# TRANSNATIONAL CORPORATIONS AND THE INTERNATIONAL COMPETITIVENSESS OF THE HOST COUNTRY

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***Abstract:***
*The trend of expansion, at all levels of globalization and especially of the economic environment is in full affirmation. New technologies have made possible the globalization and transnational corporations have transformed it into practice. Through decisions taken by them in procurement, production and investment have been created global markets and has provided the impetus for interdependences growth.*
*Globalization process is stimulated also by the interdependent development of international trade and foreign direct investment. Since most of the trade and a large part of the investments are undertaken by transnational corporations, no country can develop as an integral part of the world economy without attending to a substantial presence of transnational corporations within their borders.*

***Key words:*** *competitiveness, transnational corporations, globalization, competition environment*

***JEL classification:*** *F23 - Multinational Firms; International Business*

## 1. Introduction

Business and production globalization makes national economies and destinies of their communities to be increasingly interconnected. In traditional economic theory, foreign direct investments can, in principle, have a positive or negative impact on national welfare, but many argue that global production and competition increase efficiency of the global economy because transnational corporation encourage international labor division, so that countries become more specialized in producing goods that have a comparative advantage. Competition reduces monopolistic profits and intensifies pressure for innovation. They say therefore that transnational corporations can improve national economic performance, since these firms tend to have higher productivity than domestic firms and contribute to the spread of new technologies and to raising skill levels of national labor force.

More critical interpretations argue that this globalization of business involves an increasing divergence between corporate priorities and those of national governments and their citizens. For much of the post war period, this critical observation was common in many countries, particularly in developing countries. Here transnational corporation's activity was often seen as distorting development priorities, and producing excess profits which were repatriated abroad. A similar criticism appeared in major investing countries, including the U.S., claiming that the transnational corporations can transfer abroad jobs and technology and, therefore, affects the national prosperity. Moreover, the ability of corporations to organize production at the global level is seen as giving them a huge structural strength compared to the national government and labor force at the national level.

Skeptics about globalization thesis adopts a more traditional view, conceiving transnational corporations as national companies in essence with activities abroad; in consequence, they are exposed to national control. These divergent points of view creates the context for analyzing decisional, institutional, and structural effects of production globalization on sovereignty and autonomy of the advanced capitalist states.

## 2. Extanding transnational corporations and their impact on host state

### *2.1. Transnational company and the balance of payments of the host state*

Transnational corporation's impact through foreign direct investment, through the balance of payment of a country varies with the purpose of investment, the nature of the activity and the stage of development of investment project.

In addition to these considerations, the size and nature of the external transactions of subsidiaries of transnational corporations are influenced by specific factors to each country. Effects of transnational corporation's activity on balance of payments of a country may be direct and indirect.

*Direct effects* can be determined by identifying transactions related to their work and their reflection in the balance of payments on the credit (+) or debit (-) part.

*Indirectly impact* consists of:

- ✓ the contribution of foreign direct investment to domestic capital formation, which impulses economic growth through the investment multiplier and through the training effect. The economic growth rate, influences in it's turn, other macroeconomic variables such as exports, imports and savings rate, all reflecting direct or indirect, in the balance of payments;
- ✓ capital flows resulted from the transnational corporation's activity influence decisively (e.g., Asian crisis) the exchange rate, and therefore the price and volume of transactional goods;
- ✓ transnational corporations can induce domestic firms the ability to produce goods for which there is external demand, thus contributing to increasing exports;
- ✓ transnational corporation can turn to local suppliers who use import goods, thus contributing to increasing imports.

Regarding Romania, a comprehensive study on the effects of transnational corporations on the balance of payments has not yet been developed. A more recent research highlights interesting issues and contradicts some previous research:

- ✓ the frequency and intensity of export activity is maximum for firms with majority foreign capital comparatively to those with local capital. The value of exports exceeds 75% of turnover in 46% of these firms. It is natural to find mainly the foreign firms with pro pension towards traditional export in sectors such as textiles and furniture, with emphasis on low cost of labor force. Their orientation in this direction is verified also by the fact that at aggregate level, the share of added value in turnover is minimal for foreign firms. Apparently surprising is the inclination towards export of the foreign investment from steel and car industry, which can be considered medium or high complexity. It is in fact about the widespread practice of the art of negative transfer pricing, highlighted in the average level of branch profitability by type of ownership: -17.8% for foreign companies in steel industry and -8.9% for foreign firms in the automobile industry. Moreover, from the foreign firms who have mainly an export activity, 25% exports in loss;
- ✓ the share of imported materials is higher for foreign firms than for local firms, and in the textile industry and footwear more than half of foreign companies imports raw materials up to 100%.

