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# **China, Peoples Republic of**

## **Tobacco and Products**

### **Annual Report, Part I**

### **2000**

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#### **Report Highlights:**

**China is continuing to cut leaf production in order to reduce surplus stocks. The production of counterfeit cigarettes and cigarette smuggling continue to result in high stock levels for cigarettes. As China joins the WTO, lower leaf and cigarette tariffs will encourage direct imports, and discourage smuggling. China recently agreed to lift an 11-year old ban on imports of U.S. leaf tobacco.**

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## Tobacco and Products Situation and Outlook

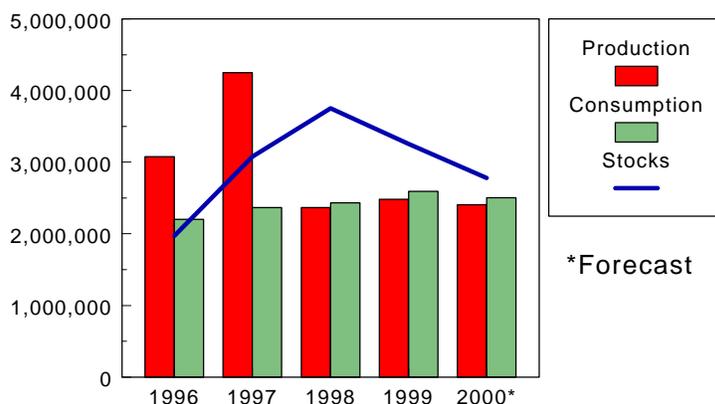
China's efforts to restructure its tobacco industry continue, but still have a long way to go. The tobacco industry still suffers from surplus stocks, high domestic support prices, overproduction of cigarettes and widespread counterfeiting and smuggling of cigarettes. Reform is a sensitive issue, since tobacco is a major source of cash income for farmers in some of China's poorest provinces, and tax revenue for provincial and local governments. Taxes on tobacco and products provide the government with its largest source of revenue, amounting to \$US11.92 billion in 1999. In order to maintain farm income in the face of lower prices, the government has cut the tax on leaf tobacco, which is levied against farmers.

1999 tobacco planted area fell to an estimated 1.3 million hectares, a drop of 4.5% over 1998. A further decline of 2.7% is forecast for 2000. Production increased in 1999 as ideal weather offset the decline in planted area. Reductions in planted area are much lower than the 30% cut in 1998. These reductions have fallen short of the government's expectations, because price reductions for other commodities have kept tobacco production relatively profitable. A key element in the effort to keep production down is price reform. Though the official procurement prices for tobacco rose in 1999, the system for calculating the price was revised to include local subsidies, causing the actual price paid to farmers to fall in many areas. The government will continue its efforts to reduce production, but the importance of tobacco as a cash crop and the lack of alternatives will limit the effectiveness of these efforts. As a result of the sharp drop in production in 1998, stocks fell by over 500,000 MT in 1999, and are forecast to drop another 474,000 MT in 2000. The government's efforts to reduce planted area and stocks have been accompanied by a campaign to improve the quality of tobacco leaf by introducing new varieties and upgrading processing facilities.

According to the National Statistical Bureau, per capita tobacco consumption is falling, as is the percentage of smokers in the general population. In the short term, continued population growth is forecast to outweigh the decline in per capita consumption, causing total consumption to grow. In the long term, however, consumption is likely to fall as growing health concerns cause per capita consumption to drop even more rapidly.

The Chinese government recently agreed to lift its 11-year-old ban on U.S. tobacco, and imports should begin before the end of the year. Both imports and exports of tobacco climbed in 1999. The jump in exports has been linked to a 13% tax rebate on the 17% VAT for tobacco exports. Increased imports are the result of growing activity by joint venture cigarette manufacturers, who import tobacco for blending. Trade in cigarettes dropped dramatically in 1999. Falling prices for exported cigarettes caused the government of Yunnan Province to place controls on exports. The drop in prices has been linked to the weak economy in Southeast Asian markets in early 1999. Imports and production of cigarettes are still heavily regulated, leading to large scale counterfeiting, smuggling and illegal production. Estimates of smuggling are impossible to make, but the amount is well in excess of legal imports.

