RESEARCH PAPER

The invisible hand: how British American Tobacco precluded competition in Uzbekistan

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Background: Tobacco industry documents provide a unique opportunity to explore the role transnational corporations (TNCs) played in shaping the poor outcomes of privatisation in the former Soviet Union (FSU). This paper examines British American Tobacco's (BAT's) business conduct in Uzbekistan where large-scale smuggling of BAT's cigarettes, BAT's reversal of tobacco control legislation and its human rights abuses of tobacco farmers have been documented previously. This paper focuses, instead, on BAT's attitude to competition, compares BAT's conduct with international standards and assesses its influence on the privatisation process.

Methods: Analysis of BAT documents released through litigation.

Results: BAT secured sole negotiator status precluding the Uzbekistan government from initiating discussions with other parties. Recognising that a competitive tender would greatly increase the cost of investment, BAT went to great lengths to avoid one, ultimately securing President Karimov's support and negotiating a monopoly position in a closed deal. It simultaneously secured exclusion from the monopolies committee, ensuring freedom to set prices, on the basis of a spurious argument that competition would exist from imports. Other anticompetitive moves comprised including all three plants in the deal despite intending to close down two, exclusive dealing and implementing measures designed to prevent market entry by competitors. BAT also secured a large number of exemptions and privileges that further reduced the government's revenue both on a one-off and ongoing basis.

Conclusions: BAT's corporate misbehaviour included a wide number of anticompetitive practices, contravened Organisation of Economic Cooperation and Development's and BAT's own business standards on competition and restricted revenue arising from privatisation. This suggests that TNCs have contributed to the failure of privatisation in the FSU. Conducting open tenders and using enforceable codes to regulate corporate conduct would help deal with some of the problems identified.

In a deal announced in 1994 and finalised in 1995, British American Tobacco (BAT) acquired the previously state-owned tobacco monopoly establishing its own private monopoly. The deal remains Uzbekistan's largest privatisation to date,[1] accounting for >30% of its foreign direct investment between 1992 and the end of 2000.[2] We have already documented the appalling impacts this investment has had on tobacco control, with BAT reducing cigarette taxes by 50%[3] and overturning tobacco legislation.[4] Other work reveals BAT's human rights abuses of tobacco farmers[5] beholden to the new monopsony. This paper instead examines BAT's corporate behaviour in Uzbekistan. It explores its influence on the privatisation process, assesses the extent to which its investment helped deal with macroeconomic problems, transform economies, and promote efficiency and growth, as the international financial organisations intended when promoting privatization, and analyses the extent to which BAT's behaviour could be considered anticompetitive.

BACKGROUND

Uzbekistan

Uzbekistan is the most populous of the five Central Asian republics. Islam Karimov seized power in the country's first (seriously marred) presidential election following independence from the Soviet Union in 1991[6] and through subsequent referenda has extended his term of office until December 2007. By the time of investment violations of basic human rights by BAT, heavy press censorship and persecution of political opponents were well established. The scale of human rights abuses has since escalated, torture is used as a routine investigation technique, victims have been immersed in boiling water, and unarmed protestors shot.[7–10]

Transition and the privatisation debate

Rapid and extensive privatisation of state-owned enterprises was a key element of the economic reforms recommended to the post-Soviet countries by the international financial organisations and the US Treasury. Proponents of the "shock therapy" approach to the economic transition assumed that rapid privatisation would be an effective driver of reform, and regulatory structures could emerge later. Other commentators advocated a more "gradualist" approach wherein the creation of a competitive environment and necessary institutional infrastructure and regulation would precede privatisation.

The largely disastrous consequences of such rapid reform for much of the former Soviet Union (FSU)[11 12] have precipitated a number of analyses of the reasons for failure.[13 14] These suggest that the environment within which privatisation takes place, including macroeconomic stability, hard budget constraints, competitive markets and adequate property rights, is crucial.[15] In the FSU, where such conditions were overwhelmingly absent, privatisation brought few benefits.[13]

Abbreviations: BAT, British American Tobacco; FSU, former Soviet Union; GKI, Uzbek State Privatisation Agency; JV, joint venture; OECD, Organisation of Economic Cooperation and Development; PMI, Philip Morris International; SFP, Samarkand fermentation plant; TNC, transnational corporation; TTC, Transnational tobacco company; TTF, Tashkent Tobacco Factory; UFP, Urgut fermentation plant

Such analyses have, however, largely focused on system and infrastructural failures including the role of weak or corrupt governments, whereas the role that transnational corporations (TNCs) may have played has generally been overlooked. Instead, the literature largely sees TNCs as victims of, rather than potential contributors to, the problems. Given that transnational tobacco companies (TTCs) were among the first and largest investors in the FSU,[2] the release of internal tobacco industry documents through litigation[16 17] provides a unique opportunity to deal with this research gap by exploring the influence of TNCs on the privatisation process.

