From Lucky Strike to Chunghwa: The Development of China's Tobacco Industry in the Twentieth Century

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From Lucky Strike to Chunghwa: 
The Development of China’s Tobacco Industry in the 
Twentieth Century

Senior Project Submitted to 
The Division of Social Studies 
of Bard College

by
Yi Chen

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Introduction

As the largest consumer and producer of tobacco in the world, which contributes to 42% of the world’s cigarettes today, China has a long history of tobacco cultivation.\(^1\) While smoking is not widely encouraged today due to its perceived negative impacts on health, it accommodates multiple meanings, both historically and socially, as a quintessential symbol of Chinese culture. Also, as an important cash crop, the development of tobacco in China demonstrates its significance through economic activities. In the 20th century, the growth of the cigarette market in China sheds light on many themes such as the shifting pattern of consumption culture, China’s long-standing participation in transregional and international trade, and the power dynamics of the Chinese state and other stakeholders in the industry, which will be discussed in this paper.

What happened in China’s tobacco industry in the 20th century? What characteristics did each period of time illustrate throughout its evolution? What role did the Chinese government play at different time? How did the changing environment shape the transition of this industry and influence its overall path throughout the rest of the century? What could be inferred from these changes? In this project, I am going to explore these questions using the primary sources such as the official WTO (World Trade Organization) report and Guoan Yang’s *Documents on the history of the Chinese tobacco industry* (中国烟草史汇典), along with the secondary sources such as Benedict Carol’s *Golden-silk smoke: a history of tobacco in China, 1550-2010* and Kang David’s *China rising: peace, power, and order in East Asia* in order to approach the implications and influences of the development comprehensively. Specifically, I am going to examine the growth and traits by dividing a huge time span of one hundred years into three

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distinctive stages, which are the Republic of China (1912-1949), China under Maoism and after (1949-1990s), and China during the time of World Trade Organization (WTO)’s negotiation and accession (1990s-2001).

During the time of the Republic of China, a liberated market emerged which enabled us to see a duopoly in the cigarette market consisted of the most influential multinational corporation and the native firm. According to Thomas Rawski, between 1912-1936, the number of cigarette-rolling machines and workers in Chinese factories increased at an annual rate of 26-30% and cigarette production expanded at a rate of about 20%.\(^2\) Although the Chinese economy in the 1930s was on the whole very poor, as Loren Brandt noted in his work: “the per capita GNP in the mid-1930s was 60 Chinese yuan, which was about 200-250 U.S dollars. Nearly two-thirds of China’s GNP originated in agriculture, and about three quarters of the population derived their living primarily from farming.”\(^3\) We see an explosive growth of domestic Chinese cigarette manufacturing in the period between the establishment of the Chinese Republic (1912) and the outbreak of the Sino-Japanese War (1937), which serves as a sharp contradiction with the overall economic condition in China.\(^4\)

Unlike during the period of Mao, when the Chinese state played a dominant role in the tobacco industry and allowed very few interactions with the outside world, the tobacco industry in the Republican China was a hybrid of foreign and Chinese elements, which is significant in understanding the developmental trajectory of the market. In the first chapter, by looking at the

\(^2\) Ibid, 355.
interplay of two predominant firms in the market, we will develop a holistic view of the landscape of the tobacco industry during this time and a nuanced understanding of the very nature and characteristics of the cigarette market itself, which, to a certain degree, served as the prototype of Chinese industrial change and will be revisited in the later period of time when China experienced its reforms and the age of globalization.

The second half of the 20th century, starting from the autarkic Maoist era (1949-76) to 1990s, witnessed the transition of the tobacco industry from a competitive market to a closed economy under the state leadership. The motivation of the Chinese state for developing and supervising its tobacco industry aggressively could be interpreted from two aspects. First of all, the political appeal of Chinese government has been particularly well demonstrated by the state monopoly in the tobacco industry. Following rules set up by the government, state enterprises fulfilled the output targets assigned and sold their products at predetermined prices, which helped the state to display and concentrate its power under the mode of planned economy.5

The other motivation for the Chinese government to put a large effort into the development of the tobacco industry lies in its economic consideration. When the People’s Republic of China (PRC) was established in 1949, the country had been devastated by a long period of war and underdevelopment, as Gang Fan and Nicholas Hope state, “there was neither private wealth nor any organized structure to take on the huge task at hand, it was the state enterprises that gradually undertook all the nation-building tasks.”6 The whole country was on the verge of bankruptcy, since “no infrastructure to speak of existed, industrial capability was minimal, education and healthcare were scarce and social security was nonexistent. China was a

5 Rawski, 5.

country with 20% of the world’s population and 7% of the world’s arable land, yet its agriculture and energy resources were underdeveloped.”

With the emergent calling for economic benefits, investing in the tobacco cultivation and cigarette manufacturing became one of the best solutions for China due to the apparent economic returns of the tobacco industry, which could increase peasant livelihoods, create factory jobs, and generate tax revenues. Given these major purposes, we see a conflict of interest in Chinese Communist Party (CCP)’s agenda persisted between the political power and the economic demand. As Karl Rebecca concludes in *Mao Zedong and China in the Twentieth-century World: A Concise History*: “the CCP was both the bearer of revolution as well as the bureaucracy in charge of economic policy and social transformation. These were inherently contradictory roles. From 1953 on, during times of emphasis on economic development at all costs, the CCP’s bureaucratic role grew, social hierarchies proliferated, and the revolutionizing of society slowed in pursuit of growth and economic efficiency [...] These oscillations largely shaped the Maoist era.”

The second transition of China’s cigarette market occurred as a product of China’s accession to the WTO. China became a member of WTO in 2001. Yet, the admission of China to the WTO was preceded by a lengthy process of negotiations starting from 1990s, which required significant changes on the Chinese economy for the purpose of China’s deeper integration into the world economy. In the tobacco industry, this global engagement reintroduced the foreign companies into the market, and marked an end of the closed economy in the tobacco sector. Yet, 

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7 Ibid.

8 Rawski, 243.

though both directed the foreign presence, the different planning and strategies employed by the state made it a completely different scenery from the competitive market we see in the Republican China.
A List of Abbreviations

BAT       British American Tobacco Company
B2C       Business to Consumer
CCP       Chinese Communist Party
CNTC      China National Tobacco Corporation
JTI       Japan Tobacco International
PMI       Phillips Morris International
PRC       People’s Republic of China
SASAC     State-owned Assets Supervision and Administration Commission
SOE       State-Owned Enterprises
STMA      State Tobacco Monopoly Administration
WTO       World Trade Organization
Chapter One

A Tale of Two Companies: The Commercial Rivalries Between Native and Foreign Firms in the Early 20th Century China

I. The Overall Landscape and Establishment of BAT in China

The end of the 19th century saw the first appearance of the machine-rolled cigarette in China under the wave of globalizing industrial economy. Produced and sold at different price levels as a branded product of uniform quality, cigarette gradually penetrated into the Chinese society on an increasingly local level, and became the most common form of tobacco used in many parts of the country today. 10

Until the mid-nineteenth century, tobacco had been air- or sun-cured, which, due to its uncertainty of techniques, resulted in a great variation of quality and taste. In 1880s, a technological invention, which used flue-curing to produce mechanized rolling cigarettes, revolutionized the tobacco industry and advanced a worldwide popularization of machine-made cigarette. In 1884, the head of the American Tobacco Company James Duke invited James Bonsack, a pioneer developing methods of machine rolling cigarettes production, to set up his invention at Duke’s factory in America. 11 12 While a hand roller could produce a maximum

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11 The prototype of BAT, which came partially as a result of the negotiation between American Tobacco Company and Imperial Tobacco Company (based in London).

volume of 3,000 cigarettes per day, the Bonsack roller could make 120,000 in the same amount of time, demonstrating an incredible speed and efficiency of mechanized production.\textsuperscript{13}

With the adoption of leading-edge technology of factory-made cigarettes, the British American Tobacco Company (BAT), as a result of the merger between American Tobacco Company and the Imperial Tobacco Company in England, was founded in 1902.\textsuperscript{14} Immediately after its founding, James Duke, the Chairman of BAT now, began to extend its reach into China extensively. However, BAT, the most giant cigarette company both in China and in many parts of the world back in the day, had not become the most preeminent player in China until 1930s. In 1925, the emergence of hand-rolled cigarette industry in small towns and cities, which quickly gained its popularity among the ordinary smokers, turned out to be a serious threat for BAT to enlarge its machine-made cigarette market in China.\textsuperscript{15}

Operating with rudimentary hand-cranked equipment, the hand-rolled tobacco industry produced cigarettes at a considerably lower cost than did industrial plants, even accounting for economies of scale. Also, the manufactories saved on the cost of labor, transportation, and primary sources.\textsuperscript{16} For example, low-quality sun-cured tobacco were sometimes used in these cigarettes to ensure its affordability.\textsuperscript{17} Since these products were made on a very low cost and the hand rollers became proficient in manufacturing during the process, a handful of workshops

\textsuperscript{13} Benedict, 133-134.

\textsuperscript{14} Ibid.


\textsuperscript{17} Benedict, 134.
started to make more money by rolling low-grade tobacco in counterfeit papers imprinted with trademarks of foreign brands such as BAT and selling them at lower prices than even the cheapest factory-produced cigarette.  

Since the fake cigarettes were virtually identical to factory-made ones, the cigarette counterfeiting caused great troubles for BAT by taking over its customers who wanted authentic products, and undermining its reputation for producing inferior goods. Thus, BAT took a long time to negotiate with the Ministry of Finance in China for their rights and interests. Eventually, policies were implemented by government to control and reduce the number of hand-rolling workshops pirating brand-name cigarettes. In 1934, all hand-rollers were required to be licensed and could only use the authorized cigarette papers to finish their products. These practices substantially reduced the number of fake BAT cigarettes, and paved the way for BAT to subsequently develop its market in China.

During 1930s, while the pipe tobacco still outpaced sales of cigarettes in most parts of the country, many consumers in Shanghai had already made the switch from pipes or snuff to factory-made cigarettes, denoting BAT’s remarkable production scales and marketing skills, which will be discussed in the fourth section. However, it is important to note that the consumer segmentation in Chinese cigarette market of Republican-era was highly stratified with significant regional and class differences. As we see, in Shanghai, which is a coastal treaty port with a large group of modern middle class, people of all income levels tended to smoke cigarettes from the

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18 Gibbs 1938: 35.

19 Yang Guo’an (2002: 792–821) for Ministry of Finance regulations applied to hand rolling workshops.


21 Benedict, 135.
beginning of the 20th century. In Beijing, however, the shredded pipe tobacco enjoyed a considerable market supported by a large section of urban poor in the city. In some places like Dingxian located out of Hebei province, we see a bifurcated pattern of consumption of both cigarette and pipe tobacco.\textsuperscript{22}

Therefore, although the primary battlefield of the commercial rivalry between BAT and Nanyang Brothers was Shanghai, Shanghai could not be generalized to represent the overall market landscape in China (in fact no single city could at this time). The identity as a production center of cigarettes and the particular commercial geography, which contained neighboring retail areas and specialized shopping districts that provided its residents with ready access to manufactured cigarettes, made Shanghai an ideal market of BAT’s machine-rolled cigarettes.\textsuperscript{23} As a global hub with the increasing level of modernization and commercial opportunities, Shanghai demonstrated a far more welcoming attitude towards machine rolled cigarettes than many other cities in China during the Republican time. As illustrated in the following table, in January, 1935, while some of the major provinces in China such as Jiangsu and Zhejiang only had the daily sale of machine-rolled cigarettes per capita consumption below 2, Shanghai demonstrated a number of 5.09, doubling the performances of other places.

\textsuperscript{22} Ibid, 150.

\textsuperscript{23} Ibid, 154.
The cigarette market in China became increasingly heterogeneous with the emerging power of native firms. Within the growing Chinese nationalism and the anti–foreign commodity boycotts that took place repeatedly from 1905 into the 1930s, some domestic cigarette firms emerged in the market. From 1905-08, more than 20 machine-rolled cigarette companies owned by Chinese were established. These native firms, all tiny in production scales and industrial sizes in comparison to BAT, were able to expand while the anti-Western boycott was underway. However, when BAT reasserted itself through aggressive market practices, they were decimated.