Tobacco Production, Consumption and Stocks, 1996 - 2000\*



## Statistical Tables

**Table 1. Unmanufactured Tobacco: Production, Supply and Distribution**

PSD Table						
Country:	China, Peoples Republic of					
Commodity:	Tobacco, Unmfg.					
	1998		1999		2000	
	Old	New	Old	New	Old	New
Market Year Begin		01/1998		01/1999		01/2000
Area Planted	1361000	1361000	1310000	1300000	1265000	1265000
Beginning Stocks	4168915	4168915	3754450	3754450	3248980	3252891
Farm Sales Weight Prod	2365000	2365000	2480000	2480000	2406000	2406000
Dry Weight Production	2010250	2010250	2108000	2083200	2045100	2021040
U.S. Leaf Imports	79	79	0	0	0	500
Other Foreign Imports	9678	9678	13000	10481	12822	10700
TOTAL Imports	9757	9757	13000	10481	12822	11200
TOTAL SUPPLY	6188922	6188922	5875450	5848131	5306902	5285131
Exports	92173	92173	108000	113259	110000	113480
Dom. Leaf Consumption	2332542	2332542	2505470	2471500	2535770	2381100
U.S. Leaf Dom. Consum.	79	79	0	0	0	500
Other Foreign Consump.	9678	9678	13000	10481	12822	10700
TOTAL Dom. Consumption	2342299	2342299	2518470	2481981	2548592	2392300
TOTAL Disappearance	2434472	2434472	2626470	2595240	2658592	2505780
Ending Stocks	3754450	3754450	3248980	3252891	2648310	2779351
TOTAL DISTRIBUTION	6188922	6188922	5875450	5848131	5306902	5285131

**Table 2. Flue Cured Tobacco: Production, Supply and Distribution**

Production Table						
Country:						
Commodity:	Flue Cured					
		1998		1999		2000
	Old	New	Old	New	Old	New
Market Year Begin						
Area Planted	1200000	1200000	1150000	1150000	1115000	1115000
Beginning Stocks	3964700	3964700	3535377	3535377	3089861	3051392
Farm Sales Weight Prod	2089000	2089000	2182000	2182000	2108000	2108000
Dry Weight Production	1775650	1775650	1854700	1832880	1791800	1770720
U.S. Leaf Imports	0	0	0	0	0	500
Other Foreign Imports	6004	6004	10340	9565	11550	9700
TOTAL Imports	6004	6004	10340	9565	11550	10200
TOTAL SUPPLY	5746354	5746354	5400417	5377822	4893211	4832312
Exports	85969	85969	91556	108865	100000	109000
Dom. Leaf Consumption	2119004	2119004	2208000	2208000	2209770	2100000
U.S. Leaf Dom. Consum.	0	0	0	0	0	500
Other Foreign Consump.	6004	6004	11000	9565	11550	9700
TOTAL Dom. Consumption	2125008	2125008	2219000	2217565	2221320	2110200
TOTAL Disappearance	2210977	2210977	2310556	2326430	2321320	2219200
Ending Stocks	3535377	3535377	3089861	3051392	2571891	2613112
TOTAL DISTRIBUTION	5746354	5746354	5400417	5377822	4893211	4832312

**Table 3. Burley Tobacco: Production, Supply and Distribution**

Production Table						
Country:						
Commodity:	Burley					
		1998		1999		2000
	Old	New	Old	New	Old	New
Market Year Begin						
Area Planted	54000	54000	50000	50000	50000	50000
Beginning Stocks	125000	125000	111643	111643	75873	88549
Farm Sales Weight Prod	95000	95000	120000	120000	120000	120000
Dry Weight Production	80750	80750	102000	100800	102000	100800
U.S. Leaf Imports	79	79	0	0	0	0
Other Foreign Imports	3174	3174	770	550	732	600
TOTAL Imports	3253	3253	770	550	732	600
TOTAL SUPPLY	209003	209003	214413	212993	178605	189949
Exports	2792	2792	3300	1894	3500	1980
Dom. Leaf Consumption	91315	91315	134470	122000	147000	128100
U.S. Leaf Dom. Consum.	79	79	0	0	0	500
Other Foreign Consump.	3174	3174	770	550	732	600
TOTAL Dom. Consumption	94568	94568	135240	122550	147732	128700
TOTAL Disappearance	97360	97360	138540	124444	151232	130680
Ending Stocks	111643	111643	75873	88549	27373	59269
TOTAL DISTRIBUTION	209003	209003	214413	212993	178605	189949

**Table 4. Oriental Tobacco: Production, Supply and Distribution**

Production Table						
Country:						
Commodity:	Oriental					
		1998		1999		2000
	Old	New	Old	New	Old	New
Market Year Begin						
Area Planted	14000	14000	12000	12000	12000	12000
Beginning Stocks	3767	3767	6600	6600	6950	7920
Farm Sales Weight Prod	24000	24000	23000	23000	23000	23000
Dry Weight Production	20400	20400	19550	19320	19550	19320
U.S. Leaf Imports	0	0	0	0	0	0
Other Foreign Imports	500	500	570	366	540	400
TOTAL Imports	500	500	570	366	540	400
TOTAL SUPPLY	24667	24667	26720	26286	27040	27640
Exports	2171	2171	1200	1500	1500	1500
Dom. Leaf Consumption	15396	15396	18000	16500	19000	18000
U.S. Leaf Dom. Consum.	0	0	0	0	0	0
Other Foreign Consump.	500	500	570	366	540	400
TOTAL Dom. Consumption	15896	15896	18570	16866	19540	18400
TOTAL Disappearance	18067	18067	19770	18366	21040	19900
Ending Stocks	6600	6600	6950	7920	6000	7740
TOTAL DISTRIBUTION	24667	24667	26720	26286	27040	27640

