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Report Highlights: Japan's domestic leaf production in 1998 was 63,960 tons, down 4,544 tons (6.7%) from the previous year. The crop area for the 1999/2000 season is expected to drop below the traditional landmark of 25,000 hectares for the first time in recent history. Japan imported 101,442 tons of tobacco leaf in 1998, up 31% from the previous year, and the U.S. share was 43,800 tons, up 41%. The shift in consumer preferences toward cigarettes with lower tar and nicotine content continued throughout 1998. Further, the policy debate about the hazards of smoking continues to intensify. In March 1999, Japan Tobacco (JT) bought RJR Nabisco Corporation's international cigarette manufacturing operations to become the world's 3rd largest producer, putting the company in a stronger position of producing/exporting cigarettes from abroad.

Includes PSD changes: Yes
Includes Trade Matrix: Yes
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Executive Summary

In 1998, as a result of poor weather, Japan's domestic leaf production, in terms of the farm sales weight, was 63,960 tons, down 4,544 tons (6.7%) from the previous year. In a chronic downtrend of Japan's farm labor available, the number of tobacco farmers employed to produce this volume of crop in 1998 also declined by 1,493 (5.5%) to 25,517, down from 27,010 in the previous year. According to a survey by the association of tobacco grower groups as of April 1999, the actual crop area for the 1999/2000 season is expected to drop below the traditional landmark of 25,000 hectares for the first time in recent history due to a lack of tobacco farmer incentives to produce and contract farming.

In March 1999, JT announced a major business acquisition, reporting that, for the price of US\$7.8 billion, JT bought RJR Nabisco Corporation's international cigarette manufacturing operations, one of the top U.S. cigarette producers. This announcement represented a major purchase by JT, but was one of many business acquisitions JT has made in recent years in an intense business diversification strategy that covers sectors such as foods, soft-drinks, pharmaceuticals, biogenetics industry and farm products.

With acquisition of the international cigarette manufacturing operations of RJR Nabisco, JT became the world's 3rd largest producer of cigarettes, next only to Phillip Morris and BAT. Furthermore, JT is now in the position to manufacture and market world-wide far more cost-competitive cigarettes than available at home to the extent where it could eventually import, economically, the products into Japan.

During 1998, 257.6 billion cigarettes of JT's domestic production were sold in 1998, up 1.2% from previous year. Sales of imported brands, on the other hand, totaled 79 billion, up 7.5% from previous year, and attained the market share of 23.5%, up 1.1 point from 1997. In terms of retail value in Yen, imported brands exceeded the benchmark of 1 trillion Yen for the first time in the history of the imported cigarette business, posting 1,002.8 billion Yen.

The shift in consumer preferences toward milder cigarettes with increasingly lower tar and nicotine content, with an average content of 8.4 mg for tar and 0.72 mg for nicotine as of 1997, continued throughout 1998. In the most recent policy development, a consensus evolved among policymakers representing JT, tobacco growers and the Liberal Democratic Party to develop a new pricing program, made official at the April 28th meeting of Tobacco Deliberations Council for implementation, starting next year.

Social and restrictive pressures against smoking in Japan, particularly in open public places and transportation systems as well as teenage smoking, continued to grow throughout the country. The voluntary retail industry restraint, initiated in April 1996, not to operate outdoor cigarette vending machines between 11.00 PM and 6.00AM has been strictly and successfully observed. There are signs that more restrictive legal requirements to regulate cigarette sales may soon evolve.

Japan imported 101,442 tons of tobacco leaf in 1998, up a whopping 31% from previous year. The U.S. share was 43,800 tons, up 41%. Total new supply of leaf, consisting of the new domestic crop and total imports, was 159,482 tons in 1998, with Japan's total imports accounting for 63.6% and U.S. exports to Japan alone comprising 43,800 tons for 43%. Over the long term, the forecast is that imported leaf will continue to replace domestic production due to Japan's consistently shrinking tobacco farming sector.

-Tobacco, Unmfg., Total

PSD Table						
Country: Japan						
Commodity: Tobacco, Unmfg.						
	1996		1997		1998	
	Old	New	Old	New	Old	New
Market Year Begin	01/1996		01/1997		01/1998	
Area Planted	26057	26057	25662	25662	26214	25276
Beginning Stocks	370251	370251	318049	318049	280235	288171
Farm Sales Weight Prod	66031	66031	68504	68504	67100	63960
Dry Weight Production	59900	59900	62020	62020	61000	58040
U.S. Leaf Imports	35747	35747	38322	38322	38500	43800
Other Foreign Imports	49887	49887	52147	52147	53000	57642
TOTAL Imports	85634	85634	90469	98405	91500	101442
TOTAL SUPPLY	515785	515785	470538	478474	432735	447653
Exports	486	486	6203	6203	2500	163
Dom. Leaf Consumption	77750	77750	74100	74100	70500	71250
U.S. Leaf Dom. Consum.	58000	58000	55500	55500	53000	53900
Other Foreign Consump.	61500	61500	54500	54500	54000	55500
TOTAL Dom. Consumption	197250	197250	184100	184100	177500	180650
TOTAL Disappearance	197736	197736	190303	190303	180000	180813
Ending Stocks	318049	318049	280235	288171	252735	266840
TOTAL DISTRIBUTION	515785	515785	470538	478474	432735	447653

PRODUCTION

Purchasing for 1998 domestic crops of tobacco leaf by Japan Tobacco, Inc.(referred to hereunder as JT), Japan's only legally authorized buyer of tobacco leaf, started in Oninawa Prefecture on July 23,1998 and ended in Yamagata Prefecture on February 16,1999.

