INTERNATIONAL ECONOMICS

CHAPTER 1. TRANSNATIONAL COMPANIES

1.1. The concept of transnational companies

The three actors in foreign direct investments are transnational private enterprises, national or international public investors, and commercial and financial banks.

1.1.1. The definition of a transnational company

Transnational companies are recognized as representatives of one of the fundamental components of international economics. This denomination is controversial, with a number of possible terminological combinations: international firm, multinational enterprise, multinational group, transnational company, global corporation.

The terminology has nevertheless become fixed around terms such as multinational or transnational company or corporation. While the majority of specialists and dictionaries of economics have resorted to "multinational companies", the organizations in the UNO system use "transnational companies".

The former term rather highlights the quantitative side of the phenomenon: the number of countries one and the same company invests its capital in. Yet, it is an ambiguous term, as it may induce the idea that a company may belong to several nations at the same time.

The latter term more precisely conveys the features of the phenomenon under debate. On the one hand, it presupposes the former term. On the other hand, it more clearly expresses the idea that a company, once it reaches the expansion stage, represents an extraterritorial extension of its native nation. Finally, under the circumstances of a globalizing economy, the idea of going beyond national borders, of the emergence of the global enterprise, is better conveyed by the term "transnational".

Several criteria for defining the transnational company (TNC) have been suggested. A number of authors, among whom the Italian N. Raineli, shows that "A transnational company is an enterprise that commands production units localized in several countries, irrespective of their size". Other authors add a number of restrictive conditions, such as: the enterprise has to be large in size (Vernon considers that the number of countries has to be at least 6, with a turnover in excess of USD 100 million.) Various theoreticians exclude the production criterion, as they consider that "any large company with subsidiaries in several countries is a multinational company".

W. Andreff defines the transnational company as "any company whose capital is invested in the international accumulation process in a productive activity, itself international. It is the way in which a part of the international capital is organized". This rather vague definition relates this notion to the structure of global capitalism, forcing us to consider the TNC production, distribution, supply, financing and know-how at an international level.

The Dictionary of Modern Economy defines the TNC as such: "A large enterprise having a home base in one country but operating wholly or partially-owned subsidiaries in other countries. Such corporations expand on an international scale to take advantage of the vertical and horizontal economies of scale."

Romanian specialists define the TNC as "a company that has extended its economic-financial activity beyond the borders of its home country. It makes up a vast ensemble at an international level, and comprises a main company – the parent company - and a number of subsidiaries, that is companies dependant on the main company, that are implanted in various countries".

As a general rule, in the literature, a transnational company is considered to consist of

four main elements:

a) The scale of its activity

Vernon believes that the dimensional factor is the one to be considered first. Thus, there exists a significant correlation between the transnationality of a company and its size measured in terms of its turnover, the number of employees or its financial assets. According to this criterion, only those companies that have a turnover in excess of USD 100 (or 200 or 300) million can be considered transnational.

Savary also highlights the positive connection between the size of the enterprise, the export index, the frequency of implanting subsidiaries abroad and the intensity of the transnationalization. Nevertheless, the scale criterion does not have an absolute value since it is in interdependency with the other criteria.

b) The existence of subsidiaries in several countries

This is the first criterion that is met. Rolfe, for example, considers that an enterprise has an international calling when at least 25% of its assets are in joint ventures. The existence of a network of subsidiaries under the direct control of the parent company represents a criterion that is difficult to object to, but the difficulty continues with respect to choosing an exact indicator. For example, Bonin suggests two elements: a minimum of six implanted countries and subsidiaries in quantum of 20% of the total assets.

c) The unity of the decision-making centre

The third criterion refers to the definition given by Bye to “the great international unity”: a group of productive units located in several regions, but under the control of a single decision-making centre. As such, the company has a transnational policy, but always resorts to common management and a single strategy. This management and this strategy are conceived and steered by an entity with a national basis that ensures the centralization of the most important functions (strategy and control). The idea of integrating and coordinating international operations through a single decision-making centre is found throughout all definitions. Nevertheless, the identity of the national basis at times raises several issues. Certain companies have an almost entirely internationalized character and kind of management, so that it is difficult to assign a nationality of origin.

d) The global strategic perspective

Bertin insists on the conception, organization and management of the company on a global scale. This global competency is an important distinctive characteristic. While the company succeeds in softening the losses caused by national methods of allocating resources, it becomes transnational. Within the same context, Michalet defined the transnational company as “an enterprise that makes, in one way or another, and according to its specialty, direct investments in several countries, and conceives present or future operations at the level of the current management or on a long term strategy from an international perspective”.

It can be noted that universal criteria for transnational companies do not exist, while using one or another of the presented criteria may result in a different number of companies to be taken under consideration. For example, if we stick to the criterion about the existence of subsidiaries in several countries, there are thousands of transnational companies, while if we adopt the criterion about the existence of a global strategy, they are less than a hundred. Nevertheless, with respect to their subsidiaries, opinions converge in that there are two main types of subsidiaries:

- relay subsidiaries, which produce and sell, on local markets, the goods belonging to the range of products already existing in the home country of the parent company;
- workshop subsidiaries, which have specialized in the production of the components of a final product for which the local demand is weak or inexistent.

Marketing subsidiaries can be added to the above-mentioned types of subsidiaries, and all they do is to distribute products manufactured elsewhere.

Apart from these definitions, transnational companies represent a complex and continually moving reality, for which the main concern is finding a diversity of policies,

objectives and behaviours.

1.1.2. The external expansion strategies of a company

The basis for the international growth of a company lies in:

- the existence of real or potential outlets in several countries, which constitute the growth reserve of the company;
- the existence of available resources to finance this growth;
- the existence of technical breakthrough transformed into increased productivity or a marketing advantage resulting from product differentiation;
- prior knowledge of the international market most often obtained through export.

Supposing all these criteria are met, we can distinguish between four successive methods for expansion:

a) The supply strategy and upstream vertical integration

The necessity to find raw material deposits is coupled with the geographic reality. A company producing aluminium, for example, will seek to control bauxite deposits and to get close to the energy sources. Characteristic of "primary" companies that step into the raw material domain and are vertically integrated upstream, this strategy is apparently in regression compared to the movement begun in the 1960s when the third world countries which had become independent sought to take control over natural resources.

In certain domains, such as the chemical one, the transport costs represent another 15 to 25% of the value of the products. As such, "the deposit strategy" remains open. In fact, questioning the direct control exerted by transnational companies over raw materials is not sufficient to reduce their market share. As a matter of fact, the marketing and technical assistance functions whose development is very important for the exploitation of both mineral raw materials and food and agricultural materials (selected seeds, fertilizers, plant protection products) are most of the time sufficient to maintain the industrial delocalisation of this market share.

b) The market strategy and downstream vertical integration

The analysis of the reasons for the first always highlights the existence of trade constraints: the company decides to produce near the market of its product especially when there are obstacles to the export. This decision therefore corresponds to a strategy aimed at exporting in another form in order to overcome the obstructions of the oligopolistic market or those imposed by the states.

The succession is as follows: the relay subsidiary sells at first the products of the parent company that it obtains by import. Then, it begins to produce these same products. The range of goods it produces depends directly on the local or regional selling opportunities, while the productive activity may be doubled by the activity of distributing the group's products. At the same time, the product transformations to adapt to the market requirements are minor.

This organizational model allows for the removal of the inconveniences of a too fragmented market, and ensures the coordination of relay subsidiaries through a central decision-making unit.

c) The strategy of industrial rationalization and horizontal integration

The company generally abandons the previous model to establish an integrated system of its operations when the delocalized industrial entities are very numerous and highly specialized. The production lines are regionalized and each subsidiary specializes in producing an element in the final production of the respective company. Each subsidiary therefore produces for a market wider than its immediate market. In this case, the evaluation of the technological level is decisive in choosing the organization and specialization of the various units.

This expansion strategy aims at the global leadership of certain economies of scale through the horizontal integration of workshop subsidiaries that produce segments of the final products.

d) The technical-financial strategy and conglomerate diversification

Large transnational banks have developed networks abroad in the countries where industrial enterprises have been established. Thus, there has been a concerted internationalization of companies and banks, and a centralization of the capital through mergers, absorption and joint ventures in order to eventually reach the formation of several international technical-financial groups, that is the formation of branched assemblies, which, in turn, bring many industrial, tertiary and financial entities under the control of the same decision-making centre: a financial holding company.

This model involves the conglomerate management of the subsidiaries belonging to very different branches. Internationalization, in this case, is based both on the management of financial assets, the capitalization of technology and the provision of services, and on the actual production. The strategy also involves banks, industrial enterprises and service, insurance and technical assistance companies. Conglomerate diversification has come to a climax in the strategies of the large groups at the beginning of the 1980s. Since then, however, a trend of recentralization has become apparent in high technology sectors.