**Table 5. Dark Air and Sun Cured Tobacco: Production, Supply and Distribution**

Production Table						
Country:						
Commodity:	Dark Air & Sun Cured					
		1998		1999		2000
	Old	New	Old	New	Old	New
Market Year Begin						
Area Planted	93000	93000	88000	88000	88000	88000
Beginning Stocks	75448	75448	100830	100830	86280	105030
Farm Sales Weight Prod	157000	157000	155000	155000	155000	155000
Dry Weight Production	133450	133450	131750	130200	131750	130200
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	208898	208898	232580	231030	218030	235230
Exports	1241	1241	1300	1000	2000	1000
Dom. Leaf Consumption	106827	106827	145000	125000	160000	135000
U.S. Leaf Dom. Consum.	0	0	0	0	0	0
Other Foreign Consump.	0	0	0	0	0	0
TOTAL Dom. Consumption	106827	106827	145000	125000	160000	135000
TOTAL Disappearance	108068	108068	146300	126000	162000	136000
Ending Stocks	100830	100830	86280	105030	56030	99230
TOTAL DISTRIBUTION	208898	208898	232580	231030	218030	235230

**Table 6. Cigarettes: Production, Supply and Distribution**

PSD Table					
Country:	China, Peoples Republic of				
Commodity:	Tobacco, Mfg., Cigarettes				
		1998		1999	
	Old	New	Old	New	Old
Market Year Begin		01/1998		01/1999	
Filter Production	1608440276	1608440276	1629350000	1629350000	1629350000
Non-Filter Production	75109724	75109724	45300000	45300000	45300000
TOTAL Production	1683550000	1683550000	1674650000	1674650000	1674650000
Imports	7225667	7225667	3439796	3439796	3439796
TOTAL SUPPLY	1690775667	1690775667	1678089796	1678089796	1678089796
Exports	24727566	24727566	22831511	22831511	22831511
Domestic Consumption	1666048101	1666048101	1655258285	1655089796	1655089796
TOTAL DISTRIBUTION	1690775667	1690775667	1678089796	1677921307	1677921307

**Table 7. Tobacco Production by Province**

China's Leaf Tobacco Production Area By Province			
	(1,000 HA)		
	1998	1999	2000
Province	Revised	Prelim	Forecast
Yunnan	323	320	312
Guizhou	199	190	185
Henan	161	160	156
Hunan	90	85	83
Sichuan	72	70	68
Hubei	68	60	58
Heilongjiang	59	55	53
Shandong	53	50	49
Chongqing	57	50	49
Shaanxi	59	55	53
Fujian	47	40	39
Others	175	165	160
TOTAL HA	1,363	1,300	1,265

China's Leaf Tobacco Production Volume By Province			
	(1,000 MT)		
	1998	1999	2000
Province	Forecast	Prelim	Forecast
Yunnan	573	580	563
Guizhou	320	380	370
Henan	311	314	304
Hunan	154	160	155
Hubei	120	121	117
Sichuan	107	127	123
Shandong	115	110	107
Heilongjiang	94	98	95
Chongqing	80	85	82
Shaanxi	93	100	97
Fujian	74	75	73
Others	324	330	320
TOTAL MT	2,365	2,480	2,406

All figures are Post estimates based on SSB, STMA and industry figures.

**Table 8. Tobacco Production by Type**

China's Tobacco Production By Tobacco Type (1998-2000)			
	Area (1,000HA)		
	Revised 1998	Prelim 1999	Forecast 2000
Flue Cured	1,200	1,150	1,115
Burley	54	50	50
Oriental	14	12	12
Dark Air & Sun Cured	93	88	88
TOTAL	1,361	1,300	1,265
	Production (1,000MT FSW)		
	Revised 1998	Prelim 1999	Forecast 2000
Flue Cured	2,089	2,182	2,108
Burley	95	120	120
Oriental	24	23	23
Dark Air & Sun Cured	157	155	155
TOTAL	2,365	2,480	2,406
All figures are post estimates based on SSB, STMA and industry figures.			

