

Schapiro Exhibit 110

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FYI . . . sorry for the long header - I'm on BB.

D

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Colleagues:

Yesterday, December 11, 2007, USTR released its annual report to Congress on China's WTO Compliance. This report has been issued each year since China joined the WTO in 2001. This year's report has an excellent discussion of the two WTO cases, one in the IPR area, the other involving trading and distribution rights for certain copy-right-based industries, that the U.S. government commenced in 2007.

As it has since 2001, IIPA testified at the annual TPSC hearing held in September 2007 that precedes the issuance of this annual report.

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2007 REPORT TO CONGRESS ON CHINA'S WTO COMPLIANCE



United States Trade Representative

**2007 REPORT TO CONGRESS
ON CHINA'S WTO COMPLIANCE**

December 11, 2007

United States Trade Representative

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FOREWORD

This is the sixth report prepared pursuant to section 421 of the U.S.-China Relations Act of 2000 (P.L. 106-286), 22 U.S.C. § 6951 (the Act), which requires the United States Trade Representative (USTR) to report annually to Congress on compliance by the People's Republic of China (China) with commitments made in connection with its accession to the World Trade Organization (WTO), including both multilateral commitments and any bilateral commitments made to the United States. The report also incorporates the findings of the Overseas Compliance Program, as required by section 413(b)(2) of the Act, 22 U.S.C. § 6943(b)(2).

Like the prior reports, this report is structured as an examination of the nine broad categories of WTO commitments undertaken by China. Throughout the report, USTR has attempted to provide as complete a picture of China's WTO compliance as possible, subject to the inherent constraints presented by the sheer volume and complexity of the required changes to China's trade regime and transparency obstacles. The report identifies areas where progress has been achieved and underscores shortcomings, as appropriate, with regard to the commitments that became effective upon China's accession to the WTO as well as those commitments scheduled to be phased in over time.

The focus of the report's analysis continues to be on trade concerns raised by U.S. stakeholders that, in the view of the U.S. Government, merit attention within the WTO context. The report does not provide an exhaustive analysis of the many areas in which China's WTO compliance efforts have or have not, in the view of the U.S. Government, satisfied particular commitments made in China's WTO accession agreement.

In preparing this report, USTR drew on its experience in overseeing the U.S. Government's monitoring of China's WTO compliance efforts. USTR chairs the Trade Policy Staff Committee (TPSC) Subcommittee on China WTO Compliance, an inter-agency body whose mandate is devoted to China and the extent to which it is complying with its WTO commitments. This TPSC subcommittee is composed of experts from USTR, the Departments of Commerce, State, Agriculture and Treasury, and the U.S. Patent and Trademark Office, among other agencies. It works closely with State Department economic officers, Foreign Commercial Service officers and Market Access and Compliance officers from the Commerce Department, Foreign Agricultural Service officers and Customs attaches at the U.S. Embassy and Consulates General in China, who are active in gathering and analyzing information, maintaining regular contacts with U.S. industries operating in China and maintaining a regular dialogue with Chinese government officials at key ministries and agencies. The subcommittee meets in order to evaluate, coordinate and prioritize the monitoring activities being undertaken and to review the steps that China has taken to implement its commitments.

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To aid in its preparation of this report, USTR also published a notice in the Federal Register on July 25, 2007, asking for written comments and testimony from the public and scheduling a public hearing before the TPSC, which took place on September 27, 2007. A list of the written submissions received from interested parties is set forth in Appendix 1, and the persons who testified before the TPSC are identified in Appendix 2.

EXECUTIVE SUMMARY

After six years of membership in the World Trade Organization, China is no longer a new WTO member. Almost all of the specific commitments that China made when it acceded to the WTO on December 11, 2001, were due to be implemented over a period of five years, ending one year ago. Accordingly, the United States has been working to hold China fully accountable – just as we, and others, hold ourselves accountable – as a mature member of the international trading system, placing a strong emphasis on China’s adherence to WTO rules. Over the last year, the United States intensified its frank bilateral engagement with China. The United States also took enforcement actions at the WTO in key areas where dialogue had not resolved our WTO-related concerns, and through our reliance on rules-based dispute settlement the United States, and China, did make some progress. The focus of this bilateral and multilateral engagement included significant market impediments and trade-distortive practices as well as other Chinese government policies and practices where the United States has needed to respond in order to defend fundamental WTO principles.

The United States brought three new WTO cases against China in 2007. In the first one, the United States challenged several prohibited subsidy programs benefiting a wide cross-section of China’s manufactured goods, and we were pleased that China later agreed to settle this case by committing to eliminate all of the subsidies at issue. The United States also filed a challenge to key aspects of China’s IPR enforcement regime, along with a challenge to market access restrictions affecting the importation and distribution of copyright-intensive products such as theatrical films, DVDs, music, books and journals. Each of these three WTO cases implicates fundamental WTO obligations, as does the WTO case filed by the United States in 2006 challenging China’s use of prohibited local content requirements in the auto sector.

