

*Original Paper*

# The Interaction between the Investment Behavior of Transnational Corporations and the International Political and Economic System

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## ***Abstract***

*With the development of economic globalization and world modularization, more and more economic activities transcend national boundaries, making the connection between the organic economic whole formed through foreign trade, capital flow, technology transfer and other activities become closer. Transnational Corporations (TNCs) come into being in this context, making the global convergence trend of the economies of the world in production, distribution, exchange and consumption links more obvious. Because TNCs usually conduct economic activities in two or more countries, their strong economic power will inevitably affect the economic, political, cultural and social life of the country. On the one hand, the investment and business behavior of TNCs will have a series of effects on the local economy of the host country, and in some economic fields, TNCs can even interfere with the political order of the host country. On the other hand, in the process of globalization, transnational corporations themselves will also be affected by the international political and economic situation.*

## ***Keywords***

*transnational corporation, foreign direct investment, international political and economic system*

## **1. The Concept of Transnational Corporations**

According to the definition given by the United Nations Commission on Trade and Development in its World Investment Report 1995, a TNC “is a joint-stock or non-joint-stock enterprise consisting of a parent company and its foreign (offshore) branches”. A more specific definition is that a TNC is an enterprise that, through outward Foreign Direct Investment (FDI), transcends the geographical limitations of national borders and has branches or subsidiaries in the host country that are engaged in business operations such as production, sales and services. The parent company of a TNC usually

enjoys a say in the capital and management of its subsidiaries, and enjoys the right to decide and control the appointment and dismissal of personnel, training mechanisms, marketing strategies, and other aspects of the subsidiaries' operations. Compared with local firms, especially in smaller developing countries, TNCs are usually larger in size, have greater competitiveness and bargaining power in the market, and are more likely to circumvent national regulations and policies.

After the Second World War, the creation and development of TNCs have not only had a significant impact directly on the creation and development of TNCs, but also indirectly on the political sphere of countries. They have also indirectly played a significant role in the political arena of various countries. The emergence of TNCs has not only strengthened the interdependence of the global economy and facilitated the rapid development of national economies, but has also inevitably led to a greater number and frequency of globalization than ever before.

The investment behavior of TNCs can be divided into two categories based on the purpose of production activities (Giorgio & Anthony, 2020), which are Horizontal Foreign Direct Investment (HFDI) and Vertical Foreign Direct Investment (VFDI). HFDI is a form of FDI in which the overseas subsidiaries of a TNC engage in the production of the same industry in the host country as in the home country. HFDI emerged as a substitute for exporting, as TNCs wanted to locate their production close to their customers, thus avoiding trade costs such as transportation costs and trade barriers. VFDI is a form of investment that shifts certain stages of production of labor-intensive products to lower-cost, labor-intensive countries for production. Moreover, while HFDI may have greater spillover effects than VFDI because of its more intensive use of intellectual capital in the local economy, on the other hand, VFDI has a relatively stronger impact on local labor demand. From the 1990s, driven by globalization, TNCs began to expand rapidly, and the influence of TNCs has further expanded. They are no longer purely economic entities, but have begun to gradually intervene in international political and economic relations.

## **2. Impact of TNCs' Investment Behavior on the International Political Economy System**

### *2.1 TNCs Make the Actors in the Political Economy System More Diversified*

International political actors refer to a number of entities that can independently participate in international affairs and play an influential role. Entities that can constitute international actors should have certain behavioral ability and political and economic strength, their own special interests, a certain degree of independence and autonomy, and have a relatively stable or solid form of organization (Laura, 2020). With the development of multinational corporations, the economic exchanges between various countries become more and more frequent.

First of all, TNCs are economically powerful and although they do not have a certain territory and population like a country, they actually have a strong influence on a certain territory, and many of them are even stronger than many sovereign countries. The economic power of many multinational corporations is even stronger than that of many sovereign states. Secondly, although many

multinational corporations are private monopolies by nature, because they carry out economic activities in two or more countries, it is easy for them to bypass the constraints and limitations of the relevant laws of some countries (Roshan, 2020). Thirdly, as TNCs are economically powerful and operate in two or more countries, their power inevitably has an impact on the political, economic, cultural and social life of these countries. Nowadays, many multinational corporations have even participated in the governmental strategies in some countries, such as directly entering the government to take up important positions, forming joint interests and so on. Thus, the relatively independent international economic behavior of transnational corporations has actually had a far-reaching impact on international relations. Therefore, as one of the main actors in international politics, TNCs can diversify the actors in the international political and economic order by virtue of their own business model, internationalization strategy, innovation ability and core competitiveness.

