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# STATE FAILURE IN THE CONTEXT OF THE OPERATIONS OF TRANSNATIONAL CORPORATIONS\*

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**Abstract:** The main purpose of the paper is to discuss issues related to the failure of the state in the context of selected areas of operation of transnational corporations (TNCs). The analysis presented in the paper showed that the state turns out to be ineffective with reference to transnational corporations in many areas of their operation (e.g. tax avoidance by TNCs, the use of their monopolistic position, their negative impact on the natural environment as well as economic sensitivity). The sustainable growth of the global economy requires actions not only in each country but also by international organisations and integrating groupings that could work out certain rules concerning compliance with tax regulations by TNCs and also more effective control over the business of those entities, including control over capital flows on a global scale. The problems discussed in the paper contribute to the main stream of research concerning the role of the state in market economy and the limited effectiveness of the state in exercising control over the operations of transnational corporations.

**Keywords:** government failure, market failure, transnational corporations, foreign direct investment, tax avoidance.

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## 1. Introduction

Transnational corporations (TNCs) are entities functioning in the global economy which raise multiple controversies among economists and politicians. Advocates of the activity of TNCs stress their importance in the globalisation process where they actively participate and create it (Kosztowniak, 2015, p. 101; Petricevic and Teece, 2019, p. 1488). They are perceived as the driving force of global economic development (Hunya, 2012, p. 1). Opponents, on the other hand, note that the size of those entities and the assets they hold provide them with such power and market position that may disturb the effective functioning of the market (Gasz, 2012, p. 29). That was, for instance, confirmed by the relatively recent financial and economic crisis that started with the fall of Lehman Brothers. The financial problems of large banks and enterprises, in particular those operating in the automotive industry, showed that in many instances TNCs were too big to fail (TBTF)<sup>1</sup>. In order to avoid bankruptcy, many enterprises approached the state for support. Due to the fact that the effects of bankruptcy would be associated with the loss of numerous jobs and could have an adverse impact on the functioning of individual economic sectors and the economy as a whole, governments in many countries developed and implemented support packages. However, as proven in practice, in many cases public funds destined to save enterprises facing bankruptcy were wasted<sup>2</sup>.

The negative effects of the activities of TNCs in the modern global economy also include issues concerning the limitation of the sovereignty of the countries in which the TNCs operate (Kordos, and Vojtovic, 2016, p. 153), continued disparities in wealth, poor labour conditions, widespread corruption<sup>3</sup>, transfer pricing policies, and inadequate consumer and environmental protection (Kolodner, 1994, p. 3). It is also highlighted in the subject literature that the increased leverage of transnational corporations has allowed them occasionally to play nations and communities off against one another in an effort to receive the most advantageous benefit package – a process that produces a “downward harmonization” of labour, consumer and

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<sup>1</sup> TBTF – is a doctrine postulating that the government cannot allow big firms to fail for the very reason that they are big (Moosa, 2010, pp. 319-333). More on TBTF also in (Acharya, Anginer, and Warburton, 2016; Cetorelli and Traina, 2018; Morrison, 2011, pp. 498-516).

<sup>2</sup> According to Stiglitz, funds that could have been spent to restructure the economy and set up new dynamic enterprises, were given away by the government to save old companies that could not cope with the situation (Stiglitz, 2010, p. XXIX).

<sup>3</sup> As pointed out by Holmes (2009, p. 383) some interactions between corporations and states or their officers constitute prime examples of power crime. A blatant form is where corporations either offer or else agree to pay bribes to state officials in order to secure a major contract. This capacity to corrupt state officials via large scale bribes gives corporations significant potential power. An example of a company that has been repeatedly accused of bribery is Siemens. According to Holmes (2009, p. 384) this company has been the subject to numerous accusations of offering bribes over the past 10-15 years, at least two of which – Singapore 1996, Italy 2004 – resulted in the corporation being temporarily banned from tendering in the respective countries.

environmental standards (Kolodner, 1994, p. 4). The growing economic strength of TNCs<sup>4</sup> resulting from their increasing ability to transfer funds within their own organisational structure, to transmit the entire production package (including technology) and to deploy factories in different countries around the world, makes it more and more difficult to reconcile the long-term public interest with the short-term interests of private companies such as TNCs. Thus the question arises whether the state holds adequate instruments (tools) that would be effective with respect to TNCs.

The objective of the article is to discuss issues related to state failure in the context of selected areas of operation of transnational corporations. The article is based on the thesis that the state has limited potential to neutralise the negative effects of the operations of TNCs. The article is composed of three parts. The first part covers the theoretical aspects of the issues related to state failure. The second part focuses on those areas of operations of TNCs where actions taken by the state proved to be ineffective and the presence of TNCs in host countries is accompanied by high economic, social and environmental costs. The third addresses the question of how to supervise the activities of the TNCs.

