Behind the Curtain of Smoke

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By

By Staff Reporter Lou Yi in Washington

After 10 years, Xu Daoren's death is still a source of anguish for the Hong Kong Independent Commission Against Corruption (ICAC).

Xu was the director of the Haoguo Company, once the most well-known distributor of smuggled cigarettes. He was set to appear as a witness in a Hong Kong court on April 26, 1995, with crucial testimony in a cigarette smuggling case. According to the ICAC investigation, Haoguo Company bribed Lu Jiankang, the director of the export department of British American Tobacco Hong Kong (BATHK), to sell 8.5 billion Hong Kong dollars' worth of cigarettes to mainland China and Taiwan with fake documents. However, Xu was murdered on March 29, less than a month before he was scheduled to testify.

China's biggest cigarette smuggling case is far from closed, and Xu's death only made it more complex. But one prominent question lingers: What role do tobacco manufacturers play in cigarette smuggling?

While Xu's case was pending in Hong Kong, a series of lawsuits targeting tobacco manufacturers were filed in European and American countries alleging that manufacturers supported smuggling to avoid trade barriers and to forge new markets. Most of these suits were dismissed with no substantial rulings, but the 1998 Minnesota judgment required British American Tobacco (BAT) to publicize thousands of internal documents related to the lawsuit. Since 2001, several investigations have been based on the released documents, shedding new light on BAT's involvement with smuggling activity in Latin America, the former Soviet Union and Asia. More specifically, the latest findings have linked BAT to cigarette smuggling in China.

In July 1998, the British Magazine Public Library of Science published an article entitled "Key to the Future: British American Tobacco and Cigarette Smuggling in China" by Dr. Kelley Lee of the London School of Hygiene & Tropical Medicine and Dr. Jeff Collin of the University of Edinburgh. The authors argue that "smuggling has been strategically critical to BAT's ongoing efforts to penetrate the Chinese market."

Several seemingly innocuous terms stand out: “transit,” “free market,” “general trade" and "duty not paid." In fact, they are key terms document researchers use to trace smuggling. All of these expressions can serve as stand-ins for the word “smuggle.”

Although China is considered the ultimate prize among tobacco’s emerging markets, it remains difficult to penetrate the Chinese market through legitimate channels. China not only imposes high tariffs and quota restrictions on foreign tobacco, but monopolizes foreign imports as well. China National Tobacco Import & Export Inc. (CNTIE) controls the import rights to foreign tobacco; after import, cigarettes are transferred to local tobacco monopoly administrations through state-owned channels and sold by retail outlets.

As a result, most tobacco in China is sold illegally. According to a BAT document, only 5.4 percent of BAT distribution in China is conducted through legitimate channels. The remainder is conducted under the umbrella of smuggling euphemisms. Lee, the co-author of the article, told Caijing that tobacco manufacturers don't directly smuggle their products, but said that they "intentionally sell cigarettes to a third party, who does usually smuggle [tobacco].”

Smuggling, though, is a lucrative business. Documents show that the export quantity sent out from Hong Kong made up 22 percent of BAT’s total export, while accounting for 27% of the firm’s total profits. The document also concludes that in 1997, the export quantity and profits would have reached 29 percent and 31 percent, respectively.

Because of this alternate revenue, BAT put the joint venture with China—which it once industriously pursued—on the back burner. In 1992, as Patrick Sheehy, then-president of BAT, prepared for his October visit to China, an internal document questioned the necessity of formally entering the Chinese market: “The present opinion is that we can receive much higher profits from export…than investment. If president is forced to promise to invest in China, it will contradict our interests.” Another advanced manager questioned BAT’s strategic goal between 1993 and 1997: Why should BAT bend backwards to establish a joint venture company if it could maintain the current transit trade?

BAT emphatically denies accusations of its involvement with cigarette smuggling. The group blames the tariff difference and import restrictions for the smuggling problem, and claims that it cannot control its entire supply. Only governments, it argues, can effectively fight smuggling.

Luk Joossens, a tobacco control analyst, pointed out that the Chinese government can use the agreement between the European Union (EU) and American tobacco giant Philip

Morris for reference if it chooses to fight tobacco manufacturers. In July 2004, the EU Commission, 10 EU members and Philip Morris signed an agreement in Brussels that resolved their legal disputes.

Philip Morris promised to allocate US$ 1.25 billion over 12 years to fund the European Union's fight against smuggled and fake cigarettes. In return, the EU Commission and the 10 EU members withdrew their lawsuit against Philip Morris for allegedly encouraging smuggling to avoid taxes.

“The most important point is that if smuggled cigarettes are found in markets—no matter their source—Philip Morris will pay huge tariffs," Joossens said. "Knowing this can effectively prevent Philip Morris from smuggling. ”

However, this agreement only applies to Philip Morris and the 10 EU countries. It doesn't include Britain—the home of BAT headquarters.

English Version by Lei Yongjian, Natalie Ginsberg, and Jennifer Liu