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## **State monopoly, Chinese style : a case study of the tobacco industry**

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## CHAPTER SEVEN

### CONCLUSION

In neoliberal discourse, SOEs are seen as economically inefficient and incapable of generating the necessary dynamic for economic development since only the private property right can assure that market economics function properly. From this perspective, SOEs are a barrier to China's transformation from a planned economy to a truly Occidental-style market economy. According to neoliberal propositions, then, China must thoroughly privatize the existing SOEs so that resource distribution is fully optimized. However, against this hegemonic neoliberal ideology, China's SOEs have continued to evolve since the late 1970s and experience dramatic growth particularly after China's WTO accession. As the *Economist* noted in 2011, "as the economy grows at double-digit rates year after year [in China], vast state-owned enterprises are climbing the world's league tables in every industry from oil to banking."<sup>1</sup> Currently China has, after the United States and Japan, the third largest concentration of Global Fortune 500 companies, and more than two-thirds of the Chinese firms on the list are SOEs.<sup>2</sup> Most of these are central SOEs, which typically take the form of an oligopoly within the state-monopolized sectors. They are the major drivers of economic growth in China in the first decade of the twenty-first century.

In this context, China's developmental model, frequently labeled "state capitalism," has triggered a heated debate in recent years. In the debate, China is viewed as the leading proponent of state capitalism nowadays, where decisions on how to distribute resources are made by state officials according to set political goals. Some argue that the rise of this form of capitalism in China presents a challenge to the free market economies in the developed world.<sup>3</sup> Accordingly, a new term has

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<sup>1</sup> Anonymous, "Let a Million Flowers Bloom," *The Economist*, March 12, 2011, accessed October 15, 2012, <http://www.economist.com/node/18330120>.

<sup>2</sup> Fortune 500 rankings are based on revenues. See Li-Wen Lin and Curtis J. Milhaupt, "We are the (National) Champions: Understanding the Mechanisms of State Capitalism in China," *Columbia Law and Economics Working Paper* 49 (2011): 2, accessed August 5, 2012, <http://ssrn.com/abstract=1952623>.

<sup>3</sup> Ian Bremmer and Devin T. Stewart, "China's State Capitalism Poses Ethical Challenges," *Policy Innovation for a Fairer Globalization*, August 10, 2010, accessed August 18 2012,

arisen for this model of relatively steady economic growth in China, particularly after the breakout of the global financial crises in 2008: the “Beijing Consensus” (sometimes used interchangeably with the “China Model”) is characterized by state-led economic sectors, state-constructed markets, and an authoritarian political regime.<sup>4</sup> Unlike the “Washington Consensus,” which used to be the standard formula employed by developing countries for establishing functioning economies through the espousal of the virtues of free markets, private property rights, and political democracy, the Beijing Consensus replaces trust in the free market with growth through “a more muscular state hand on the levers of capitalism.”<sup>5</sup> Other similar ideas characterize China’s developmental mode. For example, Nan Lin proposed “centrally managed capitalism” (CMC), under which the party-state commands the economy by controlling personnel, organizations, and capital in both the political and economic arenas and also delegating administrative authorities to diversely formed corporations to compete in the marketplace at the same time.<sup>6</sup>

In the growing rhetoric about the Beijing Consensus, the most striking contrast with the core assumption in the neoliberal doctrine lies in the state ownership of enterprises, through which the state is engaged in the economy. While state-monopolized industries, composed of several central SOEs, present a more comprehensive involvement of the state in the current economy, we still know very little about the substance of state monopolies in China; how they were constructed within China’s market-oriented reform and how they have developed over the past three decades remain open questions. By studying the state monopolies in China, the biggest question remaining to be answered is: how have the state and the market combined and engaged with one another under an authoritarian regime? How, in China’s context specifically, have they done this?

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<http://www.policyinnovations.org/ideas/commentary/data/000198/>.

<sup>4</sup> The term “Beijing Consensus” first made its appearance in the mainstream political lexicon in 2004, when the UK Foreign Policy Centre published a paper by Joshua Cooper Ramo titled *The Beijing Consensus*. A number of studies have subsequently discussed this concept: Stefan A. Halper, *The Beijing Consensus: How China's Authoritarian Model Will Dominate the Twenty-first Century* (Jackson, TN: Basic Books, 2010); John Williamson, “Is the ‘Beijing Consensus’ Now Dominant?” *Asia Policy* 13 (2012): 1-16.

<sup>5</sup> Anonymous, “Beware the Beijing Model,” *The Economist*, May 26, 2009, accessed August 3, 2014, <http://www.economist.com/node/13721724>.