While pursuing these multilateral enforcement initiatives, the United States also pursued intensified, focused bilateral dialogue with China. Working together, the United States and China pursued a set of formal and informal bilateral dialogues and meetings, including numerous working groups and plenary meetings under the auspices of the U.S.-China Joint Commission on Commerce and Trade (JCCT) and the U.S.-China Strategic Economic Dialogue (SED). Through these avenues, the United States sought resolutions to particular pressing trade issues and encouraged China to accelerate its movement away from reliance on government intervention and toward full institutionalization of market mechanisms. This bilateral engagement produced near-term results in several areas in 2007, including the suspension of overly burdensome testing and certification requirements for medical devices, the granting of biotechnology safety certificate approvals, increased insurance market access, expanded business scopes for foreign banks and securities companies, and a new civil aviation agreement. On other pressing trade issues, the United States and China continue to work together in search of pragmatic solutions.

As noted above, constructive bilateral engagement during the WTO dispute settlement process also facilitated the resolution of one of the WTO disputes brought by the United States, along with Mexico, in 2007. Following two rounds of formal WTO consultations in Geneva in March and June, the United States and China were able to reach agreement in November on the immediate elimination of all of the prohibited subsidies being challenged by the United States. Hopefully, China's willingness to take this step represents a conscious decision by China's policymakers to abandon the type of economic thinking that had relied on this highly distortive type of government intervention in the past. At a minimum, as U.S. Trade Representative Schwab remarked, it showed that "two great trading nations can work together to resolve disputes to their mutual benefit." It also demonstrated that the Administration's policy of serious dialogue and resolute enforcement is delivering real results.

All of these developments demonstrate the substantial ongoing benefits to the United States – including U.S. workers, businesses, farmers, service providers and consumers – from China's WTO membership. Prodded by the United States and other WTO members since acceding to the WTO, China has taken many impressive steps to reform its economy, making progress in implementing a set of sweeping commitments that required it to reduce tariff rates, eliminate non-tariff barriers, provide national treatment and improved market access to goods and services imported from the United States and other WTO members, improve transparency and protect intellectual property rights. Although not complete in every respect, China's implementation of its WTO commitments has led to significant increases in U.S.-China trade, including U.S. exports to China, while deepening China's integration into the international trading system and facilitating and strengthening the rule of law and economic reforms that China began nearly three decades ago. That said, more still needs to be done.

In 2007, U.S. industry began to focus less on the implementation of specific commitments that China made upon entering the WTO and more on China's shortcomings in observing basic obligations of WTO membership as well as Chinese policies and practices that undermine previously implemented commitments. According to one major trade association's testimony this Fall before USTR and the other agencies that comprise the Trade Policy Staff Committee:

[M]any of the market access concerns on which U.S. companies increasingly focus are no longer the result of China's failure to implement specific WTO commitments. Rather, these concerns focus on China's laws, policies, and practices that deviate from the WTO's national treatment principle, its inadequate protection of intellectual property rights, its insufficiently transparent legal and regulatory processes, and its opaque development of technical and product standards that may favor local companies. . . . [T]he hurdles U.S. companies must overcome result from China's falling short of full adherence to the

general principles of the WTO and not from an unwillingness to implement the specific commitments of its entry agreement.

At the root of many of these problems is China's continued pursuit of problematic industrial policies that rely on excessive Chinese government intervention in the market through an array of trade-distorting measures. This government intervention, evident in many areas of China's economy, is a reflection of China's historic yet unfinished transition from a centrally planned economy to a free-market economy governed by rule of law. As another major trade association explained in its written comments, "[t]he legacies of China's command economy continue to be a drag on China's complete integration into the global economy and, as a result, cause a variety of problems for China's trading partners."

During the fifteen years of negotiations leading up to China's WTO accession, the United States and other WTO members worked hard to address concerns created by China's historic economic structure. Given the state's large role in China's economy, the United States and other WTO members carefully negotiated conditions for China's WTO accession that would, when implemented, lead to significantly reduced levels of government intervention in the market and significantly fewer distortions in trade flows. Through the first few years after China's accession to the WTO, China made noteworthy progress in adopting economic reforms that facilitated its transition toward a market economy. However, beginning in 2006 and continuing throughout 2007, progress toward further market liberalization began to slow. It became clear that some Chinese government agencies and officials have not yet fully embraced key WTO principles of market access, non-discrimination and transparency. Differences in views and approaches between China's central government and China's provincial and local governments also have continued to frustrate economic reform efforts, while China's difficulties in generating a commitment to the rule of law have exacerbated this situation.

