

## REVIEW OF FACTORS TO INCREASE THE COMPETITIVENESS OF CENTRAL ASIAN COUNTRIES

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### Abstract

In this paper we have discussed issues of increasing competitiveness in Central Asian countries and tried to define main factors which play crucial role in it. First we have conducted a literature review, where we looked through previous research papers on increasing competitiveness of countries. Then we have made analyses of Central Asian countries policy documents and used qualitative methods to define the best strategy for increasing competitiveness through analyses of primary and secondary data. We proposed the following three directions where additional actions should be undertaken in order to positively effect on increasing competitiveness in CA countries: development of human capital, simplify access to finance for small enterprises and private entrepreneurship entities and promote the policy towards diversification of the economy.

**Key words:** competitiveness, Central Asia, human capital, small enterprises, economic diversification

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## 1. Introduction

Most of researches that focused on studies of competitiveness had a goal to find main factors, which can help countries to be more successful in competing in world markets. The main factor for long run economic growth in most of economic growth models is technological change and innovation. Basis of technological change and innovations is scientific developments. We can say that societies and economies where environment is science-technology and innovation oriented have higher chances for successful sustainable economic growth and are attain higher levels of global competitiveness. This research paper makes an attempt to define main factors which effect on the sustainable economic growth and global competitiveness of countries on example of Central Asian countries.

The OECD defines competitiveness as “the degree to which a country generates, while being and remaining exposed to international competition, relatively high factor income and factor employment levels” (Pelkman, 2006).

In Central Asia (CA), after a decline in the 1990s during the first years of independence productivity indicators showed significant growth. Growth in this region was above world average. These results were achieved through broad economic and social reforms in CA countries conducted after the end of the Soviet era.

The World Economic Forum (WEF, 2012) on the other hand defines competitiveness as “the set of institutions, policies and factors that determine the level of productivity of a country”. So we can say that productivity is another important factor of the concept of competitiveness.

Economies of countries in the Central Asian region differ in terms of existing resources and policy frameworks and it is clear that these countries can benefit from another wave of reforms focused on the development of human capital, financing small enterprises and attracting investments and through this increase their competitiveness.

## 2. Literature review

Last 25 years competitiveness became one of the most analyzed economic phenomena. However, despite of fact that there are a huge amount of researches published on this issue, there is no clear consensus on how to define and measure competitiveness. Most of general definitions re limited with the inclination and skills to compete, to win and retain position in the market, to increase market share and profitability, and eventually to consolidate commercially successful activities (Filó, 2007).

Porter (1990) gave one of the best overviews of the concept of competitiveness where he claimed that although there is a clear and agreed definition of the company's competitiveness, it is not the case with the definition of the competitiveness of nations. He shows that there are positions for which the national competitiveness is macroeconomic phenomenon that depends on exchange rates, interest rates and budget deficits. According to Porter (1990), there are people who believe that it is possible to link competitiveness with an abundance of natural resources. Moreover, he states that some do connect national competitiveness with government policies that regulate the protection, promotion of imports and subsidies. In his work he concludes that national prosperity is not inherited, but it is rather created by strategic choices, and national competitiveness. It can be seen through the prism of the four elements of every national economy: factor conditions, demand conditions, related and supporting industries and firm strategy, structure and rivalry.

It is correct to mention that OECD (1992) accepted the views that competitiveness can be defined as the degree to which, under favorable market conditions, the country can produce goods and services that can meet international competition, while simultaneously enabling the growth of real domestic income and standard of living.

Current global competitiveness level requires transformation of countries' economies into the knowledge-based economy. Usually knowledge-based economy described as a trend in advanced economies where there is higher dependence on knowledge, information and high skill levels, and the increasing need for ready access to all of these by the business and public sectors. Knowledge and technology have become increasingly complex, thus forcing firms and organizations to development links with each other and increase cooperation as a way to acquire specialized knowledge. [OECD, 2005].