Corporate conduct

Organisation for Economic Corporation and Development (OECD) guidelines for multinational enterprises working from or in OECD member states (and thus including BAT) outline a broad range of business principles, including standards on competition, which such enterprises are expected to follow.[18] These and the business standards to which the BAT itself now claims to adhere[19] provide useful benchmarks against which BAT's conduct has to be assessed (table 1). The guidelines were first developed in 1976 and amended at intervals since, including in 1991[20] and most recently in 2001.[18] The standards on competition have changed little and the OECD deems that past breaches should be judged against the current text.

It could be deemed that BAT's whole raison d'être contradicts the spirit of the guidelines, "to encourage the positive contributions that multinational enterprises can make to economic, environmental and social progress." Certainly, the documented large-scale smuggling of BAT's cigarettes into Uzbekistan,[21] BAT's detrimental impact on tobacco control[3 22] and abuse of tobacco farmers[23] contravene a number of the standards including Section VII.6 which requires companies to "Co-operate fully and in a transparent manner with public authorities in the prevention or removal of serious threats to public health and safety deriving from the consumption or use of their products." Although a comprehensive comparison of BAT's behaviour against these standards is warranted, it is beyond the scope of this paper. Instead, we focus specifically on BAT's anticompetitive practices. These are practices which restrict or eliminate competition in a market, particularly if employed by a dominant firm and include such things as absorption of competitors, exclusive dealing and erecting barriers to market entry.[24–26] The work thus builds on our concerns about the anticompetitive stance taken by BAT to the opening of the FSU markets.[27–29]

Such work should help engage the International Monetary Fund in debates around privatisation and contribute to our understanding of effective means of regulating corporate conduct. The latter becomes increasingly important as the TTCs embrace corporate social responsibility and other voluntary initiatives, including business practice standards, as a means of claiming legitimacy,[30 31] and, more importantly, as governments accept such voluntary approaches as sufficient mechanism for holding corporations to account. The OECD guidelines that form a voluntarist rather than legally binding approach to controlling corporate activities are, for example, seen as central to the government's corporate social responsibility agenda in the UK, the home of BAT, despite severe criticism of the government's implementation of the guidelines.[32]

METHODS

The legal settlements that led to the public release of BAT's documents, the creation of the company's Guildford archive and the idiosyncrasies of working in this archive, have previously been described.[16 17 27] As part of a wider search for documents relating to the FSU detailed elsewhere,[27] over 35 terms were included specifically for Uzbekistan. An iterative approach to searching was taken, informed by a prior search of tobacco industry journals and early document findings, with initial broad search terms such as "Central Asia", "CAR" (Central Asian Republics), "Uzbek*", and later narrowed to include the names of key identified individuals, places, projects and factories. Searches were performed between July 2000 and 2002 with documents taking up to 2 years to be delivered by BAT.

Analysis was based on an approach to company document analysis described by Forster and complemented by archival techniques recommended by Hill.[33 34] All documents obtained were indexed in a project database designed specifically for analysing tobacco industry documents. In all, 302 documents were coded as relevant to Uzbekistan, and were then sorted by date and topic in order to construct a chronology of events.

To contextualise and triangulate the findings, documents on relevant Uzbek legislation were subsequently identified through the on-line BAT Documents Archive established in 2004,[16] and additional information was sought from a hand search of tobacco industry journals dating from the start of 1990s to the end of 2000, from the United States Department of Agriculture, BAT Uzbekistan's records deposited at Companies House and the world wide web.

RESULTS

The Uzbek tobacco industry

At independence, the Uzbek tobacco industry consisted of a single tobacco factory, the Tashkent Tobacco Factory (TTF), and two fermentation plants in Urgut and Samarkand (UFP and SFP). The market was severely undersupplied: in 1993, TTF was producing only 3–4 billion of an estimated total market of 22 billion cigarettes.[35 36]

Key players in the Uzbek tobacco industry's privatisation were UzPisheProm, the Uzbek Food Industry Association which was responsible for the tobacco sector and the State Privatisation Agency (GKI) which owned all state assets.[37] UPP staff included its Director, Mr Khamidov and Deputy Director, Mr Husnutdin Usmanov.[38] Table 2 outlines a timeline of the events described in this paper.

