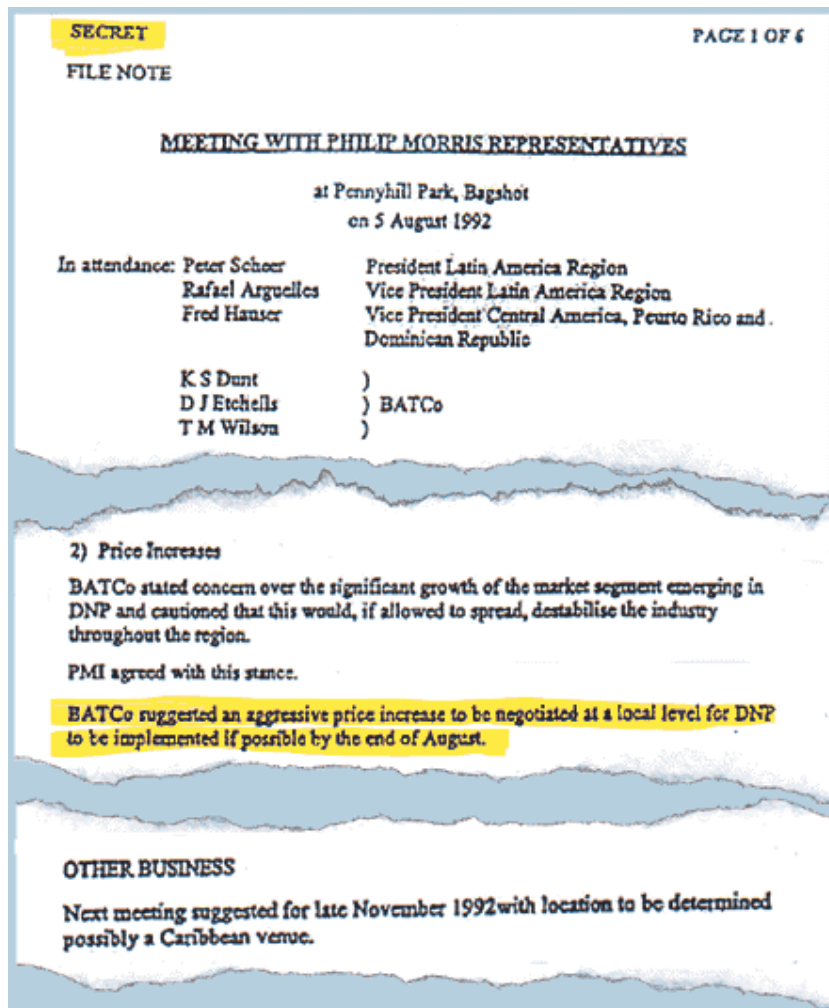


Tobacco industry

# The price is not quite right

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**Cigarette companies have been accused of all sorts of wrongdoing. Is it time to add price-fixing to the list?**



THE tobacco industry has plenty of fires to fight at the moment. It stands accused of supporting cigarette smuggling. It has also faced a raft of claims that it misled smokers about the dangers of cigarettes and marketed an addictive drug to teenagers. On June 29th, America's Supreme Court refused to hear an appeal brought by Brown & Williamson, a cigarette firm, opening the way for the first tobacco-related payout to a private individual.

The industry's legal woes have been compounded by the terms of out-of-court settlements. In settling with the state of Minnesota for \$6.6 billion in 1998, a group of companies—including Philip Morris (PM), British American Tobacco (BAT) and R.J. Reynolds (RJR)—agreed to place company documents unearthed in the litigation into public depositories for ten years. Researchers have been sifting through these for indications of further misdemeanours, with some success: some documents, for instance, raise serious questions about involvement in smuggling, which the firms deny. Equally important, they point to widespread price-fixing.

*The Economist* has seen documents that suggest the big tobacco multinationals colluded to fix prices in as many as 23 countries in Africa, Asia, the Middle East, Latin America and Europe. All of the documents come from the archive that BAT, the world's most international tobacco company, set up in Guildford, England, following the Minnesota settlement. But although they are internal BAT memos, they also suggest the involvement of its main competitors in price collusion.

Several of the documents make overt reference to price increases negotiated with rivals. An example is a memo on the Thai market, written on March 1st 1991, just after a decision by the GATT, the predecessor of the World Trade Organisation, forced the Thais to open their cigarette market to foreign firms. It says: "PM and RJR want to go in at 40 baht and continue with transit [industry jargon for smuggling] to supply demand." It goes on to explain that the rivals are advocating initial pricing at that level "to demonstrate that the legal business will be minimal". The companies, it seems, were fixing prices not only to raise their margins but for a more strategic reason: to lull the Thai government, one of the developing world's more anti-smoking administrations, into thinking that new foreign cigarette brands would not fare well, and thus avoid tobacco-control measures.