From definition of competitiveness given by WEF (2012) it is clear that innovations are very important for the competitiveness of the countries. As innovations contributes of competitiveness by decreasing cost, increasing productivity and product diversity in the global market conditions, countries should focus on both endowments and the productivity in order to achieve national prosperity.

Definition from World Economic Forum (WEF, 2012) suggests that the nation is competitive if its population can on a sustainable basis revel in high and rising standard of living with high levels of employment (EC, 2012). If to look at the macro level national we can see that competitiveness is defined as the ability of countries to reach economic growth faster than other

countries and to increase the well-being so that its economic structure changes and better adapt to the movement of international trade (Bienkowski, 2006).

Nevertheless, review of literature showed that there are also views, which oppose to above mentioned. For example, Krugman (1994), who is member of the group that believes that there is a significant difference between the perception of the competitiveness of the economy and companies. He claims that the competitiveness is meaningless term when applied in the context of the national economy. Schuller and Lindbom (2009) also in their findings propose that there is no need to measure the competitiveness of the nation.

Interesting is that despite different opinion on definition and interpretation of the concept of national competitiveness, politicians and public show high interested for the country's competitiveness level. One of the key questions where politicians and conductors of reforms try to find answers is the issue of achieving, maintaining and increasing the level of competitiveness, both at micro and macro level. Competitiveness requires the improvement and economic development of all factors which leads to the increase of national competitiveness rather than improving one on the means of others. The importance of the concept of competitiveness is now became the inseparable part of the economic policies of countries around the world. Therefore, analyzing, understanding and measuring competition in different geographic levels become a vital factor for policy makers with intention to find the ways for possible enhance of economic performance of countries and regions. This is the main reason why different international institutions create indices to measure and rank individual countries according to various aspects of competitiveness.

Lovrinčević, Mikulic and Rajh (2008) distinguish between two groups of studies, according to the approach of measuring the competitiveness of use. The first group is consists of research carried by WEF (Global Competitiveness Index) and International Institute for Management Development (World Competitiveness Ranking). The basis of their analysis is the ranking of countries according to a social and international relations, to the role of the state and institutional framework. The second group of studies, carried out by the World Bank (Doing Business Index) and The Heritage Foundation (Index of Economic Freedom), focuses on regulations related to business activities, as determinant of development. Besides the two approaches that are applied globally, there is also transition progress index that forms and monitors European Bank for Reconstruction and Development. Most of above studies use more or

less similar methods, which are based, on statistical data and on survey data. Jovan and Bradic-Martinovic (2014) in their research measure the aspects of competitiveness that are not available in standard statistics, such as for example the quality of the judiciary, the nation's propensity to innovate, the presence of corruption or the quality of company management.

Despite efforts to measure the competitiveness with adequate measures, the results of individual analyzes (Lall, 2001; Staskeviciut and Tamošiūnienė, 2010) indicate that, for example, the GCI index does not provide full reliability, since there are two major problems regarding rating the competitiveness of countries' development level. The first problem is the starting assumption that implies existence of market efficiency, and the second is related to the definition of competitiveness, which focuses on direct competition between countries, ignoring the constraints that arise when there is a transfer of methodology that is used at the micro and macro level. Berger and Bitsow (2009) also argue that the indices used to measure national competitiveness "are poor proxies in predictors of growth and are thus potentially misleading for policy makers". They perceive that indices constructors also "face the additional challenge of choosing relevant indicators and how to aggregate them".