(The Table of Per Capita Consumption of Machine-Rolled Cigarettes in China, 1935. Cited from Big business in China: Sino-foreign rivalry in the cigarette industry, 1890-1930)
radically. However, Nanyang Brothers Tobacco,\textsuperscript{24} which was established in 1905 by Cantonese businessmen Chien Chao-nan, was able to build up some customer loyalty for their products and became a major opponent to BAT in this battlefield in the beginning of the 20th century. \textsuperscript{25}

During 1900s to 1930s, the tobacco industry in China existed as a duopoly, which was consisted of BAT and Nanyang Brothers as two paramount players with some other firms such as Huacheng Tobacco playing secondary roles in the market.\textsuperscript{26} Under the context of China’s domestic political turmoil with multiple foreign forces in the Chinese territory, the commercial rivalry between BAT and Nanyang Brothers became one of the most impactful themes in the history of Chinese cigarette market throughout the Republican time.

In this chapter, I will explore the development of tobacco market through a specific case study of the business competition between BAT and Nanyang Brothers. How did these two companies born and develop? What strategies did they employ to penetrate into the market? What consisted of their identity as a Western or an Eastern firm? Was their rivalry truly a battle between the West and China as suggested by their origin of birth, or other forms as demonstrated by their actual market performances and operating principle? How did the Western philosophy and the Chinese business culture shape the characteristics of the cigarette market in the Republican China? And how did this relatively liberated market tell us about the developmental trajectory of the tobacco industry in the rest of the 20th century? I am going to answer these questions in the following analysis by revealing the similarity and differences between BAT and Nanyang Brothers in terms of their managerial and marketing strategies, which largely shaped

\textsuperscript{24} This company will be briefed as “Nanyang Brothers” in the rest of the paper.

\textsuperscript{25} Benedict, 132.

\textsuperscript{26} Ibid, 142.
their identity and traits, and made them who they were in the market during the Republican time, respectively,

**II. Battlefield Formed: Rivalries Between BAT and Nanyang Brothers**

Registered in England and extended its business to North America and China, BAT maintained a lucrative near-monopolization of the global and the Chinese markets from 1902 to 1915. As the first agent introducing the industrial cigarette to China, the omnipresence of BAT was inseparable from its enormous production capacity, extraordinary marketing ability, and efficient administrative structure that facilitated distributions down to the village level in China. As demonstrated in the following table, the market share of BAT never slipped below 55% in the first half of the 20th century. For much of the Republican period, it remained steadily between 60-80%, indicating a consistent superiority in Chinese market.

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28 Benedict, 153.
The reasons behind BAT’s unprecedented success in China are diverse and multi-layered, such as its capital-intensive technology, vertical integration, and skillful advertising, which have
been widely discussed by Sherman Cochran, the author of *Big business in China: Sino-foreign rivalry in the cigarette industry, 1890-1930*, and other scholars. In this chapter, I am going to focus on the administrative principle and marketing insight of BAT in China, which serve as an interesting comparison with its major opponent Nanyang Brothers. The reason I prioritized these two aspects than other elements such as technology and capital is that though the initial victory of BAT in China could be contributed to its transfer of the primary production source (tobacco leaf), capital, and technology from the West, these advantages turned out to play a secondary role in its long-term rivalry with Nanyang Brothers. Rather, the managerial and marketing strategies of BAT, which evinced unique Western business features along with its shrewd adoption of Chinese culture, proved to be an essential part in this tug-of-war.

In 1915, Nanyang Brothers plunged into the cigarette market at Canton. As it developed an extensive marketing system in the vicinity of Canton and demonstrated an ambition to soak the inner land of the market, BAT responded by aggressive marketing campaigns and occasional sabotage. However, Nanyang Brothers proved to be more challenging than other Chinese firms in this contest. Despite the strong opposition posed by BAT, Nanyang Brothers managed to secure a portion of the market in Canton in 1915 and successfully expanded its business into the Lower Yangzi region and North China in 1916-17.

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29 Cochran, 11.


31 Ibid, 54.

32 Ibid.

33 Ibid.
Nanyang Brothers’ legacy could be explained by many sides of its historical experience and business approach, which were highly comparable with BAT, such as the rich experiences of leaders conducting business in multiple areas in the world. The Chairman of BAT, James Duke, gained significant experience in the U.S, which laid a critical foundation for him to designate policies to BAT’s business in Asia.\(^{34}\) For example, according to Cochran, following Duke’s instruction, BAT carried out a successful investment policy in China once it established its headquarter in Shanghai. This policy was almost identical to the one that Duke had implemented earlier in the U.S, which helped BAT sprouted to the top of the American cigarette industry.\(^{35}\)

Like Duke, who acquired his business acumen in the West before leading the market in China, the founder of Nanyang Brothers Chien Chao-nan also drew plentiful lessons from his earlier career abroad in Southeast Asia. Born in a poor Canton family, Chien left home at the age of sixteen in search of better economic opportunities to finance his family,\(^{36}\) and spent most of his twentieth doing business in East Asia and Southeast Asia including Hong Kong, Japan, and Thailand.\(^{37}\) By starting with the import and export business in Thailand and working as a salesman for his uncle’s firm I-sheng Brothers Company, Chien obtained practical experiences in international trade, which laid a precious foundation for his entrepreneurship and business vision.\(^{38}\)

\(^{34}\) Ibid.

\(^{35}\) Ibid, 16.

\(^{36}\) Ibid, 55.

\(^{37}\) Ibid.

\(^{38}\) Ibid, 57.
When Chien went to Japan for the second time in 1902, he visited many cigarette companies there such as the Kawai Tobacco Company in Kobe, and was thoroughly exposed to the process and technology of cigarette making and accumulated a fair amount of capitals of cigarette production. In addition to capitals and technology, living in Japan also allowed Chien to witness the spectacular growth of his Japanese collaborator Murai Brothers Tobacco Company, which was one of the most influential tobacco companies in Japan and in Asia, as well as BAT’s successful penetration into the Japanese market accompanying with an upsurge of domestic competitors. These relevant experiences served as a valuable first-hand information for Chien to think of having his own business in China, and eventually gave birth to his company Nanyang Brothers Tobacco in 1904.

At the initial stage of Nanyang Brothers’ establishment, Chien built his factory in Hong Kong, imported cigarette-making machinery from Japan, and recruited Japanese technicians to teach Chinese labourers to operate the machinery and package the finished products. After a year of capital preparation, experimental research, and learning process, Chien’s factory began to manufacture cigarettes in 1905. As Cochran describes in his book, the factory “was small and unsophisticated, equipped only with a furnace, a hot-air curing room, an electric generator, two blade-sharpening machines and four cigarette-rolling machines” Therefore, although Chien was exposed to the modern technology in Japanese tobacco industry, he did not adopt it in his factory

39 Ibid, 57.

40 Ibid.

41 Ibid.

42 Ibid.
at the first stage. Instead, the factory was operated on a traditional labor-intensive basis which primarily relied on cheap labors and rudimentary techniques.

Nanyang Brothers was not alone. In fact, the lower level of technology and capitals and the relatively inferior quality of resources and products were common characteristics among Chinese firms during this time. Unlike BAT, which integrated tobacco purchasing with cigarette production and distribution by successfully growing American-seed tobacco in Shandong and Henan provinces in China, Chinese firms were unable to obtain the milder type of tobacco to produce higher-quality cigarettes. For example, Zhensheng Tobacco Factory, a modest cigarette firm at that time, found it extremely difficult to procure American Bright tobacco during the First World War (1914-1918), and switched to use Chinese-filler tobacco as an alternative to produce its good in the end. 43

In the establishment of Nanyang Brothers, we see that Nanyang Brothers, though a native Chinese firm managed by Cantonese people, contained many foreign elements throughout its developmental path. Since the Western science and capitals were introduced to Japan during Meji restoration, a period of imperial restoration, military reform, and social reconstruction during 1868-1912 which contributed greatly to Japan’s post-war industrialization, it was hard to remove the Western influences from the experience, production techniques, and capitals which Chien had acquired during his time there. In fact, the birth and development of Nanyang Brothers was not utterly “Chinese.” Either the Japanese technicians Chien had employed as instructors for his labors, or the fact that his first factory was built in Hong Kong, which was under British Crown rule from 1842 to 1997, illustrates the strong Western impacts and characteristics Nanyang Brothers has on its own.

Therefore, though Cochran proposes that prior to 1915 when Nanyang Brothers entered into the Chinese market, “the resourceful Chiens developed effective manufacturing and marketing systems without the assistance of Westerners,” I argue that Nanyang Brothers was born of Sino-Western parentage, and its underlying Western influences should not be ignored when we analyze this company and its rivalry with BAT in the rest of this chapter.

**III. How to Rule: The Insight of Managerial Approaches**

Similar to Nanyang Brothers, which has its root linked with multiple foreign influences, BAT was very global as an Anglo-American company, which was based in England and had the majority of its shares in hand of the U.S stockholders. As a strategic industrial organizer, BAT introduced two major innovations in its administrative planning, which not only explains its marvelous achievements in China, but also highlights a distinctive Western trait of a modern enterprise.

Prior to 1923, BAT carried out the setup of vertical integration, which integrated the mass cigarette production with mass distribution. This practice not only improved the overall

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44 Cochran, 60.

45 Cochran, 13.

46 In fact, after an intense competition in 1900s between American Tobacco and Imperial Tobacco in England, American Tobacco maintained its control of the American trade, and Imperial Tobacco controlled the trade in the British territories. British-American Tobacco Company, as a third entity and a new cooperative venture, was set up between the two to control the sale of tobacco in the rest of the world.

47 Cochran, 14.
efficiency of BAT’s Business to Consumer (B2C)’s process, but also more importantly, it enabled BAT to achieve national distribution in China, thereby making it one of the first businesses ever to distribute a trademarked product throughout the country.

In 1923, when BAT came under predominantly English management, its executive leadership introduced the second reform, which was to decentralize its managerial system and to let the regional offices playing key roles in each of China’s major marketing zone. Each office had the right to perform its own manufacturing, marketing, and administrative functions independently of the others. BAT’s top management also permitted all goods it produced on the local level to be distributed locally. This decentralized policy enhanced the efficiency of BAT’s trade in a sweeping way and served as a prototype for many of the business practices in China in the rest of the 20th century. For instance, in the third chapter, we will see a similar executional structure of China’s governing bodies in the tobacco industry after 1980s.

In addition to these innovative stratagem, the organizational linkage Duke set within its Chinese branch ensured its administrative efficiency and underlined BAT’s Western nature and supremacy. The Chairman, managers, and directors of each department at BAT were all American. However, marketing specialists and sales were comprised of British, American, and mostly Chinese. This organizational layout sheds lights on the potential success of BAT in

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48 I am deriving this meaning from the e-commerce environment. What B2C refers to here is that the transactions conducted directly between a company and consumers (the end-users of its products or services) got improved because BAT reduced the intermediary process significantly.

49 Cochran, 213.

50 Cochran, 213.


52 Cochran, 15.
China from two perspectives. First of all, it consolidated the absolute power of BAT in the hand of its own people. The key decisions regarding the direction of BAT’s future development were exclusively made by the American leaders, which again reinforced the Western identity of this multinational corporation. Secondly, having Chinese sales allowed BAT to erase its cultural and language barriers in China, which solved the biggest headache for an international company to do business overseas and facilitated a better and more effective communication with local market and communities.

However, the managerial formation of Nanyang Brothers illustrates a different story. As a traditional Cantonese enterprise, Nanyang Brothers was a family firm founded and coordinated based on the kinship of Chien and his brothers, notably his younger brother Chien Yu-chieh. Family business was a common phenomenon in China largely because of China’s unique social atmosphere and cultural heritage. “Guanxi,” originated in Confucian ideology, which stands for the relationships individuals cultivate with others, manifests the importance of personalized social networks of influence in the Chinese society.

In the business world, Chinese people also tend to make use of their personal connections to initiate and expand the business. Once the business was started and operated on the kinship-basis, it became hard to change its founding bodies because everything was built on different relationships between these people. In ancient China, it was very rare for an owner of a family-based enterprise to transfer his power to a non-relative, which, to a certain degree, created an

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53 Cochran, 30.

obstacle for such firms to succeed from generation to generation because of the uncertainty of each successor’s intellectual ability and commercial skills.