## 2. Theoretical aspects of state failure

In economic literature, the term 'state failure' (*government failure, government breakdown, regulatory failure*) is most often understood as economic ineffectiveness caused by government intervention in response to market failure<sup>5</sup>. Market failure which results from economic ineffectiveness of market mechanisms may be potentially adjusted with appropriate government policies and regulations. However, Friedman and Friedman (2006, p. 126) noted that state interference in market mechanisms may not be justified solely with the need to eliminate market errors. The concept of state failure stresses that even if individual markets do not comply with the standard conditions of perfect competition and do not result in an optimum allocation of resources as understood by Pareto, government intervention may result in a deterioration instead of an improvement of the situation of effectiveness from the viewpoint of social welfare<sup>6</sup>.

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<sup>4</sup> According to Panić (1998, p. 245) TNCs are even more powerful and 'unpredictable' than oligopolies confined to a single country. This enables them to achieve particular objectives by means not available to multiregional national enterprises, making them an awkward subject for formal analysis. It is this combination of power, mobility and adaptability that is probably the main reason why various attempts to develop theoretical models explaining the origin and behaviour of TNCs have not been entirely successful.

<sup>5</sup> A similar definition was proposed by Keech and Munger, who understand state failings as the inability of governments to solve problems resulting from classical market imperfections. According to the authors, the government may fail both without taking any action and also when actions are taken that should not have been taken (Keech and Munger, 2015, pp. 1-2).

<sup>6</sup> For instance, Wojtyna (1997) is of the opinion that imperfect markets are often better in resolving problems than imperfect governments.

It should be stressed that both in academic handbooks and in literature of the subject, the issue of state imperfection is given much less attention than market imperfections. As Leszek (2010, p. 16) states, clarifications concerning the issues related to market imperfections have a very long tradition as they date back to Plato while the category of state ineffectiveness found its way to economic literature relatively recently. Orbach (2013, p. 44) points out that the term “state failure” was mentioned for the first time as late as in the 1960s, along with intensified intellectual and political criticism of government regulations. According to Orbach, two articles pioneered the way: the first one by McKean entitled “The Unseen Hand in Government” (1965), and the other by Ch. Wolf Jr., “A Theory of Nonmarket Failure: Framework for Implementation Analysis” (1979).

If the issues of state ineffectiveness, as mentioned earlier, are a relatively new area of interest for economists, the problem of state interference in economic life has a much longer history. The beginnings can be traced back to mercantilists. In their opinion, the decisive factor to increase national welfare was the interventionism applied by the state at that time. Mercantilists endeavoured to protect their own markets against foreign competition and advocated state support to national industrial activity. They were afraid of excessive freedom and therefore they relied on the order arranged by the state and accepted a situation whereby the state was the core regulator of economic life (Ekelund and Hebert, 2007, p. 49). Both those in power and mercantilists found it desirable to increase domestic production while restricting domestic consumption. As a result, mercantilism was characterised by the overall supremacy of the state over the economy. Physiocrats represented quite contrary views on state involvement in economic processes to those of mercantilists. They supported the liberalisation of economic activity in the broadest sense as manifested in their slogan *laissez faire, laissez passer*, i.e. “let’s leave things to take their own course” (Stępnicka, 2015, p. 223). Physiocrats advocated freedom in trade, and favoured support for competition and restricted state functions. The tasks proposed to the government by physiocrats primarily consisted in ensuring natural order, financing public works and imposing taxes on the ownership of land. The state was also to take care of developing education. Similarly to physiocrats, Smith also opposed state interference in the economy that would hamper and impede natural development of economic activities. He criticised both state interference in trade in the form of export subsidies and also import restrictions, as well as believed in the operation of natural law (“invisible hand”) and was an advocate of individualism. In the economic system, Smith saw basic harmony and treated the public good as naturally stemming from the egoistic interests of individuals. According to Smith, it was natural law rather than government restrictions that would prevent abuse of individual freedoms. However, in order to ensure that any person or country could produce whatever they can do best, competition is required. Although he opposed state interference in the economy, he was of the opinion that the state had an important role to play in, for instance, supporting competition and the elimination

of monopolies from economic life (Smith, 2007, p. 20). The role of the state was also to ensure external security (financing of a regular army) and internal security – a protection guarantee for each member of society against injustice and oppression from fellow citizens which required the financing of the police and enforcement of justice. According to Smith, the state should also arrange public works and develop and maintain infrastructure, benefiting the entire society (Danowska-Prokop, 2014, p. 45; Giza, 2013, p. 58; Szarzec, 2013, p. 32-39). Smith's views on the benefits resulting from limited involvement of the state in the economy were continued by other scholars from the classical economic school, e.g. Ricardo, Sey and Mill.

