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## Abstract

This study explores the history of the illegal production, distribution and smuggling of cigarettes in mainland China. Data were obtained from a content analysis of 931 media reports retrieved from LexisNexis for the time period 1975 until 2010, and from other open sources.

The illegal cigarette trade first emerged in the form of violations of state tobacco monopoly regulations. In the course of the restructuring of the legal tobacco sector, which occurred under external political pressure to open the Chinese market to foreign competition, an illegal cigarette industry emerged which at first primarily produced fake Chinese brand cigarettes for the domestic black market. At the same time China became a destination country for smuggled genuine Western brand cigarettes. It was only after effective crackdowns against cigarette smuggling and domestic distribution channels in the late 1990s that the Chinese illegal cigarette industry shifted to exporting large numbers of counterfeit Western brand cigarettes to black markets abroad.

China's current role as a leading supplier of counterfeit cigarettes is a result of the contradictions of the economic reform process and of external licit and illicit forces that worked towards opening up the Chinese tobacco sector to the outside world.

Keywords: cigarette smuggling; counterfeiting; black market; illegal market; economic reforms; tobacco industry; China

## The changing role of China in the global illegal cigarette trade

### **Introduction**

The illegal trade in cigarettes may well be the most underrated type of transnational crime. It is seldom mentioned in the same breath with drug trafficking or human trafficking or arms trafficking. Yet, in terms of its assumed profitability and global reach as well as in its political and economic ramifications, the illegal cigarette trade has taken on similar proportions. In fact, it is assumed that the smuggling and illegal sale of cigarettes is seen by criminals “as an attractive alternative to drug trafficking because of its lower penalties and large profits” (Europol, 2011, p. 24; see also Beare, 2002, p. 227; Chow, 2003, p. 475), allegedly attracting crime syndicates as well as terrorist organizations to this illegal business (Shelley & Melzer, 2008). Recent estimates suggest that 11.6% of the global cigarette market is illicit, resulting in the loss of government revenue of \$40.5 billion annually (Joossens, Merriman, Ross, & Raw, 2009, p. 17). A considerable share of this lost government revenue translates into illegal profits (Joossens & Raw, 2002, p. 10). In comparison, the illicit trade in small arms is only believed to have a value of about \$1 billion annually (Marsh, 2002, p. 220). The illegal cigarette trade comprises a number of different schemes by which excise taxes and tariffs are circumvented and trademark rights violated, involving the illegal production, smuggling and illegal distribution of cigarettes (von Lampe, 2011). While previously genuine cigarettes dominated the black market, in the past decade counterfeit cigarettes have gained a significant market share, with the People’s Republic of China (hereafter: China) commonly assumed to be the main source country. Based on statistics on the seizure of counterfeit cigarettes (9.28 billion sticks in China in 2007) it has been estimated that between 93 and 186 billion counterfeit cigarettes are being produced in mainland China annually, which would account for between 1.6 and 3.3% of the total (legal and illegal) global cigarette market (Joossens et al., 2009; Allen, 2011). According to another estimate, the number of fake cigarettes produced in China per year is even higher, reaching 400 billion sticks (Chen, 2009). China’s importance as a producer of fake cigarettes is underscored by seizure data from Western countries. In the past decade, up to 83% of counterfeit cigarettes seized annually within the European Union and up to 99% of counterfeit cigarettes seized in the U.S. are believed to have originated from China (OECD, 2008).

At first glance it would appear that China's prominent role in the global illegal cigarette market is just another facet in the overall picture of product piracy with China appearing as the arch villain (Lin, 2011). This view, however, seems oversimplified. In fact, China's role in the global illegal cigarette market is much more complex and has undergone substantial changes over time. The purpose of this paper is to shed light on the history of the illegal cigarette trade in its many variations within China and with its diverse links between China and the rest of the world, beginning in the 1970s when China set out to venture down the path from a state planned economy to a market economy. Following up on a study of the social embeddedness of Chinese cigarette counterfeiting (Shen, Antonopoulos, & von Lampe, 2010), the aim of this paper is to gain a better understanding of the dynamics of the formation and evolution of an illegal market within the context of China as a country in transition. Accordingly, our focus is on mainland China, excluding the former colonies and current "Special Administrative Regions" of Hong Kong and Macao. We argue that in order to characterize China's role in the global illegal cigarette market, neither the label of villain nor the label of victim is appropriate. Rather, the case of the illegal cigarette trade as it relates to China shows how contradictions within the process of economic reform combine with external licit and illicit forces to shape a globalized illegal market.

### **Methods and Data**

There is little previous research on China's role in the illegal cigarette trade. Existing studies either deal with more general issues, such as product piracy (Chow, 2003; Hung, 2003; Mertha, 2005), or with more specific issues such as the complicity between particular tobacco corporations and cigarette smugglers (Lee, Gilmore, & Collin, 2004; Lee & Collin, 2006). Likewise, cigarette trafficking has received surprisingly little attention in discussions of organized and transnational crime relating to China (Chin & Godson, 2006; Chu, 2002; Curtis, Elan, Hudson, & Kollars, 2003; Lintner, 2004; Lo, 2008; Wang, 2011). Accordingly, no comprehensive understanding exists of China's role in the illegal cigarette trade.

Research on the illegal cigarette trade in China is confronted with some of the same obstacles that exist for empirical criminological research in China generally. Data on crime are difficult to access and impossible to assess because of a lack of transparency of the data collection process, and they are likely to be subject to manipulations to serve political and other interests (Bakken, 2005; Broadhurst & Liu, 2004; Shen et al., 2010). Likewise, officials have been found reluctant

to assist in criminological research out of concerns that it might discredit the Chinese government (Bennett, 2004; Broadhurst & Liu, 2004; Chin & Godson, 2006; Shen, 2005; Zhang, Messner & Lu, 2007). Furthermore, there are technical restrictions for Chinese and non-Chinese researchers to cover developments that extend across a country divided into 34 provinces, autonomous regions, municipalities and special economic zones. Combined with the vast geographical expansion of China and the size of its population, ethnic diversity and differences in the extent and pace of socio-economic development contribute to a highly complex context which does not permit generalizations from research conducted in one particular part of the country (Liang & Lu, 2006). At the same time, research on a countrywide scale meets with almost insurmountable obstacles for financial reasons alone. In addition to these impediments to prospective research, the circumspect attitude of the Chinese government have ensured that statistical information is not collected and disseminated, at least not to the extent of other countries (Brewer, Guelke, Hume, Moxon-Browne & Wilford, 1996). In an effort to capture the structure and dynamics of the illegal cigarette trade in China we therefore draw primarily on an extensive analysis of open sources from within and outside of China. Apart from a general literature and Internet search, we retrieved Chinese and international media reports from the Lexis-Nexis database of “Major World Publications” for the time period 1975-2010. Casting a wide net with different combinations of a number of alternative search terms (China, Chinese; cigarette; fake, counterfeit, smuggling, smuggled, pirated, illegal, illicit) we initially retrieved some 7,000 media reports among which eventually 931 relevant reports were identified in a manual screening process.<sup>1</sup>