Reviewing we can sketch a picture of the impact of transnational corporation on Romanian economy. Thus, transnational companies in searching markets and searching for exports coexist, sharing interest, sectors with a preponderance of more pronounced of transnational looking for exports. They have higher levels of performance in terms of productivity, utilization of capital, management and investment effort. On the other hand, they are directed to sectors with low value added, import more and exports with loss.

On average, the largest transnational corporation s has affiliates in 41 foreign countries. The ranking by the number of host countries for foreign affiliates results in a much more diversified list of home countries and industries (table1). Deutsche Post (Germany) leads, followed by the Royal Dutch Shell Group. There is a wide range of home countries and activities in this list, which indicates that the form and extent of international diversification differs widely among firms.

**Table 1. Top 15 TNCs, ranked by number of host economies of their affiliates**

| Company | Home country | Number of host economies [a] |
|---|---|---|
| Deutsche Post AG | Germany | 111 |
| Royal Dutch/Shell Group | Netherlands, United Kingdom | 98 |
| Nestlé SA | Switzerland | 96 |
| Siemens AG | Germany | 89 |
| BASF AG | Germany | 88 |
| Procter & Gamble | United States | 75 |
| GlaxoSmithKline | United Kingdom | 74 |
| Linde | Germany | 72 |
| Bayer AG | Germany | 71 |
| Philips Electronics | Netherlands | 68 |
| Total | France | 66 |
| IBM | United States | 66 |
| WPP Group PLC | United Kingdom | 64 |
| Roche Group | Switzerland | 62 |
| Novartis | Switzerland | 62 |

*Source: UNCTAD/Erasmus University database on largest TNCs.*
*a Majority-owned foreign affiliates only.*

***2.2. The impact of transnational companies on the competition environment of the host state***

The transnational corporation's impact on the competition environment of the host state is not necessarily harmful, as many radical economists argue. Penetration of a transnational corporation on a national market with a limited number of competitors relative to the market capacity may enhance competition level on the market. Corporate contribution to the competition process includes reducing prices, product differentiation, advertising, introducing new products because of research and development activity. It is possible that beside the welfare of consumers, the emergence of transnational corporations in the competitive landscape on a national market to determine the performance improvement of local firms.

Penetration of Pepsi Cola and Coca Cola on the Indian market did not remove manufacturers from the local market, the entire soft drinks industry taking advantage of the advertising campaigns of both transnational corporations'. In early 1997, local brands Thums Up (ultimately acquired by Coca Cola) and Campa (produced by Pure Drinks Ltd.) had market shares comparable to those held by Coca Cola and Pepsi Cola.

In Romania also, transnational corporation's investments in soft drinks have a stimulating effect of competition. There had appeared important local manufacturers, such as European Drinks, Leader, and development of Dorna range. In addition, the multiplier effect of Coca-Cola investment was 10:1, meaning that each job appeared to Coca-Cola has created another 10 jobs in the distribution area.

Numerous studies link the possibility of training effects appearance in the local economy due to the activity of transnational corporation's to this activity, local firms productivity increase directly proportional to their exposure to the transnational corporation competition, the latter measured by market share of transnational corporation. Such positive effects tend to occur when local firms already have certain technological capabilities above market penetration of transnational corporation sites. In Mexico and Uruguay was found that a positive relationship between the presence on market of the transnational corporations and the national companies' productivity, when the difference between the productivity of transnational corporation and the national firms was not too big. This suggests that the possibility of producing training effects is greater for investments made by transnational companies which do not have a dominant position on the world market, or which come as a residence in developing countries. Local companies' opportunities are greater because such transnational corporation operates in sectors where labor is the factor intensive and technological contribution is significantly less than for transnational corporation whose home countries are developed countries. Effects of training are not limited to technological improvements and increase productivity. There are more statistics which suggest that transnational corporation's subsidiaries oriented towards export act as catalysts of development of export capacity of local companies by opening access to foreign markets.

