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# СВІТОВЕ ГОСПОДАРСТВО І МІЖНАРОДНІ ЕКОНОМІЧНІ ВІДНОСИНИ

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## **TRANSNATIONAL CORPORATIONS EFFECT ON THE ECONOMY OF DEVELOPING COUNTRIES**

*The paper is devoted to complex research of theoretical and practical issues of influence of economic phenomenon of transnational corporations on the global economy in the emerging global marketplace. The paper analyzes the actions of transnational corporations and the results of their performance are lightened.*

**Keywords:** *transnational (multinational) corporations, economic development, globalization, the impact of corporations.*

### **STATEMENT OF THE PROBLEM**

With the rapid development of world globalization process the phenomenon of transnational corporations exists, as well as their fast expansion and proliferation in the modern global economy. This fact of course is determined by positive and negative effects on the economies of specific countries and the world economy as a whole. The identification and description of specific outcomes, benefits and damages of TNCs are still problematic.

### **OBJECTIVES FORMULATION**

Theoretical basis of the study of the problems of world globalization are researches of following foreign scientists: G. Jones, G. Hamel, J. Schumpeter, D. Ricardo, A. Smith and others.

### **BASIC MATERIAL**

The significant contribution of outstanding scientists still leaves controversial issues about the real impact of globalization in the face of MNCs on economic and social life worldwide.

The aim of the research is comprehensive research of theoretical and practical issues of influence of economic phenomenon of transnational corporations on the global economy in the emerging global market; the highlighting of the positive and negative effects of this phenomenon.

Based on the aims of the research, the following questions in the paper are considered.

Allocation of the basic definition of transnational corporations and their direct connection with the phenomenon of globalization.



Description of the points of view of supporters and opponents of multinational corporations.

Investigation of real positive and negative consequences of corporations in the global economy.

In recent 50 years multinational (also called transnational) companies surely have become a new phenomenon in the economic world. Multinational company is any enterprise that provides its goods and services not only to the country where it was established, but also to another states all over the world. Quite a surprise is a fact that some MNCs have become so successful and profitable, so that their profit is several times larger than annual GDP of many countries around the world. In fact, these corporations are so rich that they can buy countries, in theory, of course. But whether or not all the countries in the world have benefited from TNCs? And is it possible that such difference in figures exists?

Table 1

GLOBAL 500 Top Companies: 10 Most profitable (2013) [1]

Corporation	2013 profits (\$ billions)
1 Exxon Mobil	44,9
2 Apple	41,7
3 Gazprom	38,1
4 Industrial & Commercial Bank of China	37,8
5 China Construction Bank	30,6
6 Volkswagen	27,9
7 Royal Dutch Shell	26,6
8 Chevron	26,2
9 Agricultural Bank of China	23,0
10 Bank of China	22,1

As far as it's known, the main goal of any company is profit maximization. But some corporations so outdone themselves, that they have really giant sums of profit.

According to one of the largest business website CNN Money, which makes up the list of 500 the largest and successful corporations every year, almost all corporations in the list are multinational. That means that no one of them provides their goods and services only to their home country.

As it can be seen from Table 1, for instance, Exxon Mobil's profit in 2013 is about \$44,9 billion. At the same time Estonia's GDP in 2012 is about \$22,3 billion and Iceland's one is about \$ 13.6 billion (The World Bank, 2014). The annual sum of all final goods and services of these two countries is less than annual profit of one company. It is very impressive information, isn't it?

Many world economists, financiers and ordinary people are against TNCs and support them at the same time. Some people see in them good



perspectives of the world economy development and consider them to be the main «tools» of globalization. Opponents see TNCs as a threat of full control of the market and as an opportunity to become the total monopolies in the specific sectors of economy. Despite the fact that TNCs are a platform for economic development, I think that multinational corporations have more threats than perspectives for the world economy.

The main supporters of transnational corporations are people who also support globalization. TNCs are considered to be the most important tool of globalization and The World Bank, International Monetary Fund, and The World Trade Organization are “the drivers” of globalization process. The supporters believe that all over the world integration of labor, goods and services with the help of transnational corporations will bring the best results, such as fully developed economies of all the countries in the world.

