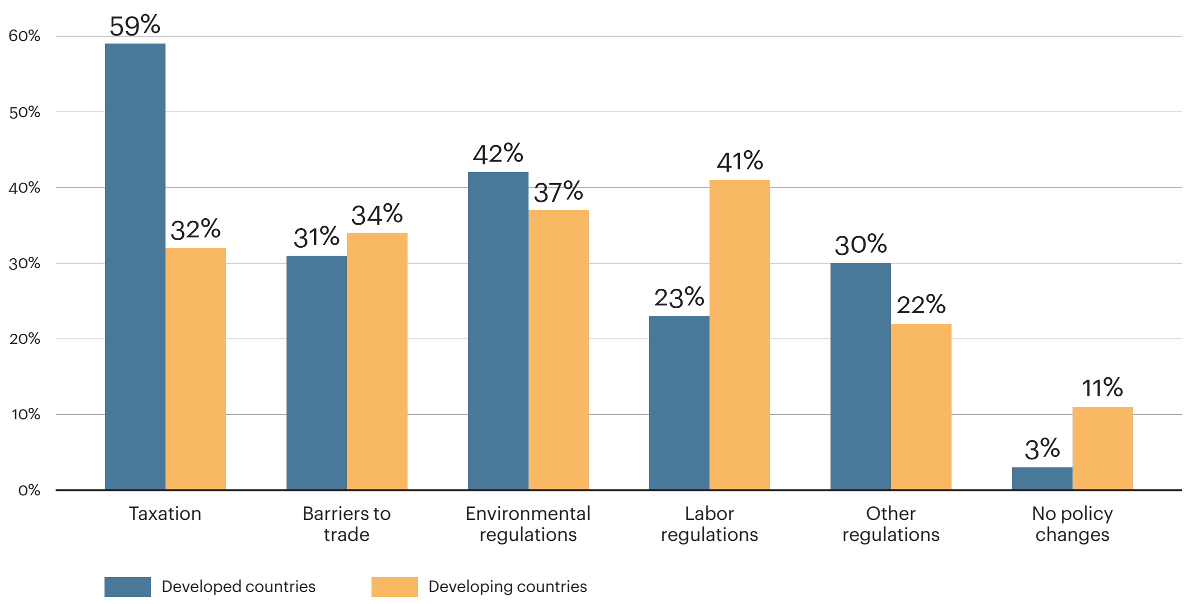
Recovery Brings a Shift to the "Global South"

In an echo of last year's results, large and medium-sized emerging markets register the most positive changes in investor outlook. China, India, and Brazil—the top three on the Index—earn the most positive outlooks from respondents. The developed-world countries in the top 25 receive a decidedly more mixed reaction. Twenty percent or more of our respondents indicate that their outlooks for the United States, United Kingdom, Japan, and Spain are more negative than they were in 2010 (see figure 8).

Figure 7

Investors anticipate different government actions in developing and developed countries

On which issues do you anticipate government taking a larger role in the economy?