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<sup>1</sup> The 931 media reports retrieved from the LexisNexis database which address the illegal production, possession, transportation or sale of cigarettes with a link to China come from a total of 167 different sources, 61 of which are sources accessed indirectly, primarily through BBC’s *Summary of World Broadcasts* and *Worldwide Monitoring* services. 24.5% (n=229) of the media reports in our sample come from mainland Chinese sources either directly (n=72) or indirectly through the BBC (n=157). Another 19% of the sample (n=177) come from media outlets in Hong Kong, either directly (n=167) or indirectly through the BBC (n=10), with the *South China Morning Post*, an English-language daily newspaper published in Hong Kong, being the most important single source in our sample, accounting for 16.2% (n=151) of all relevant items found in the Lexis-Nexis database. Other reports originate primarily from other South-East Asian countries, the British Isles, North America, Australia and Oceania and continental Europe. 28.3% (n=264) reports originate from Taiwanese and non-Chinese sources in South-East Asia, 23.3% (n=217) from the British Isles (UK and Ireland), followed by North America (U.S. and Canada) with 12.8% (n=119), Australia and Oceania with a share of 4.9% (n=46), continental Western Europe with 2.6% (n=24), Eastern Europe (former Soviet Bloc, former Yugoslavia and Albania) with 2.5% (n=23), and Africa with a share of 1.1% (n=10). Except for one report from the *Jerusalem Post*, media sources from the Middle East are not represented in our sample; neither are media sources from Central Asia, the Indian sub-continent, Latin America, or the Caribbean. It should be noted that this uneven geographical distribution is not necessarily reflective of the make-up of the Lexis-Nexis database “Major World Publications”. For example, Latin America and the Caribbean are covered by a number of English language news monitoring services, such as the *Latin America News Digest* which, judging from tentative searches, contains some 1000 crime related items and 23 items addressing cigarette smuggling for the time period 2003-2010, yet none mentioning any link to China.

These reports were then coded for types of illegal schemes and geographical scope to obtain a rough overview of major trends and patterns. Subsequently all relevant content from the Lexis-Nexis material as well as from other sources, including Chinese and international websites and the academic literature, was excerpted and entered into seven text databases organized thematically and chronologically into a total of 256 conceptual categories for an in-depth qualitative analysis.

Media reports have principal limitations as data sources (Barranco & Wisler, 1999; Franzosi, 1987; Oliver & Maney, 2000; Woolley, 2000) and the retrieval from databases like Lexis-Nexis is influenced, for example, by the choice of keywords, a process which may lead to the exclusion of reports that are peripherally relevant but may be important for the wider context of the study (Jewkes, 2011). Still, from the triangulation of the information extracted from the various Chinese and international sources emerges a fairly consistent picture. We are therefore confident that we are able to identify the main trajectories of the development of the illegal cigarette trade in China and its international ramifications over the past decades.

## **Overview**

The emergence of China as the main supplier of counterfeit cigarettes can perhaps be best understood as the result of three processes where each process, respectively, set the preconditions for the subsequent stage of development. However, while each of these processes is characteristic of a particular historic time period it would be an oversimplification to frame them as distinct phases appearing in a strict sequential order. It is more appropriate to speak of interlocking and partly overlapping processes.

The first process, initiated in the late 1970s, led to the formation of effective distribution channels for illicit cigarettes within China. The liberalization of domestic trade and commerce in the course of the economic reforms launched in 1979 facilitated the marketing of cigarettes either illegally diverted from state controlled businesses or illegally produced in excess of state set production quota.

The second process pertains to the development of brand consciousness among Chinese smokers and the competition between Chinese and foreign brand cigarettes. In this process, China saw the creation of an infrastructure for the counterfeiting and the smuggling of popular Chinese and Western brand cigarettes destined for the Chinese black market. Factors that fueled this process,

which culminated in the late 1980s through the mid 2000s, included the modernization and regional concentration of the legal tobacco industry in China as well as efforts by Western tobacco manufacturers to establish their brands on the Chinese market by legal and illegal means. The third phase, finally, is characterized by a reorientation of China's illegal cigarette industry towards black markets abroad. This development is linked to crackdowns against corruption, smuggling and illegal retail markets in China in the late 1990s and also coincides with increasing pressure exerted by governments in Europe on Western tobacco corporations to cease supplying their cigarettes to European black markets.

### **The Economic Reforms in China Since 1979**

The illegal cigarette trade in China emerged as a significant problem in the context of the reforms initiated in the late 1970s when the Chinese Communist Party decided to gradually 'open up' the country to the outside world and to modernize its economy. A broad range of measures were implemented from 1979 onwards, including the decollectivization of agriculture, the decentralization of fiscal revenues to local governments, the expansion of autonomy of state-owned enterprises, the encouragement of private businesses and the establishment of a market-based economy. The main characteristics include the creation of various special economic zones and the opening-up of coastal cities, as well as the promotion of foreign trade and investment (Bell, Khor, & Kochhar, 1993, pp. 1-2; Guthrie, 2009; Yuan, 2008). These measures, however, had not followed a coherent design, were introduced gradually and at times only half-heartedly, and not all economic sectors and not all parts of the country were equally affected (Bell et al., 1993, pp. 2-3; Naughton, 2007; Shirk, 1993, p. 14). As a result, the developments in China since the late 1970s have been marked by a number of contradictions. Perhaps the most substantial contradiction is that the economic reforms and the 'opening up' to the world did not go hand-in-hand with reforms of the political system and the one-party rule of the Communist Party (Shirk, 1993, p. 4). Contradictions also emerged as a result of the rapid economic development in the special economic zones in southeastern China, namely in Guangdong and Fujian provinces, close to Hong Kong, Macau and Taiwan, in comparison to the relatively slow progress made in the rest of the country (Broadman & Sun, 1997; He, Wei, & Xie, 2008; Reardon, 1996). This process of a desynchronization of economic development on the provincial and local level was reinforced by a

general trend towards a decentralization of authority from central to local governments (Chien, 2010; Guthrie, 2009).

### **The Legal Tobacco Industry in China**

Variations in the shape and pace of economic reforms did not only emerge from one province to the next, but also from one economic sector to the other. In fact, although the tobacco sector was one of the first to be affected by the reform policies of the late 1970s, it is also one of the sectors where even decades later government controls continue to impose restrictions on free market exchange (Wang, 2009; Zhou, 2008). The Chinese tobacco industry, from production to wholesale distribution, is organized as a state monopoly. Neither Chinese private businesses nor foreign tobacco corporations, with the exception of a few joint ventures (He, Takeuchi, & Yano, 2010; Lee et al., 2004), have been permitted to operate in China to compete with state-owned businesses (Wang, 2009). The cultivation of tobacco leaves and the retail distribution is not nationalized, but under state control (Hu, Mao, Shi, & Chen, 2010; Wang, 2009; Zhou, 2000). For example, a special permit is required for opening a cigarette-selling business (Hu, Mao, Shi, & Chen, 2008, p. 35; Shen et al., 2010, p. 241), and until 2003, retailers needed an additional permit for selling foreign cigarettes (Hu et al., 2008, p. 31).

The tight control over the tobacco sector can be explained, as Zhou (2000) argues, by the important role the tobacco industry has been playing in generating government revenues. China possesses the largest population of smokers, estimated at around 300 to 400 million or roughly one third of world smokers (Hu et al., 2010; Wang, 2009; Zhou, 2000). This huge market has traditionally been supplied almost exclusively from domestic sources, making China the world's largest producer of tobacco products, while foreign cigarettes, until recently, accounted for only a marginal share of the legal market as a result of high tariffs on cigarette imports (Hu & Mao, 2002; Hu et al. 2008), just like the Chinese tobacco industry has played no significant role on the world market with only a share of 1.8% of the world's (legal) cigarette exports in the year 2000 (Wang, 2009, p. 178). The revenues derived from the tobacco sector in the form of taxes and monopoly profits have declined in recent years but they remain substantial for the central government as well as for a number of provincial and local governments (Hu et al., 2008; Wang, 2009). In 2007, the tobacco sector accounted for about 7.6% of the central government's total revenue, compared to 11.4% twelve years earlier, in 1995 (Hu et al., 2008; Hu et al., 2010), while

local governments in important cigarette-manufacturing regions were able to derive as much as 60 to 70% of their revenues from the tobacco industry (Wang, 2009, p. 180).