1.1.3. The typology of transnational companies

a) Primary companies

These are considered to be primaries from two points of view: they step into the mining, oil and agricultural sectors, and historically represent the first form of internationalization of production. Their role is to supply industrial economies with raw materials, food and energy.

b) Companies with marketing strategies

They correspond to a process of internationalization of production through substitution of exports. This concerns truly transnational firms as long as they operate a genuine delocalization of production by deploying relay subsidiaries. However, their global expansion was achieved by operating on local markets. That is why their location depends on actual or potential demand, which means they do not deviate from the marketing logic of exporting companies. From this point of view, it is a transitory form where production has not yet been separated from sale, and rather they have been combined at the level of a geographical area.

c) Global companies

The creation of workshop subsidiaries, specialized in a segment of the production cycle, represents the form by which an internationalization based on the exploitation of the differences between wage levels and the advantages of globalization is completed. In this case, delocalization is no longer an export substitute, but rather an alternative to the obstacles to the immobility of national comparative advantages. The organization of the company's network requires world-scale planning and planetary direct management.

d) Financial companies

They represent a superior level in relation to the previous form, to the extent that the headquarters only retains directly non-productive activities: the global group strategy, the financial centre of joint venture management, patents and liquidity, research and development. Subsidiary management is now decentralized across areas and products.

1.1.4. The organization and management of transnational companies

Once an enterprise goes beyond its national borders, it will find itself facing the necessity to reorganize itself. This process needs to take place at two different levels: that of the parent company and that of the subsidiaries.

With respect to the parent company, this does not imply a reform of the existent services, but, above all, the creation of a new structure. Initially, when the enterprise decided to invest abroad, there was only an export service, often integrated with the sale service. Under these circumstances, the international activity of the company occupied a secondary, subordinate

position. The next stage of reorganization was that of integrating the international activities into the other activities of the enterprise.

The technostructure became even more complex when specialists in the economic, fiscal, legal, social legislation specific to the countries where the company has subsidiaries have been hired. These specialists carefully consider the possibilities of the implantation of subsidiaries. International financial statistics are continually researched to identify countries where the inflation rate is higher; the situation of countries which are candidates to devaluation requires measures to prevent consequences. Transnational companies tend to base their decisions as little as possible on impressions and as much as possible on realities, on information "formalized" by specialists who rely on the most recent sociology, economics, and political science data.

Relationships between the parent company and the subsidiary are often inequality relationships. The way to control foreign subsidiaries is strategic and can be exerted either on capital or on its managers.

Control over capital may be 100%, majority (over 50% of total shares), parity (50-50%) or minority. Concerning the last two, where control is shared with the host country, it can be said that they are less expensive and better protect against country risk. Subsidiary control is also exerted over the budget they receive from the parent company, based on the assessment of their performance and the place assigned to them in the organization and strategy of the transnational company.

Surveys have shown that the autonomy left to subsidiary directors is generally lower in terms of financial decisions (increase of capital, dividends and royalties, selection of investments to be made, use of the subsidiary self-financing margin, financial plan, loan from local banks) than in terms of staff management (employment, dismissal, overtime, staff payment, job restructuring, training), while the productive and marketing decisions are at an intermediate level in terms of the decision-making autonomy (new market penetration, capacity and volume of production, manufacturing processes, new products, production costs, supplier selection, customer credit, maintenance of facilities).

The factors influencing the control of foreign subsidiaries are the size of the transnational company, its form of organization, its national origin, its capital, the risks of the host country, and the results of its activity. The domain where the company operates is of no importance in this respect.

As the company develops its FDI, the number of foreign subsidiaries also grows; its organization moves from the simple form existing at the time of the first foreign investment to the U-form by multiplying the foreign subsidiaries that are controlled by an international division.

As the TNC grows, this coordination structure becomes ineffective due to the large amount of information circulating between the international division and the foreign subsidiaries, as well as to the diminishing control over too many subsidiaries. In this situation, the company adopts one of the variants of the M-form: an operational division is responsible for each product, such as ATT, Du Pont, Hyundai, Phillips, Siemens, or for each region where subsidiaries are implanted, such as General Motors, Hitachi, Nissan, Toshiba. These divisions are "quasi-companies" in this decentralized structure: they are the profit centers of the TNC and they themselves have a U-form.

Although more flexible, the matrix organization is more expensive and more complex, giving rise to conflicts of authority between hierarchical superiors: the head of the subsidiary cannot have two "masters" at the same time. That is why several companies, including Dow, have abandoned this type of organization.

Instead of the matrix organization, it is preferable to have alliances between companies or to create strategic business units that are directly defined in relation to the global market for different products, without taking into account the geographical areas, as is the case with Hoechst.

A last form of organization that emerged in the 1980s consists in establishing a functional headquarters that serves all branches in a region outside the home country. NEC Singapore

Headquarters is in charge of the research and development of all the Asian subsidiaries; Mobil has a headquarters that deals with research for all of its subsidiaries; the research for the Ford Mondeo model has been done by Ford Europe (which covers European and North American subsidiaries) who has to sell the model on a global scale. The latest Ford reorganization (1994) has generalized the experience of the Mondeo model and has divided its studies and design between two places (Europe and the USA), while a global division deals with marketing and product global definition.

The organization of transnational companies bears the mark of their national origin. This can be seen in American transnationals that have recently preferred majority subsidiaries, as well as in socialist transnationals that are organized as service companies which resort to new forms of investment.

Japanese transnationals oppose the hierarchical model of the Western transnationals. Within the hierarchical organization, the vertical transmission of information is materialized at a high cost for overseeing foreign subsidiaries and subordinates. The Japanese organization is based on the collective decision resulting from horizontal exchanges of information, mutual adaptation, and semi-autonomous coordination between subsidiaries, workshops and employees. The degree of integration in the hierarchical organization is superior to that of the Japanese organization, due to the fact that Japanese companies use subcontracting and minority joint ventures in the capital of foreign subsidiaries. The degree of formalization is also inferior with Japanese transnationals: organigrams are not clearly defined, subsidiaries are given fewer written guidelines, fewer reports and fewer user manuals. All these explain why Japanese companies, in their foreign expansion, have used so many less integrated forms of organization: the new forms of investment.

This specific organization of Japanese transnationals fades as they invest abroad, Japan's FDI having the same profile as that of the main countries investing abroad. Conversely, transnationals in other market economy developed countries sought to adopt the organization of Japanese companies. This double convergence contributes to a decrease of the influence of the nationality of the global companies. The performance of the hierarchical model, proven in a stable economic environment, decreases at the same time as the uncertainty of markets, products and techniques increases as a result of the crisis of the change from the mass production of standardized goods to the fluid production of small quantities of diversified goods according to customized demand. The flexibility and informality specific to the Japanese organization is then made into an advantage.

The 21st century represents a real challenge for transnational companies. The pace of change is accelerating. It is getting harder to stay in the top. Specialists in the field are already thinking about new organizational structures, new managerial formulas, adaptable not only to the specific field of activity, but also to each stage. Flexibility is the keyword. TNCs turned their eyes from the traditional organizational structures, relics of "the age of the factory chimneys", to those structures capable of matching the possibilities of the 21st century market. In an age of organized innovation, change is always the subject of further discussion that feeds the action of constantly overcoming. In the current context, the philosophy of the big companies is to manage change.

1.1.5. The market of transnational companies

Every transnational acts simultaneously in three economic spaces: the national one, in the case of the parent company, the foreign one, in the case of subsidiaries, and the international one, in the case of the exchanges between the units that make up the transnational or between them and the rest of the world. Through the emergence and development of these companies, the sphere of the activity of the enterprise extends considerably. It is no longer, as once, an isolated entity. There is an interaction, an interpenetration between the microeconomic, macroeconomic and global economy domains.

By virtue of the relationship between the parent company and the foreign subsidiaries, as well as between the subsidiaries themselves, the transnational company operates in its own market, which is an international market. Specific to this type of market is that the object of the exchange is made up of intermediate products, components of final products, by virtue of the specialization imposed by the parent company on its subsidiaries.

Within a transnational company there is an internal movement of products, technologies, capital and staff within the international space of the parent company and its foreign subsidiaries, a space over which the transnational exercises full control. Intra-firm captive trade is rated at 30% of world product trade.