Desire to avoid a competitive tender

Following the initial contact with the key players in Uzbekistan in April 1993[39 40] and unsuccessful attempts to "lock the Uzbek authorities into an agreement to negotiate a JV [joint venture] exclusively with BAT"[41] by contracting TTF to manufacture cigarettes using BAT-owned machinery, BAT began to negotiate a JV.[42–48]

BAT clearly aimed to avoid a competitive tender, and William Wells[37] of Schroders emphasised that "speed will be of the essence if the Uzbeks' confidence is to be secured and the risk of a competitive tender is to be minimised." Competition was intense—by the time of BAT's first team visit in May 1993, the TTF director had already signed 14 letters of intent for JVs.[38] By September 1993, two related factors served to increase the possibility of a competitive tender. The first was that the Uzbekistan authorities, having previously intended to establish a JV,[38 45] came to favour outright privatisation.[42 44] BAT judged that this reflected the influence of Price Waterhouse, appointed to advise the GKI on privatisation and possibly to educate the GKI on the "merits and demerits of tender sales".[44]

The second was the successful competitive tender in neighbouring Kazakhstan, in which Philip Morris International (PMI) acquired the Almaty Tobacco Factory or Kombinat. BAT's main concern was that a tender would "almost inevitably increase the cost of investment".[49] Aware

Table 1 Business practice standards on competition

BAT's business conduct standards	OECD standards
Group companies will ensure that they comply with the competition laws of each country and economic area in which they operate. This is because compliance is required by law and also because BAT believes in free competition	IX competition
It is the responsibility of directors and managers of group companies to be aware of and familiarise themselves with any competition laws affecting their companies and their markets and to ensure compliance within their organisation	Text
Competition laws are intended to promote a free and competitive market -place and it is in the interests of all participants that they are complied with	Enterprises should, within the framework of applicable laws and regulations, conduct their activities in a competitive manner. In particular, enterprises should
The competition laws of most countries affect both ''horizontal'' agreements, that is, those between competitors, and also ''vertical'' agreements—that is, those between a supplier and its customers Horizontal price-fixing agreements among competitors are likely to be considered among the most serious offences, with very heavy penalties for infringement for the company and possibly for the individual involved. In the UK, for example, imprisonment can be imposed, as well as heavy fines	(1) Refrain from entering into or carrying out anticompetitive agreements among competitors
Most competition laws are likely to have an impact on joint ventures and all prohibit misuses of dominant position	(a) To fix prices
Many countries also impose merger control, often with a need to notify a proposed merger for approval before implementation	(b) To make rigged bids (collusive tenders)
Although the law may be stated simply, the factual circumstances to which the law must be applied are sometimes less clear. If, therefore, there is any doubt whether a particular business practice or activity might be in breach of competition law, the matter must be referred to the relevant legal counsel	(c) To establish output restrictions or quotas or
	(d) To share or divide markets by allocating customers, suppliers, territories or lines of commerce (2) Conduct all their activities in a manner consistent with all applicable competition laws, taking into account the applicability of the competition laws of jurisdictions whose economies would be likely to be harmed by anticompetitive activity on their part. (3) Cooperate with the competition authorities of such jurisdictions by, among other things and subject to applicable law and appropriate safeguards, providing as prompt and complete responses as practicable to requests for information. (4) Promote employee awareness of the importance of compliance with all applicable competition laws and policies. (5). ……… The term ''competition'' law is used to refer to laws, including both ''antitrust'' and ''antimonopoly'' laws, which prohibit collective or unilateral action to (a) misuse market power or dominance, (b) acquire market power or dominance by means other than efficient performance or (c) engage in anti-competitive agreements. (6) In general, competition laws and policies prohibit (1) hard-core cartels; (2) other agreements that are deemed to be anticompetitive; (3) conduct that exploits or extends market dominance or market power and (4) anti-competitive mergers and acquisitions

BAT, British American Tobacco; OECD, Organisation of Economic Cooperation and Development.
On the left—BAT's business conduct standards on competition law.[19] Emphasis (underlined) added. On the right—OECD standards[18]. 1

that it had already lost tenders in Lithuania and Kazakhstan,[27 50] BAT described the matter as one of ''extreme urgency'':[42]

> there is a clear danger that BAT will be forced to compete in tenders at very high prices or be shut out of remaining business opportunities in Central Asia. … BAT was outbid in Kazakhstan by a factor of more than three on payment to the Government for shares of Almaty Tobacco Factory or Kombinat and by a factor of two for capital expenditures. … If the Kazakhs announce these figures publicly … the stakes will rise immensely in the remaining republics of Central Asia and perhaps elsewhere in the CIS [Commonwealth of Independent States] …
>
> Further delay will increase greatly the risk of a competitive tender in Uzbekistan.