Even though the Chinese tobacco industry has not been privatized in the course of the economic reforms, it still has undergone profound changes. Perhaps the most significant change has been the technological modernization of cigarette production. Beginning in 1981, cigarette factories were able to obtain Western machinery, including entire production lines, which led to a dramatic increase in productivity, production capacity and product quality (Zhou, 2000). This modernization process, however, did not embrace the entire industry. Instead, a few regions emerged with highly productive cigarette factories while other provinces fell behind, leading to a geographical shift and concentration of the tobacco industry (Wang, 2009). In particular, it was the southwestern province of Yunnan, traditionally one of the main tobacco growing areas in China but lagging behind in industrialization, which managed to establish itself as the leading producer of cigarettes through a rigorous modernization campaign carried out during the 1980s and 1990s (*China Daily*, 1 March 1999). In the process, the Yuxi Cigarette Plant, once a marginal factory, grew to become the country's biggest cigarette manufacturer with its bestselling "Hongtashan" (Red Pagoda Mountain) brand (Zhou, 2000).

It is worth noting that four of the five most prominent cigarette producing provinces in the year 2000, Henan, Hubei, Hunan, Shandong and Yunnan (Hu et al., 2008, p. 29), are not coastal regions but lie inland. This contrasts markedly with the general picture of a concentration of modern industries along the coastline (Broadman & Sun, 1997; He et al., 2008).

The example of Yunnan province illustrates the effects of the decentralization of authority and of tax revenues, which beginning in the 1980s, gave provincial and local governments the power and the incentives to adopt an active role in the development of the economy, and especially the tobacco sector, within their respective jurisdictions (He et al., 2008). Even where local governments did not promote the modernization of cigarette manufacturing, in order to increase their tax revenues they still supported an expansion of tobacco cultivation and cigarette production, because they were allowed to retain tax revenues that exceeded those previously set amounts which had to be shared with higher levels of government (Wang, 2009). As a result China saw a rapid growth in the output of cigarettes, from 852 billion in 1981 to 1,736 billion in 1993. And the trend would have continued, Zhou (2000, p. 112) argues, had not the State Tobacco Monopoly Administration (STMA) imposed a cap on the total output.

Until the late 1980s, the expansion of the production of cigarettes was met by increased consumption, partly as a result of increasing household income, partly due to the opening up of rural areas that previously had been undersupplied (Zhou, 2000). In fact, demand exceeded supply until about 1990 when cigarette prices began to drop. At this point, local governments were no longer able to increase tax revenues by simply expanding cigarette production (Zhou, 2000, p. 125). However, a change in the quota system introduced in 1992 permitted a shift to the production of higher quality cigarettes which yielded higher tax revenues. For example, the share in total output of filter-tip cigarettes rose from 5.8% in 1982 to 93.5% in 1996 (Wang, 2009, p. 178). As a result, in the mid-1990s, China experienced an excess in the supply of more expensive cigarettes favored by urban smokers and a shortage of cheap cigarettes which were in demand primarily in rural areas (Wang, 2009, p. 178; Zhou, 2000, p. 126).

At the same time, the saturation of the urban cigarette market intensified a trend towards protectionist measures adopted by local governments to shield their own tobacco industry against outside competition (Zhou, 2000, p. 126). Local protectionism had emerged as a more general phenomenon, but reportedly no other sector, perhaps with the exception of alcohol, was as highly protected as the tobacco industry (He et al., 2008, p. 927). While protectionist measures kept relatively unproductive factories artificially in business, a practice condoned by the monopoly administration, STMA, allowed provinces to trade cigarette production quotas so that those provinces with the most modern cigarette plants could legally increase their output in exchange for a share of their profits (Zhou, 2000, p. 127; Wang, 2009, pp. 186-187). This, in turn, reinforced the process of the geographical concentration of cigarette manufacturing in Yunnan and a few other provinces at the expense of other regions, including the otherwise economically advanced coastal regions.

Towards the late 1990s, China's aspirations to accede to the World Trade Organization (WTO) brought about a further profound change for the Chinese tobacco industry, which further accelerated the concentration and modernization process (Zhou, 2000). In order to be accepted into the WTO, China was pressured, not least by the United States, into removing trade barriers and eliminating prohibited subsidies (Feaver, 1996; Hu et al., 2008; Wang, 2009). This meant, for example, that China had to reduce tariffs on the importation of cigarettes from 65% before the accession to the WTO in 2001 to 25% in 2003 (Wang, 2009, p. 177). While the state monopoly was maintained and foreign cigarettes could still only be marketed legally through state controlled distribution channels (Wang, 2009, p. 181), China's accession to the WTO exposed its

tobacco industry to increasing competition from foreign cigarette manufacturers. In response, the government in Beijing pushed for a “rapid merger movement”, building upon the centers of production that had previously established themselves during the period of economic decentralization (Wang, 2009, p. 166). In 2003, the monopoly administration was restructured to reduce the influence of local governments on tobacco businesses and to facilitate the formation of large (state owned) tobacco corporations able to compete on the world market (Wang, 2009, p. 190). Small cigarette plants were closed down whereas large ones were merged, first within a region and then across regions, resulting in the number of cigarette companies dropping from 185 in 2000 to 44 in 2005 while the number of cigarette brands decreased from 1,049 in 2001 to only 325 in 2005 (Hu et al., 2008, p. 31; Hu et al., 2010). In the end, the restructuring of the tobacco industry has led to the creation of a handful of large tobacco corporations with the largest three centered in Yunnan, Hunan and Shanghai (Wang, 2009, p. 189). It is not entirely clear what effect this had on unemployment. While the official news agency *Xinhua* at one point reported that 50,000 workers were re-deployed to non-cigarette businesses (*Xinhua*, 21 April 1996), it seems that numerous workers were left unemployed as a result of the industry restructuring, thereby becoming available for illicit cigarette production (Hu et al., 2008, p. 31; Shen et al., 2010, p. 241; *Xinhua*, 18 December 1992).

### **The Emergence of a Domestic Distribution Infrastructure for Illegal Cigarettes**

The interlocking processes that eventually led to China becoming a major player in the global illegal cigarette trade were set in motion in the late 1970s and early 1980s by the confrontation of a socialist ‘economy of shortage’ and an emerging free market economy at the grassroots levels in the form of unregulated market places. These market places provided a distribution infrastructure which facilitated not only the early development of the illegal cigarette trade, but especially the marketing of large amounts of smuggled and counterfeit cigarettes in later years.

### **Violations of Legal Restrictions on Cigarette Production and Distribution**

The history of the Chinese tobacco industry since the onset of the economic transformation in the late 1970s points to a number of criminogenic factors that help understand the development of the illegal cigarette trade during that same time period. To begin with, the inability of the Chinese

government throughout the 1980s and partly well into the 1990s to meet a growing demand for cigarettes with its own production and distribution capacities while at the same time imposing legal restrictions on the private production, importation and distribution of cigarettes is almost a textbook scenario for the emergence of an illegal market. However, it is important to note that this constellation is dissimilar to the situation in which illegal cigarette markets commonly develop. In most cases, the sole rationale behind the illegal cigarette trade is to evade tobacco taxes (von Lampe, 2006; 2011). An exception to this rule, apart from the case of China, is the smuggling of cigarettes into Yugoslavia during the 1990s to circumvent international sanctions (Hajdinjak, 2002, p. 15).

In China, two main forms of illegal activity involving cigarettes characterized the late 1970s and the 1980s: the illegal production of cigarettes in defiance of the quotas set by the government, and the diversion of legally produced cigarettes into illicit distribution channels.

