

The Role of FDI from MNEs in Achieving National Competitiveness in Developing Countries: The Emerging Case of Kazakhstan

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Abstract: Internationalisation of the firm has been the central focus of attention for more than forty years, to the extent that the evolution of the concept of globalisation has consolidated itself in the new age of internationalisation. Indeed, in relation to the penetration of foreign markets through import substitution strategies, it is notable that firms, markets and industries in developed and developing nations are becoming unrecognisable. Consequently, this study focuses on the developing economy of Kazakhstan and considers emerging policy implications for the nation. Regression analysis is used in order to look at data since the country's independence in 1997, but in particular, considers the period 2003- -2006. Hence, this paper considers the following:- the relationships between the operations of MNE's and the national GDP growth in Kazakhstan; the relationships between MNEs' involvements and major industrial development in the country; and the relationships between FDI inflows and major economic activities in Kazakhstan.

Keywords: Kazakhstan, Developing nation, Economic growth, Internationalisation, Globalisation, Foreign direct investment, National competitiveness

1 Introduction

Porter (1990a) proposed the national competitiveness "diamond" model and applied this technique to explore a wide variety of reasons as to why some nations can gain competitive advantages in international markets. He presented the four factors that determine the creation of nations' competitive advantages: factor conditions, demand conditions, relevant and supporting industries, and firms' strategy and structure. Porter further discussed the four stages of competitive development: factor-driven, investment-driven, innovation-driven, and wealth-driven stages, and consequently countries generally pass through these four stages with increasing national competitive advantage and ultimately raising economic prosperity. However, these models have been the subject of considerable debate, with the criticism mainly directed towards the alleged inapplicability of the model to small and developing economies and its overlooking at the role of multinational enterprises (MNEs) and foreign direct investment (FDI). Professor Porter did acknowledge the fact that, at least for developing countries, foreign owned MNEs may serve to seed industrial clusters and thus contribute to the upgrading of the national diamond.

Nevertheless, the notion of national competitiveness is debatable (see Thompson, 2004). Seeking to explain "competitiveness" at the national level, Porter (1990a, 1990b) argued that since there is a critical link between the national environment and the corporate level of competitive advantage, the answer for the national competitiveness of nations may not rest on the whole economy but in specific industries. Such an insight is underlined by the distinct strengths of certain industries in leading industrial countries and their corresponding formation of national clusters in these industries. These patterns of industry specialization are well illustrated by the industrial profiles of the United States, Japan, and Germany. The United States appears to be strong, primarily in the high-technology industries, especially the information technology sector and life sciences, and in a number of service industries such as consulting, financial services, and motion pictures. Japan has been very strong in the design and complex assembly

manufacturing of consumer electronics, cameras, photocopiers, machine tools, and cars. German competitive advantage is somewhat similar to that of the Japanese profile, although it is particularly strong in the areas of design, manufacture and distribution of a variety of products from diverse industries such as machinery, cars, and chemicals.

A brief overview of the above industry-specific competitive advantages highlights the significance of the concept of national competitiveness, however, this national competitiveness concept can be seen to ultimately imply that the performance of firms can be related back towards the national conditions within which these firms operate (see Soskice, 1997; Caspar, 2000; Haake, 2002). Successful expansion of major industries can be achieved through national policies directed toward achieving a sustainable increase in national productivity and enhancing the competitiveness of the nation's industries (see Young et al., 1989; Hood et al., 1994; Lal et al., 1999; Hohenthal et al, 2003). Despite the high level of interest in the role of major industries in building national competitiveness, it is still not very clear what major industries can help in leveraging national economies into the global marketplace.

With this in mind, Kazakhstan has captured the imagination of the world with great speed, particularly in terms of its development in major industries during the last decade. However, a large share of Kazakhstan's economic growth has been due mainly to its natural resources - the oil and gas industries and the mining sector. Indeed, such is the extent of natural reserves and resources of this rapidly developing nation that the oil and gas sector is now Kazakhstan's biggest export category and a major driving force behind the nation's economic growth. Nevertheless, it is debatable whether the oil and gas industry alone, can provide long-term sustainable economic development for this nation. Consequently, due to the rise in wages, shortage of professional and skillful labour, problems in exploring sufficient Greenfields, pressures of environmental protection and insufficient infrastructure, Kazakhstan is now facing new challenges. Against this backdrop, the ability to promote and develop additional industries may be a key toward creating the sustainable and long term national economic growth that Kazakhstan requires in order to become a regional leader within Eurasia.