Herter[42] feared that there was ''a serious risk that unless BAT takes immediate pre-emptive steps to progress negotiations with the Uzbeks, the Uzbek tobacco industry will go to competitive tender''. His recommendation, approved by the Chief Executives Committee (CEC), was ''that BAT should aggressively pursue the existing investment opportunity'' and sign a memorandum of understanding as a matter of urgency.[42 51] This was ultimately achieved on 5th October 1993[52] and, as BAT had desired,[42] focused on the creation of a JV.[52] It included a 12-month exclusivity period,[52] which BAT successfully used to pressurise the Uzbeks not to engage in

Table 2 Timeline of events

April 1993	BAT participates in World Economic Forum visit to Uzbekistan
May 1993	First BAT team visit to Uzbekistan
June to October 1993	Ongoing visits and negotiations
September 1993	Philip Morris' JV with Almaty Tobacco Kombinat announced
28th September–5th October 1993	Uzbek delegation visit UK and Europe
5th October 1993	Memorandum of understanding signed between UPP, GKI and BAT. Includes an exclusive negotiating period of 12 months
23rd–26th November 1993	President Karimov's visit to UK
14–16th December 1993	Sir Patrick Sheehy (BAT Chairman) and Ulrich Herter (Managing Director Tobacco BAT Industries) visit Uzbekistan
15th December 1993	Protocol of Intent signed by First Deputy Prime Minister Ismael Djurabekov for the Uzbek government and Sir Patrick Sheehy for BAT
January 1994	Establishment of customs union between Kazakhstan, Kyrgyzstan and Uzbekistan announced
11th February 1994	First Presidential Decree: Cabinet of Ministers Decree signed by President Karimov approving JV with BAT. Agreement on terms of JV to be agreed by 11th May
14th May 1994	Share Purchase Agreement Signed
16th May 1994	BAT publicly announces the deal
20th June 1994	Second Presidential Decree: President Karimov signs Cabinet of Ministers Decree on establishment of JV. Confirms monopoly position
June, July, August 1994	Ongoing negotiations focus on taxation
15th July 1994	BAT discovers existence of Health Decree 30, comprehensive tobacco control legislation
Late August 1994	Tax issues resolved to BAT's satisfaction and a Tashkent decree banning street advertising is reversed at BAT's request
August–October1994	Negotiations on Health Decree 30 continue
31st October 1994	Date by which amended decree would be in force
22nd November 1994	BAT transfers first payment to establish majority stake in the Uzbek tobacco industry
20th–22nd December 1994	Sheehy visits Uzbekistan to formalise creation of the JV

BAT, British American Tobacco; JV, joint venture.

negotiations with potential competitors,[53–55] repeatedly stressing its importance.[56 57]

Use of political contacts to ward off competitors and prevent a competitive tender

Further efforts to secure BAT's position and prevent a tender relied on its extensive political contacts, and particularly the support of President Karimov. Documents suggest that Usmanov assisted BAT in attempting to move the project forward from the inside, keeping BAT in the forefront and warding off pressure from competitors:[58 59]

> Government offices are deluged with letters from various consultants fronting for PMI, RJR [R J Reynolds Tobacco company] and Rothmans…
> I can ward off this pressure, but only so much, - Usmanov said. – Sometimes these letters come to me for expert opinion and I try to keep BAT in the forefront. But I am sure that a lot of them stay in other offices and who knows what other Government officials might think. PMI for instance offers 200–300 mln Dollars and credits and KPMG are lobbying very hard for them. RJR signed with us a Protocol of Intent without an exclusivity clause but with a promise to invest …These letters go to practically all the important Government addresses complaining about the exclusivity with BAT.