#### *The Diversion of Legally Produced Cigarettes Into Illicit Distribution Channels*

Given the shortages in the supply of cigarettes and the relatively low retail prices set by the government on the one hand, the high demand for cigarettes on the other, a lucrative profit-making opportunity presented itself to those who could obtain cigarettes at official prices and sell these cigarettes with a mark-up reflecting the existing consumer demand. Such a pattern, of course, which by 1981 had reportedly become “widespread” (*New China News Agency*, 16 June 1981), was not unique to cigarettes, and not unique to the situation in China, for that matter; in all ‘economies of shortage’, parallel markets for scarce goods had developed in some form or other although cigarettes did not necessarily fall into this category (see e.g. Ledeneva, 1998).

A key component in the diversion of cigarettes from legal outlets was the complicity of persons within the state-owned cigarette plants and wholesale businesses. In one case, high ranking officials in Yunnan were accused of allotting a four-month supply of popular high-grade cigarettes to persons “who had a particularly close relationship with them” instead of selling these cigarettes on the market (*New China News Agency*, 13 June 1981). In another case, cigarettes of a particular brand could not be found in any licensed shop while there was “a large number of hawkers peddling these cigarettes” on the streets. The peddlers reportedly admitted that they “were relatives of cadres working at the bureau of industry and commerce or government-run shops” (*People’s Daily*, 10 October 1985).

It seems that the diversion of cigarettes from legal distribution channels became increasingly sophisticated over the years, involving larger, more continuous and more resourceful networks of co-conspirators within increasingly larger areas of operation. In fact, the news agency *Xinhua* claimed in 1987 “that a considerably large portion of the nation’s cigarette market has been seized by an underground network linking cigarette supply and distribution channels, cigarette traders and cigarette vendors on the street” (*Xinhua*, 14 July 1987), while the *Henan Provincial Service*, in a similar vein, suggested a year later that “individual profiteers have ganged up with each other and acted from the inside in co-ordination with operations from the outside” (*Henan Provincial Service*, 17 October 1988). In one high-profile case exposed in the central province of Hunan, various state-run cigarette marketing agencies were involved in the illegal wholesaling of 11 million cartons (2.2 billion sticks) of cigarettes to 125 traders from the coastal province of Zhejiang (*Xinhua*, 10 November 1987; 24 November 1987). In another case, staff from a postal transport station in Zhejiang used postal vehicles to smuggle expensive cigarettes from Guangdong province over a distance of several hundred kilometers (*Xinhua*, 21 July 1987). *Xinhua* also reported the use of military trucks and even aircraft for this illegal cigarette trade (*Xinhua*, 10 November 1987).

#### *The Illegal Production of Cigarettes in the 1970s and 1980s*

Whereas the diversion of cigarettes from legal outlets primarily undermined the system of state-set prices and business licensing, the illegal production of cigarettes directly challenged the state monopoly over the tobacco industry. Two forms of illegal production can be discerned, the mere production of cigarettes outside the state plans, and the production of fake cigarettes in violation of protected trademark rights and other provisions of the criminal law. As already indicated, the central government exerted pressure on local governments to close down inefficient cigarette plants. Three hundred factories had been ordered to shut down in 1983 and the sale of hand-rolled cigarettes had been made illegal in an apparent effort to reduce the waste of raw materials through ineffective production methods (*Xinhua*, 20 May 1985). Some local governments, however, continued to support the inefficient production of cigarettes by “boosting the production capacity of some plants, building new ones, and planning to resume operation of others that have already closed down” (*Xinhua*, 17 November 1987).

The illegal production of cigarettes entailed the unauthorized supply of raw materials and equipment as well as the use of illicit distribution channels (*Xinhua*, 10 November 1985). It seems that at least in the 1980s the resources, especially tobacco leaves, that were available to illegal production facilities, tended to be of a lower quality. It does not come as a surprise, therefore, to see illegally produced cigarettes being marketed under false brand names to facilitate sales. As early as 1980, the media reported of fake cigarettes being sold among a wide range of other counterfeit products, including bicycles, wrist-watches, wines and drugs using defective or discarded packing materials (*New China News Agency*, 6 December 1980).<sup>2</sup> Five years later counterfeiting was portrayed as having “become more and more serious” (*Liaoning Ribao*, 20 April 1985) with a “flooding of counterfeit cigarettes into some places” (*Xinhua*, 24 May 1985). The level of sophistication of counterfeit cigarette production, however, seems to have remained at a relatively low level. Media reports in the late 1980s indicate that businesses as well as individuals were involved, and that a significant share of counterfeit cigarettes was, in fact, hand-rolled rather than machine made (*Peking Home Service*, 24 February 1987; *Xinhua*, 13 July 1987).

### *Illegal Wholesale and Retail Selling*

The illegal production of cigarettes in the 1970s and 1980s was facilitated by the emergence of unregulated market places that served as effective distribution channels for a wide range of illicit goods. Some of these unregulated market places were illegal altogether; some of them had a legal status, such as village fairs in rural areas that had gradually been reestablished after the Cultural Revolution and, within the framework of the economic reforms launched in 1979, served the purpose of promoting individual entrepreneurial activity (Chwee-Huat, 1988). In many cases, however, the control over these markets appears to have been weak, allowing vendors of illicit goods, including cigarettes, to operate at these settings (see e.g. *Peking Home Service*, 27 April 1979; *Shanghai City Service* 28 May 1983). In the urban areas, street selling and illegal retail markets became widespread. For example, a 100-day campaign against illegal street dealers in Beijing in 1989 reportedly exposed 110,000 unauthorized businesses, including illegal vendors of cigarettes (WuDunn, 1989).

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<sup>2</sup> Original sources are cited as they appear in BBC reports, therefore references are sometimes to “New China News Agency” and sometimes to “Xinhua”.

In addition to free markets where suppliers sold goods directly to consumers, from the late 1980s through the early 1990s, free wholesale markets developed which, as Zhou (2000, pp. 123-124) points out, have played an important role in channeling the increasing output of cigarettes across China and especially to the rural areas. Local governments exacted taxes from these markets, typically at fixed rates (Behar, 2000), and shielded them against investigations by the tobacco monopoly administration (Zhou, 2000, p. 124).

### **The Competition between Chinese and Foreign Brand Cigarettes**

As the production of cigarettes increased, the focus of the illegal cigarette trade shifted from supplying a scarce product to catering to and boosting the brand consciousness of Chinese smokers. There are two dimensions to this particular process: the production of fake cigarettes, primarily pertaining to the counterfeiting of the most popular Chinese brands, and the introduction of Western brand cigarettes to Chinese smokers by way of smuggling.

### **Cigarette Smuggling into China During the 1970s and 1980s**

In contrast to the attention paid to the illegal cigarette trade within China during the 1970s and 1980s, there were only isolated media reports on cigarette smuggling. The term ‘smuggling’ was primarily used in reference to the transportation of cigarettes from one province to another in the context of domestic black market activities (see e.g. *Xinhua*, 21 July 1987).

It was only in the late 1980s that cigarette smuggling into China began to receive some attention as part of what one observer called “a burgeoning smuggling industry” that provided Western consumer goods to Chinese “at a fraction of the price charged in the state-run shops” (Usborne, 1989). The smuggling problem, it seems, initially manifested itself primarily along China’s coastline with cigarettes arriving by ship from Hong Kong, Taiwan and foreign countries (Mathews, 1980; *Xinhua*, 11 March 1989), foreboding what would come to shape the illegal cigarette trade in the 1990s.

### **Cigarette Smuggling Into China From the Late 1980s Through the Mid 2000s**

In the 1990s the illegal diversion of cigarettes from legal outlets into black market channels ceased to be addressed as a major problem while the illegal production of cigarettes became more fully a matter of counterfeiting. At the same time, China became a destination country for smuggled Western brand cigarettes.