The first argument of such «future victory of the world» is economic development. The supporters of MNCs claim that the companies help to wake up the economies of not fully developed countries. They bring more advanced technology to the states. Then like a chain process: TNCs transfer their huge production capacities into the not developed countries, which forms new jobs and reduces the unemployment level; because people are employed, the level of production and GDP in the country increases; because the increasing of GDP, national income and general life level increases in the country as well. And it seems like everyone wins – the TNC receives new revenue and then profit, and the country increases its life level.

But the real reasons of such «charitable» transfers of production are much deeper. First of all, transnational corporations shift their production capacities, because the cost of production is much lower in poorer countries. Also, the salaries which company will pay to the workers are lower. For instance, a worker of automobile plant in Germany will receive much more money than a worker of the same automobile plant in China. Because of high number of population and low life level, labor resources is very cheap in the countries of “the third world”, such as China, Thailand, Vietnam, India, Malaysia and many African countries. That’s the reason why MNCs have been criticized for using «slave labor» – workers who are paid a pittance by Western standards.

Another reason why transnational corporations are so eager to capture poor and high population countries is infrastructure’s presence. For instance, in the early years of USSR its government was deciding where to establish one of the main metallurgy centers. The most suitable place for it was Kryvorizkyi Iron Ore Basin in Central Ukraine, because there were a lot of natural resources. All the government has needed to do was just moving the labor force from rural to urban areas. But for the settlement of a lot of people together the ministry had to provide an infrastructure for new workers – to provide food, to build new places of residence, educational institutions, recreation sanatorium, etc. Because in those times there were



small villages in the Basin, but nowadays there are big towns with almost one million population in every.

But nowadays, TNCs don't need to build all the infrastructures; they just come into the already existing densely-populated cities.

Another bad impact of TNCs on the host countries is decreasing of competitiveness of local companies. Multinational corporations are becoming so successful because their products and services are recognizable and desirable all over the world. Not everybody in Brazil wants a cell phone, produced by the local company, but everyone wants American iPhone. In addition, usually, the products, provided by TNCs are high-quality, but local products not always. For this reason, when multinational corporation enters the local market, it can easily displace or even buy many firms when their products are substitutes. The local products become less needed for people with such a powerful competitor. Besides, the local firms lose their competitiveness not only of products, but also of attracting and keeping the workers. Employed people can resign and job in new and famous TNC, especially when the difference between wages in local and multinational companies exists and it's almost always the case. In addition, new for the country, but famous all over the world corporations have a lot of finance and opportunities, so they immediately will advertise themselves everywhere and easily will pay a lot of taxes.

This is how globalization is going on. The whole world changes according to the Western standards, almost every country has a lot of subsidiaries of TNCs. So everybody can travel around the world and eat in the same restaurant, live in the same hotel, buy the same products no matter where a person goes – to Italy, Japan or Peru.

The second argument presented by supporters of multinational corporations is their positive social impact. TNCs, which come to new countries, provide for people new opportunities and reduce unemployment which, of course, will increase the economy level of the states. Also, they provide them new high-quality goods and services and general mood of society should increase, all the population should benefit. Besides, the workers should proud that they work at so famous and large corporations. In addition, every MNC should face corporate social responsibility, which means that corporations fully understood and took all responsibility for their impact on local society, their human rights, ethical standards, environmental and law norms.

«Respect for applicable legislation, and for collective agreements between social partners, is a prerequisite for meeting that (corporate social) responsibility. To fully meet their corporate social responsibility, enterprises should have in place a process to integrate social, environmental, ethical, human rights and consumer concerns into their business operations and core strategy in close collaboration with their stakeholders» [2].



But the MNC's real social impact is rather negative than positive. As it was mentioned above, the corporations shift their production capacities into new states. Most of the time they used country's labor force, but almost all final products are sent back to the firm's home country, so the local population received nothing from all those goods. As a result, the people feel themselves like a big plant for producing something, but they are not consumers, they have produced it not for themselves. So, the workers have received the salaries, and the products were transported back. But all final production's results like environmental pollution, depletion of natural resources stayed for the country. Does it really have positive social and economic consequence?

In addition, the producing of some amount of products is just a half of a case. Any enterprise and also MNCs need to sell all the goods produced. And they do it through special marketing system "Formation of Demand and Sales Promotion". This system means that firstly, the firm should create the demand for their goods among people, in other words to identify the specific potential consumers. Secondly, when the demand is created, the firms need to do some actions for promotion their sales, to make people buy as much as possible. And here the most interesting part begins. How can the firms make people think that they really need their products? Of course, they do it with the help of advertising. TNCs are the kings of commercial; they have created a variety of its ways and methods of influencing people.

