

## V. INDUSTRY SECTOR REPORTS

### Chapter 7

# Legal Aspects of Foreign Investment in the Retail Sectors and E-Commerce in the People's Republic of China

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## § 7.01 Introduction

This chapter will examine the legal aspects of foreign investment in the retail sectors and e-commerce in China. Even for those readers not specifically interested in the retail sectors and e-commerce, this Chapter can serve as a useful guide for understanding China’s complex system of negative lists for foreign investment and its unique development model and national industrial policy, which were pivotal issues in the protracted trade war between the U.S. and China.

As used in the chapter, the term “retail sectors” is defined broadly, and is a shorthand way for referring to “retail, wholesale, distribution and trading,” which was the original title of this chapter. This chapter has been completely revised and updated since the previous version.

The analysis in this chapter of the laws and regulations governing the retail sectors and e-commerce provides a case study for parsing through the often confusing system of multiple and overlapping negative lists established under China’s new Foreign Investment Law. The Foreign Investment Law, which went into effect on January 1, 2020, required China to establish a system of negative lists for foreign investment and for the national treatment of foreign investors.

### § 7.02 Brief History of Legal Developments

The first time that a legal question about foreign investment in the retail sectors was posed to the author, then the resident lawyer in Beijing for an American law firm in 1985, came from the General Manager of the Sheraton Great Wall Hotel in Beijing, who asked: “Can a foreign retailer open a sales counter in the hotel?” The correct answer was “No,” because at that time, foreign investment in any kind of retail operation in China was strictly prohibited.

The legal prohibition on foreign investment in the retail sectors lasted until 1992, when the State Council issued brief regulations that permitted only “one or two” retail joint ventures in each of six major cities and five special economic zones, including Beijing, Shanghai, Tianjin, Guangzhou, Dalian and Qingdao.<sup>1</sup>

But characteristic of the Chinese development model of experimentation and government toleration of violations in legal gray zones, foreign retailers rushed ahead and established hundreds of joint venture retail stores that technically breached the national retail regulations, but which were instead approved by local government authorities.

Such blatant violations of the national retail regulations prompted the Chinese central government to crack down on these illegal local retail ventures. The Chinese central authorities tried repeatedly to implement drastic rectification and restructuring regulations. But the local government officials who had initially approved these retail ventures resisted. They welcomed the tax revenues provided by these retail ventures, as well as the retail ventures’ contribution to the local GNP, which was the principal criterion by which such officials were judged and how they advanced in their careers.

Thus, in most cases, accommodations were reached that permitted such legally ambiguous foreign-invested retail ventures to continue to flourish. The author worked on the international financing and merger and acquisition of several such foreign-invested retail ventures, as well

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<sup>1</sup> A more detailed history of the early developments in the regulation of foreign investment in the retail sectors can be found in the previous version of this chapter, “Retail, Wholesale, Distribution and Trading,” [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=3378203](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3378203).

as the organization of a foreign-invested investment fund for investing in the Chinese retail industry.

The French retailer, Carrefour, opened its first two stores in 1995 in Shanghai and Beijing, and became one of the most aggressive foreign retailers in establishing stores in numerous cities across China, reaching 182 stores by 2010.<sup>2</sup> The U.S. retailer Walmart opened its first store in 1996, and also expanded rapidly, reaching 219 stores in 2010. Between 1996 and 1999, German retailer Metro AG, Dutch retailer Makro, French retailer Auchan and Thai retailer Lotus, all entered the Chinese market.

In 1995, the Chinese government began publishing the Foreign Investment Catalogue, which classified in great detail the specific commercial sectors that were Encouraged, Restricted or Prohibited for foreign investment. The terms “Encouraged,” “Restricted” and “Prohibited,” as well as “Obsolete,” will occasionally be capitalized in this Chapter, in order to highlight their use as broad statutory categories into which the industry sectors have been classified. The retail sectors have generally been classified under the Restricted Category for foreign investment, meaning that foreign investment in such retail sectors was subject to various restrictions and licensing requirements.

China’s accession to the World Trade Organization in 2001 was a legal watershed event, as China committed to open its retail sectors comprehensively to foreign investment according to very specific deadlines set forth in the World Trade Organization agreements.<sup>3</sup> China has for the most part fulfilled all of its commitments under these agreements for opening up the retail sectors to foreign investment.

E-commerce has also developed quite swiftly in China. But in order to be able to absorb foreign investment legally under Chinese law through either foreign venture capital or foreign initial public offerings, domestic Chinese companies such as Alibaba were forced to do

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<sup>2</sup> “Checking Out,” *News China*, China Newsweek Corporation, December 2019, by Yu Xiaodong.

<sup>3</sup> China’s commitments to open up the retail sectors under the World Trade Organization agreements are analyzed in the previous version of this chapter, “Foreign Investment in Retail, Wholesale Distribution and Trading in the People’s Republic of China, 2001-2009.” [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=3378207](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3378207).

business principally through foreign affiliate companies, based in the Cayman Islands or other foreign jurisdictions. As a result, such foreign-invested e-commerce affiliates were subject to and regulated under the same laws and regulations applicable to foreign investors.

Such foreign-invested e-commerce affiliates had to circumvent the strict legal prohibition under Chinese law against foreign investment in providers of telecommunication services—which was the category under which e-commerce companies were classified. The work-around solution, which continues to exist today, and is still tolerated by the Chinese government, at least currently, was the “variable interest entity” (or “VIE”) model of foreign investment.<sup>4</sup>

The global e-commerce giant Amazon first entered the Chinese market in 2004 by acquiring Joyo, a domestic online shopping platform, which was rebranded as Amazon China in 2011. But it was soon eclipsed by domestic e-commerce companies such as Alibaba and JD.com, which adopted much more effective marketing and pricing strategies. Amazon was forced to shut its China online store in July 2019, and to focus only on overseas goods and cloud services in China.

Today, the retail sectors and e-commerce are essentially completely open to investment by foreign investors, at least to the same extent that they are open to investment by Chinese investors. Indeed, e-commerce is now classified as a sector encouraged for foreign investment. But that is not to imply that the retail sectors and e-commerce exist in a legal vacuum. Not at all—for given the Chinese proclivity for bureaucracy and rulemaking, the retail sectors and e-commerce continue to be governed by a complex web of overlapping laws and regulations, which will be outlined in the rest of this chapter.