The above discussed issues bring us to conclusion that proposed indexes need further analysis in order to improve their accuracy, especially when it comes to developing countries. Thus it is reasonable to keep conducting researches through differentiating more factors that may determine competitiveness of the nation. A common feature of all national competitiveness measures is the large number of variables that influence its formation, and multidimensionality. Theoretically, it is possible to perform generalization and reduction of variables with appropriate methodologies, in order to highlight those with biggest impact on the index value. Study done by Caudillo et. al (2000) on the Index of Economic Freedom, established by The Heritage Foundation showed that the improvement of index can be achieved by factor analysis (PCA method). Research paper results has shown the existence of few dominant components in the index, which let us more precisely measure this phenomenon. Similar research (Ganegodage, 2008) was carried out in the study where author creates an index that measures the degree of development of the economy made up of 42 variables. By the means of using the factor analysis the number of variables was reduced to a smaller number of dominant factors, with the aim of finding a successful measurement and obtaining new perspectives in the design of national policies and development strategies.

The goal of this paper is to determine main factors, actions and measures which should be undertaken in order to improve the competitiveness in Central Asian region. Both the public and private sectors recognise that there is still room for improvement both in terms of reform and in terms of implementation. The level of reform (PfC) and level of competitiveness (GCI) are both perceived to be lower than the OECD best practice. The region would benefit from further reforms to address this competitiveness perception gap. There are still questions such as which policies to address as a priority to enhance competitiveness; what is the most effective way to implement these policies and reforms; how to enhance public-private sector dialogue; which indicators measure most accurately the competitiveness performance in the region? These questions leave the necessity in qualitative study in order to find at least some answers regarding to enhancing the competitiveness in Central Asian region.

### 3. Analysis and discussion

In our research, we have collected data from primary and secondary sources. We have used several qualitative methods. We have collected documents and frameworks as a sample frame based on data provided from the local government offices, tax offices, trade unions, trading houses in Central Asian countries.

#### 3.1. Analysis of current situation

The countries of Central Asia (CA) are located at the crossroads of Europe and Asia, surrounded by several fast-growing economies of the world - Russia, China and India. From 2000 to 2009, FDI flows to the region were increased almost ninefold, while gross domestic product grew by an average of 8.2% annually. Labor productivity growth in the region outpaced the world average rate of 5%.

In addition, CA countries demonstrate underdevelopment in several priority areas that require changes to get these countries to a higher competitiveness level. After becoming independent from Soviet Union, financing of education has been decreased in all countries of CA region and is currently pretty low compared with those average indicators in OECD countries.

Mobilization of the competitive advantages of the region is largely constrained by the low quality of business environment. There is a considerable lack on financial resources, which is particularly detrimental to the development of small businesses. Thus, the average interest rate for the region is 14%.

In addition, Central Asian countries rank high in OECD country risk classification that reflects the "probability of how they can serve its foreign debt." According to the risk ranking from 0 to 7 in 2010, Kazakhstan was in category 5 risk; Turkmenistan and Uzbekistan - in the 6 th, Afganistan, Kyrgyzstan and Tajikistan - in 7-th. In this regard, the interest rates on external financing in these countries are higher than in other countries.

In CA region there is a pronounced primary resource orientation of trade and investment. Two-thirds of total FDI are directed to the energy sector. In 2008, 65% of total Kazakhstan exports were accounted for oil and oil products. The share of gold exports of Kyrgyzstan was 29%. Structural reforms in combination with innovative programs and social development will help fully realize the economic potential of Central Asia and enhance their competitiveness.

### 3.2. Data analyses

In analyses of competitiveness of CA countries, we should first determine specifics of the region, such as geographical location of the region between European and Asian continents, existing of wide range of types of energy resources, existing of huge potential for the development of agriculture, wide spread of literacy of the population in the region, similarity of culture in the region, speaking in the same language types, existing of inter-complementing economies, existing of developed transportation infrastructure, common borders.

Global competitiveness index in CA mainly determines competitiveness of Kazakhstan, Uzbekistan, Kyrgyzstan, Tajikistan. (Table 1.) Data on Turkmenistan is usually absent as there is no sufficient data to calculate competitiveness index for this country.