When, beginning in the late 1980s, the smuggling of cigarettes into China received increasing attention from Chinese and Western media, the problem was not only one of cigarettes. China found itself confronted with “floods of smuggled goods” of various kinds (*China Daily*, 15 July 1999) that were seen to pose “an increasingly serious threat to the country’s market order” (*Xinhua*, 12 November 1991) and “to the smooth implementation of the reform and opening policies” (*Xinhua*, 21 May 1991). A broad range of goods that, like cigarettes, were subjected to high import tariffs, found their way into the mainland, including electronic appliances such as television sets and video recorders, cars, motorcycles and oil products, while Chinese antiques and protected species were smuggled out of China (*Zhongguo Xinwen She*, 8 April 1991). Cigarettes, however, consistently stood out in media reports and official accounts throughout the 1990s as one of the top two or three smuggled goods.

It is not clear at what scale contraband cigarettes entered China. In 1989, according to the official news agency *Xinhua* (5 September 1990), 900,000 boxes of cigarettes were smuggled into China, which, assuming that one box holds 50 cartons or 10,000 sticks (Cook, 1998), amounts to 9 billion cigarettes. A year later, in 1990, the number was said to have increased dramatically to 35 billion cigarettes (Hutchings, 1991). In 1994, when Chinese authorities reported seizing 5.1 billion cigarettes (Higgins & Doyle, 1996), all of the estimated 80 billion foreign cigarettes sold in China were believed to have been smuggled into the country (Faison, 1997). This would constitute a market share of about 4.5% (Bonner & Drew, 1997). For 1998, estimates of the share of smuggled cigarettes in China’s cigarette market were as high as 8-9% (Hu & Mao, 2002, p. 7). The cigarettes smuggled into China primarily comprised foreign brands such as BAT’s “555” and “Hilton”, and Phillip Morris’ “Marlboro” (Cook, 1998; *Xinhua*, 12 November 1991; 17 August 1999). In addition, Chinese cigarettes were illegally re-imported into China to evade domestic taxes (Faison, 1998) or, in the case of Chinese brand cigarettes manufactured in Hong Kong (“Shuangxi” [Double Happiness]), smuggled into mainland China similar to foreign brand cigarettes (Lee, 2004). In isolated cases, the smuggling of counterfeit cigarettes from south-east Asian countries into China was also reported (Harding, 1997; Woolrich, 1992; Yu, 1996).

### *Smuggling Schemes*

According to the available data, cigarettes seem to have been primarily smuggled into China by sea with the main trafficking routes connecting Hong Kong with neighboring Guangdong province, and Taiwan with Fujian province across the Taiwan Strait. In contrast, cigarette smuggling over land, perhaps with the exception of smuggling between Hong Kong and Guangdong, appears to have been of only secondary importance.

Two main modes of smuggling cigarettes are discernible, the use of private vessels, and the use of cross-border freight container traffic. Initially, it seems that fishing boats provided the primary means of transporting contraband cigarettes (*Xinhua*, 3 October 1988), soon followed by armored boats and high-powered motorboats with modern navigation equipment that outclassed government vessels (*Xinhua*, 12 November 1991; *Zhongguo Tongxun She*, 25 July 1991; 5 October 1992). Fishing boats and other small vessels would transport cigarettes from ports in, for example, Hong Kong, Taiwan or the Philippines, or, possibly more commonly, they would rendezvous with larger vessels on the high seas (Sun, 1992; *Zhongguo Tongxun She*, 31 October 1994).

In contrast to smuggling by boat which relies on evading border controls, smuggling by freight container uses legal channels for cross-border transportation of goods. In one case, ten 40-ft. containers carrying 96 million cigarettes were seized in Hong Kong aboard a ship destined for mainland China. The cigarettes had previously been legally exported from Hong Kong to Japan where the cargo was reclassified to “lift parts” and “aluminum” (Cunningham, 1996).

Over the years, smuggling routes had become more complex to obscure the origin of shipments. Apart from Hong Kong and Japan, cigarettes would also be sent, for example, through South Korea, Malaysia, the Philippines, and Singapore (*China Daily*, 27 August 1997; Higgins & Doyle, 1996; Lo, 1998). North Korea, according to one report, also assumed a prominent role as a transshipment point for contraband cigarettes to China. In 1997, North Korea was the single biggest destination country for cigarette shipments going through Hong Kong. These cigarettes allegedly were sold for hard currency on the black market in China (Schloss, 1997).

### *Individuals and Groups Involved in Smuggling*

While information on perpetrators is scarce, there seem to have been essentially two types of smugglers directly involved in bringing contraband cigarettes ashore: fishermen engaged in smuggling as a sideline, and full-time smugglers. The first category of “fishermen-turned-traders” (*Economist*, 26 May 1990) were described in the Chinese media with some caution as “honest fishermen” corrupted by huge profits (*Xinhua*, 12 November 1991) without providing any more details while reports on full-time smugglers emphasized a high level of organizational and technical sophistication, referring to “well organized” smuggling groups (*Zhongguo Xinwen She*, 21 March 1994) and “gangs armed with assault rifles and high-tech equipment” (*China Daily’s Business Weekly*, cited in *Asian Wall Street Journal*, 31 December 1990). One example for the latter category is a smuggling group whose members were apprehended in 2002 in a fishing village in Fujian province. The group was headed by Cai Wanhe, a 51-year-old man “with no fixed job”, his two brothers and two cousins. The gang reportedly had its own fleet of vessels to bring cigarettes to shore from ships out in the Taiwan Strait. Villagers hired by the gang would then load the contraband onto vehicles for further distribution (Larmer, 2002; *Xinhua*, 28 March 2002).

Cai Wanhe and his group, in turn, allegedly used to work for China’s most notorious smuggler, Lai Changxing (Larmer, 2002). Lai Changxing, who is believed to be responsible for illegally bringing \$ 6.4 billion worth of goods into China during the second half of the 1990s, is at the center of what has been described as China’s biggest corruption and smuggling scandal (Jie, Wei & Jing, 2001). Born to peasants in 1958 and with little formal education, he started out as a small entrepreneur in the 1970s and gradually built up a business empire, Yuanhua Group, in the port city of Xiamen in Fujian province and in Hong Kong (Jie et al., 2001; Liu, 1999; McGregor, 2005). His criminal activities reportedly began in the 1980s when he engaged in “small-scale duty-evasion” and expanded to smuggling on a large scale in the 1990s (Jie et al., 2001). From the early 1990s Lai Changxing is said to have been involved in the illegal importation of cigarettes as well as electronics (McGregor, 2005). Later he diversified his smuggling portfolio to include refined and vegetable oil, automobiles, chemicals, pharmaceuticals, and textiles (Jie et al., 2001). Similar to Cai Wanhe’s group, many of the core members of the smuggling operation of Lai Changxing were close relatives. In fact, cigarette smuggling was overseen by one of Lai Changxing’s brothers (Jie et al., 2001; McGregor, 2005; Shieh, 2005).

Protected by corrupt party and government officials, the Changxiang group allegedly brought cigarettes into China embedded in legal cross-border trade using essentially two different

schemes of large-scale smuggling. One method involved illegally removing cigarettes from bonded warehouses, another the false declaration of cargo that passed through customs (Shieh, 2005, pp. 72-73). According to official accounts, which only covered the time period 1996-1999, a total of 3 million cases (30 billion sticks) of cigarettes were smuggled into China by the Lai Changxing smuggling network (Jie et al., 2001).

### *The Involvement of Tobacco Manufacturers*

It seems that in the case of China during the 1990s, large-scale smuggling rather than bootlegging accounted for the bulk of contraband cigarettes entering the country. Large-scale smuggling takes advantage of the temporary suspension of taxes and customs duties on goods ‘in transit’ until they are introduced into a market for final distribution. Compared to bootlegged cigarettes which are procured from retail outlets in low-tax countries for sale in high-tax countries, large-scale smuggling of untaxed cigarettes provides for larger profit margins that make it easier to undercut the prices for legally sold cigarettes. In fact, the black-market price of cigarettes smuggled into China not only seems to have been below official prices for legally imported foreign cigarettes but also below or at least at similar levels with the prices of premium Chinese cigarettes (Harding, 1997; Hu et al., 2008, pp. 30-31; Larmer, 2002).