### § 7.03 The New Foreign Investment Law

On March 15, 2019, the second session of the 13th National People’s Congress passed the “Foreign Investment Law of the People’s Republic

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<sup>4</sup> A more detailed description of the VIE model for foreign investment in e-commerce is set forth in the previous version of this chapter, “Legal Aspects of Foreign Investment in the Retail Sector and in E-Commerce in the People’s Republic of China,” which covers legal developments from 2009 to 2012. [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=3378192](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3378192).

of China” (“Foreign Investment Law”), which went into effect on January 1, 2020.<sup>5</sup>

According to Article 28 of the Foreign Investment Law:

“Article 28:

For fields in which the negative list for foreign investment access provides that investment is prohibited, foreign investors must not make investment.

For fields in which the negative list for foreign investment access provides that investment is restricted, foreign investors shall meet the requirements provided by the negative list in making investment.”<sup>6</sup>

The negative list concept is one that has been advocated for many years by foreign investors, which reverses the original paradigm under the Chinese economic system, derived from its socialist origins, namely: “What is not explicitly permitted is prohibited.”

Indeed, that was the prevailing legal regime in the case of setting up the sales counter in the Sheraton Great Wall Hotel, as discussed at the beginning of this chapter. At that time, there were no explicit regulations about establishing retail operations by foreign investors. Thus, in the absence of any regulation, the legal conclusion was: What was not explicitly permitted was, therefore, prohibited.

The negative list concept reverses that legal paradigm. But the new paradigm is not: “What is not prohibited is permitted.” Instead, the new paradigm is: “What is not prohibited for investment by foreign investors is permitted, but only to the same extent as it is permitted for investment by Chinese investors.” In other words, the foreign investor is entitled to national treatment. The negative list and national treatment concepts are affirmed in Article 4 of the Foreign Investment Law:

“The State implements the management scheme of pre-establishment national treatment plus negative list with respect to foreign investment.

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<sup>5</sup> Foreign Investment Law of the People’s Republic of China, [http://www.fdi.gov.cn/1800000121\\_39\\_4872\\_0\\_7.html](http://www.fdi.gov.cn/1800000121_39_4872_0_7.html).

<sup>6</sup> The English translations of Chinese laws and regulations used in this chapter are, with minor clarifying modifications, mostly from Westlaw China, [http://www.westlawchina.com/index\\_en.html](http://www.westlawchina.com/index_en.html).

As used in the previous paragraph, “pre-establishment national treatment” refers to affording foreign investors and their investments treatment, during the investment access stage, no less favorable than that afforded to Chinese domestic investors and their investments; and “negative list” refers to the special administrative measures on access that are implemented in certain fields for foreign investment as prescribed by the State.

The State affords national treatment to foreign investment outside the negative list.

The negative list is to be published by or published as authorized by the State Council.”

A lawsuit has already been decided under the new Foreign Investment Law, in which a foreign investor was able to regain ownership of his interest in a Chinese company, because his company belonged to an industry sector that was no longer on the negative list for foreign investment.<sup>7</sup>

#### § 7.04 The Negative Lists Classification System

The Foreign Investment Catalogue, which classified industry sectors into sectors that were Encouraged, Restricted or Prohibited for foreign investment, was first issued in 1995. Since then, the Foreign Investment Catalogue has been periodically updated. Today, however, instead of one single Foreign Investment Catalogue, the industry sectors classification scheme has evolved into a complex system which, for the sake of explanation and clarity, can be divided into at least six separate lists of industry sectors.

The first two lists are part of the 58-page Catalogue of Industries for Encouraging Foreign Investment (2019 Version) (“Encouraged Foreign Investment Catalogue”), applicable to investment by foreign investors.<sup>8</sup> The first list (“National Encouraged List”), the Catalogue of Industries

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<sup>7</sup> “First Case Related to New Foreign Investment Law: American Shareholder Wins Shares Back,” *Shine*, January 8, 2020, by Ke Jiayun: <https://www.shine.cn/news/metro/2001089405/>; *see also*, “Foreign Investment Law Comes into Effect,” *News China*, China Newsweek Corporation, March 2020.

<sup>8</sup> Catalogue of Industries for Encouraging Foreign Investment (2019 Version): <http://www.gov.cn/xinwen/201906/30/5404701/files/9d2dde75fa054d249dfa16267af42277.pdf>.

for Encouraging Foreign Investment Nationwide, and part of the Encouraged Foreign Investment Catalogue, is the list of those sectors in which foreign investment is encouraged on a national basis.

The second list (“Provincial Encouraged List”), the Catalogue of Priority Industries for Foreign Investment in Central and Western China, and also part of the Encouraged Foreign Investment Catalogue, is a list of the provinces in Central and Western China, and the sectors in which foreign investment is encouraged in each such provinces.

The third list (“National Negative List”), the Market Entry of Foreign Investment (Negative List) (2019 Version), is a negative list that sets forth those sectors that are prohibited or restricted for foreign investment on a national basis.<sup>9</sup>

The fourth list (“Trade Zone Negative List”), the Market Entry of Foreign Investment in Pilot Free Trade Zones (Negative List) (2019 Version), is a negative list that sets forth the subset of sectors that are prohibited or restricted for foreign investment in the Pilot Free Trade Zones, there being more latitude for foreign investment in such zones.<sup>10</sup>

The fifth list (“Market Access Catalogue”), the Market Access Negative List (2019 Version), applies equally to both foreign investors and Chinese investors.<sup>11</sup> Thus, it complies with China’s promise to grant national treatment to foreign investors, equivalent to its treatment of Chinese investors. The Market Access Catalogue first lists those sectors in which market access is prohibited for both foreign investors and Chinese investors, comprised primarily of the sectors categorized as Obsolete or Restricted in the Industrial Restructuring Catalogue, as discussed below. The Market Access Catalogue then sets forth in detail those sectors in which market access by both foreign investors and Chinese investors is permitted, but subject to regulation or licensing by specific agencies of the Chinese government listed in the Market Access Catalogue.

