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BY FAX
24th June, 1994

Dear Nick,

PROJECT UMPIRE
Import Duties

Please find attached a short note which supplements your note of 22nd June to Ulrich. I have discussed the contents of the attached note with Chris Dufty at BATCo and he agrees with it. I should add that I might have been able to re-assure the Chairman more in Tashkent but I 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.

Please let me know if you want any more information on this. Given your absence in Moscow, I have taken the liberty of copying the letter directly to Ulrich.

Yours sincerely,

William Wells

cc: Ulrich Herter
Neil Bruce-Miller
Jim Rowlands-Rees
John Selby
Chris Dufty
James King

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PROJECT UMPIRE**Application of Import Duty in the Uzbek Cigarette Market**

Set out below is a note of the handling of the imposition of import duty. This note does not address excise and VAT.

In January 1994 BAT raised with the Uzbek Ministry of Finance the possibility of the application of an import duty on imported cigarettes as well as the equal treatment of domestically produced and imported tobacco products in terms of excise and VAT. Since then, the immediate imposition of import duties and a requirement that import duties be discussed with the Ministry of Finance has not been pursued for the following reasons:-

1. *Uzbek government policy to promote tobacco product supply in the domestic market.* In February 1994 the Uzbek government specifically stated that there would be no import duty applied to tobacco products prior to 1st July, 1995. This is in order to promote the supply of tobacco products in Uzbekistan given that in 1993 the Tashkent Tobacco Factory only produced 4 billion cigarettes (or cigarette equivalents) for a market where cigarette consumption was estimated as some 16 to 18 billion.
2. *Trade-off for other privileges.* The Uzbek government has, throughout the negotiations, been highly sensitive to what it sees as anti-competitive practices. It was apparent that seeking all three of protective import duties, manufacturing exclusivity and pricing freedom was impractical. It was felt that it was initially more important to secure manufacturing exclusivity for the period necessary to expand production capacity so as to achieve domestic market dominance and freedom to price than a commitment to protective import duties.
3. *Securing competitive advantage for UZBAT.* It is expected that the equal treatment of domestically produced and imported tobacco products will permit UZBAT to secure a competitive advantage over time because of its lower delivery costs. It may be that this will not be achieved because of the dumping of tobacco products from overseas - in which case at the appropriate time (see above), protective import duties will be sought.
4. *Threat of large scale smuggling before domestic production can satisfy local demand.* The early imposition of import duty risks increasing the volume of smuggling tobacco produced imported into Uzbekistan especially if this occurs prior to UZBAT reaching full production with the construction of the new cigarette factory (currently estimated at five years after Completion).

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5. *Risk of prematurely provoking vested interest opposition.* It is clear from BAT's dealings with the Ministry of Finance that powerful vested interests are involved in the import of tobacco products. Until domestic supply can substantially satisfy demand and, perhaps, UZBAT has developed good trading relations with domestic commercial interests, it will be difficult for the Ministry of Finance to argue for import duty against these vested interests.
6. *Imposition of protective import duties.* Whilst FSU countries have little, if any, tradition of protective tariff regimes, the Uzbek government are not in principle opposed to protective import duties. Protective import duties are understood to be part of the incentives to invest in joint ventures for both Mercedes and Daewoo. It is reasonable to assume that in line with international practice protective import duties can be secured at a time when the market is predominantly supplied by domestic production and the risk of monopoly regulation diminishes with the ending of the manufacturing exclusivity period.
7. *Opportunity to establish BAT brands.* The absence of import duties at least until July 1995, by which time it is expected that production volumes at a BAT-controlled Tashkent Tobacco Factory will be rising significantly, is seen as an opportunity to establish the appropriate BAT brands by way of imports.

It should be noted that import duties would not apply to tobacco products from the other members of the Kazak-Kyrgyz-Uzbek Customs Union.

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