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Transnational Corporations and the Denationalization of the Latin American Cigarette Industry (Dialogue #17)

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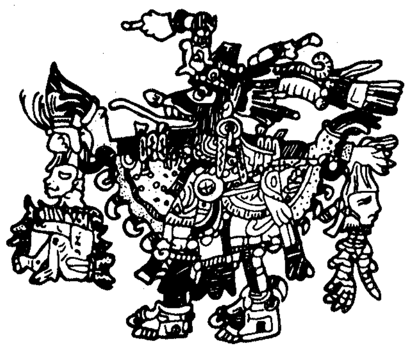

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By: Philip Shepherd

PREFACE

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Mark B. Rosenberg
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Introduction

The last 35 years have witnessed some extraordinary changes in the world tobacco industry. For example, the expansion abroad of U.S. cigarette companies (which had been domestically oriented from 1911 to 1952) first led to the breakdown of international cooperation among the major producers (a de facto cartel) in the 1960's and 1970's and, then, to the reestablishment of global "equilibrium" in recent years. This, in turn, signified the emergence of a truly global, highly concentrated transnational cigarette industry.

Likewise, other changes have had considerable impact on the industry. Medical research in the last three decades has increasingly revealed the lethal side of the industry, implicating smoking with a wide variety of illnesses, usually terminal: lung, mouth, throat and bladder cancers, emphysema, cardiovascular diseases and so forth (USDHEW, 1979). The development of the smoking and health issue in all the industrialized nations has caused stagnating and even declining cigarette sales in those nations, thus leading to a shift in growth to LDC's where, for a variety of reasons, the public health issue is much less salient. The major cigarette firms have therefore turned to LDC markets for future growths.

All these developments have been highly interrelated and linked to still others: (1) the ever-increasing predominance of cigarettes within the tobacco industry to the point where other products (cigars, chewing, etc.) have been completely overshadowed and the cigarette industry equals the tobacco industry in most nations; (2) dramatic changes in demand creation ("marketing") strategies and techniques which have enabled the major firms to hold onto older markets and expand new ones; (3) diversification into non-tobacco lines of business by the leading producers to cushion the impact of the smoking/health issue effects in home nations and make effective use of the large cash flow generated by cigarettes (a complementary strategy to expanding abroad in cigarettes);

(4) considerable changes in the technology of tobacco farming, marketing and cigarette manufacture in the direction of much more capital-intensive production; and (5) changes in the international trade of leaf tobacco and cigarettes, leading to the rise of LDC's as major leaf producers while DC's continue to dominate trade in manufactures.

I have reviewed these changes and the peculiar, often fascinating, history and structure of the industry elsewhere (Shepherd, 1979, 1981). In the present study, I will examine part of another interesting change that took place in the post-1950 era: the virtual disappearance of nationally-owned tobacco firms in many ares of the world and their replacement by a transnational corporate subsidiary (usually of Anglo-American parentage). This process of "denationalization) has been especially evident in Latin America, but it has also taken place to a surprising degree in Europe, Canada, Asia and, indeed, wherever there were national tobacco firms to be acquired. Even State tobacco monopolies in industrialized nations like Italy, France and Japan have not been immune. They have been under immense transnational corporate pressure, both through commercial means and through the "political" bargaining process in EEC institutions, trade talks, etc. ("Former Government Aide," 1975).

Thus, this work focuses on two broad topics: (1) How and why denationalization of Latin American cigarette industries occurred; and (2) some of the major effects of denationalization, including its impact on the agricultural sector of the industry.

Historical Emergence of Latin American Cigarette Industries

In Latin America, tobacco often played an important part in the economic and political struggles of the colonial era. For example, the famous "Comunero" rebellion in Socorro, Colombia in 1781, one of the precursors of the drive for Independence, was initially a protest against policies with respect to the growing and marketing of tobacco under the Crown tobacco Monopoly (Leonard, 1951). The deeply-felt hatred of the colonial monopoly eventually led to the dismantling of most Latin American tobacco monopolies (Stein and Stein, 1970:123-57; Harrison, 1952; McGreevey, 1971:111-18). Only Peru and Ecuador have had state monopolies in the 20th century (in Peru, the monopoly dated from 1904, not the 19th century). While both of these survived into the 1950's, they have subsequently been "privatized."

Under the onslaught of sentiment for "free trade" in the mid-19th century, most Latin American tobacco industries thus became at least formally "private." As Latin America was increasingly linked into the international system of trade, nations there experimented with various commodities in which they might enjoy some comparative advantage in order to finance increasing imports of manufactured and other goods from the more industrialized nations. Tobacco often figured as one of these primary products and various "export booms" centered on tobacco took place. For example, tobacco became Colombia's most important export commodity in the mid-19th century, and was intimately involved in a number of very important political economic events there during the 19th century (Harrison, 1952; Sierra, 1971; McGreevey, 1971:97-183). Tobacco exports were also important at various times in Brazil, parts of Central America and the Caribbean, Peru, and, of course, Cuba. Domestically, tobacco production and consumption was a crucial factor in governments' revenue in virtually all Latin American nations both before and after Independence (Stein and Stein, 1970:71-74 and 99-106).

Latin American tobacco industries were based on locally-grown, "dark tobacco," (tabaco negro) largely used for cigars, snuff and chewing in the pre-cigarette era. "Dark," air-cured tobaccos of this type were (and still are) traditionally favored in ares of Spanish or Latin cultural influence. In the late 19th century, the cigarette came along after cigar-type leaf production was already well-established in Latin America. Thus, early Latin American cigarette producers found it natural to make cigarettes from cigar leaf cuttings (Brooks, 1952:257-58). This is the reason why Latin America traditonally had dark tobacco (tabaco negro) cigarettes instead of the Anglo American types of light tobacco (tabaco rubio) blends.[1]

LatinAmerican tobacco firms often played important roles in the early stages of import substitution industrialization (ISI) in the region. Most Latin American cigarette firms date from the early years of the 20th centurly and some from the 1890's. Cigarette production and tobacco manufacture in general was a prime candidate for ISI efforts: Tobacco products were a luxury to import; domestic raw materials in the form of leaf tobacco were readily available; some local familiarity with the industry was often present; the scale requirements were not large; the technology was not unduly difficult to acquire or adapt to location conditions; agricultural production of leaf was labor-intensive; cigarette manufacturing did not require much silled labor, and so forth. The industry was thus ideally suited for import substitution industrialization, as was the case with other agricultural processing sectors. It also had the added advantage of providing considerable tax revenues for the state (through cigarette taxes) and cutting down on "non-essential" imports to ease balance of payments problems. Thus, it is not surprising that the industry frequently received substantial (and early) effective tariff protection.

Nationally-owned tobacco firms grew rapidly in most Latin American nations after 1900 or so. Substantial local industries developed in protected markets all over Latin America, but particularly in Argentina, Mexico, Brazil, Colombia, Chile and Peru. In a variety of nations, including Cuba, Paraguay, Brazil and Colombia, leaf exports of tobacco were also important. Because of its relative importance in ISI and its role as a source of governmental revenue, Latin Aerican tobacco indistries have played key roles in the political-economic history of a number of nations in the 20th century.

In the largest markets of the region like Argentina, Brazil and Mexico, British-American Tobacco, Ltd. (BAT)[2] entered the industry fairly early (often just prior to or after WW I), frequently acquiring a local firm. Aggressively carving out large market shares, BAT frequently met with considerable opposition from owners of national firms, the national bourgeiosie in general, and others who feared foreign penetration and control of the local economy. In some nations, such as Colombia, BAT was unable to gain a permanent foothold in the market (Shepherd, 1981). However BAT usually followed a low-profile, "live and let live" strategy for dealing with economic nationalism, and substantial local firms often grew up alongside BAT subsidiaries in some markets. Later on these locally owned firms made rather attractive targets for TNC acquisition. It was only with the wholesale take-over of these firms by other (largely U.S.) TNC's in the 1960's that Latin American tobacco industries were effectively "denationalized."

The Process of Denationalization

It is important to view the process of TNC expansion not only from the perspective of TNC's and the "Home" nations (as most of the literature on TNC's and direct foreign investment tends to), but also from the viewpoint of "Host" nations, local firms, and LDC's. Most theories of direct foreign investment and TNC expansion focus on characteristics of TNC's and their "home" economies to explain how these things are important in corporate expansion and the transformation of national firms into "transnation" firms. The idea that the causes and dynamics of TNC expansion abroad are to be located largely within the TNC itself and its immediate context of oligopolistic competition in the industrialized home nations is important. But it cearly neglects the broader context of action in which such expansion takes place. These theories do not examine the conditions under which "Host" nations are opened up to direct foreign investment or open themselves up; they tell us very little if anything about how, when, and why TNC's penetrate given national markets overseas. Rather, these theories implicitly assume -- sometimes quite unjustifiably -- that foreign nations' markets may be entered at will and at any time.

Moreover, TNC's are not merely passive actors responding to given market demands and developments, but have a substantial, though imperfect, ability to shape the context in which they operate. TNC's have often operated in the context of an international "demonstration effect" which they themselves have partially created, nurtured and manipulated.

The patterns of consumption encouraged by TNC's and their effects on the international "product cycle" can often be stated with considerable specificity. In the case of the cigarette industry, what we see is a remarkable convergence of world-wide consumption trends and patterns towards TNC product forms developed in their home markets. These are partly the result of prior TNC efforts at demand creation and partly the result of the diffusion of contemporary industrialized nations' "life-styles," first to LDC elites, and then to broader portions of the population. These are both aspects of a single process, and consumption trends in the international tobacco industry over the past thirty years bear eloquent testimony to the degree to which TNC's are able to channel and bias consumption patterns in favorable directions for their continued success and profitability. In cigarettes, these have benefitted U.S. TNC's in particular.

There have been four major worldwide shifts in the consumption of tobacco products in the last 30 years, all of them considerably influenced by TNC's: (1) From all other tobacco products (cigars, chewing pipe tobacco, etc.) to cigarettes; (2) from the consumption of "dark" tobaccos to the consumption of "light" tobaccos; (3) from the consumption of filtered cigarettes to the consumption of filtered cigarettes; and (4) from the consumption of short (70mm) cigarettes to the consumption of longer cigarettes (85mm, 100mm, 120mm). Hence, the trend has been strongly towards TNC product forms (e.g. longer-length, filtered, "light" tobacco cigarettes) and away from shorter-length, non-filtered "dark" tobacco products of national producers. In particular, there has been a decisive worldwide shift to the consumption of "American Blend" cigarettes (containing approximately 50-55% "flue-cured" tobaccos; 30-35% burley; 10-15% "Oriental/Turkis" and 2-3% Maryland), once culturally-specific only to the U.S. More comprehensive data than it is possible to present here clearly indicate these trends (Fidel et.al., 1977:3-17). For a long time, in fact, the battle lines in the Latin American cigarette industry have been drawn between domestic tabaco negro cigarettes made by national firms and foreign tabaco rubio cigarettes made by TNC's. The "winners" are clearly evident in Table 1.

The "Controlled" Product Cycle

To see why particular product forms have tended to give TNC's an advantage, it is necessary to understand that, in the course of attempting to create demand, TNC's have developed a vested interest in channeling demand into products with which they are already familiar. Rather than bother to ascertain the consumer's *existing* preferences, TNC's generally find it more profitable and efficient to attempt to stimulate in the consumer those responses which would lead him to prefer the products which TNC's already have and which they wish to establish in the market. This is particularly crucial

Table 1

Cigarette Sales (1) by Type of Tobacco Blend, 1950-1975 (in percent)

	Nation						
	Argentina			Colombia		Peru	
Year	Light Tobacco	Mixed Light & Dark	Dark Tobacco	Light Tobacco	Dark Tobacco	Light Tobacco	Dark Tobacco
1950	36	--	64	Not Available		Not Available	
1955	50	--	50	Not Available		5	95
1960	46	--	54	Not Available		13	87
1965	52	--	48	Not Available		19[2]	81[2]
1966	55	--	45	--	--	33	67
1967	60	--	40	--	--	50	50
1968	67	--	33	10	90	52	48
1969	71	3	26	11	89	55	45
1970	72	4	24	12	88	57	43
1971	72	6	23	16	84	56	44
1972	72	7	21	23	77	64	36
1973	72	10	19	24	76	67	33
1974	72	12	16	25	75	77	23
1975	75	12	13	--	--	--	--

Sources: Argentina: Depto. de Tobaco, Secretaria de Estado de A gricultura y Ganaderia, Estadistica Anual, 1950-1975.

Colombia: Estimates from La Compania Colombiana de Tobacos, S.A.

Peru: 1952-1964: Instituto Nacional de Promocicion Industrial y Banco Industrial del Peru, La Industria del tobaco en el Peru (Lima, 1965), Table 8, p. 29; 1966-74: Empresa Nacional de Tobaco, "La Industria tabacalera nactional y la participacion del estado dentro de su desarrollo," Lima, 1974), Anexo No. 1

(1) By unit volume

(2) 1964

just prior, during, and immediately after TNC entry. This channeling of demand into the well-worn grooves of the TNC's product-cycle is highly favorable to TNC's and not so favorable to national firms, especially those producing culturally-indigenous or idiosyncratic product forms.

Thus a great deal of TNCs' efforts will be directed towards making sure that markets abroad do converge along lines already well-explored and for which rents may be had for product forms and brands already highly-depreciated and discounted in the domestic market. A substantial amount of the TNCs' resources will be employed in the attempt to direct product development and consumption in these directions and to ensure that local "deviations" are not too dissimilar or that consumption does not remain at a qualitative and/or quantitative level that is rather less favorable to it in terms of appropriability (Magee, 1977; Shepherd, 1981). The attempt to direct consumption and production along a product-cycle path already well-explored will act to convey upon TNC's certain systematic advantages that are not enjoyed by local firms who have not already scouted these product-cycle paths to the degree TNC's have.

There is no <u>necessity</u> that these foreign markets will proceed along the linear, "stage" path implied by the TNCs' product-cycles. The problem from the TNC's point of view is precisely in making sure that foreign markets will, in fact, converge along similar lines given the cultural, political, social and economic diversityh which reigns abroad. In these markets, not only are products likely to be at an earlier "stage" in terms of product forms mapped out in the home market, but they are also likely to be dependent on demand configurations which correspond to idiosyncratic factors not well-known by TNC's, at least at the outset. And not only will products be "different" in the sense of response to local cultural factirs, but also, particularly in LDC's, present in forms that are much simpler and less appropriable by the private TNC (Shepherd, 1981).

The answer here, and the great success of TNC's, lies in guiding production and consumption down the product-cycle path already traced out in the home market in earlier stages. Adapatations will be made to local conditions _if_ they are relatively consistent with TNC's capacities and the requirements of appropriability. But the real trick is to move consumption and production into "international" (read TNC home nations') patterns and away from local, national idiosyncracies which may reduce appropriability and/or give local firms the decisive advantage.

These "international" consumption patterns form a milieu in which any given national market resides. This in itself creates an implicit demand for TNC product forms and brands. But what if the local national market is cut off and protected by ISI policies that prohibit the effective communication of these trends to consumers? What if the prohibition of importation of TNC cigarettes means that local, culturally-indigneous product forms are the only ones available and promoted?

Rarely, of course, has any market in the "Free World" been entirely shut off from world trade and completely isolated. Where import substitution industrialization policies have prohibited imports of cigarettes, some consumers may still be familiar with TNC products through prior acquaintance before these policies took effect. In LDC's, a small quantity of imported TNC cigarettes has often been permitted with high duties in an otherwise protected market. This is to offer what Hirschman called "gold-plated service" for the "capital-city" elite. These imports are not only for the elite's benefit; they also "comfort" the local tobacco industry and reduce the demands on it for "connoisseur goods" (Hirschman, 1970a:48-60). This, too, creates a certain latent demand for TNC product forms and goods.