Tobacco farms in Japan, particularly in the southern Kyushu Island, are chronically vulnerable each year to damage from tropical typhoons and weather abnormalities, often resulting in the loss of yield and poor quality of crops. Last year was such a year. Abnormally high temperature lasting for a few weeks, followed by protracted precipitation and a combination of a lack of sunlight and low temperature which prevailed throughout Kyushu in May through June last year, resulted in the widespread immature death and/or illness of young leaf during the growing season and the serious loss of crop yield.

As a result of poor weather, 1998 domestic leaf production, in terms of the farm sales weight, was 63,960 tons, down 4,544 tons (6.7%)from the previous year. In a chronic downtrend of Japan's farm labor available, the number of tobacco farmers employed to produce this volume of crop in 1998 also declined by 1,493 (5.5%) to 25,517, down from 27,010 in the previous year.

Crop Area

The 1998 crop area was 25,276 Ha (hectares), down 386 Ha. from the previous year and down 781 Ha. from two years before. During 1999, the official total planting area was 25,725 Ha., but according to a survey by the association of tobacco grower groups as of April 1999, the actual crop area for the 1999/2000 season is expected to drop below the traditional landmark of 25,000 hectares for the first time in recent history due to a lack of tobacco farmer incentives to produce and contract farming.

This downward trend represents a significant change for Japan. Since 1985, when cigarette imports were liberalized and production privatized in JT's hands as Japan's exclusive producer, a "gentlemen's agreement" had existed between tobacco growers and JT. This agreement required (1) that Japan's domestic tobacco crop area be maintained at over 25,000 Ha. each year, and (2) that at least 50% of JT's leaf requirements be sourced from Japanese domestic growers. Thus, this downtrend in crop area symbolizes a breakdown of and departure from the stabilization program for leaf supplies built into Japan's traditional leaf sourcing program.

There are historical and economic factors behind this downtrend trend of domestic leaf. The lack of farm successors and their rapid aging, as well as a lack of economic incentives to produce, continue to be the key constraints to securing an adequate future supply of farm labor for tobacco growing.

Tobacco Deliberations Council, Japan's tobacco policy-setting group consisting of 11 representatives from JT, leaf growers and academic/business experts in the private sector, approved of the total crop area of 25,725 Ha portion of the 1999 production plans, as shown in the following table by type of leaf.

CROP AREA BY TYPE OF LEAF TOBACCO(Hectares)				
Leaf Type	1997		1998	1999 1/
	Actual	Target	Actual	Target
Flue-Cured 2/	17,397	17,714	17,195	17,443
Burley 3/	7,836	8,061	7,694	7,892
Light Air-Cured 4/	429	439	387	390
TOTAL	25,662	26,214	25,276	25,725 5/

(Source: Japan Tobacco Inc.)

1/ Target planting area authorized by Tobacco Deliberations Council.

2/ Consisting of 4 types of leaf.

3/ Consisting of 2 types of leaf.

4/ Consisting of 3 types of leaf.

5/ Representing the following breakdown by prefecture and crop area(Hectares).

Iwate Pref.	- 5,360	Kagawa Pref.	- 1,551
Fukushima Pref.	- 4,226	Kumamoto Pref.	- 4,931
Niigata Pref.	- 2,162	Kagoshima Pref.	- 4,735
Okinawa Pref.	- 1,338	Okinawa Pref.	- 1,338

Yield

In contrast to performance in the previous year when the leaf production and yield posted 3.7% and 5.5% growth respectively over the year before, 1998 production declined 6.6% and yield 5.2% from 1997, as shown in the table below.

For outlook on performance during the 1999/2000 growing season, uncertainty remains due to weather conditions and the potential risk of another natural disaster, but other than a sizable drop in the crop area planned, indications are that no significant yield growth can be anticipated.

PRODUCTION AND YIELD PER HECTARE FOR JAPANESE LEAF TOBACCO (Units: Production-Metric Tons; Yield: Kilogram/hectare)				
	1997		1998	
Leaf Type	Farm Production	Yield 1/	Farm Production	Yield 1/
Flue-Cured	45,534 MT	2,620 Kg.	42,464 MT	2,470 Kg. 2/
Burley	21,839 MT	2,790 Kg.	20,458 MT	2,660 Kg. 3/
Light Air-Cured	1,131 MT	2,630 Kg.	1,038 MT	2,680 Kg. 4/
TOTAL	68,504 MT	2,670 Kg.	63,960 MT	2,530 Kg.
% Growth	+3.7%	+5.5%	-6.6%	-5.2%

(Source: Japan Tobacco Growers Association)

1/ Weighted average yield per hectare.

2/ Consisting of 4 types of leaf.

3/ Consisting of 2 types of leaf.

4/ Consisting of 3 types of leaf.

In terms of Japan's largest tobacco producing regions in 1998, Miyazaki Prefecture came out as the largest producer, as it did in the previous year, followed by Kumamoto Prefecture 2nd, Kagoshima Prefecture 3rd, Iwate Prefecture 4th and Fukushima Prefecture 5th.

Production Policy

With Japan's cigarette production monopolized in JT's hands as an exclusive domestic manufacturer and the legal requirement that all domestic crops are purchased by JT each year, securing an adequate crop area, farm labor and providing an effective economic incentive for tobacco farmers have always been the core issues of tobacco production policymakers in Japan. Most critical of these strategic issues, however, has been the subject of devising a fair and viable pricing mechanism for tobacco leaf acceptable to both tobacco growers and to JT as an exclusive buyer of their crops.