Looking ahead, one of the critical issues for the international trading system will be to ensure that China's leadership does not retreat from the substantial progress made to date. Evidence of a possible trend toward a more restrictive trade regime appears most visibly in a series of diverse Chinese measures over the past two years signaling new restrictions on market access and foreign investment in China. One trade association with broad representation explains:

Recent public policy debates in China have indicated a dampening of enthusiasm in some quarters for foreign participation in the economy. Some policy makers also appear to want to expand the [Chinese] government's role in directing the economy and in developing internationally competitive Chinese enterprises, while also restricting the role of international companies in certain sectors. Designation of "pillar" industries, promoting "indigenous innovation," and establishing

“national economic security” criteria to review deals are troublesome signposts that do not imply full market access for U.S. companies.

As 2007 was drawing to a close, the United States and China were completing months of preparations for two high-level meetings scheduled to take place back-to-back in Beijing in mid-December. The first one is the annual meeting of the JCCT, chaired by Commerce Secretary Gutierrez and U.S. Trade Representative Schwab on the U.S. side and Vice Premier Wu on the Chinese side, which focuses on seeking resolutions to discrete, pressing trade issues. That meeting will be followed by the semi-annual SED meeting, whose purpose is to manage the complex U.S.-China economic relationship on a long-term, strategic basis under the guidance of Treasury Secretary Paulson and Vice Premier Wu and with the participation of several other ministers on each side.

At present, several specific areas continue to cause particular concern for the United States and U.S. industry, in terms of China’s full adherence to its WTO obligations. The key concerns in each of these areas are summarized below.

Intellectual Property Rights

Since its accession to the WTO, China has put in place a relatively good set of laws and regulations aimed at protecting the intellectual property rights of domestic and foreign right holders. However, some critical measures still need to be revised, and China’s enforcement of its laws protecting the intellectual property rights covered by the WTO Agreement on Trade-Related Aspects of Intellectual Property Rights (the TRIPS Agreement) has often been ineffective. U.S. industry reports show no significant reduction in IPR infringement levels again in 2007, confirming that counterfeiting and piracy in China remain at unacceptably high levels and cause serious harm to U.S. businesses across many sectors of the economy. Indeed, despite anti-piracy campaigns in China and an increasing number of IPR cases in Chinese courts, the U.S. copyright industries’ most recent estimates indicate that 85 percent to 93 percent of all copyrighted products sold in China in 2006 were pirated, showing little or no improvement over the previous year. USTR’s annual Special 301 report, issued in April 2007, confirmed this lack of progress, as USTR continued to place China on the Priority Watch List and subject it to Section 306 monitoring.

In 2007, as in prior years, the United States placed the highest priority on improving IPR enforcement in China. The United States pursued extensive bilateral discussions with China, focusing on concrete steps that China could take to improve its legal protections and enforcement efforts so that significant reductions in IPR violations in China could be realized. These efforts achieved an agreement between the two countries’ customs authorities to cooperate on border enforcement, but other critical enforcement concerns remained unaddressed. For

example, China continued to deflect calls from the United States and other WTO members for better utilization of criminal remedies to combat rampant IPR infringement in China, claiming that its approach to enforcement was showing results. The available statistics on continuing rampant IPR infringement in China raise obvious questions about this claim.

In April 2007, after nearly three years of sustained bilateral engagement aimed at addressing U.S. concerns about specific deficiencies in China's legal regime for protecting and enforcing copyrights and trademarks, the United States requested formal WTO consultations. When the ensuing consultations did not lead to an agreed resolution, the United States sought the establishment of a WTO panel to hear the case, and a panel was established in September 2007, with 12 other WTO members joining in as third parties. A panel decision is currently expected in 2008.

The United States remains committed to working constructively with China on a bilateral basis to significantly reduce IPR infringement levels in China and continues to devote considerable staff and resources, both in Washington and in Beijing, to address the many challenges in this area. At the same time, when bilateral discussions prove unable to resolve key issues, the United States remains prepared to take further action on these issues, including WTO dispute settlement where appropriate, given the importance of China developing an effective, TRIPS Agreement-compliant system for IPR enforcement.

Industrial Policies

China continued to pursue industrial policies that seek to limit market access for non-Chinese origin goods and foreign service providers and offer substantial government resources to support Chinese industries and increase exports. In some cases, the objective of these policies seems to be to promote the development of Chinese industries that are higher up the economic value chain than the industries that make up China's current labor-intensive base. In other cases, China appears simply to be protecting less competitive state-owned enterprises.

