



**BRITISH AMERICAN
TOBACCO**

Mr Karel De Gucht
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Brussels, 5th November 2013

Dear Commissioner,

Re: WTO violations under Japan's Tobacco Excise Tax Law and Tobacco Business Law

British American Tobacco ("BAT") has serious concerns with the consistency of the Japanese tobacco excise tax regime, as set forth in the Tobacco Excise Tax Law, as well as the Leaf Purchase Obligation ("LPO") and retail list price approval system provided for in the Tobacco Business Law, with Japan's obligations under the World Trade Organization ("WTO") Agreements. These measures distort the conditions of competition to the benefit of the sole Japanese producer, Japan Tobacco Incorporated ("JT"), and serve to ensure unwarranted protection to the Japanese tobacco industry at the expense of imports from the European Union. The absence of predictability and transparency negatively affects the ability of Union producers to export tobacco products into Japan. These concerns should be raised by the EU during the next EU-Japan Summit in Tokyo on 19 November 2013.

The EU and Japan are negotiating an ambitious free trade agreement covering, in particular, the progressive and reciprocal liberalization of trade in goods. Within the framework of these negotiations, it is essential that non-tariff barriers, such as the ones maintained by Japan on the tobacco sector be addressed. A free trade agreement with Japan will only benefit Union industries if all the measures that negatively impact the access of Union producers and exporters to the Japanese market, in violation of Japan's existing trade obligations, are previously removed.

The Tobacco Excise Tax Law and the Tobacco Business Law were jointly adopted in 1984 to reorganize the tobacco market in Japan following the termination of the monopoly system. Pursuant to the first article of the Tobacco Business Law, this reorganization was intended "to foster the sound development of the Japanese tobacco industry". The protection granted to the domestic industry is highlighted by the specific rights and obligations JT enjoys under the Tobacco Business Law, including the exclusive right to manufacture tobacco products locally, and the control exercised by the government of Japan in JT. Also, as evidenced by the recent guidance issued to JT and distributors of tobacco products regarding the increase in prices to reflect the increase in the consumption tax, authorities in Japan continue to play an active role in setting approved prices and significantly influence the market.

The Tobacco Excise Tax Law imposes a two-tier excise tax system. Cigarettes are subject to a specific excise tax of 5,302 Yen per mille but cigarette brands that were formerly classified as "Third Grade" brands are subject to a much lower specific excise tax of 2,517 Yen per mille. The Third Grade brands to which this exceptional and favorable tax rate applies are all produced by JT. The excise tax preference has allowed Third Grade brands to double their market shares, at the expense of imported cigarette brands, between 2010 and 2012. Japan's two-tier tax system, by favoring domestic former Third Grade brands over like imported brands, is inconsistent with the national treatment principle set forth in Article III:2 of the General Agreement on Tariff and Trade (GATT) of 1994. Japan could comply with Article III:2 by ensuring that the preferential excise tax rate also applies to imported brands.

British American Tobacco Representation Brussels

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The Tobacco Business Law requires JT to conclude advance contracts for the purchase of domestically-grown tobacco leaf with all Japanese tobacco growers. The contracts between JT and domestic tobacco growers are concluded after consultation of the Tobacco Leaf Advisory Council, a body that exists within JT and that is composed of growers' representatives and individuals with academic experience approved by the Ministry of Finance. The LPO is also inconsistent with Japan's national treatment obligations. It violates GATT Article III:4 as it accords imported tobacco leaf treatment less favorable than domestic tobacco. In addition to violating Article III:4, the LPO scheme could be considered an actionable subsidy under the WTO Agreement on Subsidies and Countervailing Measures ("SCM Agreement") if JT is required to purchase domestically grown tobacco leaf for more than adequate remuneration and the effects of the LPO are adverse to the interests of WTO Members.

The tobacco Business Law also requires JT and distributors of imported tobacco products, including BAT, to have the retail price of their tobacco products approved by the Ministry of Finance prior to importation. To date, Japan has not published the rules regarding all the conditions that must be satisfied for a retail list price to be approved. The absence of published rules makes it impossible for distributors of tobacco products imported into Japan and other directly affected economic operators to predict the outcome of requests for price/price change approval. This absence of predictability and transparency negatively affects imports of tobacco products into Japan. By failing to publish all the rules regarding the conditions regarding the approval of retail list prices and changes to these prices Japan violates its obligations under Article X:1(1) of the GATT.

BAT has brought to the attention of the Commission services the absence of consistency of Japan's Tobacco Excise Tax Law and Tobacco Business Law with Japan's obligations under the WTO Agreements and the limits that the measures in force impose on the Union industry in seeking to introduce new brands and revise price levels on the Japanese market. BAT would welcome a meeting with your Cabinet to present in more detail the restrictions it faces in Japan.

BAT thanks you for the consideration of this very important matter and trusts that you will continue to raise the serious concerns of the EU with Japan's tobacco laws with your Japanese counterpart in bilateral settings and, where appropriate, multilateral fora such as the WTO. Japan must comply with its international trade obligations for any free trade agreement to benefit the EU industry.

We look forward to hearing from you and have attached a detailed paper which has also been shared with the Commission services.

Yours sincerely,



Cc. Jean-Luc Demarty - Director General
M. Petriccione - Director
D. Juul-Joergensen - Director