

## Chapter 2

# Defining Knowledge-Driven Economic Dynamism in the World Economy: A Methodological Perspective

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**Abstract** Although economic progress has always been knowledge-based, the scope and role of knowledge to economic processes has fundamentally changed over the last years. On these grounds scholars have argued that a new, knowledge-based economy has emerged, presenting significant opportunities for economic growth and development. This chapter builds upon the concept of the knowledge-based economy to define knowledge-driven economic dynamism and to provide a methodology for assessing it. In particular, it argues that conventional measures of economic performance are not capable of capturing the qualities of the knowledge economy and, on these grounds it introduces an appropriate measure of knowledge-driven economic dynamism, called the Economic Dynamism Indicator (EDI).

## Introduction

Economic development is and always has been knowledge-based. However, the scope and significance of knowledge to economic processes has fundamentally changed over the last years. On these grounds there have been many scholars (see for instance Dosi 1995; Neef et al. 1998; Burton-Jones 1999; David and Foray 2002; Rooney et al. 2005; Brinkley 2006; Dolfsma and Soete 2006; Leydesdorff 2006) who argued that a new, knowledge-based economy has emerged presenting significant opportunities for economic and social development.

This chapter builds upon the concept of the knowledge economy to define knowledge-driven economic dynamism and to provide a methodology for assessing it. In particular, it argues that conventional measures of economic performance are not capable of capturing the qualities of the knowledge economy and, on these

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grounds it introduces a new and more appropriate measure of knowledge-driven economic dynamism called the Economic Dynamism Indicator (EDI).

The chapter is structured as follows. The next section discusses the emergence of the knowledge economy and outlines its qualities. This provides the basis for the development of an appropriate conceptual framework in section, “A Framework for Knowledge-Driven Economic Dynamism” that enables us to define knowledge-driven economic dynamism and to specify its dimensions. This is followed by an overview of the existing measures of the knowledge-based economy. The fifth Section “Operationalising Knowledge-Based Economic Dynamism: The Economic Dynamism Indicator” considers some key methodological issues in the construction of composite indicators before it embarks to operationalise the concept of knowledge-driven economic dynamism by developing the Economic Dynamism Indicator. Last, the final section concludes the paper summarising the key findings.

## **The Emerging Knowledge-Economy Paradigm**

The idea that knowledge plays an important role in the economy is not new (Harris 2001). All economic activity rests on some form of knowledge, and all economies, however simple, are based on knowledge (Smith 2002). However, the degree of incorporation of information and knowledge into economic processes is so great today that it causes substantial structural changes in the way economy operates and is organised (Brinkley 2006; Leydesdorff 2006). In this sense, new rules, practises and institutions come to light, declaring the emergence of a new economic structure, that of the knowledge economy.

Three major shifts in the understanding of the changing role of knowledge and its links to the economy have been identified (Soete 2006). In the first, emphasis is placed on knowledge as a commodity (Drucker 1998; OECD 1999). It has been asserted that knowledge is not an external, “black-box” factor, but instead is internal to the economic system and therefore economic principles can be applied to its production and exchange. Moreover, knowledge can be produced and used in the development of goods (or even of itself), which means that it is an input in the production process. Like all goods, knowledge may be subject to depreciation and obsolescence. This is the case when people no longer use certain knowledge, or when new knowledge is created superseding previous knowledge and thereby rendering it worthless.

However, knowledge differs from traditional commodities in a number of ways (and these differences have crucial implications for the way the knowledge economy should be organised). First, it does not have a physical appearance, though it is embedded in some specific blueprint form (such as a patent, an artefact, a composition, a manuscript or a computer programme), in human beings and in organisations (Soete 2006). Second, knowledge is non-rival, i.e. its consumption by one person does not preclude simultaneous consumption by others, and also non-excludable, that is, once discovered and made public no one can be excluded from consuming it

or enjoying its benefits. Third, knowledge is not depleted by use; its consumption does not diminish in any way the amount available. In fact, the more people they use it, the greater the social return and its value become (Houghton and Sheehan 2000). As a result positive externalities arise.

The second shift highlights the role information and communication technologies (ICTs) play in the creation and transferability of knowledge (Lundvall and Foray 1996; Houghton and Sheehan 2000). ITCs have advanced the storage, speed, manipulation and interpretation of information, which enabled the codification of knowledge and made it much more accessible than before to all sectors and agents in the economy. In that sense knowledge has become globally available at low cost. For technologically leading countries or firms this “. . .implies increasing erosion of monopoly rents associated with innovation and shortening of product life cycles” (Soete 2006: 15).

The final shift has to do with the innovation processes. David and Foray (2002) have argued that, today, innovative capacity is related to great extent to the ability to both systematically combine and make new uses of existing knowledge, rather than discovering new technological principles. Thus, it is not the development of new knowledge that plays a significant role in the economic processes but its combination and reorganisation. This process is referred to as “innovation without research” (Soete 2006) and requires systematic access to state-of-the-art technologies and the establishment of procedures for the dissemination of the information.

## **A Framework for Knowledge-Driven Economic Dynamism**

With generation and exploitation of knowledge at the centre of the economic processes, an economy is transformed into a knowledge economy. Such an economy effectively acquires, creates, disseminates and uses knowledge as the main engine for long-term economic growth. In a sense, knowledge becomes its prime source of competitive advantage. On the basis of this, we define knowledge-driven economic dynamism as the potential an area has for generating and maintaining high rates of economic performance due to its knowledge capacity.

Chen and Dahlman (2005) indicate that a successful knowledge economy involves ingredients such as long-term investments in education, sufficient innovation capacity, adequate information infrastructure and an advantageous economic environment. On these grounds we argue that knowledge-driven economic dynamism embodies four building blocks. These are:

1. Human capital
2. Innovation ability
3. Information access and
4. Economic performance

Human capital refers to a well educated and skilled workforce. Such a labour base is essential to the creation, acquisition, distribution and utilisation of relevant

knowledge, which enhances total factor productivity and economic growth. Basic education is essential because it improves peoples' capacity to learn and to use information. Higher education is also important since it is associated with both the production of new knowledge and efficient adaptation and innovative use of established knowledge. Moreover, an educated population tends to be technologically sophisticated. This gives rise to local quality-sensitive demand for advanced goods, encouraging local firms to innovate and develop technologically sophisticated products and production techniques.

There are a large number of studies which have found evidence suggesting that human capital is a key determinant of economic dynamism. Barro (1991) showed a significant positive association between real GDP per capita growth and education (proxied by school-enrolment rates) for 98 countries in the period 1960–1985. Mankiw et al. (1992) and Brunetti et al. (1997) provided similar findings. Interestingly, Barro and Sala-i-Martin (1995) found that higher education has the largest effect on growth compared to both secondary and primary schooling. More recently, Hanushek and Kimko (2000), measuring the quality of education with tests of mathematics and scientific skills for a sample of 31 countries, reaffirmed the significant and positive link between education and growth.

Innovation ability refers to the development of an effective innovation system of firms, research centres and other relevant organisations and institutions, that nurtures research and development (R&D) which results in new goods, new processes and new knowledge. Such a system is expected to sustain the knowledge economy not only by producing new knowledge, but also by drawing on the growing stock of global knowledge and assimilating it to local needs.

