

PHILIP MORRIS INTERNATIONAL

INTER-OFFICE CORRESPONDENCE

120 PARK AVENUE, NEW YORK, N.Y 10017

TO: Board of Directors

DATE: December 17, 1986

FROM: Andrew Whist

SUBJECT: Philip Morris International Corporate Affairs

This has been an emergent year for Philip Morris International Corporate Affairs, for two basic reasons. First, the issues we face -- taxation, marketing restrictions, environmental tobacco smoke (ETS) -- are now literally world-wide problems, and the anti-smoking groups use sophisticated tactics to attack us on these issues throughout the world. Secondly, we have mounted challenges to these attacks through information exchange, marshalling of all resources and the enactment of integrated, targeted programs. In New York, we continue to act as a resource for and initiator of programs, both globally and in specific markets too numerous to cover fully here.

Following are highlights of our activities in 1986 and plans for 1987:

TAXATION

Through Philip Morris efforts, the Dutch government revised its tax system to narrow the gap between roll your own and manufactured cigarettes. In addition, legislation restructuring the excise tax system and increasing the specific tax from 25% to 50% passed Parliament on December 9th. This will improve our margins particularly for our premium-priced brands like Marlboro.

In the Middle East, an announcement was made in October that Gulf Council Countries (GCC) Finance Ministers would "indefinitely postpone a GCC-wide duty increase on cigarettes".

The government in Hong Kong responded to Philip Morris pressure by narrowing the differential between duties on imported leaf and finished cigarettes, resulting in the smallest differential since 1983, significantly benefitting Philip Morris.

In Australia, a Taxation Committee, representing tobacco manufacturers and the Tobacco Institute of Australia (TIA) was established. It operated effectively in preparing submissions to state and federal governments which resulted in no increases in tobacco taxation at the federal level or in five of six states.

In Quebec, Benson & Hedges pressed the government to overturn its ad valorem system of taxation on tobacco products. This was achieved through private representations to the government and a petition drive which amassed the largest number of signatures ever in the province. And we got the Prince Edward Island government to abolish its 10 percent retail tax on tobacco products.

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In Brazil, we achieved a significant tax decrease. The political climate and continued controversy between the growers, unions and the government however, makes continued vigilance a necessity. In addition, on November 21, the government announced a substantial price increase. In 1987, our government relations activities in this country will be intensified so that we maintain our competitive position.

In the Nordic countries, our network of resources initiated a continuing effort to convert the Finnish tax system to a fully specific one.

In Morocco, the EEMA Region initiated a tax study which we expect will lead to structural changes in the future. And in Guatemala, a campaign was begun to prevent changes in the countries existing price/tax structure.

In Washington, DC, we convened a strategic planning group to analyze tax issues which included participants from all the regions and experts from several countries. We will intensify and expand our work on this issue in 1987.

MARKET ACCESS

Staff from Hong Kong and New York worked closely and cooperatively with the Washington Office in developing new strategies on trade issues and market access, strengthening our relationship with the U.S. Government, particularly the United States Trade Representative's office (USTR). The outcome will greatly enhance our business in Asia.

Most notable was the Japanese government's agreement to suspend the tariff on imported cigarettes. The agreement resulted from a coordinated strategy undertaken by Philip Morris in conjunction with other U.S. manufacturers, the USTR and other U.S. government agencies, as well as members of Congress.

In Taiwan, as a direct result of Philip Morris and industry pressure, the U.S. government undertook 12 months of negotiations which resulted late this year in an agreement which will open the market for imported American cigarettes in 1987.

Effective September 1, 1986, the government of Korea lifted its prohibition on the consumption of foreign cigarettes by Koreans and established a one percent import quota. This was more of a symbolic gesture than an act with any substance or practical benefit. It does present, however, both the need and opportunity for us to intensify our activity to fully open this market.

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GOVERNMENT RELATIONS

In South Australia, Philip Morris significantly watered down an anti-smoking tobacco products control bill, which would have required a total ban on smoking in taxis and long distance buses, a notice setting out the tar, nicotine and carbon monoxide yields of cigarettes to be displayed in retail outlets, a prohibition of the sale of cigarettes in packs of less than 20 and a health warning on all tobacco signs including those for sports and other promotions.

The new French government's agreement to allow an overall price increase for tobacco products of 7.5 percent was the result of a massive and prolonged effort which dates back to 1982. While not nearly enough, it is a first step that will be vigorously followed up.

Through the EEMA Region's efforts, the GCC Health Ministers Laboratory Specialist Committee made a unanimous recommendation to ban cigarettes of our competitors which cannot be properly tested in Gulf labs and delayed health warning and maximum constituent level labeling on cigarette packs. Rotating health warning labels and initiatives to ban advertising were also defeated.

We launched a successful challenge to the Swedish government's health warning label proposal, which resulted in changes to 7 out of 16 labels. In Algeria, Philip Morris efforts led to government approval for an attribution on health warning labels.

ENVIRONMENTAL TOBACCO SMOKE

During 1986, we hosted U.S. visits for 97 journalists from five countries. This activity will continue on an expanded scale in 1987 and focus more directly on the issue of environmental tobacco smoke. We will convene media briefings for journalists in Asia, Latin American, Europe and Australia as well as increase the number of foreign journalists we bring to the U.S.