**Table 9. Procurement Prices for Flue Cured Tobacco (2000)**

	Region 1	Region 2	Region 3	Region 4	Region 5	% of 1999 procurement	% of 1998 procurement
<b>Class A</b>						<b>19%</b>	<b>15%</b>
C1F	2012.05	1951.81	1807.23	1662.65	1566.27		
C2F	1802.41	1751.81	1590.36	1465.06	1380.72		
C3F	1549.40	1506.02	1361.45	1253.01	1180.72		
C1L	1879.52	1824.10	1657.83	1530.12	1438.55		
C2L	1602.41	1554.22	1409.64	1301.20	1224.10		
B1F	1698.80	1650.60	1530.12	1409.64	1325.30		
B2F	1404.82	1361.45	1265.06	1168.67	1096.39		
B1L	1356.63	1320.48	1224.10	1127.71	1060.24		
B1R	1404.82	1361.45	1265.06	1168.67	1096.39		
H1F	1465.06	1421.69	1320.48	1216.87	1144.58		
X1F	1366.27	1325.30	1192.77	1096.39	1036.14		
<b>Class B</b>						<b>57%</b>	<b>52%</b>
C3L	1361.45	1313.25	1180.72	1084.34	1024.10		
X2F	1024.10	987.95	915.66	8072.29	795.18		
X3F	783.13	766.27	710.84	655.42	614.46		
X1L	1260.24	1221.69	1132.53	1043.37	983.13		
X2L	987.95	963.86	891.57	819.28	771.08		
B3F	995.18	951.81	891.57	819.28	783.13		
B4F	698.80	674.70	626.51	578.31	542.17		
B2L	995.18	939.76	891.57	819.28	783.13		
B3L	698.80	674.70	626.51	575.90	542.17		
B2R	1139.76	1108.43	1048.19	963.86	910.84		
B3R	879.52	860.24	819.28	754.22	710.84		
H2F	1224.10	1192.77	1103.61	1016.87	959.04		
X2V	766.27	746.99	693.98	638.55	602.41		
C3V	1200.00	1168.67	1084.34	1000.00	939.76		
B2V	910.84	886.75	843.37	775.90	734.94		
B3V	693.98	674.70	650.60	602.41	566.27		
S1	693.98	674.70	626.51	578.31	542.17		
<b>Class C</b>						<b>24% C &amp; D combined</b>	<b>33% C&amp;D combined</b>
B4L	373.49	361.45	361.45	349.40	337.35		
X3L	590.36	578.31	578.31	542.17	510.84		
X4L	301.20	301.20	289.16	277.11	265.06		
X4F	385.54	373.49	373.49	361.45	349.40		
S2	373.49	368.67	361.45	337.35	313.25		
CX1K	462.65	457.83	457.83	428.92	397.59		

CX2K	248.19	240.96	236.14	228.92	212.05
B1K	440.96	433.73	433.73	416.87	392.77
B2K	253.01	240.96	240.96	233.73	224.10
GY1	204.82	204.82	204.82	192.77	180.72
<b>Class D</b>					
B3K	144.58	144.58	139.76	127.71	120.48
GY2	91.57	91.57	84.34	81.93	77.11

**Table 10. Factory Price for Cigarettes (2000)**

Class	Price in RMB	Price in USD	Share of production for Quarter 1, 2000	Share of sales for Quarter 1, 2000
Class A	Greater than RMB 7,500/50,000 pcs.	\$903.61/50,000 pcs.	11.8	18.5
Class B	RMB 2,500 - 7,500/50,000 pcs.	\$301.20 - 903.61/50,000 pcs.	19.6	18.8
Class C	RMB 1,250 - 2,500/50,000 pcs.	\$150.60 - 301.20/50,000 pcs.	30.7	33.4
Class D/E	Less than RMB 1,250/50,000 pcs.	Less than \$ 150.60 50,000 pcs.	34.9 for D 3 for E	26.6 for D 2.85 for E

Table 11. Tobacco Tax Revenues and Profits (1999)