There have been a number of studies exploring the role innovation and R&D play in economic progress. For example, Fagerberg (1987) examining 25 industrial countries for the period 1960–1983 reported a close correlation between economic growth and technological development (measured by R&D and patent statistics). Lichtenberg (1992), using a sample of 74 countries, reaffirmed this strong link. So did Ulku (2004), who used panel-data techniques to examine the relation between R&D, innovation and growth for two groups of countries, developed and developing.

Information access has to do with the usage of information and communication technologies (ICTs). With relatively low usage costs and the ability to overcome distances, ICTs have revolutionised the transmission of information around the globe. The provision of a modern and adequate infrastructure is deemed to facilitate the effective communication, distribution, assimilation and development of ideas and knowledge.

ICTs is an essential ingredient of knowledge-based dynamism. Recently there have been a few studies exploring the links between ICT and economic growth. Thus, Schreyer (2000) has argued that ICT producing sectors induce large gains in total factor productivity at the level of the economy, whereas Oliner and Sichel (2000) and Whelan (2000) provided evidence that ICT usage increases productivity and contributes to economic growth.

The final element of knowledge-driven economic dynamism, but by no means the least, is economic performance. The idea behind this is that existing economic

conditions affect to a great extent the ability of an economy to generate and exploit knowledge as a key engine of economic growth. Put differently, initial economic conditions determine the qualities and dynamics of a knowledge-based economy in a self-sustained way. On these grounds, a positive relation is envisaged: a weak economic basis is seen as a hindrance (and a robust economy as a supporter) to knowledge-driven economic dynamism.

The relation between past economic performance and current economic growth is well explored in the literature, and particularly in studies examining the issue of economic convergence/divergence (see for instance Kormendi and Meguire 1985; Baumol 1986; Grier and Tullock 1989; Barro 1991; Barro and Sala-i-Martin 1995; Fagerberg and Verspagen 1996; Sala-i-Martin 1996). This research has made clear that initial economic conditions do matter for economic dynamism.

Concluding this section it should be emphasised that all four constructive elements just examined are important for knowledge-driven economic dynamism and are necessary for sustained creation, adoption, adaptation and use of knowledge in domestic economic production, which will consequently result in higher value added goods and services. This would tend to increase the probability of economic success, and hence economic development, in the current highly competitive and globalised world economy.

## Existing Measures of the Knowledge-Based Economy

There are literally hundreds of indicators and composite indices that have been developed throughout the world to assess economic (or socioeconomic) conditions at supranational, national, or local levels<sup>1</sup> (Sharpe 2004). Those discussed in this section are composite indices which are either widely known and used, or related specifically to the knowledge economy.

The real GDP<sup>2</sup> per capita of an economy is the most widely used measure of economic performance. Accordingly, the rate of change in real GDP, commonly known as economic growth, is taken as a measure of economic change and, as such, constitutes a measure of economic dynamism. Although this approach has certain advantages, stemming from the fact that GDP is measured frequently, widely (worldwide coverage) and consistently, scholars have criticized its applicability as an indicator of economic health for a number of reasons (see Cobb et al. 1995; Hamilton 1998; Rowe and Silverstein 1999; Vaury 2003; Bergheim 2006). In the current context, GDP is deemed as a rather limited measure of knowledge-driven economic dynamism for two reasons. Firstly, it does not take into account positive

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<sup>1</sup>For surveys on this literature see Booyen (2002), Freudenberg (2003), Gadrey and Jany-Catrice (2003), Share (2004) and Saisana et al. (2005).

<sup>2</sup>Simply put, GDP is the total value of all products and services bought and sold. It consists of consumption expenditures made by households, domestic investment, government purchases, and net exports.

externalities that may arise from education or knowledge development. Secondly, since it only counts monetary transactions, it misses other knowledge building activities that take place outside of the market system (such as tacit knowledge).

Some economists (Cobb et al. 1995; Rowe and Silverstein 1999; Lawn 2003) have created an alternative to GDP called Genuine Progress Indicator (GPI), which attempts to resolve many of the problems addressed to the former. The GPI basically consists of two blocks of measures: one for the current economic state (assessed using indicators of consumer spending, government payments, non-market production and leisure) and the other for the sustainability of economic development (assessed using indicators of depletion of resources, environmental damage, etc). Although it represents a much broader indicator of economic health, it does not take into account the knowledge dimensions of the economy; let alone the "... numerous technical difficulties" it encounters (Vaury 2003: 3).

Indicators related particularly to the knowledge economy are limited. A set of two composite indicators attempting to capture the complex multidimensional nature of the knowledge-based economy come from the European Commission's Structural Indicators exercise (see Saisana et al. 2005). The first indicator addresses crucial dimensions of investment in the knowledge-based economy (using measures such as R&D expenditure, number of researchers, etc), whereas the second assesses countries' performance in the transition to the knowledge-based economy (though patents and scientific publications produced). Both indicators are extremely relevant to the current context but they cover only EU-15 countries.

A particular aspect of the knowledge-based economy is innovation. Three relevant composite indices are generally acknowledged in the literature. The first, developed by Porter and Stern (1999), is the Innovation Index which provides a quantitative benchmark of national innovative capacity for 17 OECD countries, using eight sub-indicators (including R&D expenditure and employment, expenditure on education, strength of protection of intellectual property, etc). The other is the Summary Innovation Index (SII) which is part of the European Innovation Scoreboard. SII utilises official EUROSTAT data to measure innovation capacity of the EU-25 countries. To do this it analyses 20 variables in four areas: human resources, knowledge creation, transmission and application of new knowledge and innovation finance, output and markets. The last index in this group is the Index of Innovation Performance (IIP), provided by Freudenberg (2003) to measure innovative performance in 26 countries. IIP utilises variables in three areas: generation of new knowledge (measured by R&D performance, GDP expenditure on research, PhD holdings, etc), industry/science linkages (measured by paper publications, patents, etc) and industrial innovation (measured by the number of researchers, number of firms introducing new knowledge, etc).

Another group of composite indicators places emphasis on countries' technological advancement. The Technological Achievement Index (TAI) is designed to capture the performance in creating and diffusing technology. The index uses data from eight indicators grouped in four dimensions: technology creation (as measured by the number of patents and license granted), diffusion of recent innovations (as measured by, *inter alia*, the number of Internet hosts), diffusion of old innovations

(as measured by telephones and electricity consumption) and human skills (as measured by mean years of schooling and the gross tertiary science enrolment ratio). Another composite indicator, the General Indicator of Science and Technology (GIST), is provided by the National Institute of Science and Technology Policy (1995) to grasp major trends in Japan's Science and Technology activities and to enable comprehensive international comparisons and time-series analysis. GIST consists of 13 variables, five of which are classified as "input" (e.g. R&D expenditure, science degrees conferred, etc) and eight as "output" (e.g. scientific papers, paper citations, patents, technology exports, etc).

## **Operationalising Knowledge-Based Economic Dynamism: The Economic Dynamism Indicator**

Having developed a framework for understanding knowledge-based economic dynamism, this section attempts to operationalise the concept providing an adequate measure. Before getting there, we briefly consider some methodological issues in the construction of composite indicators.