Table 2

Recorded World exports and Recorded World Imports of Cigarettes Compared, Selected Years, 1951-1960(1) and 1967-1976(2)

Year	Recorded World Exports	Recorded World Imports	Percentage Difference
1951	126,735	106,508	16.0
1952	115,324	95,732	17.0
1953	114,869	90,708	21.0
1954	108,317	91,939	15.1
1955	108,420	92,179	15.0
1956	109,717	85,379	22.2
1957	110,129	92,334	16.2
1958	110,484	93,208	15.6
1959	108,609	86,425	20.4
1960	110,428	84,162	23.8
1967-1971(3) Average	136,356	92,058	32.5
1972	178,415	126,016	29.4
1973	191,938	133,306	30.5
1974	203,888	153,615	24.7
1975	222,659	170,778	23.2
1976	241,797	177,361	26.6

Sources: U. S. Dept. of Agriculture, World Tobacco Analysis-Consumer Marketing, February 1958; Foreign Agriculture Circulars - Tobacco FT 5-60, FT 8-62, FT-3-76, FT-2-77 (Julyl, 1960; May, 1962; July, 1976 and 1977)

(1) In thousands of pounds of cigaretts

(2) In millions of cigarettes

(3) Unfortunately, the United States Dept. of Agriculture discontinued publishing data on world trade in cigarettes after 1962 and did not resume its international cigarette trade series until 1976 in which the 1967-1972 average was provided. It may be precisely because of the large disparity between recorded exports and recorded imports that USDA discontinued the data series since it appeared so unreliable as to be worthless during the 1960's.

The Role of Contraband

More importantly, "protected" markets are often "softened-up" prior to TNC entry by contraband cigarettes. Increased smuggling of cigarettes is strongly associated with TNC expansion, especially that of U.S. cigarettes is strongly associated with TNC expansion, especially that of U.S. cigarette firms during the late-1960's (Table 2).

Significant contraband trade in cigarettes is not only evident in Latin America, but in many regions and nations, including relatively developed ones such as Italy, Belgium, Turkey, etc. In the tobacco trade press there have been scores of articles dealing with the contraband problem since the mid-1960's. (See, for example: "Former Government Aide Claims Italy Underselling Itself to Multinational Firms," 1975:51; "Maylasia: Smuggling Accord Reached," 1977:66; "Philippines: Cigarettes Go Up in Smoke," 1977:14). In Italy, for example, it was estimated that up to 200,000 Italians were earning their living smuggling cigarettes, costing the government an estimated $560 million a year in lost revenue. The practice is now so firmly entrenched that formal protests are not uncommon when police act to curb operations ("Italy: Smuggling on the Rise," 1970:20, 26).

The pattern of smuggling is well-nigh universal. TNC cigarettes are first exported from the developed countries to small, intermediary "free trade zone" nations (Hong Kong, Panama, Netherlands Antilles, Praguay, Lebanon, Malaysia, Belgium/Luxembourg, Singapore, etc.). U.S. cigarette exports to these destinations far outstrip the local potential for domestic consumption by a factor of 5 to 10, even at levels of per capita consumption characteristic of the U.S. (the highest in the world). For example, the Netherlands Antilles, with a population of 200,000, imported 4,126 million cigarettes from the U.S. in 1976. This figure equaled 20,630 cigarettes for every single man, woman and child in the Netherlands Antilles when the estimated annual per capita consumption in the U.S. was only 2,816 in 1975!!

Large quantities of these cigarettes are then re-exported to their final market destination in protected markets close to these (entrepot) centers of idstribution. These cigarettes thus make their way through illegal channels into surrounding protected markets: the Netherlands Antilles and Panama supply Colombia and the Caribbean; Hong Kong, Malaysia and Singapore supply the Philippines, Thailand and Indonesia; Paraguay supplies Brazil and Argentina; Lebanon much of the Mid-East, etc. The dollar value of this trade is considerable, even at the tax-free and duty-free prices reported at exit from the U.S.: $50 million for Hong Kong; $37 million for the N. Antiles; $18 million for Lebanon; $110 million for Belgium, to cite a few of the main smuggling centers (Shepherd, 1979:Tables 33034). The actual retail value of the contraband once it reaches the consumer is probably about twice this.

A variation on the pattern of contraband distribution takes place when TNC brands are manufactured by local subsidiaries and/or licensees for clandestine export into neighboring markets from these smaller nations. Much of the contraband into Italy, for example, comes from TNC subsidiaries in Switzerland. Other cases include cigarettes made in Hong Kong, the Canary Islands, and Belgium/Luxembourg.

Contraband provides an effective -- if unorthodox and illegal -- method of market penetration to gain a foothold in "protected" foreign markets. The increase in the contraband cigarette trade of various nations is highly correlated with the battle to take over national cigarette industries. Usually smuggling reaches its peak just prior, during, and after TNC entry into a market through direct foreign investment or licensing. It may extend for a considerable period of time if resistance by locally-owned firms is prolonged, but, after TNC entry and relatively complete denationalization, smuggling frequently declines.

The case of Columbia is illustrative (Figure 1). Colombia is one of the last wholly nationally-owned private cigarette industries with a fairly large market (above 20 billion cigarettes per annum). Until quite recently, it also produced and consumed almost exclusively "dark tobacco" cigarettes, as was once the norm in most of Latin America (Table 1). As contraband climbed in the early 1970's, domestic manufacturers were hurt and domestic output declined significantly. In the early 1970's, two licensing agreements were signed between two locally-owned firms and TNC's to manufacture the two largest-selling contraband cigarette brands -- Philip Morris' Marlboro and P. Lorillard's Kent.

This, however, was only the fist stage of the process, and smuggling resumed as the domestic firms resolved to try to fight out the tabaco rubio vs. tobaco negro battle (Perez Vasquez, 1975). Thus, TNC direct foreign investment has yet to be accomplished and contraband continues at high levels in Colombia -- approximately 4.5 billion cigarettes a year (Republica de Colombia, DNP, 1975:6; Perez Vasquez, 1975). To gain some idea of the size of this trade in illicit cigarettes, it was nearly as large as all U.S. exports of cigarettes to the EEC in the early 1970's (approximately 5.7 billion). The magnitude of contraband entering Colombia made it larger than the total 1975 cigarette exports of either the American Tobacco Co. or Liggett & Myers, roughly one-half those of P. Lorillard; 31% of all exports of R. J. Reynolds, and 29% of those of Philip Morris (Shepherd, 1981). At early 1970's prices, this clandestine trade was worth in the neighborhood of 40-50 million dollars.

The entire process is revealed perhaps most clearly by the Argentine experience. Smuggling of cigarettes skyrocketed in the early 1960's (Figure 2). It then fell off momentarily in 1962 when legal imports were briefly permitted (with low duties) to combat the problem. This did not provide domestic firms with any respite, but only made their situation worse because effective protection had been lifted (as also took place in Colombia). To defend themselves, some national firms began to establish themselves as exclusive importers of TNC's brands, thus beginning dependence on the TNC's. When legal imports were once again shut off, licensing arrangements were established for local manufacture of brands that had previously been imported. Quickly thereafter, in dire financial straits, all the nationally-owned firms were acquired at bargain prices by TNC's (Philip Morris-Massalin & Celasco; Liggett & Myers-Piccardo; Reemstma-Particulares and Imparciales) in 1966-67. This completed the denationalization process. After the period of establishment of TNC brands, smuggling fell off rapidly back to "normal," pre-1960 (unorganized?) levels (Figure @).

Where were national governments in all this, given their interests as "senior partners" in the cigarette industry through excise tax receipts? One study in Argentina estimated that some $28 million dollars were lost in government revenue, and there was a balance of payments loss of $54 million in payments for contraband cigarettes between 1961-67, <u>after</u> deducting 35% to the smugglers who (presumably?) were Argentines (ORIC, 1968:Anexo V:5;28). In fact, public policy towards the industry in both Colombia and Argentina (as well as many other Latin American nations) was extremely contradictory. It often made things worse for national firms even when governmental intent was otherwise.

It is truly remarkable how similar the basic outlines of this whole process has been -- including Latin American governments' responses to these events. The political will to take decisive action on behalf of national firms was not forthcoming, and policy tended to vacillate among various alternatives, none of them providing any real solution to the problem. Governments were totally incapable of eradicating political corruption and/or incompetence in customs enforcement and in other crucial sectors of public administration such as the military. Although governments were losing untold millions of dollars in tax revenues, advertising for TNC brands that could only enter the countries illegally was blatantly apparent along public thoroughfares and in the mass media in both Colombia and Argentina (Perez Vasquez, 1975:31; Vilas, 1974:12). Government technocrats, reasoning on neo-classical economic grounds that legal imports with fairly low tariffs would cut smuggling and recoup government revenues, experimented temporarily with lifting import bans and high tariffs on foreign cigarettes only to find that, while government revenue did recover somewhat, this served to consolidate, legitimize and expand TNC products' positions in the market. Since this did nothing to relive TNC pressures on nationally-owned firms, the latter vehemently protested, not without reason, that they had willingly borne the brunt of high taxation on their products to help support the government and were therefore entitled to some support themselves. In fact, during periods of legal imports, the effective rate of taxation on nationally-owned firms' products was actually much <u>higher</u> than that levied on the TNC imported brands (Perez Vasquez, 1975:5-20). Thus, temporary periods of legal imports alternated with increased smuggling when import bans and high tariffs were reimposed until national firms were sufficiently financially crippled to either sell out to TNC's or, at the minimum, sign licensing agreements for the local manufacture of the contraband TNC brands.[3]

Another factor in the vacillation of public policy appears to have been the protected status and quasi-monopolistic positions national firms had long held in their markets. Because of the long history of dominance and fairly significant political and economic power of these firms, lower sectors of the public administration (and some of the higher officials as well) were not about to shed many tears over their plight. Nationally-owned firms were sometimes able to finally get their way, but it often took herculean pushing and shoving in legislatures and the relevant bureaucracies. By that time it was often too late. Even when support was forthcoming, governmental action was taken not out of any great sympathy for the plight of nationally-owned firms, but rather out of concern for the effects on the economy as a whole and on tax revenues. Interviews with Latin American policy-makers confirm that many viewed national cigarette firms as predatory, oppressive monopolists finally getting a taste of their own medicine. Thus, they tacitly encouraged TNC competition, legal or illegal (Shepherd, 1981).

Thus, smuggling patterns strongly suggest that contraband has been an arm of TNC "marketing" efforts to penetrate foreign cigarette industries.[4] The benefits of smuggling go considerably beyond the simple desire to export more cigarettes wherever and however they can. Contraband TNC cigarettes "soften-up" prospective markets abroad for licensing and subsidiary operations later on by creating a demand for certain product forms and brands; by subtlely changing consumer tastes through snob appeal and lower prices (smuggled cigarettes pay neither excise taxes nor import duties); and, they cripple the local competition which, if nationally-owned and relatively weak financially, can then be easily acquired. If TNC's are licensing their brands to local manufacturers, smuggling can also be employed to press for equity participation. If legal imports are temporarily permitted to combat smuggling, TNC's can switch to legal exports, contraband will still continue somewhat (because contraband pays neither excise taxes nor import duties), and, in any event, nationally-owned firms will <u>still</u> be hurt.

The smuggling problem in its entirety is simply too complex to be considered in any detail here (Shepherd, 1977:19-21; Shepherd, 1981). The exact nature of its causes and all its dimensions are not sufficiently clear. A good "neo-classical" economist would point to relatively high taxes. high tariffs, and outright prohibitions on imports as the main sources of difficulty (Bhagwati, 1974). These are undoubtedly part of the problem. But the fact that contraband sometimes flourishes even where smuggled cigarettes are considerably <u>more</u> expensive than local products suggests that traditional economic theory is not very enlightening here -- at least as a relatively complete explanation. Because of the relatively large numbers of people involved in contraband distribution networks and the risk involved, margins on smuggled cigarettes tend to be rather high. So price differentials, in and of themselves, are not always that great or even non-existent. They are certainly insufficient as a complete account of the problem, ignoring as they do the rold of TNC's in influencing consumer choice. Other variables are clearly involved since many, if not most, LDC nations have ISI protectionism and high excise taxes. But only certain nations at certain times have had serious national smuggling problems with cigarettes. For example, Italy's state monopoly has serious problems but Japan's does not. Thus, contraband, as a general phenomenon, may be as closely related to TNC strategies and sociopolitical variables as to more narrowly economic ones (Shepherd, 1977:21).

The role of TNC's in contraband also needs clarification. Smuggling has been an effective instrument of TNC market penetration in the cigarette industry <u>regardless</u> of the precise role of TNC's in contraband activities. Whether TNC's have been directly involved in the trade, whether they have indirectly encouraged it, or whether they have had no connection with smuggling activities whatsoever, TNC's have been the primary beneficiaries of contraband in cigarettes in Latin America (and probably elsewhere as well). There is at least some (unfortunately confidentail) evidence of direct TNC involvement in smuggling in both Argentina and Colombia.[5] There is also considerable circumstantial evidence implied in the basic outlines of these massive "marketing" campaigns through smuggling: the blatant advertisement of TNC brands that can <u>only</u> be brought into a nation and bought there through <u>illegal</u> channels; the considerable financial dimensions of alternative contraband distribution networks; the rapidity with which they appear and disappear; the timing of contraband "phases" in different nations; the fact that, while a variety of cigarette brands is available in contraband markets, certain brands (usually only two or three) are much widely distributed and far outsell all others; the fact that it is precisely the manufacturers of these same brands that enter through licensing or direct foreign investment later on; and the fact that any self-respecting "marketing" personnel in charge of cigarette exports in given regions would have to be blind not to realize where massive exports to countries like the Netherland Antilles finally end up.