If, however, transnational corporations appear in unexplored areas of activity by local firms or there is a huge difference between competitive strength of transnational corporation's and the local companies and competition from importers or other transnational corporation is insignificant, the multinational corporate branch entering the market in such circumstances has from the beginning a dominant position. In this case, the market can not function effectively and records over benefits for the branch, to the detriment of consumer welfare and of dynamic growth of these sectors of activity.

## 3. Transnational companies and the competitiveness of the host state

Competitiveness is important and provocative, but must be seen as a mean pursuing an exact objective - development. Transnational companies can contribute to increasing the competitiveness, especially in developing countries and those in transition to market economy.

Transnational corporation importance in increasing the volume of trade of the host countries derive from additional capital and technology, the management know-how implemented, but also from the access to regional and global markets where transnational corporations operate. However, local resources can be supplemented with other resources that will allow expansion of the types of products consumed in the domestic market or for export, which will increase competitiveness and benefit of the host economy.

In countries facing low domestic investment due to financial constraints, transnational corporations can lead to increasing international trade by the mere provision of capital for the exploitation of natural resources and cheap labor force. Thus, transnational companies take the risk of launching new products for export. It was, in fact, the role of transnational corporations in developing countries' trade and in transition ones.

The development of international production system have a key role in increasing economic competitiveness of host countries, reflects the transnational corporations response to dramatic changes in global economic environment: increasing technological advances, liberalization of economic policies, increasing competition. Transnational companies are in a continuous search of advantages: low costs, markets, resources, etc.

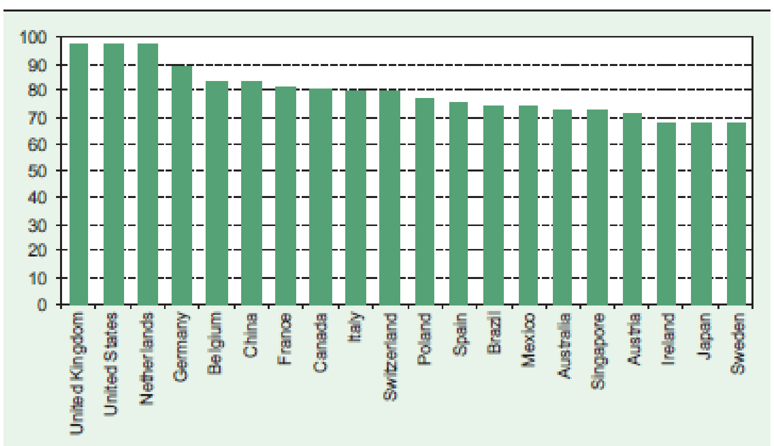
Changing strategies and systems of production to specific transnational corporation, opens new opportunities for the economies of host countries because they have the opportunity to work in technology intensive activities oriented towards export, which otherwise would not be able to address and could not become part of the international production systems. In addition, demand growth raises a number of barriers for smaller suppliers from developing countries, which have not the advantage of experience and of competitiveness which the modern system of production requires.

Improving competitiveness has significant consequences. Developed countries, particularly the United States, Germany and Japan are the main traders. However, especially developing economies such as China, Mexico, Republic of Korea, Singapore and the countries of Central and Eastern Europe, Poland, Czech Republic, Hungary are those who have earned more in terms of market share these states now part of the category of the highest 40 exporters of the world. In other words, are taking place the dramatic changes in world trade and many developing countries are among the main winners.

Increasing exports to these countries are directly linked to the expansion of international production systems, especially in consumer electronics and automotive. Subsidiaries of foreign transnational corporations have, at present, more than half of exports of some of these countries. However, such systems tend to focus on activities, regions and countries.

The preferred locations for foreign affiliates of the top 100 transnational corporations, measured in terms of location intensity, which takes into account the home country of the transnational corporations, are the United Kingdom and the United States (figure I.). The top four positions are similar to those in 2005. China ranks sixth, ahead of France and Canada. Among developing economies other than China, Brazil, Mexico and Singapore rank among the top 20 preferred locations.