Unit:	Million \$US								
Region	Industrial & Commercial Tax Revenue		Increase (%)	Industrial Profits		Increase (%)	Commercial Profits		Increase (%)
National	11923.44	11566.99	3.08	1211.74	1401.01	-13.51	1684.42	1528.42	10.21
Beijing	67.42	71.24	-5.37	3.98	0.66	500	12.50	21.74	-42.51
Tianjin	20.28	25.84	-21.49	0.00	0.60	-100	2.60	4.88	-46.68
Hebei	142.62	178.25	-19.99	2.49	8.74	-71.56	8.98	27.54	-67.4
Shanxi	49.26	46.77	5.31	5.06	0.13	3863.32	12.91	15.96	-19.11
I. Mongolia	39.84	66.48	-40.07	1.98	3.04	-34.97	7.36	17.70	-58.43
Liaoning	53.89	72.88	-26.05	0.12	3.60	-96.59	3.58	19.76	-81.88
Jilin	74.52	69.44	7.32	8.10	-0.55	1583.44	7.42	9.65	-23.14
Heilongjiang	99.83	101.39	-1.54	-1.10	1.99	-155.17	16.70	3.47	381.15
Dalian	10.77	14.64	-26.41				8.18	11.82	-30.82
Shanghai	948.87	863.59	9.88	70.78	65.95	7.33	323.36	306.74	5.42
Jiangsu	527.37	425.30	24	45.88	35.00	31.07	154.24	137.25	12.38
Zhejiang	750.51	332.12	125.98	91.35	20.66	342.2	289.63	60.87	375.79
Anhui	390.79	458.24	-14.72	9.56	28.43	-66.38	45.12	60.27	-25.14
Fujian	421.62	365.90	15.23	35.75	24.23	47.57	82.60	82.20	0.49
Jiangxi	130.27	71.18	83	7.69	-16.64	146.21	30.69	21.82	40.61
Shandong	534.28	555.18	-3.76	120.23	115.36	4.22	52.52	58.40	-10.07
Henan	493.12	475.64	3.68	24.95	27.18	-8.2	63.38	45.30	39.92
Hubei	327.79	268.38	22.13	10.40	19.00	45.25	22.91	-10.00	329.08
Hunan	1054.01	998.75	5.53	71.87	65.07	10.45	44.18	43.68	1.13
Guangdong	452.52	386.67	17.03	32.59	24.02	35.69	39.77	39.47	0.78
Shenzhen	94.97	75.84	25.22	13.59	9.64	40.9	22.34	19.11	16.89
Guangxi	162.75	179.31	-9.24	5.62	5.01	12.07	23.73	38.21	-37.89
Hainan	-5.53	21.57	-125.66	-18.78	2.04	-1020.85	4.76	6.95	-31.56
Chongqing	147.12	132.89	10.71	-1.07	10.16	-110.58	18.93	-8.02	336.1
Sichuan	392.82	378.25	3.85	20.68	22.12	-6.52	12.53	26.38	-52.48
Guizhou	396.81	412.45	-3.79	-3.36	13.21	-125.45	5.04	2.11	139.47
Yunnan	3813.34	4152.90	-8.18	632.93	893.44	-29.16	313.33	376.38	-16.75
Shaanxi	233.71	254.43	-8.14	19.87	16.81	18.16	27.77	53.87	-48.46
Gansu	54.38	61.38	-11.39	0.79	0.25	220	10.00	16.04	-37.65
Qinghai	8.76	10.76	-18.58	-0.61	0.77	-179.28	8.14	5.61	44.97
Ningxia	11.35	13.81	-17.81	0.07	0.84	-91.94	5.56	7.48	-25.68
Xinjiang	23.38	25.52	-8.39	0.37	0.24	54	3.67	5.78	-36.46

**General Notes on Statistics**

NOTE 1: There are several sources of tobacco statistics for China including the STMA, the State Statistical Bureau (SSB), the Chinese Customs Service (CCS), and industry sources. This report considers all sources and uses the data that is considered to be the most accurate and appropriate. Trade data comes from CCS statistics. The SSB is the source of production data since SSB production figures attempt to account for all tobacco grown. The STMA production estimates report only the amount of tobacco procured. Industry sources discount the crop size even further, reporting only the weight of commercially useable tobacco. Thus, losses between the farm and the manufacturer may be included along with normal processing losses. Since the discrepancy is consistent over time, the numbers are believed to reflect the relative changes in tobacco production. However, during periods of major change the spread between the three sources may widen. Because of the lag in the release of official data, estimates may be made based on relative changes in the data series available at the time.

NOTE 2: The conversion factor from farm sales weight FSW to dry weight was changed in 1999 from 90 percent to 84 percent to reflect a more realistic loss factor for China.

NOTE 3: In China, a case (da xiang ) of cigarettes equals 50,000 cigarettes. A box (jian) holds 10,000 cigarettes or 50 cartons ( tiao ), which each hold 10 packs (bao ) of 20 cigarettes.

## Production

### Tobacco

Faced with the prospect of increased competition under the WTO, the Chinese government has continued to restructure the tobacco industry with an eye to reducing surplus stocks and production, and cutting losses by the tobacco industry. Following the massive 30% reduction in 1998, tobacco planted area fell by another 4.5% in 1999, down to 1.3 million hectares. Tobacco production increased, however, as ideal weather helped to drive up yields. Planted area is forecast to drop by an additional 2.7% in 2000, with dryweight production falling by 3%. Severe late frosts in Yunnan, Guangdong and Guizhou in early spring this year did not affect tobacco production in these areas. Most of China's tobacco is flue-cured tobacco, produced primarily in Yunnan, Guizhou and Henan, though small amounts are produced in nearly every province in the country. Burley tobacco is produced primarily in Hubei, Sichuan, Henan and Shanxi, while Yunnan, Xinjiang and Hubei are the main producers of oriental tobacco.