Impact on Industrial Structure: Foreign Dominance and Concentration

The process of denationalization has largely entailed the expansion of U.S. TNC's into the region since most of the BAT subsidiaries were established much earlier. But it is not exclusively a U.S. TNC process -- either in origin or in benefits. The West German firm Reemstma acquired two of the Argentine national firms, for example. And BAT may be the eventual beneficiary in Colombia since it has now assumed P. Lorillard's international operations.[6]

One should also emphasize that there is a pattern here. The same series of events -- with some variation in the pattern and timing -- have also taken place in Brazil (1970's); Mexico (1960's); Peru (1960's); and Ecuador (1970's) as well as in many other smaller markets in Latin America. Only Venezuela, Chile, Uruguay, and Cuba have exhibited major differences. Venezuela largely escaped a major contraband assault because its oil wealth made it the largest (legal) importer of U.S. cigarettes in the 1950's. U.S. TNC's established a foothold in the market this way quite early. This led to relatively early denationalization at the outset of the formation of Venezuela's cigarette industry in the late 1950's and early 1060's. Chile seems to have deviated from the pattern somewhat because of the private, officially-sanctioned monopoly held by the locat BAT subsidiary there. A small market and depressed economic conditions all during the 1970's evidentally made it unattractive for other TNC's although Philip Morris recently entered in 1982. The case of

Table 3

Transnational Cigarette Firms in Latin America: Subsidiaries, Licensing Arrangements, and Non-Tobacco Operations, c. 1976

Nations	British-American %	Philip Morris %	R. J. Reynolds %	Liggett Group %	Rupert/ Rothman's Group %	Reemts ma %	Loew's %	Total Output 1976	Est TNC[2] Share %
Argentina	S-(42) NT	S-(22)		S-(17)		S-(19)	L	36,800	100
Barbados	S(100)							210	100
Bolivia		L		S-(NI)			L	1,700	NI
Brazil	S-(75) NT	S-(5)	S-(11)	S[3]	S[4]	S[5]		117,000	91
Colombia		L					S[6]/L	18,300	3/15[12]
Costa Rica	S-(57)	S-(16)		L				2,300	75
Chile	S-(100)							8,800	100
Dom. Rep.		S-(NI)		L				3,200	NI
Ecuador		S-(NI)	S-(NI)					3,700	NI
El Salvador	S-(76)	S-(15)						2,200	91
Guatemala		S-(45) NT					L	2,400	50
Guyama	S-(NI)							500	NI
Haiti		L						500	NI
Honduras	S-([illegible])							1,800	[illegible]
Jamaica	S-(27)				S-(70)			1,500	97
Mexico	S-(30) NT	S-(14)	S[7]/L-(NI)	L			L	45,000	60
N. Antilles		L						NI	NI
Nicaragua	S-(96)							1,700	96
Panama	S-(55)	S-(43)					L	1,100	98
Paraguay	L							700	NI
Peru	L	L[8]	L	S[9]/L			L	3,800	25
Puerto Rico		S[10]-(NI)	S-(NI)				S[10]-(NI)	NI	100
Trinidad/Tabago	S-(NI)	L						1,200	NI
Uraguay		S-(10)						3,500	10
Venezuela	S-(19) NT	S-(76)	S[11]-(2)				L	18,800	97

Sources: United Nations Conference on Trade and Development, Marketing and Distribution of Tobacco (TD/B/C.1/205), June 16, 1978. Table 9, p. 31/32; United States Department of Agriculture, Foreign Agriculture Circulation Tobacco, FT-2-77, July, 1977; and estimates by the author-based on various trade sources.

[1]In mil ns of cigarettes (not by value).

[2]Estimates which include cigarettes manufactured under licensing arrangements but not export sales (either illicit or legal).

[3]Leaf exporting subsidiary only. Liggett closed its manufacturing subsidiary in 1972.

[4]The Rupert/Rothman's Group (Martin Brinkmann) sold this subsidiary (Lopes) to R.J. Reynolds in 1975.

[5]Reemtsma sold this subsidiary (Fumos Santa Cruz) to Philip Morris in 1975.

[6]Leaf tobacco production subsidiary to supply its licensee, Protabacos, S.A.

[7]Reynolds sold its subsidiary (Baloyan) when the Mexican government forced divesture of majority TNC holdings after 1973.

[8]Licensing agreement signed in 1978.

[9]Liggett sold its subsidiary in 1975.

[10]Apparently selling companies which do not manufacture in Puerto Rico.

[11]May have been sold off in 1976.

[12]TNC sales are only approximately 3% not including contraband; approximately 15%+ including illicit imports of TNC brands.

LEGEND: S-(%): Subsidiary with significant (20%+) equity holdings. Market share (by volume) is given in parentheses).

L: Licensing agreement with a local company (either locally-owned or another TNC) in which no equity is held.

NT: No information available.

NT: Non-tobacco subsidiary operations are also present with significant (20%+) equity ownership.

Uruguay, which retained the only totally nationally-owned industry (without even licensing with TNC's) until recently, is not entirely clear. Depressed economic conditions there may have played some role as well as the disturbed political conditions characteristic of the late 1960's and early 1970's. However, Philip Morris has acquired a locally-owned firm there and Uruguay may differ over the long-run only in the relative tardiness of the denationalization process ("Philip Morris Invests in Uruguayan Firm," 1979:24).

"Denationalization" is an apt term for the process of TNC entry into the Latin American cigarette industry over the past 35 years because it took place largely through the acquisition of existing nationally-owned firms. Nearly 80% of the traceable U.S. TNC subsidiary operations in Latin America were acquisitions of this type (Shepherd, 1981). The complex reasons for this can not be explored here, but several factors were at work in addition to the debilitating effects of contraband on national firms: (1) the pressure of domestic market stagnation dictated rapid entry into foreign markets while the large cash flow from domestic sales provided the necessary funds; (2) TNC cigarette firms' demand creation advantages logically implied a strategy of acquisition to obtain some local marketing expertise, an easy entry into pre-existing distribution systems abroad, and a "national" cloak" with which to deflect possible nationalist consumer rejection and "political" reaction to aggressive competition based on "artificial," "unfair" demand creation techniques (Shepherd, 1977:14-15).

The process of denationalization has been most aggressively pressed towards complete take-over in the largest, most attractive markets with considerable growth potential, such as Mexico, Argentina, Brazil and Venezuela. In many of the smaller, more sluggish markets, TNC's have been content with licensing arrangements or with partial take-overs and minority equity positions at present, as in Peru, Bolivia, Paraguay, etc. Nevertheless, TNC market control in Latin America is quite high (Table 3).

The data are really rather striking: TNC's are present in one form or another in every single national market in the region and they are the dominating factor in most. Their market shares are quite large, giving them virtual control of most of the major Latin American cigarette industries. In the larger national markets of Brazil, Argentina, Mexico, Venezuela and Chile their dominance is obvious; but one should also note the degree of penetration of some of the smaller nations such as Ecuador, the Central American countries, and the Caribbean nations. In effect, nationally-owned tobacco industries survive in only very few nations -- Uruguay, Peru, Colombia, and perhaps one or two more. Even these are tied to the TNC's by licensing arrangements and TNC influence is plainly on the rise. Perhaps the most disquieting thing about Table 3 is that, were it possible to assemble the same sort of information for, say, 1950 or even 1960, it would look very different. Apart from most of the BAT operations (and even the BAT market control was often lower), Latin American cigarette industries were wholly national in ownership in 1950 or 1960. By the mid-1970's, however, nationally-owned cigarette firms had become a thing of the past.

After TNC entry, a radical transformation of the contours of the industry has frequently taken place. After acquisition of local firms (or even, on occation, after licensing begings), a particular pattern has tended to emerge, especially in the larger markets like Brazil, Argentina, and Mexico where denationalization was almost total. Intense oligopolistic competition for a larger market share immediately broke out -- which did not usually involve much durable price competition. There was a rather short (5-year) cycle of intense, more evenly-divided competition in terms of market shares, followed by considerable market shake-up (firms with initially large market shares declined and vice versa), and then renewed concentration and consolidation. The Argentine experience after 1966 may be a paradigm case of this pattern (Fidel et al. 1977:21-39).

While there are a number of factors at work making for high levels of market concentration in Latin American cigarette industries, not all of them directly traceable to the impact of TNC's, TNC entry has done nothing to reverse these, and, on the contrary, has served to accentuate and accelerate high levels of concentration. Thus, although nationally-owned cigarette industries have operated in conditions of tight oligopoly or quasi-monopoly historically, the entry of TNC's has further concentrated market structure. For example, prior to TNC entry in Argentina in the mid-1960's, there had been 5-7 major firms. Led by BAT's subsidiary with approximately 35-40% of the market, for decades the rest of the market had been relatively evenly-divided among locally-owned firms. After a short period of intense oligopolistic rivalry following TNC take-overs, however, successive mergers have now reduced the industry to only two firms, a duopoly in the hands of BAT and Philip Morris. This transition from loose oligopoly to "workable competiton" and then to renewed concentration and consolidation under TNC's has also taken place in other Latin American markets, including Brazil, Mexico and Venezuela.

TNC Expansion of Demand

After TNC entry, the market was often "turned around" towards very rapid growth rates both in terms of total output and per capita consumption. This was usually in great contrast to the relatively stagnant aggregate market growth rates realized by nationally-owned firms (Table 5). The primary method by which this has been accomplished is a vast increase in demand creation efforts, primarily advertising, but also through rationalization of distribution systems, increased sales forces, and other promotional techniques.[7]

In Argentina, for example, there was a dramatic upsurge in advertising expenditures after 1966 (Table 6).[8] Once the industry "shake-up" had taken place, new brands launched, and old ones repositioned or eliminated, advertising and

Table 5

Sales of Nationally-Made Cigarettes[(1)] in Argentina, 1950-1975

(in packs of 20)

Year	Packs (millions)	Index 1960=100	Packs per capita (number)	Index 1960=100	Packs per capita 17 yrs.+	Index 1960=100
1950	876	81.0	51.1	97.3	77.6	97.2
1955	1,047	96.8	55.3	105.3	84.0	105.3
1960	1,082	100.0	52.5	100.0	79.8	100.0
1965	1,248	115.3	56.3	107.2	85.0	106.5
1966[(2)]	1,207	111.6	53.7	102.3	80.8	101.3
1967	1,241	114.7	54.4	103.6	81.7	102.4
1968	1,307	120.8	56.5	107.6	84.6	106.0
1969	1,376	127.2	58.7	111.8	87.7	109.9
1970	1,467	135.6	61.8	117.7	92.0	115.3
1971	1,509	139.5	62.7	119.4	93.2	116.8
1972	1,595	147.4	65.4	124.6	97.0	121.6
1973	1,676	154.9	67.8	129.1	100.4	125.8
1974	1,891	174.8	75.7	144.2	112.0	140.4
1975	1,905	176.1	73.5	140.0	108.6	136.1

Sources: Departamento de Tobaco, Secretaria de Estado de Agricultura y Ganaderia, and Instituto Nacional de Estadistica, Republica de Argentina.

[(1)] Does not include cigarette imports, either legal or illicit and hence is not a meausre of actual consumption.

[(2)] 1966 is the year of entry of Philip Morris and Liggett and Myers as well as Reemtsma. It is the year usually given for the "denationalization" of the Argentine cigarette industry, although the largest firm in the industry, Nobleza (BAT) was established in 1913.

Table 6

Cigarette Advertising Expenditures in Argentina Before and After Entry of Transnational Cigarette Firms, 1958-1976

Year	Expenditure at Constant Prices(1) per 1,000 packs of cigarettes (1960 pesos)
1958	40.0
1959	16.0
1960	20.0
1961	46.0
1962	79.0
1963	80.0
1964	70.0
1965	83.0
1966 - Entry of TNC Cigarette Firms	73.0
1967	107.0
1968	312.0
1969	428.0
1970	249.0
1971	238.0
1972	197.0
1973	184.0
1974	133.0
1975	93.0
1976	118.0

Source: Julio Fidel and Jorge Lucangeli, "Cost-Benefit of Different Technological Options in the Context of a Differentiated Oligopoly: The Case of the Argentine Cigarette Industry," United Nations Economic Commission for Latin America and Inter-American Development Bank Research Program in Science and Technology, Working Paper No. 18, Buenos Aires, October, 1978, Table 5, p. 18.

(1) Deflated by the non-rural wholesale price index.

other promotional expenditures declined in the 1970's. The increasingly dysfunctional advertising war led to a "truce" in the form of a voluntary agreement to ban advertising in radio, TV and movie theaters between September, 1969 and July 1971, ratified by the Argentine government (Fidel and Lucangeli, 1978:11). Highly-inflationary conditions coupled with governmental price controls caused a decline in the real price of cigarettes to consumers which aided in the effort to increase consumption and stimulate market growth. But, in the context of an advertising war, this was a mixed blessing since it also seriously affected profit levels. Hence, the advertising ban and the new, more settled equilibrium which evolved in the mid-17s0's (Table 6).

TNC brand strategies after denationalization in markets like Argentina, Brazil, and Mexico, also demonstrate the often-tenuous nature of the advantage TNC's obtained over nationally-owned firms, the full significance of both the contraband phase, and the role of acquisition of national firms. Nationally-owned firms were not simply decisively defeated in a relatively open, "fair" game of commercial combat with TNC's. Often enough, nationally-owned firms were well-established, and their brands had accumulated a large stock of "good-will" and market appeal. Most nationally-owned firms put up credible opposition to the entry of TNC's, both commercially and politically. They did not simply "cave in" or sell out at the first hint of foreign competition. Without the debilitating effects of contraband and governmental vacillation, nationally-owned firms probably could have survived in many markets in Latin America.

Shortly after TNC entry and the acquisition of nationally-owned firms, there was usually a significant degree of demand creation emphasis placed on the TNCs' "international" (read home market) brands, such as Marlboro, Kent, Winston, etc. This was to gain market acceptance of locally-made versions of the "international" brands formerly made available through smuggling.[9] Over the longer-run, however, these "international" brands play a somewhat less important role in subsidiary operations. National brands which were developed by local firms before TNC entry have normally comprised a large, often major, portion of TNC's subsidiaries' sales.[10] Although Marlboro alone accounted for more than one-third of Philip Morris' international sales (including exports), about 60% of its volume abroad was in regional and national brands in 1976 (Philip Morris, Inc., 1976:6).

The continued popularity of national brands for the majority of consumers suggests that TNC footholds in the market with international brands during the contraband stage were actually rather fragile and did not really provide the basis for long-term success in the market. Hence, acquisition of national firms' brands played a central role in TNC success. In the absence of the "unique" conditions of massive smuggling, public policy vacillation and so forth, nationally-owned firms probably could have been viable enterprises. Indeed, they had been quite successful for long periods of time in may Latin American markets prior to TNC assault.

Evaluation of the Performance of the International Cigarette Oligopoly in LDC's

Focusing largely on Latin America -- but also on LDC's generally, this section attempts a brief overview of TNC cigarette firms, agro-industrial performance in a variety of areas: pricing behavior, profitability, technology and employment, trade and balance of payments, linkage effects and income distribution. In addition, I will focus on two broad areas of TNC impact on LDC's which appear particularly problematic: (1) questions of basic human needs and product appropriateness, including the smoking/health issue; and (2) questions of cultural imperialism and dependence.

Pricing Behavior. Because of the high levels of concentration manifested in the international cigarette industry durable price competition would seem quite unlikely. Both the past history of the industry and theory suggest that non-price competition through demand creation techniques like advertising and product form variation would be much more common. Administered prices and oligopolistic price leadership patterns do, in fact, characterize many overseas cigarette markets in both TNC- and non-TNC-dominated markets. But TNC's have an independent impact on pricing which evidentally functions in addition to national-level market power and concentration *per se*. This deserves far greater attention than it is possible to give it here.

It is interesting to see what happens to prices in LDC markets when TNC's take over local oligopolists. As one example, notice the pricing changes that took place in Argentina after the acquisition of local firms in 1966 (Table 7). This is a "conservative" comparison because the Argentine market has long been oligopolistic and BAT has had a strong market position there since WW I. BAT, in fact, bought out two of the then-existing six national firms in 1961. Nevertheless, the complete denationalization of the industry in 1966 had a profound effect on prices. Whereas the real average price of a pack of cigarettes was 12.0 pesos in the five years (1961-65) preceding the entry of other TNC firms in 1966, in the five years following 1966 (1967-71), the price jumped to an average of 15.5 pesos -- a 23% increase. It was not until stricter price controls were imposed by the Peron government in 1972 that the real price declined back to pre-1966 levels.