The coordinating center generally imposes the exchange relationships, which its component units need to maintain between them, as well as the practicable prices. In their domestic trade, transnational companies do not use the world market price, and instead use internal transfer prices, which are set independently from the competition. They aim at gaining or maintaining a dominant position, reducing the amount of income tax owed to the host state, circumventing foreign exchange control, and protecting against currency fluctuations. Transfer pricing allows the redistribution of the profits of the subsidiaries to the parent company or to a holding company established in a tax haven or to exercise control over the exchanges of the host state. With the goal of maximizing global profit, transnational firms manipulate prices to increase the benefit of the subsidiary in the country where the tax rate is low and vice versa. When devaluation is imminent, the TNC will seek to remove most of its profits from the country and move it to the strong-currency countries; taking into account the characteristic features of the transnational companies market, it can be said that within its framework uncertainties related to fluctuations in supply and trading prices diminish. The competition with the other transnational companies begins at the border of the domestic market of such a company.

1.2. The fundamentals of the transnationalization of companies

The attempt to find the determinant factors of the transnationalization of companies rests upon the answer to these three questions:

1) Why does a company choose implantation abroad instead of simply exporting products?

2) Where does it decide to localize the activity of its various subsidiaries?

3) How does it determine the quantity and structure of its international production?

A simple answer comes immediately to our minds: an enterprise decides to invest abroad because it expects a higher profit for the same value of investment. Although the pertinence of this answer cannot be questioned, its scope remains small, and its generality cannot explain the different reasons for transnationalization.

The results of the various surveys conducted on the managers of transnational companies most often reveal the following as reasons for the investment abroad:

- the transnational company operates, on an international scale, a particular technological, organizational or marketing advantage it holds at a given moment in relation to its competitors on its home market;
- it capitalizes on international differences in terms of costs and sets up in regions where production factor prices are the lowest;
- it chooses implantation in raw material production areas to reduce their transport costs;
- the company delocalizes production in regions where demand is high to overcome state protectionist barriers;
- it retaliates against the destabilizing initiatives of its competitors who have already opted for transnationalization;
- it seeks to benefit from exchange rate differences and interest rates in the management of its financial assets;

- finally, most of the time, the company takes its production and marketing decisions on the basis of global planning that considers the world a space made up of opportunities, risks and losses that the company either mobilizes to overcome or it bypasses them.

These reasons for investment abroad will be further addressed in the light of the various existing theories in the field.

1.2.1. The theory of capitalizing on market imperfections

According to the market imperfection model, foreign direct investments are determined by:

- the difference in the profit rate between different markets as a result of the imbalance in the factor market (difference in capital supply, labor cost, pace of technological innovation) or in the financial-currency market;

- distortions generated by government intervention (tariff and non-tariff barriers, taxes, control of prices and profits, anti-monopoly regulations, etc.);

- imperfections in the structure of the market, such as restrictions on the emergence of new businesses;

- imperfections caused by market failures (externalities, economies of scale and public goods).

The first theories on foreign direct investments argue that investment flows are determined, as in the case of portfolio investments, by the differences in profit (or interest) in different countries.

The theory of the international portfolio investment explains, rather, the international capital movement as a factor of production. This theory argues that the motivation of capital movement from one country to another is determined by the difference in interest.

Hymer (1960) made a first critical analysis of the portfolio investment theory as an explanation of foreign direct investment flows, arguing that the behavior of the foreign direct investment flows has historically been different from that of portfolio investments. He believes that foreign direct investments take place because of a higher gain rather than a higher interest rate. This also explains why transnational companies acquire or merge with local businesses, and pay a higher price than local competitors, because their expectations of higher profits are based on the knowledge and the better experience they have gained in their country of origin.

Hymer's explanation relies on two types of market imperfections:

1) structural imperfections - forming the object of the industrial organization theory that analyzes the partial balance of markets. Investors seek to control a foreign enterprise through merger or acquisition in order to be able to apply the possible cartel arrangements between themselves.

2) the transaction and informational imperfection cost, generated by unequal distribution of knowledge and benefits between existing or potential enterprises.

A company resorts to the abroad development of assets generating added value, owned and controlled by the company, because it thus avoids competition and capitalizes on one or more advantages that are in its ownership, a fact that derives their exclusive character. Advantages are, in Hymer's theory, those stemming from knowledge, economies of scale, distribution networks, product differentiation and financing. These advantages allow investment companies to overcompensate for the disadvantages of engaging with local firms in the implanted economies. In other words, assets developed by transnationals abroad are more profitable than local businesses; in this manner, the transnationals increase their monopoly power. Hymer also takes into consideration the specific advantages of the implantation country, as well as the specific advantages of certain implantation sectors.

As such, the existence of certain advantages in the exclusive property of the investing companies is based on a certain failure, a certain imperfection of the markets, which is optimally capitalized on not by exports or licensing, but by FDI under certain conditions, namely:

- the marginal cost of the FDI access to a given market is lower than the marginal income from this operation;

- international production is more profitable than export (sale, alienation of benefits) or than renting them, by licensing foreign firms.

In his turn, Kindleberger (1969) considered that direct investments abroad were a result of market imperfections. "In order for a foreign investment to be possible and to enjoy success, there must be either imperfections in the goods or factors market, including technological differences, or an administrative intervention or undertakings that affect the rules of free competition by segmenting the market."

This suggests two conditions for overseas investment to take place under oligopoly conditions (the benefit theory):

Condition 1:

Obviously, the company needs to earn more abroad than in the country of origin to cover the costs and risks of operating in an unknown environment. However, the benefits in terms of costs are not enough, the profit of the subsidiary needs to be superior to that of the enterprises already established in the host country, otherwise simple exports would be enough.

This first argument is logical. Thus, if we estimate the marginal costs of the production for exports for the same company, irrespective of the offer, then international production generates additional fixed costs, but lower marginal costs. We will have the following graph:

In the case of export, the company maximizes its profit in point C, where the marginal cost of exports is equal to the marginal income of sales abroad. This produces the Q_1 quantity under the P_A selling price.

In the case of international production, point D, where the marginal cost of production abroad is equal to the marginal income of sales abroad, is the strategy of maximizing profit. The quantity produced is Q_2, and the selling price P_B.

Savings on variable costs as a result of implantation are indicated by the surface of the PCCDPD trapezoid. If they are higher than the fixed cost of setting up the unit abroad (not appearing on the figure), the delocalization of the production is certainly the best option.

Condition 2:

The company must have an advantage over competing companies, an advantage that can be transported abroad and which local companies cannot obtain. Four types of advantages, monopoly factors, entail foreign investments:

- those relating to the imperfections of the competition on the product market (particular selling techniques, product differentiation);

- those related to the imperfections on the production factor market (superiority in a technique inaccessible to competitors, a greater mobilization of funds);

- those resulting from internal or external economies of scale (the horizontal and vertical integration of the company, the quality of the place of implantation);

- finally, those resulting from the intervention of the governments in the host country which is at the same time the country of origin (subsidies, tax incentives, customs duties).

1.2.2. The theory of the monopoly or oligopoly advantage

Although the theory of the monopoly or oligopoly advantage may be classified as "market imperfections," it nevertheless contains elements deriving both from the macroeconomic theoretical approaches to development or international trade (for example the oligopolistic competition theory) and from the enterprise theory (Hymer).

The theory of the foreign direct investment monopoly advantage claims that the investing enterprises have monopoly advantages that allow them to place subsidiaries abroad which in turn are more profitable than national enterprises (Hymer, 1976). The monopoly advantages of a transnational enterprise include two categories: superior knowledge and the economies of scale (mass production).

In presenting this theory, a distinction is made between "horizontal foreign investment" and "vertical foreign investment".

Horizontal investments mean that the investment enterprise places a subsidiary in the host country which manufactures the same product it produces in its home country, which is rather a geographic diversification of the production line of the transnational enterprise.

Vertical investments are made when the investment enterprise establishes new production capacities in a foreign country to produce intermediate products that are used as inputs for its production in the home country (investment in extractive industries) or manufactures the product in order to market it in a more advanced stage, close to the final consumer (assembly lines).

Horizontal investments are linked to superior knowledge and product lifecycle, while vertical investments are linked to the oligopoly advantage (economies of scale).

Having superior knowledge allows the transnational enterprise to create better differentiated products with physical traits (derived from technological knowledge) and psychological traits (marketing knowledge) that distinguishes them from the products of the competition. In this way, the enterprise obtains control of product prices and sales, which brings about an "economic rent" out of its knowledge assets. So, the transnational enterprise produces differentiated goods and services based on knowledge that it can transfer to a foreign market at no cost or at a very low cost.

Caves (1971) developed the theory according to which differentiated product-based oligopoly is the most widespread industrial structure in foreign direct investments. For an exclusive advantage to lead a company to invest abroad, two conditions must be met:

1. first of all, it is necessary for that advantage to have the character of a public good within the company, so that its capitalization on other markets does not entail the full cost of its research. Knowledge and information are the prototype of such advantages. The essential characteristic of an FDI-inducing asset does not necessarily lie in its 0-level opportunity cost, but in its low level in terms of FDI income;
2. secondly, the incomes obtainable as a result of capitalizing on the advantage of the company on a foreign market must depend, at least to a certain extent, on the local production conditions.