The liberal economic doctrine and conviction that market mechanisms will ensure the automatic regulation of prices, volumes of goods and income if only it may operate in an unrestricted way (Bochenek, 2010, p. 72) was weakened along with turbulences in global economy brought about by the Great Depression of the 1930s. Those severe economic events showed that the market was not a perfect mechanism of allocation of goods in the economy, it has its weaknesses (imperfections) and may prove unreliable. The concept of state interventionism developed by Keynes proved to be a remedy for the large drop in production, mass unemployment and poverty. A major element of "Keynes revolution" was the challenge to the thesis of self-regulating economic mechanisms and their ability to restore balance automatically (Wojtyna, 1988, p. 97). According to Keynes, the economy could enter a permanent status of imbalance or, in other words, it may reach the status of equilibrium with the material underutilisation of production factors. The conclusion may be drawn – as stressed by Wojtyna (1988, p. 97) – that state macroeconomic policies may materially support market mechanisms and state intervention is both necessary and effective. Keynes was advocating not only state intervention in production (with an active impact on the levels of private spending on consumption and investment, as well as the levels of savings which affected the rate of capital accumulation and thus determined conditions for economic growth) but also of the terms of wealth distribution to minimise the negative effects of excessive income and wealth differentiation and thus reducing the level of enforced unemployment (Danowska-Prokop, 2014, p. 51).

It should be noted that state interventionism was commonly accepted and in Western countries it produced positive results until the late 1960s (Bochenek, 2010, p. 73). In the early 1970s, phenomena occurred in global economy (oil shock, increased inflation, reversal of the proportional dependence between inflation and unemployment, growing budgetary deficit, growing public debt, slowdown of economic growth)<sup>7</sup> that undermined the belief in the effectiveness of Keynesian policies and in the fact that the state was the entity whose actions could contribute to complete removal or at least mitigation of the adverse effects of crisis situations.

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<sup>7</sup> The global economic situation in the 1970s was often termed as a commodity, fuel and food crisis (Dudziński, 2013, p. 20).

The above phenomena undermined the basis of Keynes' theory of the need for the active involvement of the state in resolving economic problems (Dach, 2008, p. 12). As a result of the breakdown of Keynes paradigm<sup>8</sup>, views based on the principles of economic freedom called neoliberalism became to predominate in economic theories (Dach, 2008, p. 12). The most important characteristic of neoliberal concepts, as opposed to Keynesianism, was an unwillingness to increase the role of the state in the economy and a belief in the effectiveness of market mechanisms (Wojtyna, 1990, p. 54). The neoliberal mainstream usually covers such economic doctrines as monetarism, new classical economy, the Austrian school, public choice theory and supply-side economics (Wojtyna, 1990, p. 54).

However, as stressed by Z. Dach, now the fashion for pure neoliberalism passed away since the rationalisation of economic thinking takes place and the growing role of the state in the economy is noted once again (Dach, 2008, p. 12).

When the role of the state in the economy is increased, it is necessary to remember that in many areas the state may prove unreliable. Frey (1992, p. 10) noted that market failure and state failure are often subject to the same delusion, or more accurately, if one system of taking social decisions manifests shortcomings, the other system will be relatively better in that respect. However, that does not have to be true. In circumstances when the market does not operate effectively, the government may function even less effectively; when the government commits errors, it does not have to be true that the market will operate in an optimum manner as understood by Pareto. One of the reasons is that certain circumstances which generate market imperfections also contribute to state ineffectiveness.

Similar to market unreliability (ineffectiveness), also state unreliability may be manifested in three spheres of its functioning, namely in the sphere of allocation, stabilisation and redistribution. According to Lipowski (2002, pp. 167-169), the allocation function of the state may be split into two: ownership and regulatory functions. In the case of the ownership function, the state as the owner, to a larger extent than private owners, is exposed to ineffective behaviour taking the form of soft financing of its enterprises and appointment of the managerial staff of state enterprises on the basis of personal relationships rather than criteria related to their competencies. In the case of the regulatory function, the state with access to various instruments functions in the economy as an entity determining macro and microeconomic conditions of the functioning of enterprises. In that function the state may operate ineffectively since – instead of guarding public interests – it is tempted to pursue the interests of specific groups, including: 1) political decision makers

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<sup>8</sup> Major criticisms of Keynesianism were discussed e.g. by Wojtyna, who included among them the lack of a convincing theory of inflation, insufficient consideration for the role of monetary policies, excessive development of the public sector, neglect for the supply side of the economy, unilaterally biased assessment of reasons for unemployment, little consideration given to the role of transnational corporations and the issue of income redistribution, and the underestimated role of expectations voiced by economic entities (Wojtyna, 1988, pp. 10-12).

(the group is focused on generating its own income, and by behaving like a typical monopolist it often pursues discriminating policies), 2) government officials – bureaucrats (unlike for politicians, the employment of officials is not related to any term of office – they have better access to information than politicians and they may use such information to pursue their own goals and to maximise their own influence and income), 3) grassroots pressure groups (the groups that represent specific sectors may financially support politicians and bureaucrats in order to obtain their own benefits. In exchange, the sector ‘intercepts’ control over government agencies).