These price hikes reflected the initial efforts of the TNC firms to maintain or increase oligopolistic profit margins in the face of heightened non-price rivalry, especially the vast increase in advertising (Table 6) and the launching of new, more-expensive product forms and brands. With increased costs and stricter price controls, TNC's were eventually unsuccessful at maintaining profitability (Fidel and Lucangeli, 1978:14-21). A closer look at prices within given product forms reveals some minor price shading over the

Table 7

Argentina: Sales of Nationally-Made Cigarettes

and Average Real Price per Pack of 20, 1950-74

	Sales (millions of packs)		Average Real Price/Pack (1960 Pesos)*
1950	876		10.3
1951	890		10.1
1952	968		9.6
1953	992		10.3
1954	975		10.9
1955	1,047		13.3
1956	1,068		12.7
1957	1,097		12.0
1958	1,118		10.9
1959	1,167		9.2
1960	1,082		12.1
1961	1,161		12.9
1962	1,174		11.6
1963	1,185		12.0
1964	1,256		11.0
1965	1,248	Entry of TNC	12.7
1966	1,207	Cigarette Firms	15.2
1967	1,241		15.9
1968	1,307		16.6
1969	1,376		16.3
1970	1,467		14.7
1971	1,509		14.2
1972	1,595		12.2
1973	1,676		12.0
1974	1,891		11.9

Source: Based on Estudio Sur, Estudio de la demanda de tobaco nacional (Buenos Aires: mimeo, 1975), Table A-3, p. 10.

*Deflated by a general index of inflation.

period 1967-76 for new brand launches and brand "repositioning," but little true price competition over the longer-run. What price competition there was seems as much the result of price control changes and rapid inflation as of TNC policy. Price identity did not always obtain within product categories and price controls, extremely rapid inflation, new brand launches and the overall shift towards higher-priced products. Price changes were sometimes so erratic and rapid they left consumers bewildered. These conditions make the Argentine experience somewhat atypical. In markets like Venezuela, Mexico and Peru, where more stable macro-economic conditions prevailed, pricing by TNC's or their licensees showed more evidence of typical oligopolistic price rigidity.

Perhaps the most significant independent impact of TNC's on pricing behavior has been the overall shift towards "sophisticated," more expensive,higher-margin product forms and brands. This is especially true with regard to the introduction of "international" brands like Marlboro, Kent, Winston, Pall Mall, etc. Orthodox oligopoly theory predicts this behavior in markets dominated by a few large TNC's (Kaldor, 1949). For example, a 1976 survey of retail cigarette prices in 36 capital cities around the world found the "international" brand Marlboro priced higher (and sometimes considerably more so) than the largest-selling national brand in all but 7 cities. In only one (Brussels), was it lower in price. Of the 10 LDC capitals surveyed, Marlboro was priced higher in all but one (Bueons Aires), where it was the same price (UNCTAD, 1978:Table 23, p. 76). Differential taxation may account for some of these differences, but the basic pattern of higher prices would likely remain even if taxes were factored out.

In addition, we cannot be sure whether most LDC consumers may in fact want all the "consumer welfare" embodied in high-priced, higher-quality, "connoisseur goods" like TNC cigarettes. As Helleiner suggests, Lancaster's "consumption technology" theory might be used to see if consumers in LDC's consume efficiently when they buy TNC products (Helleiner, 1975:172-86); Lancaster, 1975). Any product contains a bundle of identifiable characteristics. TNC's produce cigarettes that change the shape of and shift the "consumption frontier" curve to the right, e.g. they offer products with more "luxurious" characteristics like fancy packaging, social prestige, international brand names, etc. which are also higher in price. This forces lower-income smokers, who may only value "essential" characteristics like smooth smoking quality, basic packging to keep the tobacco fresh, the simple convenience of ready-made cigarettes over roll-your-own cigarettes, etc. to buy more luxurious characteristics than they otherwise would if they could obtain the "essential" features separately. Given the scarcity -- or disappearance altogether -- of cheaper, more basic product forms after TNC entry in many markets in Latin America, this seems quite likely to have been the case. Moreover, for consumers who value indigenous product forms as "essential" characteristics in the sense of reaffirming their cultural identify, the shift to "foreign" product forms also deprives them of an essential characteristic, replacing it with luxurious ones they may not wish. Thus, these consumer groups may be forced to consume "inefficiently."

Profitability. High levels of concentration and oligopolistic pricing strategies imply excess profits over and above a competitive profit rate equilibrium. Despite generally higher costs of demand creation and higher quality products, it seems probably that TNC cigarette firms' profitability is usually well above ordinary industrial levels. Extraordinary curcumstances aside -- such as the price control/inflationary squeeze in Argentina -- TNC's have normally earned oligopolistic profits. This is particularly important for LDC's because of its implications for domestic income distribution, internal shifts in scarce investment funds, and inter-country control and distribution of wealth. Simply put, profitability is important to explaining international development and equity.

Unfortunately, "there are important empirical and conceptual complications in trying to evaluate how profitable foreeign operations are" (Moran, 1973:381). Two major difficulties are the general absence of reliable disaggregated data on profits on individual operations abroad and the "creative accounting" implicit in the wide discretion TNC's have in where they declare their profits. Thus what data is available is of very limited utility.

The little data available for cigarette TNC's is subject to all these vagaries and thus difficult to interpret. In 1978, Philip Morris reporte "Net Earnings" of 14.9% on "Net Assets" in its wholly-owned foreign subsidiaries (almost entirely tobacco operations) (Philip Morris, Inc., 1978:46). If this figure is accurate and conceptually similar, PM's level of profitability abroad appears quite similar to that enjoyed domestically by U.S. firms during the heyday of the American cigarette industry from 1911-1950. Tennant characterized this level of profitability as "far above competitive levels and [it] bespeaks a high degree of market control vigorously exercised" (Tennant, 1950:342).[11]

Likewise, in the mid-1970's, BAT reported that its Latin American subsidiaries, with only 11-12% of its total net assets, accounted for a full 19-20% of its total "Turnover", and some 20-21% of its total "Operating Profits" (before interest). This implies a high level of profitability on Latin American operations. In fact, in 1974 BAT reported much higher profit rates on its operations in Latin America, Asia and Africa than in its UH, European, U.S/ Canada, and Australian regions. "Operating Profits" as a percentage of "Net Assets" were 29.0% in Latin America, 35.5% in Asia and 29.2% in Africa. The (Operating" profit rate on "Turnover" (including taxes) was 7.3% in Latin America and a hefty 13.2% in Asia and 13.8% in Africa (BAT Ltd., 1874:12). Similarly, Rothman's International reported only 15% of its total sales in Asia and 3% in other nations outside the UK and Europe in 1976. But a full 30% of its "Trading Profits" were garnered in Asia and 10% in other nations outside UK/Europe (UNCTAD, 1978:50).

Technology and Employment. In cigarette manufacture, this is some substitutability as between labor and capital. The range is rather narrow, however. Cigarette production is highly capital-intensive with any of the several existing "generations" of process technology. Thus while technological "fixity" is, in a strict sense, not correct, the labor-absorption potential of cigarette manufacture is rather low with any type of methods other than the most primitive, "sweat-Shop' hand-rolling techniques. The range of substitutability is simply not very significant for employment creation. The industry is thus an anomaly of sorts: a "traditional" industry (like textiles or food) but a very capital-intensive one with very low capacity for labor absorption (Fidel *et al.*, 1977:50-58).

With the progressive introduction of the more fashionable, "latest" product forms through the TNCs' product cycle, there is a tendency for TNC's to employ more capital-intensive, sophisticated process technology. There is no inexorable relationship between products and processes, however, and TNC's have sometimes utilized relatively antiquated technology when certain local conditions obtain, as in Argentina (Fidel *et al.*, 1977). But the replacement of older, more labor-intensive methods *has* been the trend in a variety of markets in Latin America. Licensing of "international" brands by local firms, for examaple, almost invariably involves the importation of newer, more capital-intensive machinery to produce them. Licensing has pushed local firms in this direction in both Colombia and Peru, for instance. This may be more important from a balance of payments or domestic technological development perspective than an employment-oriented one.

Thus, TNC cigarette making technology employed in Latin America apparently varies only marginally from that used by many nationally-owned firms, at least in a labor-saving sense. TNC's have, on occasion, made imaginative use of local engineering talent and skilled labor to maintain and improve older technology, as in Argentina, although the general institutional bias is definitely towards the transfer of more capital-intensive, developed-nation processes. Compared to national firms, however, TNC performance has not always been much worse.

The real employment impact is to be found in agricultural production. The range of alternative technologies for leaf production is much broader in terms of labor absorption, and runs from very labor-intensive to highly capital-intensive. Historically, leaf production was extremely labor-intensive even in developed nations and it remains relatively labor-intensive as modern agricultural technology goes. In recent years in industrialized nations leaf production has become much more capital-intensive, however.

One interesting aspect of the agricultural production is that there are no inherent technological reasons for the production of tabaco rubio (flue-cured, burley and oriental tobaccos) to be more labor displacing than that of tabaco negro. As a matter of fact, some facets of light tobacco-production (more demanding cultivation, harvesting and curing techniques, for example) make it potentially more labor-intensive and employment-generating, at least as compared to "traditional" technologies for dark tobacco production, so the TNC push for light tobacco is not inherently adverse for employment; it all depends on technology choice.

This is not to say that TNC-inspired shifts from tabaco negro to tabaco negro have not had an overall negative impact on agricultural employment in this industry, however. Four considerations are important here. First, precisely because employment has depended on technology choice, there has been a marked tendency for labor displacement with greater TNC dominance of the industry. Few cigarette firms directly produce leaf tobacco. Farm operations are normally left in the hands of growers who are at least nomimally independent. Nevertheless all cigarette firms are heavily involved in leaf production, marketing and processing through the development and promotion of agricultural technology, extension, contracting, financing and myriad other activities. This involvement is usually more direct and extensive in Latin America than it is in DC's, and national firms have definitely performed better in adapting technology to local conditions and providing agricultural employment. U.S. TNC's, in particular, have clearly encouraged more capital-intensive practices with adverse employment effects. BAT, with longer experience in the Third World, has tended to avoid this, however.

Secondly, the rapid displacement of tabaco negro by tabaco rubio has often resulted in considerable regional dislocation within countries causing unemployment in the older, tabaco negro regions while the newer "booming" tabaco rubio regions suffer from labor shortages. This is because, generally speaking, the soil requirements fortabaco ruio and tabaco negro are quite different (the former requires lighter texture and lower fertility while the latter requires a heavier texture and higher fertility, especially nitrogen). Thus, all over Latin America one encounters older, established dark tobacco zones in crisis (Corrientes in Argentina; Tumbes in Peru; Sander in Colombia) while newer light tobacco regions booming but lack workers (Salta, Jujuy in Argentina; Satipo, Tingo Maria in Peru; Huila in Colombia).

Another disturbing impact on employment has resulted from the relatively rapid shift to tabaco rubio by TNC's. Although there is no technological reason for it, especially given the low rural wage rates common in Latin America and the general lack of economies of scale in leaf production, the development of light tobacco production has led to a general shift from smaller to larger production units. Whereas tabaco negro was and is generally produced by small farmers, peasants and sharecroppers (the "traditional sector"), the farming of tabaco rubio has come to be concentrated among larger, richer "commercial" farmers (the "modern sector").

There are various reasons for this, only briefly explored here. First, governmental local content policies and the need for large quantities of light leaf in a short period of time led TNC's (and national firms to an extent) to focus on larger farmers. Secondly, to induce farmers to produce a new crop like Light tobacco, firms had to offer relatively high prices which attracted larger commercial farmers. Thirdly, certain infrastructure investments such as curing barns require a certain scale for efficient utilization and larger financial capacity than most smaller producers in Latin America prossess. Finally, most TNC's, in their haste to get production rolling, have reasoned that it is much easier administratively, to supply credit, extension, technical assistance, inputs, etc. to a smaller number of larger commercial farmers than it is to work with large numbers of small producers.

Lastly, it is undoubtedly true that TNCs' vast expansion of cigarette output has created greater demand for leaf and thereby created considerable secondary employment in the agricultural sector of many LDC's, Latin America included. On the other hand, even if total employment is now greater than it was before, the quality of and income from that employment is almost certainly worse. In other words, while the total number of jobs in producing leaf may have expanded, those jobs are now poorer paying unskilled labor on larger light tobacco farms as opposed to higher paying, higher skilled labor as small producers of dark tobacco.

With the introduction of improved, new products and rapid growth in cigarette manufacturing, the TNC-dominated industries of Latin America have witnessed a substantial transfer of technology in both the industrial and agricultural sectors. Domestic skills have been improved, production quality has been raised, and secondary employment created. Nevertheless, technological dependence continues and is likely to get worse as demand is increasingly tied to the international product cycle. Virtually no TNC R&D is carried out locally, local

local products such as dark tobacco cigarettes are being phased out, and both industrial and agricultural production is becoming inextricably bound up with the "international trends" of the industry through imported process and product technology. In these conditions, what local industrial and agricultural know-how as exists is likely to atrophy or at least be confined to local "adaptation" chores.[12]

Trade and Balance of Payments. World trade in cigarettes is not large compared to total world production -- about 6% in 1975 (USDA, 1976). The most important reason is the presence of substantial tariffs and other trade barriers in most markets. Nations have traditionally tended towards protectionism with regards to local tobacco industries for balance of payments and fiscal reasons. Import substitution industrialization in the LDC's has simply imitated the attitude of DC's vis-a-vis this "non-essential" commodity. All governments have thought that there are far better ways of spending scarce foreign exchange.

Another factor limiting trade has been the almost exclusive dominance of a handful of TNC's in the trade that does take place. Protectionism came first, but TNC's have tended to reinforce the pattern in various ways. Without concentration of the industry in the hands of TNC's it seems likely that there would be a somewhat larger world trade in cigarettes. For example, if TNC's were not so dominant there would probably be more local and regional trade because TNC's routinely impose territorial restrictions on subsidiaries not to export their production of "international" brands. These export restrictions are often imposed on licenses, too. TNC's are not about to try to export Marlboros from Brazil to Argentina when they also have a subsidiary producing them in Argentina. Subsidiaries and licensees are prohibited from taking part in international trade which is reserved to the "home" plants back in the industrialized nations. Thus, export performance in cigarettes is affected by TNC policies as well as by governmental protectionism.

On the other hand, the development of leaf tobacco has been supported by TNC's who "have persuaded local government, desperate for foreign exchange and operating on starvation budgets, that growing tobacco themselves will give their farmers a new cash crop, beef up government revenues through tobacco taxes and bring in hard currencies via tobacco exports" (Ross, 1980:146). The development of local sources of leaf has been consistent with TNC interests in lower leaf prices worldwide and TNC's have often been forced by local content regulations to develop local tobacco suplies. So TNC's have tended to encourage a product-cycle-type shift of leaf production to LDC's, which now account for some 55% of world leaf tobacco exports (UNCTAD, 1978:96).

About one-quarter of all leaf produced enters international trade (UNCTAD, 1978:96). In Latin America, Argentina, Mexico, Brazil and Colombia are significant exporters and several smaller nations (Nicaragua, Honduras, Paraguay) also export. None are very dependent on tobacco exports, however. Brazil, for excample, exported $60-70 million annually 1971-74 but this accounted for less than 1.2% of its exports (UNCTAD, 1978:96).

Several factors have influenced the decisive shift of leaf production to LDC's, breaking up long-established leaf trade patterns. First, UN-imposed trade sanctions against Rhodesia in 1965 partially removed the U.S. growers' principal quality export rival in flue-cured leaf, leading to a scarcity of high quality leaf and wider price differentials. In many ways this respite simply postponed the day of reckoning for U.S. farmers. This, in turn, opened up some space in the world flue-cured markets for cheaper LDC "filler" leaf and gave rise to greater price competition (USDA, 1976a). Moreover, technological changes in manufacturing have made it possible to substitute more filler leaf while the quality of LDC leaf has improved. Finally, TNC expansion abroad, the shift to "American Blend" light tobacco cigarettes, and TNC development of local sources of supply have opened up alternative markets outside DC's as well as greater possibilities for exports to DC's on major cigarette leaf categories like flue-cured and burley (USDA, 1976b:1).