### *2.2 Developing Countries Are Influenced by Some Developed Countries' TNCs in the Economic Field*

The establishment of subsidiaries of TNCs in developing countries will bring advanced production technologies and management concepts to these countries. TNCs play an important role in transferring and disseminating innovative technologies, marketing techniques, and management and organizational practices, enabling partner enterprises to learn from their advanced technologies and management techniques, while at the same time creating employment opportunities in the host countries (Abbas, 2023). Moreover, TNCs' strong financing capacity can ease the problem of insufficient capital in developing countries. Therefore, many developing and emerging countries have formulated national policies aimed at attracting TNCs to their countries, such as tax reduction, concessionary rent and development of industrial zone facilities, the establishment of promotion agencies and many other incentive policies.

However, the entry of TNCs can have a negative impact on developing countries. The main purpose of subsidiaries located in developed countries may be the wide distribution market and good infrastructure there, or a stable political environment and suitable market structure. Moreover, the main purpose of subsidiaries located in developing countries may be cheap land and labor, or abundant natural resources and huge market potential. These are all for the ultimate purpose of chasing the maximum profit. Although there are conflicts between local interests and global interests, short-term interests and long-term interests due to the internal principal-agent relationship of multinational corporations, TNCs will not give up the pursuit of profit. In order to increase production efficiency and maximize profits, TNCs often establish subsidiaries only in developed countries or strong developing countries. These countries have complete infrastructures and huge market potential, which are favorable for TNCs to carry out economic activities. As for countries in less developed regions, TNCs usually do not invest in them. Therefore, in the long run, the gap between developed and developing countries will further widen, and the gap between the rich and the poor will become more and more obvious. At the same time, most of the developing countries are economically backward and the local enterprises are weak, TNCs can easily monopolize in some sectors or industries with their advanced technology and

development concepts, and too much control may affect the economic autonomy of these countries, which is not conducive to the development of national enterprises. Although the subsidiaries of TNCs carry out production activities in the host countries, the ultimate decision-making power of the subsidiaries remains in the hands of the parent companies. This results in the host countries being limited in their ability to control the pursuit of reasonable taxation, trade, industrial structure and consumption structure orientation.

### *2.3 Developing Countries Face Interference in the Political Sphere by Transnational Corporations from Some Developed Countries*

As the core of economic globalization and non-state actors, the emergence of TNCs may cause erosion of the sovereignty of the host country (Pla-Barber et al., 2021). The impact of TNCs on the national policies of host countries should not be underestimated. TNCs have been benefiting from the host country's economic and policy preferences, but because the production and operation and profitability of subsidiaries are still constrained by the host country's policies, after a certain degree of development, TNCs will try to find ways to expand their influence in the field of resources, capital and even politics. In order to gain a favorable position in the competitive international environment, TNCs often influence the host country's government policies and regulations through Corporate Political Activity (CPA), and push the host country's policies to develop in their own favorable direction. In addition, the home countries of most TNCs belong to developed countries. They usually monopolize the advanced technology of the industry, and use entering or exiting a certain country's market, opening or blocking a certain technology as a bargaining chip to put pressure on technologically weak companies as well as underdeveloped countries, forcing them to change the current policy. As a result, developing countries may be subjected to the intervention of developed country TNCs in the political field.

### *2.4 TNCs Strengthen the Political ties among the Nations of the World*

Transnational corporations generally locate their headquarters in their home countries and, through FDI, set up corresponding subsidiaries or branches in other countries or regions to compete on a global scale. The business objective of profit maximization of transnational corporations has largely contributed to the development process of economic globalization, as well as political globalization, and the deepening of relations between countries (Li, 2022). Especially in recent years, in each country's high-level diplomatic activities, economic and trade cooperation is placed in an increasingly important position, many countries' leaders visit other countries, will bring to the transnational corporations entrepreneurs as the representative of the industrial and commercial entrepreneurial team, and the success of the visit to the important evaluation criteria is to sign the amount of trade, the major economic and trade issues resolved as well as to attract the number of investment funds. It can be seen that the behaviour and activities of transnational corporations, while accelerating the process of economic globalization, have also strengthened the political ties between the countries of the world, and the strengthening of international economic ties has led to the strengthening of the interdependence of the world as a whole.

### **3. The Impact of the International Political and Economic Situation on the Investment System of TNCs**

#### *3.1 Subsidiaries' Marketing Capabilities Are Negatively Affected by Political Risks in Host Countries*

Political and security relations between countries, as well as economic relations outside the TNC, can also affect the TNC's business development and its strategic plans. For example, regional tensions and conflicts caused by changes in a country's geopolitical and security environment and adjustments in the region's strategic power balance can not only result in a loss of profits for a multinational corporation, but also in a serious loss of assets and a disruption of the entire production chain in the region. The company has influence over the State, but the final decision-making power rests with the State. Therefore, the fate of companies also rests in the hands of the State.