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<sup>9</sup> Market Entry of Foreign Investment (Negative List) (2019 Version): <http://www.gov.cn/xinwen/201906/30/5404703/files/d0a86e1a90eb4e898e9a9ea6eb59703a.pdf>.

<sup>10</sup> Market Entry of Foreign Investment in Pilot Free Trade Zones (Negative List) (2019 Version): <http://www.gov.cn/xinwen/2019-06/30/5404702/files/64ff7f3f9b674aec9dede71bca8c563a.pdf>.

<sup>11</sup> Market Access Negative List (2019 Version): <http://www.mofcom.gov.cn/article/jiguanzx/201911/20191102916059.shtml>.

The sixth list (“Industrial Restructuring Catalogue”), the Catalogue for Guiding Industry Restructuring (2019 Version), is a 132-page series of lists, which divides 1,477 industry sectors of the Chinese economy into the three categories of Encouraged, Restricted or Obsolete.<sup>12</sup> As discussed above, the sectors in the Obsolete and Restricted Categories constitute part of the sectors that are prohibited for investment by foreign and Chinese investors in the Market Access Catalogue. The Industrial Restructuring Catalogue outlines a comprehensive plan for restructuring and modernizing the Chinese economy, and is emblematic of China’s development model and national industrial policy, and its arguably excessive micro-management of the economy.

In summary, the previous Foreign Investment Catalogues have been reorganized into a system that is perhaps cosmetically more acceptable to the U.S. negotiators during the U.S.-China trade war between 2018 and 2020. The first four lists are applicable to foreign investors only, and are comprised of two long lists of sectors encouraged for foreign investment, and two quite short negative lists of sectors prohibited or restricted for foreign investment. The remaining two lists, the Market Access Catalogue and the Industrial Restructuring Catalogue, are equally applicable to all “market players,” that is, all foreign investors and Chinese investors.

### § 7.05 Nationally Encouraged Retail Sectors

The National Encouraged List sets forth those specific sectors within the retail and wholesale industries that are encouraged for investment on a national level. According to the Encouraged Foreign Investment Catalogue, National Encouraged List, Chapter (6), entitled “Wholesale and Retail Industries,” Sections 366, 367 and 368, the following sectors are encouraged for foreign investment:

“(6). Wholesale and Retail Industries

(366). Common distribution of common commodities, cold-chain logistics of live and fresh agricultural products and low-temperature distribution, special medicine and other logistics, as well as supply and application of relevant technological services;

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<sup>12</sup> Catalogue for Guiding Industry Restructuring (2019 Version):  
<http://www.gov.cn/xinwen/201911/06/5449193/files/26c9d25f713f4ed5b8dc51ae40ef37af.pdf>.

(367). Rural chain distribution;

(368). Construction and operation of pallet and container unit sharing system.”

The language in the above appears to be quite broad, in the use of phrases such as: “common distribution of common commodities,” and “other logistics, as well as supply and application of relevant technological services.”

For the sectors listed in the Encouraged Foreign Investment Catalogue, including both the National Encouraged List and the Provincial Encouraged List, the Chinese government has granted certain favorable treatment, for example, duty-free importation of “equipment for self-use which is imported within its total amount of investment and the technologies, supporting accessories and spare parts that are imported together with the said equipment.”<sup>13</sup>

#### § 7.06 Nationally Encouraged E-Commerce

The National Encouraged List encourages foreign investment in e-commerce, in contrast to various previous Foreign Investment Catalogues, in which e-commerce was classified under the Restricted Category for foreign investment.

The Encouraged Foreign Investment Catalogue, National Encouraged List, Part (7), entitled “Information Transmission, Software and Technical Service Industry,” Section 369, states that the following sector is encouraged for foreign investment:

“(7). Information Transmission, Software and Technical Service Industry

(369). Services for development and application of electronic commerce.”

The indigenous Chinese competitors in the e-commerce segment of the economy have become so strong nowadays, so that the Chinese

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<sup>13</sup> See, Announcement of the General Administration of Customs on Relevant Issues of Implementation of the Catalogue of Industries for Encouraging Foreign Investment (2019 Version) and related attachments: <http://www.customs.gov.cn/customs/302249/302266/302267/2556867/index.html>.

government is no longer wary of foreign competitors entering the Chinese market.

### **§ 7.07 Encouraged Retail Sectors in Central and Western Provinces**

As discussed above, the Encouraged Foreign Investment Catalogue is comprised of two separate lists, the National Encouraged List, listing sectors encouraged for foreign investment nationally, and the Provincial Encouraged List, listing the sectors in which foreign investment is encouraged in the provinces in Central and Western China.

The Provincial Encouraged List is quite useful in putting in one place the sectors locally encouraged for foreign investment, which used to be scattered in separate regulations and announcements by the various different provinces.

The following is a listing of the retail sectors (including retail, wholesale, distribution and trading) and the sectors relating to e-commerce that are encouraged for foreign investment in various of the provinces in Central and Western China.

#### **[1]—Shanxi Province**

The Encouraged Foreign Investment Catalogue, Provincial Encouraged List, Shanxi Province, Section (29) states that “(29) Warehousing facilities construction and commerce and trade services related to logistics business” are encouraged for foreign investment.

#### **[2]—Heilongjiang Province**

The Encouraged Foreign Investment Catalogue, Provincial Encouraged List, Heilongjiang Province, Sections (30) and (31) state that the following retail sectors are encouraged for foreign investment:

“(30) Warehousing facilities construction and commerce and trade services related to logistics business;

(31) Construction of cross-border e-commerce retail centers and commodity import and export distribution and logistics centers.”

**[3]—Jiangxi Province**

The Encouraged Foreign Investment Catalogue, Provincial Encouraged List, Jiangxi Province, Section (29) states that “(29) Warehousing facilities construction and commerce and trade services related to logistics business” are encouraged for foreign investment.