Against this backdrop, this paper describes the roles of MNEs and FDI inflows towards the sustainable economic growth and the national competitiveness of Kazakhstan, especially those having industrial policy implications. Accordingly, the three primary objectives of this research are:

- (1) To examine relationships between MNEs operations and the national gross domestic product growth in Kazakhstan;
- (2) To examine relationships between MNEs' involvements and major industrial development in the country;
- (3) To examine relationships between FDI inflows and major economic activities in Kazakhstan.

2 Literature Review

MNEs constitute one of the foremost international entities of international business, and international trade, and as a result, their financial impact has significant consequences on the global economy. Furthermore, MNE's can be seen to be responsible for generating ever larger shares of global wealth, employment and production in regional and country specific markets. On this note, MNEs can be seen as a source of economic power, and therefore their importance has grown precipitously over the previous four decades (e.g. Hood and Young, 1979; Porter, 1986; Parkhe, 1991; Hanvanich and Cavusgil, 2001). Indeed, their economic preponderance affects not just the constitution and organization of domestic economic systems, but has wrought fundamental change on the linkages between national economies.

By creating complex commercial networks, geographically disparate production, assembly, and distribution systems, and by operating highly complex profit repatriation corridors and cross-border financial management systems, MNEs have deepened interdependence and the functional linkages that bind global economies together. Hence, in a very real sense - it has been MNEs, their investment, locational, R&D and production decisions, as well as their sales, distribution and marketing systems that have intersected in-

ternational financial and trading markets and made real - the much heralded processes of globalisation (e.g. Hymer, 1979; Bartlett and Ghoshal, 1989; Buckley and Casson, 1992; Rodrik, 1997; and Rao, 2001).

MNEs have thus been both instrumental and definitive to the character, constitution and operation of the global economy, and central to any appreciation of the forces causing global economic change. Accordingly, they tend to influence the contours that shape its practices, and the mechanisms by which its constitutive realms reflexively interact. Against this backdrop, economic globalisation refers to the increasing integration of economies around the world, particularly through trade, financial flows, the movement of workforce, and technology that transcend international boundaries. The concept of globalisation therefore encompasses not only the internationalization of consumption through cross-border trade in goods and services, but also the global integration of capital markets and the internationalization of product through FDI. In recent years, globalisation has been the subject of an increasingly intense public dialog, as international trade and investments have grown thereby creating patterns of trade and investment that have evolved and assumed new forms.

With this in mind, this phenomenon has not been confined to the developed world, particularly as we see geographic patterns of international business shifting towards the large and developing economies such as Brazil, Russia, India and China, which have grown rapidly, thereby acquiring new competencies, and becoming more open towards foreign trade and investment. Such has been the impact of globalisation that views on the benefits and costs are diverse and essential to prosperity and the efficient allocation of resources (e.g. Levitt, 1983; Ohmae, 1987; Hay and Rosamond, 2002; Chang, 2003; Bruff, 2005; Crenshaw and Robison, 2006; Ghani and Lockhart, 2006).

On the other hand, some theorists worry that it may result in a race to the bottom, in which competition from low-wage countries results in reductions in wages and a loss of jobs, or in which measures to protect the environment lead to shifts in production to countries with permissive environmental regimes (e.g. Weiss, 1988; Hirst and Thompson, 1996; Sassen, 1998; Stiglitz, 2002; King and Waddington, 2005; Buchman, 2005; Burkle Jr., 2006; Glaser, 2006; Thomas, 2006). Against this backdrop, it is clear that the issue of globalisation is a significant phenomenon, which is important to be conceptualised, contextualised, and clearly understood and therefore cannot be underestimated.