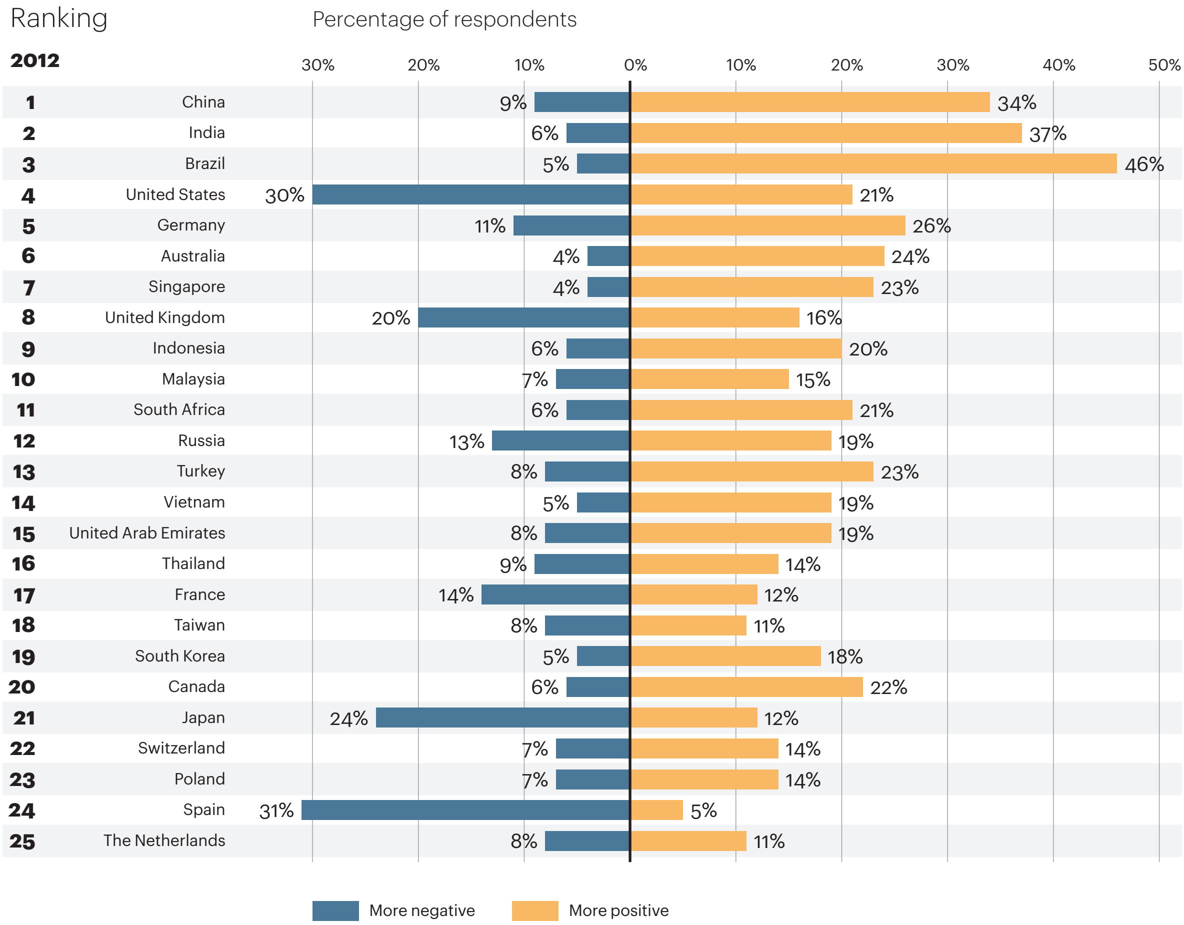


Source: A.T. Kearney Foreign Direct Investment Confidence Index®, 2012

Figure 8

North American respondents have noticed the most government and regulatory activity

Is your outlook on this country more positive or negative than it was in 2010?



Source: A.T. Kearney Foreign Direct Investment Confidence Index®, 2012

Emerging markets have eclipsed developed countries in terms of FDI inflows, absorbing more than half of global FDI inflows for the first time in history, and now comprise more than half of the Index's top 25 countries. This trend will likely accelerate over the next three years and perhaps beyond. More than one-quarter of respondents report that emerging markets have gained a significantly larger share of their FDI portfolio, and another 12 percent anticipate that the share of emerging markets in their portfolios will rise somewhat (see figure 9). In contrast, only 7 percent see developed countries with a significantly larger portion of their investment, and only 10 percent have allocated a somewhat higher share to developed countries.

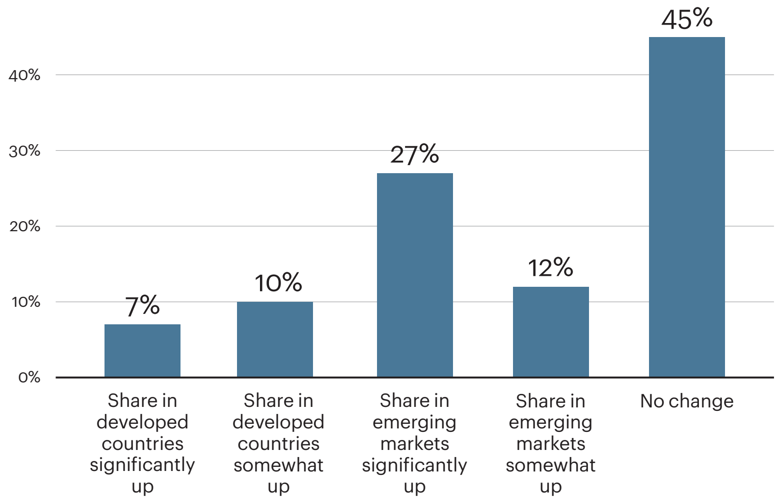
This trend is just starting. Investors looking for promising markets are assigning higher priority to emerging markets as investment picks up; 71 percent cite these markets' size and 37 percent cite their strong consumer market growth as key factors in their FDI allocations (see figure 10). This is a strong vote of confidence for consumers in developing countries.

In contrast to the traditional view that emerging-market investments are made to take advantage of low-cost labor, only 12 percent of respondents cite sourcing costs as their main driver. Labor arbitrage, in addition to prudent domestic policies and internal investments, has helped fuel the

Figure 9

More than one-quarter of respondents are increasing investment in emerging markets

How has your FDI portfolio changed in geography in the last two years?