In addition to the potential impact on firms’ long-term prosperity, the kinship base might also induce conflicts between heads which remain difficult to resolve. For instance, by autumn of 1916, Nanyang Brother’s expansion began to outrun its capitalization, creating financial burdens that required radical solutions. A clash arose between Chien Chao-nan and Chien Yu-chieh regarding this matter: Chien Chao-nan hoped to solve this difficulty by achieving greater growth for his firm through technological innovation, and thus ordered new American cigarette machines preparing for this reform. Yet, Chien Yu-chieh was reluctant to do so considering the reality that Nanyang Brothers might not be able to afford those expensive additions, thus intercepted and canceled the order.55

In this instance, Chien Chao-nan and Chien Yu-chieh came to an agreement in the end as Chien Chao-nan prevailed and reordered the machines. Nonetheless, we still see the problems of China’s family-based network. On the one hand, only people with strong family connections could participate in the decision-making processes of the company, which deprives the possibility of employees who have stronger leadership capabilities, business acumen, and greater familiarity with the regional market to offer better advice. On the other hand, as the leadership of a large corporation becomes onefold in its composition, the decisions and solutions become increasingly personal and subjective, which might block up the future development of the firm.

Moreover, the Canton-based family network of Nanyang Brothers served as a challenge for it to firstly expand its business into the Lower Yangzi Region, because their personal connections were predominantly built up in the Canton areas. Ironically, Nanyang Brothers

55 Chien Chao-nan to Chien Yu-chieh, February 3, 1917, Nanyang, 55.
encountered a problem which did not even exist for BAT when they penetrated into the Chinese market, since BAT always enlarged and strengthened its team by recruiting local employees who know better about the domestic market instead of heavily relying on its original connections.

Comparing the organizational layout between BAT and Nanyang Brothers, it is not difficult no note that BAT, as a multinational enterprise, illustrates a great diversity in its human capitals formation, which engaged the British boss, American managers, and Chinese sales. Although the top authority was absolutely secured and hard to alter, the position and title of each middle- and entry-level worker was given on his or her professional competency instead of the family name. Also, since the promotion of these jobs was largely based on the individual performance at the workplace, employees would develop a self-driven incentive to do better jobs in order to make more money, which resulted in greater revenues for the company.

Contrastively, Nanyang Brothers suggested a distinctive Chinese feature of kinship-based network. As a firm which had been constantly managed by the Chien family not only in the beginning of its establishment, but throughout the 20th century, Nanyang Brothers had never allowed its capitals and power to be transferred or diluted by non-relatives. The family tie acts as a two-edged sword which either encourages or undermines the entrepreneurship of a firm. Although Nanyang Brothers is a positive example here whose capitals were successfully raised and leaders were trustworthy on stage to govern the company, there are still many negative aspects of it, such as a lack of profit incentive for other members of the firm to work hard, because non-relatives have a very rare chance to be placed even on the middle level leadership position regardless of their ability and professional performances.

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56 Cochran, 220.
Therefore, the different placing in administrative hierarchy of BAT and Nanyang Brothers allows us to see their managerial models, respectively. From the vertical integration of production and distribution, the decentralization of power into regional departments, to the administrative linkage of its company in China, BAT illustrated its comprehensive improvement of efficiency as a mature international enterprise, which ensured its success globally. However, the operational basis of Nanyang Brothers was less complex and inclusive in terms of the leadership assignment. It was true that Chien Chao-nan and Chien Yu-chieh were strong leaders themselves, yet, the underlying shortcomings such as the fluctuation of successors’ qualifications and a lack of broad and diverse decision base were still revealed in its business practices throughout the development.

**IV. The Fire is On: The Marketing Strategies Vibrated with the Tension**

In the last section, we see distinctive styles of management of BAT and Nanyang Brothers. BAT’s structural setup signifies a particularly Westernized trait in terms of its vertical integration of production and distribution and the allocation of staff. Nevertheless, its connections with China gradually emerged, and was further tightened as BAT started to hire Chinese compradors and contractors to recruit cheap labors and incorporate Chinese elements into its advertising campaigns, which symbolized a new liaison between BAT and its new Asian market.\(^5\)

The climax of cigarette advertisement in Shanghai occurred when Nanyang Brothers plunged into the market in 1915, which revealed its fierce rivalry with BAT primarily in the form

\(^5\) Cochran, 25.
of marketing strategies.\textsuperscript{58} BAT hired Chinese artists to design advertisement through illustrations and figures on newspaper, magazine, and calendars that highlighted Chinese culture and aesthetics. In the following selection of BAT’s advertising posters in 1930s, we see Chinese elements being particularly displayed and emphasized through women’s clothing style and postures as well as the depiction of traditional Chinese family, which appealed to BAT’s Chinese customers.\textsuperscript{59-60}

\textsuperscript{58} Ibid, 62.

\textsuperscript{59} Ibid, 35-36.

\textsuperscript{60} Also, female smoking became a demonstration of modernization in Shanghai during this time, which contributed to a great number of relevant advertising themes.

However, the advertising contest between BAT and Nanyang Brothers indicated another scene. When Nanyang Brothers opened its Canton branch in 1915 and demonstrated an ambition to enter the interior market of China, a series of boycotts of Japanese goods organized by Chinese nationalists took place in many regions of China. The purpose of these boycotts was to protest against the Twenty-One Demands, a set of demands made by Japan under the context of the ongoing First World War, which greatly extended Japanese control of Manchuria and of the Chinese economy. Confronting the arrivals of both the business competitor and the nationwide anti-Japanese sentiment, BAT associated these two events and quickly launched a campaign to attack Nanyang Brothers by identifying it as a “Japanese firm” in nature. BAT claimed that despite the seemingly patriotic Chinese facade, Nanyang Brothers was in fact a “Japanese firm” which was financially and technologically supported by Japan. BAT even sent hawkers out to buy a substantial amount of Nanyang Brothers’ cigarettes and resell them, while loudly proclaiming that their cigarettes were made by Japanese.

Although BAT’s move to destroy its opponent was aggressive and cruel, BAT was not making a completely false statement in this battle. As I argued before, the rise of Nanyang Brothers owned largely to its capital base and learning experience Chien had accumulated in Japan. In 1902, Chien even became naturalized as a Japanese citizen using the name Matsumoto Shonnashi to establish Sheng-tai Navigation Company in Kobe, Japan. When these hidden connections were deliberately revealed by BAT to assault its challenger, it provoked a strong

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62 Ibid, 63.
63 Ibid.
64 Ibid, 64.
wave of criticism against Nanyang Brothers among the public which seriously impaired Nanyang’s brand in China.\(^{65}\)

While BAT accused Nanyang Brothers of being a traitor in the time of China’s political upheaval, Nanyang Brothers responded by reconstructing its patriotic image through philanthropy and the membership in nationalistic organizations. In the following years, by joining and mustering the support of Cantonese merchant organizations such as the Hong Kong Overseas Merchant Association, the founders of Nanyang Brothers, Chien Chao-nan and Chien Yu-chieh successfully associated Nanyang’s name with nationalism. They adopted the nationalistic slogans of these associations as their own motto and popularized them during the time of anti-Japanese boycotts.\(^{66}\) Then, they circulated the books and investigate reports they made to stress their closeness with patriotic organizations after attained the membership, as Cochran states, “to disprove BAT’s allegation that Nanyang was a lackey of the Japanese, the Chiens staged ‘investigations’ intended to show that Nanyang was a genuinely Chinese company and circulated literature documenting this findings.”\(^{67,68}\) Moreover, by investing heavily in charitable activities such as the donations to the needy Cantonese in South China and to citizens suffering from the natural disasters like flood, Nanyang Brothers established a positive image in

\(^{65}\) Ibid, 63.

\(^{66}\) Cochran, 69.

\(^{67}\) Ibid.

\(^{68}\) Nanyang Brothers also alleged that BAT had much more Japanese and Western affiliations in the hope of stirring up people’s patriotic feelings and aversion to BAT, given the fact that Japan and China were in an impasse at that time. However, since the slogan and idea had been used by BAT before, and nationalistic appeals in Shanghai were not as strong as in Canton, Nanyang Brothers failed to outcompete BAT by adopting this similar marketing strategy.
China, becoming a representative figure as a benevolent and nationalistic businessmen in the
eyes of Chinese customers.⁶⁹

In addition to nationalism, the other distinctive theme utilized by Nanyang Brothers to
give a heavy blow to BAT was the role of superstitions in China. Since talking about death in
public violated the taboo in Chinese culture, people in the occupation that closely related with
death such as funeral service workers were regarded as a despised class who stood for bad luck
(huiqi 晦气) in Chinese society. Knowing this tradition, Nanyang agents hired furnery service
workers to deliberately smoke BAT products in the public sphere, and even paid for “riff-raff” to
follow the funeral party and to loudly inform people that the coffin bearers were smoking BAT
cigarettes along the way. After the information was circulated among the populace, the
popularity of BAT cigarettes greatly declined in the market.⁷⁰

While BAT had associated Nanyang’s name with Japan and anti-nationalism, Nanyang
besmirched BAT by involving the ideas of bad luck and death with its brands in response. Unlike
the administrative structure, which illustrates different features and principles, the advertising
vying between BAT and Nanyang Brothers suggests their common characteristics of adopting
the local culture and tradition in marketing a product in a specific environment. In this case, such
practices of Sinification in marketing strategies effectively helped firms to generate their
exceptional performances in market and enabled them to become two major players in Chinese
cigarette industry during the Republican time.

V. What Can We See: The Rise of A Tobacco Empire

⁶⁹ Ibid, 66.

⁷⁰ Cochran, 68.
In this chapter, we see the huge success BAT obtained in its Chinese market during the Republican time, which could be interpreted from three perspectives, political, economic, and social. By examining these factors in the following paragraphs, I argue that BAT’s success, though impressive and projected lasting influences in the tobacco sector of China’s economy, was in fact hard to be copied.71

First of all, China’s political climate during the Republican time, which was consisted of both domestic struggles and international turbulence, served as the best ground for foreign firms to germinate and grow. This specific time and social environment also created the one and the only perfectly competitive market in China’s tobacco sector in the entire 20th century, which further underscored the importance of timing for international business to expand in China. With the English and French forces spawning in many areas of Shanghai, multinational corporations were exempted from the strict intervention of Chinese government and might even enjoy some extra protection and assistance from the colonizing force of their home country. As we see in the second section, BAT was able to establish a market of factory-made cigarette and secured its rights and position by negotiating with the local Chinese officials. BAT’s negotiation power with the government, which resulted in a significant elimination of small hand rolling tobacco workshops in China, highlighted the recognized position and dominance of foreign firms in China during the Republican time, which was hard to be observed in the rest of the 20th century.

Secondly, a lot of economic factors such as BAT’s cutting-edge technology, impressive production scales, rich capitals, and cheap laborers recruited from the local regions in China helped it to grow exponentially. In particular, the managerial system enabled BAT to be a

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71 In fact, BAT found it extremely challenging to regain its dominance in Chinese market after 1990s, as we will see in the third chapter.
pioneer in Chinese cigarette market. As Alfred Chandler says in *The Visible Hand*, James Duke became the most powerful entrepreneur in the cigarette industry because “he was the first to build an integrated enterprise.”

While the enhancement of production scales and technology contributed greatly to the economies of scale of BAT, the innovative practices in managerial system enhanced the efficiency within the system, which made BAT more competitive in the market.

In this aspect, BAT exemplified a great model for foreign firms who want to explore a remote and unfamiliar market overseas. BAT’s vertical integration made it develop into a centralized entity while still guaranteed its operating efficiency. Its managerial hierarchy and the integration of mass production and distribution worked perfectly together and successfully solved the dilemma some firms may encounter during their developmental path, which, in *The Analysis of History of Finance and Economics in China* (財政史研究), is called “it dies out if you hold it too tightly, yet it became a mess if you let it grow freely without supervision (一抓就死，一放就乱).”

Overall, the strategies utilized by BAT in China demonstrated its guiding principles and distinctive features: it placed the core of its business such as technology and the managerial authority exclusively on the hand of its own people. Meanwhile, it also passed some of its power.

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This phrase was actually used in this book to describe a dilemma Chinese tobacco industry has faced all the time, meaning that if the central government regulates the market too strictly, the market will probably die because of the absence of market freedom. Yet, if the market becomes perfectly competitive, there would be a lack of order and necessary regulation which undermines the growth of the industry. I use it here to describe a general situation of the entities who have conflicting attitudes of the use of power.
to the local personnel in the field of sales, marketing, and advertising. This assignment of authority effectively utilized the comparative advantages of Chinese over American in doing marketing communications in China and thus promoted a better cooperation of BAT’s leadership with the regional offices. Instead of an absolute sovereignty, the different portion of power BAT distributed to each sector ensured everyone’s willingness and incentive to work, which also contributed to the great efficiency of the system.