«In the US, 75 % of commercial television time and 50% of public television time is paid for by the 100 largest corporations. Projected global advertising expenditure for corporations in 2006 is over \$427 billion dollars» [3].

So, we can only imagine how great impacts TNCs have on all the people. They propose to us a lot of unnecessary goods under different commercial slogans and people really begin to think that it is exactly what they want. For instance, there are many cosmetics advertising that were designed for women. First of all, a lot of skin changes due to the age and other skin problems will be shown to women, so they need to see that they also have the problems. In other words, it's obligatory to show the people theirs even not existing defects. And this feeling of inferiority will stimulate them to go and buy some goods that will delete the problems. As a result, there are a lot of "empty" needs which TNCs impose to people with the help of subtle psychological influence. And this influence is done with bright and attractive advertising.

That's why I think TNCs have not any positive impact on society in general, and especially on the societies of their host countries.

The final argument advanced by supporters of transnational corporations is their actions of keeping the environment clean. When the companies shift their production it, of course, leads to the pollution of the



local environment. And all companies claim that they comply with the local environmental laws and do not cause any harm to the surrounding area.

«Our community water programs are designed to support healthy watersheds and sustainable programs to balance the water used throughout our production process. We do this by working on a wide range of locally relevant initiatives, such as watershed protection; expanding community drinking water and sanitation access; water for productive use, such as agricultural water efficiency; and education and awareness programs» [4].

«We are working with the Scottish Forest Alliance to benefit future generations as the trees mature over this century and beyond» [5].

The BP's citation means that the third-largest energy company in the world has planted the trees in Scotland and nothing has been said about its other projects. But does this company really understand how many trees should it plant all over the world to cover all its damaging the world environment?

As it was mentioned above, at most cases companies come into the new countries with cheap labor force. In addition, these countries usually are not very developed, and this means that their legislature is not very strong too. In other words, multinational companies fall in "production paradise": cheap labor, weak legal system for protecting the environment, and, as a consequence, unlimited opportunities of using natural resources. Of course, there are environment protection laws, but I don't think that these laws in Indonesia are more strict than in the USA. So, companies produce their goods and services, using local labor and natural resources, and then send all produced products to their home countries or export them to other countries. And the host countries stay with their environmental problems and only some international organizations can help them. I don't think that it has any positive impact on the countries' economies, so on the whole world's economy too.

So, in my opinion all these environmental protection actions of multinational corporations are just like one additional way of attracting attention to themselves. Despite the fact that some companies really pay a lot of attention to these problems, and spend a lot of finance for solving bad consequences of their production, I think, the most part of these corporations are not serious about the environmental protection.

Turning to the real life example, it is worth to describe British Petroleum's multinational corporation and Azerbaijan's example. As far as it is known, after the Soviet Union disintegration, all post-soviet countries had suffered a lot from economic disasters. Every country started its own new independent life and the Republic of Azerbaijan was not an exception. But the country has huge advantage in comparison with others: oil, so, when the strict regime of USSR government was over, BP quickly has come into such rich in resources, young and economically weak country.



According to official website of British Petroleum, BP has been in Azerbaijan since 1992 and is the largest foreign investor in the country, exactly after the country has got its independence.

«In Azerbaijan, BP is the largest foreign investor and operates two PSAs, Azeri Chirag-Gunashli (ACG) and Shah Deniz, and also holds other exploration leases. BP is expecting to progress the sanctioned Chirag Oil project by starting up the West Chirag production and drilling platform in late 2013» [6].

In order to verify whether the appearing of BP corporation had significant impact on Azerbaijan economy, an econometric analysis will be implemented. As far it is known, the gross domestic product is one of the main indicators of the economy's state. In general form it consists of consumption, investment, government spending and net export of the country in period  $t$ . With the help of linear regression model the equation is as follows:

$$GDP_t = \beta_1 + \beta_2 C_t + \beta_3 I_t + \beta_4 G_t + \beta_5 NX_t + \varepsilon_t$$

Where  $\beta_1$  is constant and does not has any statistical impact on dependent variable (GDP in period  $t$ ),  $\beta_2$  is parameter which shows by how much GDP will grow if consumption increases by 1%,  $\beta_3$  stands for investment with the same interpretation and  $\beta_4$  and  $\beta_5$  stand for government spending and net export respectively.  $\varepsilon_t$  stands for standard error.