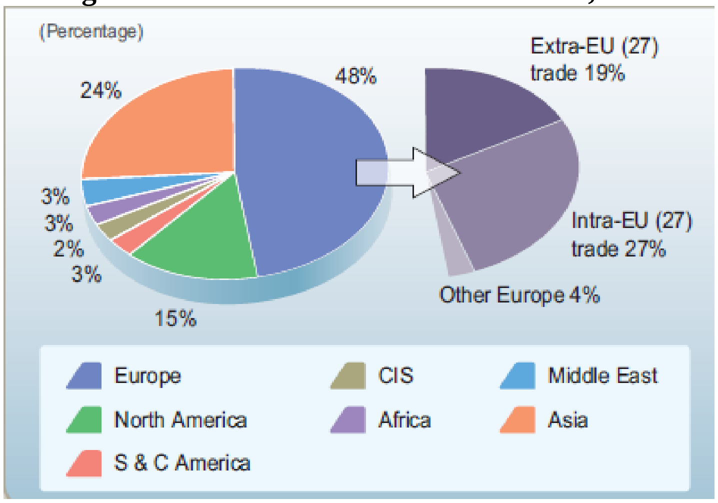
**Figure 1. Location intensity of the 20 most preferred host economies, 2007**




*Source: UNCTAD, based on Dun & Bradstreet, Who Owns Whom Database.*

It is possible that the export dynamism that is being experienced by "winners" to spread to other developing countries, because international production tends to develop. But until now, most of the activities related to export of transnational companies - especially in the most dynamic sectors of the economy - are concentrated in few countries, mainly in East Asia and South East and from areas which links with North America and the European Union. However, transnational companies are significant players in many countries are not major exporters worldwide.

**Figure 2. Total commercial services trade, 2007**




*Source: World Trade Organization* - „ International Trade Statistics 2008"

In each of these countries, transnational companies have played a role in increasing international trade. But regardless of how big is the involvement of transnational companies in the international trade of these countries, it varies considerably. China, Hungary, Ireland, Mexico managed to classes among the strongest exporters, relying on foreign direct investment. But each country had its specific advantages that allowed them to be linked to international systems of production.

The advantage of China is the size of the economy and population, in Ireland and Mexico is about access to important markets. In Ireland a particular role had had national policies to attract foreign direct investment with a high level of technology. That is why Ireland is the most globalize country in the world, mainly due to capital flows and foreign investment, but also high-tech industries.

Improving export competitiveness is important and challenging, but do not represent an objective in itself. It is a mean that leads to "promote development. Thus, questions arise on the benefits resulting from the association with transnational companies, starting from improving trade balance and ending with the modernization of export operations and supporting it in time. Although foreign direct investment helps increasing exports, subsidiaries of transnational companies call also imports. Therefore, the question is that of the way in which the host state will know how to make the most of the transnational companies presence. Everything depends on the strategies promoted by transnational companies, of one hand, and policies of the host countries, on the other.

Transnational companies can contribute to increasing the competitiveness of a country either through investment in high value added industries in which was not previously invested, either by passing in an industry, from low-productivity activities, with low level of technology and very low work built, to activities that involve a high productivity, high technology and intelligence. This underlines the importance of ensuring sustainability of the subsidiaries of transnational corporation. If these subsidiaries will be included in the economies of host countries, they will evolve establishing links with national companies. Where such links creates exports that take place not only will be beneficial for the host country, but will bring a higher national added value but also will contribute to strengthening the competitiveness of national enterprises.

The success of national industrialization strategies of a large number of countries (especially Asian), who have combined efforts to attract transnational corporations towards export with development, represents a model.

It appears that the export activities of transnational corporations can be exploited further. Technology is changing. Processes and functions are divisible, and the boundaries between internal and external for firms are in motion. Reduction of transport costs allows extending distances to be covered. New activities will join the gallop of globalization, including many developing countries and some of economies in transition.

The challenge for states that will want to improve export competitiveness in combination with transnational companies is, first, the creation of links with the production systems of these firms.