With JT arguing the importance of pursuing productivity improvements in Japan's tobacco farming and greater cost-competitiveness of domestic crops, they are obliged to buy imported cigarettes, in the face of growing market competition, on one hand, and domestic growers, on the other, constantly pressing for better prices, supported by their strong political lobby, the need for a revised and fairer pricing mechanism has been recognized and debated by both groups in numerous fora in the past but never to a mutually satisfactory conclusion. In the most recent development, however, a consensus evolved among policymakers representing JT, tobacco growers and the Liberal Democratic Party to develop a new pricing program, made official at the April 28th meeting of Tobacco Deliberations Council for implementation, starting next year.

This proposed pricing mechanism consists of the following elements.

- 1) A new formula for cost calculations will be established, incorporating a mutually agreed-upon "basic, standard yield benchmark" and any productivity gain over and above this benchmark by growers will be identified and refunded to the growers in the form of a monetary benefit.

Based on the value of an "appropriate yield" traditionally agreed upon between JT and the growers as an ideal balance of yield and good crop quality, the value of 267 Kg/Ha will be used as the benchmark for a fixed term of 3 consecutive years, subject to revision in later years, depending on changes in the production cost variables.

- 2) A new subsidy program will be launched as an incentive to encourage tobacco farmers to grow better-quality leaf.
- 3) For production of the Burley and Light Air-Cured leaf requiring more time-consuming labor than the Flue-Cured type of leaf, a straight extra payment of 30,000 Yen/Ha cropped will be made for tobacco farmers. Note: Approximately 100 more hours of labor than for the Flue-Cured leaf are reportedly required to grow Burley and Light Air-Cured leaf per hectare, and approximately 13,000 tobacco growing family farmers in 6 prefectures of Japan's Tohoku region will qualify for this extra payment.

Prices

While JT's basic pricing guideline for 1998 crops had been determined to remain flat for the 10th consecutive year in a row, JT's actual and average pricing, based on such variable factors as type and crop quality of the leaf, grade and yield, was 1,850 Yen per Kg., down 2.5% from the previous year.

The history of JT prices by leaf type follows.

AVERAGE PURCHASE PRICES BY TYPE OF LEAF (Yen per Kilogram; Farm Sales Weight Basis)					
Crop Year	Flue-Cured	Burley	Light Air-Cured	Average	Yr./Yr. Change
1998	1,916	1,721	1,870	1,853	-2.5%
1997	1,974	1,745	1,950	1,901	+1.5%
1996	1,949	1,718	2,008	1,872	-3.6%
1995	2,011	1,789	2,055	1,941	-0.7%
1994	2,048	1,761	2,061	1,955	+2.8%
1993	1,979	1,749	2,051	1,901	-3.5%
1992	2,032	1,809	2,161	1,969	+5.2%
1991	1,931	1,721	2,131	1,872	+0.9%
1990	1,937	1,656	2,060	1,854	+0.8%
1989	1,940	1,570	2,060	1,840	-

(Source: Japan Tobacco Growers Association)

CONSUMPTION

Information on JT's actual leaf tobacco consumption for cigarette production and inventory level requirements remains proprietary and cannot be confirmed.

However, indications are that the annual leaf consumption and year-end inventory level for tobacco leaf fluctuates around 200,000 metric tons a year. Post estimates that 35% to 40% of JT's total consumption is comprised of domestic-grown leaf, with the balance coming from imports. Over the long term, the forecast is that imported leaf will continue to replace domestic production as a major share of their raw material requirements, due to Japan's consistently shrinking tobacco farming sector.

TRADE

As indicated in the tables below, Japan imported 101,442 tons of tobacco leaf in 1998, up a whopping 31% from previous year. The U.S. share was 43,800 tons, up 41%. Total new supply of leaf, consisting of the new domestic crop and total imports, was 159,482 tons in 1998, with Japan's total imports accounting for 63.6% and U.S. exports to Japan alone comprising 43,800 tons for 43%.

While much depends on such variable factors as the future of domestic supply, currency exchange rates, Japanese cigarette market demand and, most noticeably, the currently growing market penetration of manufactured imported cigarettes, it is estimated that the importance to JT of imported leaf will increase for the foreseeable future.

Japan's export of leaf tobacco in 1998 was only 163 tons, down from 486 tons in 1996 and 6,203 tons of the previous year, with the destinations for these export shipments confined mostly to only a small number of countries. Information on the nature of these widely fluctuating exports is not immediately available, but no significant export growth is anticipated in 1999.

Import Trade Matrix			
Country: Japan		Units: Metric Tons	
Commodity: Tobacco, Unmfg., Total			
Time period: Jan-Dec			
Imports for	1996		1997
U.S.	34907	U.S.	44991
Others		Others	
Brazil	16836	Brazil	20321
Zimbabwe	7021	Malawi	7269
Malawi	5769	Zimbabwe	6387
Greece	5225	Greece	4146
Turkey	3145	Turkey	3163
Italy	2461	Italy	2475
China	1663	China	1997
Thailand	1009	Thailand	1114
Macedonia	783	Argentina	840
Argentina	397	Macedonia	547
Total for Others	44309		48259
Others not listed	6418		5155
Grand Total	85634		98405

Export Trade Matrix			
Country: Japan		Units: Metric Tons	
Commodity: Tobacco, Unmfg., Total			
Time period: Jan-Dec			
Exports for	1996		1997
U.S.	1	U.S.	1
Others		Others	
Australia	484	Belgium	2848
Kuwait	1	Canada	2042
		Egypt	996
		Malaysia	202
		Australia	100
Total for Others	485		6188
Others not listed			14
Grand Total	486		6203

POLICY

As Japan's authorized monopoly for manufacture of cigarettes, JT continues to dominate Japan's leaf tobacco consumption. The possibility of ending JT's monopolization of the cigarette manufacturing business, by allowing other producers in Japan, has been raised by members of Japan's national legislature (Diet) over the years, but has not received serious attention.