In *Big Business in China*, Cochran states: “the true pioneers of tobacco products in China long antedated BAT. They were Chinese who had introduced tobacco as early as the 17th century and had widely distributed it by the end of 19th century. These Chinese paved the way for BAT’s later introduction of cigarettes by distributing tobacco through an elaborate marketing system and persuading Chinese to smoke pipes on a gigantic scale.”  

Indeed, BAT was neither the forefather who discovered the potential market of cigarette in China, nor the progenitor of the tobacco commercialization in this market. Nonetheless, I argue that BAT was a pioneer in Chinese tobacco industry in terms of its innovative conduction of administrative hierarchy. Given the pervasive Chinese family businesses in the market, BAT’s Westernized style of management projected long-term impacts on the development of China’s tobacco industry and business culture. BAT not only invented the new technology and capitals that were critical for the industrial growth of tobacco, but also more importantly, it brought a new way of doing business in China, which served as a classical case book for both foreign and native firms to learn. The combination of local production force, foreign capitals and technology, foreign managerial ideology, and local sales team co-existed with each other in harmony and proved to

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74 Cochran, 27.
be highly effective in its practice. Hence, as the first international cooperation doing tobacco business in China, BAT is a pioneer and a classical figure in this field.

Last, the social aspect of it, such as Shanghai as a modernized metropolis with an open environment for foreign capitals and goods to flow and China’s long history of cigarette use prior to BAT’s marketing campaigns, served as an accelerator for BAT’s growth in China. As Benedict Carol says in *Golden-silk smoke: a history of tobacco in China, 1550-2010*: “cigarette manufacturers benefited greatly from the fact that many Chinese were already habituated to tobacco. The dynamic fashion system of tobacco use already evident in some quarters also facilitated the cigarette absorption into China’s local cultures of consumption.”

Therefore, given the political, economic, and social elements, I argue that although the extraordinary achievement of BAT in China offered many lessons for us to learn, it did not create a consistent model that could be replicated by other firms. Among these factors, only the economic strand could be taken and reproduced through practice and learning. Other components, including the favorable political atmosphere and social milieu, were in fact created by the big environment of China at a specific time than by the company itself, which explains why BAT, with larger production scales and a much more mature system, was unable to regain its predominance in China after 1990s. Therefore, the story of BAT in China in the early 20th century was indeed an amazing business case, yet also a classical model that was hard to be recreated given the determining impacts of social forces on business in China.

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75 Benedict, 131.
VI. The Undisclosed: Implications and Lessons

After evaluating the influences of BAT on the micro level, I would like to assess its implications in a larger environment, and see what it tells us about the development of China’s tobacco industry and the society as a whole during this time. Similar to the previous approach, we could examine this question from three angles in order to attain a holistic understanding of it.

Politically, the period of Republican time witnessed China’s engagement with global economy through the Western enterprises. BAT’s dramatic success in delivering machine-rolled cigarettes to millions of Chinese customers not only in coastal treaty ports but also in the interior provinces, indicated its exceptional marketing capacities. It also highlighted a premier example of China’s incorporation into the global trend through the Western agency, which was multinational corporations at this time. While the rivalry between BAT and Nanyang Brothers promoted new products and growth of the market, it also revolutionized the culture, tradition, and social aesthetics in China, as a demonstration of China’s engagement with globalization.

Specifically, the advertising rivalry between BAT and Nanyang Brothers created a radical change of people’s perceptions and recognitions as self-agencies through the “internalization of daily life” and “democratization of desire.” During the 1910s-30s, the growing popularity of cigarettes signified an exceptional transformation in consumer preferences in China. The rapid spatial diffusion of manufactured cigarettes from the coast to the interior and from cities to villages were accelerated by BAT’s pervasive advertising posters. As Benedict states, the shift of consumer preferences from pipe tobacco and snuff to cigarettes could be regarded as part and parcel of the “internationalization of daily life,” occasioned by China’s encounter with Western

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capitalism and modern consumerism in the late 19th and early 20th centuries.\textsuperscript{77}

While the realization of “internationalization of daily life,” which was specified by the phenomena that expensive brands were inscribed into the culture of smoking as an upgraded lifestyle, the widespread advertising of cheap tobacco products also spurred consumer demand for cigarettes in the interior markets. Cigarettes’ popular appeal to ordinary customers in rural areas, which could be viewed as a “democratization of desire,”\textsuperscript{78} served as an interesting comparison and contradiction to the “internalization of daily life” dominated by urban elite.\textsuperscript{79} Driven by the increased level of consumption culture and competition between cigarette companies, this trend signified the particular cultural milieu under the epoch of globalization since everyone, regardless of their financial and social status, started to develop the awareness of individualities and taste and learned to pursue their desire in the market.

Economically, the excellent market performance of Nanyang Brothers allows us to see the resilience of Chinese capitalists, which was hardly seen during the Mao era and after when the state outed foreign capitals and competitions from the inner land market and nationalized all native firms with a strict level of supervision and significant protectionist measures. During the Republican time, Chinese firms operated under a highly stressful and unstable circumstance with social chaos, political upheaval, and an absence of effective legal protection, not even mentioning the protectionist policies.\textsuperscript{80} However, Chinese capitalists such as Nanyang Brothers

\textsuperscript{77} Benedict, 143. The phrase “internationalization of daily life” is from Esherick 2000:1.

\textsuperscript{78} The notion of “democratization of desire” was originally phrased by Carol Benedict in *Golden-Silk Smoke, A History of Tobacco in China, 1550–2010*.

\textsuperscript{79} Benedict, 147.

\textsuperscript{80} BAT was trying to attack Nanyang Brothers using the legal terms and reported to the Hong Kong layers and officials when it firstly entered into the mainland market, which also indicates its dominant power in negotiating with the state and the vulnerability of the Chinese government
were able to find the ways out and to seize the opportunities created by wartime conditions in order to manage their business, which made them achieve an extraordinary success confronting the pressure from the West.

In this age, we see a flourishing cigarette market in China demonstrated with various forces and changes mainly produced by BAT and Nanyang Brothers in a competitive market, as “each company adapted to the circumstances that faced businesses in China by recruiting the appropriate Chinese to give its operation social respectability, guide its product through the existing market structure, adjust its advertising to suit the political atmosphere and cultural milieu, and perform other tasks that made a business acceptable to Chinese society at all levels -- regional and local as well as national.”

It was the best of times. It was the worst of times. While some people perceive the Republican epoch as a scary experience in China’s tobacco industry because the foreign competition created significant challenges for native firms to take part in the market, I argue that because of the introduction of the Western capitalists, the Chinese enterprises such as Nanyang Brothers had the chance to interact with the global entities and were exposed to a completely new system of the Western business model and ideology. This exposition enabled Nanyang Brothers become increasingly experienced and resilient in this confrontation, and was eventually equipped itself with skilled strategies to fight in the most liberated and competitive market in China throughout the 20th century. As Cochran concludes, “these two big businesses did not concentrate exclusively on each other or compete in a vacuum at that time.

81 Cochran, 218-219.
but also became involved in the social, economic, and political context of their time. [...] They were, in short, businesses in history.”

82 Cochrane, 219.
Chapter Two
A Closed Economy: The State Socialist Market in China During 1950s-90s

I. The Economic Environment of China Under Maoism

The Mao era (1949-1970) in China, which was characterized by the labor-intensive self-sufficiency, or autarky, was generally perceived as a period of economic crises. Events such as the Great Leap Forward (1958-1960) and the Cultural Revolution (1966-1976) took place, which resulted in catastrophic impacts on China’s heavy industries and the agricultural sector. For instance, the Great Leap Forward and ensuing famine (1959-1961) slowed the agricultural production to 5.1% annually in China. However, it is important to distinguish China’s tobacco industry from other parts of the economy due to its unique characteristics and the different reforms it went through, such as the consolidation of small private firms, vertical integration, and the use of cigarettes in Chinese Communist Party (CCP)’s political propaganda. These political, economic, and social factors thus contributed to the distinctive features and developmental trajectory of China’s tobacco industry in the second half of the 20th century.

In 1950s, the CCP decided to adopt the Soviet path of development. The Soviet model was based on the maximum extraction of surplus from the rural areas to fund heavy industrialization in urban space, and required a centralized state to allocate and distribute its resources. Since China and the Soviet were in a diplomatic relation at that time, and Chinese

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83 Benedict, 105-108.
84 Ibid.
85 Ibid, 85.
economic weaknesses were so thoroughgoing and the Euro-American Japanese embargo so crippling, the Chinese state realized that it had to come up with a central plan to produce everything they needed on their own. Consequently, the decision was made on the hope that it could save Chinese economy from its suffering status.\textsuperscript{86} Therefore, during the Mao era, the self-sufficiency in agriculture, clothing, and all basic necessities became a hallmark of its policy and practice.\textsuperscript{87}

Similar to Stalin's ideals, Mao tried to rapidly convert the Chinese economy to a socialist society through industrialization and collectivization along with the practice of land reform, which abolished land ownership from the landlord class and returned the land to the vast numbers of peasants. With land reform providing stable conditions for a steady source of agricultural surplus, the First Five-Year Plan (1953-57) experienced an average annual rate of industrial growth of 16%. Total industrial output more than doubled over the course of the five years. The industrial working class also grew from six to ten million, and urban population rose tremendously as well.\textsuperscript{88}

Yet, though both targeted peasants as the main subject of their reform, the changes happened in the tobacco industry were completely different. For instance, during the Republican period, the tech-driven foreign companies such as BAT produced the factory-made cigarettes which were relatively expensive and remained out of reach for rural and low-income

\textsuperscript{86} Ibid.

\textsuperscript{87} Ibid.

consumers.\(^{89}\) However, during the Mao era, a massification and rustication of the industrial cigarette consolidated the customer base of rural smokers, which helped to produce a homogenous good market consisted of only cheap cigarettes and revolutionized the landscape of the tobacco industry in the following years.

Although many sectors in Chinese economy were in a disastrous condition during the Mao era, we saw no interregnum in the development of China’s tobacco industry or in its emerging culture of cigarette consumption. On the contrary, during 1963–1966, the revenues in the tobacco sector rose dramatically as the tobacco taxes remitted surged from 4.1 billion yuan to 5.6 billion yuan, demonstrating an evident growth.\(^{90}\) Also, the tobacco industry experienced some significant improvements of its managerial model under the governmental instructions, which largely paved the way for the subsequent explosion of cigarette use in the post-Mao period.\(^{91}\)

During the Mao era, the cigarette market went through enormous transformations ranging from the administrative reconstructure, industrial reform, to the CCP’s influences on the cigarette market through political propaganda, we see different characteristics illustrated by the economic planning and government policies. However, after the Mao era, we see a continuity of the market structure in the tobacco industry with a persisting dominance of state control, which was not reformed in 1978 as many other economic sectors were.

\(^{89}\) Benedict, 240.


\(^{91}\) Ibid.
In this chapter, I will explore the market dynamics in the tobacco industry from two perspectives: the industrial and organizational reform in the tobacco sector, and the role of government in influencing the market formation and consumer preferences in China. By examining these two aspects of the cigarette market during 1950s-90s, I will argue that in the tobacco industry, the Chinese state played its roles as a regulator and a shareholder interchangeably in its SOE (State-Owned Enterprises) system, and although 1978 marked a significant moment for China’s economy, the time after 1978 reform until 1990s should be interpreted as a continuity instead of a transition in the developmental trajectory of China’s cigarette market.