Caves thought that these requirements are found in the case of a differentiated product-based oligopoly, as necessary conditions for an increased incidence of the FDI on the horizontal. A differentiated product is, in Caves' approach, a set of similarly functional goods made by competing producers, goods that differ in minor characteristics or in subjective distinctions, created by marketing and advertising. Owing to the different companies' success in differentiation, the profit rate will be different, so that at least part of the profits will not be subjected to competitive pressures.

Another hypothesis assumes that the FDIs are motivated by the need to follow the actions of a leader in an oligopoly. Thus, Graham (1978) believed that large transnational enterprises invest one in the home country of the other as a self-defense in the realm of oligopolistic competition.

Graham's reasoning starts from the fact that, by applying the theories of Hymer and Caves, which motivate local production by gaining a sector-specific advantage, it cannot be explained why European enterprises invest in the USA in the same industrial sectors as those in which American investors invest in Europe. FDIs emerge as a counter-threat from a European enterprise to the establishment of an American enterprise in Europe. It results from a rivalry behavior defined as a "competitive conduct" between enterprises in an oligopolistic industry (compared to simple competition which would be the normal behavior of an enterprise in a sector with perfect competition).

A weakness of this theory is that it does not explain why the first action (investment) is generated, which is then answered with a "counter-threat". However, it provides a complementary explanation for the FDI flows and introduces multiple dimensions of the causality of the investment flow evolution and their existence.

The product lifecycle theory (Vernon, 1966) demonstrates that the location of the production activity of a transnational enterprise evolves over the lifecycle of the product and mainly explains the dominant role of the USA as the main inventor, exporter and investor in the world immediately after WWII. The product lifecycle determines the shift of the transnational companies from export to foreign direct investments. The theory has the advantage of integrating a large number of important factors that allow the explanation of a "sectoral derivation" or the successive delocalization of industrial activities in countries featuring a technological progress, first to the so-called "early imitator" countries , and then to "late imitators".

According to this theory, the internationalization of production takes place in three stages:

Stage 1:

The innovative country enjoys a vast market, high incomes, abundant capital and, finally, a highly skilled workforce. Product design, production and marketing operations, corresponding to product life cycle stages 0, 1 and 2, are concentrated in that country. At first, product differentiation favors demand under the conditions of low price elasticity. Ultimately, however, this advantage is threatened by the emergence of competing or substitution products. To maintain sales volume, the company in the innovative country will look to delocalize its production.

Stage 2:

In the early imitator country - a European country for Vernon - the demand for the new product is on the rise, stimulated by the imitation effect. At first, this demand can be met by imports. Then progressively, the need for implantation in this country will be felt, especially as the country's workforce is sufficiently qualified for a technology that has become standardized. Finding a lower price for the workforce plays just as decisive a role as the shift in demand. When the average cost of production for the implantation country becomes less than the marginal cost of additional production at the cost of transporting the goods exported by the innovative country, the decision to delocalize production is required. At this stage, the home country of the new product ceases to produce it and becomes a net importer to meet the rest of its national demand.

Stage 3:

In this last stage, less developed countries can offer an advantage for a new delocalization. These generate demand by imitation, and the workforce, although poorly qualified, is adaptable to the production conditions in large batches. The other two groups of countries then become importers of the product whose demand is declining.

Vernon's theory gives a dynamic outlook to foreign investments and is based on innovation and product development. As a weakness of the theory, the product lifecycle is seen in a deterministic vision and it can only be applied to products that bear standardization.

1.2.3. The theory of the internalization of production

One of the frequently asked questions is the following:

"Why does the enterprise prefer to internalize, that is integrate, all its functions, from supply to marketing, into its organization?" There is only one answer - because the international factor and goods market is imperfect and therefore bears "transaction costs". Any good or service may be the object of the property right. Any asset so protected by such a right may be the object of a transaction or a contract. The transaction costs are the result of factors which are related to the lack of transparency and market fluidity, to the technological monopoly of certain enterprises, to the lack of trust between buyers and sellers, to the uncertainty about the formation of the selling price, to the difficulties of spontaneously adjusting the supply to the characteristics of demand, to the taxes on commercial transactions. Internalization allows for the reduction, if not the complete suppression of these inconveniences, in other words, the reduction of transaction costs.

Internalization becomes indispensable at the same time as the internationalization of

activities. Export involves the use of numerous intermediaries in international trade (transport, storage, distribution, etc.) and of foreign services (insurance, banking, advertising, etc.) whose quality, reliability and price are decisive. The best solution for ensuring the proper functioning of these services is for the company itself to deal with them, rather than assigning them to others. The internal control procedures made possible by the total or majority ownership in the collaborating units of the company are the most appropriate ways of organizing transactions, taking place between individuals and groups linked by authority and subordination, generated by the right to ownership.

Tu sum up, Buckley and Casson's theory of internalization (1982) demonstrates that transnational enterprises invest abroad to absorb the externalities on the market: economies of scale in production and marketing, ownership and the public good character of knowledge, and market constraints imposed by governments. In other words, the company's own discoveries, as well as other benefits that they derive from their own business, lead them to foreign direct investments when intra-company transfers are less expensive than open foreign market transactions. From the perspective of the internalization theory, the transnational enterprise is an institution that has the mission to create and capitalize on the benefits of national markets.

Buckley and Casson differentiate their theory from previous theories. Although they admit there are certain similarities, they criticize the others because they take the specific advantage of an enterprise as a "given", while they do not take into account the cost of acquiring it, and therefore ignore the basis of the investment option as an alternative of advantages. The theories of Hymer and Kindleberger consider the "advantage" to be a single invention or patent, while Buckley and Casson emphasize that it is "the transfer of the ability to invent".

The previous ideas, which were very simple in the beginning, were applied in the analysis of transnationalization. Rugman stated:

"Internalization is the process of creating a market within the company. The internalized market of the company replaces the now weaker normal market and brings solutions to the problem of allocating and distributing resources according to administrative instructions. Whenever the market makes mistakes (both in terms of price formation for intermediary goods and knowledge dissemination), or the costs of the transaction on the normal market are excessive, then internalization finds its justification. On a global scale, the more obstacles to trade and other market imperfections, the more reasons for creating transnational companies. "

1.2.4. The eclectic theory

An approach that seeks to integrate the essential ideas and common elements of the trends in foreign direct investments and transnational activities, namely the theory of monopoly advantage and the theory of internalization, while also giving them a necessary local dimension, is the "eclectic paradigm" developed by Dunning (1977).

Within this model, the grounds for the internationalization of production lie within three categories of so-called advantages: ownership advantages, internalization advantages and localization advantages. Their level and combination determines the intensity of the foreign direct investment flows, their sectorial structure, and their spatial orientation.

a) Ownership advantages

Dunning embraces the vision according to which ownership advantages are at the same time competitive advantages. He defines ownership advantages as representing the ownership of certain "assets" understood as resources that have the potential to generate a future income flow. These assets include not only the tangible elements, such as natural resources, workforce and capital, but also the intangible assets or capabilities, such as technology and information, managerial skills, marketing and entrepreneurial skills, organizational systems and market access.

b) Internalization advantages

The eclectic paradigm identifies market imperfections as arguments for internalizing the

markets within the hierarchical structures of transnationals. Such imperfections can be avoided by the companies by diversifying their value-adding activities, by re-establishing their ownership and organizational structures. When they resort to internalization, through the development of productive assets abroad, companies aim both to maximize net benefits resulting from lower production or transaction costs, and to gain maximum economic income by capitalizing on the ownership advantage they hold.

c) The localization advantages

Localization variables are specific to the host economy where the company carries out foreign direct investments and develops value added-generating activities, but, in Dunning's paradigm, they are found in the home country of the investing company as well. These variables include: the supply of natural resources and created economic resources; the skill of the workforce and the productivity of labor; international transport and communication costs; investment or trade barriers and incentives; the economic system and economic policy; the political, social, cultural and educational differences between countries.

In the context of the eclectic model, the level and structure of the assets of a company generating added value abroad are determined by a system of four conditions:

1. the extent to which the company has sustainable ownership advantages when compared to the companies of other nationalities operating on the same markets;

2. considering that condition (1) is met, the extent to which the company perceives that its interest is best served not by selling its ownership advantages or the right to use them, but by adding value to those assets through internalization;

3. considering that (2) and (3) are met, the extent to which the company's overall interests are satisfied by the use of its ownership advantages within the facilities developed on a certain foreign market, depending on the localization advantages specific to it;

4. finally, in the context of a certain configuration of the ownership, the internalization and localization advantages that determine companies to examine the prospect of international production, the level and structure of the value added-generating assets developed abroad depend on the extent to which the international production is consistent with the long-term strategy of the company as well.