There is no specific trade barrier to leaf tobacco that can be identified, and the product enters Japan duty-free.

JT's Acquisition of RJR-Nabisco's International Operations

In March 1999, JT announced a major business acquisition, reporting that, for the price of US\$7.8 billion, JT bought RJR Nabisco Corporation's international cigarette manufacturing operations, one of the top U.S. cigarette producers. This announcement represented a major purchase by JT, but was one of many business acquisitions JT has made in recent years in an intense business diversification strategy that covers sectors such as foods, soft-drinks, pharmaceuticals, biogenetics industry and farm products. The significance of this management decision lied in the implications, as reported in the media, that acquisition of the U.S. firm's existing facilities, reportedly enjoying greater cost-competitiveness than JT in their raw material leaf used and operating facilities, was considered to be the most realistic and strategic business decision for JT. The company faces chronic problems over procurement of more cost-competitive tobacco leaf domestically and the lack of assurance about the supply stability for domestic leaf.

In 1997 Japan exported 12.5 billion pieces of cigarettes, up 5.8% from previous year. Last year, however, the export volume was 11 billion, down 12% from previous year, due perhaps to the loss of Japanese cigarette's export-cost competitiveness in the overseas markets, resulting from Yen's depreciation during the last year on the world currency markets, among other factors. It has been reported that, with a direct access to cost-

competitive manufacturing operations overseas, JT could enhance its competitive position internationally in its export cigarette markets and that they might even import cigarettes produced in JT's new overseas plants back into Japan's domestic market.

In December, 1998, Mr. M. Mizuno, JT's president and chief executive officer, appeared in a press interview, addressing many of these management strategy issues facing his company. The gist of his comments, indicative of Japan's current tobacco industry situation and policy issues, follow (Source: The Yomiuri Shinbun; Dec.13,1998).

C Regarding impact of the repeated price hike on cigarettes, effective April 1997 and December 1998

"The price hike we had to implement last year on our products was 10 Yen per pack and we deliberately chose certain brands to be marketed at the new, higher prices. This year, the price hike is 20 Yen per pack and we are afraid our cigarette sales may be adversely impacted. Foreign cigarette producers, on the other hand, have strategically taken no price action or deliberately limited the range and scope of price hike and, in the light of a slow but steady downturn in the market demand, they present to us a serious and challenging competition."

C Regarding higher costs of domestically procured tobacco leaf, compared to more cost-competitive raw material leaf available to JT's foreign competitors in Japan;

"JT's purchasing cost for domestic crops of leaf tobacco has remained the same for the last 10 years, and these leaf cost JT 3 or 4 times as much as leaf available to U.S. producers. Foreign cigarette producers enter Japan duty-free and enjoy all the benefits of a totally liberalized market for product distribution with an unmistakable competitive edge."

"60% of the raw material leaf used by JT for cigarette production comes from imports already and, in order to encourage our domestic farmers to keep growing tobacco with assurances for their revenue, however, JT cannot afford to cut back prices for their crops so easily. For this reason, it is of critical importance to seek productivity improvements for cost-cutting in our manufacturing operations, however challenging it may be."

C Regarding JT's marketing strategy for the U.S. market;

"The U.S., along with China and Eastern Europe, are the world's leading markets for cigarette consumption and is way ahead of Japan in the manufacturing, distribution and marketing sectors. The export share of most U.S. cigarette producers is 40% or higher, with Japan serving as their largest overseas market. Since their Japan market share is growing, JT also needs to strengthen its position in the U.S. market. We plan to expand business in China as well."

C Regarding the status of JT's business diversification strategy beyond the cigarette business;

"Japanese population growth will peak out before long and there is a limit to the significant growth potential of cigarette market demand. Some of the foreign producers earn as much as 50% of their sales revenue from non-cigarette businesses, such as foods and financial services. JT's business diversification plan is intensely under way also and it will continue to grow."

-Tobacco, Mfg. Cigarettes:**PSD Table**

PSD Table						
Country: Japan						
Commodity: Tobacco, Mfg., Cigarettes						
	1996			1997		1998
	Old	New	Old	New	Old	New
Market Year Begin	01/1996		01/1997		01/1998	
Filter Production	269673	269673	253321	253321	248750	186851
Non-Filter Production	1359	1359	1246	1246	1250	1199
TOTAL Production	271032	271032	254567	254567	250000	188050
Imports	77293	77293	73448	77516	73000	80560
TOTAL SUPPLY	348325	348325	328015	332083	323000	268610
Exports	11780	11780	12468	12468	12000	11010
Domestic Consumption	336545	336545	315547	319615	311000	257600
TOTAL DISTRIBUTION	348325	348325	328015	332083	323000	268610

PRODUCTION

As is the case with information on JT's actual leaf consumption, JT's cigarette production data are not officially available. According to available data, however, it is estimated that 1998 production decreased substantially from previous year to 188 billion pieces, down 25% or so.

Because of the changing market preference, continuing for some time now, the share of non-filter production kept on shrinking in magnitude, sharing less than 1% of the total production. This downtrend is expected to continue into this year.