**[4]—Henan Province**

The Encouraged Foreign Investment Catalogue, Provincial Encouraged List, Henan Province, Sections (27) and (28) state that the following retail sectors are encouraged for foreign investment:

- “(27) Construction of cross-border e-commerce retail centers and commodity import and export distribution and logistics centers;
- (28) Warehousing facilities construction and commerce and trade services related to logistics business.”

**[5]—Hubei Province**

The Encouraged Foreign Investment Catalogue, Provincial Encouraged List, Hubei Province, Section (27) states that “(27) Warehousing facilities construction and commerce and trade services related to logistics business” are encouraged for foreign investment.

**[6]—Hunan Province**

The Encouraged Foreign Investment Catalogue, Provincial Encouraged List, Hunan Province, Section (30) states that “(30) Warehousing facilities construction and commerce and trade services related to logistics business” are encouraged for foreign investment.

**[7]—Guangxi Zhuang Autonomous Region**

The Encouraged Foreign Investment Catalogue, Provincial Encouraged List, Guangxi Zhuang Autonomous Region, Section (25) states that “(25) Warehousing facilities construction and commerce and trade services related to logistics business” are encouraged for foreign investment.

**[8]—Hainan Province**

The Encouraged Foreign Investment Catalogue, Provincial Encouraged List, Hainan Province, Sections (27) and (28) state that the following retail sectors are encouraged for foreign investment:

“(27) Warehousing facilities construction and commerce and trade services related to logistics business;

(28) Construction of cross-border e-commerce retail centers and commodity import and export distribution and logistics centers.”

**[9]—Chongqing Municipality**

The Encouraged Foreign Investment Catalogue, Provincial Encouraged List, Chongqing Municipality, Sections (25) and (26) state that the following retail sectors are encouraged for foreign investment:

“(25) Warehousing facilities construction and commerce and trade services related to logistics business;

(26) Construction of cross-border e-commerce retail centers and commodity import and export distribution and logistics centers.”

**[10]—Sichuan Province**

The Encouraged Foreign Investment Catalogue, Provincial Encouraged List, Sichuan Province, Sections (29) and (30) state that the following retail sectors are encouraged for foreign investment:

“(29) Warehousing facilities construction and commerce and trade services related to logistics business;

(30) Construction of cross-border e-commerce retail centers and commodity import and export distribution and logistics centers.”

**[11]—Yunnan Province**

The Encouraged Foreign Investment Catalogue, Provincial Encouraged List, Yunnan Province, Sections (1) and (26) state that the following retail sectors are encouraged for foreign investment:

“(1) Planting, development, cultivation, sale and deep processing of coffee, tea and oil tea as well as the breeding and promotion of new varieties;

(26) Warehousing facilities construction and commerce and trade services related to logistics business.”

**[12]—Tibet Autonomous Region**

The Encouraged Foreign Investment Catalogue, Provincial Encouraged List, Tibet Autonomous Region, Sections (13) and (17) state that the following retail sectors are encouraged for foreign investment:

“(13) Warehousing facilities construction and commerce and trade services related to logistics business;

(17) Construction of cross-border e-commerce retail centers and commodity import and export distribution and logistics centers.”

**[13]—Shaanxi Province**

The Encouraged Foreign Investment Catalogue, Provincial Encouraged List, Shaanxi Province, Section (25) states that “(25) Construction of cross-border e-commerce retail centers and commodity import and export distribution and logistics centers” is encouraged for foreign investment.

**[14]—Gansu Province**

The Encouraged Foreign Investment Catalogue, Provincial Encouraged List, Gansu Province, Section (19) states that “(19) Warehousing facilities construction and commerce and trade services related to logistics business” are encouraged for foreign investment.

**[15]—Xinjiang Uygur Autonomous Region**

The Encouraged Foreign Investment Catalogue, Provincial Encouraged List, Xinjiang Uygur Autonomous Region (including the Xinjiang Production and Construction Corps), Sections (30) and (31) state that the following retail sectors are encouraged for foreign investment:

“(30) Warehousing facilities construction and commerce and trade services related to logistics business;

(31) Construction of cross-border e-commerce retail centers and commodity import and export distribution and logistics centers.”

### § 7.08 Retail Sectors Negative Lists

As discussed above, in accordance with the Foreign Investment Law, the sectors that are prohibited or restricted for foreign investment, and only applicable to foreign investors, have been segregated into two relatively short lists, the National Negative List, applicable nationally, and the Trade Zone Negative List, which is applicable in the Pilot Free Trade Zones.

There are only a few items on the negative lists with respect to foreign investment in the retail sectors. According to the National Negative List, “Special Management Measures,” Part (5), entitled “Wholesale and Retail Industries,” Section (13), the following is prohibited for foreign investment:

“(5). Wholesale and Retail Industries

(13) Foreign investment in the wholesale and retail of tobacco leaves, cigarettes, re-dried tobacco leaves and other tobacco products is prohibited.”

Similarly, according to the Trade Zone Negative List, “Special Management Measures,” Part (5), entitled “Wholesale and Retail,” Section (10), the following is prohibited for foreign investment:

“(5). Wholesale and Retail Industries

(10) Foreign investment in the wholesale and retail of tobacco leaves, cigarettes, re-dried tobacco leaves and other tobacco products is prohibited.”

### § 7.09 E-Commerce and the Negative Lists

Although e-commerce is now a sector that is encouraged for foreign investment, e-commerce is also classified as a type of value-added telecommunication services under the Chinese legal classification system, which is a category that is still highly regulated.

According to the National Negative List, “Special Management Measures,” Part (7), entitled “Information Transmission, Software and Information Technology Services,”

Sections (20) and (21), the following sectors are restricted for foreign investment:

“(7). Information Transmission, Software and Information Technology Services

(20) Telecommunications companies: foreign investment shall be limited to telecommunications services that shall be liberalized by China under its commitments upon accession to the World Trade Organization, foreign investment shall not exceed 50% in value-added telecommunications services (*excluding e-commerce*, domestic multiparty communications, storage and forwarding, call center services) and basic telecommunications services shall be controlled by Chinese shareholders.

(21) Foreign investment in the Internet news information services, online publication services, online audio-visual program services, online cultural business (*excluding music services*) and the Internet public information release services is prohibited.