Price reforms continued during 1999. The average purchase price for tobacco jumped from \$US 29.1/50 kg in 1998 to \$US 42/50kg in 1999. This increase is somewhat deceptive, however, as the government changed the method for calculating the price in 1999. While the official procurement price increased, local government subsidies are now factored into the price, eliminating any benefits that might accrue to farmers from such subsidies. The practical effect has been a cut in farm prices for areas with heavy local government subsidies, and an increase in prices for areas with few or no subsidies. Official sources believe that the net effect has been a reduction in the price paid to farmers. In order to provide some relief to farmers, the central government also reduced the agricultural tax on tobacco leaf from 31% to 20%.

The government is devoting considerable effort to improving tobacco quality. Procurement results indicate success in this area, as the proportion of Class A and B tobacco procured has grown, while procurement of Class C and D has fallen. The government is promoting the use of new varieties, which accounted for 14.6% of the total planted area in 1999. Trials were also conducted using floating seedlings and tray seedlings to increase insect and drought resistance. Three-phase curing has been extended to 80% of the total tobacco planted area. Top priority has also been given to eliminating production in those areas where quality is the lowest.

Illegal and unreported tobacco production continues to be widespread: the total officially contracted production for 1999 only amounted to 989,300 hectares, leaving 310,700 hectares unaccounted for. Of this, roughly 150,000 hectares are likely planted to non-flue cured types, which are not regulated by the government. Much of the remaining non-contracted production is believed to go into illegal cigarette production and production of counterfeit cigarettes. The large quantity of illegal tobacco production underlines the difficulties that the government faces in reducing tobacco supplies. In many cases the restructuring campaign has been stymied by reforms in other areas. Though price reform has reduced absolute returns from tobacco, sharp cuts in prices for other commodities continue to make tobacco relatively profitable.

The central government has also found itself working at cross-purposes with provincial and local governments. These entities continue to promote tobacco production both as a way to maintain rural incomes and as a way to

supplement their own treasuries through the tax revenues generated from tobacco (see Table 11). In 1999, the central government also reduced the agricultural tax on tobacco leaf from 31% to 20%. This cut reduced the tax burden for farmers, while cutting local governments' receipts from tobacco taxes. Though central government subsidies on seed, fertilizer, pesticides, agricultural films and other inputs have been largely eliminated, many local governments continue to offer these inputs at a substantial discount. In Henan province, such subsidies have reportedly reduced the cost of many inputs to almost nothing. Henan also provides mechanical cultivation assistance to tobacco farmers.

In addition to reducing prices and production, the tobacco industry is also attempting to reduce losses by increasing its efficiency. A key component of this has been increased cooperation with foreign tobacco companies. Several planting trials were undertaken during 1999, with considerable success. Phillip Morris is among the most active companies in this area, and is reportedly conducting planting trials in Fujian, Henan, Hubei and Yunnan. French and British firms are also conducting trials in Xinjiang and Yunnan.

### **Cigarettes and Cigars**

Cigarette production fell by 1.9% in 1999, down to 32.825 million cases. As with last year, much of the decline was accounted for by filterless cigarettes, production of which dropped by 5.8%, compared with 1.8% for filtered. Filtered cigarettes dominate production, commanding a 97% share. Overall cigarette sales fell by 1.2%, down to 32.45 million cases. According to STMA statistics, profits from cigarette production have fallen by 13.51%. Production is forecast to remain steady during 2000. Within that framework, however, the market share for blended cigarettes is forecast to continue growing, reaching 17%, compared to 14% in 1995, according to STMA officials. In order to improve the quality of Chinese blended cigarettes, the China Tobacco Leaf Corporation has organized four Chinese cigarette companies in Henan and Yunnan to cooperate with RJ Reynolds on research and development of blended cigarettes.

Cigarette production is heavily regulated, and maximum production quotas are allocated to factories. Nonetheless, many plants produce beyond quota. Anecdotal evidence indicates that, once again, the central government's efforts in this area are being undermined by local government actions. Over quota production from legal factories occurs with the complicity of local officials (some of the plants are owned by the government), and in some cases is actually encouraged by them as a means of increasing profits for local business and tax revenues for the government. Anecdotal evidence indicates that legal factories are also producing counterfeit cigarettes, again with the complicity of local officials.