### 4. Conclusions and perspectives on the relationship between host state ant the transnational corporation

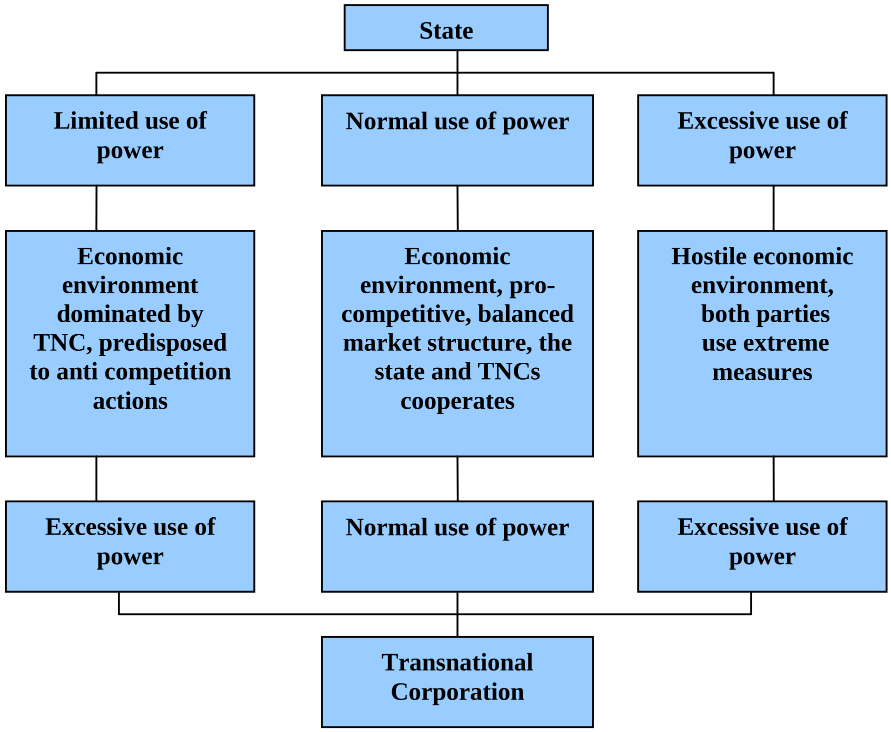
Whether it aims the settlement of some problems related to balance of payments, the competitive environment or social environment, the most effective measures that state can take are the ones to promote free competition. Moreover, the result of research among managers of multinational specialized on consultancy was even more trenchant: pro competitive policies are the only having a positive impact on the national market. Promote free competition does not mean the sudden and total liberalization of markets, but creating the conditions that this liberalization to be beneficial for the national economy. Transforming a state monopoly into a private one is not free, but only an evidence of state weakness. On the opposite side, the excessive use of state power by discriminatory and restrictive measures is only an attempt to hide the weaknesses of the state. The state knows that national firms can not face foreign competition and is entitled to protect them, even on social considerations. This protection must have a predictable end and to rely on strategy to develop firm specific advantages. In this case, the temporary protection of local firms, in order to increase their capacity to face competition of transnational corporations, in the moment of the surrender to such protection from the state, is also a measure to promote competition. Among measures to promote free competition may be included application of the laws on control of strategic alliances, mergers and acquisitions, the transfer pricing practices and any challenges that the transnational company may raise, voluntarily or involuntarily, to the competitive environment of the host state.

However, measures to promote free competition does not mean “laissez-faire”, but the involvement with regulatory role of the state in the economy, to prevent and remedy the market failure. In Romania, the state is unable to implement pro competitive measures. And because, in itself, in a world of global competition, different competition policies at the national level creates disparities between states and increase the free rider phenomenon among corporations.

Transnational corporation, by its very nature, tends to abuse its market position and to use excessively power. She will never have, and it is reasonable to be so, the initiative to create a competitive environment. Conversely, when will encounter poor side of the host state in whose territory it operates, resulting economic environment will be dominated by corporation and will have the characteristics of a limited monopoly or oligopoly.

If the policies that the host state adopts are against transnational corporations, economic environment that is created is one of mutual mistrust, which can often lead to a spiral of retaliatory measures or even disinvestment processes, motivated not by the environment itself but by the fact that the environment no longer allows corporation to obtain expected profits. The solution is therefore in the middle: the state should use its normally power trough policies to promote free competition, which in turn to require corporation to refrain from abusive behavior on the market. All these are described in the model of state-corporate partnership proposed in the Figure 3.

**Figure 3. The model of the state-transnational corporation partnership**




The solution is bi and multilateral agreements to protect free competition in parallel with the introduction and enforcement of codes of conduct for multinational corporations in their dealings with the host state, and for the host state in their relations with transnational companies.

In the next decade, successful transnational companies will be those who will benefit from global economies of scale by selling similar products worldwide and by providing similar services in dozens of countries. However, they must harmonize their local operations to win the market, to learn what competition wants and to have access to ideas, tactics and new technologies. Exchange of information and innovation should be encouraged within a company to ensure competition advantage, to respond more quickly to anticipated or actual competitive markets.

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