

# America's tobacco cartel



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- Lisa Krier

## Introduction

It is a well-known fact that in 1998 the four major big tobacco producers, Altria, R. J. Reynolds, Brown & Williamson, and Lorillard crafted a \$200 billion legal settlement with the nation's state attorneys general. For several years, these four tobacco companies have been threatened with lawsuits stating that they did not divulge the health risks and the addictive properties of cigarettes. The large tobacco companies were to pay a \$200 billion over a 25-year period to states to assist with the health care costs associated with smoking. Now these big tobacco companies face a new risk as two very small tobacco importers challenged the legal agreement (Woolley, 2004).

## The Crux of the Problem

What is not as well-known is that in order for the big tobacco companies to settle, states had to construct barriers to entry into the market. Ironically, it was state governments assisting the big tobacco companies by stopping smaller companies from selling their tobacco products for less. Many states passed laws that required new tobacco companies to pay fees that added up to more than what the big tobacco companies were paying out in the settlement. These states passed these laws as they stood to benefit by receiving larger payments if the big tobacco companies were doing better (Woolley, 2004).

Smaller tobacco companies alleged that the states and the big tobacco companies were engaging in price fixing and violating federal antitrust laws. Both the states the four big tobacco companies claimed that they had legal

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immunity as they already had a settlement ironed out. The Second Circuit Court of Appeals in New York disagreed, stating that even though the cartel had been sanctioned by the states, that didn't absolve them from federal antitrust laws. The unanimous decision implied that the states were sheltering the cartel from the Sherman Act so that they could benefit from monopoly pricing (Woolley, 2004).

The first antitrust law, passed by Congress in 1890, was known as the Sherman Act. The legislation was written to preserve free and unrestricted competition. The penalties for violations regarding the Sherman Act can be both civil and criminal. Penalties can be severe, up to \$100 million for corporations and \$1 million for individuals, and up to a ten year prison sentence if convicted (FTC, 2014).

Despite their best efforts, to keep the four big tobacco producers profitable, the states expect their settlement fees to continue declining. The big tobacco companies have lost sales to smaller companies, whose share of the market continues to rise. The big tobacco companies only have themselves to blame, as they raised their wholesale price drastically, which was much than was needed to pay their compensation costs to the states (Woolley, 2004).

### The Structure of Monopolies

A monopoly market structure is when there is only one seller of a product, and the monopoly sets the price of a good or service, whereas an oligopoly market structure consists of a few businesses selling product. Oligopolies have limited power over pricing, except when collusion is involved. A natural

monopoly is an enterprise such as a public utility company. These companies have no competition in the area where they are providing the service, but natural monopolies are subject to price regulation by the government. An example of a government monopoly would be the U. S. Postal Service. In monopolies, the demand curve is the same as the market demand curve, as a monopoly is the industry in the market. A monopoly has a downward sloping demand curve because market demand is not perfectly elastic (McConnell, Brue, & Flynn, 2012).

Some characteristics of a monopoly include having market power by affecting price to its benefit. Since it is the price maker, monopoly pricing uses the marginal revenue equals marginal cost rule, or ( $MR = MC$ ). A monopoly tries to maximize its economic profits by keeping the price-quantity arrangement in the elastic region. As the monopoly does have market power and sets the price for their good or service, it falls under the category of imperfect competition. Monopolies are not typically efficient, as they prefer to sell a lesser amount of goods at higher prices than other producers. As the monopoly chooses not to produce the optimal amount of units, this results in allocative inefficiency. This efficiency loss is also referred to as a deadweight loss. As firms in more competitive industries are constantly looking for ways to be more efficient, monopolies do not have this pressure. As a result, this lack of incentive to be more efficient can lead to x-inefficiency, or producing units at more cost than necessary. Another unfavorable characteristic of a monopoly can be rent-seeking behavior, which is shifting income or capital to themselves at the expense of society (McConnell, Brue, & Flynn, 2012).

Monopolies and oligopolies are not always dangerous for society. An example of a good monopoly would be the local electrical utility company, as the cost of this service is regulated by the government that encourages efficient production. The cost of having to run a generator 24 hours per day to provide electricity in the home, and then coupled with everyone in the city doing the same, would be incredibly expensive and very impractical. When a new product is invented, and that company receives a patent, that firm technically becomes a monopoly. The protection that patents provide inspires innovation, invention, research, and development. Pure monopolies that are unregulated can be dangerous. An example of a pure monopoly that was harmful was De Beers. At the pinnacle of its power, De Beers controlled the diamond industry by directing all resources and pressuring wholesalers and jewelers to accept its demands by crafting a false misconception that diamonds were rare, which insured the company huge profits for over a century. While diamonds are certainly not a necessity, buyers who did purchase diamonds had no idea how much profit De Beers was making (Mayer, 2010).

## Conclusion

While the government usually steps in to regulate or break-up monopolies and cartels are illegal in the United States, the four big tobacco companies are the exception to the rule. It is beneficial for the states to ensure that the big tobacco companies stay profitable, and states have imposed substantial fees or smaller competitors to make sure that happens. As a result, smaller rival companies are fighting back with filing lawsuits claiming that the tobacco cartel and the states have violated federal antitrust laws (Woolley, <https://assignbuster.com/americas-tobacco-cartel/>)

2004). Not all monopolies are detrimental, and some are good for society. Natural monopolies, such as public utility companies, are useful to society and cost efficient. Government regulation ensures this efficiency and dictates what public utilities can charge their customers. Firms that are awarded patents are another example of a monopoly that is beneficial. Patents protect inventors against rivals for 20 years, and they assist the patent holder in recouping some of their costs for research and development. Pure monopolies that are unregulated tend to be harmful as they restrict competition and charge whatever price the customers will pay. The price charged by pure monopolies in no way reflects the actual cost of production. Often these companies are forced to break up into competing firms or face regulation (Mayer, 2010).

#### Bibliography/References

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