### ***Methodological Considerations Towards the Development of Composite Indicators***

Composite indicators are increasingly recognised as useful tools in analysis and public communication. This is because they are able to capture and describe complex concepts (e.g. sustainability, competitiveness, knowledge-based economy, etc.) with a simple measure that can be used to benchmark performance and to assist comparisons (both between places and across time). However, they may send misleading policy messages if they are poorly constructed or misinterpreted. The main advantages and disadvantages of using composite indicators are presented in Table 2.1.

As a result of all these merits and demerits composite indicators do stir controversy. Yet, over the last years we have seen a proliferation in their use in various policy domains. Reviewing the literature (see for instance Booyesen 2002; Freudenberg 2003) it becomes evident that there is no commonly accepted methodology on constructing composite indicators. This is due to "... the intrinsic 'vagueness' or ambiguity of composite indicators" (Saisana et al. 2005: 2). However, there have been some serious attempts to provide guidelines and directions towards the development of good quality composite indicators (see, for example Booyesen 2002; Saisana and Tarantola 2002; Freudenberg 2003; Saltelli et al. 2004; Saisana et al. 2005; Nardo et al. 2005). Succinctly, composite indexing involves five steps:

**Table 2.1** Pros and cons of composite indicators

Pros	Cons
1. Can summarise complex or multi-dimensional issues in view of supporting decision-makers	1. May send misleading policy messages if they are poorly constructed or misinterpreted
2. Easier to interpret than trying to find a trend in many separate indicators	2. May invite simplistic policy conclusions
3. Facilitate the task of ranking countries on complex issues in a benchmarking exercise	3. May be misused, e.g. to support a desired policy, if the construction process is not transparent and lacks sound statistical or conceptual principles
4. Can assess progress of countries over time on complex issues	4. The selection of indicators and weights could be the target of political challenge
5. Reduce the size of a set of indicators or include more information within the existing size limit	5. May disguise serious failings in some dimensions and increase the difficulty of identifying proper remedial action
6. Place issues of country performance and progress at the centre of the policy arena	6. May lead to inappropriate policies if dimensions of performance that are difficult to measure are ignored
7. Facilitate communication with general public (i.e. citizens, media, etc.) and promote accountability	

*Source:* Saisana and Tarantola (2002)

1. Developing a theoretical framework.
2. Identifying and selecting the relevant variables.
3. Standardising variables to allow aggregation.
4. Weighting variables and aggregation.
5. Validating the composite indicator.

It is important to note that this process should not necessarily be seen as a sequential one and in many occasions these steps are taken concurrently (Booysen 2002).

### **Theoretical Framework**

Since a composite indicator is in essence a summary of a phenomenon, the starting point for indexing should be the adoption of a theoretical framework that enables understanding of the phenomenon under study. Ideally, this framework should provide a clear definition of what it is that is being measured and indicate what kind of individual measures should be sought and weighted in a manner that reflects the dimensions of the concept under study.

### **Variables Selection**

A composite indicator is the sum of its parts. As such, its quality depends largely on the quality of its constituent variables. Ideally, variables should be selected on the



basis of their analytical soundness, measurability and relevance to the phenomenon under indexation, and not exclusively on the availability of data series. In practise, however, the lack of required data is the norm. Statistics may not be available either because a certain phenomenon cannot be measured or just because nobody has attempted to measure it. Proxy measures can be used in this case; a solution which should be adopted even when problems of cross-country comparability arise (Nardo et al. 2005).

Because there is no single definitive set of indicators for any given purpose, the choice of which variables should be selected in the indicator remains an inherently subjective exercise. Different variables can be selected to monitor progress in the same performance or policy area. Selection, however, requires a balance between simplification and complication which arises as a result of the tendency to keep on adding variables and components (Booyesen 2002). Although capturing the full essence of the phenomenon under measure is significant, simplicity should be not undervalued. Finally, to have an objective comparison across countries of different size, scaling variables by an appropriate size measure (e.g. population, income, land area, etc.) is required.

## Standardisation

Since all variables are not measured in the same units or scales, they need to be converted into common units to avoid problems of mixing different measurement units (avoid adding “apples” with “oranges”). This is known as standardisation or normalisation process. There are many techniques that can be used in this respect. Commonly used methods include<sup>3</sup>:

1. Standard deviation from the mean, which imposes a standard normal distribution (i.e. a mean of zero and a standard deviation of one). Thus, positive (negative) values for a given country indicate above (below)-average performance.
2. Distance from the group leader, which assigns 100 to the leading country and other countries are ranked as percentage points away from the leader.
3. Distance from the mean, where the mean value is given 100, and countries receive scores depending on their distance from the mean.
4. Distance from the best and worst performers, where positioning is in relation to the sample’s maximum and minimum and the index takes values between zero (laggard) and a hundred (leader).
5. Categorical scale, where each variable is assigned a score (either numerical or qualitative in ordinal scale) depending on whether its value is above or below a given threshold.

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<sup>3</sup>Details of each method can be found in Booyesen (2002), Freudenberg (2003), Saisana et al. (2005) and Nardo et al. (2005).

Each method has its advantages and disadvantages. Different methods will produce different results. The selection, therefore, of the appropriate method is not trivial and requires special attention. It should take into account the properties of the data and the objectives of the composite indicator. Booyesen (2002) argues that the most important criterion in selecting a scaling technique is to achieve a balance between the width of the range and the spread of index scores.

## **Weighting**

Variables that are used for the construction of a composite indicator have to be weighted to reflect the significance, reliability or other characteristics of the underlying data. The weights that are given to different variables may substantially alter the outcomes of the composite indicator. For this reason, weights ideally should reflect the underlying theoretical framework adopted. However, it is sometimes quite difficult to provide weights based on theoretical grounds. As such, the most common practice is to give equal weights to all variables used, largely for reasons of simplicity. This implies, however, that all indicators in the composite have equal importance, which may not be the case.

Another way to identify appropriate weights is through empirical analysis, particularly using methods based on correlations among the variables used (e.g. regression analysis, principal components analysis, factor analysis etc.; for details see Saisana et al. 2005). However, it is not certain that the correlations will correspond to the real-world links between the phenomena being measured (Freudenberg 2003). Alternatively, weights can be established in co-operation with various stakeholders (e.g. experts, policy makers, etc.) on the condition that they understand the strengths, weaknesses and particularities of the data within a given theoretical framework. Yet, another approach is to attach weights in accordance with the quality and availability of data; an attempt that partially corrects for data problems.

Since different weighting techniques can produce quite different results, no weighting approach is above criticism. It is for this reason that Babbie (1995) argues that equal weighting should be the norm. Booyesen (2002) seems to embrace such a view on the basis of simplicity in terms of composite construction and interpretation.

## **Validation**

As discussed, several judgements are made with regard to selecting, weighting, standardising and aggregating variables into a composite indicator. Outcomes may depend largely on the approach selected. For this reason, sensitivity tests should be conducted to analyse the impact of including or excluding various variables, changing weights, using different standardisation techniques, etc., on the results of the composite indicator. A combination of uncertainty and sensitivity analyses

can be used to assess the robustness of the composite indicator and to improve quality. Uncertainty analysis examines how uncertainty in the input factors propagates through the structure of the composite indicator and affects its values, whereas sensitivity analysis evaluates the contribution of the individual source of uncertainty to the output variance.