3 Methodological Approach

Understanding the concept of globalisation requires an examination, analysis and evaluation of international trade theory including those particular facts that can be seen as being key ingredients in any assessment of this important phenomenon. In attempting to do examine this concept, Landefeld and Whichard (2006) discussed some of the issues involved with respect to two major ways in which globalisation manifested itself in terms of cross-border trade in goods and services and foreign direct investment and the resulting international activities of MNEs (see also Peleg and Arieli, 2006). Hence, in this paper, the authors consider the case of Kazakhstan in terms of the application of a variety of measures of FDI in relation to the economic activities of MNEs. As a consequence, the authors recognised the need to complement these data with statistics that describe the operations of the firms, in which there is direct investment. This recognition has arisen partly from the increased interest in globalisation that has accomplished an increased importance and partly from the inclusion in trade agreements of provisions that recognise commercial presence as a mode of supply (Landefeld and Whichard, 2006).

Various terms have been used to refer to these data, including statistics on the “activities of multinational enterprises” or “MNEs operations data.” Whatever the name, these data generally consist of key measures of operations which are compiled for direct investment enterprises. This study follows international guidelines for compiling such data (see OECD’s manual, 2005) and in order to be consistent with the recommendations of the international guidebook, we use data from the Agency on Statistics of the Republic of Kazakhstan (2007). On this note, this Kazakh Agency compiles several different indicators of MNEs operations including: sales on domestic market; imports; outputs of works and services; payroll number of

employees; and the number of enterprises with foreign shares (or interest holders). In adopting this particular approach, this has allowed the authors to analyse and evaluate a diverse range of issues than would have been possible - if only a few indicators were collected.

In understanding the nature of FDI-based indicators for this study, these appear to be among the most widely available and commonly used measures of economic globalisation. They are designed and intended to measure the extent to which cross-border investments have been made with the objective of obtaining a lasting interest in foreign business enterprises, and a degree of influence over the management of those enterprises. International guidelines for measuring FDI are given in the International Monetary Fund (IMF)'s manual (IMF, 1993) and in the OECD's manuals (OECD, 1996, 2005). Against this backdrop, and in order to be consistent with the recommendations of international guidebooks, the issue of gross inflows of FDI in Kazakhstan (Agency on Statistics of the Republic of Kazakhstan, 2007) includes the following factors:

- Purchase not less than 10%-share in Kazakhstan share-capital by non-residents except sale by non-residents of their share in Kazakhstan share-capital to residents
- Reinvested earnings (a share of direct investors undistributed income or loss in Kazakhstan companies)
- Loans and commercial credits, granted by direct investors both in cash and another form (as goods, services, intangible assets and so on) without Amortization

In considering the issue of sustaining the national economic growth by MNEs's involvement, a number of economic reforms were motivated by the views of those who thought that the only way to balance Kazakhstan's unbalanced status was to change the fundamentals of the economy's trajectory by steering it away from the natural resources dependent development, and these reforms resulted in a change of the development strategy. Having adopted the primary strategy of diversified industrialization in the early 2000s, the Kazakhstan economy has experienced remarkable growth over the past 6 years. Its macroeconomic measures have spurred economic growth of 113.5%, 109.8%, 109.3%, 109.6%, 109.7%, and 110.6% (as of previous year) in 2001-2006 respectively (World Bank, 2007). The compound annual growth of per capita income was well in excess of 10 percent, making it one of the fastest growing economies in the world during this period.

A further important factor of consideration are the measures of association in terms of those particular numerical values that yield information about the relatedness of variables. Hence, the measure of association applied in this study is regression analysis, which is the process of determining a measure of the strength degree of relatedness between many independent variables and a dependent variable. Logically, the GDP growth should be related to economic activities by MNEs, FDI inflows, trade balance, exchange rate, and others. However, since the set of independent variables to be included in the model is grounded and derived through the literature review, the authors initially employ a confirmatory perspective to specify the relationship of an independent variable and the dependent variable in the regression model. Therefore, one question which arises in relation to a sample of Kazakhstan data examines if there is a correlation between the growth of GDP and sales amount in the domestic market by MNEs. On this note, the sampleframe of raw data for this study included the 4 cases of time series data during the period from year 2003 to 2006.

4 Results and Discussion

In considering the results of this study, the regression coefficient ($b = 2.922$, $\text{sig.} = 0.014$) between the amount of GDP and the sales on domestic market by MNEs indicates significant positive correlation. That is, as the sales on domestic market by MNEs increases, the amount of GDP accordingly gets larger, see Table 1.