**Table 1. Rank of CA countries on global competitiveness based on main factors**

Countries	Factors						
	Organizations	Infrastructure	Macroeconomic environment	Health and education	System of higher education	Efficiency of commodity markets	Efficiency of labor markets
Kazakhstan	57 (4,02)	62 (4,25)	27 (5,74)	96 (5,37)	62 (4,51)	54 (4,46)	15 (4,90)
Kyrgyzstan	124(3,21)	115 (2,80)	104 (4,16)	101 (5,29)	91 (3,89)	77 (4,25)	92 (4,02)
Tajikistan	65 (3,90)	120 (2,65)	69 (4,70)	83 (5,56)	88 (3,97)	114 (3,99)	63 (4,25)
Uzbekistan	56 (4,10)	66 (3,46)	103 (4,34)	59 (5,54)	49 (4,25)	66 (4,16)	43 (4,49)
Average in CIS	95 (3,44)	84 (2,98)	77 (4,68)	86 (5,14)	75 (3,76)	94 (3,82)	48 (4,50)

Source: WEF (2014)

**Table 1. (continued) Rank of CA countries on global competitiveness based on main factors**

Countries	Factors				Global competitiveness index
	Level of technology securitization	Market size	Business efficiency	Innovation potential	
Kazakhstan	61(4,16)	52 (4,26)	91 (3,77)	85 (3,14)	50 (4,42)
Kyrgyzstan	111 (2,90)	117 (2,76)	119 (3,44)	132 (2,48)	108 (3,73)
Tajikistan	116 (2,83)	116 (2,76)	82 (3,83)	80 (3,17)	91 (3,93)
Uzbekistan	84 (2,92)	70 (3,30)	59 (4,17)	42 (3,55)	62 (4,13)
Average in CIS	98 (2,66)	80 (3,24)	99 (3,52)	83 (3,00)	84 (3,85)

Source: WEF (2014)

Specialists of Economic researches institute under the Ministry of economic development and trade in Kazakhstan claim that main reasons of the low results in most indicators on competitiveness of CA countries are the followings (AEF, 2011):

- Low level of economic potential;
- Mismatch of infrastructure, particularly that some countries of the region are too much rely on resource supplying aspects of their economy and that there is a low development of reproduction aspect of the economy in the region;
- Sensitivity to the external conjuncture of the economy due to low level of investments to the non-raw material sectors of the economy in countries of the region;
- Low opportunities for small enterprises to obtain financial resources;
- Small sizes of internal market;
- Low level of technological development;
- Geographical farness from sea ports;
- Existence of social problems, relatively low investments to education.

Beside of defining main negative factors in growth of competitiveness power of the region those specialists provide with their own methods and tools to increase global competitiveness of the economy of CA countries (AEF, 2011). First, they claim that there should be increased attraction of foreign investments, second, should be increased integration levels and links between countries of the region. This component according to their research will help to solve problems on water-energy resources, mutual use of innovative technologies, and efficient exploitation of



transit potential, speed up of solving other mutual regional issues. Third, cooperation in issues related with water-energy resources exploitation. Socio-economic and ecologic prosperity of the region depends on rational usage of trans-border river waters. There is a strong need in developing common policy for the usage of water resources of the region taking into account world's modern trends in solving such issues.

Our opinion about above-mentioned first approach is that it negatively effects on competitiveness of national economy when countries are limited with sources of internal financing and when they are not equipped with new technologies. Today statistical results show that Kazakhstan is the leader in the region on terms of attracting foreign investments. According to the data of UNCTAD Kazakhstan is in the list of countries, which attract FDIs more than 5 billion USD, then Turkmenistan and Uzbekistan, which are in the list of countries who attracted from 1 to 5 billion USD. The rest of countries of the region attract have much lower results where Kyrgyzstan attracted from 500 million up to 900 million USD and Tajikistan up to 500 billion USD (WIR, 2014). It is strongly required from these countries to take additional actions on improving business environment to attract foreign investments in order to reach average level of the region.