CONSUMPTION

According to the Tobacco Institute of Japan, an international trade association of Japan Tobacco and foreign cigarette producers in business in Japan, 257.6 billion cigarettes of JT's domestic production were sold in 1998, up 1.2% from previous year. Sales of imported brands, on the other hand, totaled 79 billion, up 7.5% from previous year, and attained the market share of 23.5%, up 1.1 point from 1997. In terms of retail value in Yen, imported brands exceeded the benchmark of 1 trillion Yen for the first time in the history of the imported cigarette business, posting 1,002.8 billion Yen. This was up 8.7% from previous year, while JT's domestic brands grew only 3.8% to 3,087 billion Yen.

According to JT, 2 price hikes implemented for cigarette retail in April 1997 and December 1998 are inevitably expected to further slow down sales of its own domestic productions and, for the current year, it is anticipated that sales will decline 3.7% (approx. 9.5 billion pieces) to 248 billion pieces. Increasing competition from imported brands on the Japanese cigarette market is also considered a formidable factor against further market penetration.

The shift in consumer preferences toward milder cigarettes with increasingly lower tar and nicotine content, with an average content of 8.4 mg for tar and 0.72 mg for nicotine as of 1997, continued throughout 1998. Most noteworthy is the finding in another trade survey that the market share of cigarettes with less than 3mg of tar has grown from 13.2% in 1996 to 15.6% in 1997 and then, up to 17.6% in 1998. Of those products in this category with less than 3mg of tar content, growth in the market share of brands with 1 mg of tar content was most remarkable, increasing from 8.4% in 1996 to 9.9% in 1997 and achieving 11% in 1998. This trend is an indication of Japanese smokers' growing sense of health-consciousness, stimulated by growing social pressures against smoking as a serious health hazard. This market trend is expected to continue for the foreseeable future.

JAPAN'S CIGARETTE CONSUMPTION BY YEAR, VOLUME & VALUE (Volume-Billion p'cs : Value-Billion Yen/Japanese Fiscal Year: Apr.-Mar.)				
Year/ Domestic Vs. Imports	Volume		Value	
	Sold	% Change	Sold	% Change
1998	336.6	+2.6%	4,089.9	+4.9%
Domestic:	257.6	+1.2%	3,087.0	+3.8%
Import	79.0	+7.5%	1,002.8	+8.7%
Share(23.5%)				
1997	328.1	-5.8%	3,897.1	-2.5%
Domestic:	254.6	-5.9%	2,974.3	-2.8%
Import	73.5	-5.4%	922.8	-1.9%
Share(22.4%)				
1996	348.3	+4.1%	3,999.2	+4.3%
Domestic:	270.6	+2.6%	3,058.6	+2.9%
Import	77.7	+9.4%	940.7	+9.2%
Share(22.3%)				
1995	334.7	+0.1%	3,832.7	+0.4%
Domestic:	263.7	-1.9%	2,971.6	-1.5%
Import	71.0	+8.4%	861.1	+7.6%
Share(21.2%)				
1994	334.4	+0.5%	3,818.3	+0.9%
Domestic:	268.9	-1.5%	3,018.0	-1.0%
Import	65.5	+9.7%	800.3	+9.2%
Share(19.6%)				
1993	332.6	+1.1%	3,781.7	+1.6%
Domestic:	272.9	+0.1%	3,049.0	+0.7%
Import	59.7	+6.2%	732.8	+5.8%
Share(17.9%)				
1992	328.9	+0.2%	3,721.6	+0.7%
Domestic:	272.7	-0.5%	3,029.3	+/-0%
Import	56.2	+3.6%	692.4	+3.7%
Share(17.1%)				
1991	328.3	+2.0%	3,696.5	+2.8%
Domestic:	274.1	+1.2%	3,028.9	+2.0%
Import	54.2	+6.1%	667.6	+6.8%
Share(16.5%)				

(Source: Tobacco Institute of Japan)

According to JT's market survey, conducted each year by statistical sampling method, approximately 770,000 smokers quit smoking in 1998. Ex-smokers consisted of 220,000 men and 550,000 women and represented a consistent slide in the total smoking population combining both sexes, continuing for 3 years in a row. Female smokers posted the first shrinkage in number in 2 years and the shrinkage in male smokers represented a year-to-year decline continuing for 7 years in a row, as shown in the table below.

JAPAN'S SMOKING RATE AND POPULATION 1/						
Year	Smoking Rate(%) 2/			Smoking Population (10,000) 3/		
	Male	Female	Total	Male	Female	Total
1998	55.2	13.3	33.6	2,647	681	3,328
1997	56.1	14.5	34.6	2,669	736	3,405
1996	57.5	14.2	35.1	2,708	714	3,422
1995	58.8	15.2	36.3	2,736	755	3,491
1994	59.0	14.8	36.2	2,716	727	3,443
1993	59.8	13.8	36.1	2,719	670	3,389
1992	60.4	13.3	36.1	2,712	637	3,349
1991	61.2	14.2	36.9	2,715	672	3,387
1990	60.5	14.3	36.7	2,651	668	3,319
1989	61.1	12.7	36.1	2,643	587	3,230

(Source: Japan Tobacco Inc.)

1/ Based on analysis of 11,255 respondents(70.3% response ratio) to JT's survey in May 1997.

2/ Statistical average rate.

3/ Statistical estimation.

POLICY

Three key policy developments stand out for the near-term.

(1) Debate on smoking as a public health hazard:

Meetings of the 17-member group of professional experts, called the "Committee to Explore Measures On Smoking in the 21st Century", commissioned in early 1998 by the Japanese Ministry of Health and Welfare to deal with issues of smoking as a public health hazard, continued thereafter and the group announced a final report August 31, 1998, summarizing pro and con comments and issues debated during 8 meetings of the

Committee on the need to regulate smoking. Controversial in nature, the group has not drawn any conclusion in its final report but disclosure of the agenda and issues pursued by this task force group was indicative enough of what was to be expected in the near future: a legal and regulatory program to restrict smoking and identify the health risk involved in smoking.