Composite indicators usually measure phenomena that are linked to well-known and measurable concepts (e.g. economic growth). These links can be used to test the explanatory power of a composite. Simple cross-plots provide a good means to illustrate such links. Correlation analysis is equally useful for validation, where high correlation indicates a composite indicator of high quality.

### *The Economic Dynamism Indicator*

Having examined some key methodological issues in the construction of composite indicators, the chapter now turns to formulate such an indicator that measures knowledge-driven economic dynamism, called the Economic Dynamism Indicator (EDI).

As discussed, the first step in the construction of any indicator is to specify an appropriate theoretical framework which clearly defines the phenomenon to be measured and outlines its dimensions. This framework has been elaborated in section “The Emerging Knowledge: Economy Paradigm”. On the bases of this, knowledge-driven economic dynamism has been defined as the potential an area has for generating and maintaining high rates of economic performance due to its knowledge capacity. Four fundamental dimensions of the concept have been identified: human capital, innovation ability, information access and economic performance. These four dimensions constitute the four components of the EDI.

The next step is to select appropriate variables that reflect the four components just described. The goal of the EDI is to provide a current assessment of economic dynamism for all countries in the world. In order to ensure data consistency, we decided to obtain data from one, but reliable, source, that is the World Bank. On these grounds the variables that have been selected to reflect EDI’s components are:

#### *Human capital*

- EDU: Gross enrollment ratio in tertiary education
- LIT: Literacy rate as a percentage of adult population

#### *Innovation ability*

- RD: R&D expenditure as a percentage of GDP
- RE: Researchers in R&D per million inhabitants
- PT: Patents per million inhabitants

#### *Information access*

- W: Internet users per thousand inhabitants

### *Economic performance*

- Y: Real GDP per capita in PPP (constant at 2000, measured in international dollars)
- g: Real GDP per capita annual growth in PPP (constant at 2000, measured in international dollars)

These variables were selected because internationally comparable data were available for a large number of countries. However, there were quite a lot of missing values. In order to improve the geographical coverage and reliability of data, instead of the value of the last year, we used the average of the last 4 years available for each country. This also has a “smoothing” effect on the data (since it reduced the influence of extreme values) improving their quality and reliability. Table 2.2 indicates the sizes of samples finally achieved.

The variables selected for the EDI are expressed in various units (e.g. RD is a percentage of GDP, PT is the number of patents per million people). The “minimum–maximum” method is used here to normalize or standardize the variables. This method transforms actual values into a number ranged between zero (laggard with minimum value) and one (leader with maximum value). For a given country, the index expresses their distance from the overall best and the worst performing countries:

$$SV = \frac{x_i - x_{\min}}{x_{\max} - x_{\min}}, \quad (2.1)$$

where SV is the standardised value,  $x_i$  is the actual value,  $x_{\max}$  is the maximum value and  $x_{\min}$  is the minimum value.

The normalisation method does not affect the country rankings for individual indicators (since any normalisation method is just a simple transformation of the initial values). In contrast, it can affect the overall findings of a composite indicator, since individual indicators are not only normalised, but also aggregated into a composite.

Whereas the influence of the standardisation method on the results of composite indicators seems limited, the weights attached to individual indicators in contrast strongly influence the overall index. The weighting used in this study reflects the

**Table 2.2** Indicators used and sample size

Variables ( $x_i$ )	No of countries with available data	Years of available data
EDU	104	1991, 2000–2004
LIT	104	1990, 1995, 1999
RD	101	1996–2004
RE	87	1996–2004
PT	116	1990–2004
W	197	1995–2004
Y	171	1990–2004
g	171	1990–2004

idea that knowledge-driven economic dynamism is a result of economic and knowledge characteristics. Or to put it differently it is the compound effect of the “pure economic” dynamism and the dynamism stemming from the knowledge elements of the economy. However, there is an important asymmetry here: knowledge economy is a relatively recent phenomenon whereas conventional economic dynamics have shaped a country’s development path for a much longer time. On these grounds we assert that knowledge-driven economic dynamism should primarily reflect current economic performance which has to be adjusted for the knowledge characteristics of the economy. These four knowledge dimensions of dynamism are given equal weight.

On the basis of the above, the formula for calculating the EDI is as follows:

$$EDI = EP \left( 1 + SV \sum_{i=1}^n SVx_i \right) \quad (2.2)$$

where  $x_i$  is the actual value of the sub-indicator  $i$ ,  $SV$  is its standardised value and  $EP$  is a measure of economic performance.

Before we move to reveal the different forms of the EDI, it is necessary to make an important note here. As may have been noted, economic performance refers to the whole first part of the product in the equation presented above ( $EP$ ), and also constitutes an element of its second part ( $x_i$ ). This is because two different aspects of the economy are taken into account: one concerns the economic conditions which are currently exhibited in a country and the other reflects to the consequent effects of past economic dynamism or economic growth (i.e. the momentum of the past performance). Accordingly, two forms of the EDI can be envisaged, one [described by the (2.3)] which places higher value on the growth dynamics of the economy (i.e.  $g$  is the first part of the product of the equation), and the other [(described by (2.4)] which gives emphasis on the current economic performance.

$$EDI_a = g \left( 1 + SV \sum_{i=1}^n SV(Y, x_i) \right), \quad (2.3)$$

$$EDI_b = Y \left( 1 + SV \sum_{i=1}^n SV(g, x_i) \right). \quad (2.4)$$

The combination of different variables gives eleven EDI’s for each one of the two EDI forms. Table 2.3 below presents the descriptive statistics. As can be seen, correlations between the EDIs and conventional measures of economic dynamism ( $Y$ ,  $g$ ) are quite high; an indication of the high quality of the EDIs produced. However, the quality of the indicators, in terms of the number of countries where data are available, reduces with the number of variables added. Thus, the EDIs