In 2007, examples of the trade-distortive measures implementing these industrial policies remain readily evident. China continues to apply auto parts regulations that prolong prohibited local content requirements for motor vehicles while the WTO-consistency of those regulations is being challenged in panel proceedings at the WTO. China is also making increasingly restrictive use of export quotas and export duties on a number of raw materials where it is the world's leading producer. Through these export restrictions, China is able to drive up world prices while lowering domestic prices, thereby providing substantial artificial advantages to a wide range of downstream producers in China when they compete against foreign downstream producers in the China market and around the world. In addition, even after re-committing to technology neutrality for 3G telecommunications standards at the April 2006 JCCT meeting, China's

regulatory authorities continue to promote the home-grown TD-SCDMA standard and to expand its test market. China also continues to pursue unique national standards in a number of areas of high technology where international standards already exist, and it pressures foreign companies seeking to participate in the standards-setting process to license their technology or intellectual property on unfavorable terms. Meanwhile, a July 2005 industrial policy that calls for the state's management of major aspects of China's steel industry remains in effect, and excessive government subsidization continues to benefit a range of domestic industries in China. China has also sought to protect many domestic industries through an increasingly restrictive investment regime, as recent measures impose requirements for state control of "critical" equipment manufacturers, establish rules for foreign mergers and acquisitions that confer broad and vaguely defined powers on the government to block investments in a range of industries, and prevent further foreign investment in "pillar" industries. Some of these industrial policy measures raise questions about China's compliance with its WTO obligations in the areas of national treatment, market access, export restrictions, technology transfer and subsidies, among others.

While bilateral discussions yielded little progress in resolving U.S. concerns regarding most of these industrial policy measures in 2007, the United States was able to leverage its use of the WTO dispute settlement mechanism, as noted above, to gain China's agreement to eliminate several prohibited subsidy programs that had been providing substantial benefits to a wide range of manufactured goods being sold in China and being exported to the United States and other markets around the world. Reached in November 2007 after months of negotiations, this agreement committed China to discontinue all of the challenged subsidies by January 1, 2008, and not to reinstate them in the future.

In 2008, the United States will continue to pursue vigorous bilateral engagement to resolve the serious disagreements that remain over a number of China's industrial policy measures, including China's highly trade-distorting use of export restrictions on raw materials. If dialogue fails to address U.S. concerns, however, the United States will not hesitate to take further actions seeking elimination of these industrial policy measures, including WTO dispute settlement, where appropriate.

Trading Rights and Distribution Services

Many in U.S. industry consider trading rights and distribution services to be "the most important of the WTO commitments China has so far implemented," according to one trade association with broad representation. These commitments called for full liberalization of trading rights – the right to import and export – and distribution services, including wholesale and retail services, franchising services and related services, by December 11, 2004. With determined U.S. engagement, China has implemented these critical commitments in most sectors, and many U.S. companies and individuals are now not only able to import and export goods directly without

having to use a middleman, but are also able to establish their own distribution networks within China.

Nevertheless, some serious problems still remain. In particular, despite extensive and persistent bilateral engagement by the United States, China has continued to maintain import and distribution restrictions on copyright-intensive products such as theatrical films, DVDs, music, books and journals, in apparent contravention of China's trading rights and distribution services commitments. These restrictions reduce and delay market access for these copyrighted products, creating additional incentives for infringement in China's market. Once it became clear that bilateral discussions were not leading to changes to address U.S. concerns, the United States invoked the WTO dispute settlement mechanism by filing a request for formal WTO consultations in April 2007. After two rounds of consultations in Geneva failed to resolve the dispute, the United States requested the establishment of a WTO panel to hear the case, and a panel was established in November 2007.

In two other key areas, the United States continued to engage China bilaterally as 2007 was drawing to a close. First, while China has taken steps to implement its commitment to open its market for sales away from a fixed location, also known as "direct selling," China continued to subject foreign direct sellers to unwarranted restrictions on their business operations. In addition, China continued to discriminate against foreign retailers seeking to open new stores by making them satisfy burdensome requirements not applicable to domestic retailers. The United States will continue to pursue these important issues in 2008 to ensure that China fully meets its applicable WTO commitments.

Agriculture

U.S. agricultural exports to China in 2006 totaled more than \$7.6 billion, making China the United States' fourth largest agricultural export market. To date, 2007 has been a comparably successful year, characterized overall by steady growth. For example, U.S. exports of bulk agricultural commodities continued to perform strongly, with soybean exports increasing dramatically. China also remains the leading export destination for U.S. cotton, among other products.