(Services already liberalized by China under its commitments upon accession to the World Trade Organization shall be excluded from the foregoing services.) [*Emphasis Added*]

Similarly, according to the Trade Zone Negative List, “Special Management Measures,” Part (7), entitled “Information Transmission, Software and Information Technology Services,” Sections (17) and (18), the following sectors are restricted for foreign investment:

“(7). Information Transmission, Software and Information Technology Services

(17) Telecommunications companies: foreign investment shall be limited to telecommunications services that shall be liberalized by China under its commitments upon accession to the World Trade Organization; foreign investment shall not exceed 50% in value-added telecommunications services (*excluding e-commerce*, domestic multiparty communications, storage and forwarding, call center services) and basic telecommunications services shall be controlled by Chinese shareholders (Business operators thereof shall be legally established companies specializing in basic telecommunications services).

The pilot policy applied in the original areas of the China (Shanghai) Pilot Free Trade Zone (28.8 square kilometers) shall be rolled out in all FTZs.

(18) Foreign investment in the Internet news information services, online publication services, online audio-visual program services, online cultural business (*excluding music services*) and the Internet public information release services is prohibited. (Services already liberalized by China under its commitments upon accession to the World Trade Organization shall be excluded from the foregoing services.) [*Emphasis Added*]

As highlighted above, e-commerce is explicitly excluded from the 50% limitation on foreign investment in Internet services in both the National and Trade Zone Negative Lists. We have also previously noted that e-commerce is a sector that is encouraged for foreign investment.

Nevertheless, “e-commerce” is a general term that can also be much more broadly defined to include many other aspects of paid Internet-related services. The major e-commerce companies in China all have many subsidiaries and affiliates that are engaged in many other lines of paid services and Internet-related businesses, some of which are highly regulated, such as online payment systems.

The previous version of this chapter discussed foreign investment in Internet music services, which was permitted pursuant to a 2010 ruling in a case brought by the U.S. against China at the World Trade Organization.

### § 7.10 Market Access Catalogue and National Treatment

The Market Access Catalogue is a complex and elaborate series of lists of the existing prohibitions, restrictions and licensing requirements governing market access into numerous industry sectors in the Chinese economy, applicable equally to both foreign investors and Chinese investors.

The Chinese government has trimmed the National and Trade Zone Negative Lists so that they are much shorter than the Restricted and Prohibited Categories in the previous Foreign Investment Catalogues. One way that this was accomplished was by moving many of sectors that were previously in the Restricted and Prohibited Categories of the Foreign Investment Catalogues to the Market Access Catalogue, which applies equally to both foreign investors and Chinese investors. Since the Market Access Catalogue applies to foreign and Chinese investors

alike, the Chinese government can claim that it is granting national treatment to foreign investors.

As discussed above, the national treatment of foreign investors is stipulated in the new Foreign Investment Law. According to Article 4 of the Foreign Investment Law, national treatment means “affording foreign investors and their investments treatment, during the investment access stage, no less favorable than that afforded to Chinese domestic investors and their investments.”

The Market Access Catalogue is quite useful in that it gathers in one place all of the restrictions and prohibitions applicable to all of the industry sectors of the Chinese economy, and applicable to “all market players,” that is, all foreign and Chinese investors.

According to the notice by the National Development and Reform Commission and the Ministry of Commerce announcing the issuance of the Market Access Catalogue:

“We shall strictly implement the management model of ‘one list nationwide.’ We will ensure firmly the unification, seriousness and authority of the market access negative list system and ensure ‘the list shall be the only one and shall include everything.’”<sup>14</sup>

The Market Access Catalogue also lists the many Internet-related services and value-added telecommunication services that continue to be highly regulated and strictly controlled by the Chinese government. A comprehensive analysis of the regulatory scheme governing foreign investment in Internet-related value-added telecommunication services is perhaps more appropriately located in another chapter of this volume, and is, therefore, beyond the scope of this chapter.

### **§ 7.11 Sectors Restricted for Market Access by Foreign and Chinese Investors**

The Market Access Catalogue describes generally the sectors of the Chinese economy in which market access is prohibited for both foreign investors and Chinese investors, which include the following:

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<sup>14</sup> Notice of the National Development and Reform Commission and the Ministry of Commerce on Printing and Distribution of the “Market Access Negative List (Version 2019),” October 24, 2019: [https://www.ndrc.gov.cn/xwdt/ztzl/sczyfmqdxgkpt/tzggg1/201911/t20191122\\_1204475.html](https://www.ndrc.gov.cn/xwdt/ztzl/sczyfmqdxgkpt/tzggg1/201911/t20191122_1204475.html).

- (a) Investment is prohibited in any of the sectors set forth in the Obsolete Category of the Industrial Restructuring Catalogue, as discussed below. The Market Access Catalogue also contains an appendix that lists various updates and amendments to the Industrial Restructuring Catalogue.
- (b) New additional construction is prohibited in industry sectors listed in the Restricted Category of the Industrial Restructuring Catalogue.
- (c) Market access to various Internet-related sectors, including Internet-related finance businesses, continues to be highly regulated and strictly controlled by the Chinese government.
- (d) The import and export of those goods that are listed in the List of Goods Prohibited for Import and List of Goods Prohibited for Export are prohibited.
- (e) The sale of foreign cipher code products is prohibited.
- (f) Animal medical institutions are not allowed to engage in animal trading or animal fostering activities at animal clinics.

### § 7.12 Import and Export Trading

We will discuss in the next several sections of this chapter those retail sectors in which market access by foreign investors and Chinese investors is permitted, but is regulated or subject to licensing by agencies of the Chinese government. These sections correspond to various sections in the previous versions of this chapter.

As discussed above, the term “retail sectors” is defined broadly in this Chapter to refer to “retail, wholesale, distribution and trading,” and in this context, the term “trading” refers principally to the import and export of goods.

The Market Access Catalogue states in Category (2), entitled “Licensed Permitted Category”, Chapter (6), entitled “Wholesale and Retail Industries,” Section (42), as follows:

“(42) No one may engage in the operation, circulation, trading and import and export (including transit) of certain products, technologies and services such as agricultural products and crude oil without obtaining the relevant licenses, quota or qualifications.