II. The Production and Industrial Reorganization During the 1950-60s

The cigarette market across the country during 1950s was hugely diverse in different geographical locations. In the first Tobacco Industry Conference held in 1950, Yuhe Song, the Deputy Minister of the Ministry of Food and Agriculture in China, addressed that “in the newly emerged wave of national tobacco industrialization, there are two different scenarios that are worth our discussion. First, in the northeast area of China, where the land reform was completed and the industrial reform was half way through, the price level was relatively stable with the rise of people’s purchasing power. From February to October in 1949, the average sales of tobacco per month was 7,678 boxes. During January to May in 1950, it raised up to 13,648 boxes per month, increasing up to 77.75%, which was pretty exemplary. On the other hand, however, in
Shanghai, from June to December in 1949, the average sales per month was 57,892 boxes. From January to April, 1950, it dropped to 35,593 boxes, which suggested a 36.53% rate of decline.92

In his speech, Yuhe Song suggested that these two situations served as a sharp contradiction of the changing environment between a previously underdeveloped region and a modernized metropolis. The northeast area demonstrated a successful transition from a poor province in China, which was under the semi-colonization of the Japanese force for a long time, to a liberated space backed up with its excellent market performance. Yet, Shanghai, the coastal city where the old money and Western capital had once flowed, started to decline sharply when the strong foreign companies left its market.9394

Indeed, in 1953, the dominant foreign firms including BAT were ousted by the Chinese government given the industry’s nationalization following the establishment of the People’s Republic of China (PRC). The cigarette market during 1950s-1960s thus became a typical example of state socialist economy, characterized by the social ownership of means of productions and strong governmental forces in its main economic sectors. In the tobacco industry, this period signified a temporary end of the liberated market China had once have during the Republican epoch, and marked a return of the age when major industries followed the state planning with the absence of Western capitals and competitions.95

92 The Analysis of History of Finance and Economics in China (财政史研究), 262.

93 Ibid.


After clearing out the foreign influences, in 1952, China set up the “Tobacco and Alcohol Monopoly Agency” (烟酒专卖机构) in many provincial areas, which served as a particular facility monopolizing the sales of cigarettes and drinks on the regional level. In 1953, the state monopolized all the purchasing and marketing practices (统购包销) of hand rolled tobacco, and carried out a series of highly concentrated policies to regulate its market. Starting from this point, all firms including the nationalized ones, the state-private ownership of individual firms (公私合营), and private firms were overseen under the monopolized agencies, who directly reported to the state.96

The monopoly of cigarette purchases and sales was followed by a great gain of revenue and production in the tobacco sector. In 1957, the production of hand rolled tobacco reached 4.45 million boxes, which was 1.68 times more than the number reached in 1952 before the monopoly of cigarette sales was implemented. The GDP of the industry reached to 1.14 hundred million yuan, indicating a 27% increase comparing with the one achieved in 1952.97

At the inception of 1959, the state recognized the hand rolled tobacco as the “Category II” product in the state plan (国家计划二类商品). Following this plan, the hand rolled tobacco was only allowed to be purchased and distributed by the Ministry of Commerce, who bought the tobacco from the “Distribution Stations of Category II Hand Rolled Tobacco” from various local areas (二级卷烟调拨供应站) and distributed them collectively to different places. Here, we see the organization excising the direct power of monopoly on the tobacco industry changing from the “Tobacco and Alcohol Monopoly Agency” to the Ministry of Commerce as the sole power in

96 The Analysis of History of Finance and Economics in China (财政史研究), 262.266.
97 Ibid, 275.
the system, which demonstrated a gradual shift of authority from the local level to the state level as an indication of the reconcentration of the governmental power in China.

Therefore, in the beginning of 1960s, the concentration of political authority was largely completed in the tobacco industry as demonstrated by their sole rights of tobacco purchase and marketing plans. These organizational adjustments, including the setup of agencies and state bureaus with specific power of monopoly, consolidated the dominance of CCP in leading the important economic sector in its developmental trajectory. In addition to the political purpose which also contributed to the growth of economic revenue, the state also attempted to advance the industrial production of cigarettes by organizing trusts and enabling large enterprises to produce better goods in the market.

In mid-1960s, twelve industrial corporations including the cigarettes industry were set up as trusts on a trial basis throughout the country. By grouping individual enterprises and economic organizations into a specialized corporation, the practice of trust unified the management of major industrial sectors such as tobacco, thereby promoting the development of these industries through the enhancement of specialization and comparative advantage.98

Secondly, the state integrated small private cigarette firms into large and profitable ones and reduced the inferior factories and brands for better production efficiency. The number of cigarette factories throughout the country was reduced from 107 to 65 after mid-1960s, with 15 major factories produced 61% of the cigarettes for the country. 470 inferior brands were eliminated with the greater efforts made in coordination with the Ministry of Agriculture to

98 The Analysis of History of Finance and Economics in China (财政史研究), 275.

Yet, during the Great Cultural Revolution in 1966, the industrial corporations that resembled trusts were eliminated. Some of the 12 industrial corporations were broken up, whereas others stopped to exist except in name.
produce higher-quality tobacco leaf and cigarettes. Through a unified management system and an inclusive improvement of the processes of purchasing, re-flue-curing, allocating, and grading the tobacco, the production of high-quality cigarettes was ensured under the limited capitals and resources.\(^{99}\)

These policies proved to be effective by the exceptional economic outcome in the following years. The elimination of low-grade brands made the high-quality products quickly to grow. For example, Chunghwa, one of the most famous and popular native brands in China, experienced a tremendous increase from 1,600 boxes to 3,000 boxes during this time. Also, the market performance and production capacity of tobacco industry were enhanced significantly. The number of total sales of tobacco climbed from 1.6 million boxes in 1949 to 2.65 million in 1952.\(^{100}\) The domestic cigarette production in China also demonstrated an average annual increase of 11% between 1949 and 1958.\(^{101}\)

As we see, by reforming the institutional structure of tobacco industry through the introduction of special agencies and stations, and by establishing the trusts and strengthening the major firms to be more competitive in the tobacco industry, the Chinese state incorporated both its political and economic interests into these practices and reached a desirable outcome in terms of the production capacity and revenue generation of the industry. However, although the positive impacts of this highly centralized planned economy was clear, the negative aspects of CCP’s policies were also easy to perceive, such as the lack of profit incentive and market

\(^{99}\) The Analysis of History of Finance and Economics in China (財政史研究), 275.

\(^{100}\) Ibid, 264.

\(^{101}\) Benedict.
information of firms, which was a typical characteristics of a state-owned enterprise in a closed economy.

After the state implemented the monopolization in the tobacco industry, the production and sales were completely detached with each other, thereby making the cigarette producers insensitive to the actual performance of their products in the market. Ershi Ma, the Vice President of China’s National Tobacco Corporation once admitted: “because of the monopolization of cigarette productions and sales, all production goals and the categories of products in the sugar, tobacco, and alcohol industries had to be determined by the central state, who had no idea about the market dynamics and consumer preferences on the local level. And no one calculated and documented the market information either.”

The lack of interaction between supply and demand also resulted in a shortage of several popular brands and products in the market.

In 1964, when the central government sent out personnel to investigate the local market in the major areas of cigarette production in China such as Shandong and Henan provinces, they noticed such problems and wrote the *Investigative Report About the Cigarette Purchase and Sales System in Xuchang, Henan* (关于许昌地区烤烟收购调拨体制问题的调查报告). The report documented the conflicts persisted between suppliers and producers in the local market, which inhibited the growth. Due to the inadequacy of market knowledge and the experience in the rural areas, the specialized agency of cigarette purchases not only had difficulties giving constructive advice to local farmers, but was also unable to set up a consistent standard of tobacco purchase system in its region. Instead, the agency purchased the cigarettes according to their own preferences and judgement, sometimes with bias, thereby increasing the transaction

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102 It is translated by me. The original statement is in Chinese available from *The Analysis of History of Finance and Economics in China* (财政史研究), 275.
cost by adding oscillations into the purchasing processes in the market. Moreover, a lack of coordination and communication was also seen in the tobacco allocation, re-curing, and leavening, thus greatly undermining the quality of cigarettes.

In response to the problems of poorly coordinated market, the state reformed the purchasing system of tobacco products again in late-1960s. First, they eliminated the regional restrictions on tobacco purchase by replacing the old mechanism with a cross-areas purchasing system, which offered local agencies more possibilities to obtain good and suitable products from other provinces. Second, they invited the local residents to join the team as a “lubricant” to improve the relationship and establish the trust between local purchasing stations, production teams, and the peasantry. Third, they incorporated some cigarette factory workers into the purchasing agencies’ group and thus made the purchasing team more professional and specialized in choosing and buying cigarettes.

As we see, these three changes implemented by the state take place on the administrative level and the interplay between regional offices and ordinary customers. By adjusting the composition of middle level authorities instead of decentralizing its power to the local ground, the Chinese state prioritized its political interest, specifically, the predominance of state in significant economic sectors, thus demonstrating an important characteristics of the State-Owned Enterprises (SOEs) in China. In this case, the reform did not influence the dominance of the state power, yet made certain structural changes in the intermediary process to improve the overall efficiency of the industry.

In fact, the balance and conflict between political stability and economic goals occurred many times in China when the government tried to regulate the SOEs in major industrial
sectors. Since the SOEs are entirely owned by the government, they might have to compromise their profit-maximizing and cost-minimizing goals in order to prioritize on other state plans, as Qiao Liu says: “the investments carried out by SOEs are more likely driven by managerial rent-seeking incentives.”

In this case, where the state plays a direct role in managing the tobacco industry, its conflicting roles as a regulator and a shareholder become easy to perceive. As a regulator, the government would be prone to maintain its superiority in every respect of the society. As a shareholder, however, the government should aim at increasing the value of investment by exclusively focusing on the economic development. This classical contradiction of state interests highlighted the tension between the Communist Party's desire for the economic affluence and its constant pursuit of political solidity.

The industrial reorganization of Chinese state in its tobacco sector illustrates multiple implications. On the one hand, the organizational reform, which assigned the power of monopoly to the regional agencies and reconcentrated them to the state level, signifies the predominance of the state in SOEs in important industrial sectors. On the other hand, the economic planning

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103 It is translated by me. The original statement is in Chinese available from The Analysis of History of Finance and Economics in China (财政史研究), 275.


105 Liu, 96.


107 Joe McDonald, “China is running into trouble with its version of ‘too big to fail’” Nov. 19, 2015.
carried out by the central bureau, including the establishment of trusts and the huge support to large enterprises and high-quality brands, indicates its mechanism for market growth. Moreover, in the aspect of narrowing the discrepancy between cigarette producers and sellers, the state resorted to the cross-regional purchasing system and the role of peasantry in ameliorating the tension between bureaucracies and farmers. In these macro and micro adjustments, we see the role of government constantly appearing at the center of the stage, which becomes a key theme in the tobacco industrial development under Maoism.

III. A Celebrated Culture: Smoking During the Maoist Years

In the previous section, we saw the administrative and industrial transformations in the tobacco industry, and how these changes brought both positive and negative influences into the economy. In fact, these large-scale adjustments not only revolutionized the landscape of cigarette market in China on the macro-level, but also affected its supply and demand in specific ways. Unlike the changes on the supply side, which were mostly a result of governmental regulation, the change of demand in cigarette market was less quickly and explicitly to be perceived. Instead, it was gradually shifted by CCP’s public activities, which helped to consolidate a larger and even more robust market base for cheap cigarettes than the liberated market created in the Republican China. In this section, we will see how the state designate the marketing activities, which was conducted on a distinctly revolutionary and nationalistic cast through the propaganda posters that encouraged the Chinese peasantry to become a new leading force of cigarette purchase.

As we see in the first chapter, during the Republican time, the consumer segmentation of cigarettes was very stratified. China’s deeply inequitable social structure made the manufactured
cigarettes expensive and remained out of reach for the majority of its people, except for the residents living in Shanghai or in other wealthy coastal regions. Therefore, although cigarettes were widely available in villages, rural consumers still chose to buy pipe tobaccos or low-quality cigarettes throughout the Republican time.\textsuperscript{108}

Since the large population smoking pipe tobaccos in rural areas had a long history prior to the outset of Mao era, Cochran argues that the market scenery before 1949 laid a concrete foundation for the massification of Chinese cigarette in the second half of the 20th century. \textsuperscript{109} In fact, the consumer profile exhibited during the Republican period was not radically changed in Mao era. While the urban elite viewed smoking as an integral part of their bohemian lifestyle in Shanghai, the poor peasantry did not suddenly become rich or ascend into a higher level of social status, which allowed them to join the elite customers group. Instead, during Maoist years, these peasants still lived in rural places and smoked cheap tobaccos or cigarettes, while occupying the majority of cigarette market shares in China as it did in the first half of the 20th century.

However, what was changed during this time was that through CCP’s propaganda and policies which emphasized on the smoking culture, particularly the use of cheap cigarettes, among the peasantry, it consolidated the mass base of cigarettes purchase, thus realizing a transformation of the market type from a diversified group containing numerous brands and products in the Republican China, to a homogeneous basket consisted of cheap cigarettes with similar types circulated nationwide.

Under the state monopoly, the supply of cigarettes was exclusively supported and managed by the state. Therefore, solving the problem of demand became the most significant one for CCP during this time. How did the Chinese leadership achieve this transformation of the

\textsuperscript{108} Benedict, 150.

\textsuperscript{109} Cochran, 166–67.
market? In the following discussion, we will analyze this phenomenon from two angles. On the one hand, the CCP undermined the premium cigarette by creating additional barriers for it to be purchased and associating it with negative influences which could bring to its smokers through political propaganda and social activities. On the other hand, the state supported the circulation of cheap cigarettes by increasing its availability in market and stressing its underlying relations with the ideas of masculinity and the political leadership on stage in propaganda posters, thereby creating an appealing image of cheap cigarettes and consolidating people’s preferences of it.