While U.S. exports of agricultural commodities largely fulfill the potential envisioned by U.S. negotiators during the years leading up to China's WTO accession, trade with China in the agricultural sector remains among the least transparent and predictable of the world's major markets, as it continues to be plagued by uncertainty, largely because of selective intervention in the market by China's regulatory authorities. As in past years, capricious practices by Chinese customs and quarantine officials can delay or halt shipments of agricultural products into China, while SPS measures with questionable scientific bases and a generally opaque regulatory regime

frequently bedevil traders in agricultural commodities, who require as much predictability and transparency as possible in order to preserve margins and reduce the already substantial risks involved in agricultural trade.

In 2007, the principal targets of questionable practices by China's regulatory authorities were poultry, pork and soybeans, and anticipated growth in U.S. exports of these products was impeded. In addition, China continued to block the importation of U.S. beef and beef products, even after these products had been declared safe to trade under international guidelines.

In 2008, the United States will continue to pursue vigorous bilateral engagement with China in order to obtain progress on its outstanding concerns. The United States also will not hesitate to take other actions to resolve its concerns if dialogue fails.

Services

Overall, the United States enjoyed a substantial surplus in trade in services with China in 2006, as in prior years, and the market for U.S. service providers in China remains promising. However, in some sectors, it appears that China's commitments to increase market access and remove restrictions have still not been fully realized. Chinese regulatory authorities continue to frustrate efforts of U.S. providers of banking, insurance, telecommunications, construction and engineering, legal and other services to achieve their full market potential in China through the use of an opaque regulatory process, overly burdensome licensing and operating requirements, and other means.

In 2007, U.S. engagement through the SED meeting in May led to some limited progress. China committed to eliminate the backlog of U.S. non-life insurers' applications for conversion from a branch to a subsidiary, and it followed through on that commitment. In addition, China committed to act on the applications of foreign banks incorporated in China seeking to issue their own domestic currency credit and debit cards, although it has not yet done so, hindering the banks' ability to attract Chinese individuals as new customers. China has also failed, to date, to fulfill a commitment that it made at the April 2006 JCCT meeting to lower excessive capital requirements that have been blocking market access for foreign providers of basic telecommunications services.

Meanwhile, two serious WTO concerns that arose in 2006 have so far resisted resolution through high-level bilateral engagement. In particular, Xinhua, the Chinese state news agency, persisted in its refusal to withdraw rules issued in September 2006 imposing new restrictions on foreign providers of financial information services, raising questions about China's implementation of specific WTO commitments that it had made. In addition, questions were raised about China's failure to implement important commitments scheduled to be phased in by December 11, 2006,

which would allow foreign credit card companies to provide electronic payments processing services for domestic currency transactions.

In 2008, the United States will continue to engage China and will closely monitor developments in an effort to ensure that China fully adheres to its services commitments. If necessary, the United States also will not hesitate to take further actions seeking to enforce China's WTO commitments, including WTO dispute settlement, where appropriate.

Transparency

One of the fundamental principles of the WTO Agreement, reinforced throughout China's WTO accession agreement, is transparency. Transparency permits markets to function effectively and reduces opportunities for officials to engage in trade-distorting practices behind closed doors. While China's transparency commitments in many ways require a profound historical shift, China made important strides to improve transparency across a wide range of national and provincial authorities during the first four years of its WTO membership. However, two shortcomings stood out. As of December 11, 2005, China had still not adopted a single official journal for publishing all trade-related measures, and it had yet to regularize the use of notice-and-comment procedures for new or revised trade-related measures prior to implementation. In 2006, after the United States elevated this issue to the JCCT level, China finally adopted a single official journal, although much work remains for China to ensure full participation by all relevant government entities. The United States has also pushed China to adopt a mandatory notice-and-comment practice, and this issue will be a key topic for discussion at the SED meeting taking place in December 2007. To date, however, notice-and-comment remains an optional practice in China. As a result, many of China's regulatory regimes continue to suffer from systemic opacity, frustrating efforts of foreign – and domestic – businesses to achieve all of the potential benefits of China's WTO accession.

Conclusion

In 2008, the Administration will continue its concerted efforts to ensure that China fully implements its outstanding WTO commitments and fully adheres to its fundamental obligations as a WTO member, with particular emphasis on reducing Chinese government intervention in the market, lowering IPR infringement levels in China and making China's trade regime more predictable and transparent. Throughout this process, the Administration will continue to solve problems with dialogue if possible, legal action when necessary, and work within the rules-based international trading system. The Administration will continue to work cooperatively and pragmatically with China – through the robust set of formal and informal U.S.-China bilateral dialogues and meetings, including the JCCT and the SED – to ensure that the benefits of China's WTO membership are realized by the United States and the world and that problems in our trade relationship are appropriately resolved. When bilateral dialogue is not successful, however,

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the Administration will not hesitate to employ the full range of enforcement tools available, whether it be the dispute settlement mechanism at the WTO or the enforcement of U.S. trade laws – under the WTO’s rules-based system – to ensure that U.S. interests are not harmed by unfair trade practices.