**Table 2.3** Descriptive statistics of the developed EDIs

DI's form	EDI	$x_i$	N	Max	Min	Variance	Standard deviation	Mean	CV (%)	Correlation with Y	Correlation with g
g(1 + SVΣSVx)	Y	g	171	59,880.27	568.25	99,092,573.7	9,954.52	9,469.33	105.12		
	A1	Y,RD,RE,PT,EDU,W,LIT	171	1,476	0.030	0.012	0.111	0.102	109.12		
	A2	Y,RD,RE,PT	40	0.2663	0.0627	0.0015	0.0389	0.1302	29.89		0.56
	A3	Y,RD,PT	70	0.2778	0.0593	0.0017	0.0410	0.1246	32.90		0.61
	A4	Y,RD	91	0.2806	0.0310	0.0016	0.0403	0.1163	34.63		0.60
	A5	Y,EDU,W,LIT	99	0.2985	0.0307	0.0020	0.0448	0.1237	36.18		0.68
	A6	Y,EDU,W	82	0.2626	0.0398	0.0015	0.0391	0.1240	31.51		0.56
	A7	Y,RD,RE,PT,EDU,W	120	0.2806	0.0366	0.0020	0.0452	0.1219	37.05		0.64
	A8	Y,RD,PT,EDU,W,LIT	61	0.2784	0.0589	0.0018	0.0422	0.1334	31.62		0.55
	A9	Y,RD,PT,EDU,W	54	0.2672	0.0482	0.0015	0.0391	0.1266	30.86		0.53
	A10	Y,RD,EDU,W,LIT	80	0.2800	0.0342	0.0019	0.0433	0.1261	34.30		0.59
Y(1 + SVΣSVx)	A11	Y,RD,EDU,W	55	0.2673	0.0483	0.0015	0.0389	0.1268	30.65		0.53
	B1	g,RD,RE,PT,EDU,W,LIT	83	0.2839	0.0344	0.0019	0.0431	0.1278	33.73		0.61
	B2	g,RD,RE,PT	40	61,777.84	847.66	328,152,237.83	18,114.97	19,775.39	91.60	0.99	
	B3	g,RD,PT	71	85,281.49	793.77	321,925,697.16	17,942.29	20,088.37	89.32	0.98	
	B4	g,RD	89	76,445.78	797.82	252,036,544.53	15,875.66	16,395.49	96.83	0.98	
	B5	g,EDU,W,LIT	97	84,712.56	803.62	282,796,113.96	16,816.54	16,816.06	100.0	0.98	
	B6	g,EDU,W	82	66,163.37	621.95	258,232,326.99	16,069.61	13,155.13	122.15	0.99	
	B7	g,RD,RE,PT,EDU,W	120	64,892.07	569.04	277,461,421.35	16,657.17	14,303.26	116.46	0.99	
	B8	g,RD,PT,EDU,W,LIT	61	63,909.55	789.67	337,174,796.03	18,362.32	22,127.87	82.98	0.98	
	B9	g,RD,PT,EDU,W	54	61,288.52	867.15	285,882,491.61	16,908.06	16,178.26	104.51	0.99	
	B10	g,RD,EDU,W,LIT	79	62,458.00	789.67	302,702,571.63	17,398.35	18,448.63	94.31	0.99	
B11	g,RD,EDU,W	55	61,249.24	870.53	284,381,197.84	16,863.61	15,948.36	105.74	0.99		
			82	64,311.94	789.67	317,832,111.58	17,827.85	18,603.47	95.83	0.99	

which combine all the variables that the theory has addressed (i.e. A1 and B1) maintain only 40 observations; which means that only 40 countries (out of the 218 in the world) avail of data on all the variables employed. These indicators, though valuable, give a rather partial picture at the world scale. However, the situation improves significantly when specific EDI's are considered. For instance, indicator A6, which highlights the element of human capital, retains a quite high number of observations (120). So does indicator A3, which stresses the innovation aspect of EDI and provides observations for 91 countries. Instead of examining all EDI's one by one, the rest of the section focuses on these two indicators (which highlight different but complementary sides of EDI) to shed further light on the qualities of the key indicator developed.

Figure 2.1 below presents the boxplots of the selected EDIs which are seen in comparison to the concept with which they are linked, i.e. the GDP growth (g). As can be seen the new indicators exhibit a greater dispersion compared to growth, and on these grounds we can argue that the former are able to magnify and highlight the differences between countries in terms of growth.

The same is also evident when we plot the selected EDIs against growth (see Fig. 2.2). What becomes clear is that the higher the economic growth exhibited the greater the dispersion of the EDI, indicating the ability of the developed indicator to provide a more accurate assessment of the phenomenon under study.

Having assessed (a least to a degree) the quality and validity of the new indicator the figures that follow portray the countries in accordance to the EDI score that they get. In particular, Figure 2.3 ranks the countries in terms of their economic growth

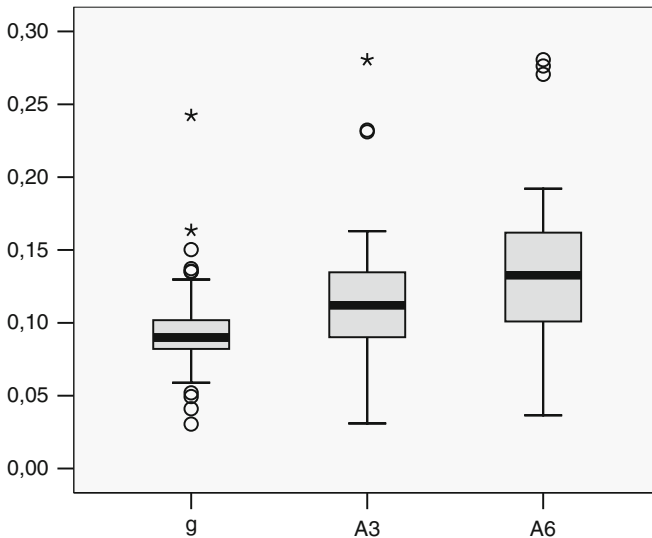
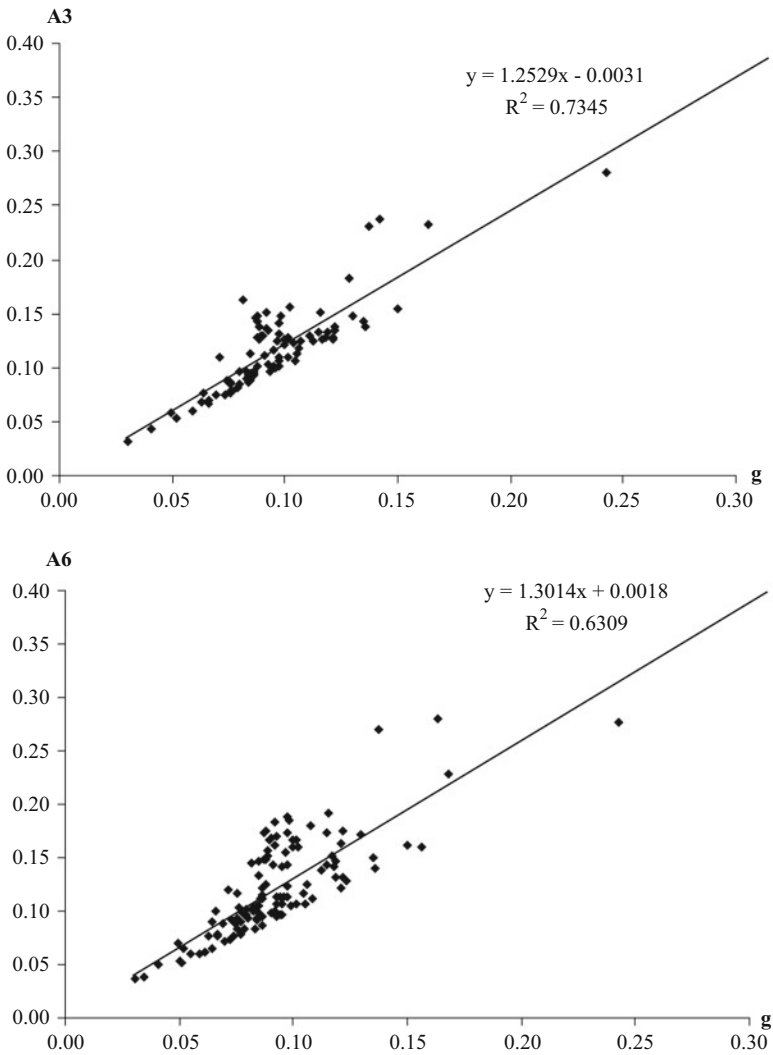