<sup>6</sup> Nan Lin, “Capitalism in China: A Centrally Managed Capitalism (CMC) and its Future,” *Management and Organization Review* 7 No. 1 (2011): 63.

Adopting the approach of historical institutionalism, this thesis selects the tobacco industry as a single case study to explore the abovementioned questions by answering why competition would happen in the tobacco state monopoly from the outset and how it has evolved in China. Seen as a form of monopoly controlled by fiat, most monopoly literatures criticize state monopolies as eradicating competition. However, fierce competition exists within China's state-monopolized industries. Given that competition is regarded as the essence of "normal" market economics, this paradoxical phenomenon—the coexistence of state monopoly and competition—would be a critical ingredient in any discussion on the dynamic state-market relationship in China.

Moreover, while competition has also occurred in other state-monopolized sectors, the tobacco industry is an ideal case for studying the correlation between state monopoly and competition because it has, of all the state monopolies, clearly exemplified a type of central state control that is the most comprehensive. Led by their theoretical biases, neoliberals would normally not bother to research this topic, but the insights provided by this study help to understand not only the complexity of China's state-market relationship—that there have existed many ways of organizing the state monopolies—but also the legitimacy crisis that the Chinese authorities now face today.

In the following, I first summarize and then conclude the theoretical implications derived from this research. Although it may be too early to tell what direction the existing tobacco state monopoly is taking or when the next critical juncture will happen, some critical problems are already surfacing under the current governance pattern. These will be explored in the final section.

## **7.1 Summary**

In this study, I argue that the emergence of competition in the tobacco state monopoly resulted from a certain industrial governance pattern, which emerged incrementally and was strengthened through interactions between local governments and the local agents of China's National Tobacco Corporation. As the institutional settings where local governments and the CNTC's local agents were embedded changed, the governance pattern and the resulting competition type transformed as well over three distinctive phases—quasi-free competition under the two-track system in the first phase (1982-1993), restrained competition under prevalent local

protectionism in the second phase (1994-2004), and quasi-oligopoly competition under the central-led competitive monopoly in the third phase (2005-2012).

The consequences of competition in each phase would then trigger a regulatory change in the tobacco state monopoly at critical junctures, which would constitute the new premise for the following stage where another governance pattern would emerge. By tracing the development of these three temporal phases, we see that not only have the local governments already become the *de facto* agents for serving the CNTC while indirectly strengthening its control capacity, but also that the state control and the competition alike would both be reinforced and intensify. At the same time, the current central-led competitive monopoly prevents collusion between emergent oligopolies. In contrast to the typical dualist dichotomy of mutually exclusive state control and competition, “state monopoly, Chinese style” has been formed in this context.

## **7.2 Theoretical Implications**

A single case study based on one state monopoly in China makes generalizing about the characteristics of all state-monopolized industries in China challenging, since the nature of the regulation varies from sector to sector. However, the tobacco industry, in light of its most comprehensive and strict regulation, may provide an ideal benchmark for comparing the features of other state-monopolized industries. From this research, then, theoretical implications in the field of China’s contemporary political economy, along with the state-market relationship in general, may be summarized as follows.

### **7.2.1 The Changing *Tiao-Kuai* Matrix in China’s Central-Local Relationship**

Local governments’ involvement in the state tobacco monopoly is the crucial factor for explaining the coexistence of state monopoly and competition and their evolution. On the surface, the state tobacco monopoly was formulated as a vertical management system (*tiao*), but local governments (*kuai*) had their own forms of leverage in this system from the beginning. Therefore, the developmental history of the *tiao-kuai* relationship reflects the developmental trajectory of the tobacco industry.

From phases one to three, the *tiao-kuai* relationship has experienced cooperation, usurpation, and reversal. At the outset, the *tiao* could not have been set

up without cooperation from the *kuai*. However, exchange and compromise were involved in this “cooperation” such that the *kuai* could influence the operation of the *tiao* within their own geographical jurisdictions. This participation gradually prompted the *tiao* to deviate from its original design of total state-monopoly such that the authority of *kuai* came to dominate locally more than the *tiao*. Given that the state monopoly had already deteriorated into local monopolies, the central state sought to rebuild the authority of the *tiao* in order to block further manipulation by the *kuai*. In addition to restoring the domination of the *tiao* in this sectoral governance, the *kuai* in fact were compelled to serve the *tiao* to further consolidate its steering capacity. In this context, the *tiao-kuai* relationship has been completely reversed.

