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## **China, People's Republic of**

## **Tobacco**

## **Cigarette Smuggling In the Middle Kingdom**

**1998**

Approved by:

**Ralph Bean**

**U.S. Embassy, Beijing**

Drafted by:

Freda Chao

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### **Report Highlights:**

**The report examines the issue of cigarette smuggling in China and the current government crackdown on smuggling. Translation of a remarkably direct and in-depth interview with a government tobacco official is included, along with a short article regarding the sentence to death of another tobacco official for accepting bribes.**

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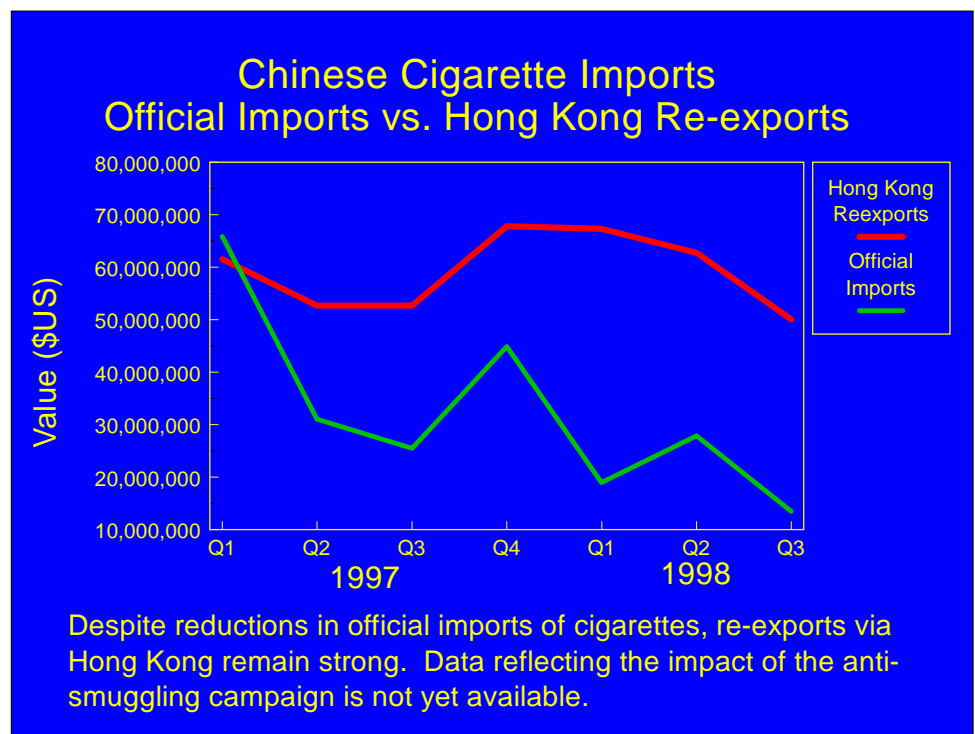
## Demand For Foreign Cigarettes Forges a Path

Cigarette smuggling seems to be one of the enduring features of trade in the 20<sup>th</sup> century, and China is no exception. With an estimated 1/3 of the world's smokers and rapidly growing incomes, foreign cigarettes have become quite popular in China. At the same time however, China is suffering from a surplus of domestically produced tobacco, caused in part by high government support prices that make tobacco production more profitable than other crops. As a result, the Chinese government has placed severe limits on imports, allowing only a small number of duty-free shops and tourist hotels to sell them legally. Over the past few years the combination of high demand and restricted imports has created a brisk trade in smuggled cigarettes. Some foreign companies have even launched promotional campaigns in spite of the fact that, officially, imports of their products are extremely limited.

Illegal imports cost the government substantial tax and tariff revenues, as well as potentially undermining their efforts to reduce the surplus of domestic tobacco. In response, the government recently launched an aggressive anti-smuggling campaign, which has seen an unusual degree of success. The anti-smuggling campaign is part of a larger crackdown on corruption. This effort however, has led to growing production of counterfeit cigarettes which bear famous foreign brand names, but are produced locally with domestic tobacco, and are usually inferior in quality. The government is taking the counterfeit problem seriously, as counterfeits also evade government taxes. Interestingly however, the government treats smuggled merchandise differently from counterfeits: counterfeits are destroyed, while smuggled cigarettes are confiscated and resold by the government, which pockets the proceeds.

## Via Hong Kong

A large proportion of smuggling takes place through Hong Kong, which, through its proximity and free commerce, provides an ideal base for smugglers. By comparing Hong Kong export data for cigarettes with import data from China Customs, one can get an idea of the size of the problem. This method does not account for imports that are smuggled without passing through Hong Kong, so it understates the level of smuggling by excluding both merchandise smuggled through other countries, such as Macao, Vietnam and the Philippines, as well as cigarettes smuggled directly from the source country. Some of the re-exports from Hong Kong may enter China through legitimate channels,



resulting in a limited amount of double-counting. The graph shows a substantial decline in official imports as the government tightened import restrictions in response to growing domestic supplies. The impact of the crackdown on smuggling is less apparent however, since the campaign didn't get into full swing for cigarettes until October.

Two articles that appeared recently in the Chinese press follow: The first is an interview with a State Tobacco Marketing Authority official, describing the problems of smuggling and counterfeiting. The second describes a death-penalty conviction to the State Development and Planning Commission official in charge of planning cigarette production, on charges of soliciting bribes.

## **STMA Official On Cigarette Smuggling and Counterfeits**

Oriental Tobacco News, November 20, 1998

Interview with Yang Chaunde, Vice Administrator, State Tobacco Monopoly Administration on November 3, 1998 (conducted in Beijing on Nov. 3, at the site of the burning of 500,000 cartons confiscated counterfeits.)