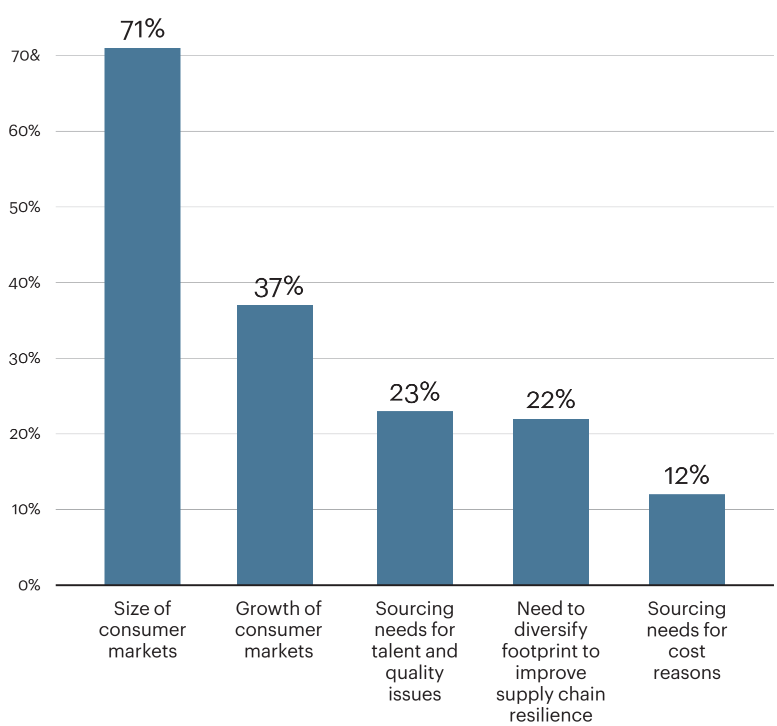


Source: A.T. Kearney Foreign Direct Investment Confidence Index®, 2012

Figure 10

Consumer-market size and growth draw investors to emerging markets

If your share of FDI in emerging markets has increased in the last two years, why?



Source: A.T. Kearney Foreign Direct Investment Confidence Index®, 2012

growth of sizeable consumer markets with higher incomes, thus producing a secondary swing to emerging markets—this time for their consumers rather than their labor. These dynamics are yielding a much more resilient developing world. "In the immediate future, emerging markets cannot stand alone in the event of another recession," says Uri Dadush, senior associate and director of the International Economics Program of the Carnegie Endowment for International Peace. "However, they are lessening their dependency by developing the demographics, investment profile, and ability to absorb new technology."

Moreover, key emerging economies are shifting the FDI landscape with their own investments. The portion of FDI outflows from developing countries increased from 12 percent in 2005 to 23 percent in 2010. It is expected to continue to grow thanks to economic growth, abundant financial resources, and moves to acquire strategic assets abroad. These outflows are being directed primarily toward other emerging economies (70 percent in 2010), whereas developed countries direct 50 percent of their investment to these economies.

Rising **incomes**, urban **migration**, and increased **demand** for consumer goods in China **continue to attract** foreign investment.

Investment from emerging economies ($388 billion) is now more than one-third of the corresponding level from developed countries ($935 billion), and the relative tendency of the former to favor other emerging economies as targets could trigger a major shift in the competitive landscape. Given increasingly fierce competition from local investors, companies with aspirations to invest in emerging markets will need to craft strategies supported by a strong understanding of local markets and consumers as well as robust supply chains.

Regional Findings

Asia Pacific

The Asia Pacific region remains the top destination for investors, attracting about one-fifth of global FDI in 2010. Supported by strong growth and political stability, China tops the Index once again. India moves up a spot to second place. Southeast Asia performs particularly well on the back of soaring inflows, with its five major economies ranking in the top 20.

China has held the top position since 2002, when it took the spot from the United States. Rising incomes, urban migration, and increased demand for consumer goods in the world's most populous consumer market are surely contributing to continued increased foreign investment. Inflows rose 18 percent to $175 billion in 2010, $7 billion above the previous peak in 2008. There are a number of concrete examples of high-profile investment projects. In April, builders broke ground on the $4.4 billion Shanghai Disney Resort, the company's first theme park in mainland China. Coca-Cola, which already has 40 factories in China and employs more than 48,000 workers, is intensifying its commitment with a $4 billion investment over the next three years.

With this growing emphasis on domestic consumption comes a shift toward services. FDI flows into China's services sector grew faster than any other industry in the first four months, jumping 31.3 percent from May 2010 to May 2011, outstripping a 22.9 percent rise in the manufacturing industry.