This reversal provides an insight to better understand the prevailing notion of “fragmented authoritarianism,” which argues that authority below the top of China’s bureaucratic system is disjointed, with the fragmentation intensified by the course of market-oriented reform. Since this idea first appeared, the argument has remained one of the most frequently mentioned frameworks for describing the inner workings of the Chinese bureaucracy; the importance of bureaucratic bargaining is emphasized in this vein.<sup>7</sup> Many studies have continued to flesh out this concept, and the fragmented market in the tobacco sector during the 1990s would bear it out as well. However, this study demonstrates that the fragmentation state of China’s authoritarian regime has not always been static. On the contrary, it has evolved, continuing to change and moving into a more integrative situation by transforming the *tiao-kuai* matrix. In this sense, this study offers a theoretical reframing for the now-current argument for China’s fragmented authoritarianism.

The reversal of *tiao-kuai* relationship also makes clear one of the major features of China’s state capitalism that is rarely recognized in the extant debates, including Wang’s. One of the most remarkable changes of the market-oriented reform was to give the horizontal line of authority priority over its vertical counterpart in a range of spheres by introducing a series of decentralization measures. Consequently, the function of *tiao* was largely eroded under those circumstances. Starting in the mid-1990s, however, the situation changed when the central state created a vertical chain of command for collecting taxes under the tax-sharing system. Such rebuilding of the *tiao* also occurred in a number of key regulatory departments to discipline local governments in their economic

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<sup>7</sup> More references in Lieberthal and Lampton, *Bureaucracy, Politics, and Decision Making in Post-Mao China*.

management. For example, in Mertha's study, he recognized that the Administration for Industry and Commerce and the Quality Technology Supervision Bureau were ordered to alter their relationship with regard to authority, changing from a decentralized (*kuai*-based) structure to a centralized (*tiao*-based) one in the late 1990s in order to counter local protectionism and establish standardization in policy enforcement. In the new "vertical management" system (*chui zhi guan li* 垂直管理), these bureaucracies were directly controlled by their functional administrative superiors (*tiao*) rather than by the local governments (*kuai*) so that the central policies were more likely to get implemented.<sup>8</sup>

As indicated in this study, the *tiao* also reappeared in state monopolies in the past decade. One could, however, distinguish this from the recentralization measures in other regulatory departments. In fact, the departments of the state monopoly formed the pivotal *tiao* during the time of planned economy but have since experienced a dramatic transformation under the SOEs reform once market-oriented reform was initiated.

Viewed from the standpoint of tobacco, a first difference may be found in the method of recentralization. Rather than reallocating administrative authorities, here the *tiao* was rebuilt through corporatization reform, which created centralized governance within the parent-subsidiary corporate framework and formally removed the leverage of local governments. The second difference was that, after the *tiao* was set up, the *tiao-kuai* relationship was reversed. This has rarely been the case in other administrative departments where the *tiao* have been reshaped. As analyzed in Chapter Six, the CNTC would go on to take advantage of the fiscal predicaments of local governments in order to force them to act as its *de facto* agents for the purposes of accelerating capital accumulation.

This reversal was not only caused by the straightforward process of redistributing authority; it was also propelled by the fiscal plight of local governments under the tax-sharing system. In fact, this converted *tiao-kuai* relationship has grown increasingly obvious, especially after the global financial crisis in 2008. Taking the place of foreign direct investment, the central SOEs of state monopolies have grown to become the most desirable source of investment for many local governments. This situation is even called "the central SOEs buying their

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<sup>8</sup> Yongnian Zheng, "Power to Dominate, Not to Change: How China's Central-Local Relations Constrain its Reform", *EAI Working Paper* 153 (2009):16-9, accessed January 12, 2012, <http://www.eai.nus.edu.sg/EWP153.pdf>; Mertha, "China's 'Soft' Centralization," 794-5.



local maid” by China’s media.<sup>9</sup> Moreover, given that the personnel appointments of central SOEs in the state monopolies are controlled by the central state, the reversed *tiao-kuai* relationship actually implies another determinant by which the central state could further exercise its influence over localities.<sup>10</sup>

The rebuilding of a vertical line of command in the tobacco state monopoly has also further pushed the central SOEs of state monopolies to become profit-seeking entities in the market rather than executors of planned economy. Therefore, the reversed *tiao-kuai* relationship here is not a return to the old planned-economy regime where market mechanisms were eliminated; rather, it represents a move toward a type of capitalism led by the central state where state control and market mechanism are combined and engaged with one another. In this vein, this study further expands our understanding of the “Beijing Consensus.”