These changes have had considerable negative impact on U.S. leaf tobacco exports, once overwhelmingly dominant in international trade. The U.S. share of world tobacco exports has dropped from 61% in 1960 to 29% in 1979 and U.S. cigarette firms have increased the proportion of foreign tobacco in U.S. cigarettes from some 11% in 1965 to 30% in 1980 (Kinney, 1981:119).

Figures 3-8 tell most of the story of the decline in U.S. tobacco's place in world trade and the rise of LDC producers. World production of unmanufactured leaf has outpaced U.S. production consistently since 1965; while U.S. production has not really declined in absolute terms, foreign producers (mostly LDC's) have accounted for almost all the new growth (Figure 3). More remarkable is the fact that non-U.S. producers' growth has been especially rapid in precisely the types of tobacco (flue-cured and burley) that were of U.S. origin and are the major components of the "American Blend" light tobacco cigarette (Figures 4-5). Burley leaf production, once almost a monopoly of U.S. growers, and only a quarter of which was produced outside the U.S. in 1965, is increasing especially rapidly in foreign nations and non-U.S. production is now larger than U.S. production (Figure 5).

U.S. growers, with much more institutional market power in the form of price supports, an auction system, the USDA grading system, etc., have not kept pace with inflation but have lost much less ground than LDC producers on a price/lb. basis. They have accomplished this, however, only at the cost of increasingly pricing themselves out of the world market. For example, in 1983 the price of roughly comparable grades of flue-cured leaf was $1.80/lb. in the U.S., $0.68 in Zimbabwe and $0.69 in Malawi (USDA, 1983:10). Thus, price differentials between U.S. and foreign leaf have tended to widen over the years with LDC producers trying to make up the difference in falling real prices for their by expanding total production. Simply put, LDC growers have been more exploited by the market and hence their prices have been lower and rising less rapidly, enabling them to gain more of the market (Figures 6-8).

This increasing Third World pressure on prices and U.S. growers has begun to cause dislocations in the U.S. tobacco economy. Since 1975, leaf prices have fallen seriously below the USDA parity index and President Reagan signed a bill in early 1983 to freeze tobacco price support levels for 1983-84 (USDA, 1983:10). There have been suggestions made by large leaf traders and TNC's that the U.S. abolish the auction system price supports, etc. and move to a system of direct "contract buying" (whereby large buyers' oligopsony market power can be more easily exercised) like that commonly employed in LDC's. This would supposedly "save" the U.S. tobacco export market by keeping prices down and eliminating "government intervention" and distortions.

TNC's and the large leaf tobacco trading firms based in DC's have thus aided in the emergence of exports from LDC's such as India, Brazil, Argentina, Philippines, Malawi, etc. This leaf trade is highly concentrated and some of the major TNC's are important leaf dealers (BAT and Imperial) (UNCTAD, 1978:88-115). On occasion, exports have helped local growers partially escape the effects of TNC monopsony power in the local market, thus partly "backfiring" against TNC's in the long run, as in Argentina. In other markets like Brazil, however, BAT markets some 80% of leaf exports and buys the great majority of leaf used locally as well (UNCTAD, 1978:88).

TNC involvement in smuggling is also problematic for the trade situation of LDC's. This obviously drains away scarce foreign exchange, although the acute contraband phase does not usually last more than several years. More important -- though difficult to document here in the absence of more specific data -- the TNCs' higher propensity to import. Fancy, "international brand" products and more capital-intensive processes tend to require a variety of imported components. For example, it is quite common for governments to grant a 5-10 year "grace" period during which TNC's are allowed to import a progressively declining percentage of foreign tobacco for their high-quality brands while TNC's develop local sources of supply. This imported, pre-mixed and highly-processed tobacco blend can be very expensive. This grade period is often granted when TNC's license local firms.

Higher import coefficients of TNC's are linked to other materials as well. Sophisticated, high-speed cigarette-making machinery used by TNC's will usually not run with locally-made cigarette paper, filter rod material, glues, etc. And the "quality standards" imposed by TNC's for their "international" brands often require imported packaging materials, filters, etc. Technology fees on these brands and other "technical assistance" charges further aggravate balance of payments problems.

TNC's may also have a direct pecuniary interest in expanding intra-firm trade -- which in turn permits lucrative transfer pricing strategies. BAT may, for example, suggest the vital necessity of buying new cigarette-making machinery from Molins and imported packaging materials from Mardin (in both of which it holds a substantial interest.) Philip Morris noted that it had made a net positive contribution of over $200 million to the U.S. balance of payments through the export of cigarettes, leaf tobacco and other manufacturing components in 1978 (Philip Morris, Inc., 1978:11). TCN-inspired imports can thus wipe out any foreign exchange gains from increased tobacco exports. This has reportedly taken place in Zambia (Ross, 1980:146).

On the other hand, TNC's have not always performed much worse than local firms in some of these areas. TNC's have sometimes complied better with local content directives than local firms which tend to resis the investment this implies. Local firms making light tobacco cigarettes on their own or under license often import more foreign tobacco. And local content regulations on cigarette paper, filters, etc. may make it difficult to produce lower tar cigarettes locally without importing these components from industrialized nations.

Linkage Effects and Income Distribution. The most important linkage on this industry is with leaf production. In terms of sheer numbers of people this is a very important question, and especially so since leaf growers tend to be small farmers, peasants and sharecroppers in LDC's. Overall, TNC performance with respect to leaf growers has not been clearly worse than that of locally-owned firms. On the whole, TNCs' relationships with farmers have probably been better than those of national firms. Local firms have tended to act like robber barons vis-a-vis local tobacco growers, exploiting them to the hilt. In Peru, for example, patron-client relations and monopsonistic exploitation by local firms have been the rule. TNC relationships with growers have more often followed the model of their relationships with local labor unions, creating "labor aristocracies," and if TNC's can be faulted it is for a tendency to work with larger, richer "commercial" farmers.

There is also a certain cycle involved in TNC-farmer relations. To foment light tobacco production, for example, TNC's have often started out offering substantial incentives to local farmers: high leaf prices, low-cost inputs, free technical assistance, low-interest loans, los-cost infrastructure construction, etc. Once production is well established five to ten years later, however, monopsonistic power takes over and the terms harden considerably. Since marketing, technical assistance, and input channels are all monopolized through exclusive contracts, this means farmers' costs and income are largely company-dicated. These kinds of problems with farmers led Mexico to force TNC's into minority equity positions in the early 1970's. In other nations, such as Argentina, only astute political organization, the slow development of countervailing power, and export markets have enabled growers to partially escape these effects of TNC monopsony.

National firms have probably done better in developing other linkages with local suppliers than TNC's. The latter have tended to import non-leaf components when possible. Prior to denationalization, local Argentine firms had developed a wide variety of backward linkages with local suppliers, produced parts themselves, adapted production processes and even built entire machines from scratch (sometimes copying established engineering designs a la Japan).

The situation with respect to local distributors, jobbers and retailers is less clear. BAT does not have a very good historical record in this regard in Latin America, having preferred to control distribution itself or squeeze local distributors' margins. But U.S. TNC's do not seem to have acted so rapaciously, nor has BAT more recently. And national firms have had their own struggles with these sectors, sometimes integrating vertically into wholesaling.

With respect to Income distribution, the worst offenders in this industry are governments. Latin American governments have frequently had relatively antiquated fiscal structures in which highly-regressive cigarette taxes have figured importantly. In the early 1970's, 10-15% of many Latin American nations' revenues came from cigarette taxes. These taxes were often the single largest source of internal revenue. These taxes are highly regressive in their incidence, transferring money out of the pockets of consumers (many of them poor) and into government coffers. Like high tariffs in the U.S. during the 19th century, they also have the unfortunate effect of relieving pressure on the government to levy effective and progressive income taxes. Little cigarette tax revenue is usually returned to the poor in the form of public services useful to them. While cigarette taxation is highly regressive in most nations, it is probably more inequitable in LDC's with their greater inequalities of income distribution.

In round figures, governments have normally received some 50-60% of the retail price of cigarettes in Latin America in the form of taxes, manufacturers and distributors have received 30-35%, and leaf growers have received about 5-10%.[13] Apart from the portions going to growers and some part of the distribution force, not much of the proceeds have gone to unskilled labor. The majority of income generated has probably gone to the top 25-30% of the work force, although it is difficult to specify without more precise data. Despite all this, the industry still probably performs better in an income-distribution-sense than many other "modern" and/or TNC-dominated sectors such as autos and chemicals. This is because there are at least <u>some</u> payments to low-income groups like farmers and portions of the wholesale and retail sales force. With expanding sales under TNC's, this effect has been reinforced.

Although local cigarette firms have also operated in tight oligopoly or even quasi-monopoly conditions, TNC market power has had an independent adverse effect on income distribution in the industry. National firms are usually owned by resident nationals. This tends to reduce the international transfer of income. And national firms have usually been less efficient at getting consumers to spend their money on cigarettes. Thus, there has been less regressive impact, especially through taxation, but also to the oligopolists themselves. TNC's, however, have shifted prices even higher when possible, convinced more consumers to spend more of their scarce income on cigarettes, and transferred at least some of this income abroad. To the extent to which TNC's have caused a lower labor/capital ratio (especially in agriculture), this may also have had an adverse impact on income distribution.

<u>Basic Human Needs and Product Appropriateness</u>. For reasons of public health, cigarettes are quite obviously not a very "appropriate" product. The case against cigarettes may be much stronger in LDC's where vast sectors of the populace frequently lack the most rudimentary forms of food, clothing and shelter, and initial health standards are already low. Furthermore, there is abundant evidence, some of it cited above, that TNC's are more adept at the promotion of

cigarette smoking and at increasing the per capita consumption of cigarettes. Our analysis above of the demand creation and production aspects of the industry suggests that the case for even nationally-owned private cigarette firms might be doubly-strong: (a) they are almost certainly less efficient at promoting cigarette consumption than are TNC's, which is "good" because of the adverse health effects of smoking and basic needs resource allocation considerations; and, (b) they are not likely to be too inefficient in cigarette production at even very low levels of volume because of the lack of production economies of scale. If the production scale economies are close to non-existent in the industry, and the economies of scale that do exist are private ones involved in the advertising, distribution and promotion of cigarettes, then the traditional argument for TNC's as "more efficient" than national companies does not hold in this industry. On the contrary, both basic needs and public health criteria would clearly indicate virtually any other alternative than the very "efficient" TNC. In fact, the somnolent decay of a full national monopoly -- either private or public -- might be just what the doctor ordered.

Although this is not as unabiguously clear as the TNC ability to increase cigarette consumption, it appears that the diffusion of "safer" (if there is such a thing) low tar/low nicotine product forms to LDC's has been collectively slowed or "withheld" by the international cigarette oligopoly until such time as the product-cycle for older and less "safe" product forms has run its course in LDC's and health issues surrounding cigarettes become much more publicly controversial than they are at present. No TNC cigarette firm has been eager to implicitly raise this issue itself by the introduction of these product forms in LDC's. To do so would be to make obsolete a fair proportion of the TNC's existing products for which rents may still be had. Many LDC's have only recently begun to consumer substantial quantitites of "first generation," 1950's-style filtered cigarettes in place of non-filters. In many other markets, product form variations on the basic "first generation" filter cigarette are still a novelty (e.g. 100mm and 120mm filters, menthol filters, charcoal filters, etc.). Thus, TNC's have usually been careful in their operations in LDC's not to "jump the gun" and release more "advanced" product forms than the given national market is "ready for" in the product-cycle.[14]

The industry retort to this is that "revealed consumer preference" in LDC's is for their relatively high tar/high nicotine product forms, especially since per capita consumption is relatively low. As a BAT spokesman put it, "If you are smoking only one or two cigarettes a day you want to feel you have had something for your money" ("Third World Tobacco Push Hit," 1978:2). While may be partially true in a few LDC markets where per capita consumption is extremely low and cigarette smoking is not well-established, it probably does not apply in the great majority of LDC markets where per capita cigarette consumption among the smoking age population is already much greater than "one or two cigarettes a day." More importantly, if consumers do not have the alternative of choosing between cigarette brands with high tar/nicotine and those with low tar and nicotine because the latter are simply not made available (or not promoted heavily where they are), then how can "consumer preference" manage to "reveal" itself in favor of high tar/nicotine cigarettes? Consumers do not have a meaningful choice.

In most LDC's, the smoking/health issue has been almost totally absent from public debate. The adverse health effects of cigarette smoking have not become public knowledge. Nor has the serious public health hazard that smoking poses become an object of governmental action in most LDC's. This in itself has greatly facilitated TNC expansion: TNC's often find it easier to market their products in LDC's than in their home nations because there are few restrictions on advertising and the notion of warnings on individual packs is virtually unheard of ("Third World for Cigarettes Expands," 1978:13). For example a recent

World Health Organization survey showed that of 100 governments providing information, 70 had no legislation whatsoever aimed at controlling the promotion or use of cigarettes ("Next Step Toward WHO Tobacco Control," 1976:14). Despite WHO efforts in recent years, and heightened government activity in industrialized nations to reduce smoking hazards to health, most governments in LDC's have taken no action in this area. Another survey by the U.S. National Clearinghouse for Smoking and Health revealed that over two dozen LDC's (including all 14 Latin American nations surveyed) had taken no action in the regulation of cigarette advertising and the great majority had no warnings on cigarette packs (Pakkala, 1976:55). Thus, smoking and health activities remain in a very low key in most LDC's. As Tanzania's health director put it succinctly, "Smoking-related diseases are not regarded as a matter of concern at the present time" ("Third World Tobacco Push Hit," 1978:2).

It seems likely that the smoking/health aspects of the international cigarette oligopoly's operations in LDC's will become increasingly subject to scrutiny and criticism. Despite LDC's public inaction on this score, the issue is already becoming the subject of considerable debate in the WHO and other international fora. The WHO reported last year: "In some developing countries the epidemic of smoking-related disease is already of such magnitude as to rival even infectious disease or malnutrition as a public health problem" In Brazil, lung cancer became the leading cause of male death in 1974 and Brazilians dying of cardiovascular disease linked to smoking has gone up 5% since 1970 (Ross, 1980:145).

Cultural Imperialism and Dependence. Is dependence and cultural imperialism involved in the TNC's evident ability to change consumption patterns in LDC's? Is cultural identity linked to a brand name or product form in the local language and tradition? In other words, is part of the Latin American national and regional identity linked to the consumption of *tabaco negro* rather than *tabaco rubio* cigarettes? There clearly are psychological links between products and cultural identities. Anyone who has lived in Latin America for any period of time knows the snobbish preference for foreign-made or foreign-brand goods is often very strong, particularly among the elite. And to the extent that this tends to denigrate or destroy the validity of the person's cultural identity and heritage, some kind of destruction of the local culture does take place.

In many parts of Latin America, this kind of preference for foreign goods and brand names is very strong (Schmidt, 1971). It is undoubtedly part of the contraband problem It often entails a certain degree of depreciation of Latin Americans' perspective on their own style of life and patterns of consumption. It reinforces a sense of backwardness and dependent. In Peru, for example, the idea that poor-wuality, nationally-made products are a reflection of Peruvian underdevelopment and dependence is quite evident. This is clearly related to the kind of "facaso-mania" (failure complex) and down-grading of one's own cultue that Hirschman noted in Latin American (Hirschman, 1970b:340).