By January 1994, Usmanov claimed to have succeeded in securing the temporary exclusion of the tobacco industry from the privatisation programme and advised BAT not to await privatisation since it ''would then be dealing with 'closed' joint stock companies which he thought would be more difficult.''[57]

The nature of Uzbek politics meant that presidential approval for any JV plans would be critical. Contact with the president did not occur until President Karimov's visit to the UK in November 1993,[53 60–63] followed by chairman Sir Patrick Sheehy's visit to Uzbekistan in December. During this visit, the Protocol of Intent was signed,[49 64–66] a crucial document for BAT:

> Usmanov believes the meeting with the President and the Protocol of Intent make life much harder for the competition. Now we can cay [sic] to all the others: go to the President and secure his support, then we will deal with you. So far he is with BAT.[58]

At this point, pressure for a competitive tender was building both externally from BAT's competitors, and internally from GKI and KPMG, newly appointed to advise specifically on the tobacco industry deal (having acted as advisers to the Kazakhstan government on the Almaty deal).[55] The fact that BAT now had ''the active support of President Karimov'',[49] who was willing to issue a presidential decree authorising the establishment of a JV with BAT,[49] was vital to BAT's anti-competitive strategy. This was evident in a note to the CEC describing Karimov's response to arguments advanced by GKI that a competitive tender would yield higher investment and greater employment protection:

> Rather than being concerned about the valuation issue, when the President heard of this debate and the possible delays in implementing the investment, he instructed the Deputy Prime Minister to prepare a Presidential Decree authorising the establishing of a joint venture with BAT to be submitted to the Cabinet of Ministers on 1st February for his signature on 4th February.

A presidential decree signed on 11th February 1994[55 67] approved the JV with BAT, based on the TTF, SFP, UFP, and including the construction of a new cigarette factory and leaf-processing plant in the Samarkand region. Earlier documents suggest Samarkand was a politically expedient choice, being the President's home town.[68] As Herter reported to the CEC, the decree also confirmed BAT's sole negotiator status:

> Although due to the Decision, GKI has to accept BAT as sole negotiator at least until 11th May 1994 it will probably look for opportunities to state its case for an open tender if BAT's proposal is short of its expectations.
> …Although KPMG lobbied strongly against BAT having a sole negotiating position they will have to work within the aims and terms of the Cabinet of Ministers decision.[55]

Absorption of competitors

BAT had deliberately included TTF and both fermentation plants in the JV to exclude the possibility of domestic competition in what effectively amounts to absorption of competitors. Despite intending to close the SFP and ultimately the TTF,[35 36 55] with the UFP alone recognised as "a lynchpin to any investment in Uzbekistan",[69] BAT took "pre-emptive action" to deny all three to competitors,[55 65 69] noting in relation to TTF:

> in order to provide immediate access to the most concentrated consumer market in Uzbekistan and to deny the market and TTF to BAT's competitors, it was agreed that it would be desirable to be located in Tashkent for at least the short term.[69]

Exclusive dealing and erecting barriers to market entry

Having secured sole negotiator status, prevented a competitive bidding process and absorbed potential domestic competitors, BAT then attempted to secure the Uzbek market from competition that could arise through imports or new market entrants. Referring openly to "protection of the domestic tobacco products market",[62] BAT set about achieving this through exclusive dealing and erecting barriers to market entry.

It requested a number of anticompetitive preconditions to its investment,[35 49 55 61 70 71] summarised clearly in the draft Skeleton Business Plan,[35] which indicates that BAT aimed to:

> secure a dominant position in the market, achieving 80% market share by the year 1997 by concluding a joint-venture with the Uzbek Cigarette Industry which will guarantee our position over the plan period through providing competitive advantage particularly the restriction on imports.[35]

BAT sought exclusive cigarette manufacturing rights,[49 55 70] an exclusive arrangement with Bakalea (the state distribution agency)[61 69 70] and with local advertising agencies,[70] confirmation that the tobacco industry was not subject to legal constraints as a monopoly,[61] and reform of the tobacco excise and import tax systems.[55 61 70 72]

Exclusivity of distribution through Bakalea, a one-way arrangement that would tie up Bakalea for at least 5 years but not preclude BAT from using other distributors,[35] was seen by Dean Sims, BAT's marketing expert, as a prerequisite. Sims also sought the application of import duties on imported cigarettes, qualified by a 3-year indemnity for BAT imports and higher taxes on advertising of imported products.[70] He emphasised the scale of the opportunity associated with an investment if these conditions could be obtained:

> It must be absolutely clear that what we wish to buy is not manufacturing assets or brands but an opportunity to dominate the market.
> The TTF assets and brands are worthless without the above guarantees…
> With these guarantees it could emmerge [sic] as one of the most significant and lucrative Group investments in the last twenty years. The impact on Group profits could be considerable.
> No effort or avenue should be ignored to try to achieve the above guarantees but this must be immediate. This may require unorthodox arrangements to be made with the decision makers but this will have to be weighed against the scope of the opportunity.[70] (original emphasis)