China has also shown strong leadership and the ability to move up the value chain in the technology sector. It has improved R&D capabilities and better educated its workforce while also successfully creating vast technology clusters that are important nodes in the global technology supply chains. However, in response to rising salaries and property prices in eastern China, many cost-conscious firms are moving inland where wages and the cost of living are lower. FDI in western cities in the first four months surged 55.8 percent in May 2011 from the previous May, compared with a rise of 23.4 percent in the east.

On the other hand, reduced tax incentives and higher labor costs may have contributed to driving labor-intensive, low-margin sectors such as footwear and textiles to Bangladesh, Cambodia, Vietnam, and elsewhere. Collective Brands, the U.S. footwear group that owns the Payless shoe chain, is shifting a chunk of production from China to Indonesia. Gerry Weber International AG, Germany's second-largest maker of women's clothing, is also shifting more production to sites with cheaper labor, including Vietnam. The erosion of low-cost manufacturing was not unanticipated, but how China will develop its current economic model based on low-cost labor and an undervalued currency remains to be seen.

Given its strong growth and huge potential, **India should see a firm rebound** if it can continue to reassure investors that reform is on the way.

Benefiting from its close economic relationship with mainland China, Hong Kong also quickly recovered from the shock of the global financial crisis. FDI inflows reached a historic high of $69 billion in 2010, a 32 percent increase from 2009. If taken separately from mainland China, Hong Kong would rank 3rd in the Index, mainly because of its status as an entry point for funds into China. In addition to being the regional home for most global investment and commercial banks, private equity funds, large investment institutions, and international legal and accountancy firms, Hong Kong is seeing more interest from manufacturing and retail.

India moves up one spot to 2nd place this year, passing the United States, as investors return to India after a few years of soft inflows. In 2008, India attracted $43 billion in overseas investment. The following year FDI dipped to $36 billion, and then to $25 billion in 2010. A significant portion of this decline was due to weak inflows into service spaces such as computer software and hardware, financial services, banking, and construction, industries where the global economic crisis led firms to scale back their overseas operations.

Persistent local challenges, including the slow pace of reform and poor governance, may also be at play. Senior government officials have acknowledged that the country needs to improve its business climate, particularly as other emerging markets craft investor-friendly policies. The country's leading companies recently launched a campaign called "Credible India," aimed at countering a tide of corruption cases that has weighed heavily on India's attractiveness as a leading investment destination. A passionate discussion of corruption is a positive development, as temptation will only grow as the economy develops.

Given its strong growth and huge potential, India should see a firm rebound if it can continue to reassure investors that reform is on the way. Its current ranking on the Index confirms this optimism among investors. Several large FDI proposals in the oil and gas, metal, and telecom sectors point to continued interest in the market. ArcelorMittal, which despite its Indian heritage has no plants in the country, may soon become the first overseas steelmaker to build in India, with Karnataka state authorities in the process of handing over land for the $6.3 billion project. Its success would be a major boost for the investment climate after several setbacks for major industrial projects, which often become mired in standoffs with farmers and state governments unwilling to part with land in a country where two-thirds of the population depends on agriculture. In 2008, for example, Tata Motors was forced to pull out of West Bengal after spending 28 months building a factory to produce the $2,500 Nano car, as it faced intense pressure from activists, displaced land owners, and opposition parties.

It's little surprise that **emerging markets fare well in the rankings**, considering the economic turbulence in the developed world.

Wal-Mart has expressed confidence that India will ultimately loosen restrictions that currently limit foreign entities presence in retail, one of the most pressing issues for investors. Top luxury goods makers such as LVMH, Canali, and Jimmy Choo are waiting to take advantage of the Indian luxury market, which was estimated at $4.76 billion in 2009 and is expected to triple to $14.7 billion by 2015.

Several other developed countries in Asia Pacific perform strongly this year. **Australia** moves up one place to 6th as investors seem to remain confident about future prospects for the Australian economy and business environment. Inflows recovered somewhat to $32 billion in 2010 after they dropped from $47 billion in 2008 to $26 billion in 2009. Mining remains Australia's largest FDI target, attracting 32 percent of the country's total. **Taiwan** returns to the Index at 18th, with well-developed legal and commercial infrastructure, a diversified economy, and a tradition of entrepreneurial dynamism. Boasting advances in information technology and proximity to huge markets in China and India, **South Korea** returns at 19th after being unranked in 2010. **Japan** returns to the Index at 21st, after falling off last year and placing 15th in 2007. In the wake of the March 11, 2011, earthquake and tsunami, Japan's supply chains showed tremendous resilience. Despite the severity of the damage, by June most supply chains had been restored; for example, production at Toyota had recovered to 90 percent of its pre-earthquake level. Investor sentiment is positive, with reconstruction projects offering significant opportunity.