Lastly, this changing *tiao-kuai* relationship also provides a testing ground for existing state-rescaling literatures, which emerged to decipher how inherited global, national, regional, and local relations were being recalibrated through capitalist restructuring and state retrenchment in the 1990s.<sup>11</sup> While the economic restructuring from a Keynesian welfare regime to a neoliberal competition state appeared in Western Europe, a parallel transformation from planned economy to market economy appeared in China’s context. From the late-1970s, China underwent a process of state rescaling similar to what was identified in the post-Fordist Occidental countries as decentralization. However, after that, China’s state rescaling has followed a different route compared to Occidental countries, even though they all have been under the pressure of economic globalization. What is more, the

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<sup>9</sup> Jiang Chenghua, “Yangqi zai defang ‘mai ya huan’, anzang jiecao buhele yinyou” (Central SOEs buying maids locally, implying the problem of unreasonable structure), *China Enterprise News*, March 20, 2012, accessed April 6, 2013, <http://finance.jrj.com.cn/2012/03/20011112526499.shtml>; Qiang Wang, “Yangqi weihe gan yaoxie defang zhengfu” (Why dare central SOEs to threaten local governments), *New York Times* (Chinese edition), October 11, 2012, accessed April 6, 2013, <http://cn.nytimes.com/article/china/2012/10/11/cc11wangqiang/>.

<sup>10</sup> Kjeld Erik Brødsgaard, “Politics and Business Group Formation in China: The Party in Control,” *The China Quarterly* 211 (2012): 624.

<sup>11</sup> Neil Brenner, “Beyond State-centrism: Space, Territoriality, and Geographical Scale in Globalization Studies,” *Theory and Society* 28 (1999): 39-78; Bob Jessop, “Institutional Re(turns) and the Strategic-relational Approach,” *Environment and Planning A* 33 (2001): 1220-32.

Chinese government took advantage of its entry to the WTO to strengthen its state monopolies and made a central-led competitive monopoly.

Where many state-rescaling literatures based on Occidental experiences have tended to accept the premise of the neoliberal capitalist state, where state practices are significantly minimized under globalization, we cannot simply apply it to China's development.<sup>12</sup> The changing *tiao-kuai* relationship, moreover, further demonstrates that state rescaling in such a huge transitional post-socialist economy like China is a complicated process and involves the combinations of institutional interaction in both the horizontal and vertical domains at different stages. Namely, the changing path of *tiao-kuai* matrix in China's context provides unique insights into the extant state-rescaling literatures: the decentralized powers are not simply "fixed" at lower levels of state administration but may be reshaped by interactive relations between vertical and horizontal bureaucratic systems. This may even push in the opposite direction of state rescaling, as the reversed *tiao-kuai* relationship demonstrates from this study.

### **7.2.2 The State-Market Relationship under the State Monopoly**

This study argues that competition, rather than merely existing, has evolved within the state tobacco monopoly. By exploring its developmental trajectory along three temporal phases, this study demonstrates that the state/market interaction has been dynamic under the state monopoly framework; a point rarely discussed in most monopoly literatures. This demonstrates there exist many ways to organize a state monopoly, not just one, but this variety too has been ignored or overlooked in general.

Conversely, this study could illuminate those literatures on the developmental state that hold states may intervene into markets strategically and aggressively to help the nation's economic growth. But China's development, compared with that of other East Asian countries, is more complex where the state-market relationship is concerned. Firstly, one core feature of the developmental state is its close public-private cooperation (or the so-called state-business alliance), which constitutes an institutional foundation for effective state intervention in private business. Nonetheless, unlike the dominance of private ownership in other East Asian countries, China has preserved a certain proportion of SOEs in its national

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<sup>12</sup> Carolyn Cartier, "City-space: Scale relations and China's spatial administrative hierarchy," in *Restructuring the Chinese City: Changing Society, Economy and Space*, ed. Laurence J.C. Ma and Fulong Wu (New York, NY: Routledge, 2005), 23-5.

economy. This feature of state ownership even extends to cover entire sectors, i.e., state-monopolized industries as exemplified by the tobacco industry. Without the private-public link, this study indicates that in spite of the state monopoly, the Chinese government could create competitive mechanisms via its industrial policy such that national teams could be forged and then further go abroad under such circumstances. This state capacity, however, results from a constant, dialectic evolution and is based on the multi-level state-market interactions of the previous three decades.

Unlike other East Asian countries, these multi-level state-market interactions reflect yet another distinctive feature of China: a transitional economy with a massive bureaucratic system. As a post-socialist state, China had to create market circumstances from its planned economy, and the method it chose for this was not direct privatization of the SOEs but the granting of greater autonomy to its local governments and SOEs by means of a series of decentralization measures. Taking the tobacco industry as a point of reference, one can see that there have been two main threads in the state-market relationship: 1) market/local government, and 2) market/central government. All of the players have, through their interactions, experienced great change and undergone change themselves.