The BP's intervention into the Azerbaijan's economy could be seen in foreign direct investment inside it, but, it is impossible to find exact data for it, as far as many multinational corporations try to hide the precise amounts. But it is possible to see whether the appearance of British Petroleum has changed considerably the economic situation inside the country with the help of structural brake testing.

Taking Azerbaijan GDP per capita example and 1992 year (year of appearance of BP) as breakpoint, it could be assumed that before this structural change and after, the situation took absolutely different turn.

Table 2

Azerbaijan, GDP per capita (current US\$) [7]

Year	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
Current US\$	1237,3	1209,2	676,2	530,1	436,2	397,2	409,2	505,6	561,9	573,9	655,1	703,7
Year	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	
Current US\$	763,1	883,6	1045,0	1578,4	2473,0	3851,3	5574,6	4950,3	5843,2	7189,8	7163,7	

With constructing in EViews a least square equation, we will get the next results:



Dependent Variable: GDP  
 Method: Least Squares  
 Date: 02/13/14 Time: 16:59  
 Sample: 1990 2012  
 Included observations: 23

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	2139.633	485.7829	4.404505	0.0002
R-squared	0.000000	Mean dependent var		2139.633
Adjusted R-squared	0.000000	S.D. dependent var		2329.733
S.E. of regression	2329.733	Akaike info criterion		18.38740
Sum squared resid	1.19E+08	Schwarz criterion		18.43677
Log likelihood	-210.4551	Hannan-Quinn criter.		18.39982
Durbin-Watson stat	0.078201			

Using stability diagnostics and Chow breakpoint test with 1992 as breakpoint date, it is achieved:

Chow Breakpoint Test: 1992  
 Null Hypothesis: No breaks at specified breakpoints  
 Varying regressors: All equation variables  
 Equation Sample: 1990 2012

F-statistic	0.328541	Prob. F(1,21)	0.5726
Log likelihood ratio	0.357045	Prob. Chi-Square(1)	0.5502
Wald Statistic	0.328541	Prob. Chi-Square(1)	0.5665

The probability of structural change in 1992 is 0,5726 which is higher than significance level 0,05. And the null hypothesis that no break in 1992 is considered is rejected. However, we do not examine what exactly has happened inside the Azerbaijan economy in 1992, but the fact that British Petroleum «is the largest foreign investor in Azerbaijan» allows to conclude that the structural change in 1992 in GDP per capita occurred precisely due to the emergence of BP inside the Azerbaijan's economy.

The example above proves that one huge corporation can influence significantly the whole economies of many countries. Nowadays, British Petroleum has about 92 subsidiaries in the Republic of Azerbaijan and the state has approximately 0.6 % of world oil resources. It is interesting, what will happen with Azerbaijan economy if the resources will run out, isn't it? Whether British Petroleum still will be so interested in the development of the country.

### CONCLUSIONS

To sum up, I would like to say that, in my opinion, multinational corporations have both positive and negative aspects. The companies provide many opportunities for economic development, but they use cheap labor of the countries for making their own profit, they pay the workers a pittance in more poor countries, and they decrease the competitiveness of local companies. The multinational corporations reduce unemployment level of the countries and provide for people high-quality goods and





services, but they create a lot of «empty» needs for stimulating people buy their products with the help of advertising. The TNCs claim that they fully comply with the requirements of laws on environmental protection and participate in a variety of environmental projects, but they use the fact that poor countries do not have proper legislation for protecting their nature, and they use other countries' natural resources.

In my opinion, general situation can be changed if the companies will be more limited in their abilities to rule the world economy. The host countries should establish more strict limits of company's introduction into economic, social and environmental spheres of their life. Because the world economy will never be fully developed, until so unequal distribution of resources, labor and finance exists.

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## **ВПЛИВ ТРАНСНАЦІОНАЛЬНИХ КОРПОРАЦІЙ НА СТАН ЕКОНОМІКИ КРАЇН, ЩО РОЗВИВАЮТЬСЯ**

*Робота присвячена комплексному дослідженню теоретичних і практичних питань впливу економічного явища транснаціональних корпорацій на світову економіку в умовах формування глобального ринку. В роботі проведено аналіз дій транснаціональних корпорацій, а також висвітлено результати їх діяльності.*

**Ключові слова:** *транснаціональні (мультинаціональні) корпорації, економічний розвиток, глобалізація, вплив корпорацій*

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