State failure in the sphere of stabilisation may be due to five factors which include: delays in the monetary mechanism (which relate to the response of production and employment to changes in the financial sector caused by interest rate variation), the ousting effect (crowding out private spending by government spending), a political business cycle (state decisions on budgetary spending and money supply being subject to a specific electoral cycle (Lipowski, 2002, pp. 170-172). In accordance with the theory of political business cycle, governments apply various instruments of macroeconomic policies in order to attempt to stimulate the economy just before elections so as to improve their prospects of re-election<sup>9</sup>), inflationary expectations (with predictable expectations, stimulation of demand may prove ineffective), a real business cycle (changes to economic cycles due to supply shocks resulting from rapid technological changes and consumer preferences result in a situation whereby in such circumstances the state is not able to keep production and employment at desirable levels since real factors materially interfere with the impact of demand instruments on the production sphere).

State failure in the sphere of redistribution consists largely in the ineffective application of social welfare programs in order to reduce income differences and to limit poverty (Lipowski, 2002, p. 172). According to certain economists, social welfare financed by the state has an anti-investment, anti-innovation and anti-entrepreneurial effect (Friedman, 2008; Lindbeck, 1988, pp. 19-38).

The issues related to state failure were also discussed by Stiglitz who in his work “Economics of the Public Sector” presented four core areas of the phenomenon (Stiglitz, 2004, p. 79):

- Restrictions in access to information. Due to no access to complete information and the complexity of social phenomena, the effects of the actions taken by the state are difficult to predict. Additionally, the state often does not have the information that is required to pursue adequate public programs. For instance, the allocation of funds as social welfare to all the handicapped people who need such support may be difficult due to the lack of accurate and reliable information

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<sup>9</sup> The problems relating to the political business cycle are discussed in more detail in the following papers: (Drazen, 2000, pp. 75-117; Dubois, 2016, pp. 235-259; Kramer, 1971, pp. 131-143; Nordhaus, 1975, pp. 169-190).

concerning the actual and not a simulated disability of the persons who apply for such support.

- Limited control with respect to the effects of state actions in private markets. The state is not able to perform direct and complete control over public spending. In the case of medical benefits, despite the prices being set by the state, it is the doctors and patients who largely decide about the volume and types of provided services which ultimately determine the final spending.
- Limited control over bureaucracy. This refers to a situation when discord exists between the legislative bodies and executive bodies. In certain instances, government agencies design too-detailed regulations which distort the intentions of the legislators while others fail to enforce the existing regulations adequately. It also happens that officials of government agencies do not have sufficient incentives to make their actions compliant with the legislator's expectations. For instance, officials responsible for implementing regulations in a certain sector, when thinking about their own professional career, may take decisions beneficial to the owners of enterprises in the sector but detrimental to the consumers.
- Political restrictions. MPs may take actions under the pressure of certain interest groups in their pursuit to have their electoral campaigns financed.
- Opponents of state intervention are of the opinion that the failures listed above are a sufficient argument in favour of the state refraining from interfering in the economy and – as stated by Stiglitz (2004, p. 12) – so that the state would refrain from attempts to remedy actual or frequently apparent imperfections (defects) of market mechanisms.

### **3. State failure in selected areas of TNC operations**

Transnational corporations are most often defined as enterprises that are involved in foreign direct investments (FDI) and own or somehow control production and trading activity (with value added) in more than one country (Dunning and Lundan, 2014, p. 3). According to the OECD, transnational corporations are companies or other entities with private, state or mixed capital, operating in all sectors of the economy, located in various countries and inter-related so that each of them individually or jointly may exert a major impact on the business of other entities; the level of autonomy of each unit within an enterprise may be different depending on the type of TNC (OECD, 2012, p. 9). UNCTAD understands transnational corporations as enterprises that pursue their business in the form of joint stock companies or in other legal forms, composed of a parent entity and its foreign subsidiaries (UNCTAD, 2008, p. 249).

On the basis of these definitions, it can be concluded that a transnational corporation is essentially an organisation that expands its activities beyond the borders of its own country. In other words, the distinguishing feature of a TNC is the use of hierarchical coordination methods (managerial directives) to organise cross-



-national interdependencies. Market prices are another way of organising international interdependencies (Hennart, 2000, p. 72). In order to understand the existence of transnational companies, it is crucial to explain why entities that are located in different countries are better coordinated when they are part of a transnational corporation than if they were independent entities responding to market prices.