At first, when the central state initiated the market-oriented reform via decentralization in its fiscal policy and SOE governance, the interaction between local governments and the CNTC's local agents led to the expansion of markets under the two-track system. In this, local governments acted both as promoters of the market and participants in it; without their involvement, the market track might not have grown so fast in this phase. Accordingly, quasi-free competition began to arise in the enlarging market. However, after moving into the second phase, local governments pressured by the tax-sharing system sought to manipulate the CNTC's local agents by placing trade barriers to protect the market shares of cigarette manufacturers in their geographical jurisdictions. Under such circumstances, local protectionism arose and led to constricted competition in this sector.

From this perspective, local governments became the initiators of market fragmentation so that few if any large cigarette conglomerations were established during this period. However, after China's accession to the WTO, the central state was further motivated to build a national team for the Chinese tobacco industry. In the third phase, then, the central state centralized authority through its corporatization reform so that the barriers to trade would largely be removed. By this, the domestic market began to transform, moving from fragmentation to

unification, while interactions between local governments and the CNTC's local agents would trigger the formation of large cigarette manufacturers in the market, thus bringing about a quasi-oligopoly competition across the industry.

From this developmental trajectory, it can be seen that local governments have evolved first from market promoters to market dividers to facilitators of market competition. Following the incremental changes caused by interactions between the local governments and the CNTC's local agents, the central state-market relationship has also continued to develop along with the temporal phases. For example, when quasi-free competition gradually led to the chaos of gluts, the central state became a market regulator by introducing controls on overall quantity. Also, when the market was fragmented by local protectionism, the central state turned into an initiator of market integration by introducing the corporatization reform.

In discussing these three phases, the state/market interaction in the state monopoly does not emerge in a simple one-to-one relationship. In light of the multi-tier governmental system and the gradual market-oriented reform, state/market interaction in China's context has found itself in dialectically dynamic situations, even under the framework of state monopoly. Not only were local government-market relationships able to change incrementally with interactions between the local governments and the CNTC's local agents, it also could also be dramatically transformed by the central state-market relationship. Without an elaborate investigation and analysis of the multi-tier state-market relationship, it would be difficult to grasp why state control and market competition reinforce and intensify each other simultaneously as presented in the regime of central-led competitive monopoly nowadays.

### **7.3 The Crises of the Existing State Tobacco Monopoly System**

By analyzing how state and market have combined in a typical state-monopolized sector like the tobacco industry, this study attempts to flesh out China's developmental model rather than attempting to determine whether the Beijing or Washington Consensus is superior. In fact, although the central-led competitive monopoly in the tobacco sector goes against the neoliberal doctrine, the two seemingly opposite approaches actually produce a similar consequence in the form of increasing economic inequality. Thus, a legitimacy crisis now looms in China's state tobacco monopoly.

### 7.3.1 Increasing Economic Inequality and Distributive Injustice

As the profits and taxation of the tobacco industry grew under the central-led competitive monopoly, disputes regarding economic inequality and distributive injustice continued to rise. For one, economic inequality has been revealed as a feature of this sector; as mentioned in Chapter Six, tobacco procurement prices were not adjusted upwards to match the growth of profits and tax revenues. Instead, the STMB decided to restructure the tobacco-producing process and related organizations through the “modern tobacco agriculture” project in order to lower tobacco production costs rather than raising the procurement prices. As a result, the income distribution gap between the agricultural department and the industrial/commerce departments in this industry has widened. Accordingly, the real income of tobacco farmers has actually declined compared to the period of the three-in-one system. Moreover, given that the size of scale planting has not increased significantly, local governments have continued to push to implement the restructuring project in rural areas. Under the circumstances, it can be predicted that the procurement prices for tobacco leaves will not rise greatly since this will not move forward the land transfer needed for the modern tobacco agriculture project.

Accordingly, whenever local governments for the fiscal reasons have assumed the duty of ensuring tobacco procurements, tension between local governments and tobacco farmers becomes exacerbated, further endangering local governance. In fact, this developmental trend reveals that the “statist approach” practiced here is not necessary for guaranteeing a more equal economic distribution. In other words, the state capacity presented in a state-led market is bolstered by a certain set of state/society relationships whereby local governments, especially those at the grassroots level, have to confront the discontents and protests from individual farmers directly. In this context, when economic inequality becomes a predicament for local governance, it implies also that the crisis has already arisen in the state tobacco monopoly since local governments act as the CNTC’s *de facto* agents.