Major Southeast Asian economies enjoyed a huge upswing in FDI this year, presumably reaping the benefits of low-cost labor that were once primarily China's domain. These countries are luring investors with their large and increasingly wealthy consumer markets. The region has nearly 600 million people and an economy bigger than India's. **Singapore**, as a global financial center and a regional hub for many multinationals, has benefited considerably from increasing investment in Southeast Asia. It saw a sharp 153 percent increase in inflows in 2010 to $39 billion and moved up to 7th in the Index. **Indonesia** makes significant gains this year, moving from 20th to 9th place. FDI inflows were $13 billion in 2010—160 percent higher than 2009 and well above the 2008 high of $9 billion—ostensibly fueled by strong growth, a large consumer market, and abundant natural resources. Similarly, **Malaysia** moves up the Index from 21st to 10th, and inflows jumped 537 percent to $9 billion. In 2011, the country received a $7 billion commitment from United Arab Emirates-based Mubadala Development Company, which will invest in Malaysia's aluminum sector as part of a strategic partnership deal with Malaysia Development Berhad, a strategic development company owned by the Malaysian government.

Vietnam is the only Asian nation to fall in the rankings this year, dropping from 12th to 14th. Inflows rose 7.5 percent to $8 billion in 2010, a positive number but nevertheless slow compared to its neighbors. Despite increased openness and relative political stability, investors may be concerned about high inflation, currency depreciation, and strained public finances. Yet, some companies are shifting production to Vietnam, lured by cheaper labor compared with China and deeper ports that can accommodate large container vessels sailing directly to the United States, Europe, and Asia.

Thailand returns to the Index this year in 16th place, demonstrating its growth as a production base and gateway for exporting industrial products to Southeast Asian markets. Inflows increased 17 percent to $6 billion, a vote of confidence despite political chaos resulting in battles in the streets of Bangkok and an iconic shopping mall burning to the ground. Political disorder aside, industry in Thailand has enjoyed legal and regulatory predictability in its operating environment, in contrast to some of its neighbors.

The Americas

The United States remains the top investment destination in the developed world, as it has been since our first FDI Confidence Index in 1998, but it drops in this year's rankings from 2nd to 4th. Brazil moves up a spot to 3rd, owing to its large domestic market and solid economic growth.

While still the developed world's most popular investment destination, the drop by the **United States** from 2010 is a strong indication that the debt gridlock, financial instability, and depressed consumer spending may be weighing down investor sentiment. Mirroring the slowdown in global flows, U.S. FDI inflows dropped sharply from $306 billion in 2008 to $153 billion in 2009, the lowest level since 2005. In 2010, it posted a 49 percent increase in flows to $228 billion, making it the world's largest FDI recipient by far. Still, the current level is far below 2008. In the wake of the crisis, U.S. inflows may have benefited from the major restructuring that occurred in many industries, including financial services, pharmaceuticals, and automotive.

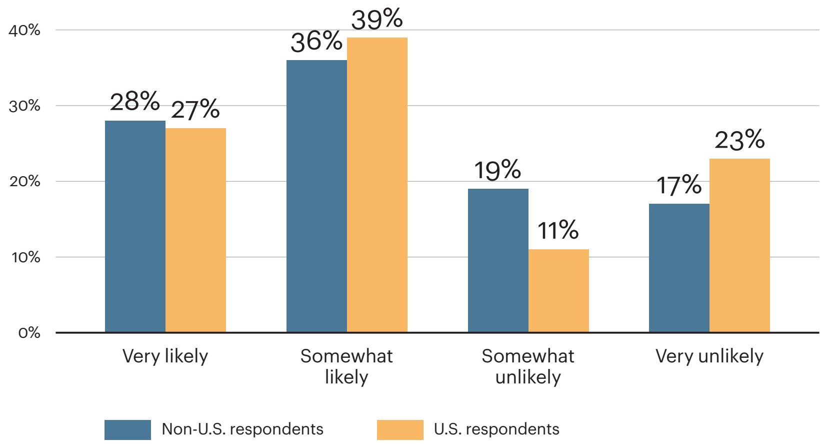
Yet, after the country's turbulent showing in 2011, including a sovereign debt downgrade, investors seem relatively less optimistic about the United States than many other less established economies, suggesting slow investment growth in the years to come. In this year's survey, more than 60 percent of respondents, both foreign and American, report that their investments are somewhat or very likely to be negatively influenced by the growing U.S. debt burden (see figure 11).

We conducted our survey in the late summer and early fall of 2011, as the U.S. debt standoff was at the forefront of global news. While the downgrade of U.S. sovereign debt is not directly

Figure 11

U.S. government debt negatively influences investment decisions for most investors

How likely will the growing U.S. government debt burden negatively influence your future decisions on investment in the United States?