#### **4. Current competitiveness challenges in Central Asia and recommendations to overcome them**

Based on analyses of historical data, documents, policy frameworks and current legislation we can make our own recommendations on actions to undertake in order to reach higher diversification of the economy and to increase the competitiveness of CA countries.

##### **4.1. Development of human capital**

Human capital is defined by the OECD as the knowledge, skills, competencies and attributes embodied in individuals that facilitate the creation of personal, social and economic well-being (OECD, 2007). Human capital development is crucial for competitiveness. The literature suggests that each extra year of educational attainment in the population is associated with at least 5% increase in aggregate productivity, with stronger long-term effects through innovation (de la Fuente and Ciccone, 2003).

It is noteworthy that among countries of CA Uzbekistan has reached some achievements on the way of increasing innovativeness of its economy. One example from the report of “Inssad” Business School, France, which is in the list of top five best business schools of the world on the

topic “Innovation global indexes” in 2012 conducted in cooperation with World Intellectual Property Organization. In that report it is stated that when innovation development was analyzed with counting all related factors from 141 countries Uzbekistan had 35<sup>th</sup> place on terms of its development of human capital, and achieved second place in the world on development of education. Despite of these facts the overall situation in the region is still far from being called ideal. Most of countries of CA have higher levels of development of primary education, while secondary and higher education does not meet all requirements of the labor market.

In the decade following independence, the significant decline in spending on education by the region’s educational systems caused a marked deterioration in the quality of education. According to the Policies for Competitiveness (PfC) Assessment Framework results developed by the OECD Secretariat, the educational systems of these countries do not meet the needs of employers, while vocational education is poorly funded and does not provide the skills demanded on the market. Arrangements for involving employers in decision making on education policy, provision of training, syllabuses and standards are still weak. Human capital in Central Asia is thus less well-developed than it should and could be. This acts as a brake on productivity growth and competitiveness. It is obvious that in this direction there is a need for more precise reforms.

Based on mentioned above we can propose the following recommendations on the development of competitiveness of CA countries on the improving of situation on human capital development:

- The share of financing for higher and secondary education system should be increased and private sector should be involved into the process of financing and strategic development of education system;
- Development of the efficient mechanisms for creating competitive environment between institutions of higher education;
- Develop the program towards demographic development in order to provide future sustainability and growth of population of the country;
- Increase the efficiency of reforms in social and health protection;
- Develop reforms on pension system through taking into account current demographic situation.

#### **4.2. Support of small enterprises and private entrepreneurship**

In some countries of the region, environment for small business, as well as working conditions are not ideal. There is a lack of financial resources due to high risks on return of external debts, which causes high interest rates. Beside of it there is a problem of integration of regional financial systems with international financial system. Access to finance for small enterprises allows the efficient re-allocation of resources by increasing firm dynamics, and allows small business to develop and create jobs (WBCSD, 2007). Finally, attracting investments under certain conditions may bring competitive benefits to domestic firms via systematic, positive productivity spillovers and technology transfers (Rodriguez-Clare, 1996; Blomstrom and Kokko, 1997).

Access to finance is critical for enhancing the competitiveness of Central Asia. The financial systems in the region are not yet globally integrated (except for Kazakhstan) and often do not provide a diverse range of financial products to the businesses in the region. The large interest rate spreads -14% and collateral requirements – on average 131% for the region in 2008 are further impeding firms' access to finance. For example, in the Country Risk Classification which is coordinated by OECD and constitutes the basis for calculating premium rates to cover risk of non-repayment of export credits on top of interest rates, the economies of Central Asia have low ratings. As a result, exporting firms from the region are facing higher interest rates.