BAT's exclusive dealing did not stop with Bakalea. On the marketing front, concerned that it was being outdone,[70 73–75] BAT wanted to tie up all the key players to prevent competitor access:

> No advertising agencies in the true sense of the word exist locally. All creativity and printing must be sourced externally. However, the limited number of people currently working in this field exercise disproportionate influence and as with financially stable distributors, we should tie them up with exclusive contracts now.[70] (original emphasis)

Lest these wide-ranging measures be insufficient, to further foreclose the possibility of any competition, BAT also specified that no other domestic or foreign business should be licensed to process leaf (at least until facilities had been installed at UFP) or to manufacture tobacco products (for 5 years or 6 months after the new factory is fully operational)[35] and that no local or international brands would be registered without prior consultation with BAT.[35]

It is also clear that, although BAT planned to establish a monopoly, it hoped to achieve this without being subject to anti-monopoly regulation, as freedom to price was seen as an absolute precondition to investment.[35]

Investment privileges

In addition to established foreign investor tax privileges,[61 72 76] BAT sought various additional and wide-ranging privileges.[61 70 77 78] It noted that these would lead to considerable savings,[77] further bolstering its position while reducing potential government revenue from BAT's investment—for example, despite internally acknowledging that existing legislation provided a 2–5 year income tax holiday and that the 5-year exemption being offered was "extremely generous",[78 79] BAT pushed for an additional 5-year exemption. Other privileges sought included a 5-year exemption from taxes on foreign currency income and a 10-year exemption from import, customs and excise duties on materials imported for processing.[78]

Securing the deal

On 14th May 1994, 3 days after the deadline for establishing the JV set out in the presidential decree,[55] official agreement was reached in the form of a Share Purchase Agreement[80 81] and BAT formally announced the deal.[82 83] On 20th June 1994, Karimov signed a second Presidential decree effectively activating the Share Purchase Agreement and guaranteeing BAT its desired monopoly position.[80] Although the Uzbekistan party had made unilateral changes from a previous agreement,[80 84] the decree gave BAT more or less what it had demanded: exclusive manufacturing and processing rights for 5 years,[80 85] freedom to contract with tobacco farmers, release from the state order for cigarettes and leaf, and receipt of the privileges contemplated in the May Agreement.[80] A subsequent United States Department of Agriculture report notes that with the import duty exemptions granted for 5 years, they were then also extended for a further 5 years, and that BAT was given a 10-year exclusive right to grow, process and export the Turkish leaf variety "Izmir".[86] Above all, BAT was given freedom to price its cigarettes while avoiding inclusion on the monopolies register, as Nick Brookes, director of new business development noted:

> 5. We have negotiated a 5 year monopoly for cigarette manufacture in Uzbekistan. This could only be achieved by arguing that competition would be available from imports.

> 6. Despite being a monopoly we have, nevertheless, negotiated exclusion from the Uzbek Monopolies Committee which amongst other things, would have restricted our freedom to set prices.[87]

He also admitted that, as a result of BAT's efforts to redesign the taxation system,[3] the argument that competition existed from imports was largely spurious:

> 8. If the new level playing field tax regime is properly applied, cigarettes entering Uzbekistan from outside the CIS should in any event reach the market at a price disadvantage to locally manufactured cigarettes owing to higher ex-factory prices, transportation costs, etc.[87]

The fact that the Uzbekistan monopolies committee deems firms with a market share of >65% as ''dominant''[88] while BAT aimed for a share of 80%,[22] achieving a 72% share by 1999,[89] makes BAT's exclusion all the more remarkable.

Hiccoughs at the final stages

Although by July 1994 completion of the deal seemed imminent,[90 91] several issues emerged to delay the progress. Most notable were excise reforms[3] and BAT's discovery in August of a tobacco control decree (Decree 30) issued by the Ministry of Health in July.[22 92 93]

BAT made considerable efforts to influence levels of import and excise duties, starting before the share purchase agreement was signed and continuing long afterwards, as detailed elsewhere.[3] Initial plans to have ''punitive''[61] import tariffs imposed, as alluded to above,[70] were abandoned because the Uzbek government had been highly sensitive to what it saw as anticompetitive practices[87 94] and it had become apparent ''that seeking all three of protective import duties, manufacturing exclusivity and pricing freedom was impractical''.[94] Instead, BAT sought and ultimately achieved considerable reform of the excise system which bolstered its monopoly position.[3]