From Mao era and forward, the Chinese state had implemented a series of incentives to encourage people to purchase cheap cigarette or tobacco products. During 1950s, because of the increased availability of cheap cigarettes in market, many smokers switched to rolled tobacco products, which tripped the cigarette consumption per capita in Shanxi, China at that time.\(^{110}\) Between 1952-1982, since the state allowed peasants to plant and sell sun-cured tobacco outside the state plan, pipe tobacco gained a growing popularity as the most affordable tobacco product in rural areas.\(^{111}\)

In addition to the variations in central policies, the CCP’s political propaganda also celebrated cigarette smoking by relating it with the notions of masculinity and revered political leadership, which enjoyed a considerable acceptance by its rural residents. For instance, the widespread of images depicting Chairman Mao smoking cigarettes in the public space and sometimes with people around engaging an easy conversation became an iconic scene during this time. While many of the images displayed by the CCP served to underscore Mao’s power and

\(^{110}\) Benedict, 144.

\(^{111}\) Ibid, 244.
mastery, other images humanized Mao by showing him smoking cigarettes with the masses.¹¹² By disseminating the images like these, the CCP not only articulated on its encouragement of cigarette smoking, but also tried to reiterate the charm of its leadership by revealing the intimacy between the peasantry and Mao through the habit of smoking,¹¹³ as suggested by the CCP’s leading slogan, “the mass is always the foundation for revolution.”¹¹⁴

¹¹² Ibid, 245.

¹¹³ Ibid.

¹¹⁴ Ibid.
While the cheap tobacco products demonstrated a great popularity buttressed by the governmental actions, the expensive premium cigarettes experienced a hard time. During 1949-57, most of the premium cigarettes became difficult to come by because they were reserved for a small number of government officials and elites. For the public, these cigarettes had to be purchased only with coupons which were distributed in special holidays and festivals. These practices significantly raised the standard for ordinary smokers to obtain such goods, and

\[\text{\textsuperscript{115} Benedict, 243.}\]
therefore made them quickly look for other alternatives such as the cheap rolled tobacco which was accessible ubiquitously in the market.

Although the premium cigarettes were allowed to be used by CCP’s cadres and bureaucracies, smoking premium brands beared the danger of bringing negative influences to oneself such as the charge of indulgence and corruption, which reduced the number of governors smoking such types of cigarettes, at least in the public sphere.\textsuperscript{116} For instance, during the Cultural Revolution, a big-character poster (\textit{dazibao}) leveled against a rural official in China revealed the discovery of a stash of foreign cigarettes at his workplace, which made him being labeled as a counter revolutionary force by the Red Guard raids and completely ruined his reputation and social standing.\textsuperscript{117}

When smoking became a tool of political propaganda and acculturation, it implied more meanings than simply being a personal habit in the spare time. Unlike the marketing strategies employed during the Republican time, which relied on current political climate to create appealing theme and trend to attract people, CCP’s propaganda directly associated the type of cigarettes and the behavior of smoking with its political principles and created a market under the state monopoly. In doing so, the state not only promoted a ready demand for cheap cigarettes, which matched with its production plan, but also more importantly, it stressed its relationship with the mass through propaganda posters, thus formed its political power more firmly. Hence, the Chinese states combined its political and economic interests together to support the tobacco industry in the 1960s and after.

In addition to the political purposes, the influence of the CCP’s propaganda posters as a result of marketing activities in the cigarette market could also be discussed and understood from \textsuperscript{116} Benedict, 243.\textsuperscript{117} Ibid, 244.
the perspective of economics and business practices. While in *Veblen in Plain English: A Complete Introduction to Thorstein Veblen's Economics*, the distinguished economist Ken McCormick interprets the ideas of marketing by Thorstein Veblen, a representative figure in institutionalist economists and a witty critic of capitalism, McCormick states that “the objective of business is profit. Profit is ultimately realized in the sale of goods and services. Selling is as important as producing. To use Veblen’s terms, ‘vendibility’ of output is therefore more important than ‘serviceability for the needs of mankind.’” Veblen claims that since most marketing takes in form of “competitive advertising,” which aims at transferring the purchasing behavior from one canal to another under the same category and raises the cost without improving the welfare of the society, marketing is a “parasitic lines of business.”

Here, we see some of the statements hold true from the welfare analysis perspective, I want to point out that the importance of marketing cigarette also lies in the aspect that instead of marketing the good itself, almost all the advertising campaigns we see from the Republican time to Mao era aims at creating and selling an experience of smoking. Either the association of cigarette with masculinity or the emphasis on modernity of smoking brings consumers a pleasant journey and a self-justified mechanism of smoking in addition to the value of cigarette itself. For demerit goods like tobacco and alcoholic drinks, whose consumption is perceived as unhealthy, degrading, or socially undesirable due to the negative effects on consumers, advertising plays a key role in these goods by creating an “experience” or notion which could temporarily remove the negative influences of these products on people through multiple ways.

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119 Ibid.
IV. Mao Era with a Step Forward: The Alchemy of China’s Cigarette Market

After Mao era, the late 1970s witnessed the CCP’s attempt to open up and modernize its economy through a wide range of measures including the decollectivization of agriculture, the expansion of SOEs, and the establishment of a market based economy.\(^{120}\) These policies, however, did not bring equal impacts to all economic sectors in China.\(^{121}\) For instance, the tobacco industry did not experience a radical change following these movements, which had been tightly controlled under the state command with a persistence of protectionism until the 1990s. However, the introduction of Western technology, the incentive of taxation, and the setup of tobacco governing bodies, occurred and continued to support the development of domestic cigarette market.

In 1981, an all-around introduction of Western machinery induced a dramatic rise in the productivity and quality of goods of China’s cigarette firms, which enabled specific regions to grow rapidly.\(^{122}\) For instance, the southwestern province of Yunnan managed to establish itself as a leading producer of cigarettes through a rigorous modernization and technological advancement during the 1980s and 1990s.\(^{123}\) In this process, the Yuxi Cigarette Plant, once a


\(^{121}\) Ibid, 2–3.


\(^{123}\) China Daily, March 1, 1999.
marginal factory, grew to be the biggest cigarette manufacturer in China, which is known for its bestselling signature “Hongtashan” (Red Pagoda Mountain) brand today.  

Meanwhile, along with the technological transformation, the newly implemented mechanism of tax revenues collection became an incentive for tobacco producers to grow their goods. This tax collection system stipulated that the local governments were allowed to retain their tax revenues that exceeded those previously set amounts which had to be shared with higher levels of government. By transferring the money and power into the hand of firms, this tax system generated an expansion of tobacco cultivation and cigarette production in the tobacco sector, especially in those specialized provinces. Later, in 1992, a change of the quota system permitted a shift to the production of higher quality cigarettes which yielded greater revenues, thus motivating more producers to make better cigarettes. Following this change, the share in total output of filter-tip cigarettes grew from 5.8% in 1982 to 93.5% in 1996, indicating an extraordinary rate of growth in the domestic region.

Institutionally, in 1982, the State Council established a state monopoly over the tobacco industry named China National Tobacco Corporation (CNTC) as a manufacturer of tobacco products in China. Two years later, the State Tobacco Monopoly Administration (STMA) was established to govern CNTC. STMA had had its bureaucratic affiliations under multiple Ministries of People’s Republic of China (PRC) as its shareholders during different time.

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124 Zhou, 114–33.
125 Ibid.
126 Ibid.
128 Ibid, 84.
Between 1985-2003, the tobacco industry in China was solely managed under CNTC and STMA.129

The collaboration of CNTC and STMA highlighted a solid vertical institutional network comprised of various STMA branches in different juridical areas in China. As demonstrated in the following graph, the STMA system invented the vertical bureaucracy that governed China's tobacco industry as a whole, while the STMA outlined the horizontal administration constructed of regional agencies and governments that managed the tobacco firms in localities. This system guaranteed the interests of the tobacco sector in different provinces, while still let the overall industry tied closely under the leadership of STMA.130

129 Ibid, 183.

130 Ibid, 183.
As a national leadership body combining vertical and horizontal bureaucrats, the STMA and CNTC have been effectively overseen the business performances of all of China’s tobacco companies and the production of major cigarette factories throughout the time. As the official website of STMA and CNTC concludes, the tobacco sector in Chinese economy has
been a state monopoly which “has put into full play the advantages of its management system” and “ensured a continuous increase of economic returns.”\textsuperscript{131}

As we see, thirty years of China’s closed economy and the reform period from 1978 to 1990s witnessed the changing dynamics in its tobacco sector. Ranging from the setup of monopolized agencies and state bureaus to manage the cigarette market, the establishment of trusts and the integration of small firms into the large enterprises, the cross-area purchasing system, the CCP’s strategies of consolidating the cigarette market base through mass propaganda, to the taxation and quota incentives, we see a series of efficiency-enhancing and cost-cutting measures implemented by the government to improve the overall development of this industry and to secure the supremacy of the state in the market. While the vertical integrated industrial structure created an advantage over the structure characterized by specialization of production, the division of labors among enterprises promoted the market transactions and solidified the comparative advantage of specialized production.\textsuperscript{132}

Instead of serving as purveyors of cigarettes to social groups and local markets, firms during the second half of the 20th century were constantly led by the central command. However, while we see various adjustments taking place inside of this industry, no change was observed on the macro level in terms of the structural transformation that affected its overall market type. In fact, due to the lack of competition and the remaining force of state protectionism, the tobacco industry did not make any major breakthrough during the time of 1950s-1990s. Unlike many other industries in China, which experienced the revolutionary moment after the open door

\textsuperscript{131} Chinese Government Official Web Portal, available online on February 10, 2012 \url{http://english.gov.cn/2005-10/03/content_74295.htm}.

\textsuperscript{132} Li, 156.
policy implemented by Deng Xiaoping in 1978, I argue that the periodization for cigarette market’s reform should not be identified as in 1978. Instead, it was the time during China’s WTO accession, including its negotiation period during the 1990s, that altered its market structure and practices in a more profound way.

With only some modest changes made in 1980s such as the technological progress, the time after 1978 could not be truly regarded as a particular historical monument for China’s tobacco industry in the 20th century. Since domestic cigarette production in China during the 1980s and 1990s still took place in SOEs primarily, the production regime introduced in the early PRC under Maoism continued through to that period, which was proved by the constant existence of the labor-intensive production and the reconcentration of the government power.

The changes in corporate organization of tobacco industry after 1978 was also very similar to that in 1963. The establishment of STMA and CNTC served as a physical entity realized by the state governance, resembling the role of different ministries supervising the local purchasing stations under Maoism. Hence, the de facto closed market introduced at the beginning of the Mao era when BAT was pushed out continued to hold through the 1990s. Although political scientists generally regard 1978 as a crucial moment of transition in Chinese economy, for the tobacco industry, the time between 1950-2000 shows more as a form of continuity than a transition in its market, once the transition to socialism was completed in 1956.

Hence, instead of a radical economic reform, the changes happened in the tobacco sector remained as a dynamics of institutional reorganization during this time: from the local agencies of purchase and sales to the state bureaus responsible for managerial affairs, we see the allocation of power constantly changed under the government control. The reconcentration of the central authority allowed the Chinese government to regulate its important economic sectors with
flexibility while still maintained its dominance. Although the tax incentives carried out during the late 20th century helped to decentralize the government authority to a certain degree, the institutional reform in relation to the ultimate supremacy of the state had never taken place throughout the second half of the 20th century, which highlights a long-standing characteristics of the state socialist economy throughout the time.
Chapter Three

The Second Turning Point of the Tobacco Industry Under the WTO Accession


During the Mao era, many political movements and policies in China such as the Great Leap Forward dragged its economy and the international image into a plight. Although 1978 reform had upgraded China’s economy domestically, China had not attained an equally important progress in its global engagement through this reform. As Xuetong Yan, the director of International Studies at Tsinghua University states: “China still has a sense of being isolated, primarily by the United States-led club of Western countries.” Therefore, in the post-Mao age, a prevalence of a great anxiety considering China’s development, particularly its international relations, occurred nationwide among the scholars and ordinary netizens. In 1990s, a survey with the sample size of 25,000 people on how the Chinese youth view the 1978-1998 reform showed that 67% respondents ranked China’s international status as the NO.1 concern to be conceived and resolved by the state.