Counterfeit cigarette production also continues to be a problem, despite the government crackdown. In 1999 the government seized 100 billion cigarettes, worth about \$US 722 million, an increase of 26% over 1998. The number of brands copied has increased from 30 to more than 100. Many counterfeits are actually being manufactured in Vietnam and Cambodia and imported, including 35 varieties of counterfeit Marlboros. STMA estimates illegal cigarette sales at 2.16 million cartons in 1999, and sales of counterfeit cigarettes at 1.14 million cartons. Evidence on the movement of illegal cigarette sales is contradictory. Increased seizures may reflect the government's more aggressive policy, or it may reflect growing traffic in illegal cigarettes. Likewise, recent increases in cigarette tax revenues are ambiguous, since this would include revenue from illegal production out of legal factories. STMA sources believe that the problem is getting worse.

## Consumption

The proliferation of smuggling, counterfeiting and other illegal cigarette sales makes it extremely difficult to estimate actual consumption. Current statistics indicate that 32% of men and women over the age of 15 are smokers. This rate is expected to drop to 30% by the year 2010, but near term population growth will more than offset this decline. As a result, the smoking population is forecast to reach 307 million in 2000. The National Statistical Bureau (NSB) estimates that the average cigarette smoker in China smoked 15.5 cigarettes per day in 1999. According to NSB surveys, per capita cigarette consumption dropped by 0.6% per year from 1997 to 2000. The rate of decline in per capita consumption is forecast to accelerate from 2000 to 2010, dropping by 1.5% per person per year. Smoking is most prevalent in rural areas. Though the number of female smokers is growing, males over the age of 15 still dominate smoking population, accounting for over 70%.

Factory prices for cigarettes have remained constant, but market prices have dropped sharply over the past year. A general slowdown in consumer demand during 1999 is blamed for the drop. The decline was sharpest for high-end and famous brand cigarettes. This is partly due to increased competition at the high-end of the market, as more domestic companies are producing high-quality cigarettes. Keen competition from counterfeits and smuggled cigarettes is also a factor, as was the economic slowdown during 1999. Demand is expected to recover in 2000, as the national economy appears to be making a recovery. Increased competition, however, is likely to keep prices from rebounding to any great extent.

## Stocks

Though stocks are declining, China continues to hold massive quantities of surplus tobacco leaf: 1999 ending stocks are estimated at 3.2 MMT. This is enough tobacco to keep China supplied for over 15 months at current consumption levels. Official government policy has set the goal of reducing leaf stocks by 1 MMT within three years. The government has successfully reduced stocks by cutting tobacco production. With production forecast to remain nearly stable in the future, however, the forecast reduction in 2000 is the result of increased consumption. Over the long term, consumption is likely to fall, which will make it difficult to continue reducing stocks without further cutting production. Industrial and commercial cigarette stocks increased by 15.7% during 1999, reaching 3.44 million cases. Stock reduction efforts for cigarettes are complicated by the fact that smuggled cigarettes seized by the government are sold onto the domestic market, with the government pocketing the money. By contrast, domestic counterfeits are destroyed.

## Trade

### Tobacco

Leaf tobacco exports jumped by 23% in 1999, and are forecast to remain high in 2000. Industry sources have attributed the increase to a 13% rebate on the 17% VAT (i.e., exporters pay 4% VAT instead of 17%), which was made available to tobacco exporters beginning July 1, 1999. Increased cooperation between local processors and leaf wholesalers has also facilitated exports. The bulk of exports originate in China's main tobacco producing province, Yunnan. In 1999, Yunnan exported 49,789 MT of flue-cured tobacco, more than doubling their volume from the previous year. Yunnan also exported 1,391 MT of oriental tobacco. Exports go

primarily to nearby markets, such as Indonesia, the Philippines and Vietnam, as well as Egypt. Small amounts also make their way to U.S. and European markets.

Tobacco imports increased by 7.4% in 1999, though the total volumes remain small. Increased imports have been supported by the activities of joint venture cigarette manufacturers, which import foreign tobacco for blending. Imports of U.S. tobacco were banned for 11 years due to concerns over tobacco blue mold. However, these concerns have been resolved, and Chinese buyers are now expressing an interest in purchasing U.S. tobacco. As a result, Post forecasts initial shipments of 500 MT in 2000. This is likely to increase rapidly in 2001 as processors become more familiar with the U.S. product.

### **Cigarettes and Cigars**

In contrast to tobacco, cigarette trade suffered in 1999. Exports imploded after the Yunnan provincial government placed controls on exports in response to falling export prices. The decline in export demand during 1999 reflects the general economic slowdown in China's primary export markets in Southeast Asia, Hong Kong and Macao. Exports to these areas dropped by 67% compared to 1998. Cigarette imports have also fallen, though the reasons for this are not entirely clear. At least one industry expert attributes this to the improvement in the quality of domestic cigarettes, particularly with respect to tar content. Foreign companies believe that tariff cuts that will go into effect after China joins the WTO will increase the volume of imported cigarettes.