In a document that indicates how BAT and Schroders were aware of the dubious nature of such practices, William Wells outlines how he was unable to allay the BAT chairman's concerns about the failure to pursue punitive import duties during his visit[37] because he ''was not entirely clear to what extent it was appropriate to talk about what might be construed as anti-competitive practices, in front of Neil Buckley of the Financial Times.''[94]

By October 1994, after aggressive and persistent negotiations, ultimately involving President Karimov, BAT successfully secured exemption from the Health Ministry's Decree 30 which would inter alia have banned advertising and smoking in public places,[95 96] instead implementing its own voluntary code on
2 advertising.[22 97]

Outcomes

By November 1994, final agreement on the deal was reached[98] with BAT transferring their first payment on 22nd November 1994[99] as planned[81] to acquire a 51% stake in the Uzbek tobacco industry.[98 100] Documents indicate that a total of US$60.08 million was transferred to Uzbek accounts at Chase Manhattan Bank,[99] the equivalent of £38.2 million at exchange rates at that time, but Companies House records indicate that BAT invested £44.9 million.[100] When asked for an explanation, BAT attributed the £6.7 million discrepancy to capitalisation of related costs including legal and merchant bankers fees and travel costs incurred in the acquisition (Michael Prideaux, personal correspondence, July 2005), suggesting, therefore, that such costs contributed a very high 17.5% of the deal price.

Sir Patrick Sheehy and other BAT delegates visited Uzbekistan in December 1994 to formalise the JV deal. BAT documents record that they met with President Islam Karimov:

> who praised BAT as a solid international partner with a vision, and assured the guests of his continuing personal support for the company's long-term investment plans..... According to senior Uzbek officials, Sir Patrick's trip has greatly contributed to the image of BAT in Uzbekistan as a serious investor and a responsible corporate citizen.[101]

Public reports of the deal indicate that BAT made further investments to an estimated total value of >US$300 million (~ £200 million) by 1998 with its shareholding increasing to 97%.[2 102 103] Companies House records suggest that of the investments made by the end of 1998, £144 million was cash.[104] As planned, its production levels increased gradually until 1999, export activities had begun[105] and BAT's market share had reached over 70%.[89] In 2000 and 2001, BAT Uzbekistan made profits of approximately £1 million and £2.8 million, respectively.[104] Subsequently, however, sales have fallen[106–108] and BAT Uzbekistan has recorded a loss.[109 110]

DISCUSSION

This paper clearly demonstrates that BAT wielded powerful influence over the privatisation process in Uzbekistan, particularly through the support of President Karimov. It prevented a competitive tender, despite considerable pressure from both internal and external agencies, and established a monopoly, yet used spurious arguments to ensure exclusion from the Monopolies Commision and freedom to set prices. BAT engaged in a broad range of anticompetitive practices that cemented its dominant position and precluded the possibility of any effective competition from either inside or outside the country. These included absorption of competitors and exclusive dealing, exclusive rights to manufacture tobacco products and process leaf, and a veto over the registration of cigarette brands. Although its efforts to implement tariff barriers in the form of import duties failed, BAT managed to ensure that the excise system was reformed to its benefit. Simultaneously, it negotiated incredibly favourable investment terms that resulted in the Uzbekistan government foregoing large amounts of revenue.

BAT's conduct in Uzbekistan clearly contradicts the OECD guidelines which outline how competition laws prohibit action to ''abuse market power or dominance'' or ''acquire market power or dominance by means other than efficient performance''(table 1).[18] It is also dramatically at odds with BAT's self-proclaimed business conduct standards, which state ''British American Tobacco believes in free competition'', raising serious doubts about the validity of such standards.[19] Combined with BAT's contravention of other OECD standards as described above, our findings suggest that voluntary business practice initiatives are inadequate in constraining corporate conduct, lending weight to arguments that corporations should be legally required to abide by an international set of social standards such as an international framework on corporate accountability.[32 111 112]

Indulgence in anticompetitive behaviour is not unique to Uzbekistan. We have previously shown how BAT successfully avoided a competitive tender in the Ukraine, and attempted to do so in Russia and Moldova, in the latter again hoping to shore-up its position with protective excise policies.[27 29] Other documents indicate that TTCs colluded to fix prices in as many as 23 countries across Africa, Asia, Latin America, Europe and the Middle East.[113]