"Vice Administrator Yang said that losses from cigarette smuggling are estimated at least 15 billion yuan (approximately US\$ 1.8 billion) per year, and growing. Yang expressed that the government cannot be soft in cracking down on smuggling and counterfeits. We can only stop these crimes by being tough and strict. STMA is determined to do a good job in the next stage of the crackdown.

Yang said that the smuggling of cigarettes began in the early 1980s. At the early stage, it was only small quantities, but now it has developed into single large-value cases, as well as gang-organized, specialized, and intelligent crime. Some even transport illegal imports by means of commercial fraud. Crime in the cigarette industry has taken on several new characteristics. First, the scale of manufacturing counterfeits is growing. It has expanded from the coastal provinces to the whole country. Counterfeits have flooded from rural areas to the cities. Counterfeit brands are increasing, and almost all high quality brands have been counterfeited. Manufacturing technology has also advanced; cigarettes that were previously hand-made by farmers are now machine-made. The capacity of manufacturing has also increased tremendously. Counterfeit cigarette manufacturing has been streamlined and has a network that spans processing, manufacturing, transporting, wholesaling, and retail sales. Second, the techniques of manufacturing counterfeit cigarettes have become highly sophisticated. Consumers can hardly distinguish the counterfeits from the real thing. Third, some of the technical personnel and equipment have become sources of underground factories. Last, some local governments unfortunately believe that for farmers, especially in poor areas, making counterfeits is a fast track to getting rich. Therefore these local governments have not cracked down on the counterfeiting activities.

Yang told the reporters that at least one million cases (100 billion cigarettes) of illegally imported cigarettes enter China each year, as opposed to a mere 14,000 cases (1.4 billion cigarettes) of legally imported cigarettes. Smuggled cigarettes are increasing at the rate of 10 percent each year. Large quantities of smuggled cigarettes not only have a large impact on legally imported cigarettes, but also on the domestic tobacco industry. Beijing alone has 40,000 cigarette retailers, and some sell illegally imported cigarettes openly.

Yang also said that because of the huge profits from smuggling cigarettes, even some government officials have become involved. The smugglers pay no taxes on their cigarettes, so they can keep the price of imported cigarettes low. Since China's consumption of cigarettes is one third of the world's total, many foreign cigarette

companies want to get their brands to China by any means, legal or illegal. In northern China, many people prefer foreign brands, so the demand for foreign cigarettes is quite large, which only further fuels corruption.

The government has lost huge tax revenues from millions of cases of counterfeited cigarettes. The manufacturers of counterfeits have evaded over tens of billions of yuan in taxes each year, and have damaged the country's and the tobacco industry's interests. Consumers are the direct victims, because the counterfeits are made of low-grade tobacco and mildewed tobacco leaf--even, in some cases, tree leaves that have been treated with sulphur fumes.

Yang indicated that during the first six months of this year, STMA spared a large number of personnel to implement the crackdown on cigarette smuggling. 24,931 cases of counterfeits were tracked down, and 479 counterfeit manufacturing sites were destroyed. STMA seized and confiscated 423 machines and 314,000 cases of counterfeit cigarettes. Recently, officials in Shenzhen uncovered a whole set of falsified customs forms and over a hundred counterfeit customs seals at a counterfeit cigarette manufacturing site.

Mr. Yang spoke about the next step STMA would take to prevent smuggling. Yang said they would organize a special task force together with customs officials, public security bureaus, and business communities in each province. STMA will also try to get support from local governments in preventing and cracking down on smuggling. STMA will close down cigarette wholesale free markets, continue to track down the manufacturers of counterfeits, and strengthen the management of cigarette manufacturers' personnel and equipment so that counterfeit manufacturers will not have sources for obtaining technical personnel and equipment.

STMA officials also revealed that great success has already been achieved in preventing and countering smuggling in China. Sales in legal retail networks have been climbing. On the open market in Beijing, Marlboro, which previously sold for a little more than 60 yuan RMB (approximately US\$7.26) per carton, is now selling for 90 yuan (approximately US\$ 10.88). Total cigarette sales in the domestic market are on the increase."

## **SDPC Official Dying for Cigarettes**

China Economic Times, 12/8/1998

"On the morning of November 7, Beijing's First Municipal Intermediate Court publicly announced a death sentence with two years of reprieve to former State Development Planning Commission employee Deng Chengshan, for accepting bribes of as much as 1 million RMB. Deng was Division Chief of the Food and Tobacco division of the Electrical, Machinery and Light Industry Department. Cheng's political rights have been suspended and all his private property has been confiscated. The 1 million yuan which are now held by the court will be turned over to the national treasury.

Cheng is 40 years old. While serving as deputy chief of the Food and Tobacco Division in 1995 he was in charge of planning cigarette production for all cigarette companies nationwide. Cheng asked Yunnan Hongtai Corporation to donate money and asked Yunnan Yuxi Tobacco Conglomerate to donate 1 million yuan, ostensibly to help SDPC renovate their offices. Deng returned the money given by Yunnan Hongta Corporation in May, 1997, when he learned that he was being investigated."

## Appendix: Hong Kong Re-export Data and China Customs Data

China's Cigarette Imports (Value in \$US)							
	1997				1998		
	Q1	Q2	Q3	Q4	Q1	Q2	Q3
Hong Kong Re-exports to China	61,542,753	52,701,627	52,701,497	67,809,997	67,304,297	62,767,731	50,086,092
China Official Imports (China Customs Data)	65,883,192	31,058,598	25,506,062	44,875,939	18,951,147	27,848,997	13,474,557
Total*	127,425,945	83,760,225	78,207,689	112,685,936	86,255,444	90,616,728	63,560,649
*Note: This number does not include imports smuggled directly from source countries, or smuggled imports that are transshipped through countries other than Hong Kong.							