The governance of TNC subsidiaries exists at the corporate level with internal shareholders and boards of directors and at the national level including home and host country, so that the operation and marketing ability of subsidiaries will be affected by the domestic political risk of the host country. The risk of political relations can have a negative impact on the subsidiary. If there are political risks within the host country such as internal conflicts, changes in the political situation, the presence of violent/terrorist organizations, weak corruption control, etc., these instabilities create a great deal of uncertainty for the TNCs. The subsidiary will have an increased likelihood of suffering losses due to its inability to engage in policy marketing activities. Political risk can also stem from the diplomatic relations between the home and host countries. Political games between the two countries can affect the interaction between subsidiaries and the host country, such as trade protectionism, which can result in subsidiaries receiving harsher regulations and restrictions from the host government.

#### *3.2 The Corporate Governance Structure of the Host Country Affects the Information Transparency of TNCs*

The corporate governance structure of the host country where the TNC subsidiary is located will affect the transparency of corporate information. Corporate governance structure can be broadly divided into four types: Anglo-American model, German-Japanese model, family control model and insider control model (Hoang & Sardar, 2022). The most contrasting ones are the Anglo-American model represented by countries such as the United States, the United Kingdom and Canada and the German-Japanese model represented by countries such as Japan and Germany. In the Anglo-American model, the securities market is mature, the financial market is developed, the equity is more decentralized, and there is no major shareholder. The interests of the shareholders of subsidiaries in such countries are ensured through the relevant information disclosed by the company in the securities market. In contrast, under the German and Japanese model, the equity is relatively concentrated, and the company has a small number of major shareholders whose shares account for a very large proportion, so the transmission of corporate information mainly takes place between the managers and the major shareholders, and thus the information transparency of this model is much lower than that of the Anglo-American model.

In addition to the political and legal system, culture is also one of the most important factors affecting the disclosure of information by multinational corporations. The influence of cultural factors such as risk aversion, individualism, and power hierarchy on the level of corporate disclosure is significant. Moreover, with the enrichment of the information environment, legal system factors have a significant impact on the level of corporate disclosure. There is a tendency that the influence of legal system factors on the level of corporate disclosure is weakening. In particular, there is a significant difference between Western and Eastern cultures. For example, countries such as the United Kingdom and the United States advocate freedom and emphasize individualism, whereas countries such as Japan and China emphasize more on collective concepts, and in terms of hierarchy of rights, Japan attaches much more importance than Western countries.

### *3.3 Transformation of International Investment Rules Promotes the Transformation of Transnational Corporations*

International investment rules are a legal system that establishes the rights and obligations of parties to each other for the promotion and protection of international investment through international negotiations on the basis of countries' policies for absorbing foreign investment (Thrasher, 2021). The institutionalist theory of the "commitment effect" suggests that International Investment Agreements (IIAs) can be designed to change national incentives and thus national behavior, as violation of treaty commitments will lead to diplomatic disputes, resulting in damage to the host country's reputation, a decline in its credit rating, and an increase in the cost of loans from the International Monetary Fund (IMF) and the World Bank. Therefore, States parties often chose to comply with international investment rules, which compensated for the absence of their foreign investment regimes and improved other domestic regimes to match them, reducing the host country's investment risk and helping to ensure the continuity of the investment relationship and enhance the effectiveness of investment.

In addition, the role of different international investment rules on the macroeconomic operating environment varies. For example, Bilateral Investment Treaties (BITs) establish the rights and obligations of investors between countries with similar levels of economic development and cultural backgrounds, and significantly improve the effectiveness of investment. The role of international investment rules is also reflected in industry differences. Energy and real estate industries are more obviously affected by international investment rules, so multinational corporations will change their global business layout according to the changes in international investment rules in order to maximize their interests.

## **4. Conclusion**

This paper analyzes the political and economic interactions of TNCs and the international political and economic system from two perspectives, which are the impact of their investment behavior on the international political and economic system, and the impact of the international political and economic situation on TNCs. As non-state entities, the development and expansion of transnational corporations

can make the behavior in the political economy system more diversified. TNCs investing in subsidiaries abroad can bring innovative technologies and advanced management concepts to host countries, but may form monopolies in certain technologies or fields in less developed developing countries, affecting the economic autonomy of host countries. In order to make the host country's policy develop in the direction favorable to itself, TNCs will also expand their influence in the political field by virtue of their strong economic power, and even infringe on their national sovereignty. At the same time, the international political and economic situation also affects the investment behavior of transnational corporations. The political risk of the host country has a negative impact on the marketing ability and profitability of TNCs, and the corporate governance structure of the host country can also affect the transparency of information within TNCs. The transformation of international investment rules affects the global business layout of TNCs and pushes the transformation of TNCs.

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