Large-scale smuggling of untaxed cigarettes implies a link of some form or other between smugglers and black market distributors on one side and legal tobacco manufacturers as the ultimate source of untaxed cigarettes on the other. There are clear indications that for many years such links did indeed exist in the case of China, involving both Chinese and foreign companies. This is similar to cases of collusion between tobacco manufacturers and smugglers that have been reported and documented in various other parts of the world during the same time period, including North America, Europe and Africa (Beare, 2002; Joossens & Raw, 2002; LeGresley, Lee, Muggli, Patel, Collin, & Hurt, 2008).

According to *The New York Times* it had been an open secret that the producer of the top-selling “Hongtashan”, the Yuxi Cigarette Plant in Yunnan, “was earmarking a major part of its cigarettes for export and then smuggling them back to China, to avoid heavy duties” (Faison, 1999).

In two other well-documented cases, executives of tobacco corporations colluded with cigarette traffickers and allegedly received kickbacks for allowing cigarettes to be sold into smuggling channels. One case pertained to “Shuangxi” cigarettes produced at a plant in Hong Kong by

Nanyang Tobacco, a subsidiary of Shanghai Industrial Holdings (Lee, 2004). The other, more notorious case, involved British American Tobacco (BAT) in Hong Kong where executives over many years during the 1980s and 1990s allowed a business, Giant Islands Ltd., to be supplied with cigarettes that were smuggled into mainland China and Taiwan. A string of export directors reportedly received HK\$ 50 ( $\approx$ US\$ 6.5) for every box (10,000 sticks) of “555” cigarettes sold to Giant Islands, amounting to monthly payments of over HK\$ 2 million (US\$ 257,000). Although executives lined their own pockets and BAT denied any involvement, from internal documents that have become publicly available it appears that this collusion was quite in line with BAT’s marketing strategy (Campbell, Beelman & Schelzig, 2000; Lee & Collin, 2006; Lee et al., 2004). For example, an internal memo on distribution initiatives within China noted in 1993 that as long as sales of contraband cigarettes “remain dominant, alternative routes of distribution of unofficial imports need to be examined, evaluated and, if appropriate, maximised” (cited in Lee & Collin, 2006, p. 1085). In fact, “unofficial imports” to China, equivalent to about 80-90% of all imports (Bonner & Drew, 1997; Lee & Collin, 2006, p. 1082; Smith, 1996), contributed significantly to the overall profitability of BAT. In the 1990s, BAT brands reportedly held a share of about 50% of the Chinese cigarette black market, accounting for about 20-30% of BAT’s total worldwide profits (Doyle & Higgins, 1995; Lee & Collin, 2006, pp. 1082, 1085).

### *Smuggling and Corruption*

Just as the collusion between smugglers and tobacco industry executives seems to have been crucial for the steady supply of cigarettes to the black market, the influx of these cigarettes into China appears to have hinged to a large extent on the involvement of corrupt officials from various branches of government, including the customs service, police, and the military. In this respect, China seems to constitute a deviant case. For other major cigarette black markets, namely the UK and Germany, the influx of contraband cigarettes seems to be facilitated primarily by the sheer volume of cross-border trade and traffic in comparison to the manpower of customs, while only isolated cases of corrupt customs officials have been documented (Joossens & Raw, 2008; von Lampe, 2002).

The involvement in China of corrupt officials, as disclosed in a number of media reports during the 1990s, ranged from the mere non-enforcement of the law to active participation in cigarette smuggling, and from the passive acceptance to the extortion of bribes. In essence, corrupt

officials, especially along China's southeastern coast, systematically collected fees for the safe passage of smuggling shipments, at times providing armed escorts and logistical assistance to smugglers (*Xinhua*, 26 December 1991; 29 May 1994; *Zhongguo Xinwen She*, 10 September 1996).

In July 1998, the Chinese leadership launched a "large-scale and joint campaign against smuggling" (Jie et al., 2001). This not only entailed aggressive measures against smugglers, such as impounding or sinking smuggling boats (Rosenthal, 2000; *Xinhua*, 22 June 1999). Unlike previous anti-smuggling campaigns, the main thrust was directed against corruption, and for the first time the military was pressured to participate in the effort. In fact, the first measure announced by President Jiang Zemin was to order the People's Liberation Army (PLA) to withdraw from all business activities, legal or illegal (*Deutsche Presse Agentur*, 23 July 1998). The PLA had been encouraged since the early 1980s to generate funds, and it had entered into various lines of business, including mining, agriculture, pharmaceuticals, and telecommunications (Laris, 1998; Minder, 1998). Over time, however, as a Hong Kong newspaper reported, it became more difficult for the military to remain competitive in legal markets, while its resources, namely transportation and military equipment, provided a competitive advantage in the smuggling business (*Ping Kuo Jih Pao*, 24 September 1998). The campaign launched by President Jiang Zemin led to the exposure of numerous cases of corruption. The largest investigation centered around Lai Changxing, the abovementioned smuggler from Xiamen in Fujian province. The investigation revealed a far-reaching network of corrupt ties on the local, provincial and even national level to Party, government, military and law-enforcement officials as well as to executives of state-owned businesses. In the end, almost 300 individuals were convicted, some receiving life sentences or the death penalty (Liu, 1999; Jie et al., 2001; Shieh, 2005). Those receiving the death penalty included the head of Xiamen customs, the deputy director of the provincial Public Security department, and the vice-mayor of Xiamen. The highest-ranking member of the military convicted for accepting bribes from Lai Changxing was a general who had served as the head of the military intelligence in the General Staff Department. Lai Changxing himself was warned of the impending investigation and managed to evade prosecution for twelve years by leaving the country (Shieh, 2005, pp. 80, 86). It was only in July of 2011 that he returned to China and was placed under arrest after being deported by Canada (Johnson & Wines, 2011).

Chinese and foreign observers seem to be in agreement that the anti-smuggling drive and the accompanying crackdown on corruption was not merely a propaganda stunt, but had a tangible impact on the scale of smuggling in terms of the availability and price of formerly smuggled goods on the domestic Chinese market as well as in terms of government revenues (*China Daily*, 14 September 1998; Cook, 1998; Rosenthal, 2000; *Xinhua*, 26 July 2000). The number of smuggling cases investigated by Chinese authorities increased by 36% in 1999 over 1998 (*Xinhua*, 1 February 2000). At the same time, revenues from import tariffs increased sharply, as much as 117% in the first half of 1999 (*China Daily*, 15 July 1999). There is some indication that the anti-smuggling drive and the resulting shortage in contraband cigarettes paved the way for a surge in cigarette counterfeiting. As the Chinese government celebrated its success against cigarette smuggling it noted a rise in the sale of fake cigarettes (*China Daily*, 17 January 2000).<sup>3</sup>

### **Cigarette Counterfeiting During the 1990s and 2000s**

Cigarette counterfeiting, since it was first reported by the Chinese media in the year 1980, had gradually moved towards the center of attention during the 1990s. In a series of campaigns and crackdowns increasing numbers of production sites were targeted and fake cigarettes seized. The first such campaign, it seems, was launched by the tobacco monopoly administration in 1992 leading, over a six-month period, to the confiscation of 2.5 million cartons (500 million sticks) of cigarettes and the destruction of 266 illegal cigarette factories (*Xinhua*, 18 December 1992). In the following year, 1993, 640 million counterfeit cigarettes were seized and 50 “production centres” were destroyed (*New China News Agency*, 29 January 1994). In 1997, following the introduction of stiffer penalties for cigarette counterfeiters, the number of fake cigarettes seized by the tobacco monopoly administration had risen to 4.7 billion while 684 production sites were destroyed (*Xinhua*, 31 March 1998). At this point, cigarette counterfeiting had apparently reached a volume similar to that of the smuggling of genuine cigarettes into China. Once the national anti-smuggling campaign got underway in 1998, however, counterfeiting seemed to have become the main source for illegal cigarettes. While the number of smuggled cigarettes dropped as a result of government efforts, the number of counterfeit cigarettes on the Chinese market reportedly continued to increase (*China Daily*, 17 January 2000; 11 January 2003; O’Neill, 1999; *Xinhua*,

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<sup>3</sup> On previous anti-smuggling campaigns, see *Xinhua*, 12 November 1991, *New China News Agency*, 7 March 1994.