The final regression model and its specified equation to maximize the explanation power are shown as: $Y = \square + \square 1 \times 1$

Table 1 The output of data analysis by OLS regression

	Unstandardized Coefficients	Standard Error	t-value	Sig.
(Constant)	1037508	749418.600	1.384	0.300
Sales on domestic market by MNEs	2.922	0.343	8.513	0.014
Dependent Variable: Gross domestic product, million tenge R=0.986, R square=0.973, Adjusted R square=0.960, F-value=72.469, significance=0.014 Standard error of the estimate=486638.4				

Source: The authors generated from data

Where, X1: sales on domestic market by enterprises with foreign share, million tenge. After the regression run on the sample data, the following specific equation was obtained: The amount of GDP (million tenge) = 1037508 + 2.922 X1

4.1 Improving Economic Activities by MNEs Involvement

Evidence in support of these assertions is not difficult to find. The importance of MNEs can be manifestly demonstrated through any assortment of data available from the National Statistics Agency. Here MNEs describe “active enterprises with foreign share” in Statistical Yearbook. The data that is presented in “The section on the activity of enterprises with foreign share” were based on information received after processing the data from statistical reports of enterprises with foreign investor’s share - and of enterprises that were fully owned by foreign investors. To date around 9,000 joint ventures (8,881 enterprises were registered to the government’s Tax Agency as of the end of 2006) with the participation of foreign capital were established in Kazakhstan.

Surveying some of these reveals the extent of MNEs contributions to gross domestic production and to the livelihoods of tens of thousands of people. As of 2006 in Kazakhstan, for example, the number of MNEs had grown to 8,881 enterprises, employing 421,519 employees (8.8% of total employees), and sales on domestic markets 23,967 million US Dollars (29.6% of GDP), see Table 2 for details.

In examining Table 2, these trends are not simply proportionate to growth in the nation’s economy. The extent and reach of MNEs relative to the nation’s economy reveals absolute growth in the economic power and influence of MNEs’ operations. More pointedly, the importance of MNEs to the nation’s economy has grown markedly since 2003 and much of this is dominated by the commercial interests of MNEs. In 2006, for example, the volume of economic activities MNEs generate to the nation’s economy is nearly 30% of the nation’s GDP and in terms of international trade MNEs account for nearly 63% of external trade of the nation.

Table 2 MNEs’ operations data in Kazakhstan (MNEs’ share as % of total)

	2003	2004	2005	2006
Number of MNEs, units	6,597	7,070	8,670	8,881
FDI inflows, million USD	4,624	8,317	6,618	10,437
Gross domestic product, million USD	30,828	43,162	57,072	81,061
Sales on domestic market by MNEs, million USD	8,044 (26.1%)	11,757 (27.2%)	18,319 (32.1%)	23,967 (29.6%)
Employees in MNEs, thousand persons	346.1 (8.2%)	357.5 (8.0%)	401.6 (8.6%)	421.5 (8.8%)
External trade turnover by MNEs, million USD	13,737 (64.4%)	21,019 (63.9%)	31,985 (70.7%)	38,545 (62.2%)

Source: raw data from The Agency on Statistics of the Republic of Kazakhstan (2007)

4.2 Improving Diversification of the Nation's Economy

Although income inequality somewhat increased, the change was modest during the same period (1997-2006) such that all things considered, Kazakhstan was one of those countries among those better performing nations - with respect to distributing the fruits of development evenly. Generally speaking, Kazakhstan's economy has experienced one of the most rapid structural transformations since the industrial revolution. Today, the Kazakhstani economy is well diversified with manufacturing, construction, trade, transportation and communications, financial services, as well having a rapidly growing and well developed real estate business sector. MNEs have played a distinctly supporting role in the diversification of the nation's economy and the evolution of the nation's competitive advantages, see Table 3 for details of important factors directly associated with the Kazakhstan's economic activities.