A Cuban cigar company recently signed a contract with STMA to sell hand-rolled premium Havanas in the Chinese market. The Chinese market for cigars is still extremely small, and is dominated by Macanudos and Davidoffs, which gained access to the market in 1994. The agreement will provide a foothold for Habanos, which plans to focus on high-end markets in Beijing and Shanghai.

### **Tariffs and Non-Tariff Barriers**

China has agreed to cut its tariffs on both leaf tobacco and manufactured tobacco when it joins the WTO. The current MFN tariff rate on tobacco leaf is 40%, with a 17% VAT. This rate is restrictive, and penalizes high-value tobacco products more heavily than cheaper imports. MFN tariff rates for manufactured tobacco remain at 65% for MFN nations, again with a 17% VAT. This will change dramatically when China accedes to the WTO. Under the agreement negotiated with the United States, China will gradually reduce tariffs on tobacco from the current 40% rate down to 10% by 2004. Tariffs on cigarettes will also be reduced, falling from 65% down to 25% by 2004. The current high tariff rates are a major contributor to the smuggling problem. Japan Tobacco, among other companies, has expressed its conviction that WTO will bring about a major change in the business, forcing the China National Tobacco Corporation to open markets wider than in the past.

China recently agreed to lift its ban on U.S. leaf tobacco. Phytosanitary restrictions related to tobacco blue mold have prevented U.S. tobacco from entering China for the past 11 years for purposes other than testing, and U.S. tobacco is expected to enter the market before the end of the year. Chinese companies have already expressed interest in importing U.S. tobacco leaf.

## Smuggling

Like counterfeiting, smuggling is a major problem for government regulators. Fujian and Beijing continue to be centers of smuggling despite recent government crackdowns, and both official and unofficial sources believe the problem may actually have become worse in the past year. Foreign cigarette manufacturers have become increasingly complicit in smuggling, and several companies are rumored to be exploring “alternative routes of distribution of unofficial imports.” In one case, a foreign company was convicted of organizing an entire division to engage in smuggling activities. Assuming WTO tariff cuts are implemented, smuggling is likely to decline in importance. This should yield benefits to the government through increased tax revenues.

## Policy

### Tobacco

At present, only the production of flue-cured tobacco is regulated. Pricing is a complicated affair, due to the proliferation of grades and types, and the use of different price structures in different regions. For purposes of pricing, China’s production of flue-cured tobacco is divided into five regions. Region 1 consists of China’s largest single tobacco producer, Yunnan Province, and commands the highest prices. Region 2 includes the southeastern provinces of Fujian, Guangdong, Guangxi, Hunan and Jiangxi. Region 3 includes Anhui, Hubei, Shandong, Henan, Guizhou and Sichuan provinces. The lowest prices are paid in minor growing areas in Region 4 (Shanxi, Inner Mongolia, Liaoning and Shaanxi) and Region 5 (Hebei, Jilin, Heilongjiang and Gansu). Current prices are expected to remain in effect until the end of 2001. Table 9 provides some indication of the wide range in procurement prices.

### Cigarettes

The main problem for China’s industry continues to be overproduction of cigarettes resulting from an overabundance of manufacturing companies. In addition to restrictions on production, the Chinese government has also recently acted to limit the appearance of new companies. Beijing has stopped approving new joint venture cigarette manufacturers, and is refusing to approve the setup of wholly foreign-owned enterprises, curing plants or joint venture filter manufacturers.

## Marketing

Tobacco-related health concerns are only starting to attract attention in China, despite the fact that China now has the world’s highest incidence of lung cancer. Anti-smoking concerns are being voiced largely by health organizations, women’s groups and non-smokers. Government action on this front has been limited to restrictions on advertising and a 1999 proposal to use a portion of tobacco taxes to fund control programs. Nonetheless, domestic companies are already presenting defensive studies. China’s largest manufacturer, Hongta, has been conducting a publicity campaign claiming that health risks for its cigarettes are lower than for other brands. Hongta has also claimed that poor air quality and kitchen smoke are greater health risks to women than smoking. (Women constitute one of the fastest growing populations of smokers in China).

Due to the large number of cigarette manufacturers in the domestic market, the number of brand names and varieties has grown dramatically, reducing the ability of any one company to dominate the market. Market fragmentation is especially pronounced at the high-quality end of the market, which may account for the relatively sharp decline in prices for premium cigarettes as compared to low-quality product. The primary casualty of this increased competition has been industry giant Hongta which, while remaining strong, has seen its control of the markets weaken.