Some of the issues debated and disclosed in the report:

c Overall background

The issue of legally regulating smoking, basically a matter of personal, individual taste, was debated as essentially a bad practice but, on the other hand, the argument that the Ministry of Health and Welfare, with a distinct responsibility for ensuring public health, has a natural obligation to take a preventive administrative action against smoking as a public health hazard, was shared by all as a legitimate government task.

c Measures to prevent and/or minimize smoking

The need to prevent and/or minimize smoking by the public, by minors in particular, was agreed upon by all members. In support of this goal, marketing of cigarettes by vending machines, mass-media advertising and sales promotion practices and methods were debated. The fact that, under the Japanese tobacco legislation, any new cigarette retailer must have a vending machine installed adjacent to his place of business and that, since April 1998, no mass media advertising (i.e. radio, TV) is implemented and that no vending machine is placed in operating conditions after 11pm by retailer initiatives were reported as steps in the right direction.

c Designation of smoking area

The idea and widespread practice of designating an area for smoking in offices and public places was applauded by all members as a program to be expanded even further. Pro-active education for smokers was considered essential against bad smoker manners in public and a concern was expressed by some as to the adequacy of smoking area designation in terms of protecting non-smokers against the risk of secondary smoking.

c Costs of promoting a program to restrict smoking in designated area

Substantial costs involved in promoting this program in other places and facilities of public interest were pointed out, resulting in a suggestion by some members that they should be passed on ultimately to cigarette producers and smokers in the form of greater cigarette taxes or prices.

c Dissemination of Risk Information

Cigarette producers' practice of posting on the cigarette packages no information other than an average tar and nicotine content was criticized as one-sided and inadequate. Greater disclosure of information on other chemical substances involved and potential risk to health was suggested as critical in the future to allow smokers maximum risk information.

(2) Impact of escalating cigarette taxes on the market demand

A series of tax reform legislation for permanent tax cuts affecting Japanese income, residence, corporate and property taxes, enacted by the Japanese legislature in 1997 through 1998 primarily to deal with issues of reviving a depressed and recessionary economy, have resulted in a substantial shrinkage of tax revenue not only for the central government, but for prefectural and local governments already impacted severely by loss of traditional tax revenue resulting from negative economic growth. As a result, a new act was enacted to authorize a change in the distribution of cigarette tax revenue, revising respective revenue shares of the central government and local governments (i.e. prefectures, municipalities, townships) in a shift from the traditional 50/50% to 43/57% in favor of the local governments. This newly legislated distribution of cigarette tax revenue is to be implemented, by law, starting May 1, 1999.

Of greater concern to the industry than this new distribution of tax revenue, however, in terms of a potentially negative impact on the future of market demand, was a series of cigarette tax hikes since 1997, causing manufacturers to raise cigarette retail prices in order to pass on the added tax burden to the market. When the Japanese sales tax was raised from 3% to 5% in April, 1997, cigarette manufacturers were forced to raise their retail prices but, as a result of another piece of new legislation, they are now required, effective December 1, 1998, to pay the so-called "special tax" devised to help pay for huge indebtedness of the now-insolvent Japan National Railroad System and of the government-owned National Forestry, as illustrated in the table below.

10-Year History of Cigarette Tax Burden (Yen per Pack/20 pieces)				
Payable To:	Effective Dates			
	Apr. 1, 1989	Apr. 1, 1998	Dec. 1, 1998	May 1, 1999
Central Gov't:	62.52	62.52	62.52	54.32
Local Gov'ts: 1/	62.52	62.52	62.52	70.72
("Special Tax")	-	-	16.40	16.40
Total Tax Burden:	125.04	125.04	141.44	141.44

(Source: Japan Tobacco, Inc.)

1/ Municipalities, townships, villages.

Because of these added tax burdens, retail prices for most cigarette brands on the market, both domestic and imported, were raised by 10 Yen in 1997 and 20 Yen per pack in 1998 respectively. While retail sales posted 2.6% growth over the previous year in Japanese fiscal year 1998 (i.e. April '98-March '99), it is estimated that, sooner or later, these price actions will inevitably help slow down sales.

(3) JT's overseas strategy in cigarette production and export

With acquisition of the international cigarette manufacturing operations of RJR Nabisco, JT is expected to be the world's 3rd largest producer of cigarettes, next only to Phillip Morris and BAT. Furthermore, JT will be in a position, as a result of its new overseas business venture, to manufacture and market world-wide far more cost-competitive cigarettes than available at home to the extent where it could eventually import the products into Japan.

Implications of such a development with the Japanese exclusive manufacturer of cigarettes, still owned 60% in stock by the government, are far-reaching and would be worthy of close attention as an issue of policy consideration.