4.3 Increasing FDI Inflows

In 1997, the government eliminated most of the obstacles of foreign direct investment regulations and accelerated the implementation of FDI-friendly policies. In this regard, the Kazakhstan government has taken various measures - after prior consultations and exchange of views with foreign investors - particularly, within the framework of the Foreign Investors' Council (FIC), which was set up by the President of Kazakhstan in June of 1998. Basic guidelines of national social and economic policy pursued since 1998 (for further implementation of the investment policy) are based on the principles of "improving standard basis aimed at boosting the influx of domestic and foreign capital in the sphere of investments" (The Administration of the President of the Republic of Kazakhstan, 2007).

Characteristically, over the last decade, MNEs appear to have more than tripled in terms of the number of enterprises with foreign share - and increased substantially - the number of people they employ and the amount of external trade turnover. Since then, the Kazakhstan economy has been well sustained by large

Table 3 MNEs' economic activities in Kazakhstan

Year	MNEs sales as % 1)		MNEs Employees as % 2)	
	2005	2006	2005	2006
Total	72.9%	65.9%	15.7%	15.7%
Agriculture, hunting and forestry	0.5	0.6	1.8	2.1
Fishing, fish breeding	n.a.	n.a.	4.1	2.2
Mining	20.2	23.2	37.6	41.6
Manufacturing	20.2	23.2	45.1	44.4
Production and distribution of electricity, gas and water	2.0	1.5	12.3	8.2
Construction	57.6	29.6	19.3	18.5
Trade	59.2	47.2	41.9	36.2
Hotel and restaurants	34.7	30.9	52.1	46.5
Transport and communications	18.8	28.9	9.9	10.4
Financial activities	21.7	10.1	29.5	29.7
Real estate activities	14.1	31.1	14.1	14.4
Education	1.7	1.1	0.7	0.7
Health care and social work	2.3	2.3	0.6	0.9
Community, personal service	30.2	35.9	17.7	17.2

1) multinational enterprises' sales on domestic market, as % of gross domestic product.
2) number of employees in enterprises with foreign share, as % of total employees in enterprises.

inflows of FDI and by MNEs active involvement to the nation's economy. For example, the "Central Asia-Russia-China: from Geopolitics to Geo-economics in Eurasia" conference, which was held in London at the end of 1997, reported that right behind Hungary, Kazakhstan had the second highest indicator of attracted FDI per capita among the former Soviet Union (Russia Embassy of the Republic of Kazakhstan, 2007). As a result, in 2006 Kazakhstan has attracted a total of more than 10 billion US Dollars of FDI inflows, which contributed 678 US Dollars per capita to the total population (total population of Kazakhstan was 15,396,900 at the end of 2006).

On a similar note, the aggregate foreign investments into Kazakhstan's economy during the period from 1993 to 2006 has exceeded 51 billion US Dollars (Agency on Statistics of the Republic of Kazakhstan, 2007). During this particular period, MNEs from the USA were the major investors in Kazakhstan, as measured by the level of gross FDI inflows. Specifically, USA based MNEs had a 26.4% share (accumulated amount in total was approximately 13.5 billion US Dollars) of Kazakhstan's gross FDI inflows as compared with all other investing countries. Since the year 2000, European Union (EU) countries, especially United Kingdom, Netherlands, Switzerland, Italy and France have accelerated their investments, and have become major players of FDI inflows into Kazakhstan. Since 2003, East Asian countries, particularly South Korea (total 2.1 billion USD and total 4.2% share), Japan (total 1.3 billion USD and 2.6 % share), and China (total 2 billion USD and 4.0% share) have accelerated their investments, and have become emerging players of FDI inflows into Kazakhstan. In terms of regional portfolio, North America has invested a 30% share (total 15.5 billion USD), East Asian countries approximately 11% share (total 5.5 billion USD), and European Union countries have a 50% share with investments reaching 25 billion US Dollars of inflows to Kazakhstan.

It is noted that the sheer weight of economic resources controlled by MNEs and the volume of their investments make their investment decisions highly significant to the well-being of the Kazakh nation's economy and to great swaths of the nation's workforce. Emblematic of this is the fact that nations actively compete to attract MNEs' investment through investment promotional boards, various policy instruments designed to defray establishment and operational costs, and through membership to international forums in order to guarantee and indemnify foreign investors against loss through some nefarious political activities. Despite the reprehensible activities and human rights abuses associated with some MNEs' operations in other countries, (and Kazakhstan does not appear to suffer from such behaviours) the investment that MNEs bring to Kazakhstan, along with the various positive externalities associated with their presence, sustains a highly competitive environment actively seeking to attract further MNEs' investment.