Source: A.T. Kearney Foreign Direct Investment Confidence Index®, 2012

related to FDI, the government's inability to keep its fiscal house in order undoubtedly was a key consideration for investors. While observers mostly shrugged off the Standard & Poor's (S&P) debt downgrade in August 2011, investors seemed to take the view that the country was by no means out of the woods.

It is important to keep in mind, though, that FDI flows into the United States were still twice that of its closest competitor, China, in 2010. Fiscal instability aside, the size of the U.S. domestic market and the quality of its skills and technical resources continue to make it a key market for most multinationals. While American business policies remain open and friendly to new entrants, foreign investors apparently no longer feel as certain about political consistency. From corporate tax rates to wavering support for renewable energy, firms that rely heavily on the U.S. government as a customer or partner do not seem to be as confident about the future.

Speculation that the United States is facing decline is common today. But, to some extent, "declinism" has come in and out of fashion as long as the United States has been a country. The Soviet launch of Sputnik in 1957 profoundly undermined American postwar optimism. Warnings were issued again in the 1970s during the economic malaise and in the 1980s, when academics such as Paul Kennedy warned of "imperial overstretch." That said, with seemingly intractable unemployment and great hesitation for domestic investment, the United States faces serious obstacles to a strong recovery that will restore prior levels of stability.

There are, however, just as many reasons to be sanguine about the prospects for further U.S. growth. The country is still endowed with a stable currency, the world's largest market, and a highly skilled and increasingly productive workforce. Furthermore, with the future of the European economy considerably more uncertain that that of the United States, investors will likely continue to view the United States as the bedrock of investment stability among developed nations (see figure 12).

Brazil, which leapfrogs the United States into 3rd, exemplifies the shift to emerging markets. Its rise from 4th place comes on the back of a surge of foreign investments, which rose 87 percent to $48 billion in 2010. The country, which attracts more than half of FDI in Latin America, experienced particularly strong growth in inward investment in the renewable energy, electronics, chemicals, and food and beverage sectors. In 2010, China became Brazil's largest foreign direct investor for the first time, accounting for about $17 billion of inflows, with the bulk of investment related to commodities and energy. The biggest transaction was Chinese oil company Sinopec's $7.1 billion purchase of a 40 percent stake in Repsol Brazil.

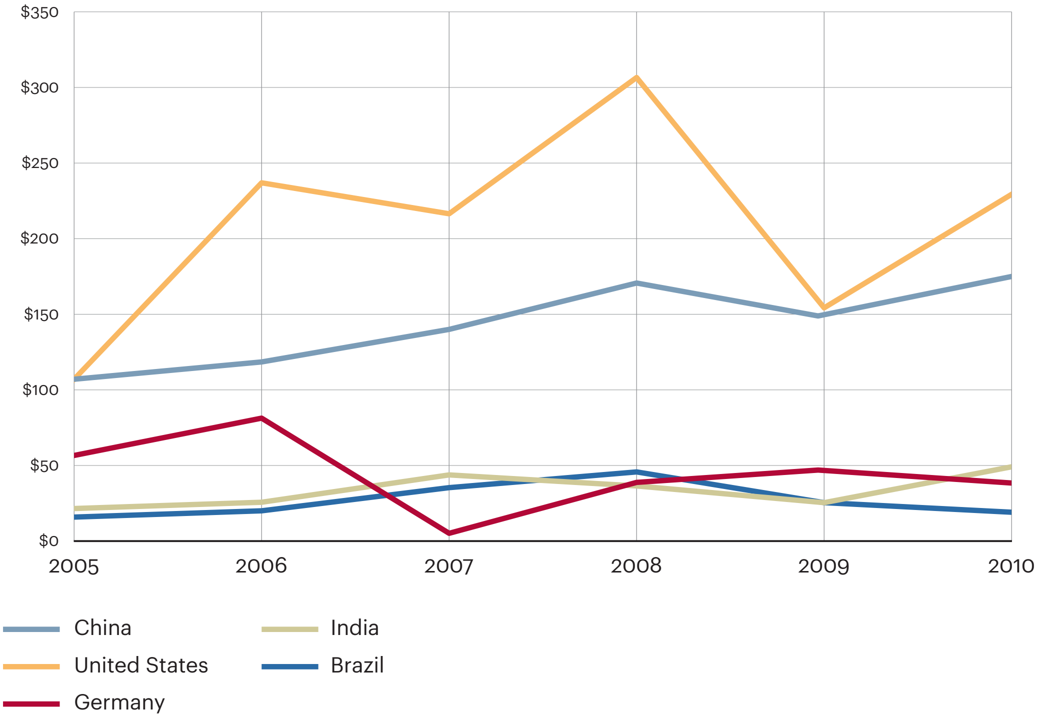
Canada drops from 9th to 20th. Its FDI inflows plummeted to $21 billion in 2009, a staggering 82 percent drop from its 2007 high; it increased slightly to $23 billion in 2010. Yet, it has the second-largest crude reserves after Saudi Arabia (including unconventional liquids) and is thus a top location from primary sector investors, particularly energy-hungry China. So far, the largest single Chinese investment in the Canadian energy sector is Sinopec's $4.65 billion acquisition of Syncrude Canada Ltd. from ConocoPhillips in 2010.