According to Hymer (1970, 1976), Kindleberger (1969) and Caves (1971), transnational corporations owe their existence to structural market imperfections. It is these market imperfections that enable TNCs to gain advantages – resulting from their oligopolistic position – on foreign markets. Transnational corporations are entities that embody the imperfections of the market mechanism. An oligopolistic company, striving to minimize costs, will try to allocate production factors primarily within its organisational structure. The process of intercepting the company's external transactions with other economic entities and replacing them with intra-company transactions is called the internationalisation of the activities of multinational corporations. The concept proposed by Coase (1937, pp. 386-405) in which a company can avoid (or at least significantly reduce) its transaction costs if it takes over market functions itself and performs transactions within its organisational structure, thereby replacing external transactions, referred primarily to the domestic market. Nevertheless, several economists, among them Williamson (1975), Buckley and Casson (1976), Hymer (1976), Rugman (1981) and Teece (1986), broadened this concept to the international market, shifting it into the field of transnational corporations. Hennart (2000, p. 72) suggests that transaction costs theory provides the best explanation of why this is the case, and hence the best reason for the existence and development of TNCs. Transnational corporations use hierarchy to eliminate market transaction costs. TNCs make it possible to organize some interactions which cannot be organized by prices, thus bringing gains of trade to the interacting parties and a net gain for society. Hence while Hymer and Kindleberger see TNCs as a method of maximizing monopoly power, or in other words, as a way of internalizing pecuniary externalities, for transaction costs theorists, TNCs emerge to reduce transaction costs and internalize non-pecuniary externalities (Hennart, 2000, pp. 75-76).

In view of the above, it can be concluded that market and state failures function, as it were, in parallel in the economy. Therefore the response to a market failure is not only the intervention of the state, which turns out to be inefficient, but also the emergence of transnational corporations as large hierarchies which by their very nature are to some extent a departure from the market.

Before those specific areas of operation of TNCs are discussed where the state fails, it is worth quoting data that indicates that enterprises of that type constitute one of the most important entities of the global economy, occupying a position that is stronger than ever before. Nowadays the number of TNCs is estimated at about 60 thousand with about 500 thousand foreign subsidiaries, located all over the world (Kordos and Vojtovic, 2016, p. 152). According to J. Madeley (2008, p. 1),

those entities have a material impact on politics, economy and social and cultural issues in individual countries.

Table 1 presents data on the value of sales and assets of foreign subsidiaries of TNCs against global GDP and exports of goods and services on a global scale.

**Table 1.** The value of sales and assets of foreign subsidiaries of TNCs compared to global GDP and exports of goods and services globally in 1990-2017 (value at current prices, billions of US dollars)

Item	1990	2005-2007	2015	2016	2017	2018
Sales of foreign subsidiaries of TNCs	7,136	24,621	26,019	25,649	26,580	27,247
Assets of foreign subsidiaries of TNCs	6,202	50,747	91,261	95,540	104,915	110,468
World GDP	23,439	52,366	74,664	75,709	80,118	84,713
World exports of goods and services	4,414	14,957	20,953	20,555	22,558	24,971

Source: (UNCTAD, 2018, p. 20; UNCTAD, 2019, p. 18; UNCTADstat, n.d.).

Apart from the values presented in Table 1, it is worth looking at other indicators reflecting the economic power of TNCs. During the period 1990-2018, the headcount in those entities grew over two and a half times. In 1990 foreign subsidiaries of TNCs employed 28,558 thousand people, while in 2018 it was as many as 75,897 thousand people (UNCTAD, 2019, p. 18). The data published by UNCTAD also shows that transnational corporations materially affect the creation of global capital flows. The value of global direct investments by TNCs grew over six times in 1990-2018 (UNCTAD, 2019, p. 18). The inflow of global FDI in 1990 was USD 205 billion while in 2018 it was USD 1,297 billion. As noted by M. Rosińska-Bukowska (2015, p. 157), the growing capital power results in the automatic weakening of the power and potential impact of the state on financial markets and thus contributes to intensified sensitivity of the real economy to impulses and turbulences in the sphere of international finance.

The economic power of TNCs is also visible when their revenue is compared to GDP of each country (Table 2).

The data presented in Table 2 shows that the US company Walmart in 2018 generated revenues higher than GDP of six countries in the specification: Thailand, Austria, Iran, Norway, United Arab Emirates, and Nigeria. In this situation, it is reasonable to ask the question if countries are able to exercise control over the entities that operate in their territories. The large economic power of transnational corporations makes the state fail in certain areas and the legal regulations affecting the business of TNCs are ineffective in many instances. The negative phenomena related to the functioning transnational corporations that the state is not able to cope with as manifested in practice include the following:

- Tax avoidance by TNCs – transnational corporations resort to a growing number of methods to reduce their tax burden. UNCTAD identified three core mechanisms related to tax avoidance by TNCs (UNCTAD, 2015, p. 192): 1) different tax rates in various countries (thus providing the potential to manipulate transfer

**Table 2.** List of the 30 largest global TNCs in terms of their revenue and the 30 countries with the highest GDP in 2018 (USD million)