In Canada, we overturned a federal adjudicator's ruling that ETS constitutes a workplace hazard.

In addition to developing a public advocacy campaign, including advertising to address this issue, we will continue to create scientific symposia dealing with ETS. A definitive study concerning ETS will be released by the Imperial College of the United Kingdom in March, 1987.

Employing U.S.-developed testing equipment, we will test air quality in selected international airlines throughout the world. As more equipment becomes available, restaurants, bars and hotels will be added to the sites to be tested. An international cadre of technicians is being developed to undertake the testing procedures which will be backed by institutions of international repute.

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With special attention on Japan, ETS will be the focus of our initiatives leading up to the 1987 World Health Organization's Smoking and Health Conference to be held in Tokyo.

RESTRICTIONS

In Australia, the manufacturers and TIA responded successfully to a proposed smoking ban on domestic airlines by rallying the chief executives of the major carriers. In addition, through ongoing contact with the heads of the restaurant, hotel, motel and licensed club associations in Victoria, an effort to place restrictions on smoking in restaurants was thwarted.

In Italy, Philip Morris responded to a sharp increase in proposed anti-smoking legislation by convincing the other importers of cigarettes to form a unified strategy, which included the setting up of a credible "Documentation and Information Center on Tobacco," intensive lobbying and a media campaign.

In the United Kingdom, Germany and the Netherlands we faced similar anti-smoking initiatives in 1986. Although the Voluntary Agreement on advertising negotiated between the industry and the British government is not satisfactory, it does leave the industry the right to advertise and promote a legal product.

In Argentina, the industry's voluntary advertising code was written into law, and the government accepted industry recommendations for mandatory health warning texts. A series of price increases was successfully negotiated as well.

In Guatemala, several campaigns against advertising and promotional restrictions are in the process of being developed. Through our manufacturers association, we have commissioned an economic impact study which will include not only cigarettes, but tobacco growing for export as well.

A law prohibiting tobacco advertising was passed in Ecuador but, after a mobilization of journalists from throughout Latin America and numerous international organizations, it was vetoed by the President. A similar bill was proposed in Peru, but was sent back to committee for reconsideration.

Additional legislation to ban tobacco advertising is pending in Costa Rica, but we believe this too will be defeated. We are now able, however, to sponsor sporting events. We have received the tacit approval of the Costa Rican government and are at present sponsoring several events.

In Venezuela, we were successful in stopping a detrimental, self-regulating advertising code, and are now negotiating a new one. Our work in Senegal resulted in a new advertising decree which reversed a total advertising ban.

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We anticipate that these issues will resurface in the coming year, but we are better prepared to meet the challenges than in prior years, having established the most effective corporate affairs team in the industry.

An imbalance exists, however, in industry affairs which requires attention and action. A priority objective for 1987 will be to promote greater industry cooperation, while encouraging our competitors to increase the size and effectiveness of their own corporate affairs units around the world.

BUILDING COALITIONS

In New York, we continued our successful political contact program through the America-European Community Association (AECA) and The New York Society for International Affairs. AECA was equally active in London, Paris and Amsterdam, and will continue to expand in other European countries in 1987.

Philip Morris has taken a leading role in the Philippine Chamber of Commerce, which is now chaired by Mr. Richard L. Snyder. We assisted with the highly successful U.S. visit made by President Aquino. Philip Morris International personnel now occupy key positions in a wide array of international organizations that can assist us in the years to come.

In Germany, we initiated a series of successful parliamentary discussion groups, bringing together members of the legislative and executive branches for presentations on industry issues.

In the GCC member countries, we have set up a major network of information sources and resources through which to lobby the appropriate officials.

In Canada, we orchestrated a national media tour by the U.K. leader of the Freedom Organization for the Right to Enjoy Smoking Tobacco (FOREST), which generated a large amount of favorable media coverage and led to the creation of a Canadian counterpart, Smokers Freedom Society.

In cooperation with Japan Tobacco Incorporated and other manufacturers, we have now established a Tobacco Institute of Japan. Moreover, in the past few years, national manufacturers associations have been established in some 36 countries.

PROMOTIONS

Each region conducted literally hundreds of local and regional promotions which ranged from art and music to academic awards and competitions. They are far too numerous to mention here. Most notable among the trans-national promotions was the Philip Morris Superband of jazz musicians who performed in Australia, the Philippines, Japan and Canada, and a special Marlboro Superband that performed in four cities in Spain.

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The Superbands received exceptional media coverage in each market, including television and radio "specials" in Australia, Japan and Spain.

We sponsored the Isamu Noguchi Exhibition at the Venice Biennale, the Paris Opera Ballet's visit to U.S. for the Statue of Liberty Centennial and the Alvin Ailey American Dance Theater's European Tour. In recent weeks, we have had several highly successful events in Turkey leading into our 1987 Philip Morris/Marlboro promotion of the Age of Sultan Suleyman the Magnificent Exhibition which opens at the National Gallery of Art in Washington in January.

CONCLUSION

Libertad, our program to address the issue of commercial free speech, advocacy advertising, media and other briefings on ETS, expansion of our initiatives on taxation, and meeting head on, the other attacks on our marketing freedoms, will form the basis of our activities in 1987. We are confident that with the mechanisms we now have in place and our on-going programs, we are in a good position to defend the company and our industry in 1987 and beyond.

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