Moreover, distributive injustice revolves around the dividends submitted from the SOEs to the state and the resulting allocation. In fact, the distributive dispute has occurred not only in the tobacco industry but also in other state monopolies. When the tax-sharing system was initiated in 1994, the SOEs were exempted from paying dividends to the state coffer since most were in dire straits at the time.<sup>13</sup> In this

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<sup>13</sup> Mikael Mattlin, “Chinese Strategic State-owned Enterprises and Ownership Control,” *Asian Paper* 6 (2009): 6, accessed March 5, 2013,

context, payment of taxes was the only obligation SOEs had to the state. The situation did not change until the *Interim Management Measures of Collecting Capital Gains from Central SOEs* was promulgated in 2007.<sup>14</sup> Given that many previous loss-makers had already been turned into profit-makers over the past decade, with some in strategic sectors that are even highly profitable, the *Interim Management Measures* was issued and three different rates of dividend—zero, five, and ten percent—were formulated to apply to a variety of central SOEs.

In light of the lavish profits, the dividend rates of central SOEs have been criticized as too low, and a high level of profit retention has been blamed for exacerbating economic inequality. According to the statistics released by China's Ministry of Human Resources and Social Security in 2009, the average salaries of employees in central SOEs of state monopolies—including electricity, banking, tobacco, telecommunications—were two to three times higher than the average in other industries. If non-salary income, such as housing funds and a range of other benefits, is included, then the income gap balloons to five to ten times higher.<sup>15</sup>

Even within state monopoly industries, the income gap between senior SOE executives and other employees has continually widened, increasing to 17 times the average salary of the companies' regular employees in 2011 from 8.68 times in

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[http://www.vub.ac.be/biccs/site/assets/files/apapers/Asia%20papers/Asia%20Paper%204\(6\).pdf](http://www.vub.ac.be/biccs/site/assets/files/apapers/Asia%20papers/Asia%20Paper%204(6).pdf).

<sup>14</sup> See the document issued by the Ministry of Finance and the State-owned Assets Supervision and Administration Commission, "Cai zheng bu guoziwei guanyu yinfa 'zhongyang qiye guoyou ziben shouyi shouqu guanli zhanxing ban fa 'de tong zhi, no. cai-qi (2007) 309" (The notification of 'the interim management measures for collecting capital gains from central SOEs' printed by the Ministry of Finance and SASAC ), [http://big5.gov.cn/gate/big5/www.gov.cn/zwgk/2007-12/17/content\\_836608.htm](http://big5.gov.cn/gate/big5/www.gov.cn/zwgk/2007-12/17/content_836608.htm) (accessed April 8, 2013).

<sup>15</sup> Wang Renqui, "Gao shouru hungye sanshi nian bianqian: longduan hungye shouru gaoyu yiban hungye da shibei" (The development of high-income industries over three decades: the income of monopoly industries ten times higher than the others), *Xinhua News*, May 18, 2009, accessed March 30, 2013, <http://biz.icxo.com/htmlnews/2009/05/18/1382467.htm>; Anonymous, "Gongjijin qinan fangda bugong" (How could the housing provident fund expand social inequality?), *Information Times*, December 20, 2012, accessed April 5, 2013, [http://informationtimes.dayoo.com/html/2012-12/20/content\\_2079010.htm](http://informationtimes.dayoo.com/html/2012-12/20/content_2079010.htm); Zao Yong, "Yuanze shang guanbuzhu tuojiang de longduan fuli" (Unable to manage the impertinent monopoly benefits in principle), *Qiliu Evening News*, April 3, 2013, accessed April 10, 2013, <http://epaper.qilwb.com.cn/qlwb/content/20130403/ArticleA02005FM.htm>.

2000.<sup>16</sup> Consequently, the question of how to deal with the distributive controversy of central SOEs has been placed on the political agenda and discussed heatedly in the National People's Congress and the Chinese People's Political Consultative Conference in recent years.<sup>17</sup>

Against this background of rising discontent, the highest dividend rates for central SOEs rose to five, ten, and fifteen percent in 2011, while the rate for the tobacco sector increased to twenty percent in 2012—the highest of all industries, with the CNTC producing the highest profits for the state coffer.<sup>18</sup> Even so, the raising dividend rates have not solved the problem of worsening economic inequality, as most of the submitted profits have actually been returned in order to nurture the existing central SOEs (see Table 7.1 below).

One sees clearly that the general public has rarely benefited from the profit contribution of the central SOEs. Apart from the seven percent used for social security, the rest more or less went back to the SOEs themselves.<sup>19</sup> Thus, even though the dividends they have submitted to the state appear to grow, their usage allocation does not contribute to the public welfare. Instead, this allocation method

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<sup>16</sup> Sina News, “Yangqi gaoguan jiang shxing chayihua xinchou, zhewu xiafei jiang she shangxian” (The reform of central SOEs’ executives’ salary will be carried out and setting the ceiling on their position-related consumption), accessed Sept 3, 2014, <http://m.news.sina.com.tw/article/20140830/13238943.html>.