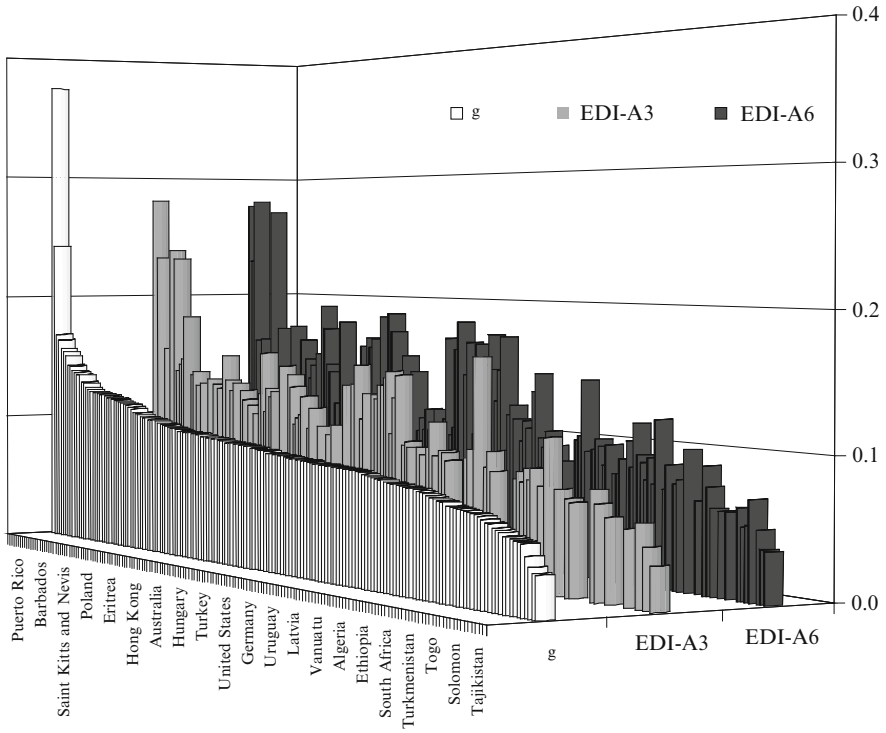
Fig. 2.1 Boxplots of selected EDIs



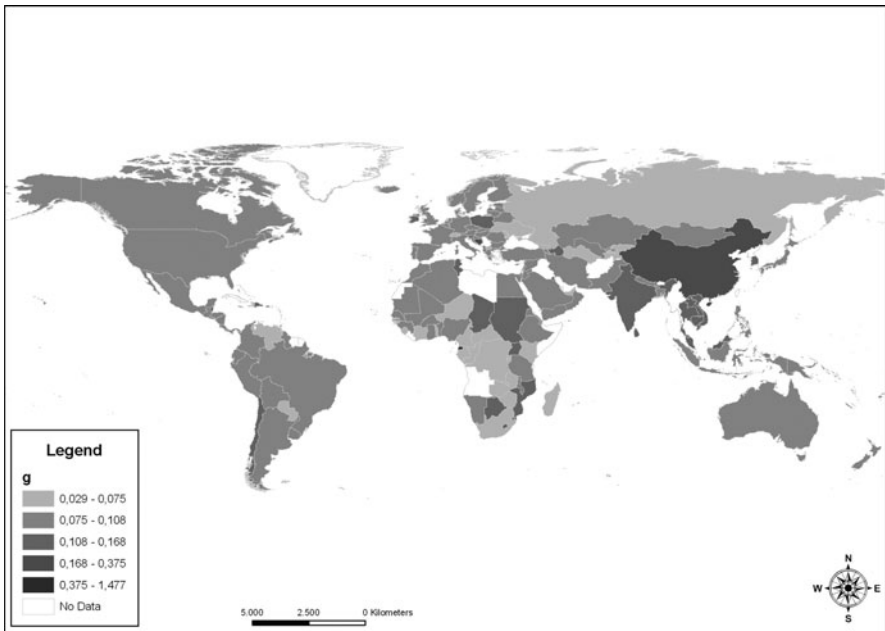
**Fig. 2.2** Plotting selected EDIs against economic growth

and the respective EDI score they maintain, whereas Figs. 2.4–2.6 map the world in terms of the exhibited growth and the scores countries acquire for the selected EDIs. Finally, Table 2.4 presents the top-ten and bottom-ten countries for growth and EDI A3 and A6 respectively. A complete rank of all countries in terms of both EDI scores is provided in the Appendix.