BACKGROUND

China's WTO Accession Negotiations

In July of 1986, China applied for admission to the WTO's predecessor, the General Agreement on Tariffs and Trade (GATT). The GATT formed a Working Party in March of 1987, composed of all interested GATT contracting parties, to examine China's application and negotiate terms for China's accession. For the next eight years, negotiations were conducted under the auspices of the GATT Working Party. Following the formation of the WTO on January 1, 1995, a successor WTO Working Party, composed of all interested WTO members, took over the negotiations.

Like all WTO accession negotiations, the negotiations with China had three basic aspects. First, China provided information to the Working Party regarding its trade regime. China also updated this information periodically during the 15 years of negotiations to reflect changes in its trade regime. Second, each interested WTO member negotiated bilaterally with China regarding market access concessions and commitments in the goods and services areas, including, for example, the tariffs that would apply on industrial and agricultural goods and the commitments that China would make to open up its market to foreign services suppliers. The most trade liberalizing of the concessions and commitments obtained through these bilateral negotiations were consolidated into China's Goods and Services Schedules and apply to all WTO members. Third, overlapping in time with these bilateral negotiations, China engaged in multilateral negotiations with Working Party members on the rules that would govern trade with China. Throughout these multilateral negotiations, U.S. leadership in working with China was critical to removing obstacles to China's WTO accession and achieving a consensus on appropriate rules commitments. These commitments are set forth in China's Protocol of Accession and an accompanying Report of the Working Party.

WTO members formally approved an agreement on the terms of accession for China on November 10, 2001, at the WTO's Fourth Ministerial Conference, held in Doha, Qatar. One day later, China signed the agreement and deposited its instrument of ratification with the Director-General of the WTO. China became the 143rd member of the WTO on December 11, 2001.

China's Protocol of Accession, accompanying Working Party Report and Goods and Services Schedules are available on the WTO's website (www.wto.org).

Overview of China's WTO Commitments

In order to accede to the WTO, China had to agree to take concrete steps to remove trade barriers and open its markets to foreign companies and their exports from the first day of accession in virtually every product sector and for a wide range of services. Supporting these steps, China also agreed to undertake important changes to its legal framework, designed to add transparency and predictability to business dealings.

Like all acceding WTO members, China also agreed to assume the obligations of more than 20 existing multilateral WTO agreements, covering all areas of trade. Areas of principal concern to the United States and China's other trading partners, as evidenced by the accession negotiations, included the core principles of the WTO, including most-favored nation treatment, national treatment, transparency and the availability of independent review of administrative decisions. Other key concerns could be found in the areas of agriculture, sanitary and phytosanitary measures, technical barriers to trade, trade-related investment measures, customs valuation, rules of origin, import licensing, antidumping, subsidies and countervailing measures, trade-related aspects of intellectual property rights and services. For some of its obligations in these areas, China was allowed minimal transition periods, where it was considered necessary.

Even though the terms of China's accession agreement are directed at the opening of China's market to WTO members, China's accession agreement also includes several mechanisms designed to prevent or remedy injury that U.S. or other WTO members' industries and workers might experience based on import surges or unfair trade practices. These include a unique, China-specific safeguard provision allowing a WTO member to restrain increasing Chinese imports that disrupt its market (available for 12 years, running from the date of China's WTO accession), a special textile safeguard (available for 7 years) and the continued ability to utilize a special non-market economy methodology for measuring dumping in anti-dumping cases against Chinese companies (available for 15 years). The Administration is committed to maintaining the effectiveness of these mechanisms for the benefit of affected U.S. businesses, workers and farmers.

With China's consent, the WTO also created a special multilateral mechanism for reviewing China's compliance on an annual basis. Known as the Transitional Review Mechanism, this mechanism operates annually for 8 years after China's accession, with a final review by year 10.

STATUS OF CHINA'S WTO COMPLIANCE EFFORTS

Trading Rights and Distribution Services

Within the context of China's WTO commitments, the concept of "trading rights" includes two elements, i.e., the right to import goods (into China) and the right to export goods (from China). It does not include the right to sell goods within China, as that right is governed by separate commitments principally relating to "distribution services" set forth in China's Services Schedule (see the Distribution Services section below). In the global business world, trading rights and distribution services are fundamentally interrelated, and often an enterprise will need both of them to carry out its business plan.

China's commitments on trading rights and distribution services are critically important. They continue to offer the potential to enormously expand the scope of business opportunities available to a wide range of U.S. and other foreign industries doing business, or seeking to do business, in China. These commitments were scheduled to be fully phased in (subject to a few product exceptions) by December 11, 2004, when existing restrictions on companies already invested in China were to be removed, and U.S. companies were to be fully able to import and sell goods in China or export goods from China. It was envisioned that these changes would enhance the efficiency with which a wide range of U.S. companies could distribute and provide related logistics services for imported or domestically produced goods in China, while also enabling U.S. companies to integrate their China operations more easily with their global networks.