1.3. Brief history of transnational companies

The interest in transnational companies was born relatively late, especially with the expansion of American enterprises in Europe after 1950. Nevertheless, the phenomenon is very old and is closely linked to the development of capitalism.

International investment has actually emerged at the same time as the generalization of banking practices and the formation of modern states at the end of the Middle Ages. The first capital movement was organized in the sixteenth and seventeenth centuries and centred on the commercial cities and the royal and princely courts: Amsterdam, Antwerp, Bruges, London, Genoa and Venice. The traders became the first international investors when, for one reason or another, dissatisfied with their foreign correspondents, they sent a family member or an employee to work abroad. The great Dutch, English or Italian merchants have always acted this way.

1.3.1. 1800-1914: the golden age of international investment

Transnational companies have really thrived beginning with the nineteenth century. Four features characterize the golden age of international investment:

a) The European origin

Throughout the first part of the nineteenth century, Britain was practically the only country that invested abroad and, until 1914, English capital remained dominant. This country had abundant savings, supported by the financial market in London and an international banking

network (3000 agencies in 1914). Enjoying a considerable economic advance, it had to meet its raw materials needs and to cover by means of import the need for the food it had given up producing.

France also engaged in the process of internationalization at an early stage. Starting with the 1850s, France's foreign investments grew rapidly, multiplying 6 times by the First World War. It invested in Europe and overseas, and, pushed by its alliance policy, it lent considerable sums to Russia and the Ottoman Empire.

As far as Germany was concerned, it promoted a trade expansion policy through far-reaching operations in Brazil and Turkey. Belgium headed to Congo, the Netherlands to the East Indies. Since the late nineteenth century, the USA has shown aggressive sales dynamics for the products for which it held a technological edge. The stock of US investment relative to the GNP was already the same as the one in 1982, around 7%.

b) International investment mainly takes the form of private operations

The foreign investment initiative was almost entirely owned by banks and private companies, except for cases when it was imperative to appeal to the power of the public (for example, for the construction of the Suez Canal).

c) Portfolio investments prevail

Issuance of titles for state or private foreign companies was made through the financial markets of London, Paris and Amsterdam. Until 1914, approximately 80% of the British and French investments took the form of the purchase of shares and bonds, with direct investment being the exception.

d) Direct investments were geared towards capitalizing on new countries where European emigrants were heading to (the USA, Brazil, Argentina)

There was a convergence between the population exodus and capital flows. Investments were geared towards the infrastructure (ports, access roads) needed to capitalize on plantations and mining resources. Railway construction absorbed nearly half of the investments and facilitated both access to the wheat fields of Argentina and the exploitation of Australian mining resources or the development of the Russian industry.

Investments in raw materials and agriculture were of prime importance. The beginning of the century corresponded to the era of great coffee, tea, cocoa plantations, as well as to the emergence of the first companies integrated in the sugar, tropical fruit and tobacco sectors.

The political-military stake in controlling the areas of influence was also considerable, and the outbreak of the First World War shook the balance of the dominated regions.

1.3.2. The period between the two world wars: the nationalist withdrawl

Three aspects characterize this period that was favorable to the development of international investment:

a) The risk associated with remote activities dominates the behaviour of investors until the end of this period

The magnitude of monetary issues related to the payment of debts arising from the conflict prevented a return to the balance from the beginning of the century, and disturbed the confidence that was essential for both direct and portfolio investments. Each country, sheltered by its own borders, tried by all means to maintain its balance of external payments. For investors, the most important was the search for secure placements, especially the short-term operations.

b) The war reversed the traditional roles on the capital market, Europe ceding its dominant position to the USA, which had become a big creditor.

Although it ranked second in terms of assets, the USA became the number one investor through exported capital flows. The USA investments diversified very quickly, and at the same time the control power of an ever more limited number of companies over a branch of activity became more prominent. New companies created their first subsidiaries in the 1930s, Phillips, Alcan, Pirelli, Firestone, Procter and Gamble, and certain branches came to be dominated by a

small number of trusts and cartels.

c) Between 1918 and 1939, two-thirds of the investments were geared towards developing countries to control raw material resources, such as non-ferrous metals, oil, tropical foods. American investments flourished in Latin America, especially in the mining sector.

1.3.3. From the Second World War until 1970: the expansion of transnational companies

The Second World War brought a profound disruption to the international investment arena. The post-war period can, in its turn, be divided into two distinct sub-periods:

a) Between 1945 and 1955, when international capital demand exceeds the offer

The USA was the only source of investment. An important US public capital flow (USD 23 billion between 1946 and 1951 mainly distributed through the Marshall Plan and the Import-Export Bank) accompanied the European reconstruction and favoured the resumption of a parallel movement of private capital. The US domestic market was initially the only one able to offer favourable prospects of profitability, a fact which did not prevent the country from tripling its private investments in the rest of the world within 10 years. The main concern of the US enterprises was the control of the strategic raw material supply sources. This concern explains why the most dynamic element of US investments abroad between 1945 and 1955 was the big oil companies. While oil reserves in the Middle East, controlled by British firms, dropped from 72% in 1940 to 29% in 1963, US-controlled ones rose from 10% to 58%, with major property and acquisition transfers taking place between 1950 and 1954.

b) After 1955, when the rebuilt Europe became the main pole of attraction for the American private capital

American transnational companies developed very quickly in the new EEC area, created in 1957, and in Canada, particularly in new technology sectors, such as chemistry, electronics, informatics and telecommunications.

The attention of the emerging American and European companies was also directed to the third world countries, which were in a full decolonization movement. However, capital movements were not as present as before 1914. Developing countries, having become independent, represented only a quarter of the international investment destinations, while the vivacity of the nationalist phenomena (in Chile, Algeria, India and even in Canada) negatively impacted the desire for expansion.

1.3.4. The period after 1970: the disarray of direct investments

Five trends characterize the investments of the companies after 1970:

1. The development of cross-investments between industrialized countries. In the middle of this group of countries, the expansion of the British, German and Japanese enterprises is the fastest. In the field of electronics and automotive construction, the penetration of Japanese groups allowed Japan to be among the first investors between 1970 and 1980. The American market, characterized by its size, security and profitability opportunities, is in its turn the preferred destination of international investments. The USA is the first investing country and at the same time the first direct investment host country.

2. Replacing traditional implantations in the vicinity of raw material resources and investments in order to conquer local markets with investments in the export platforms that aimed at promoting an integrated structure of the activity of the companies and their subsidiaries.

3. The quick development of association formulas that do not necessarily involve a share in the social capital. These formulas respond to the need for flexibility dictated by the fight with the competition that imposes the use of systems of world or regional rationalization of production processes.

4. The emergence of new forms of financing, in particular the explosion of bond issues (Euro-shares and Eurobonds). The analysis of the current period shows an unprecedented

development of the global financial sphere (multiplication of the financial products, liberalization of the capital market, extension of the arbitration formulas) that contrasts with the weak dynamism of the economic sphere and trade exchanges.

5. The emergence of transnational companies originating in several developed countries with a little presence in the history of capital internationalization: Australia, New Zealand, South Africa, Austria, Denmark, Norway, and in newly industrialized countries: South Korea, Singapore, Taiwan, Hong Kong, India.

1.4. The contribution of the multinational companies

Multinational companies influence the factors that determine the process of economic growth through the contribution to capital formation, the transfer of "hard" and "soft" technology, the development of human resources, the expansion of international exchanges and long-term economic growth. Although a separate, individual contribution can be identified, it is significant that all these factors act together. For this reason, assessing the overall contribution of multinational companies to the economic growth of a country should take into account not only the direct effect for each factor, but also the implications of the interactions between these factors. Likewise, the interrelations with the national economy of the host country stimulate growth. The transfer of technologies (technical and managerial procedures) is disseminated over time to the rest of the economy. The presence of multinational companies stimulates competition, encourages novelties and new enterprises, induces horizontal production opportunities.

The contribution of multinational companies is not only quantitative - through the package of assets and indirect effects - but also qualitative, as the agents of integration, organization and management of economic activities. That is why multinational companies are an engine for economic growth in the conditions of operating in a permissive and stimulating economic system.

The development priorities for developing countries include achieving sustained national income growth by increasing investment rates, enhancing technology capacities, improving the competitiveness of their own exports on the international market, fair distribution of growth benefits by creating new opportunities for employment, and the protection and preservation of the environment. The globalization of the international economy causes considerable pressure on developing countries, which need to increase their resources to achieve these goals.

The activity of multinational companies can play a significant role in completing the efforts of national companies. But the objectives of multinational companies are not entirely in line with those of the host country governments: governments seek to accelerate national development, while multinational companies seek to increase their own competitiveness in the international environment.