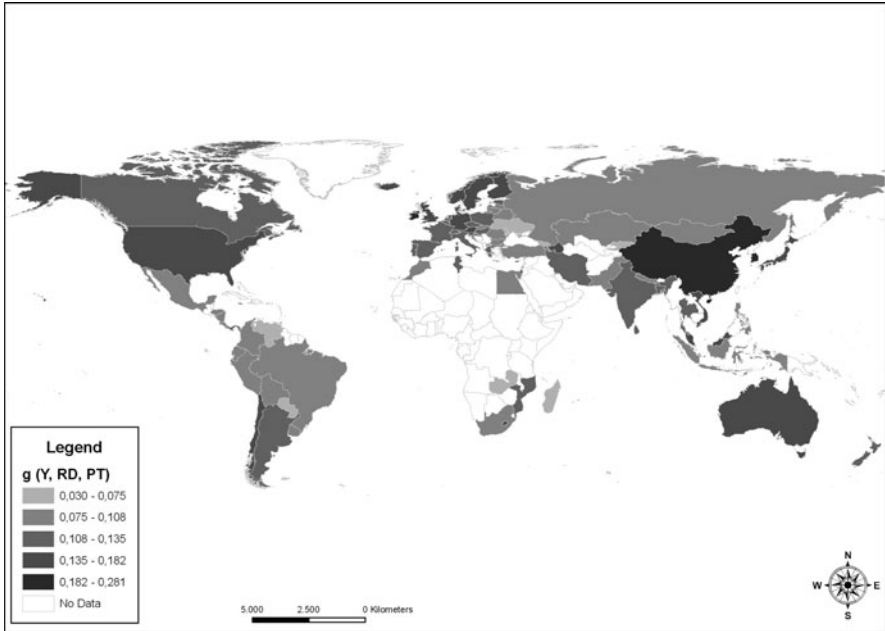




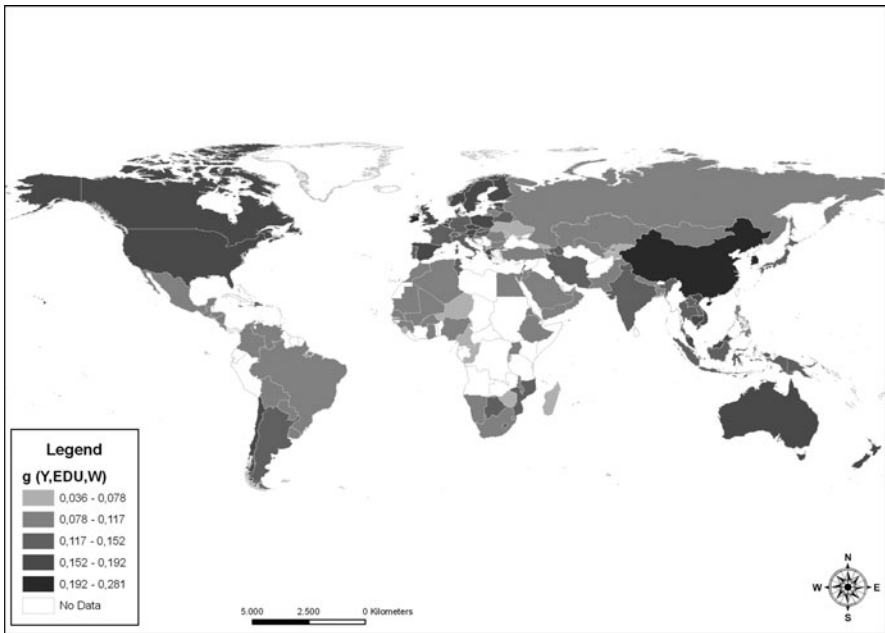
**Fig. 2.3** Ranking of countries in terms of economic growth (g) and selected EDIs (A3, A6)



**Fig. 2.4** Economic growth in the world



**Fig. 2.5** Knowledge-driven economic dynamism in the world: the aspect of innovation (EDI-A3)



**Fig. 2.6** Knowledge-driven economic dynamism in the world: the aspect of human capital (EDI-A6)

**Table 2.4** Top-ten and bottom-ten countries

	Rank	Country	g	Country	EDI-A3	Country	EDI-A6
Top 10	1	Equat. Guinea	1.48	China	0.28	Ireland	0.28
	2	Bosnia	0.37	Luxembourg	0.24	China	0.28
	3	China	0.24	Ireland	0.23	Korea Rep.	0.27
	4	Lebanon	0.17	Korea Rep.	0.23	Lebanon	0.23
	5	Ireland	0.16	Singapore	0.18	Slovenia	0.19
	6	Cambodia	0.16	Japan	0.16	Australia	0.19
	7	Bermuda	0.15	Denmark	0.16	Norway	0.19
	8	Viet Nam	0.15	Viet Nam	0.15	USA	0.18
	9	Puerto Rico	0.14	Slovenia	0.15	Estonia	0.18
	10	Luxembourg	0.14	USA	0.15	Malaysia	0.17
Bottom 10	10	Guinea-Bissau	0.05	Jamaica	0.08	Angola	0.07
	9	Kyrgyzstan	0.05	Venezuela	0.07	Kyrgyzstan	0.06
	8	Burundi	0.05	Paraguay	0.07	Niger	0.06
	7	Zimbabwe	0.05	FYROM	0.07	Madagascar	0.06
	6	Ukraine	0.05	Zambia	0.07	Sierra Leone	0.06
	5	Haiti	0.05	Madagascar	0.06	Zimbabwe	0.05
	4	Georgia	0.04	Ukraine	0.06	Burundi	0.05
	3	Tajikistan	0.03	Kyrgyzstan	0.05	Georgia	0.05
	2	Moldova	0.03	Georgia	0.04	Tajikistan	0.04
	1	Congo Dem. Rep.	0.03	Moldova	0.03	Moldova	0.04

## Conclusions

The knowledge-based economy has become an important concept of modern economic thought. The pervasive features of knowledge are now evident everywhere in the economy, in terms of new jobs, new products, new industries and new trading links created. Over the last 20 years or so, researchers have systematically theorised, empirically explored and developed further the idea of the knowledge-based economy, marking the advent of a new intellectual shift that places knowledge at the centre of economic analysis. On these grounds knowledge has been seen as a major source of economic growth and development. However, little progress has been done so far in measuring and assessing the knowledge-based economy and the degree of economic dynamism that it brings forward (Harris 2001).

The current paper has worked on this front. It has presented a framework of knowledge-driven economic dynamism and, building upon this, it has constructed a set of indicators (EDIs) which are able to assess the quality of an economy's knowledge-based dynamism. Although further research is required along this front there are indications that EDIs can provide a robust basis for measuring economic dynamism of this sort. Policy makers and assessors should be informed by these type of measures and make use of them if they wish to have a more precise and accurate picture of the knowledge-based dynamism (or lack of it) that economies exhibit.

## Appendix

### Ranking of countries by economic growth and EDIs A3 and A6

Rank by g	g	Rank by EDI-A3	EDI-A3	Rank by EDI-A6	EDI-A6
Equatorial Guinea	1.48	China	0.28	Ireland	0.28
Bosnia	0.37	Luxembourg	0.24	China	0.28
China	0.24	Ireland	0.23	Korea Rep	0.27
Lebanon	0.17	Korea Rep	0.23	Lebanon	0.23
Ireland	0.16	Singapore	0.18	Slovenia	0.19
Cambodia	0.16	Japan	0.16	Australia	0.19
Bermuda	0.15	Denmark	0.16	Norway	0.19
Viet Nam	0.15	Viet Nam	0.15	United States	0.18
Puerto Rico	0.14	Slovenia	0.15	Estonia	0.18
Luxembourg	0.14	United States	0.15	Malaysia	0.17
Samoa (American)	0.14	Israel	0.15	Finland	0.17
Korea Rep	0.14	Chile	0.15	New Zealand	0.17
Lesotho	0.14	Norway	0.15	Sweden	0.17
Azerbaijan	0.14	Sweden	0.15	Poland	0.17
Chile	0.13	Finland	0.14	Chile	0.17
Singapore	0.13	Azerbaijan	0.14	United Kingdom	0.17
Barbados	0.13	Australia	0.14	Netherlands	0.17
Laos	0.12	Iceland	0.14	Hong Kong	0.17
India	0.12	Germany	0.14	Czech Republic	0.17
Malaysia	0.12	Malaysia	0.14	Canada	0.17
Sri Lanka	0.12	Lesotho	0.14	Kuwait	0.16
Chad	0.12	Austria	0.14	Austria	0.16
Mozambique	0.12	United Kingdom	0.14	Viet Nam	0.16
Kuwait	0.12	India	0.13	Cambodia	0.16
Saint Kitts and Nevis	0.12	Mauritius	0.13	Greece	0.16
Mauritius	0.12	Poland	0.13	Denmark	0.16
Bostwana	0.12	New Zealand	0.13	Belgium	0.16
Trinidad and Tobago	0.12	Malta	0.13	Spain	0.15
Belize	0.12	Netherlands	0.13	Thailand	0.15
Thailand	0.12	Canada	0.13	Germany	0.15
Sudan	0.12	France	0.13	Azerbaijan	0.15
Slovenia	0.12	Trinidad and Tobago	0.13	Israel	0.15
Poland	0.11	Mozambique	0.13	France	0.15
Dominican Republic	0.11	Hong Kong	0.13	Italy	0.15
Tunisia	0.11	Belgium	0.13	Mauritius	0.15
Malta	0.11	Sri Lanka	0.13	Japan	0.14
Uganda	0.11	Czech Republic	0.13	Dominican Republic	0.14
Cape Verde	0.11	Thailand	0.13	Argentina	0.14
Estonia	0.11	Estonia	0.13	Portugal	0.14
Iran	0.11	Spain	0.12	Hungary	0.14
Eritrea	0.11	Tunisia	0.12	Trinidad and Tobago	0.14
Panama	0.11	Cyprus	0.12	Lesotho	0.14
French Polynesia	0.10	Greece	0.12	Tunisia	0.14
Indonesia	0.10	Iran	0.12	Latvia	0.13
Albania	0.10	Hungary	0.12	India	0.13
Cyprus	0.10	Panama	0.11	Bostwana	0.13