Overall, China remains in basic compliance with its trading rights commitments, although one significant exception involves the importation of copyright-intensive products such as theatrical films, DVDs, music, books and journals, which China still reserves for state trading. Meanwhile, China has made substantial progress in implementing its distribution services commitments, although some technical challenges remain. However, as in the trading rights area, one significant exception involves the distribution of copyright-intensive products such as theatrical films, DVDs, music, books and journals, which China continues to restrict. After extensive dialogue with China failed to resolve U.S. concerns, the United States turned to the WTO dispute settlement process in April 2007, launching a challenge to China's restrictions on the importation and distribution of these products.

Trading Rights

In the trading rights area, until shortly before its WTO accession, China severely restricted the number and types of enterprises that could import or export, and it also restricted the products that a particular enterprise could import or export. For the most part, China confined trading rights to certain state-owned manufacturing and trading enterprises, which could import or export goods falling within their approved scopes of business. China also granted trading rights to certain foreign-invested enterprises, allowing them to import inputs for their production purposes and export their finished products.

In its accession agreement, responding to concerns raised by members of the WTO working party on China's accession, China committed to substantial liberalization in the area of trading rights. China agreed to eliminate its system of examination and approval of trading rights and make full trading rights automatically available for all Chinese enterprises, Chinese-foreign joint ventures, wholly foreign-owned enterprises and foreign individuals, including sole proprietorships, within three years of its accession, or by December 11, 2004, the same deadline for China to eliminate most restrictions in the area of distribution services. The only exceptions applied to products listed in an annex to China's accession agreement, such as grains, cotton and tobacco, for which China reserved the right to engage in state trading. China also agreed to take a number of liberalization steps during the years prior to its adoption of an automatic trading rights system, including trading rights for Chinese enterprises immediately upon China's accession, followed by trading rights for joint ventures with minority foreign ownership within one year after China's accession and trading rights for joint ventures with majority foreign ownership within two years after China's accession.

As previously reported, during the phase-in period, China timely implemented its commitments relating to Chinese enterprises, but fell behind in implementing the commitments for joint ventures with minority foreign ownership (scheduled for implementation by December 11, 2002) and joint ventures with majority foreign ownership (scheduled for implementation by December 11, 2003). It was not until April 2004, after the United States had made trading rights one of its priority issues during the run-up to the April 2004 JCCT meeting, that China finally began to take steps to implement its commitments more fully. Shortly before that meeting, the National People's Congress issued a revised *Foreign Trade Law*. It provided for trading rights to be automatically available through a registration process for all domestic and foreign entities and individuals, effective July 1, 2004, almost six months ahead of the scheduled full liberalization required by China's accession agreement. In June 2004, China's Ministry of Commerce (MOFCOM) issued implementing rules setting out the procedures for registering as a foreign trade operator in time for the new registration process to be operational on the July 1 effective date. U.S. companies have continued to report few problems with this trading rights registration process.

However, China has not yet implemented its trading rights commitments insofar as they relate to the importation of copyright-intensive products such as theatrical films, DVDs, music, books and journals. Under the terms of China's accession agreement, China's trading rights commitments apply fully to these products, as they are not among the products for which China reserved the right to engage in state trading. As a result, trading rights for these products should have been automatically available to all Chinese enterprises, Chinese-foreign joint ventures, wholly foreign-owned enterprises and foreign individuals as of December 11, 2004. Nevertheless, China continues to wholly reserve the right to import these products to state trading enterprises, as reflected in a host of measures, including the *Regulations on Administration of the Films Industry*, issued by the State Council in December 2001, the *Provisional Rules on the Entry Criteria for Operating Film Enterprises*, issued by the State Administration of Radio, Film and Television (SARFT) and MOFCOM in October 2004, the *Administrative Regulations on Publishing*, issued by the State Council in December 2001, the *Administrative Regulations on*