In some of the larger nations of the region (Argentina, Brazil, Mexico), the sense of "consumer nationalism" is nevertheless somewhat more developed. In cigarettes, at least, these nations have shown some enduring preference for national brands and product forms with indigenous features. These have some national cultural identity that somehow "fits" with their history and traditions. Thus, TNC's in these markets have sometimes had to go to considerable length to develop or "reposition" national brands embodying these features. They have frequently been rather unsuccessful at popularizing the more ostentatiously "foreign" brands. Despite years of heavy promotion, for example, Marlboro is still not a very large-selling cigarette in Argentina. However, European TNC's like BAT and Reemstma have been rather less ethnocentric in this sense, perhaps because of their longer history of operations overseas or their experiences within the multicultural European context. They have not pushed their "home-grown" successes in Latin America to the degree U.S. firms have. Particularly in the earlier years of U.S. TNC expansion, U.S. firms did not always appreciate the degree to which American cigarettes and their demand creation strategies were ill-adapted to local conditions. For excample, despite its status as the world's largest-selling cigarette, Marlboro's "Cowboy" advertising has met considerable cultural resistance and local criticism in a variety of markets from Brazil to Australia ("Marlboro's Brazilian Move," 1976). "Consumer nationalism" and critical reactions to TNCs' cultural impact has been manifested in a number of ways, from protests against the use of foreign models in cigarette advertising to "National Cigarette Weeks" ("Local Talent in Phillipines, " 1977; "Indonesian Cigarette Week Observed," 1979).

The initial TNC foothold in many markets was often gained by the promotion of foreign "international" brands. But even national brands developed or "repositioned" by TNC's light tobacco "international" brands. Hence, once the snobbish preference for foreign products becomes apparent, and TNC product forms are viewed are "superior" -- aided and abetted by TNC demand creation efforts -- then dependence is almost a foregone conclusion for national cigarette industries. With consumption directed down through product forms and channels in which TNC's possess the overwhelming competitive advantage, dependence is indeed difficult to escape. National firms are at a continual and systematic disadvantage in this kind of competitive situation.

But even if TNC's are responsible for shifting consumption patterns towards their products, might this not be the direction of "better" in some objective sense than nationally-owned firms' products? It is not clear, for example, whether the trend to light tobacco and "American Blend" cigarettes reflects some "autonomously-determined," world-wide trend towards a "superior" product (as perhaps in the world-wide diffusion of the radio, railroads, or maybe even the automobile) or whether this trend is a specific, wholly demand creationinduced effect of TNC's. What becomes very difficult to ferret out here is the degree to which the "revealed preference" or apparent demand for U.S.-style light tobacco cigarettes is due to their inherent, "real" quality (which commands an economic rent viewed as legitimate), on the one hand, or whether it is due to the effective demand creation efforts of TNC's and a snobbish preference for foreign goods of the elite, on the other. At least by the standard of "revealed preference" are we to assume that the consumer welfare is greater from TNC brands? A judicious assessment of this thorny question would probably entail the recognition that in some specific aspects TNC product quality is probably higher than many nationally-owned firms' products. But "revealted preferences" have been powerfully shaped by TNC's themselves through effective techniques of demand creation (and, as we have seen, even taking advantage of contraband).

At this juncture, some kind of normative or "political" judgement is indispensable, precisely the kind of criteria usually eschewed by neo-classical and mainstream economists as unjustified. In LDC's, even if product quality is "better" in some sense, import substitution industrialization strategies and broader concerns of political-economic, and perhaps cultural, autonomy may dictate the sacrifice of some short-run consumer welfare in high-quality goods for the longer-run industrialization, political-economic and cultural independence, and basic needs of a poor country. There really is nothing very new or startling about this notion. It was practiced in an effective manner by most of the now-industrialized nations of the world vis-a-vis British goods to protect their "infant industries." Finally, there is no escape from the almost-trite, but requently-resisted, observation that all goods and services are <u>not</u> equal in importance. Some measure of increased consumer welfare from higher-quality TNC cigarettes quite simply <u>has</u> to be balanced against the obviously more important and pressing basic needs of the broad mass of the population in LDC's. Appropriately reduced in significance in this manner, the consumer welfare gained from higher-quality TNC cigarettes in LDC's is virtually meaningless, if not absurd.

On basic needs grounds, there may also be a prima facie case for socially-unnecessary or socially-harmful goods like cigarettes to be supplied locally, not only in strict accordance with local tastes, cultural patterns, etc., but also in rather unsophisticated and minimally-attractive forms. Since basic needs do not presumably include cigarettes, which have always and almost universally been classed as an unnecessary luxury by governments, these are not high priority items in a poor society. Whatever solace is afforded by cigarettes (and tobacco products generally) should be provided in "generic," that this does not necessarily imply low quality as regards "essential" product characteristics. This can be done in line with culturally-indigenous tastes and product forms not unlike much of the liquor industry in LDC's at present. With a "technical" efficiency of production not much different from TNC's and with a lower efficiency in creating demand for these kinds of products, smaller nationally-owned firms (either public or private) might be a much more rational solution for LDC's.

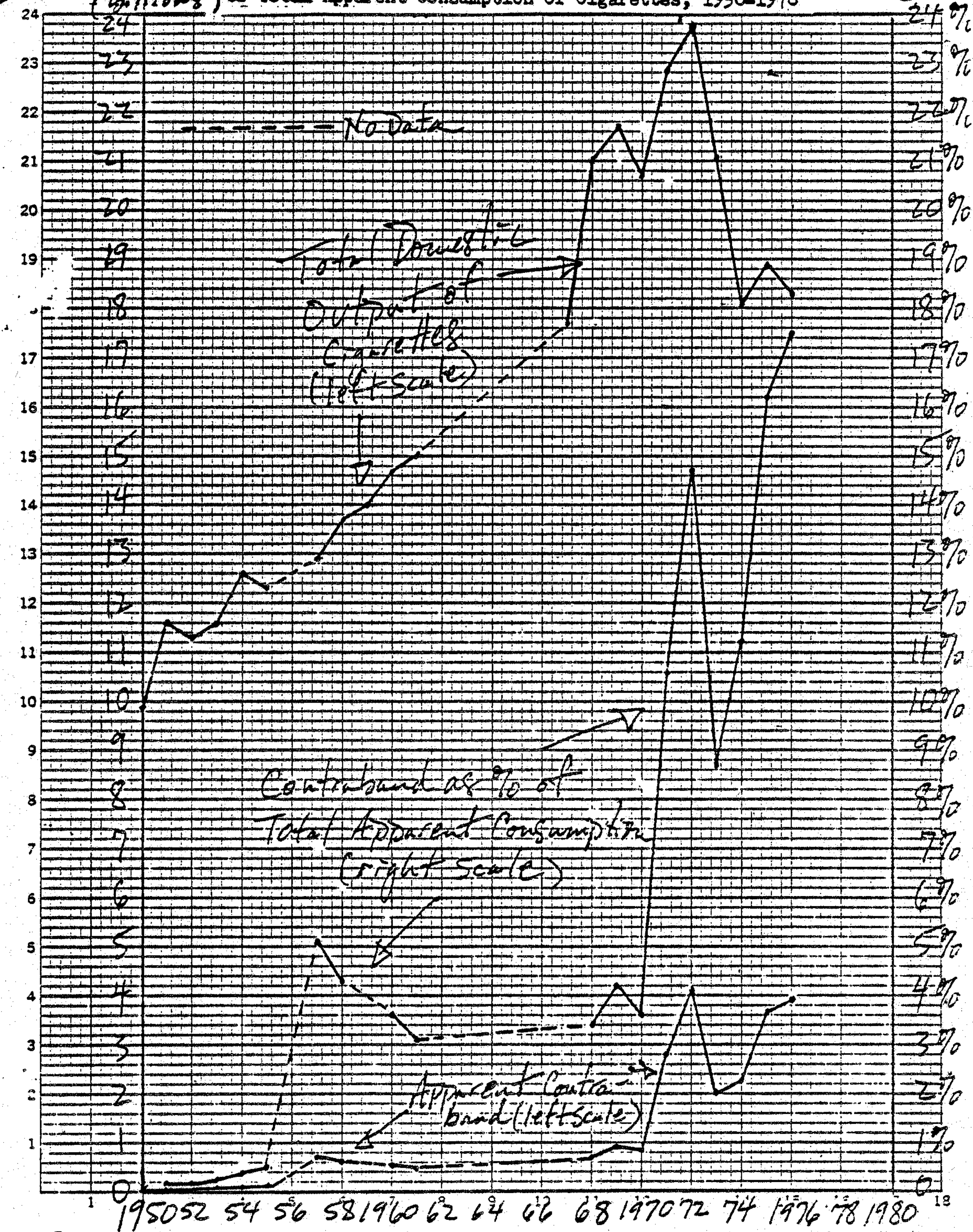
The main problem with this kind of strategy is obvious, at least with respect to the cigarette industry in Latin America: to a considerable degree, it has already been tried and found wanting. LDCs' markets do not exist in a vacuum. World-wide shifts to certain types of product forms (in part created by TNC's themselves) and the ability of TNC's to penetrate these markets by one mechanism or another mean that "independent," nationally-owned firms without links to TNC's will probably encounter a variety of difficulties, not the least of which is smuggling. This is particularly so where the political will and capacity to hermetically seal off the national market is absent. But it may also be true where local manufacturing is somewhat shoddy and/or product forms are fairly idiosyncratic as compared to the light tobacco filter cigarette

-- the new "international" norm. The absence of some minimum degree of consumer nationalism is also relevant. Since for various reasons these are all likely to be characteristic of LDC's in one degree or another, these nations are left with the prospect of increased dependence, TNC dominance, and no easy choices for their local cigarette industries.

Figure Cigarettes (billions)

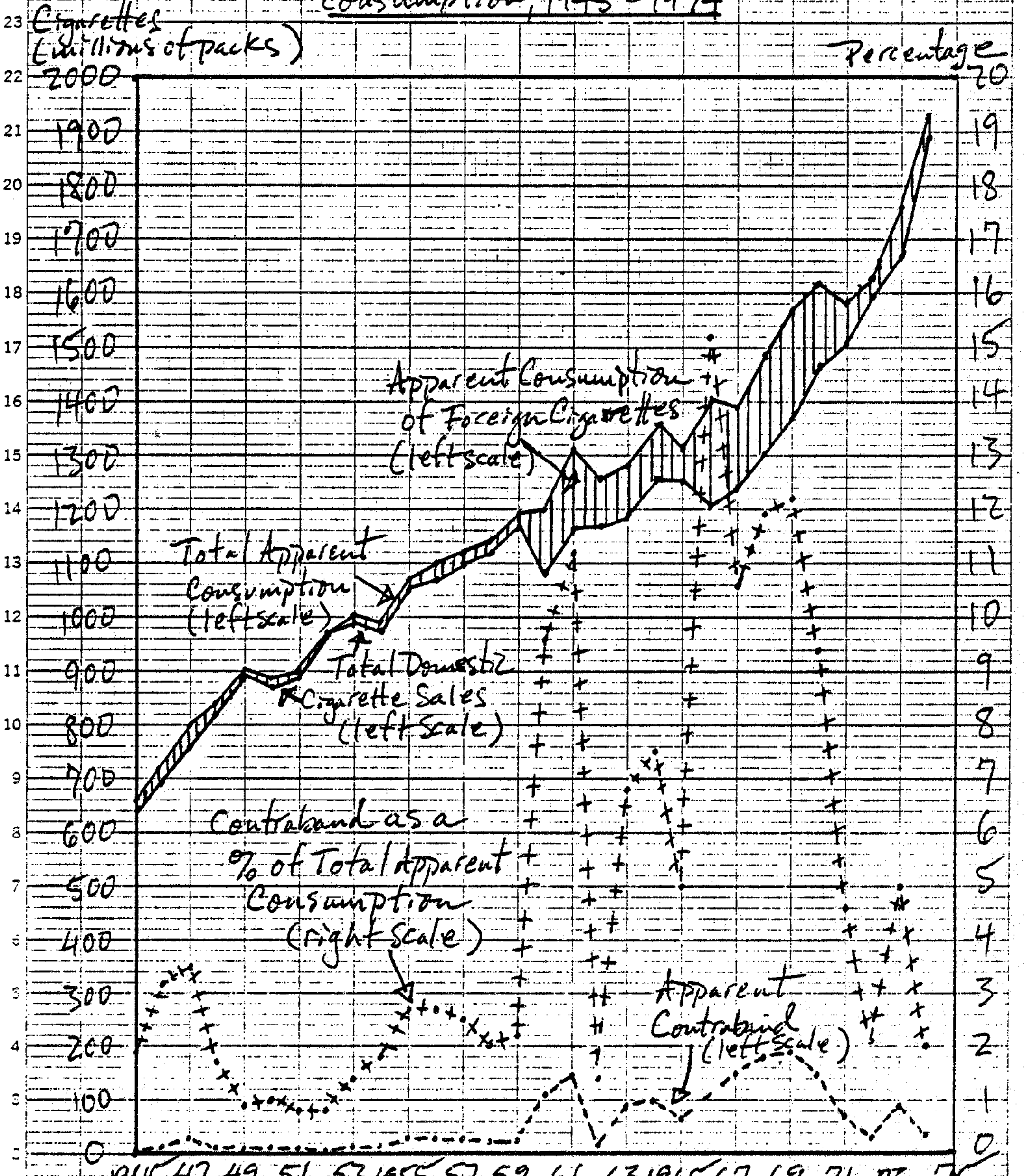
Colombia: Domestic Output of Cigarettes, Apparent Contraband, & Contraband as a Percentage of Total Apparent Consumption of Cigarettes, 1950-1976

Percentage



Source: Shepherd, 1980 (based on USDA estimates of total domestic output, legal imports, U.S. exports and Depto. Nacional de Planeación

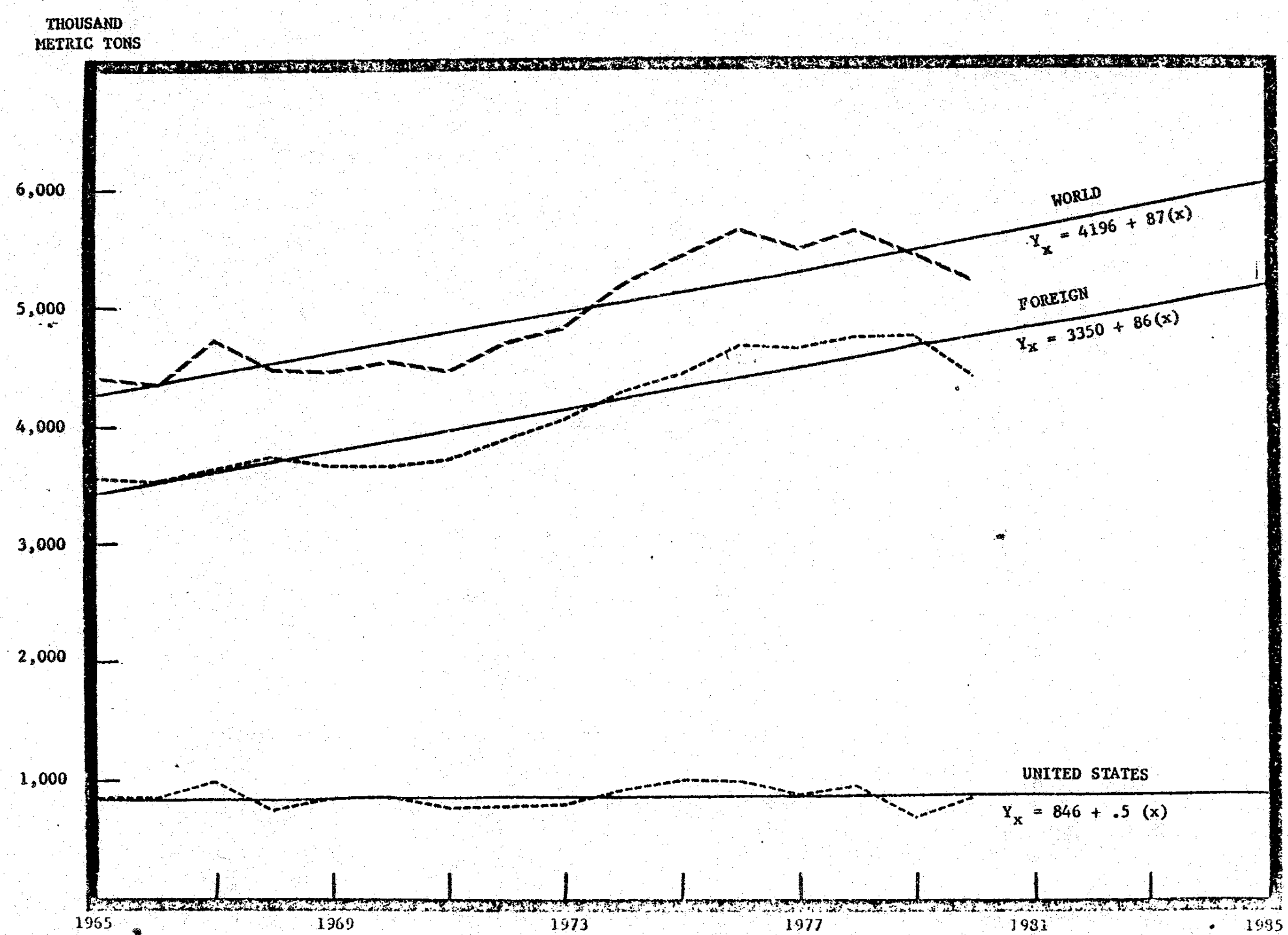
Figure: Argentina: Total Sales of Domestic Cigarettes, Total Apparent Consumption, Apparent Contraband, Apparent Consumption of Foreign cigarettes, and Contraband as % of Total Apparent Consumption, 1945–1974



Sources: Estudio Sur, Estudio de la Demanda de Tabaco Nacional (Buenos Aires: mimeo, 1975), Cuadro A-17, p. 24; Anexo C, Cuadro C-4, p. 81.