No.	Company	Sales	No.	Country	GDP value (current prices)
1	Walmart	500,343	1	United States of America	20,494,050
2	State Grid	348,903	2	China	13,407,398
3	Sinopec Group	326,953	3	Japan	4,971,929
4	China National Petroleum	326,008	4	Germany	4,000,386
5	Royal Dutch Shell	311,870	5	United Kingdom	2,828,644
6	Toyota Motor	265,172	6	France	2,775,252
7	Volkswagen	260,028	7	India	2,716,746
8	BP	244,582	8	Italy	2,072,201
9	Exxon Mobil	244,363	9	Brazil	1,868,184
10	Berkshire Hathaway	242,137	10	Canada	1,711,387
11	Apple	229,234	11	Russia	1,630,659
12	Samsung Electronics	211,940	12	South Korea	1,619,424
13	McKesson	208,357	13	Spain	1,425,865
14	Glencore	205,476	14	Australia	1,418,275
15	UnitedHealth	201,159	15	Mexico	1,223,359
16	Daimler	185,235	16	Indonesia	1,022,454
17	CVS Health	184,765	17	The Netherlands	912,899
18	Amazon.com	177,866	18	Saudi Arabia	782,483
19	EXOR Group	161,677	19	Turkey	766,428
20	AT&T	160,546	20	Switzerland	703,750
21	General Motors	157,311	21	Poland	589,391
22	Ford Motor	156,776	22	Sweden	586,015
23	China State Construction Engineering	156,071	23	Belgium	533,153
24	Hon Hai Precision Industry	154,699	24	Argentina	518,092
25	AmerisourceBergen	153,144	25	Thailand	487,239
26	Industrial & Commercial Bank of China	153,021	26	Austria	457,637
27	AXA	149,461	27	Iran	452,275
28	Total	149,099	28	Norway	434,937
29	Ping An Insurance	144,197	29	United Arab Emirates	424,635
30	Honda Motor	138,594	30	Nigeria	397,270

Source: (Fortune Global 500, 2018; World Economic Outlook Database, 2019).

pricing – incorrect pricing of goods being traded, in particular intangible assets, intellectual property, etc.), 2) inconsistency between legal regulations (hybrid arrangements, derivative transactions, concealing domestic investments), 3) issues related to double taxation (acquiring contractual benefits, triparty transactions, omission of contractual thresholds). With complex transactions and the appropriate use of legal gaps, TNCs pay taxes not in the countries where they produce goods and services but in those that offer the most advantageous tax rates. The development of outsourcing and offshoring along with increasingly complex organisational structures provided TNCs with conditions to use (within their structures) special purpose entities (SPEs) and to use them for capital flows to optimise the tax burden. The scale of the issue related to tax avoidance by TNCs is shown in analyses by the *Tax Justice Network*, a UK organisation that monitors the phenomenon. The analysis shows that in over 80 offshoring centres and jurisdictions disguised as tax havens, capital flows in 2010-2012 were between USD 21 and 23 billion (*The price of offshore revisited...*, n.d.). Tax scandals were related, among others, to such companies as Walmart, Starbucks, Yahoo, Dell, Google, Facebook, Amazon and Apple. For instance, analyses by Bloomberg show that Apple – with its investments in Ireland – paid only 1.8% in taxes while the revenue generated by the company accounted for about 55% of its total revenue generated outside the USA (*EU Probe of Apple's Tax...*, n.d.). It should be stressed that state weakness in fighting practices related to tax avoidance by TNCs is visible in all countries of the world, including Poland. A report developed in 2015 by the Analysis Centre of the Jagiellonian Club shows that losses related to the application of transfer pricing in our country are estimated at about PLN 10 billion annually. The authors stated that the losses were primarily due to the institutional and personnel weaknesses of the Polish fiscal authorities. Infrequent inspections were held in relation to the application of transfer pricing by TNCs and they were not preceded by risk analysis. Additionally, the fiscal authorities did not have access to key tools to detect the phenomenon, for instance in the form of a database of capital and personal relationships between the entities operating in the market (*Znikające miliardy...*, n.d.).

- Use of monopolistic position – with their monopolistic power, TNCs often generate above-average profits at the expense of consumers. For instance, in 2018 British-Dutch Shell generated a net profit of USD 23.4 billion, which was synonymous with a growth of 80% against 2017 (*Shell zwiększył zysk...*, n.d.).
- Degradation of the natural environment – the transport of almost all goods in today's economy is made with the use of fossil fuels. Transnational corporations often manufacture goods in countries like China or India where salaries are low and they transport the goods to European countries and the United States on large container ships or tankers. The practice of extensive transport, combined with consumption of energy and resources, inseparably related to large-scale production, results in the degradation of the natural environment (for instance,

the ecological catastrophe in 1989 at the shore of Alaska caused by MT Exxon Valdez carrying oil, owned by Exxon, USA)<sup>10</sup>. It should be stressed that damage due to the pollution of the natural environment is becoming more intensive since in less economically developed countries to which TNCs transfer their production, environmental regulations are less restrictive (Rivera and Oh, 2013, p. 246). As a result of the less restrictive standards, large volumes of toxic waste are generated. Environmental pollution is also intensified with the shortened life cycles of products by TNCs. The shorter life of radio and television equipment and household appliances is specifically severe in terms of environmental costs (Bressanelli, Saccani, Perona, and Baccanelli, 2020, p. 1).