TRADE

Import Trade Matrix			
Country: Japan		Units: Million p'cs	
Commodity: Tobacco, Mfg., Cigarettes			
Time period: Jan-Dec			
Imports for	1996		1997
U.S.	73524	U.S.	73319
Others		Others	
Germany	1193	Germany	1721
United Kingdom	1149	United Kingdom	1594
Switzerland	429	Malaysia	346
Netherlands	357	Netherlands	155
Malaysia	159	Switzerland	126
China	109	China	107
Austria	62	Austria	46
France	38	Indonesia	40
Indonesia	33	France	39
Hong Kong	25	Poland	4
Total for Others	3554		4178
Others not listed	215		19
Grand Total	77293		77516

Export Trade Matrix			
Country: Japan		Units: Million p'cs	
Commodity: Tobacco, Mfg., Cigarettes			
Time period: Jan-Dec			
Exports for	1996		1997
U.S.	482	U.S.	616
Others		Others	
Korean Republic	3141	Taiwan	3383
Hong Kong	2582	Korean Republic	3159
Taiwan	1821	Hong Kong	1521
Afghanistan	1196	Singapore	953
Singapore	882	Afghanistan	797
United Arab Emir	325	United Arab Emir	158
Uruguay	126	Chile	153
Thailand	91	Uruguay	108
Syrian Arab Rep.	90	Tajikistan	104
Chile	76	Thailand	97
Total for Others	10330		10433
Others not listed	968		1419
Grand Total	11780		12468

Japan imported 77.5 billion cigarettes in 1997, slightly up from the previous year. Of this total import volume, the U. S. share as an exporter was 73.3 billion, retaining its dominant 95% market share from 1996. In 1998, Japan's total imports grew 4% to 80.5 billion pieces, with most of the key exporter countries, including the U.S., significantly growing their Japan-bound export shipments, as shown in the table below.

1998 Cigarette Imports By Japan(Million pieces)			
Exporter`	1997	1998	% Change
U.S.	73,319	75,768	+3.3%
UK	1,594	1,918	+20.3%
Germany	1,721	1,764	+2.5%
Malaysia	346	492	+42.2%
Austria	46	193	+319.5%
China	107	190	+77.6%
Netherlands	155	88	-43.2%
Indonesia	40	43	+7.5%
Switzerland	126	39	-69.0%
France	39	36	-7.7%
Others	23	29	+26.1%
Total:	77,516	80,560	+3.9%

(Source: Ministry of Finance)

Cigarette exports in 1997 from Japan grew also 5.8% from previous year, with the U.S. as an overseas market rising 27.8% in the number of shipments received. In 1998, however, Japanese export was down 12% , as shown in the table below.

1998 Cigarette Exports from Japan(Million pieces)			
Importer	1997	1998	% Change
Taiwan	3,383	5,894	+74.2%
Korean Rep.	3,159	1,880	-40.5%
U.S.	616	990	+60. Tajikistan
Tajikistan	104	473	+354.8%
Afghanistan	797	324	-59.3%
U.A.E	158	196	+24.0%
Singapore	953	182	-80.9%
Hong Kong	1,521	176	-88.4%
Chile	153	162	+5.9%
Others	1,624	733	-54.8%
Total:	12,468	11,010	-11.6%

(Source: Ministry of Finance)

MARKETING

The importance of vending machines in cigarette retailing continued in 1998, with its share of total cigarette sales advancing from 38.9% of 1997 to 41.8% in 1998. The number of machines newly added to the market during the last year was a surprising 21,230 units, making the total number of cigarette vending machines at work as of the end of December, 1998, 527,100, up 4.2% from a year earlier, as shown below in the table.

Number of Cigarette Vending Machines on the Market(1,000 units)		
Year	Units	% Change
1998	527.1	+4.2%
1997	505.9	+0.3%
1996	504.5	+1.1%
1995	498.8	+0.9%
1994	494.0	-1.0%
1993	495.0	-0.9%
1992	495.9	+6.9%
1991	489.0	+13.4%

(Source: Japan Automatic Vending Machinery Industry Ass'n.)

Based on the number of retailers in business as of the end of 1997, 527,100 units of vending machine translated into 1.78 units per retailer, which meant most retailers operated more than one vending machine by the places of their business. Two additional features of this growth in vending machine sales were the following.

- 1) The share of machines with a larger capacity for columns to accommodate a growing number of cigarette brands for display has increased, supported by marketing promotions of the vending machinery industry. In 1998 alone, the share of units with columns of 40-49 was 34.4%, those with columns over 50, 27.7% and with columns of 30-39, 20.3%, making the combined total market share 82.4%, a big share, meaning vending machines are becoming larger in size and sales capacity.
- 2) As the result of voluntary industry restraint against TV and Radio commercials in force after April 1998, manufacturers have started a campaign of leasing vending machines at competitive rates to their retail accounts. As a result, their geographical market coverage has substantially expanded.

Social and restrictive pressures against smoking, particularly in open public places and transportation systems as well as teenage smoking, continued to grow throughout the country. The voluntary retail industry restraint, initiated in April 1996, not to operate outdoor cigarette vending machines between 11.00 PM and 6.00AM has been strictly and successfully observed. There are signs, however, that more restrictive legal requirements to regulate cigarette sales may evolve sooner or later. Fukuyama City Council in Hiroshima Prefecture, for example, passed a local city ordinance in March, 1999, requiring retailers to operate outdoor vending machines only between 5.00AM and 11.00PM. While there is no financial penalty for violators of this ruling with its objective being to further minimize chances for minors and pre-adult persons below 20 years of age gaining access to smoking, there is a possibility that other municipalities and local agencies will take similarly imposing and more regulatory actions. Ban on all advertising and sales promotion activities on mass media, billboards and the Internet as well as on the streets, initiated since April 1998 again as a policy of voluntary industry restraint, also continued.

According to an official survey of the Government, Japan's total population on October 1, 1997 was 126,170,000 of which 15.3% represented minors below 14 years of age and 15.7% persons over 65 years of age. Compared to the population mix of 12 years before, the share of minors was down 6.2% and the share of senior citizens over 65 up 5.4%, as the share in the productive age bracket (i.e. 15-64) peaked at 69.6% in 1994, indicating that Japan's population is greying. The aging of Japan's population is an important precautionary factor because, according to a cigarette market research, the rate of smoking diminishes among persons over 60, compared to those below in age brackets.