Although a large domestic market continues to be a powerful magnet for investors, multinational companies operating in the world market are increasingly interested in having an adequate infrastructure, trained workforce, innovative capabilities, an environment where there are efficient suppliers, competitors, research institutes, etc. Moreover, they may be interested in acquiring certain created assets that characterize competitive companies in the host country, a fact that may lead to the restructuring of these companies. The existence of cheap labor force remains a source of competitive advantages, but its relevance diminishes since it does not provide a strong basis for sustainable growth. The same applies to natural resources.

There cannot be a conflict between exploiting the static sources of a competitive advantage and developing some new, dynamic ones, since existing advantages already provide the means by which new ones can be developed. An appropriate evolution from one category of advantages to others creates the basis for sustainable growth. In this respect, an appropriate policy framework is needed to facilitate and accelerate the process, which is the very essence of

the competitiveness strategy. The need for such a strategy does not disappear with the acceleration of growth or when the economic development reaches a certain level, since the strategy perpetually changes its shape and objectives. This explains why competitiveness remains a concern for governments both in developing countries and in developed countries.

Government policies on foreign direct investments by multinational companies seek to counteract two types of market failures. Firstly, there are failures to inform or coordinate in the investment processes, which may lead to an insufficient attraction of foreign direct investments or to inadequate investments. Secondly, the private interests of investors do not converge with the economic interests of host countries, and that is why multinational companies can induce negative effects on the development, or positive, but static, effects in the short term. Of course, private and social interests may contradict those of national or foreign investors, and therefore policies are needed to remove these divergences for all the investors.

Certain divergences are, however, specific to multinational companies. Their activity differs from that of national companies in view of the fact that the decision-making and the sources of competitiveness are located outside the host country. Moreover, governments consider that the activity of multinational companies should be controlled for non-economic reasons, such as the preservation of cultural and strategic activities in the national "patrimony".

The role of the multinational companies in governments' efforts to achieve development goals varies considerably, depending on the type of economy and economic policy. Certain countries (Malaysia, Singapore, Thailand) have relied heavily on the FDI flows to integrate their economies into the multinational companies' production networks and to promote their competitiveness within these networks. Other countries (South Korea, Taiwan) have pursued the development of local enterprises and the creation of autonomous innovation capacities, with the multinational companies being designed as a source of technology.

A strategy to attract multinational companies valid for all countries and for all stages of the economic cycle cannot be outlined. A viable strategy must reflect the level of country's economic development, its resource base, the specific technological context, its competitive position, the government’s capacity to implement appropriate economic policies.

The main problems faced by governments in their efforts to attract multinational companies can be grouped into four categories: information and coordination failures; considerations related to young industries (infant industries), since the development of local enterprises may be endangered by that of multinational comapanies; the static nature of the advantages transferred by multinational companies when local capacities are diminished and do not improve or when multinationals do not make sufficient investments to increase capacity; inappropriate legal framework that may lead to the unequal distribution of advantages or to the abuse of the dominant position of multinational companies.

Each multinational company has a complex set of company-level attributes that are dispersed in varying amounts and qualities from one host country to another, making it difficult to separate and quantify these attributes. Where their presence has multiple effects, identification is much more difficult. It is not possible to establish a precise method that would show economic development in case multinational companies had made certain investments.

The ownership advantages of multinational companies can be obtained only from the companies that create them. These can be reproduced, but the costs of such an operation are extremely high, especially in developing countries and in the case of high technology. Technology is added to the factory and trade marks, professional skills, the ability to organize and integrate production on an international scale, the creation of marketing networks, privileged access to the capital market. The combination of these advantages can make a significant contribution to the economic development of the host country if it creates an environment conducive to the transfer of these advantages in an appropriate way and has the capacity to use them appropriately.

Multinational companies can provide access to the international market both for goods (and certain services) that are produced in the host country, thus contributing to the transition

from the domestic market to the global market, and for new activities that employ the competitive advantages of the host country. Increasing exports brings other benefits as well (the rules of learning with respect to the technological environment, achieving economies of scale, stimulating competitiveness).

Multinational companies have worldwide access to a skilled workforce with advanced skills and knowledge, which they are able to transfer to foreign subsidiaries through experts as well as professional training. New organizational practices, managerial techniques, adaptable skills can increase the competitive advantages of the companies, supporting employment in the context of the evolution of the economic and technological environment. International production generates employment opportunities that are particularly relevant in those host countries with high unemployment rates, which also applies to Romania. In the recent years, the number of employees in the subsidiaries of multinational companies has increased, this trend having manifested to a higher degree in the subsidiaries in developing countries.

The activity of multinational companies involves the injection of capital into host countries, with foreign direct investment flows being more stable than portfolio investments. Unlike other sources of capital, multinational companies invest in long-term projects. The capital base of international production, regardless of how it is funded, is reflected by the value of the assets held by foreign subsidiaries. It exceeds about four times the stock of foreign direct investments in developed countries, and is slightly higher than the stock of foreign direct investments in developing countries.

Multinational companies have modern technologies at their disposal, and some of them cannot be available in the absence of foreign direct investments, while at the same time contributing to increasing the efficiency of using the available technologies. They can adapt the technologies to the local conditions due to their experience in other countries. In some cases, they can establish local research and development facilities, improve technologies owing to innovation and changing consumer habits, while at the same time stimulating the technological efficiency of local firms, suppliers, customers and competitors by increasing competition and providing assistance, thus fulfilling the part of a role model. Multinational companies are the ones that have made the most progress in the development of "clean" technologies and management systems that integrate environmental concerns, and can use them in those countries where they operate. These technologies and managerial practices can lead to the change of management within local companies operating in the same branches as the foreign subsidiaries.

Developing countries can benefit from these advantages, but this does not mean that simply opening up market access is the best way to gain them. The existence of market failures causes governments to get involved by adopting promoting measures.

CHAPTER 2. THE BALANCE OF EXTERNAL PAYMENTS

The balance in a given economy finds support in the economic, monetary, financial, currency and social conditions specific to a stage that it is going through. National economies tend to strike a balance in the economic relations between them. This balance depends on the decision making in the form of the financial distribution and credit decisions or the transfer of certain amounts determined by the economic, financial and credit flows. At the level of the national economy, the financial-monetary decision is made in the form of the balance of external payments.

For a state whose economy is in a state of crisis and, above all, facing the issue of making radical structural changes, stabilizing the balance of external payments - a document which relays the international economic relations - is one of the main conditions to solving important socio-economic problems that allow for greater integration and broader economic relations with other states.

Studying and researching the balance of external payments is an important issue because:

• the balance of external payments includes aspects of the financial economic nature, and reflects the degree and meaning of engaging the economy in the international labor division, in the foreign exchange potential created by exports, and in other external operations.

• elements of the balance of external payments, which present the volume and structure of foreign exchange receipts and payments, as well as their main correlations, allow value judgments on the efficiency of external economic programs.

• the balance of external payments creates the possibility for the state to steer the external economic activity by means of the financial-currency levers to ensure the efficiency of the import-export operations.

The balance of external payments is a basic tool for the country's foreign exchange and foreign trade policy, and provides information on import-export, capital movements, international loans.

The balance of external payments is, in essence, the gauge of a country's economic and financial activity. It highlights the capacity of goods production and their competitiveness on the international market, both in terms of quality and price.

2.1. Definition and role of the balance of external payments

The position of a national economy in its relations with the rest of the world is reflected in two documents: the balance of external payments and the balance of external debt and commitments – knowing them is needed in the process of developing the foreign economic policy of any government in an increasingly independent world.

According to the IMF definition ("Balance of Payments Manual", fifth edition, 1994), the balance of external payments is a statistical chart in accounting form that systematically records all real, financial and monetary flows between residents of an economy and the rest of the world during a specific time period (usually one year). Residents are considered to be the national or foreign economic agents, natural or legal persons who live and carry out activities, usually and permanently, within a country, including branches and subsidiaries of foreign companies. Embassies, consulates, international institutions and their representations (included in the category of non-residents) are excluded from this category. Practically, the distinction between the two categories of economic operators is based on the economic meaning of residence: the main base of interest or activity.

At the core of BEP is the concept of international transaction, thereby understanding the creation, transformation, marketing, transfer or extinguishment of an economic value in the

relations of an economy with the rest of the world. The transaction involves the exchange of ownership of material assets and / or financial rights, the provision of services or the availability of workforce or capital in the relations between residents and non-residents.

It should be noted that the balance of external payments refers only to operations carried out by residents operating within the economic territory. It should also be noted that the economic territory does not always coincide with the national territory, and may be more restricted (enclaves or territories belonging to other countries or international institutions are excluded from the economic territory) or more extensive.