Mexico falls out of the Index this year from 8th place last year, despite some recovery from the recession. Investors may have been deterred by press reports of escalating instability. No doubt declining economic conditions in the United States also contributed to the shift.

Although Brazil is the only Latin American country ranked this year, the region achieved 13 percent growth in FDI in 2010, a year during which worldwide investment was fairly flat. According to the United Nations Economic Commission for Latin America and the Caribbean, Latin America's FDI growth trend is set to continue, with FDI in the first half of 2011 54 percent higher than in the same period one year prior. As the recovery continues, demand will grow

Figure 12
The United States remains the largest recipient of FDI

FDI inflows (US$ billions)



Source: United Nations Conference on Trade and Development not just for the region's natural resources, such as metal mining products, hydrocarbons, and food, but also for products such as automobiles and integrated circuits and services including telecommunications and software development.

Europe

The future of FDI in Europe—and around the globe—hinges on the outcome of the euro crisis, which rages on as 2012 begins. Uncontrolled, the result could be catastrophic, given the large role that banks play in Europe's economy and the sheer volume of debt involved. The European Union's ability to respond is constrained by the need for agreement by its separate member states, and the fact that countries have far fewer arrows in their quiver than before the global recession.

Part of the continent's drop in FDI may be due to renewed efforts by financial services firms to diversify their holdings. Two of the most stable banks in Spain, BBVA and Santander, are performing much better through the crisis due to their presence in Latin America. Others may follow suit, offloading assets in Europe to reach the right capitalization ratio or to augment holdings in other, better-performing regions. At the same time, as European banks may be headed for difficulties, they can become attractive targets for outside investors seeking to snap up assets when prices are low.

As Europe's core reels from the sovereign debt crisis, **neighboring countries are attracting more attention**.

Lackluster economic recovery, exchange rate instability, and the sovereign debt crisis weighed heavily on investors' FDI plans for Europe. **Germany** has led the way to recovery in the EU and remains in 5th place this year. The country's success has been driven by strong domestic economic activity as companies ramp up investment in machinery and construction, and as household spending increases, bolstered by record-low unemployment. It is likely that Germany's strong economic management has encouraged investors, resulting in inflows of $46 billion in 2010, up from $38 billion in 2009 and well above the devastating $4 billion of 2008.

The **United Kingdom** moves up two spots to 8th. Much of the decline in flows to the United Kingdom in recent years occurred in the services sector, mostly financial services, and manufacturing flows were largely unchanged, implying that the dive was likely recession-related rather than the start of a new pattern for U.K. investment flows. With the 2012 Olympics approaching, the country is anticipating major investments in infrastructure and communications.

As Europe's core reels from the sovereign debt crisis, neighboring countries are attracting more attention for their proximity to key markets and growing consumer bases. **Russia** moves up six places to 12th. In August 2011, U.S. oil giant Exxon Mobil agreed to invest alongside Russia's state oil company Rosneft in a project estimated in the dozens of billions of dollars—one of the largest ever FDI projects in the country—swapping shares in projects in the United States for access to Russia's potentially lucrative Arctic Sea. That conservative Exxon would agree to such a large project seems to be a vote of confidence in a country where Western oil leaders have had difficulties before, as evidenced by Royal Dutch Shell's exit from Sakhalin in 2006 and BP's problems with its TNK-BP venture. While FDI soared in other emerging markets, in Russia it saw a more modest 13 percent increase to $41 billion in 2010. However, FDI inflows are expected to increase in light of the more investor-friendly environment, the anticipated accession to the World Trade Organization, and a new round of privatizations. It is the most popular target for investment from other developing nations by far, accumulating $68 billion from 2003 to 2010. The fast-growing local consumer market is attracting more attention: PepsiCo acquired Russian soft drinks brand Wimm-Bill-Dann for $3.8 billion, and Germany's Metro AG opened 17 new stores around the country.