30 October 1999). At the same time, fake cigarettes began to establish a noticeable presence abroad, most of them linked to China as the country of production (Lee & Collin, 2006, p. 1085; O'Neill, 1999).

From the available data it seems that Chinese cigarette counterfeiters originally targeted popular Chinese rather than foreign brands. The first mention of counterfeit foreign cigarettes, “Marlboros”, can be found in 1992 (Woolrich, 1992). However, as *Xinhua* reported in the same year, most fake cigarettes continued to be imitations of well-known Chinese brands such as “Hongtashan” (*Xinhua*, 18 December 1992). According to a report from 1996, 85% of the counterfeit cigarettes that had been seized in China carried the “Hongtashan” label (Yu, 1996). Interestingly, cigarette counterfeiting was most prevalent in the same southeastern coastal regions that were also at the center of the smuggling problem, namely the provinces of Guangdong and Fujian (*China Daily*, 14 November 1999; O'Neill, 1999; Pun, 2003; Shen et al., 2010, p. 244). Production sites originally included cigarette plants and hand-rolling operations that, one can surmise, in the course of the modernization and concentration process of the 1980s and 1990s no longer had a place in the legal tobacco sector. From the late 1990s onwards, reports increasingly refer to ‘underground’ facilities set up for the covert production of counterfeit cigarettes (see e.g. *Xinhua*, 30 October 1999). These production facilities were literally underground in cellars and caves, or they were set up in commercial buildings and private residences. In some cases, machines were mounted on trucks or ships to better evade detection (HM Customs & Excise, 2004; O'Neill, 1999).

The increasingly covert nature of the business apparently was only one reason why authorities encountered great difficulties in curbing cigarette counterfeiting. From the time when cigarette factories began producing outside of the quota set by the tobacco monopoly administration, the illegal production of cigarettes had taken place under the protection of local governments that sought to maintain a valuable source of tax revenues (*Wen Wei Po*, 30 March 1994). This kind of local protectionism, at least in some cases, extended to the counterfeiting of cigarettes, allegedly because it was so deeply rooted in local communities to the extent that “whole villages” were engaged in this kind of illicit activity (*Xinhua*, 24 July 1987). The social embeddedness of cigarette counterfeiting also manifested itself repeatedly in mass protests and acts of resistance against agents of the tobacco monopoly administration (Korski, 1997; *Xinhua*, 16 August 2001). Against this background it is not surprising that despite government vows to crack down on cigarette counterfeiting, the business prospered.

The technology used by counterfeiters has reportedly improved over time; in particular since the mid 1990s with the deployment of more sophisticated machinery for the rolling of cigarettes and the printing of packaging, while the quality of the cigarettes as such seems to have lagged behind well into the 2000s (*China Daily*, 11 January 2003; Michael, 2003). As early as 1996, Chinese counterfeit cigarettes were said to be “almost indistinguishable from the real thing” (Yu, 1996), whereas analyses of the content of these cigarettes revealed tobacco of poor quality and the contamination with material and substances not found in genuine cigarettes or at least not at the same level. Counterfeit cigarettes, according to Chinese authorities cited by the London *Times*, contained, for example, “160 percent more tar, 80 percent more nicotine and dangerously high levels of arsenic” (McGrory, 2005; see also Shen et al., 2010; von Lampe, 2006, p. 240).

The low quality of counterfeit cigarettes does not seem to have had an impact on their marketability within China, perhaps because of the reportedly lower quality of Chinese cigarettes in general. In any case, a functioning system for the distribution of fake cigarettes existed in the form of wholesale and retail markets and street vendors (Chow, 2003, p. 476). When the government began to crack down on cigarette counterfeiting it not only targeted production facilities, but also these distribution channels. In 1999, at the height of the government campaign against the illegal cigarette trade, close to 300 illegal cigarette markets throughout the country were reportedly shut down (*China Daily*, 17 January 2000). Although there is no direct evidence to support this claim, it appears plausible to assume that because of these measures, as well as because of the bigger profit margin when selling counterfeit cigarettes abroad (see Shen et al., 2010), counterfeiters sought to open up new markets for their products outside of China. In so doing, they could take advantage of the smuggling infrastructure that had been created in the 1980s and 1990s for illegally bringing genuine cigarettes into the country. In fact, anecdotal evidence points to some of the same individuals and groups originally being involved in smuggling cigarettes into China later being involved in the production and trafficking of counterfeit Western brand cigarettes (Chen, 2009; Chow, 2003, p. 475).

### **China as a Source Country for Counterfeit Cigarettes in the 1990s and 2000s**

Prior to 1999, China had played a marginal role at best as a source country for illegal cigarettes. Some bootlegging of genuine cigarettes from the mainland to Hong Kong flourished following a 100% increase in Hong Kong’s tobacco taxes in 1991 (Porter, 1993). Cigarettes exported to

China also found their way back to Hong Kong in large-scale smuggling schemes (*South China Morning Post*, 17 November 1994). Finally, there were some initial forays into foreign markets by traders of Chinese counterfeit cigarettes. But it seems that these early endeavors were short-lived. In 1996, container loads of Chinese-made fake cigarettes appeared in shops in Sydney, Australia. Customers complained about the bad quality and in the end, according to one of the affected tobacco companies, only a small number of cigarettes entered the market (Gosman, 1996). In 1997, an operation that smuggled genuine cigarettes into China and fake cigarettes from China to Vietnam was dismantled by authorities in Hong Kong (Chow, 1998). Around the same time, the state of Washington in the U.S. experienced “an influx” of Chinese counterfeit cigarettes (Goldreich, 1998). As far as can be seen, none of these incidents represented more than just isolated events.

It was not until a few years later, around 1999, that the development of the Chinese illegal cigarette trade entered its current phase when fake cigarettes from China first gained a lasting foothold in certain black markets abroad, judging by repeated seizures over an extended period of time and consistent media reports confirming such a presence. Somewhat surprisingly, this is true for less than a handful of countries, namely Australia, the U.S. and, first and foremost, the United Kingdom. In fact, according to industry estimates, counterfeit cigarettes generally have a strong presence only in certain parts of the world (British American Tobacco, 2010).

The UK had emerged as the major illegal market for cigarettes in Europe during the late 1990s, fueled by bootlegging and the large-scale smuggling of genuine, mostly UK-brands. After a major crackdown on cross-channel smuggling and a radical change in the marketing strategies of the major tobacco manufacturers, genuine cigarettes were increasingly replaced by fake cigarettes, most of them believed to be coming from China (von Lampe, 2006). The share of counterfeits on the UK black market, according to some estimates, rose as high as 85% by 2005, accounting for almost 3% of the total of cigarettes smoked in the United Kingdom (Elias, 2005; HM Customs & Excise, 2004; Pagnamenta, 2007).