Certain import and export goods shall be subject to quota administration (refer to the catalogue of goods subject to import license administration and the catalogue of goods subject to export license administration this year for detail information concerning the products that are currently subject to the quota administration).

Certain import and export goods shall be subject to license administration (refer to the catalogue of goods subject to import license administration and the catalogue of goods subject to export license administration this year for detail information concerning the products that are currently subject to the licensing administration).

Certain goods shall be subject to administration by import and export State-run trade operation qualification (currently applicable to the exports of corn, rice, cotton, tobacco, crude oil, refined oil, coal, tungsten, antimony and silver, as well as the imports of wheat, corn, rice, cotton, sugar, tobacco, crude oil, refined oil and fertilizer).

The processing trades of some key sensitive products are subject to administration (currently applicable to products such as copper concentrate, satellite receiving facilities, raw hides, among others).”

The Ministry of Commerce is the government agency that regulates and/or licenses the above sectors.

The Market Access Catalogue further sets forth in Category (2), entitled “Licensed Permitted Category”, Chapter (6), entitled “Wholesale and Retail Industries,” Section (42), the retail sectors that are regulated by various other government agencies, as follows:

“(42) No one may engage in the operation, circulation, trading and import and export (including transit) of certain products, technologies and services such as agricultural products and crude oil without obtaining the relevant licenses, quota or qualifications.

Export of live poultry and livestock to Hong Kong and Macao shall be subject to business qualification administration (refer to the catalogue of goods subject to export license administration this year for the detail information concerning the products currently subject to the business qualification administration).

Certain goods (wheat, corn, rice, cotton, sugar, wool, wool top and fertilizers) shall be subject to import tariff quota

administration. Import and export of technologies shall be subject to administration by licenses.

Imported feed and feed additives shall be subject to registration and license. Refined oil retail shall be subject to business qualification examination and approval.”

The above sectors are variously regulated and/or licensed by the Ministry of Commerce, the National Development and Reform Commission and/or the Ministry of Agriculture and Rural Affairs.

The Market Access Catalogue further sets forth in Category (2), entitled “Licensed Permitted Category”, Chapter (6), entitled “Wholesale and Retail Industries,” Section (43), as follows:

“(43) No one may engage in import and export transportation, specific cargo warehousing, circulation trade, among others, without obtaining relevant licenses or fulfilling legal procedures.

Supplying bonded oil to vessels of international navigation Establishment of duty-free sites shall be subject to examination and approval; establishment of duty-free shops shall be subject to examination and approval. Establishment of warehouses for storing goods that are under the Customs control shall be subject to business qualification examination and approval. Entry (transit) of animals, plants and their products shall be subject to quarantine approval.”

The above sectors are variously regulated and/or licensed by the Ministry of Commerce, the Ministry of Transport, the Ministry of Finance and/or the General Administration of Customs.

In addition, the Market Access Catalogue sets forth in Category (2), entitled “Licensed Permitted Category”, Chapter (6), entitled “Wholesale and Retail Industries,” Section (44), as follows:

“(44) No one may engage in the operation or import and export of products and technologies that are under specific restrictions without obtaining the relevant licenses or fulfilling legal procedures.

Import and export of dual-use items and technologies shall be subject to examination and approval. Import of radioisotopes falling within the catalogue of restricted imports and exports shall

be subject to examination and approval. Import and export of discs under processing trade shall be subject to examination and approval. Export of nuclear items and related technologies shall be subject to examination and approval. Import and export of gold and its products shall be subject to examination and approval. Export of military products shall be subject to license.”

The above sectors are variously regulated and/or licensed by the Ministry of Commerce, the State Administration of Science, Technology and Industry for National Defense, the Ministry of Ecology and Environment, the State Press and Publication Administration and/or the People’s Bank of China.

### § 7.13 Direct Selling and the Auction Business

Direct selling has always been a type of retailing that was highly regulated in China, as described in the previous editions of this Chapter. The Market Access Catalogue sets forth in Category (2), entitled “Licensed Permitted Category”, Chapter (6), entitled “Wholesale and Retail Industries,” Section (46), as follows:

“(46) No one may engage in auction or direct selling without obtaining licenses or relevant qualifications.

Engagement in the auction business shall be subject to license. A direct selling enterprise and its branches shall obtain qualifications and licenses to engage in direct sales.”

Direct selling and the auction business are variously regulated and/or licensed by the Ministry of Commerce and/or the State Administration for Market Regulation.

### § 7.14 Grain and Oil Businesses

The grain and oil sectors have also always been highly regulated and controlled by the Chinese government. The Market Access Catalogue sets forth in Category (2), entitled “Licensed Permitted Category”, Chapter (6), entitled “Wholesale and Retail Industries,” Section (45), as follows:

“(45) No one may engage in specific grain and oil business operations without obtaining the relevant licenses or qualifications.

Military food items supply stations and military food items supply agents shall be subject to qualification certification. Grain purchase shall be subject to qualification certification. Enterprises entrusted with the storage of central grain reserves shall be subject to qualification certification.”

The grain and oil sectors are regulated and/or licenses by the National Food and Strategic Reserves Administration.

### **§ 7.15 Drugs and Medical Devices**

As in most other countries, the drugs and medical devices sectors have always been highly regulated in China. The Market Access Catalogue further sets forth in Category (2), entitled “Licensed Permitted Category”, Chapter (6), entitled “Wholesale and Retail Industries,” Section (47), as follows:

“(47) No one may engage in the wholesale, retail, operation, import and export of certain products such as drugs and medical devices without obtaining the relevant licenses or fulfilling legal procedures.

Enterprises shall obtain license to engage in the wholesale or retail of pharmaceutical products. Imported drugs, and pharmaceutical products made in Hong Kong, Macao or Taiwan (including imported drugs, imported medicinal materials, and temporarily imported drugs) shall be subject to registration examination and approval. Units that can be engaged in the purchase and business operation of toxic drugs for medical use shall be subject to examination and approval.