5 Conclusions and Policy Implications

Improve the doing business environment for MNEs. Effective foreign economic activities of Kazakhstan have been pursued purposefully and consistently. They tend to rest on the transparency of the economy, full-fledged and equal participation in the international division of labour and integration in the world economic system, and all this serves as one of the major motive forces of the country's strategic plan to secure sustainable economic growth. Essentially, Kazakhstan can afford many of the conditions favouring reliable prerequisites of successful development of its foreign economic relations. More particularly, the key factors here appear to be: wealth of natural resources, a fairly competent level of manpower, and political stability.

In terms of strategy implementation, there are many institutional support mechanisms which serve for the further development and diversification of the economy. Consequently, as the primary task of the government in the nearest and mid-term future must remain the continuation of structural and institutional reforms, these must be aimed at developing competition, improvement of investment climate, strengthening of transparency and liberalisation of the economy, improvement of judicial system, deregulation of the market. Maintenance and development of favourable conditions for further growth of the private sector

should also remain the top priority. At the same time, amongst the country's top priorities must be the encouragement of FDI and MNE operations into industries of agriculture, innovation, and the processing sectors in order to decrease the dependence of the economy on energy and extracting sectors and to ensure sustainable diversified growth of the nation's economy. The following policy measures are recommended to address this task:

- the main industrial stock should be updated;
- capital and innovative technologies of MNEs should be attracted into the economy;
- positive policies should be initiated in order to create and stimulate the growth of the knowledge economy

Improve the environment for FDI. As an emerging market, Kazakhstan is facing many challenges. The government is alive to some of the major problems which still remain in the economy and tries to further improve the investment climate and respective business environment within its borders. Here, Kazakhstan's investment policy must adhere to a number of fundamentally, but strategically important principles of stability and predictability in terms of: transparent legal norms; protection of investors' legal rights; equal conditions for foreign and local investors; sanctity of contracts; encouraging direct investments to such priority sectors of the economy as agriculture, the manufacturing sector, industrial infrastructure, social, cultural and tourism infrastructures.

Noticeably, there are a range of political factors promoting investors' work and this requires considerable political support in Kazakhstan for issues such as: preservation and strengthening of political and social stability, ensuring that there is an intergrated national regime of activities targeting foreign investors in terms of giving a right of free repatriation of profit. The government still needs to continue with a relatively flexible macroeconomic policy thereby ensuring a market competitive environment without administrative interference. Furthermore, a purposeful improvement of investment climate, attraction of new investments and an improvement of its state support system should be priority directions for Kazakhstan's policymakers.

Accelerate accession to the World Trade Organisation (WTO). In examining key issues associated with membership of the WTO, we note that this is an additional tool that is now being used by the Kazakh policymakers in terms of economic modernization and strengthening Kazakhstan's competitiveness on the world markets. It is critically important for Kazakhstan to observe international standards and rules of trade which have been highlighted by the WTO - following the publishing of the results of the country's unsuccessful application for entry into the WTO. Consequently, following a review of the WTO's recommendation to the nations policymakers, negotiations on Kazakhstan's accession are moving ahead at fast speed. A major part of the laws regulating the international trade regime, either have already been harmonized in accordance with WTO requirements or are under discussion within the Kazakh parliamentary system. Hence, to fully utilise these opportunities, it is now clear that Kazakhstan must eliminate all economically unjustified limitations on foreign investors' participation in equity of local companies in those sectors where the government has not already done so. Along with this, measures must be taken to bring the national foreign trade legislation in compliance with WTO principles and standards.

In terms of further practical implementation measures, it is necessary for the Kazakhstan government to continue to carry out reforms of the tax and customs administration; redirect the government assistance towards domestic producers; modify domestic standards of technical regulation (in accordance with international standards of the WTO); and continue with their reform initiatives directly associated with the financial services market. Finally, the government must continue to focus research efforts on the global economy - where Kazakhstan can be a competitive supplier - and, based on the results of this study, there is a need to establish a specific and attentive program of reforms which foster international competitiveness of national products and services.

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