PSD Tables**-Tobacco, Unmfg., Flue-cured**

Production Table						
Country: Japan						
Commodity: Flue Cured						
	1996		1997		1998	
	Old	New	Old	New	Old	New
Market Year Begin	01/1996		01/1997		01/1998	
Area Planted	17698	17698	17397	17397	17714	17195
Beginning Stocks	222218	222218	193601	193601	165541	173477
Farm Sales Weight Prod	41735	41735	45534	45534	43000	42464
Dry Weight Production	38000	38000	41000	41000	39000	38500
U.S. Leaf Imports	22366	22366	22250	26000	22500	26500
Other Foreign Imports	23503	23503	23890	28076	23500	28772
TOTAL Imports	45869	45869	46140	54076	46000	55272
TOTAL SUPPLY	306087	306087	280741	288677	250541	267249
Exports	486	486	5200	5200	2000	133
Dom. Leaf Consumption	50000	50000	49000	49000	46000	46300
U.S. Leaf Dom. Consum.	40000	40000	39000	39000	37000	36900
Other Foreign Consump.	22000	22000	22000	22000	22000	22300
TOTAL Dom. Consumption	112000	112000	110000	110000	105000	105500
TOTAL Disappearance	112486	112486	115200	115200	107000	105633
Ending Stocks	193601	193601	165541	173477	143541	161616
TOTAL DISTRIBUTION	306087	306087	280741	288677	250541	267249

-Tobacco, Unmfg., Burley

Production Table						
Country: Japan						
Commodity: Burley						
	1996		1997		1998	
	Old	New	Old	New	Old	New
Market Year Begin	01/1996		01/1997		01/1998	
Area Planted	0	7718	7836	7836	8061	7694
Beginning Stocks	122789	122789	106427	106427	100972	100972
Farm Sales Weight Prod	22565	22565	21839	21839	23000	20458
Dry Weight Production	20300	20300	20000	20000	21000	18600
U.S. Leaf Imports	13381	13381	16072	16072	16000	17300
Other Foreign Imports	17957	17957	21476	21476	22000	21791
TOTAL Imports	31338	31338	37548	37548	38000	39091
TOTAL SUPPLY	174427	174427	163975	163975	159972	158663
Exports	0	0	1003	1003	500	30
Dom. Leaf Consumption	26000	26000	23500	23500	23000	23500
U.S. Leaf Dom. Consum.	18000	18000	16500	16500	16000	17000
Other Foreign Consump.	24000	24000	22000	22000	23000	23200
TOTAL Dom. Consumption	68000	68000	62000	62000	62000	63700
TOTAL Disappearance	68000	68000	63003	63003	62500	63730
Ending Stocks	106427	106427	100972	100972	97472	94933
TOTAL DISTRIBUTION	174427	174427	163975	163975	159972	158663

-Tobacco, Unmfg., Light Air Cured

Production Table						
Country: Japan						
Commodity: Light Air Cured						
	1996		1997		1998	
	Old	New	Old	New	Old	New
Market Year Begin	01/1996		01/1997		01/1998	
Area Planted	641	641	429	429	439	387
Beginning Stocks	1897	1897	1747	1747	1167	1167
Farm Sales Weight Prod	1731	1731	1131	1131	1100	1038
Dry Weight Production	1600	1600	1020	1020	1000	940
U.S. Leaf Imports	0	0	0	0	0	0
Other Foreign Imports	0	0	0	0	0	0
TOTAL Imports	0	0	0	0	0	0
TOTAL SUPPLY	3497	3497	2767	2767	2167	2107
Exports	0	0	0	0	0	0
Dom. Leaf Consumption	1750	1750	1600	1600	1500	1450
U.S. Leaf Dom. Consum.	0	0	0	0	0	0
Other Foreign Consump.	0	0	0	0	0	0
TOTAL Dom. Consumption	1750	1750	1600	1600	1500	1450
TOTAL Disappearance	1750	1750	1600	1600	1500	1450
Ending Stocks	1747	1747	1167	1167	667	657
TOTAL DISTRIBUTION	3497	3497	2767	2767	2167	2107

-Tobacco, Unmfg., Oriental

Production Table						
Country: Japan						
Commodity: Oriental						
	1996		1997		1998	
	Old	New	Old	New	Old	New
Market Year Begin	01/1996		01/1997		01/1998	
Area Planted	0	0	0	0	0	0
Beginning Stocks	23347	23347	16274	16274	12555	12555
Farm Sales Weight Prod	0	0	0	0	0	0
Dry Weight Production	0	0	0	0	0	0
U.S. Leaf Imports	0	0	0	0	0	0
Other Foreign Imports	8427	8427	6781	6781	7500	7079
TOTAL Imports	8427	8427	6781	6781	7500	7079
TOTAL SUPPLY	31774	31774	23055	23055	20055	19634
Exports	0	0	0	0	0	0
Dom. Leaf Consumption	0	0	0	0	0	0
U.S. Leaf Dom. Consum.	0	0	0	0	0	0
Other Foreign Consump.	15500	15500	10500	10500	9000	10000
TOTAL Dom. Consumption	15500	15500	10500	10500	9000	10000
TOTAL Disappearance	15500	15500	10500	10500	9000	10000
Ending Stocks	16274	16274	12555	12555	11055	9634
TOTAL DISTRIBUTION	31774	31774	23055	23055	20055	19634