As Uzbekistan's largest foreign investor and a major tax payer, BAT has helped support and maintain Karimov's regime. When political commentators have raised concerns about the appropriateness of doing business with "nasty regimes", BAT has claimed it is not a "political animal".[114] Yet, our analysis clearly shows BAT's close links with Karimov whose personal intervention secured BAT its desired deal and ensured tobacco control legislation was overturned.[4] Concerns have also been raised about the inability of the press to accurately cover tobacco control issues and torture has been used on those who have attempted to do so (unnamed source, personal correspondence, August 2006).[115]

BAT's conduct puts those who support the company in an invidious position. Schroders and its staff who, in acting as BAT's advisers, were clearly knowledgeable of and, it seems, active in supporting the behaviours outlined in this paper and those outlined elsewhere.[3, 21–22] It is also noteworthy that KPMG seems to have a potentially conflicting role in the processes outlined, being appointed by GKI to advise on the tobacco deal while also, two documents suggest, lobbying for PMI in Uzbekistan.[58, 59] KPMG was unable to confirm or refute this information, being unable to trace any record of KPMG in the UK working on tobacco privatisation in Uzbekistan (Judith
3 Dow, personal correspondence, KPMG London).

On the issue of privatisation, our findings also suggest that the purported economic benefits of privatization, which underpin the multilateral financial organizations' support for this process, may not be realised. The Uzbekistan government failed to capitalise on the sale of its tobacco industry, as BAT cajoled it into foregoing a competitive tender and providing numerous tax holidays and favourable excise policies, all of which substantially reduced revenues. These diverse exemptions are not unique to Uzbekistan. The TTCs also secured 5–10-year exemptions from profit tax in Ukraine,[116] Kyrgyzstan and Hungary.[117]

The findings also lend support to those who argued for a gradual approach to privatisation by illustrating the ease with which a leading TNC was able to act in an anticompetitive manner. Had there been institutional mechanisms to ensure competition and good corporate governance in place, it would have been far harder for BAT to have behaved in this way. Moreover, rather than raising business standards in Uzbekistan as the company would have us believe, and the International Monetary Fund and others had predicted would occur through privatisation, BAT's poor conduct has reinforced corrupt and inappropriate practices. This is in line with Hellman *et al*'s[118] findings that foreign firms investing in the region were significantly more likely than local firms to engage in certain forms of corrupt behaviour, enjoy substantial benefits from doing so and contribute to problems of governance.

If a competitive rather than a monopolised market had emerged, there could of course have been implications for tobacco control, given evidence that competition tends to fuel consumption. However, as we have outlined elsewhere,[21] overall, our evidence suggests that the key influence on tobacco control and consumption is the presence of a private rather than a state-owned company and its very different modus operandi, notably the use of mass marketing, negative influence on tobacco control and cigarette pricing.[3, 4]

In summary, these findings may help fuel further opposition to privatisation in the tobacco industry.[119, 120] Not only does privatisation seem to encourage rising tobacco consumption[121, 122] and threaten tobacco control[3, 22] with inevitable consequences for health and subsequent indirect negative economic impacts, its theoretical economic benefits may also not be realised. More broadly, while not refuting the view that weak and corrupt state performance is a key factor explaining the failure of privatisation in the FSU, our findings indicate that the behaviour of TNCs may also have contributed and that building the appropriate infrastructure (the creation of a competitive market, adequate property rights, anti-monopolies commission and so on) before privatisation may have helped to prevent such practices. They also highlight concerns about the conduct of a major international company and the inadequacy of voluntary business practice initiatives, suggesting that TNCs must be more closely regulated through enforceable codes of conduct.[32, 111] This and the conduct of transparent tenders would go some way towards addressing the problems identified.

What this paper adds

After the collapse of the Soviet Union, the International Financial Organisations promoted privatisation of previously state-owned industries to help deal with macroeconomic problems, transform economies and promote efficiency and growth. Yet, privatisation failed to bring these predicted benefits. Blame has been centred on infrastructural failures including the role of weak or corrupt governments while the role of transnational corporations (TNCs) has generally been overlooked. Meanwhile, TNCs, governments and international organisations are adopting voluntary means of controlling industry's conduct with little information on their ability to effectively hold corporations to account.

By using internal tobacco industry documents to examine British American Tobacco's (BAT's) conduct during its investment in Uzbekistan in the mid-1990s, this paper suggests that TNCs contributed to the failure of privatisation in the former Soviet Union by engaging in anticompetitive practices. By showing the ease with which BAT contravened established standards of business conduct, it also suggests that voluntarist means of holding corporations to account will be ineffective, lending weight to arguments that corporations should be legally required to abide by an international set of social standards such as an international framework on corporate accountability.

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