Such worries on China’s international standing being denigrated were further reflected on Sino-American relations. As David Kang states in China Rising, since the mid-1990s, “China has attached great importance of cultivating a public image of a responsible cooperative power in the

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134 Ibid.
Chen

135 Thus, it became imperative for China to be recognized by the leading power in the global community such as the U.S after 1978.

In addition to diplomacy, the economic planning was also perceived by Chinese populace as an increasingly urgent task for China to achieve its growth. According to a survey conducted by *China Youth Daily* in 1995, the majority of its interviewees expressed the opinion that despite China’s extraordinary commitment in political stability and military strength, China’s economic situation was significantly behind and requested immediate solutions.136 In the age of globalization, it was crucial for China to seek a way to demonstrate and strengthen its economic force.

Given the political and economic entreaties, joining an appropriate international organization became an effective tool for China to justify its reputation and qualification as a growing global player. However, though China had associated with the United Nations Security Council and the nuclear powers club, the diminishing significance of these two traditional status since the mid-1990s let China consider its steps in finding a new and more powerful seat on the international stage.137 Consequently, the World Trade Organization (WTO), which resonates

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135 Kang, 52.

Also, according to a BBC news published in 2001: “the key turning point came in November 1999, when the United States and China signed a trade deal that was narrowly endorsed by the U.S Congress [...] The restrictions on its capital markets will eventually have to be lifted and market access for foreign goods and firms will be improved.” China’s international relation was indeed largely depended on its acceptance by the U.S at that time.

136 Kang, 52.

137 Kang, 58.
with both its political and economic ambitions, became undoubtedly the best status booster for China at this time.

In this chapter, I will examine the impact of China’s WTO accession on its economy, particularly in the tobacco industry. While the 1978 reform did not create a revolutionary modification on the tobacco sector, China’s global engagement through the WTO membership reintroduced the foreign brands into its domestic market, signifying another watershed in its development. How did the WTO agreement influence the tobacco manufacturing in China? What actions did China take in response to the changing environment under the WTO rules? And what are the economic and political results and implications induced by these changes? By analyzing different interest groups in China’s WTO accession and various policies and reforms taking place during 1980s-90s, I will address both the challenges and opportunities created by this time, which implies the changing characteristic and the unshakable nature of China’s tobacco industry.

II. The Pushing Force of China’s WTO Accession: BAT’s Lobbying Efforts and Strategies

China’s WTO accession, accompanied with numerous domestic struggles and international disputes, took a decade to be accomplished. In the tobacco industry, the foreign corporations, notably BAT, played an essential role in China’s negotiation with WTO and its membering countries. As the most active lobbyist in accelerating this accession, BAT voiced strong support for China's WTO membership. Martin Broughton, the Chairman of BAT during this time, said in its first Annual General Meeting in 1999 that “British American Tobacco has been a long standing supporter of accession. We welcome the Chinese commitment to
participate fully in the international trading system and hope that the negotiations are concluded quickly.”

BAT wished that WTO could help it to open up China’s closed economy, which produced a ready access for it to be redirected into this profitable market, since such an emerging market would be important “to the future of the tobacco business, and to BAT's objective to regain the number one position.”

Paul Adams, the director of BAT's Asia Pacific region, also made a very clear statement that “China is by far the largest and most profitable opportunity. [...] The market remains fiercely protected and controlled and no change to this is anticipated in the short term. However, China is keen to join the WTO. Its membership has its obligations as well as its privileges.”

While acknowledging the huge potential Chinese market had, BAT hoped to reenter this lucrative land once China’s WTO accession makes it an open economy to the world.

Overall, what BAT expected here was a win-win situation: if China’s accession to WTO was realized, it sparked the second chance for BAT to access this market. However, even though the accession failed, BAT still deserved some credits for its efforts and might be treated well by the Chinese government, which may result in a less strict governmental policy that is more friendly to its company. As BAT claimed: “if we are perceived as facilitators for China's accession, we may expect a ‘preferential treatment’[by the Chinese government].”

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138 Kang, 58.


141 Kang, 58.
Moreover, BAT’s eagerness in pursuing China to join the WTO membership could also be understood with a general context of the global cigarette market in 1990s. While the rise of educational level caused the number of smokers to fall in the West, many developing countries like China still demonstrate a great pool of cigarette consumers, serving as a huge attraction for foreign brands to seek.¹⁴² In China, the smoking rate by educational level was the same as in other countries, which was lower among the people with college education and above, and higher among those only went to primary schools. However, China signifies no decline in its tobacco use by males with a higher educational level. The rates of smoking among males with college educational background were 45% in 1984, 48% in 1996, and 45% in 2002, indicating a consistent trend. Therefore, having a voluminous and well-founded market, China became the most desirable place for foreign companies such as BAT to expand their businesses.

After a decade of negotiation course along with BAT’s lobbying efforts, China requested to accede to the WTO in 1995, and formerly established its membership in 2001.¹⁴³ The official accession in WTO exposed China’s domestic cigarette sector to multiple challenges, ranging from the reintroduction of foreign competition to a diminishing governmental role which had secured the longevity of China’s native producers for almost forty years.

III. What Did WTO Accession Bring: China’s Response and the Changing Policies

Countless reforms and policies were executed following China’s WTO accession. In the tobacco industry, these schemes could be interpreted from two stages and perspectives: the first


¹⁴³ Ibid.
stage was the implement of WTO legislation and its effects on China’s cigarette market. The second one was China’s response to these rules and its approaches on empowering its domestic sector in this changing surrounding. By tracing the path of different strategies, we will see a continual interplay of the international organization, the Chinese state, and the market, and find out the answers of those questions I proposed in the end of last section.

China’s WTO accession brought new legal requirements to its economy, such as the cut of tariff and tax treatment, which deprived the advantages enjoyed by national firms during the Mao era. In the tobacco industry, the most pronounced change was China’s reduction of tariff on the importation of cigarettes, which dropped from 65% in 2001 to 25% in 2003. Other adjustments included the reduction of tariff on tobacco from 28% before 2001 to 10% in 2005, and of cigars from 65% before 2001 to 25% in 2005.

Moreover, WTO dispossessed the power of important Chinese agencies such as China National Tobacco Corporation (CNTC), a critical state bureau regulating the tobacco industry, in placing additional restrictions on imported products. The section of China’s accession in WTO report stipulated that a single license should authorize the sale of all cigarettes, irrespective of their country of origin, and China shall eliminate “other restrictions regarding points of sale for imported products, such as could be imposed by the CNTC.”

However, it is important to note that even though the power of CNTC was declining, during China’s long-term negotiations with the U.S in regard to China’s WTO membership, the Chinese government maintained its bottom line for the state role in the tobacco industry, which


\[146\] Wang, 177.
means that the State Tobacco Monopoly Administration (STMA), another major authority paralleling to the position of CNTC in the tobacco sector, still holds the sole right of importing and of selling foreign cigarettes in the domestic wholesale market. This rule left some flexibility for the Chinese state to oversee and manage its market in the future.\textsuperscript{147,148}

As we see, the WTO terms discussed above wiped out certain barriers for foreign products to be imported to China. However, another part of the WTO rules specifies the particular property of cigarettes, which allows the Chinese state to supervise the foreign cigarettes through the conducts of license, quota, and price control. For instance, in the first annex of the WTO report, all the tobacco-related sources and products, along with grain, vegetable oil, and sugar, are classified as special goods subject to the state trading (import). The third annex \textit{Products Subject to Import License, Import Quota and Import Tendering} also identifies the tobacco leaf and cigarette as the products under license, quota, and import tendering control.\textsuperscript{149} Thus, unlike regular commodities in the retailing market, tobacco and cigarettes are regulated as special goods in China’s international trade. Although WTO asked China to put an end to its state pricing practice, it may not necessarily apply to the cigarette sector as a special good market exempt from several rules, which serves as a tool for China to carry out protectionist policies on its domestic tobacco industry.\textsuperscript{150}

After a careful appraisal of the WTO regulation, we notice that some of the WTO rules were significant, yet not a determining factor in explaining the overall movement of China’s

\textsuperscript{147} Ibid, 183.

\textsuperscript{148} Ibid, 166


\textsuperscript{150} Ibid, Annex 4.
tobacco industry during this time. While it raised some standard on China’s economic sector, it was difficult to assess the direct effect it brought to the tobacco industry because of cigarettes’ unique identity, both commercially and institutionally. Yet, as the French saying goes, à bon chat, bon rat. Given the uncertain pressure from WTO legislation on tobacco trade, the Chinese state carried out a series of actions to back up its domestic market during the negotiation process and after its formal accession to WTO. The measures included a unique taxation system in the tobacco sector, governmental subsidy, and an industrial movement in the tobacco industry, which offered domestic companies more incentives to grow, established a small number of large and competitive cigarette firms, and reconcentrated the central authority in regulating this market.

In China, the cigarette tax combines an ad valorem tax (a tax based on the assessed value of the good) and a specific excise tax (an indirect tax charged on the sale of this good). Because the excise tax is paid by customers, given the constant amount of cigarettes a smoker has to buy every day, consumers are willing to buy better products in the market, thereby existing as a great incentive for producers to improve the quality of their goods. However, the ad valorem tax, which makes better cigarettes more expensive, might also induce the tendency of consumers to switch to cheaper cigarettes when excise rates are too high, which serves as a two-tiered mechanism for producers to adjust brand prices in order to pay lower tax rates. Hence, this taxation system, which results in greater quality of goods and motivations for production, was an effective stimulus for producers to make goods in the cigarette market.

In addition to the taxation tactics, the excessive amount of government subsidy during 1990s substantially financed China’s tobacco industry. China had heavily subsidized its domestic tobacco sector before its official accession to WTO. The government subsidy increased exponentially from 1.2 billion yuan in 1994, 8.62 million yuan in 1995, 926 million yuan in 1996,
to 1,025 billion yuan in 1997.\textsuperscript{151} Although subsidies were scheduled for cancellation with China’s entry into the WTO, the generous input on the cigarette market of Chinese government during its negotiation with WTO demonstrated a strong governmental protection to this domestic sector, which implied the reluctance of the Chinese state to open its tobacco industry for global competition.

Last, the Chinese state launched an industrial movement which found the key for its dilemma in the state managerial system of the tobacco sector. This movement consolidated the authority of STMA and resulted in the cross-regional corporations by merging the small firms with the well-established companies, which enabled the domestic cigarette firms to be increasingly competitive.

Nonetheless, the distribution of power in STMA and CNTC system induced the second tier of protectionism in addition to the state protectionism in this industry, which was local protectionism. Given the significant amount of revenue tobacco manufacturing generated each year and the large number of factories and firms in China, some of the local governments started to pursue their own economic interests under their jurisdictions, which undermined the efficiency of horizontal bureaucracies and segmented the tobacco market nationwide.\textsuperscript{152} In order to solve the problems of the fragmented market and local authorities while still maintained the supremacy of the central state, the Chinese government embarked on a new plan which established independent tobacco trade companies and built them into national-level or cross-regional corporations. Many small cigarette plants were thus closed down for making those large ones

\textsuperscript{151} Teh-wei Hu, 219.

\textsuperscript{152} Ibid, 183.
merged, resulting in the number of cigarette companies dropping from 185 in 2000 to 44 in 2005. The number of brands also decreased from 1,049 in 2001 to 325 in 2005. In doing so, the jurisdictional blocks that local governments deliberately created to protect their regional businesses got demolished due to the dominant power and strong competitiveness of a small number of major companies in the market.

This movement successfully cultivated large-scale tobacco corporations, with the biggest three in Yunnan, Hunan, and Shanghai. These influential enterprises embraced the advantages of economies of scale, which reduced the costs per unit due to the increased total output of a product. Also, they lowered the transaction costs associated with horizontal management and improved the overall efficiency of the industry, which was a further demonstration of China’s attempt in enabling its domestic firms to be more competitive in the presence of foreign brands. Instead of reorganizing the governing bodies, the Chinese state reconstructed the tobacco industry by replacing some of the local authorities with large firms’ dominance. This practice not only enhanced the competitiveness of the domestic tobacco industry in China, but also more importantly, it helped the central government regained its power from the separate local authorities, which stressed their prerogatives of decision-making and policy-directing in this important industrial sector in China.

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153 Ibid.
154 Wang, 189.
155 Wang, 183.
156 Ibid.
157 Wang, 167.
As a result, China’s WTO accession generated multiple-layered influences and reforms on its cigarette market. Although the accession had led to the tariff concession and the deprival of CNTC’s power to a certain degree, the particular legal and commercial nature of cigarette enabled it to be exempted from several restrictions imposed by WTO rules. In response to the potential impact and competition China’s WTO membership could bring to its market, the Chinese state performed various practices during its negotiation period with WTO in 1990s. The policies such as taxation, heavy subsidies, and industrial merges were effective to strengthen the monopolization in its domestic tobacco industry.