According to the PfC surveys, in the Central Asia region there is a gap in access to finance which disproportionately affects small enterprises. Despite their importance as generators of employment and growth, small enterprises typically face more severe constraints to growth than large companies do. In emerging economies, in particular, larger firms (including multinational and international corporations) are the preferred targets of banks in a typical business landscape. Moreover, for the available loans, the interest rates and collateral value are much higher for small enterprises. The limited access to finance reduces opportunities for small enterprises to grow and move up the value-chain. In order to overcome these issues in our opinion the following measures should be undertaken:

- Continue strengthening of legislative and economic institutions, strengthen legislative norms to provide legal protection of rights of entrepreneurs and private business entities;
- Reconsider the mechanisms of access to raw materials for private entrepreneurs to simplify it, provide the transparency. Organize sales of raw materials and resources for business through open commodity exchange and trade fairs;

- Provide financial support to small enterprises in village regions;
- Increase the potential of enterprises through the improvement of business environment;
- Provide in internal markets conditions for pure competition.

### 4.3. Economic diversification

We can observe such situation in the region that investments and trade is oriented to work with raw materials, which can cause another problem in the way of diversification of the economy. Improving investment policy frameworks and developing more targeted investment promotion capabilities is imperative to further attract FDI. Although FDI inflows in the region grew at 19 percentage points above the world average (CAGR) in the period 1998-2008, 22 the region has attracted less per capita investments than neighboring regions such as Eastern Europe and the South Caucasus, and investments are mainly concentrated in energy and energy-related sectors. Most Central Asian economies are over-dependent on natural resources and the region's exports are heavily concentrated in a few primary products whose prices are determined in world markets. For instance, in 2008 65% of Kazakhstan's total exports were petroleum and petroleum-related products, while 29% of all Kyrgyz exports are gold. This commodity concentration makes the economies vulnerable to the volatility of oil prices and overly exposed to global commodity market developments in general.

To reach goals in diversification of the economy we propose the following recommendations:

It is important to attract investments to non-raw material sectors of the economy and increase its efficiency. There is no doubt that such sectors of the economy as chemical, oil-gas, mechanical engineering, metal processing, construction materials production, light industry, food industry, industries with high technology involvement should be prioritized as they give higher added value and increases export potential of the economy.

### 5. Conclusion

In this paper we have made an attempt to investigate various factors which may positively impact on competitiveness of Central Asian countries through qualitative analyses of policy papers and legislative documents. By analyzing situation in Central Asian countries we found that there are main three directions which in our opinion may effect on competitiveness of CA countries in global markets.

The reviewed literature claims that countries must design and develop science-technology-innovation based competitiveness, economic growth and development strategies by improving

the conditions for research and development, qualified human capital, infrastructure, higher education, cooperation between the state, industry and university, information and communication infrastructure, accessing the internet, patent protection laws, royalty fees, financial, institutional and structural deficiencies, government policies and externalities. As a result the advances in science-technology-innovation are main driving engine of global competitiveness, economic growth and development in both in economic theory and country practices. Therefore countries can direct global competitiveness, economic growth and development in the long run by applying appropriate economic policies stimulating developments in science-technology-innovations. In case of Central Asian countries in their current economic conditions these mentioned factors can be grouped into three main areas. In order to accelerate its competitiveness potential, Central Asia has to leverage its endowments and further build capabilities in the areas of human capital, support of small enterprises and private entrepreneurship entities through simplifying access to financial resources and promote the policy towards diversification of the economy. Education must provide skills demanded by the market through dialogue with employers; small enterprises, essential for growth, must have easier access to finance including reforms related to early-stage financing and guarantee schemes; and to diversify the economy the investment climate must be enhanced by improving investment policy and promotion reforms.

If the CA region carries out mutual political reforms and improves regional cooperation and industrial competitiveness, the Central Asian countries will expect economic prosperity in the future.

In addition, we must accept the fact that the development of regional cooperation will depend mostly on "oil economics" and appropriate use of oil and gas income flow. In general, the development of competitive manufacture and regional cooperation competitiveness, along with agricultural development are key components of sustainable development of the region.

Our results provide general recommendations and to define detailed steps in each of three promoted areas further research deep analyses and research should be undertaken. Future studies must pay attention on quantitative methods of analyses and check statistical relations of proposed factors.

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