5 Squares to the Centimeter

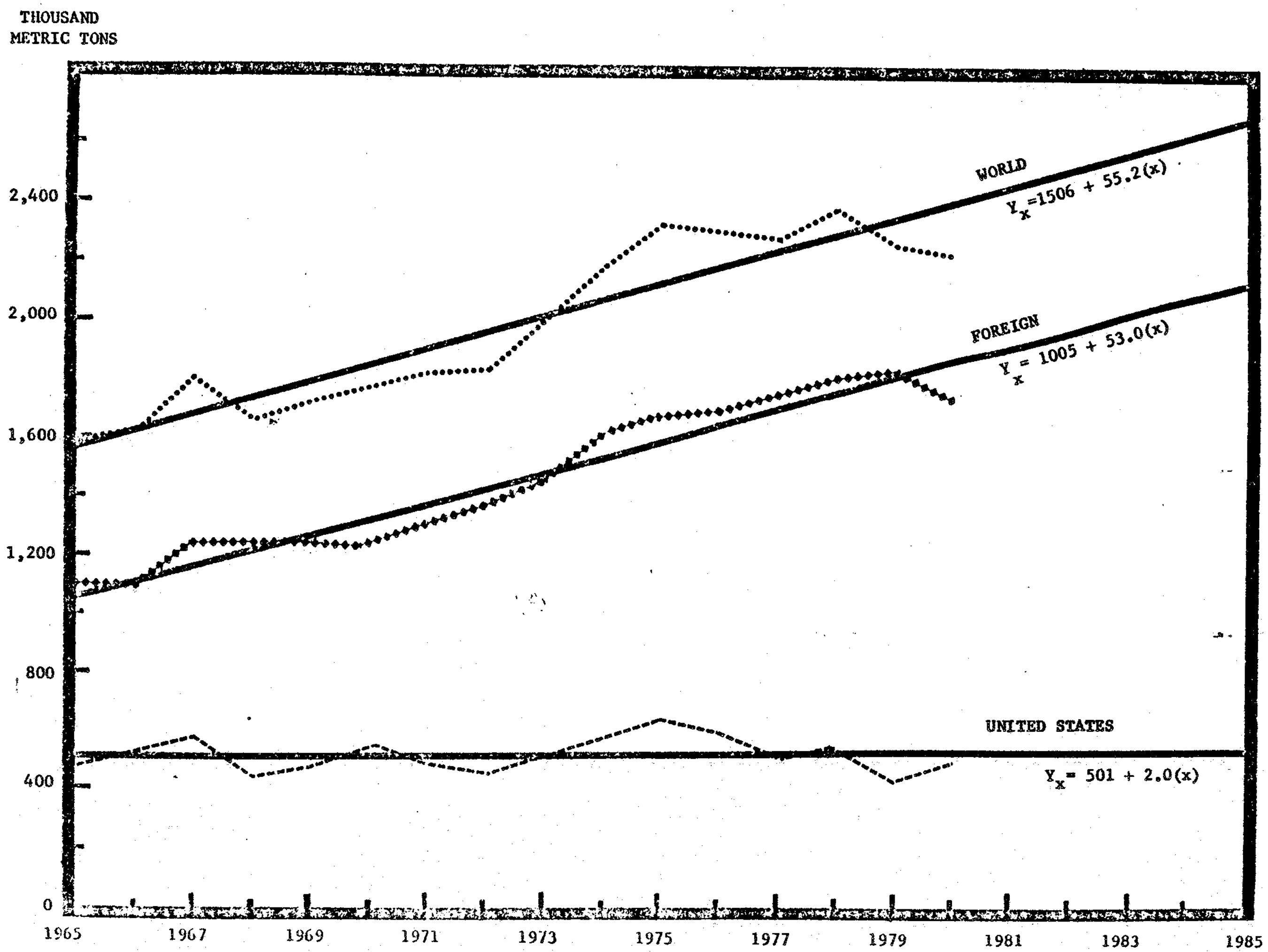
Figure 3: UNMANUFACTURED TOBACCO PRODUCTION: ACTUAL 1965-80 AND TREND



MARCH 1981

COMMODITY PROGRAMS, FAS, USDA

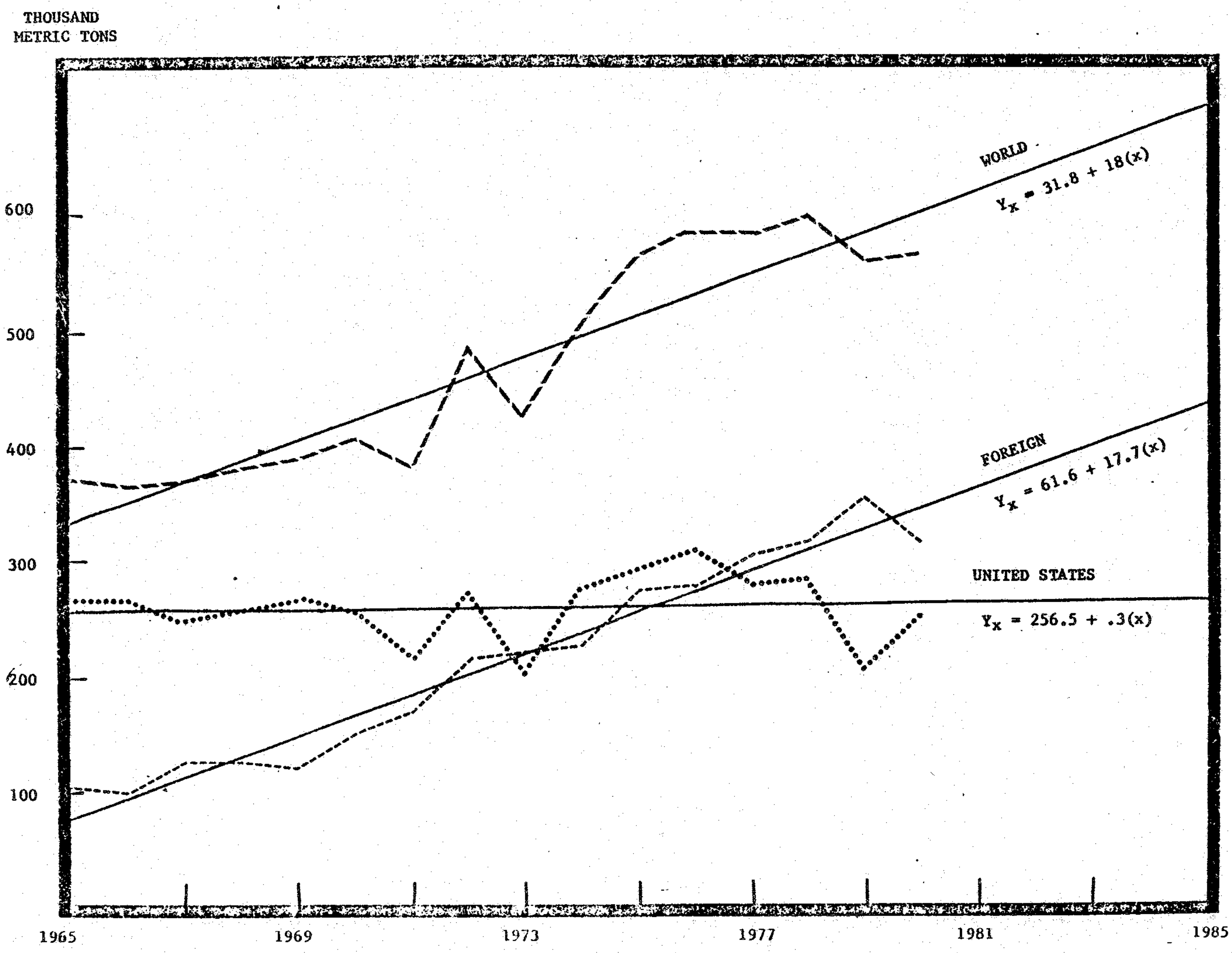
Figure 4: FLUE-CURED TOBACCO PRODUCTION: ACTUAL 1965-80 AND TREND



MARCH 1981

COMMODITY PROGRAMS, FAS, USDA

Figure 5: BURLEY TOBACCO PRODUCTION: ACTUAL 1965-80 AND TREND



MARCH 1981

COMMODITY PROGRAMS, FAS, USDA

Table 3

Transnational Cigarette Firms in Latin America: Subsidiaries, Licensing Arrangements, and Non-Tobacco Operations, c. 1976

Nations	British-American %	Philip Morris %	R. J. Reynolds %	Liggett Group %	Rupert/ Rothman's Group %	Reemts ma %	Loew's %	Total Output 1976	Est TNC[2] Share %
Argentina	S-(42) NT	S-(22)		S-(17)		S-(19)	L	36,800	100
Barbados	S(100)							210	100
Bolivia		L		S-(NI)			L	1,700	NI
Brazil	S-(75) NT	S-(5)	S-(11)	S[3]	S[4]	S[5]		117,000	91
Colombia		L					S[6]/L	18,300	3/15[12]
Costa Rica	S-(57)	S-(16)		L				2,300	75
Chile	S-(100)							8,800	100
Dom. Rep.		S-(NI)		L				3,200	NI
Ecuador		S-(NI)	S-(NI)					3,700	NI
El Salvador	S-(76)	S-(15)						2,200	91
Guatemala		S-(45) NT					L	2,400	50
Guyama	S-(NI)							500	NI
Haiti		L						500	NI
Honduras	S-([illegible])							1,800	[illegible]
Jamaica	S-(27)				S-(70)			1,500	97
Mexico	S-(30) NT	S-(14)	S[7]/L-(NI)	L			L	45,000	60
N. Antilles		L						NI	NI
Nicaragua	S-(96)							1,700	96
Panama	S-(55)	S-(43)					L	1,100	98
Paraguay	L							700	NI
Peru	L	L[8]	L	S[9]/L			L	3,800	25
Puerto Rico		S[10]-(NI)	S-(NI)				S[10]-(NI)	NI	100
Trinidad/Tabago	S-(NI)	L						1,200	NI
Uraguay		S-(10)						3,500	10
Venezuela	S-(19) NT	S-(76)	S[11]-(2)				L	18,800	97

Sources: United Nations Conference on Trade and Development, Marketing and Distribution of Tobacco (TD/B/C.1/205), June 16, 1978. Table 9, p. 31/32; United States Department of Agriculture, Foreign Agriculture Circulation Tobacco, FT-2-77, July, 1977; and estimates by the author-based on various trade sources.