Therefore, the strategic combination of institutional setup and industrial reorganization supported China’s domestic cigarette market to grow in the presence of foreign brands, who had never had a chance to regain their dominance that they had during the golden-age of the Republican China. According to the following chart, all of the leading foreign brands coming to China after the WTO time, including BAT, Phillips Morris International (PMI), and Japan Tobacco International (JTI), consisted of 1% of the overall retail volume in China by the time of 2010, which implied their difficulty in occupying a market share as a partial result of China’s inclusive strategies of market protectionism on its domestic sellers.
While the Western products suffered from their longest winter in China, the domestic tobacco industry continued to flourish. As a key generator of revenue for local governments in the tobacco-dependent provinces like Yunnan and Guizhou, the cigarette manufacturing brought additional benefits to their society. In Yunnan, where the cigarette manufacturing was the single largest sector with 38% provincial government corporate profit tax, about 45% of total revenue was used to finance its rural development, education, and social welfare system. Similarly, Guizhou, where the cigarette manufacturing was responsible for more than 30% of its government revenue, relied heavily on the economic performance of its tobacco sector to support other social benefits in its region. Another explicit example would be Da Yin Jie Town, a town close to China’s largest cigarette manufacturer, Hongta Group in Yunnan province, enjoyed an

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Ibid.
industrial revenue growth from less than 200 million yuan to more than 2.2 billion yuan, among which 90% was earned from the cigarette accessories production. The significant revenue growth derived from the production of cigarette accessories also made it become one of the richest towns in Yunan today.

In conclusion, in the tobacco industry, although WTO agreements led to a seemly open and globalized environment in China by reintroducing the Western brands such as BAT and Phillips Morris International (PMI), BAT’s optimistic anticipation before China’s accession that “the concessions will almost certainly result in a significant opening of the Chinese market through a phased reduction in import duties and the removal of non-tariff barriers” was not fully realized. In fact, China’s accession to WTO failed to provide a perfectly competitive market in the tobacco sector. As the state socialist economy under Maoism was end and the market became more liberated than before, China’s strict supervision on foreign cigarettes and its significant protectionist measures for domestic manufacturers made the competition difficult to happen on the real sense.

**IV. What is Behind the Appearance: The Role of State and its Tactics**

From China’s negotiation process to its final accession to WTO, we see conflicting interests of different stakeholders in the tobacco industry. WTO, as the regulator of world economy, was aimed at lowering the non-tariff barriers in China to facilitate the flow of international trade. However, BAT represented the global interest of multinational corporations, who hoped to reclaim the market share after China’s WTO accession. Yet, the Chinese state,

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159 Ibid.
though very eager to join the WTO group due to its political and economic considerations, was reluctant to open up its important industrial sectors for foreign competition, and thus implemented a series of indirect controls and policies to secure the state monopolization in the industry.

Given the different interests and inclinations, we see the dynamics of power going on in this confrontation. Initially, in hope of many developed countries that China’s WTO accession should mark a clear commitment towards multilateralism, China’s transformation from a state monopoly to an open market seemed like a “compromise” the PRC government made in order to become a member of WTO, given its lack of motivation to develop a globalized environment and introduce foreign competition to its crucial economic sectors.\(^{160}\) However, although the accession made China unavoidably engage in the global competition, China’s admission did not illustrate its willingness to develop a free market, at least in the tobacco sector. In fact, China was strategically engaging itself in the global atmosphere and solidified its power of governing the tobacco sector through manipulations of various laws and institutes such as the maintenance of STMA’s power of regulating the imported cigarettes, as we discussed in the previous sections.

While China’s WTO accession helped it to establish a public image as an active global player in the international community, it did not produce a perfectly competitive market in the tobacco industry. In the post-WTO time, we do not see any huge differences of the tobacco industry in terms of its market break-down and the number of major firms and competitors, which are supposed to be seen under an open market economy. It was true that new products from BAT, PMI, and Japan Tobacco International (JTI) were reintroduced into the market. Nevertheless, these foreign giants ended up with a negligible market share in the vast land of

China’s tobacco industry as a result of the state intervention. Hence, the transition from the state socialist economy under Maoism to a liberated market facilitated by the WTO accession was not a crossroad in the development of China’s tobacco sector, since its major market composition and the role of the state did not fundamentally shift following China’s WTO engagement.

On the contrary, China solidified the state supremacy in its domestic cigarette sector during the time of its WTO negotiation. By concentrating the power from local governments through the establishment of large enterprises, the Chinese state showed a high interest in using the WTO accession to further strengthen its authority in the cigarette industry. For example, in 1996, BAT and Guangzhou NO. 1 Cigarette Factory entered into a joint venture under the leadership of CNTC to develop the Cocopalm brand.\(^\text{161}\) This practice seemed to create more opportunities for foreign products to be sold in China, yet it also made the operations of the Western companies constantly under the CNTC’s regulation.

Therefore, I argue that in the field of tobacco trade, China’s WTO accession indicated a larger ambition in its political demand than in the economic appeals. Instead of a demonstration of the free trade and market economy, China accepted the WTO concessions and redirected the foreign cigarette brands into its domain as an exchange of power, which enabled China to step onto the international stage and engaged with other dominant countries in the world.

While the degree of China’s global engagement is increasing, the dominance of its state leadership in the domestic cigarette market had never been altered from the establishment of PRC until now, which was not difficult to be understood given the historical context of China. The intense rivalry between BAT and Nanyang Brothers during the first three decades in the 20th century, which signified the strong competitiveness of foreign firms in gaining a substantial

\(^{161}\) Ibid.
market share in Chinese market, serves as a rooted fear of imperialism in China, which shaped the subsequent Chinese foreign policies and commercial practices in the tobacco industry. Even today, we see the Chinese state subsidize the important industries in both private and public sectors such as the Internet and the Smartphones in order to protect them from foreign competitors and to help them secure a major market share in the domestic environment.

Also, as the largest tobacco producer and exporter country in the world, China was lacking a major incentive to open its import section of the tobacco industry and let the foreign products to challenge and invade its well-established domestic market. Throughout the time, China had never expressed the wish to invite foreign organizations to support its tobacco trade, and did so only in accordance with the WTO legislations. Therefore, while the WTO allowed foreign firms to compete with other brands in China, the Chinese state responded by carrying out multiple strategies such as the taxation incentive system and STMA’s power of regulation to strengthen its native firms and to create additional obstructions for international companies, which highlighted its consistent protectionist attitude towards important industrial sectors in its economy. As I said, China’s WTO accession acted more as an exchange of power than of commodities in its cigarette sector, which has been projected great influences in its development throughout the 20th and the 21st centuries.
In China’s tobacco industry, the tremendous power of the STMA and CNTC often lead critics to refer to the tobacco industry as “the last bastion of China’s planned economy.” From the institutional perspective, although strategies employed by many democratic countries in the world are effective in achieving economic growth rapidly, it is unacceptable for China in lights of the potential threat of political dominance these strategies may impose to it. However, given the leading position of the Chinese government after 1949 in the tobacco industry, how did this significant industrial sector manage to thrive as a SOE? What can be inferred from its evolution in relations to the bigger landscape of Chinese economy?

In the first three decades of the 20th century, we see a duopoly made of BAT and Nanyang Brothers in the tobacco market, which resulted in a great progress of Chinese consumption culture and a market expansion of cigarettes. While the managerial and marketing strategies of BAT were insightful and worth learning, the robust performance of Chinese companies also laid a critical foundation for the growth of the cigarette market in the rest of the century.

However, during the Mao era, the cigarette market became state-owned after the nationalization of all tobacco companies in the 1950s. The government ousted foreign competition and deliberately boosted the overall supply of cigarettes by encouraging local

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162 Ibid.
production of cured tobacco and establishing new factories in the interior. In 1978, the first economic reform in China began to turn over the traditional practice of planned economy and advocate for modernized technology and strategies. Yet, the tobacco industry remained steadily closed under the state control with the founding of CNTC and STMA in early 1980s, demonstrating a relatively modest market transformation comparing with the one achieved during the turning point of 1949.

Although, as argued in “China’s Innovation Challenge: Overcoming the Middle-Income Trap,” China was far from being a market economy at that time, it is still significant that its attempts to “curb aggregate self-financed investment” since 1980 have resulted in an outright bans on investment in surplus goods like cigarettes. Therefore, China was marching towards the market economy after 1978 in a gradual way. The process from a closed economy to an open market was a staged procedure with different progress made in its heavy industry, light industry, and the sector of consumer goods. Therefore, though the SOEs still maintained a robust standing in China’s economy, the proportional contribution of SOEs made to its GDP declined by degrees as a result of its effort in becoming a market economy accompanied with a rapid growth of other private sectors in the domestic surrounding.

The development of China’s tobacco industry in the 20th century enables us to see many reappearances of policies and strategies such as the merge movement and the vertical integration. Also, China’s engagement with the global community was done through its multiple interactions with the multinational corporations like BAT and its WTO accession in 1990s-2000s. According to John Dunning and Sarianna Lundan, the global engagement of China also becomes

\[\text{\textsuperscript{164}} \text{Ibid.}\]
increasingly outward-looking through the conductions done by its institutions.\textsuperscript{165} For instance, CNTC has been actively exporting cigarettes since the 1980s and invested in key strategic areas to target specific markets overseas after 2000. As Jennifer Fang states: “seeking to further decrease the operational costs for greater profit margins, CNTC’s overseas operations strive to use locally grown tobacco leaf and hire locals where possible, thereby increasing efficiency through removing cultural and language barriers.”\textsuperscript{166} This practice, which was similar to BAT’s strategy of penetrating into the Chinese market in the beginning of the 20th century, demonstrates the profound impact of the duopolistic rivalry in the Republican China on the tobacco industry.

Therefore, instead of a simple amplification of earlier patterns of tobacco production, marketing, and consumption, the development of China’s tobacco industry illustrates essential implications and varying characteristics throughout different periods. From my point of view, the most radical transition of this market took place at the time of PRC’s establishment under the leadership of Mao. This transition of China’s tobacco sector from a liberated economy to a closed entity marked the emergence of the state dominance and the heyday of China’s SOEs. Later, though WTO’s accession suggested China’s return to the global setting, we do not observe a radical transformation of the market type in the tobacco sector under the continued authority of STMA and CNTC.

However, while we see the trend in industries like tobacco, sugar, and alcohol resumed in the late 20th century, other economic sectors such as the light industry were transforming gradually, marking a progress towards market economy in China. Yet, in the tobacco sector, the dominance of SOEs had never disappeared in history, and probably will not in the future. In

\textsuperscript{165} John H. Dunning, Sarianna M. Lundan, Multinational Enterprises and the Global Economy.

\textsuperscript{166} Jennifer Fang, 7.
December, 2006, the State-owned Assets Supervision and Administration Commission (SASAC) in China declared that the SOEs must play a dominant role in certain industries including tobacco.\textsuperscript{167} Mr. Xi, the president of China, has also made similar remarks over the past years.\textsuperscript{168}

Therefore, in China, the legacy of tobacco industries was not lied primarily in the nature and impacts of its SOEs, yet, the booming of domestic cigarette market could not be separated from its industrial features. Following the practices in the cigarette market, we see China employed similar protectionist measures in industries that might face outside competition due to the disparity of technology, and used the tariff, exchange rate regulation, and subsidy to create trade barriers for foreign firms in order to protect its domestic producers. For instance, the high tax rates for imported foreign cars in China allowed its domestic automobile industry to survive, which resulted in some influential native brands in China such as BYD (比亚迪) and Geely (吉利).

Conversely, the introduction of global cosmetics market in China, which also relied heavily on chemical innovation and technical improvement, made the national brands such as Pehchaolin, which lacked the advanced technology, lost its prestige. Therefore, China’s motivation for maintaining a state regulation in certain sectors demonstrates its two-tiered considerations: although it is advantageous to have a perfectly competitive market which brings better goods and services into the market, the state would be inclined to prioritize on the development of important industries in its planning for other purposes, such as for the tobacco industry as a major revenue generator. Moreover, the role of government in major industrial

\textsuperscript{167} Liu, 11-12.

sectors also helped to strengthen China’s political authority in an explicit way, given the increasingly tightened trend of the central governance today.
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