<sup>17</sup> Ifen Net, “Lianghui gongshi zhi dapo longdua guoqi” (Breaking the monopoly SOEs as the consensus in NPC & CPPCC), accessed April 3, 2013, <http://finance.ifeng.com/news/special/gongshiguoqi/>; Wang Weiguo, “Weiyuan jujiao kuoqi gao shouru: longduan hungye hongli ying zhishao shangjiao 50%” (CPPCC members targeting the high-come SOEs: the dividends of monopoly SOEs should pass to the state upward 50%), *South China*, accessed March 29, 2013, <http://finance.ifeng.com/news/special/2013lianghui/20130310/7753354.shtml>.

<sup>18</sup> People’s Daily Online, “Yangqi shangjiao hongli bili yunnian shangtiao, zhuanjia cheng xianyou bili taidi” (The profit submission of central SOEs should rise, the experts argue that the existing rates are too low), accessed April 15, 2013, [http://big5.xinhuanet.com/gate/big5/news.xinhuanet.com/fortune/2013-02/16/c\\_124349894.htm](http://big5.xinhuanet.com/gate/big5/news.xinhuanet.com/fortune/2013-02/16/c_124349894.htm); The tobacco industry passed profits of around 30,000 million to the state coffers in 2013; the petroleum industry was second with 28,760 million. For more information see: <http://dhnews.zjol.com.cn/dhnews/system/2013/03/26/016240682.shtml>.

<sup>19</sup> Huang Chen, “Jinnian yangqi hongli 76 yiyuan yongyu minsheng, zhanbi bushing fanjiang” (7600 million of central SOE profit used in public benefits this year, the proportion declining instead of rising), *Caixinwang*, March 27, 2013, accessed April 15, 2013, <http://special.caixin.com/2013-03-27/100506931.html>.

provides more capital to the central SOEs, with some even turning to speculative business. For example, the CNTC emerged as the “new king of land” in Beijing real estate speculation in 2010, further fostering the public’s discontent with around unaffordable housing.<sup>20</sup> In this sense, the existence of central SOEs in the state monopolies seems to lead to a further deterioration with respect to economic inequality.

**Table 7.1 Expenditure Allocation of Central SOE Submitted Profit in 2013**

<b>Category</b>	<b>Details</b>	<b>Amount (100 million RMB)</b>	<b>Percent age (%)</b>
Restructuring of State-owned Economy	-Supporting the mergers between central SOEs -Strengthening the control capacity of central SOEs in the field of state security -Solving historical problems of central SOEs	379.88	35
Investment in Key Projects of Central SOEs	-Supporting key projects of central SOEs in the fields of state security, national core competitiveness and comprehensive national strength	336.12	31
Industrial Upgrading and Development	-Strengthening the innovative capacity of central SOEs	176.76	16.3
Expenditure on Social Security		76.34	7
Investment and Cooperation abroad	-Supporting central SOEs to purchase strategic resources and enterprises with core technology abroad	67.9	6.2
Reserved Fund	-Used for emergency situations regarding central SOEs	21.11	1.9
Subsidy to Retired	-Subsidizing medical and living expenses for retired staff of central	20	1.8

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<sup>20</sup> Lu Huan and Zhai Hui, “Beijing maidi rijin baiyi, yangqi fawei yitian pengchu sandiwang” (Beijing earning 1000 million per day by selling land, three kings of land emerging from central SOEs within a day), *Beijing Times*, March 16, 2010, accessed April 10, 2013, <http://money.huagu.com/financing/0000021552.html>.



Employees	SOEs		
Other		5	0.4
Total		1083.11	100

Source: Adapted from China's Ministry of Finance, accessed April 6, 2013, [http://yss.mof.gov.cn/2013zyczys/201303/t20130322\\_784806.html](http://yss.mof.gov.cn/2013zyczys/201303/t20130322_784806.html)

In this light, state monopolies are becoming increasingly suspect, even without the ever-emerging corruption scandals. More and more often, questions are being asked about them: With such unprecedented profitability, where should the profits of the central SOEs go? And apart from their increasing power and influence, what is most important about the central SOEs of state monopolies in today's China?<sup>21</sup>