Import and export of protein assimilation preparation and peptide hormone shall be subject to registration examination and approval. License is required for the operation of Category-3 medical device products. Operation and purchase of pharmaceutical precursor chemicals in Category I shall be subject to examination and approval.

Import and export license of narcotic pharmaceuticals and psychotropic substances shall be subject to verification and issuance. Enterprises engaging in nationwide wholesale of narcotic pharmaceuticals and Category I psychotropic substances shall be subject to examination and approval. A nationwide wholesale enterprise shall be subject to examination and

approval when selling narcotic drugs and Category I psychotropic substances to medical institutions that have obtained the qualifications for the use of narcotic drugs and Category I psychotropic substances.

A regional wholesale enterprise shall be subject to examination and approval when it needs to sell narcotic drugs and Category I psychotropic substances to medical institutions that have obtained the qualifications for the use of narcotic drugs and Category I psychotropic substances located in other provinces, autonomous regions or municipalities directly under the Central Government which are adjacent to the administrative area where the regional wholesale enterprise is located.

Regional wholesale enterprises engaging in the business of narcotic drugs and Category I psychotropic substances shall be subject to examination and approval; operations of enterprises specially engaged in the wholesale of Category II psychotropic substances shall be subject to examination and approval. Regional wholesale enterprises purchase narcotic drugs and Category I psychotropic substances from designated production enterprises shall be subject to examination and approval.”

Purchase of narcotic drugs and psychotropic substances shall be subject to examination and approval. Transportation of narcotic drugs and Category I psychotropic substances shall be subject to certification. Certification of the mailing of narcotic drugs and psychotropic substances shall be subject to verification and issuance. Retail business of Category II psychotropic substances shall be subject to examination and approval.

The drugs and medical devices sectors are regulated and/or licensed by the National Medical Products Administration.

#### **§ 7.16 Tobacco Products**

As discussed above, the tobacco-related sectors are on the National and Trade Zone Negative Lists, and are prohibited for foreign investment. Similarly, such sectors are also highly regulated for Chinese investors, as well as foreign investors.

The Market Access Catalogue sets forth in Category (2), entitled “Licensed Permitted Category”, Chapter (6), entitled “Wholesale and Retail Industries,” Section (48), as follows:

“(48) No one may engage in wholesale, retail, operation, and import and export of tobacco, alcohol and related products without obtaining the relevant licenses or fulfilling legal procedures.

Purchase of leaf tobacco shall be subject to monopoly operation. The licenses for tobacco monopoly wholesale, retail and transportation shall be issued after verification. Establishment, division, merger and cancellation of a tobacco product wholesale enterprise shall be subject to examination and approval.

The import and export of tobacco monopoly products shall be subject to monopoly operation. The import and export of tobacco goods shall be carried out in a unified way by authorized entities. Licensing is required for the purchase, sale and transfer of tobacco-specific machinery.”

The tobacco-related sectors are regulated and/or licensed by the State Tobacco Monopoly Administration.

### § 7.17 The Industrial Restructuring Catalogue

The Industrial Restructuring Catalogue is a 132-page document that classifies 1,477 industry sectors in the Chinese economy into the three categories of Encouraged, Restricted or Obsolete. As discussed above, the Obsolete and Restricted Categories of sectors in the Industrial Restructuring Catalogue also constitute the sectors that are prohibited for market access by both foreign investors and Chinese investors in the Market Access Catalogue.

The Industrial Restructuring Catalogue is a remarkable manifestation of China’s development model and national industrial policy, and perhaps also of its overreaching micro-management of the economy. The Industrial Restructuring Catalogue divides 1,477 industry sectors into the following: 821 sectors in the Encouraged Category, 215 sectors in the Restricted Category, and 441 sectors in the Obsolete Category.<sup>15</sup>

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<sup>15</sup> National Development and Reform Commission Revises Market Access Catalogue, *Reuters*, November 5, 2019: <https://www.reuters.com/article/%E4%B8%AD%E5%9B%BD%E7%BB%8F%E6%B5%8E%EF%BC%9A%E5%8F%91%E6%9>

The Industrial Restructuring Catalogue reaffirms the encouragement of e-commerce, discussed above in the context of the National Encouraged List and Provincial Encouraged List. The Industrial Restructuring Catalogue states in in Category (1), entitled “Encouraged Category,” Chapter (28), entitled “Information Industry,” Section (37), that “(37) E-commerce and e-government system development and application services” are encouraged.

Similarly, the Industrial Restructuring Catalogue sets forth the following sectors for encouragement, in Category (1), entitled “Encouraged Category,” Chapter (32), entitled “Commercial Services Industry,” Section (8), as follows:

“(8) Supply chain management services (referring to the design, planning, control and optimization of logistics, business flow, information flow and capital flow in the supply chain based on modern information technology, to manage single, decentralized order management, procurement execution, customs declaration, tax refund, logistics, and services such as management, financing, data management, trade and commerce, settlement, etc.).”

In addition, the Industrial Restructuring Catalogue lists the following sectors as encouraged, in Category (1), entitled “Encouraged Category,” Chapter (33), entitled “Trade Services Industry,” Sections (5) and (6), as follows:

“(5) Construction of a unified distribution and distribution network for business enterprises;

(6) Using information technology to transform and upgrade traditional commodity trading markets.”

Moreover, the Industrial Restructuring Catalogue states in Category (1), entitled “Encouraged Category,” Chapter (39), entitled “Sports,” Section (10), that “(10) Sale, lease and trade agency of sporting goods and related products” are encouraged.

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4%B9%E5%A7%94%E4%BF%AE%E8%AE%A2%E4%BA%A7%E4%B8%9A%E7%BB%93%E6%9E%84%E8%B0%83%E6%95%B4%E6%8C%87%E5%AF%BC%E7%9B%AE%E5%BD%95%EF%BC%8C%E9%BC%93%E5%8A%B1%E7%B1%BB%E6%96%B0%E5%A2%9E%E4%BA%BA%E5%B7%A5%E6%99%BA%E8%83%BD%E5%92%8C%E5%AE%B6%E6%94%BF%E7%AD%89-idCNL3S27M0RX.