Two major categories of flows are recorded in the balance of external payment (BEP): real flows and financial flows between residents and non-residents. The moment when these flows are recorded in the balance is determined in terms of the moment when the transfer of ownership between residents and non-residents takes place.

Real flows refer to the international trade in goods and services (export and import). Basically, the balance records these flows in value, the difference between inputs (imports) and outputs (exports) being the trade balance of a country. The flows of goods are recorded and accounted for separately from the trade in services. These services include transportation, communications, insurance, consultancy, copyright trade, technical assistance, etc.

If, in the customs statistics, the registration of exports is done at the FOB value and of imports at the CIF value, in order to be brought to the same parity and for comparison, in the balance of external payments, the registration of imports and exports is made at the FOB value, while the CIF value of imports is corrected by a margin of 5% (virtually this margin is deducted from the CIF value), and the external transport / insurance services will be recorded in other balance positions.

Financial flows are recorded in separate accounts - the capital account or the financial account. The payment of financial flows is recorded in the current account (for example, paid or credited dividends or paid / collected dividends are recorded under "Income" in the current account of BEP). These financial flows are detailed by their type in the investment flows (direct or portfolio), external credits (guaranteed or non-guaranteed), reserve assets (gold, foreign currency, SDR), etc.

The financial flows are those transactions between economic agents belonging to distinct states which are expressed and executed by means of payments and credit. These flows include two categories of transactions:

- trade offset flows, any movement / transfer of tangible or intangible products, one-way provision of services between the contact partners resulting in a reverse flow of the flow of payments;

- financial flows independent from commercial activity, which are reflected in capital movements, with the income from external financial investments as the results of capitalizing on a market other than the original one. Nevertheless, the unilateral financial transfers fall under this same category.

Since it is a synthesis chart detailing analytical accounts and sub-accounts that have been developed for a given period of time, the balance of payments allows a quantitative and qualitative comparison of a country's real and financial exchanges with foreign countries. The balance of payments is not just a simple descriptive record of commercial or financial transactions, it provides the diagnostic elements that allow the assessment of the advantages and disadvantages that each nation has in trade with third party countries, with creditors / debtors or international financial institutions.

The analysis of the balance of external payments and the balances of its accounts can be used to draw a series of conclusions regarding the external competitiveness of the national economy, especially with regard to trade in goods and services. Based on the balance of payments, the international investment position of an economy can also be determined, which shows a country's net lending / borrowing position as well as the degree of attractiveness of the domestic business environment for resident and non-resident investors (when the business

environment deteriorates, investors steer their capital towards more attractive markets).

By offering the possibility of analyzing exchange ratios at the macroeconomic level, the balance of payments is an important tool in shaping and coordinating external trade policies. When there is a chronic imbalance in the trade balance (more imports than exports), it can theoretically be reduced by means of a package of tax measures (increase of customs duties, tax incentives for foreign investors, subsidies, preferential credits) or one of a commercial nature (promoting and stimulating exports).

2.2. Presentation froms for the balance of payment

Two fundamental forms for the presentation of the balance of external payments are used in economic practice: the standard form and the analytical balance sheet form.

The standard form implies the recording of statistical data on actual and financial flows in its own structure or according to the structure recommended by the IMF. In order to ensure comparability between countries, the IMF has made strong efforts to develop standard rules on the structure and methodology of data recording in BEP. It should be noted that IMF member countries have to use the recommended structure. The structure envisaged in the IMF Manual on BEP consists of three parts:

- Part I: Goods and services, unilateral transfers (no counterparty);
- Part II: Movement of capital and reserve assets;
- Part III: Correlation between part I and part II (errors and omissions).

The analytical balance sheet form of the balance of payments additionally implies the use of helping tables to allow a careful analysis by the specialists who recommend policies and strategies to ensure a better position in international economic transactions. This balance form is much more detailed and more complex than the standard form.

Among the most used forms of balance of external payment are:

• The global balance of payments: it records all the economic operations of a country with the rest of the world.

• The regional balance of payments: it records all the economic operations of a country with a group of countries, an economic or monetary union;

• The bilateral balance of payments: it records the economic transactions between two countries;

• The program balance of payments: it is projected onto a future time horizon, with projections mainly referring to the current account and net investments in the economy. Depending on the projected values, resource requirements will be determined to cover any current account deficits that may be obtained from external credits or from reserve assets;

• The market balance: it regards the receipts and payments flows in foreign currency recorded over a specified time period (typically less than one year). For this balance, the prospects for potential receipts / payments are also recorded.

The balance of external payments may be static (when all the claims and payment obligations at that time, regardless of their maturity, are recorded) or dynamic, when the flows occurring within a specified time period are recorded, including the outstanding, but due flows for the current period, and which have been paid / collected up to the date the balance of payments has been made.

2.3. Principles of recording in the balance of external payments

The balance of external payments is a statistical statement for a given period of time, which systematically summarizes a country's economic transactions with the rest of the world. The balance of external payments only records flows over a period of time, while capital

accumulations or the stocks of goods and services are not recorded. In other words, the BEP does not record the total assets / liabilities of an economy, only their movement to / from another country.

Even if in the name of this synthetic instrument the words "external payments" are decisive, in the new IMF meaning, the balance of payments records not only the receipts / payments flows related to the international economic transactions involving the counterparty, but also the transactions with foreign countries that do not involve a service in return or a cash payment on behalf of the residents / non-residents: donations, non-reimbursable financial assistance, compensations (barter or clearing), related or parallel commercial operations (re-export, lohn, buy-back) etc.

The basic principle of recording real and financial flows in BEP is that of double entry, each supply of real or financial resources being offset by a payment. By default, any input of real or financial resources is offset by a payment. If this compensation does not occur, the operation is considered to be a transfer. If this principle is complied with, the net balance of all balance entries must be zero in theory. In practice, however, the registration system in BEP is not perfect, and because the recorded data is obtained from different sources, there are a number of value differences that are carried over into a special account of errors and omissions.

A second principle concerns the recording of inputs and outputs of real and financial resources in BEP. As in any balance that complies with the double entry principle, there is a credit and a debit position for each BEP account and sub-account. As a general rule, resource inflows are recorded in the balance credit, while outflows are recorded in the balance flow.

Synthetically, the main operations are recorded in the BPE as follows:

Inflows - CREDIT	Outflows - DEBIT
Exports FOB	ImportS FOB
Provided services	Paid services
Collected dividends, interest, wages	Paid dividends, interest, wages
Unilateral transfers from foreign countries	Unilateral transfers to foreign countries
Capital invested from foreign countries	Capital invested in foreign countries
Loans raised	Loans granted
Increase of the reserve assets	Decrease of the reserve assets

As can easily be seen, each transaction giving rise to an estimate inflow is recorded in the BEP asset (credit), and any transaction that generates an estimate outflow is recorded in the balance liabilities (debit). Exports and imports of goods and services are recorded in the light of the receipts and payments flows that they generate.

2.4. The structure of the balance of external payments

The profound interdependencies between the forces that govern the global economic space and those related to its component parts have made the balance represent the interface of the national relations with the rest of the world. Over time, the IMF's vision of this issue has evolved

continuously. Initially, the balance of payments was structured into two accounts - the current account and the capital and financial account; subsequently, the structure changed to three accounts, where the capital account was separated from the financial account (which also included reserve assets as well as errors and omissions).

In the version with two accounts or three accounts, we could talk about the deficit of the balance of external payments (or imbalances in BEP), and there was practically a whole theory on how to rebalance it. At present, under the current, improved structure which is detailed on four accounts, the theoretical balance of payments can no longer be deficient.

In reality, however, the balance of external payments undergoes in the short term permanent changes to its interim accounts, with the overall balance being a medium / long term objective that each government seeks to achieve, by using all the rebalancing instruments at its disposal (export stimulation , investments, financing through external credits, increase of reserve assets, etc.).

According to the latest IMF recommendation on the balance of external payments, its structure must be detailed in four basic accounts: the current account, the capital account, the financial account and the error and omission account, each account having its own detailing.

All of these accounts and sub-accounts have a credit and a debit position as well as partial and total balances. Overall, the total credit of the balance of payments should equal its total debit, with differences occurring only at the level of the interim accounts (current account, capital account or financial account).

2.5. The international investment position

Deriving from the balance of external payments, another important synthetic picture is the one showing the investment position of a country. In determining the international investment position, flows included in the financial account of the balance of payments are taken into account in particular: reserve assets, medium and long-term external debt and short-term receivables and commitments. The investment position is a useful tool in designing a macroeconomic policy of the adequate external financing of the balance of external payments deficits or other internal deficits (budget, fiscal, etc.), while taking into account all the financial resources that can be attracted from the international financial markets which are able to complement the(public or private) internal resources.