### 7.3.2 The Rising Medical Costs

Along with the abovementioned inequality and distributive injustice, controversy surrounding the state tobacco monopoly becomes even more serious in light of harm caused by tobacco products. With the largest population of smokers in the world, China suffers significantly from tobacco-related diseases, annually resulting in more than 1.2 million fatalities, or 12 percent of all mortality. China also has the largest population of lung cancer patients in the world; smoking has already become the main cause of death for Chinese people. The Ministry of Health announced in 2008 that the tobacco-related death toll in China will reach 100 million by the middle of the twenty-first century if smoking levels do not drop in the coming decades. Smoking and its harmful effects have been clearly identified as one of the greatest challenges confronting China's public health system.<sup>22</sup>

Given that the tobacco industry is such a major contributor of tax revenue, it is not hard to understand the Chinese government's resistance to reducing cigarette production, despite its having already signed the World Health Organization Framework Convention on Tobacco Control (FCTC) in 2003, the core of which aims to lessen the production and consumption of tobacco products. In fact, the Chinese government has been continually urged by the international public health

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<sup>21</sup> Zheng and Chen, "China's State-Owned Enterprise Reform," 39-40.

<sup>22</sup> The Office of the Leading Group for Implementing the Framework Convention on Tobacco Control, *2008 nian zhongguo kongzhi xian baogao* (2008 China tobacco control report) (Beijing, China: Ministry of Health Publication, 2008), 2; Cheng Li, *The Political Mapping of China's Tobacco Industry and Anti-Smoking Campaign* (Washington, DC: Brookings, 2012), 2-3, 28-9.

community to take initiatives on tobacco control, as it is impossible to have a breakthrough in the international anti-smoking campaign without a success in China.

Under this international pressure, the Twelfth Five-Year Plan finally adopted a resolution calling for “the overall implementation of a smoking ban in public places” at the meeting of National People’s Congress in 2011.<sup>23</sup> However, the gap between the regulation itself and the reality of its enforcement has not closed, particularly when tax revenue from the tobacco industry remains steady at more than seven percent of the total annual central government revenue. This is why the Minister of Industry and Information Technology (the supervising authority of the STMB), Li Yizhong (李毅中), would tell the media bluntly in 2010 that China’s tobacco industry had made the greatest contribution to China’s economic recovery during the global financial crisis.<sup>24</sup>

However, it has been shown that the medical expense of treating those with smoking-related illnesses had already begun to surpass the tax revenue and profits generated from the tobacco industry after 2000.<sup>25</sup> What is worse, the share of medical expenditure paid by individuals is much higher than what is covered by the state so that the poor suffer the most, hardly being able to afford the necessary healthcare in today’s China. In other words, while individuals and their families are largely responsible for the cost of care for problems related to cigarette consumption, the government and enterprises benefit through tax revenues and the profits from cigarette production. Furthermore, the study conducted by Hu’s research team proves that medical expenses resulting from smoking have increased the poverty level in China.<sup>26</sup> It is no exaggeration to say that the disparity between costs and benefits where ordinary people and the government are concerned may lead to even greater economic inequality and increasing political tension in years to come.<sup>27</sup>

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<sup>23</sup> See the document issued by the General Administration of Quality Supervision, Inspection, and Quarantine, “Zhongguo yancao kungzhi kuihua (2012-2015)” (The plan for China’s tobacco control 2012-2015), [http://guoqing.china.com.cn/zwx/2013-02/25/content\\_28046824.htm](http://guoqing.china.com.cn/zwx/2013-02/25/content_28046824.htm) (accessed March 25, 2013).

<sup>24</sup> Miao Xiaojuan and Wang Cong, “Ahead of the World Expo, China acts to promote smoking controls,” *Xinhua News*, March 10, 2010, accessed March 5, 2013, [http://news.xinhuanet.com/english2010/china/2010-03/10/c\\_13205579.htm](http://news.xinhuanet.com/english2010/china/2010-03/10/c_13205579.htm).

<sup>25</sup> Tao, *Zhuanmai tizhixia*, 149-50.

<sup>26</sup> Teh-wei Hu and Zhengzhong Mao, *Zhongguo yancao kongzhi de jingji yanjiu* (Economic research on China’s tobacco control) (Beijing, China: Economic Science Press, 2008), 109.

<sup>27</sup> Cheng Li, *The Political Mapping*, 31-7.

From the case of the tobacco industry, one can see that, although the Chinese government has demonstrated that it is capable of shaping competitive circumstances in the state monopoly to make the central SOEs more powerful and influential, doing this does not alleviate the existing economic inequalities and distributive injustice and may in fact exacerbate them. The problems illustrated above, all of which may be found in the current state tobacco monopoly, do not imply that privatization would be a better option, but they are issues with which the Chinese government must contend. Otherwise, the legitimacy of state monopolies in general will have gradually been eroded.