In another document from 1991, this time on Latin America, a BAT manager explains to a colleague that Philip Morris "agreed to raise Marlboro's price above BES [a BAT brand] earlier this year as part of a series of price increases to restore industry profits after the 'war' of 1989." A further memo, from 1992, concerning El Salvador, refers to local BAT managers consulting a Philip Morris executive on price increases. "We continue to negotiate with competition," it concludes.

Perhaps the most extraordinary document shows the minutes of a meeting between managers from BAT and Philip Morris at Pennyhill Park, a hotel near London, on August 5th 1992 (see box ). Among those present were Peter Scheer, then president of Philip Morris's Latin American operations, and Keith Dunt, a BAT executive who went on to become the company's chief financial officer. The minutes reveal that the executives discussed fixing prices in several Latin American countries, in both the legal market and the "DNP" market. DNP stands for duty not paid—ie, smuggled.

These are not isolated cases. In a 1991 document entitled Summary of Group Marketing Strategies, the third strategy on the list is to "implement regular price increases, on an industry basis wherever possible, which at least cover inflation to secure adequate profitability..."

Nor do the documents refer merely to straightforward price collusion. Market share was fixed, too. A note on BAT's Zimbabwe strategy, marked "secret", refers to the lack of profits growth in that market being in part attributable to "a 50:50 sharing agreement with Rothmans of the 2.4 billion annual market, thus discouraging any real management dynamics." Rothmans merged with BAT in 1999.



Reuters

Often in cases of alleged price-fixing, the companies involved claim it was all the fault of rogue country managers far away. In this case, that is hard to argue. Although most of the documents seen by *The Economist* relate to developing countries far from head office, some of them were most likely read by senior BAT executives. The Zimbabwe document was headed "Note to TEC", a reference to the Tobacco Executive Committee, which consisted of company top brass. A number of other documents were sent or copied to senior managers at head office. In some cases, the authors were top executives at BAT's export arm, BATUKE.

### **An expensive drug**

Another claim made by industry sources is that it would be pointless to try to fix prices in the developing world, as in most countries the global players are up against local monopolies that dominate the market; without their co-operation, it would be impossible to keep prices artificially high or low. But this claim is spurious, too. Even in those countries where the tobacco multinationals have only a modest share of the overall cigarette market, the market can essentially be divided into two: cheap local brands, and the so-called "premium" market of international brands such as Marlboro and Camel. In this high-margin segment, two or three multinationals usually dominate—and can easily manipulate prices if they collude.

Eric LeGresley, a consultant based in Ottawa, says the documents strongly suggest that tobacco multinationals have operated as a cartel, with price-fixing as an integral part of their operations. "Once you rationalise that your products will be killing half of your customers," he argues, "everything else questionable that you might do must seem rather pedestrian."

BAT declined requests for an interview about the documents. "These are old documents taken out of context," it said. RJR said it could not answer questions about its international operations, as these were sold to Japan Tobacco in 1999. Philip Morris said the documents were not new, and that it abides by the laws of all countries in which it does business.

## **Leaving a trail**

Taken as a whole, the documents strongly suggest that the fixing of prices and of market share was widespread in the late 1980s and early 1990s. Clearly, at that time the tobacco companies did not expect that their internal documents would end up in public archives. Even so, there were attempts to avoid leaving a paper trail. In one memo, dated March 8th 1990, a manager pleads with a colleague not to name "interested parties" and to keep communication oral whenever possible. Another document of around the same time, entitled "Low Category Pricing", refers to a meeting with people from RJR, and advises that "we should stick to the

letter of the agreement—even though it will be purely oral!” It is hard to see why agreements would have to be oral, unless they involved something questionable.

What of BAT’s dismissal of the documents as old? Certainly, they are all at least five years old. Even if they were to admit that the documents referred to actual price-fixing, the companies might argue that they have changed their ways—and there is no evidence to suggest that any such thing is still going on. If such evidence exists, it would not be found in the depositories, as they only cover the period up to 1995. It is possible that none of the price-fixing in the documents was illegal at the time—Thailand, for instance, only formally banned price-fixing in 1999—but, legal or not, it was certainly unethical.

Might the industry have cleaned up its act voluntarily? Perhaps. One thing seems clear, however. Tobacco firms have always fought tooth and nail against price rises imposed on them by governments. But price hikes fixed within the industry? That is a different matter entirely