Turkey jumps from 23rd to 13th in this year's Index. The country is still recovering from the effects of the global recession, with inflows up 8 percent to $9 billion but still well below its 2007 high of $22 billion. Roughly 91 percent of the FDI from January to July of 2011 was from EU countries, indicating that Turkey is a goods and services base for Europe in addition to an important consumer market in its own right. While concerns remain over possible new financial crises in international markets that could affect the country's economic stability, the investor outlook is optimistic about the improvement of laws, regulations, and intellectual property rights in Turkey. In October, SABMiller agreed to a $1.9 billion asset swap with Turkey's Anadolu Efes to create a regional beer maker with combined sales of about $3.5 billion. While the European group is attracted to the growth prospects of the Turkish market, this deal is viewed mainly as an entry point to Eastern Europe, Central Asia, and the Middle East—demonstrating Turkey's suitability as a platform for international growth.

The EU's FDI inflows dropped 13 percent in 2010, and rankings for France and Poland suffered accordingly. **France** places 17th in the Index, down from 13th in 2010, as it faces concerns about its ability to reform the economy and handle a banking crisis. **Poland** plummets from 6th to 23rd this year (echoing its 22nd place standing in 2007), as the glow from its strong showing through the global recession fades.

Switzerland, Spain, and the Netherlands, on the other hand, saw better results than last year, ranking 22nd, 24th, and 25th, respectively. **Switzerland**, not a member of the EU but with strong ties to it, debuts on the Index this year. Centrally located, boasting a business-friendly government, an excellent business infrastructure, and a well-educated workforce, Switzerland is attractive as a base for business. Investors may also be attracted by Switzerland's market-growth potential. Tiffany & Co. opened its first boutique in Zurich Airport's Airside Center, and U.S.-based jeweler Harry Winston plans to open a new store in Geneva. In **Spain**, despite concerns about the banking system, increasing numbers of international investors are taking a contrarian view on the country, seeking out bargains at distressed prices. Crisis aside, Spain has strengths that seem to be attractive to investors, including expertise in renewables and infrastructure and its status as a gateway to Latin America. **The Netherlands** enjoys the relative stability of Northern Europe, strong economic ties with Germany, and a host of advantages, including a highly educated and English-speaking population, favorable tax climate, and well-established transportation links.

Middle East and Africa

South Africa makes a strong return to the Index at the 11th position this year. In 2010, South Africa recorded $2 billion in inflows, down from $5 billion in 2009 and $9 billion in 2008. However, renewed demand in its automotive and chemical industries and spending on the World Cup are helping South Africa restore growth after it slipped into recession during the global downturn. South Africa's fast-growing middle class is attractive as well; Wal-Mart bought 51 percent of Massmart in 2011.

China in particular is showing interest in South Africa's natural resources. It has agreed to $2.5 billion in investment projects with South Africa, centered on geology and mineral resources, including a plan by China Metallurgical Group to build an iron-titanium mine and by China National Nuclear Corporation's talks to build a nuclear power plant.

The **United Arab Emirates** (UAE) ranks 15th this year, suggesting that it has regained investor confidence after economic difficulties in 2009-2010. As an investment gateway to the Middle East, it is affected by the instability affecting the region, with serious uncertainty in Bahrain, Egypt, Libya, Syria, Tunisia, and Yemen. However, the country may benefit from the current political upheavals sweeping the Middle East and North Africa, as foreign investors concerned by the turmoil in other countries could opt for the UAE's stability. The UAE saw about $4 billion in inflows in 2010, just below 2009's number and less than one-third of its $14 billion high in 2007.

Persistent Anxiety

More than three years since the onset of the global recession, downside risks seem to outweigh potential upside opportunities in many geographies. With prospects for near-term economic recovery increasingly uncertain, FDI flows may not see the pickup that the world was hoping for any time soon.

The timing and location of renewed investment will play a major role in the future global economic landscape. Emerging markets are poised to benefit from an FDI recovery, as they comprise more than half of the Index's top 25 countries. They are attracting investment on their own merits, mostly importantly large and growing consumer markets. Meanwhile, the developed world may continue to be bogged down by lackluster growth and debt crises. If they are not able to engineer a breakthrough, it is likely that developed and emerging economies alike will suffer through reduced investor appetite. However, our findings show that while investors are concerned and trying to reorient themselves in a new economic landscape, if the economic prospects do not deteriorate, companies are slowly but surely increasing their appetite to invest in foreign markets, which in itself will be an important part of a global economic recovery.

Authors

Paul A. Laudicina, managing partner and chairman of the board, Chicago
paul.laudicina@atkearney.com

Erik R. Peterson, managing director of the Global Business Policy Council, Washington, D.C.
erik.peterson@atkearney.com

Johan Gott, manager, Washington, D.C.
johan.gott@atkearney.com

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