This tool is particularly important in developing strategies to finance the current account deficits or internal deficits (for example the budget deficit). This instrument shows the external indebtedness of an economy, the external debt structure, according to its origin and final destination, as well as the situation of the foreign direct and portfolio

Both the balance of payments and the international investment position are analyzed using a set of specific indicators, such as:

• Coverage of imports: exports (X) / imports (M);
• Trade balance size: (X-M) / (X + M);
• Exchange rate indices (net and gross);
• Foreign currency assets in months of import;
• External debt / per capita (or GDP).

The analysis of the balance of payments and the international investment position can also be made in terms of dynamics, considering in this case the evolution in time of the balances of the main accounts or positions.

2.6. The stability of the balance of external payments

Overall, the balance of payments is always and necessarily stable, with the assets being equal to the liabilities (respecting the principle of double entry). Typically, surplus (active) or

deficient (passive) balance of payments terms are sometimes used, when in reality there is an instability of the balance of payments (the trade balance, current account, capital sad financial account).

Deficits in the external payment balance reflect a lack of external competitiveness or a massive outflow of foreign or domestic capital as a result of a deterioration in the overall business climate. A fundamental role in this respect is the credit of trade and current account balance. External balance of payments instability can affect the domestic economy, causing disturbances in the foreign exchange market (the credit of trade balance may cause appreciation or depreciation of the domestic currency), money market, credit market, capital market, etc. In addition, a chronicly deficient balance reduces international creditworthiness, diminishing the confidence of international creditors in the ability of the country in question to honor its payment obligations.

The underlying factors of the instability of the balance of external payments may be endogenous factors or exogenous factors. Endogenous factors play a fundamental role in creating the passive (deficit) credit of the balance external payments.

The endogenous factors that destabilize the BEP:

• Significant reduction in exports due to natural disasters or fortuitous events (revolutions, civil wars);
• Increasing imports amid domestic demand increase;
• Insufficient coverage of domestic demand (reduction of exports);
• Decreasing the external competitiveness of domestic products (low quality, high prices);
• Decrease in the degree of processing of exports;
• Deterioration of the internal business climate;
• Insufficient promotion / stimulation of exports;
• Inefficient business policy (tariff / non-tariff);
• The branching structure of the national economy.

The exogenous factors that destabilize the BEP:

• Destabilizing world prices for products with a high weight in the structure of foreign trade;
• The commercial policy of other states (both tariff and non-tariff);
• Lack of real competitive (comparative) advantages;
• Destabilizing the commercial flows in an area as a result of international conflicts / commercial disputes.

It is obvious that the number of factors that may have a direct or indirect impact on the state of the balance of external payments is much higher.

2.7. Techniques to stabilize the balance of external payments

With respect to the stability of the balance of external payments, there are two different concepts in the literature: the stability of the balance of payments is induced automatically by the general economic syability or the stability can be obtained by promoting macroeconomic policies or by using specific stabilizing techniques. In the first case there is no need for a state intervention to stabilize the balance of payments, since it will become stabilized at the same time as the general economic stability.

One mechanism for the automatic adjustment of the balance of external payments is the price mechanism (an assumption supported by Ricardo and Hume). This price mechanism explains the automatic adjustment of the instability in the trade balance (exports <imports). The mechanism is relatively simple: a trade balance deficit results in a drop in the money in circulation (the money will be located in the bank as a result of the purchase of foreign currency on the market, which is necessary for the payment of the surplus of imports, an operation which has the effect of diminishing reserve assets). The quantitative theory of money stipulates that a

fall in monetary mass will implicitly cause a fall in prices. This fall in prices will be an incentive for exports and a brake on imports.

The basic prerequisite for such a mechanism is for the value ratio between currencies (exchange rate) not to undergo significant changes (pronounced depreciation).

The automatic stabilizing of the balance of payments will also result from the fact that the deflation generated by the decline in the monetary mass in circulation will entail an increase in the need for funds in the economy, which implicitly will lead to an increase in interest rates. Attracted by the higher interest rates offered, foreign investors will steer their capital towards this market, which will lead to a stabilizing of the balance of payments. This automatic adjustment mechanism is called compensatory financing, with the interest differential being the element that stabilizes the balance of payments (the instability of the trade balance is offset by an additional contribution of external financial flows).

Another theory is that of income equilibrium (Keynes, Robinson, Harrod, Machlup) who argue that there are internal mechanisms for correcting external instability such as income levels or the degree of use of the workforce.

For the most part, these theories are no longer applicable in practice, with economic phenomena becoming more and more complex (for example, the adjustment of BEP through prices can no longer be made if the monetary mass is no longer correlated with the level of reserve assets). Consequently, under the current conditions where more than 60% of foreign exchange systems are based on free floating of the exchange rates, the automatic stabilization of the balance of payments is more difficult to achieve, while the state plays an increasingly active role in correcting external deficits.

There are a number of specialists who argue that state’s intervention in the economy in order to achieve a general balance of status focuses on three main directions: full use of the workforce, domestic price stability and stabilizing the balance of payments through specific techniques and mechanisms. Stabilizing the balance of payments remains a complex and difficult issue, most of the time stabilizing interventions damaging the interests of partner countries. It should also be noted that the chronic instability of the balance of payments of a large economic power (the USA, for example) has often had repercussions on the general state of the world economy.

2.8. Policies to stabilize the BEP

The state has several policies that it can use to adjust deficits in the balance of external payments:

- Monetary policies: interest rates, free-market operations by the Central Bank, mandatory bank reserves, issue or withdrawal of money from the market, credit limitation. These policies can have a direct influence on capital flows in the sense of attracting them through an increase in interest rates. Monetary policies can have a beneficial effect on the balance of external payments by stabilizing prices on the local market. Inflation and interest are factors that are strong enough to stabilize the balance of external payments.

- Budget policies: policies aimed at increasing tax and tax income (can be achieved through increased taxation or a better collection of the funds owed to the state) and reducing budget expenditures. Generally, they are the taxes and duties that can severely affect the financial and real flows recorded by the balance of external payments. These policies have the role of limiting the size of the domestic budget deficit, which is often externally financed through loaned funds (especially in the case of developing countries). In addition, these deficits are often financed in an inflationist way through issuing more currency, which may be harmful to exports, further aggravating the current account deficit.

- Devaluation of the exchange rate: an integral part of the monetary policy, it has the direct effect of encouraging exports and discouraging imports (which become more expensive in

the national currency). The underlying condition is that depreciation is higher than domestic price increases. Unfortunately, depreciation is not the most inspired way of stabilizing the balance for a country dependent on foreign trade. Moreover, depreciation inhibits technology imports and thus reduces the reengineering processes of companies that want to export more, to be more efficient and more competitive on international markets. Any company, in order to face international markets, must use the latest technological solutions in the field, and if it does not have the possibility of financially supporting a serious research and development activity in the field, it will need to import this technology, but the depreciation blocks this very thing.

- Establishing tariff and non-tariff barriers to import with a role in quantitative import restrictions. Tariff barriers are currently one of the major obstacles to international trade flows, with a wide variety of such barriers today, some of which are hard to identify and counteract.

- Stimulating and promoting exports through different methods (export subsidies, subsidized export credits, tax incentives, export credit insurance and guarantee, etc.) leads to a stabilization of the trade balance. Promoting exports includes: financial or logistical support for participation in international fairs and exhibitions for local companies, signing trade treaties, navigation or trade agreements, the creation of free trade areas or customs unions, the creation of information centers in the country meant to support the export activity or an increased commercial representation abroad.

- Financing of BEP deficits refers to the possibility of covering a trade deficit through an external credit from different sources (the IMF through the wider financing mechanism or the issuance of government bonds on the international market). This policy has an advantage in the short term, while in the long run the credits only postpone the resolution of the real causes that led to this trade deficit. Moreover, it should not be neglected that by recording the payment of these credits (paid interest) in the income account (current account) the deficit is carried forward for a future period of time.

- Attracting foreign direct and portfolio investment contributes to stabilizing the balance of payments through foreign capital injected into the economy, which can reduce the pressures on the exchange rate generated by a trade balance deficit. Attracting foreign investors can be done by granting facilities (land concession, commercial premises, buildings, utilities) or tax incentives on the one hand (tax cuts, reductions or exemptions to indirect taxes), but also by promoting the image abroad on the other hand. It is obvious that no matter how many facilities would be offered to foreign investors, and no matter how much effort would be taken to make the host country known, the lack of a proper business development environment would keep foreign investors away.

In conclusion, the state can intervene directly through numerous levers and mechanisms to stabilize the balance of external payments. The reason for intervening in the sense of stabilizing the BEP is the absence of an automatic adjustment and the effects that the BEP instability may have on the overall economic balance. The balance of payments remains the main means of measuring the value and the external competitiveness of an economy, while being a particularly useful tool for designing the main macroeconomic policies.

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