- Economic sensitivity resulting from the functioning of a small number of large entities – a large number of small independent enterprises creates opportunities for the better stability of the economy since if one becomes bankrupt, the others may continue their business. However, when an economy is dominated by a small number of large corporations, it becomes more susceptible to crisis situations. As already mentioned, such enterprises are too big to fail. During the recent financial and economic crisis which peaked in the global economy in 2008-2009, many enterprises were provided with support packages from the state. The provision of enormous public support in certain countries, in particular to the automotive industry, became controversial. The concerns were voiced that such support (in the form of loans, subsidies, tax credits, etc.) in fact led to the incorrect allocation of resources (Oręziak, 2011, p. 31). In certain countries, governments intervened and provided support to their local producers, sometimes due to the fact that producers in other countries were provided with such support and the lack of support to their own production would position the domestic producers at a competitive disadvantage versus their foreign competitors. As stressed by Oręziak (2011, p. 31), a question arose about the sense of providing public aid to the automotive industry considering that such actions – contrary to the financial system provided with such support – were not systemic.

#### 4. Supervision of TNCs

Firstly it should be noted that creating situation at a global level in which undesirable practices by the TNCs are constrained is a long-term process and requires not only the cooperation of national governments at supranational level, but also depends on strict national rules regulating business operations (Leaver and Cavanaugh, 2010). Additionally, the process should include civil movements and consumers who,

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<sup>10</sup> Another example of degradation of the natural environment to which TNCs have contributed is the explosion and sinking of an oil rig and oil leak in 2010 due to drilling commissioned by BP, which resulted in an ecological catastrophe in the Gulf of Mexico (see: *Eksploracja na platformie...2017; 17.2 mld dol. ...., 2017*).

through their decisions to purchase (or limit their purchases) goods and services, may enforce TNCs to adopt appropriate corporate behaviour. Boycotting, marketing campaigns and labelling are some of the forms of action that can effectively undermine corporate power outside institutional channels. Consumer support, boycotts or threats of boycott against such companies as Gap, Starbucks and Levi-Strauss have helped to convince these corporations to adopt codes of socially responsible practices (Diermeier, 2012).

Practice has shown that national regulations are often insufficient to combat abuses effectively since TNCs are able to transfer their activities from one country to another within their internal organisational structure. National governments should support proposals to integrate social standards (regarding consumer protection, the environment and labour rights) in trade agreements.

However, it should be emphasised that international legislation and conventions will not have the desired effect if they are not governed by strict national standards. The literature on the subject underlines that governments should not soften national laws hoping that TNCs will operate to a greater extent within the country than outside its borders. Instead, they should act both domestically and internationally to make corporations more socially responsible (Leaver and Cavanaugh, 2010).

More than 40 years ago, national governments tried to negotiate a United Nations Code of Conduct regarding the activities of TNCs and the international investment agreements they conclude. The aim of the Code was to establish a broad framework that would define in a balanced manner the rights and obligations of TNCs and host governments in their mutual relations (Sauvant, 2015, p. 11).

The attempts undertaken to regulate the activities of the TNCs have so far proved ineffective and the responsibility of transnational corporations still remains a global problem (Omoteso and Yusuf, 2017, p. 54).

Despite the adoption of Corporate Governance Codes (CGs) such as the UK Merger Code 2006, now replaced by the UK Corporate Governance Code 2012, or the US Sarbanes-Oxley Act 2002, and the CG standards, the principles and guidelines are protected by international authorities such as the OECD (Organisation for Economic Cooperation and Development) and the World Bank, their activities in this field are insufficient, while the dominance of transnational corporations in the global economy still continues apace. According to Omoteso and Yusuf (2017, p. 54-55) the current normative basis of CG and Corporate Social Responsibility (CSR) are not designed to address the problem and the deficiencies of liability and abuse by TNCs.

Issues associated with the use of reprehensible practices by TNCs are particularly evident in the case of developing countries, especially in Africa. Over the last two decades, there has been a significant increase in research conducted on the activities of the TNCs, especially their overseas subsidiaries in developing countries due to some prominent cases of human rights violations and trials brought against transnational corporations (Hazenbergh, 2016).