Figure 7: **Flue-Cured Tobacco: Average Grower Prices**

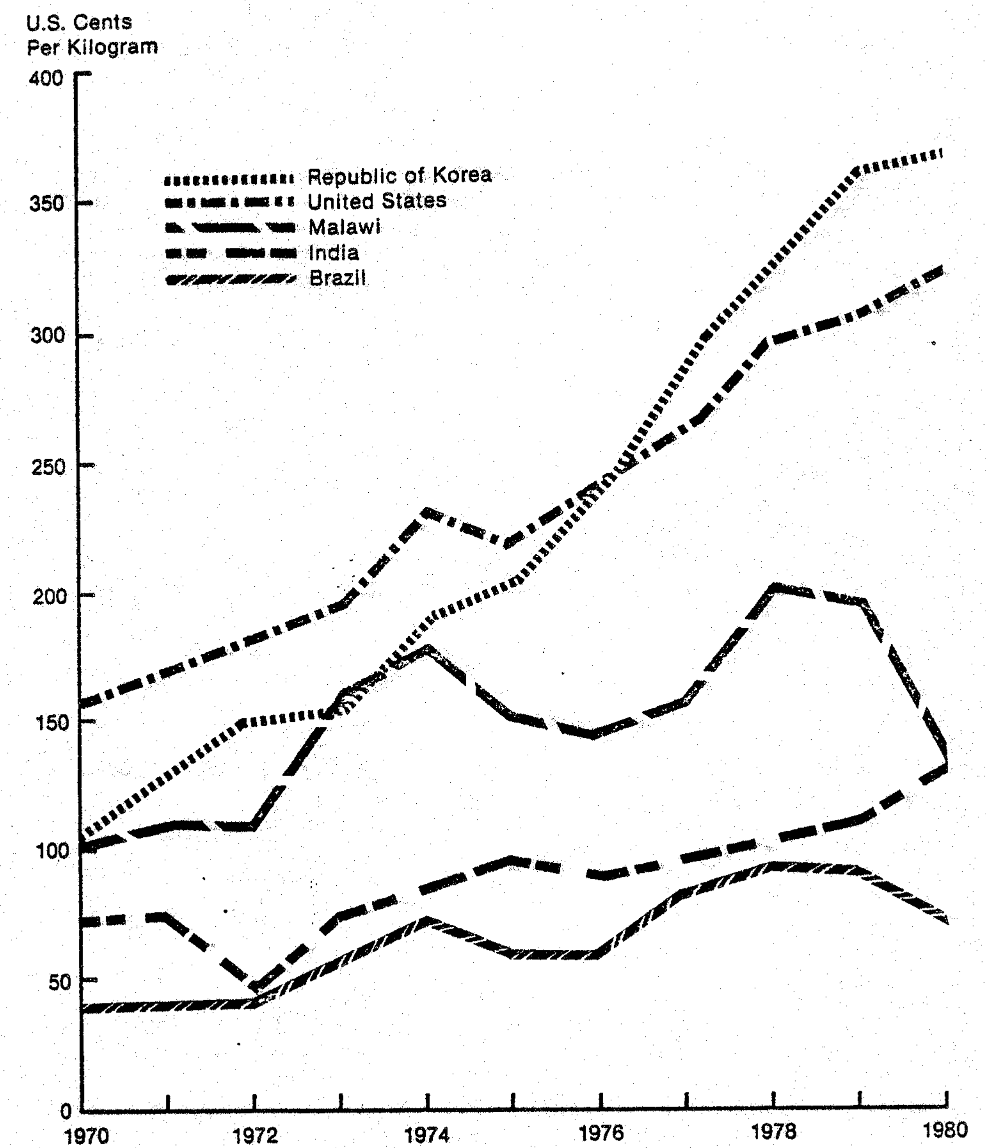
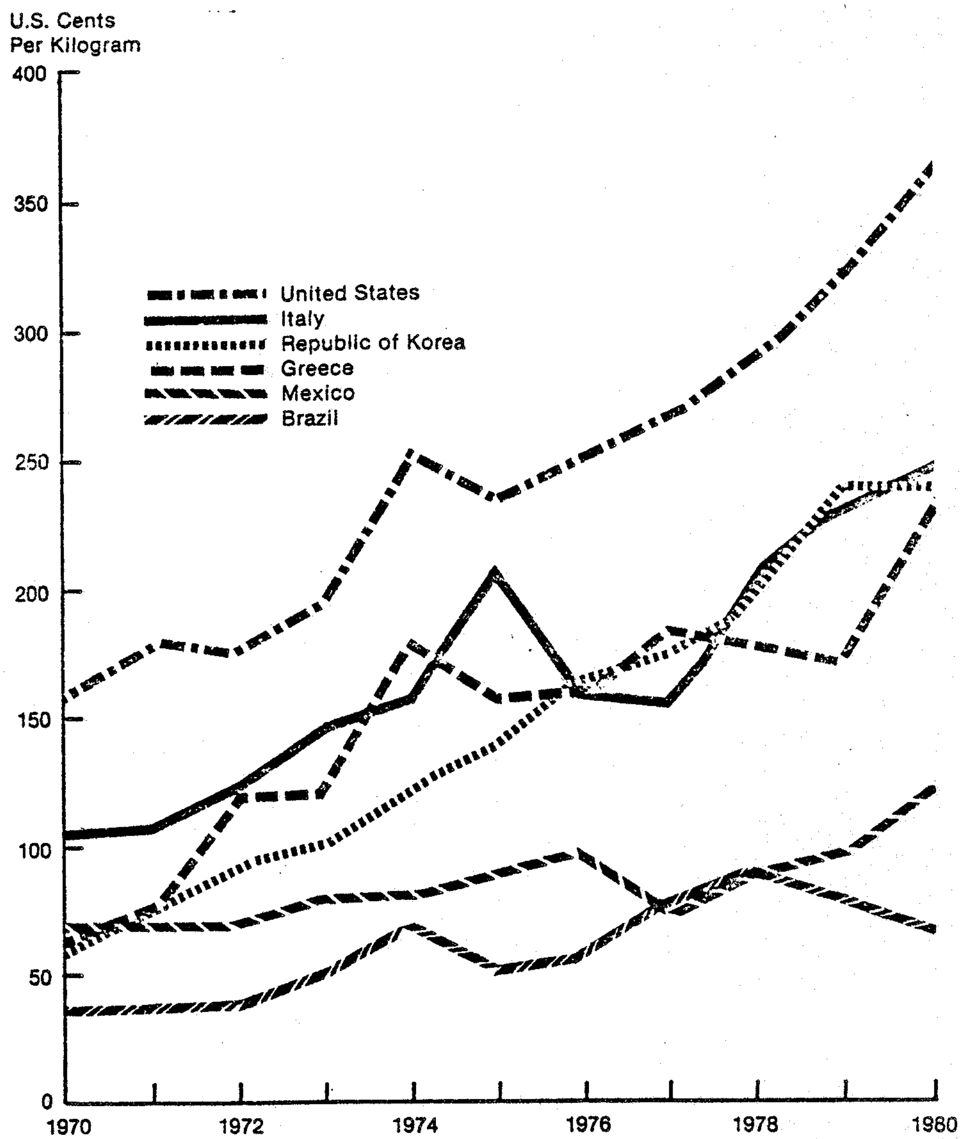


Figure 8: **Burley Tobacco: Average Grower Prices**



NOTES

1. The terms refer to color but also reflect smoking quality. Roughly, light tobaccos are associated with mildness and cigarette manufacture, dark tobaccos with strength and much more non-cigarette usage, as in cigars. See Shepherd, 1981: Appendix D.

2. British-American Tobacco was originally a joint venture of U.S. and English tobacco firms (American Tobacco Co. and Imperial Tobacco Co.). Formed in 1903, with two-thirds U.S. and one-third British holdings, BAT was the result of a cartel agreement whereby American Tobacco would control the U.S. market and Imperial the U.K. makret while BAT would serve the rest of the world outside the U.S. and the U.K. In the aftermath of the 1911 anti-trust case (which broke up AMerican Tobacco), however, control of BAT eventually shifted to British stockholders. Thus, since the early 1920's, BAT has been a British firm (a fact not usually realized in Latin America). BAT is and has been for some time the world's largest tobacco firm with substantial holdings throughout the world, including Latin America (See Shepherd, 1979 and Table 3 below).

3. In Argentina, successive devaluations also had a disastrous effect on local firms by: (1) making it much more difficult for national firms to import badly-needed equipment to increase production efficiency and manufacture similar product forms; (2) making it difficult for national firms to pay royalties on TNC licenses; and, (3) inflating the buying power of foreign currencies, thus enabling TNC's to buy stock in the local firms at bargain rates (already depressed, of course, bacause of their difficulties with smuggling). All this also took place in the context of a general political-economic policy oriented towards the promotion of foreign investment by the Ongania regime (Vilas, 1974: 13-15).

4. It is in this context that the significant upswing in U.S. cigarette exports since the late 1960's should be interpreted. U.S. cigarette exports were over 70 billion in 1978, valued at $692 miliion. This comprised over 10% of total U.S. cigarette output, the largest percentage going abroad (other than to U.S. Armed Services) since the year 1920. Cigarette exports from the U.S. are now over 60% of the value of leaf tobacco exports, traditionally the most important U.S. tobacco export commodity (Data from the U.S. Dept. of Agriculture, 1978:4-5). While a number of factors have influenced increasing exports--oil exporting states' imports, the world-wide trend to "American Blend" cigarettes, and the "multiplier effect" of the presence of U.S. TNCs' operations abroad that is claimed by the industry (Philip Morris, 1976:7)-- increased smuggling around the world is also a factor. Since U.S. cigarette exports (legal or illegal) to any given national market normally fall off dramatically after the establishment of TNC operations in that market, continued high levels of exports will likely be dependent on the ability of U.S. TNC's to "roll over" from one market to another. Eventually, however, U.S. exports are likely to fall off once overseas manufacturing facilities for these brands have been set up in most markets. There is still considerable potential for this kind of progressive market penetration, as markets in the Mid East, Africa and Asia become

4. (continued)

"worthwhile," but one doubts that high levels of either legal or illegal exports can be sustained for a long period of time.

5. Names, dates and places cannot be cited but the basic outline of the TNC links to smuggling can be revealed. One common pattern has apparently been the employment of local, "national" advertising/publicity/marketing agencies to run interference with local smugglers. It is understood that part of the local marketing agency's job is to deal with the kingpins of contraband in the general area (say, Netherlands Antilles and Panama for Colombia, or Paraguay for Argentina). The primary TNC interest is to make sure that the company's brands are "well represented"---perhaps overwhelmingly so---in smuggling networks and distribution channels. "Seed money" needed for developing or maintaining contraband distribution systems and the appropriate bribes to local smugglers can also be transferred indirectly through these "marketing" personnel using the local advertsing/promotion budget. Not only is money thereby channeled to local smuggling rings, but, similarly, payoffs to customs officials and other governmental personnel can be made in this manner without any direct involvement by corporate employees.

6. Given the size of the parent firms, it is perhaps not surprising to find these cigarette TNCs' subsidiaries among the largest industrial firms in Latin America. In 1972, 10 of the largest 130 industrial firms in Latin America were tobacco firms, and eight of these were subsidiaries of TNC's: Souza Cruz (Brazil-4th); Nobleza (Argentina-23rd); La Moderna (Mexico-36th); Massalin y Celasco (Argentina-77th)' Cigarros El Aguila (Mexico-84th); Piccardo (Argentina-103rd); Imparciales (Argentina-104th); and Particulares (Argentina-128th) (Frenkel et al., 1974). These firms are also important in their respective national economies. In Argentina, for instance, Nobleza (BAT) was continuously ranked among the top 15 industrial concerns from 1960=1974, and Piccardo (Liggett), Massalin y Celasco (Philip Morris), Particulares and Imparciales (both Reemtsma) were also ranked in the top 50 firms during those years.

7. It is of some interest to see precisely how this market growth took place. The demand creation efforts were successfully directed at three basic groups: women and young non-smokers as well as older smokers of the more idiosyncratic domestic product form (in Latin America these are usually cheaper, short (70mm), non-filter, dark tobacco brands). The basic idea underlying demand creation campaigns aimed at women and adolescents is obvious: to create primary demand growth where the marginal eficfciency of demand creation techniques is often highest. This also has the appealing feature of providing a "positive-sum" game for the firms. The strategy behind demand creation techniques aimed at established smokers of the older domestic product forms is more complex. The effort to move these smokers towards more expensive, "sophisticated" product forms (although often still "national" brands) was designed to eliminate relatively cheap, unprofitable brands where appropriability is much lower (as are, incidentally, the barriers to entry to new competition). The strategy of "converting" established smokers to more "advanced" more expensive product forms even involved the creation of a new "hybrid" product form in Argentina--

7. (continued).

--the "mixed" light and dark tobacco cigarette (Table 1). By using revised versions of some of the older brand names, and by mixing dark tobacco with light tobacco in longer, filtered product forms, these smokers could be more easily weaned from the older, cheaper products.

8. Reported advertising expenditures were actually larger than reported earnings (108%) for Philip Morris' Massalin y Celasco subsidiary in 1967. High levels of advertising also produced reported losses for three of the five TNC subsidiaries in Argentina during the years 1967-1970.

9. Domestic versions of the "international brands" made "under license" are frequently considerably different from the original brand manufactured and sold in the home market. This is not simply because of local governemtnal requirements mandating the usage of some minimum proportion of locally-grown tobacco, either. One example may serve to illustrate the point. In Argentina, the locally-made KEnt is a large seller and is clearly advertised as employing the "Famous Micronite Filter (the phrase even appears across the front of the pack itself). Technically, however, this is simply not true. The "Micronite Filter" is an identifiably different filter rod patented in the U.S. (as are many other filter materials). But the filter used in Kents in Argentina is in fact indistinguishable from the filter rod materials used in most of the other filter cigarettes in Argentina, and is definitely not a "Micronite Filter."

10. Evenat the height of international brand popularity in Argentina during 1975 (because the combination of governmental price controls and extreme rates of inflation had made the more expensive"international brands" relatively cheap), these brands accounted for only some 32.7% of the Argentine cigarette market by volume of sales (Data from Camara de la Industria del Cigarrillo, 1975).

11. On the other hand, U.S. TNCs" profitability abroad has apparently not matched that of its domestic business in cigarettes. From 1974 to 1978, for example, Philip Morris reported that between 25.2-29.5% of its "Operating Revenues" came from abroad but only 19.5-23.4% of its "Operating Income" did. Likewise, its ratio of Operating Income" to "Operating Revenue was between 10.4 and 12.0% in 1974-78 on international operations vs. a much higher 19.1-23.3% on its domestic cigarette busines (Philip Morris, Inc.. 1978). There are several possible reasons for lower profit rates abroad and lower profit rates abroad than European TNC's like BAT and Rothman's. U.S. TNC's, being latecomers to international operations, may still be involved in extensive cross-subsidization efforts, thus lowering o verseas profitability. Philip Morris, for example, is incurring large losses in Brazil to gain a foothold there, challenging BAT's overhwelming dominance in the Brazilian market. Different patterns of transfer pricing may also reduce U.S. TNCs' reported profits abroad. Different levels of excise and other taxes may also explain some of these differences. As compared with the U.S. cigarette business, foreign cigarette markets are

11. (continued).

generally characterized by higher excise taxes, lower unit profit margins, lower-priced products (before taxes), more extensive price controls, and lower levels of per capita consumption. Moreover, faced with the stagnation of sales in the U.S. because of the smoking/health issue, it is poosible that U.S. firms have decided to take as much profit as possible in the domestic market to finance their overseas tobacco businesses and finance domestic non-tobacco diversification projects. All this suggests that, high as overseas subsidiaries' profit rates might be, they still do not rival those of domestic cigarette operations for U.S. firms.

12. The rapid shift to tabaco rubio and the conditions under which it was introduced in Latin America have also led to enormous economic waste. Most light tobaccos (especially flue-cured and oriental) are not easy crops to manage. They require entirely different and technologically difficult harvesting and curing processes, are more demanding in terms of soil requirements, cultivation practices, etc. They are crops whose technology and quality production evolved over relatively long periods of time in their countries of origin. For example, fifty years after the introduction on a large scale of flue-curing in North Carolina, complaints about poor quality curing were still common in the 1920's among leaf buyers (Tilley, 1948). In Latin America, considerable economic resources invested in tabaco rubio were simply wasted or lost in crop failures of one sort or another; areas unsuitable for production had to be abandoned after large investments had been made; acceptable tobacco from the field was lost by poor curing and hadnling, etc., etc. Thus, it is not uncommon in rural Latin America to see abandoned flue-curing barns where tobacco is no longer being produced, mute monuments to this waste.

13. These estimates are based on various studies of the distribution of cost items of retail value by major economic agents in the industry in Argentina and Colombia (Estudio Sur, 1975; Republica de Colombia, Depto. Nacional de Planeacion, 1975).

14. In addition, TNC cigarettes made abroad (either by subsidiaries or licensees) are usaually much higher in tar and nicotine than their look-alike brands in the U.S. For example, a recent comparison test showed that Marlboro, Kent, Chesterfield, and Kool averaged 17.5 mg. tar in the U.S. while the same brands made in the Philippines averaged 31.8 mg. tar (Ross, 1980:144-45). In part, these differences may be explained by local content regulations. There is, however, another basic reason why the diffucion of more advanced, low tar/nicotine product forms to LDC's has been so slow. Locally-mandated rules on the use and availability of many of the basic inputs in cigarette manufacture for import substitution industrialization reasons often cause considerable differences in cigarette-making cost structures in LDC's vs. those characteristic of DC's. In industrialized nations, leaf tobacco is normally the most expensive input by far. Filter rod material, cigarette paper, wrapping materials, packaging, etc. are all relatively insignificant costs. Hence, complex filter designs,

14. (continued).

low density, high-porosity cigarettes wityh "puffed" tobacco and low tar/nicotine delivery are in fact cheaper to manufacture than are higher tar/nicotine products which contain more tobacco. The old, 70mm and 85mm non-filter cigarettes are the most expensive of all brands to produce in DC's. In LDC's however, the cost structure is often reversed: tobacco is cheap while other inputs--often imported or available locally from other oligopolistic and high cost suppliers--are relatively more expensive. Not only would the higher costs of more sophisticated low tar/nicotine filter cigarettes possibily affect unit profitability, but more importantly, higher cigarette prices for these brands would possibly reduce aggregate sales given the higher price-elasticities of demand typical of cigarettes in LDC's, in turn, the result of lower per capita income, unequal income distribution, etc. Thus, there are at present very few economic incentives to promote the diffusion of more advanced product forms in LDC's.

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