(continued)

Rank by g	g	Rank by EDI-A3	EDI-A3	Rank by EDI-A6	EDI-A6
Denmark	0.10	Italy	0.11	Laos	0.13
Bangladesh	0.10	Portugal	0.11	Iran	0.13
Hong Kong	0.10	Argentina	0.11	Slovakia	0.12
Greece	0.10	Switzerland	0.11	Papua New Guinea	0.12
Czech Republic	0.10	Bangladesh	0.11	Mozambique	0.12
Macao (China)	0.10	Costa Rica	0.11	Belarus	0.12
Yemen	0.10	Indonesia	0.11	Switzerland	0.12
Norway	0.10	Turkey	0.10	Indonesia	0.12
Tonga	0.10	Slovakia	0.10	Lithuania	0.12
Papua New Guinea	0.10	Nepal	0.10	Albania	0.12
Australia	0.10	Peru	0.10	Uruguay	0.11
New Zealand	0.10	Egypt	0.10	Egypt	0.11
Peru	0.10	Belarus	0.10	Turkey	0.11
Costa Rica	0.10	Pakistan	0.10	Oman	0.11
Argentina	0.10	Croatia	0.10	Costa Rica	0.11
Spain	0.10	Brazil	0.10	Uganda	0.11
Fiji	0.10	Latvia	0.09	Kazakhstan	0.11
Egypt	0.10	Uruguay	0.09	Romania	0.11
Hungary	0.10	Romania	0.09	El Salvador	0.11
Grenada	0.10	Mexico	0.09	Nepal	0.11
Mali	0.10	Kazakhstan	0.09	Eritrea	0.11
Nepal	0.09	Morocco	0.09	Bangladesh	0.11
Ghana	0.09	Antigua and Barbuda	0.09	Bolivia	0.11
Oman	0.09	Armenia	0.09	Mexico	0.10
Pakistan	0.09	Bolivia	0.09	Yemen	0.10
Syria	0.09	South Africa	0.09	Jordan	0.10
Turkey	0.09	Lithuania	0.09	Bulgaria	0.10
Bahrain	0.09	Nicaragua	0.09	Croatia	0.10
New Caledonia	0.09	Colombia	0.08	Uzbekistan	0.10
El Salvador	0.09	Bulgaria	0.08	United Arab Emirates	0.10
United Kingdom	0.09	Philippines	0.08	Brazil	0.10
Mauritania	0.09	Mongolia	0.08	Armenia	0.10
Uzbekistan	0.09	Ecuador	0.08	Saudi Arabia	0.10
Austria	0.09	Russia	0.08	Namibia	0.10
United States	0.09	Honduras	0.08	Pakistan	0.10
St. Vincent and Grenadines	0.09	Jamaica	0.08	Ghana	0.10
Portugal	0.09	Venezuela	0.07	Philippines	0.10
Netherlands	0.09	Paraguay	0.07	Mali	0.10
Djibouti	0.09	FYROM	0.07	Nigeria	0.10
Namibia	0.09	Zambia	0.07	Mauritania	0.09
Canada	0.09	Madagascar	0.06	Colombia	0.09
Belgium	0.09	Ukraine	0.06	Nicaragua	0.09
Germany	0.09	Kyrgyzstan	0.05	Mongolia	0.09
Iceland	0.09	Georgia	0.04	Guatemala	0.09
Finland	0.09	Moldova	0.03	Algeria	0.09
Israel	0.09			Jamaica	0.09
Slovakia	0.09			Morocco	0.09
France	0.09			Russia	0.09

*(continued)*

Rank by g	g	Rank by EDI-A3	EDI-A3	Rank by EDI-A6	EDI-A6
Sweden	0.09			Swaziland	0.09
Burkina Faso	0.09			Venezuela	0.09
Uruguay	0.09			South Africa	0.09
Belarus	0.09			Burkina Faso	0.09
Kazakhstan	0.09			Honduras	0.08
Seychelles	0.09			Malawi	0.08
Nigeria	0.09			Senegal	0.08
Romania	0.09			Paraguay	0.08
Bolivia	0.08			Guinea	0.08
Guyana French	0.08			Ethiopia	0.08
Latvia	0.08			Cameroon	0.08
Italy	0.08			FYROM	0.08
Armenia	0.08			Congo. Republic of	0.08
Guatemala	0.08			Rwanda	0.07
Mexico	0.08			Gambia	0.07
Morocco	0.08			Ukraine	0.07
Nicaragua	0.08			Angola	0.07
Benin	0.08			Kyrgyzstan	0.06
Vanuatu	0.08			Niger	0.06
Malawi	0.08			Madagascar	0.06
Dominica	0.08			Sierra Leone	0.06
Tanzania	0.08			Zimbabwe	0.05
Antigua and Barbuda	0.08			Burundi	0.05
Brazil	0.08			Georgia	0.05
Jordan	0.08			Tajikistan	0.04
Japan	0.08			Moldova	0.04
Algeria	0.08				
Bahamas	0.08				
Colombia	0.08				
Croatia	0.08				
Philippines	0.08				
Senegal	0.08				
Saudi Arabia	0.08				
Saint Lucia	0.08				
Ethiopia	0.08				
Guinea	0.08				
Swaziland	0.08				
Ecuador	0.08				
Bulgaria	0.08				
Honduras	0.08				
Lithuania	0.08				
Mongolia	0.08				
South Africa	0.07				
Cameroon	0.07				
Jamaica	0.07				
Rwanda	0.07				
Switzerland	0.07				
Gabon	0.07				
Gambia	0.07				
Venezuela	0.07				
Turkmenistan	0.07				

*(continued)*

Rank by g	g	Rank by EDI-A3	EDI-A3	Rank by EDI-A6	EDI-A6
Congo, Republic of	0.07				
Paraguay	0.07				
Zambia	0.07				
United Arab Emirates	0.07				
Kenya	0.07				
Comoros	0.07				
Angola	0.06				
Togo	0.06				
Russia	0.06				
FYROM	0.06				
Niger	0.06				
Central African Republic	0.06				
Madagascar	0.06				
Cote d Ivoire	0.06				
Sierra Leone	0.06				
Solomon	0.05				
Guinea-Bissau	0.05				
Kyrgyzstan	0.05				
Burundi	0.05				
Zimbabwe	0.05				
Ukraine	0.05				
Haiti	0.05				
Georgia	0.04				
Tajikistan	0.03				
Moldova	0.03				
Congo Dem Rep	0.03				

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<http://www.springer.com/978-3-642-14964-1>

Innovation, Growth and Competitiveness  
Dynamic Regions in the Knowledge-Based World  
Economy

Nijkamp, P.; Siedschlag, I. (Eds.)

2011, XII, 380 p., Hardcover

ISBN: 978-3-642-14964-1