Apart from Australia, the U.S. and the UK, three other countries, South Africa, Ireland, and the Philippines, stand out, although the record is less clear. Still, the media reports included in our study suggest that there has been some continuity in the smuggling of fake cigarettes from China since 1999. Ireland is particularly interesting because at first it was believed to serve primarily as a transit country for shipments destined for the burgeoning cigarette black market in the UK (Macmanus, 1999). It took several years until, in 2008, Ireland saw itself confronted with a large-

scale black market of its own, accounting for an estimated 20% of the overall cigarette market (Boyle, 2009). Initially, genuine and counterfeit cigarettes were believed to hold about equal shares of this black market. By 2010, however, the share of fake cigarettes, judged by the ratios among seized cigarettes, had risen to almost 80% (Cullen, 2010).

Interestingly, Hong Kong for a long time did not figure prominently as a destination for Chinese counterfeits. The first reports to that effect which we have been able to identify are from 2003, when an “alarming trend” in the import of fake cigarettes from the mainland was noted (Michael, 2003), with about 80% of illegal cigarettes being counterfeit (Lo, 2003). The case of Canada is similar in that the first pertinent reports we have identified also date back to 2003 (Humphreys, 2003; Song, 2003), even though cigarette smuggling had long been rampant in the country (Beare, 2002). And it was not until 2008 that Canadian authorities were “increasingly seeing counterfeit cigarettes imported from China” (MacCharles, 2008).

It is beyond the scope of this paper to explore the global geography of Chinese counterfeit cigarettes in any more detail. A closer analysis of each destination country would be required to understand the patterns of trafficking routes and the variations in black market prevalence. What should be pointed out, however, is that there appears to be no easy answer to the question why illegal cigarettes from China established a market presence in certain countries at certain points in time. Geographical proximity to mainland China, for one, does not explain much when one compares relatively remote countries such as the UK, Australia and the US with, for example, a country in relatively close proximity such as Malaysia which has had a significant smuggling problem but does not seem to be faced with a large number of counterfeit cigarettes from China (Mitchell, 2010). New Zealand is also a case in point. The seizure of one shipment of counterfeit “Marlboros” from China was reported in 2002 (Gardiner, 2002), but as it turned out, this did not signal the influx of large numbers of illegal cigarettes (ASH New Zealand, 2010).

Likewise, countries with a high prevalence of Chinese contraband cigarettes do not necessarily have closer ties with China than other countries. While there are indeed a number of transit and destination countries where cigarette trafficking is linked to Chinese diaspora communities, namely Australia, Canada, the Philippines, South Africa, the UK, and the U.S., other countries with similarly close ties to China have been much less affected, especially with regard to the trafficking in counterfeit cigarettes, such as, for example, the Netherlands. In the media reports we have analyzed, the Netherlands are not mentioned at all despite a rather prominent role in the illegal cigarette trade (van Duyne, 2003; van Dijk, 2007). And there are countries like Ireland

where Chinese counterfeits are highly prevalent, yet the main players in the business are believed to belong to the indigenous population or to immigrant groups from regions other than South-East Asia, namely Eastern Europe (Cullen, 2010).

### **Discussion and Conclusion**

The present study indicates that the marketing of large numbers of Chinese counterfeit cigarettes in countries such as the Philippines, Australia, South Africa, the UK, Ireland and the United States marks the tentative endpoint in a 40-year development, characterized by the entrepreneurial restructuring of the Chinese tobacco sector and the forced opening up of the Chinese cigarette market.

The process of economic reforms “unleashed enormous entrepreneurial energy” (Lin, 2011, p. 4) while at the same time undermining China’s normative order, creating an anomic situation within which illegal activities could flourish (Liu, 2005; Naughton, 2007). All aspects of the tobacco sector were affected, beginning with the emergence of a parallel retail market for cigarettes diverted from legal distribution channels and the production of cigarettes in violation of the state monopoly. The geographical concentration and rapid modernization of legal cigarette manufacturing as a result of the decentralization of authority in the tobacco sector during the 1980s and 1990s led to a fairly clear-cut separation between legal and illegal cigarette production. The illegal cigarette industry that emerged on a grand scale during the 1990s in southeastern coastal provinces such as Guangdong and Fujian, initially focused on the domestic market with the production of imitations of popular Chinese brand cigarettes.

During that same time period, China also saw the influx of large volumes of Western brand cigarettes that were smuggled into the country to circumvent rigid import quotas and high tariffs. The smuggling, it seems safe to assume, occurred with at least the tacit agreement of Western tobacco manufacturers who, in light of declining cigarette consumption in North America and Europe, understandably viewed China as the most lucrative market of the future. By supplying their cigarettes to illicit distribution channels into China, however, the Western tobacco corporations fostered a smuggling trade that became increasingly skillful and sophisticated and eventually shifted its direction from bringing genuine cigarettes into China to smuggling counterfeit cigarettes out of China.

The smuggling of Western brand cigarettes has been only one facet in the forced opening up of the Chinese cigarette market. China, in the course of its accession to GATT and the WTO, was pressured into opening up its domestic cigarette market to foreign competition. This mirrors the development in other Southeast Asian countries like Japan, South Korea and Thailand, which had previously liberalized their tobacco markets mainly under pressure from the U.S. government on behalf of American tobacco corporations (Gruner, 1996; He et al., 2010). Even though China was able to hold on to its tobacco monopoly for the time being, it was still forced to restructure its tobacco industry in order to become more competitive. One side effect of the restructuring was the emergence of an illegal cigarette industry that eventually came to specialize in the production of Western brand cigarettes. Here, as well, the Western tobacco corporations, through their lobbying efforts against protectionist policies, contributed in some way to the problem.

In addition to these factors that took shape over an extended period of time, more narrowly definable events apparently account for China becoming the main global supplier of counterfeit cigarettes around the year 2000. First, the successful national anti-smuggling campaign launched in 1998 reduced the influx of contraband cigarettes which created a void on the domestic black market that could be filled with counterfeit cigarettes (*China Daily*, 14 September 1998; Cook, 1998). Second, the crackdown on domestic wholesale and retail markets culminating in 1999 made the distribution of illegal cigarettes more difficult within China, thereby creating pressure towards reorienting the illegal cigarette trade to markets abroad. This combined with the growing reluctance of Western tobacco corporations to allow their products to be diverted to black markets in places such as the UK, opened up opportunities for the marketing of Chinese counterfeit cigarettes abroad (von Lampe, 2006), while the commercial trade that had increasingly connected China with the rest of the world, especially after China joined the WTO in 2001, provided the logistical basis for the smuggling of cigarettes on a grand scale. Finally, the shift to exporting counterfeits may have been profit driven in that profit margins were simply much bigger for selling counterfeit cigarettes abroad (Shen et al., 2010).

Given the Chinese government's ability to curb the illegal cigarette trade within China to some extent, the question arises to what degree it is in the hands of the Chinese government to also crack down on the export-oriented counterfeit cigarette industry. Chow (2006) has argued that there is indeed a lack of political will and that China could resolve the problem of counterfeiting just as it has resolved the problem of smuggling in the 1990s. In the case of cigarettes, this argument is not fully convincing, however. While the smuggling problem was closely linked to

the corruption of centralized branches of the government like the military which could be fairly easily brought in line by Beijing, the production of counterfeit cigarettes is protected by local corruption and the embeddedness in local communities. Finally, as Peerenboom states, China's institutional problems are (...) also a function of wealth'. Changes are called for but 'such changes take time and resources' (Peerenboom, 2008, cited in Davies & Shen, 2010, p. 252). Cigarette counterfeiting, therefore, seems to be more of a traditional challenge of policing socially embedded illegal business activities. On this level, China has apparently stepped up its efforts to curb cigarette counterfeiting in recent years, often in cooperation with foreign law enforcement agencies and foreign tobacco corporations. These efforts, however, do nothing to change the fundamental social and economic factors that contribute to the continued existence of the illegal cigarette trade, including a burgeoning market economy in China and a demand for cheap cigarettes abroad. Counterfeiting in China, it seems safe to assume, will remain a high profile, but low priority type of criminal activity.

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