A number of cases in industrialised countries where multinational corporations are domiciled – mainly in the UK, the USA, Canada and Australia – are slowly increasing the space within which it is possible for applicants from host countries to hold TNCs legally responsible in their countries. For instance in the United States the most useful instrument to date is the Alien Tort Claims Act (ATCA), a 200-year-old law which gives the US courts a jurisdiction to hear cases of human rights abuses (violations of customary international law) occurring anywhere in the world as long as the US courts have jurisdiction over the defendant. In turn, in Australia, a case has been brought against the mining company BHP for destroying the livelihood of 25,000 people in Papua New Guinea (*Controlling corporate...*, 2020).

The efforts to increase accountability and control over the TNCs are visible not only at the level of individual countries, but also at regional level.

As an example the European Union, which has been involved in corporate responsibility issues since the 1970s has issued a number of directives, mainly on labour conditions, concerning the behaviour of TNCs. Existing EU accountability mechanisms include the European Court of Human Rights, the human rights provisions of the Treaty of Amsterdam (1997) and the Treaty of Maastricht (1992), and the provisions of the EU Social Charter on collective complaints, which have been successfully applied in several instances for example regarding child labour in Portugal. The solutions adopted by the OECD are also worth mentioning. This organisation has developed many agreements and guidelines for member governments concerning transnational corporations. The OECD Guidelines for Multinational Enterprises, developed in 1976 and revised several times, most recently in 1999, have a wide scope and cover employment, labour relations, environmental issues, disclosure and transparency, competition, taxation and other aspects of corporate activity. However, the above-mentioned guidelines are commonly perceived as detached from actual corporate behaviour and crippled by their voluntary nature. In particular, the inertia and inefficiency of the National Contact Points (NCPs), which constitute the mechanism for enforcing the Guidelines is criticized (*Controlling corporate...*, 2020).

In response to the criticism in 2011, the OECD has revised its guidelines and in conjunction with the UN Guiding Principles on Business and Human Rights has increased transparency of definitions and improved practices on corporate responsible business conduct. It should be highlighted that the existing guidelines need further improvements since certain aspects concerning the current activities of the TNCs (e.g. climate change, ‘externalities’, data-collection, privacy and artificial intelligence) have not been taken into account (OECD, 2018, pp. 14-15).

## 5. Conclusion

On the basis of the analysis presented in the paper, a conclusion may be drawn that the state – with reference to transnational corporations – has proved to be ineffective in many areas of its activity while state interventions aimed at mitigating the negative

effects of operations by TNCs were ineffective. It seems that the problem is more profound and concerns issues related to the model of corporate capitalism currently in existence (Żakowski, 2010). The challenges facing the global economy in the near future, such as intensifying social inequalities, environmental pollution and the related climate changes, or hazards in the form of a trade war between the global economic leaders – the United States and China – require the existing model to be modified. To enable the global economy to grow in a more sustainable manner, actions are required not only in each country but also by international organisations and integrating groupings that could create certain rules concerning not only compliance with tax regulations by TNCs, but also more effective control over the business of those entities, including control over capital flows on a global scale<sup>11</sup>. Possibly an effective method would be to prevent TNCs from becoming so large, which would however require more restrictive regulations concerning mergers and acquisitions by TNCs.

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<sup>11</sup> More details on the ongoing discussion among economists concerning control of international capital flows are provided e.g. by Wojtyna (2017, pp. 5-28).



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## ZAWODNOŚĆ PAŃSTWA W KONTEKŚCIE DZIAŁALNOŚCI KORPORACJI TRANSNARODOWYCH

**Streszczenie:** Głównym celem artykułu jest omówienie kwestii związanych z zawodnością państwa w kontekście wybranych obszarów działalności korporacji transnarodowych (KTN). Przeprowadzona analiza wykazała, że państwo w odniesieniu do korporacji transnarodowych okazuje się nieefektywne w wielu obszarach ich działalności (np. unikanie opodatkowania przez KTN, wykorzystywanie pozycji monopolistycznej przez te przedsiębiorstwa, ich negatywny wpływ na środowisko naturalne, a także ekonomiczna wrażliwość). Zrównoważony rozwój gospodarki światowej wymaga podjęcia działań na szczeblu nie tylko poszczególnych krajów, ale także organizacji międzynarodowych i ugrupowań integracyjnych, które mogłyby wypracować określone zasady dotyczące nie tylko przestrzegania prawa podatkowego przez KTN, ale także uzyskania większej kontroli nad działalnością tych podmiotów, w tym kontroli na przepływami kapitału w skali globalnej. Dyskutowane w artykule problemy włączają się w nurt badawczy dotyczący roli państwa w gospodarce rynkowej oraz ograniczonej efektywności tego podmiotu w zakresie sprawowania kontroli nad działalnością korporacji transnarodowych.

**Słowa kluczowe:** zawodność państwa, zawodność rynku, korporacje transnarodowe, bezpośrednie inwestycje zagraniczne, unikanie opodatkowania.