As for sectors that are obsolete and outdated, the Industrial Restructuring Catalogue states in Category (3), entitled “Obsolete Category,” Part (2), entitled “Outdated Products,” Chapter (9), entitled “Light Industry,” Section (16), as follows:

“(16) Disposable foam plastic tableware, disposable plastic cotton swabs (Till December 31, 2020).

Plastic products containing plastic beads (production prohibited after December 31, 2020; Sales prohibited after December 31, 2022).”

It remains to be seen whether China will be able to follow through and implement and enforce on a national level the above green environmental initiatives.

### § 7.18 The E-Commerce Law

On August 31, 2018, the 5th Session of the Standing Committee of the 13th National People’s Congress adopted the E-Commerce Law of the People’s Republic of China, which went into effect on January 1, 2019.<sup>16</sup>

The E-Commerce Law makes the e-commerce platform business operator jointly and severally liable for certain intellectual property infringements by sellers on the platform. According to Article 45 of the E-Commerce Law:

“Article 45. Where E-commerce platform business operators know or should know that on-platform business operator infringe any intellectual property right, they shall take necessary measures such as deleting, blocking or disconnecting links and terminating transactions or services; and where necessary measures are not taken, e-commerce platform business operators shall be *jointly and severally liable* together with infringers in such cases. *[Emphasis Added]*”

The annual report filed with the U.S. Securities Exchange Commission in 2020 for the e-commerce company, JD.com, provides a useful summary of the E-Commerce Law.<sup>17</sup>

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<sup>16</sup> E-Commerce Law of the People’s Republic of China, [http://www.npc.gov.cn/zgrdw/npc/lfzt/rlyw/2018-08/31/content\\_2060827.htm](http://www.npc.gov.cn/zgrdw/npc/lfzt/rlyw/2018-08/31/content_2060827.htm).

“Pursuant to the E-Commerce Law, an e-commerce platform operator shall:

- (i) collect, verify and register the truthful information submitted by the third-party merchants that apply to sell products or provide services on its platform, including the identities, addresses, contacts and licenses, establish registration archives and update such information on a regular basis;
- (ii) submit the identification information of the third-party merchants on its platform to market regulatory administrative department as required and remind the third-party merchants to complete the registration with market regulatory administrative department;
- (iii) submit identification information and tax-related information to tax authorities as required in accordance with the laws and regulations regarding the administration of tax collection and remind the individual third-party merchants to complete the tax registration;
- (iv) record and retain the information of the products and services and the transaction information on its platform and the sales information for no less than 3 years;
- (v) display the platform service agreement and the transaction rules or links to such information on the homepage of the platform;
- (vi) display the noticeable labels regarding the products or services provided by the platform operator itself on its platform, and take liabilities for such products and services;
- (vii) establish a credit evaluation system, display the credit evaluation rules, provide consumers with accesses to make comments on the products and services provided on its platform, and restrain from deleting such comments; and
- (viii) establish intellectual property protection rules, and take necessary measures when any intellectual property holder

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<sup>17</sup> JD.com, Inc., 2019 Form 20-F, April 15, 2020, as filed with the U.S. Securities Exchange Commission: <https://www.sec.gov/ix?doc=/Archives/edgar/data/1549802/000119312520108084/d875897d20f.htm>.

notify the platform operator that his intellectual property rights have been infringed.”

The initial draft in 2016 of the E-Commerce Law, its subsequent revisions and the official commentaries on successive drafts of the E-Commerce Law, are set forth in detail on the website of the National People’s Congress.<sup>18</sup>

The Chinese government has established many new pilot zones for cross-border e-commerce, partly as a way of stabilizing foreign investment and trade during the Covid-19 coronavirus pandemic.<sup>19</sup>

### § 7.19 Conclusion

The economic crisis caused by the Covid-19 pandemic has demonstrated the importance of the retail consumer in powering the Chinese economy.<sup>20</sup> Foreign retailers such as Costco are continuing to enter and seek success in the Chinese retail market.<sup>21</sup> It is gratifying to review in this Chapter the history of the legal development of foreign investment in the retail sectors in China, and to marvel at how much China has progressed from the days when just setting up a foreign sales counter in a hotel was illegal. With the recent enactment of the Foreign Investment Law and the E-Commerce Law, the legal regime governing foreign investment in the retail sectors and e-commerce in China will continue to develop and mature in the future.

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<sup>18</sup> E-Commerce Law (December 2016—August 2018), [http://www.npc.gov.cn/zgrdw/npc/lfzt/rlyw/node\\_31841.htm](http://www.npc.gov.cn/zgrdw/npc/lfzt/rlyw/node_31841.htm).

<sup>19</sup> “China Takes Steps to Stabilize Foreign Trade, Investment,” *Xinhua*, April 7, 2020: [http://www.xinhuanet.com/english/2020-04/07/c\\_138955166.htm](http://www.xinhuanet.com/english/2020-04/07/c_138955166.htm).

<sup>20</sup> “As Rest of World Locks Down, China Tries to Get Shoppers Out,” *Bloomberg News*, March 30, 2020: <https://www.bloomberg.com/news/articles/2020-03-30/as-rest-of-world-locks-down-china-struggles-to-get-shoppers-out>; *see also*, “China Should Stand Up to Revive Global Demand,” *Financial Times*, Editorial Board, March 29, 2020: <https://www.ft.com/content/b19ffca2-7030-11ea-89df-41bea055720b>.

<sup>21</sup> “Costco Set to Open New Store in China’s Suzhou City,” *Reuters*, April 9, 2020, by Sophie Yu and Ryan Woo: <https://www.reuters.com/article/us-china-costco-wholesale-suzhou/costco-set-to-open-new-store-in-chinas-suzhou-city-idUSKCN21R1QP>; *see also*, “Costco Bets It Can Outsell Rivals In China By Getting To Know Its Customers Better With Big Data,” *South China Morning Post*, October 22, 2019, by Holly Chik: <https://www.scmp.com/business/companies/article/3034063/costco-bets-it-can-outsell-rivals-china-getting-know-its>; *and also*: “Joining the Club,” *News China*, China Newsweek Corporation, December 2019, by Xu Ming.