Audiovisual Products, issued by the State Council in December 2001, the *Catalogue for Guidance of Foreign Investment Industries*, issued by the National Development and Reform Commission (NDRC) and MOFCOM in November 2004, the *Several Opinions on Introducing Foreign Investment into the Cultural Sector*, issued by the Ministry of Culture, SARFT, the General Administration of Press and Publication (GAPP), NDRC and MOFCOM in July 2005, the *Measures for the Administration of Import of Audio and Video Products*, issued by the Ministry of Culture and the General Administration of Customs in April 2002, the *Measures for Administration of Chinese Foreign Contractual Distribution Ventures of Audiovisual Products*, issued by the Ministry of Culture and MOFCOM in February 2004, the *Administrative Regulations on Electronic Publications*, issued by GAPP in December 1997, and the *Procedure for Examination and Approval of Establishment of Publication Importation Entities*, issued by GAPP in December 2005. After raising this matter and China's related restrictions on distribution in numerous bilateral meetings with China and at the WTO during the annual transitional reviews before the Committee on Market Access and before the Council for Trade in Goods since 2005, the United States initiated a WTO dispute settlement case against China in April 2006, challenging China's restrictions on the importation and distribution of copyright-intensive products such as theatrical films, DVDs, music, books and journals. Subsequent WTO consultations held in June and July 2007 failed to lead to an agreed resolution, and the United States filed a request for the establishment of a WTO panel in September 2007. A panel was established at a November 2007 meeting of the WTO's Dispute Settlement Body, with the European Communities (EC), Japan, Korea and Australia joining in as a third parties.

Distribution Services

Prior to its WTO accession, China generally did not permit foreign enterprises to distribute products in China, i.e., to provide wholesaling, commission agents', retailing or franchising services or to provide related services, such as repair and maintenance services. These services were largely reserved to Chinese enterprises, although some foreign-invested enterprises were allowed to engage in distribution services within China under certain circumstances. For example, joint ventures have had the right to supply wholesaling and retailing services for the goods they manufacture in China since the issuance of the *Regulations for the Implementation of the Law on Chinese-Foreign Equity Joint Ventures* by MOFCOM's predecessor, the Ministry of Foreign Trade and Economic Cooperation (MOFTEC), in December 1987. Similarly, wholly foreign-owned enterprises had this same right under the *Detailed Rules for the Implementation of the Law on Wholly Foreign-Owned Enterprises*, issued by MOFTEC in April 2001.

In its WTO accession agreement, China committed to eliminate national treatment and market access restrictions on foreign enterprises providing these services through a local presence within three years of China's accession (or by December 11, 2004), subject to limited product exceptions. In the meantime, China agreed to progressively liberalize its treatment of wholesaling services, commission agents' services and direct retailing services (except for sales away from a fixed location), as described below.

Overall, China has made substantial progress in implementing its distribution services

commitments. While delays in implementation and confusion over eligibility characterized much of 2005, these problems largely disappeared in 2006 after MOFCOM began allowing provincial-level authorities to grant wholesale and retail distribution licenses, although some technical challenges remain. At the same time, foreign retailers seeking licenses for new outlets face discriminatory requirements, and China continues to place excessive restrictions on direct selling, or sales away from a fixed location. In addition, the distribution of some products remains unjustifiably restricted, including copyright-intensive products (such as theatrical films, DVDs, music, books and journals), pharmaceuticals and crude oil and processed oil. The restrictions on the copyright-intensive products are currently the subject of a WTO dispute settlement case brought by the United States. In 2008, the United States will continue to work closely with U.S. companies as they seek to overcome these remaining market access barriers and discriminatory requirements and provide the full range of distribution services in China.

Meanwhile, U.S. and other foreign companies will continue to face challenges unrelated to China's WTO obligations, particularly as they attempt to create nationwide distribution networks in China. Currently, distribution networks remain highly fragmented in China, as there are no Chinese distribution companies with nationwide networks and no Chinese distribution company holds a market share greater than two percent, due largely to infrastructure limitations and restrictive provincial and local requirements. Nevertheless, the central government has a strong interest in addressing these impediments and developing nationwide distribution networks, which will foster economic and employment growth and help revitalize rural areas in China.

Wholesaling Services and Commission Agents' Services

China committed that, immediately upon its accession to the WTO, it would permit Chinese-foreign joint ventures and wholly foreign-owned enterprises to distribute at the wholesale level within China any goods that they make in China, without any market access or national treatment limitations. Within one year after accession (or by December 11, 2002), China agreed to permit foreign service suppliers to supply wholesaling services and commission agents' services within China for almost all goods, whether made in China or imported, through joint ventures with minority foreign ownership. Excepted goods included salt, tobacco, chemical fertilizers, processed oil and crude oil as well as books, newspapers, magazines, pharmaceutical products, pesticides and mulching films. Within two years after accession (or by December 11, 2003), China agreed to permit foreign service suppliers to supply wholesaling services and commission agents' services within China through majority foreign-owned joint ventures, subject to the same exceptions. Within three years after accession (or by December 11, 2004), China agreed to permit foreign service suppliers to supply wholesaling services and commission agents' services within China through wholly foreign-owned enterprises. In addition, by this time, the exceptions for books, newspapers, magazines, pharmaceutical products, pesticides and mulching films were to be eliminated. The exceptions for chemical fertilizers, processed oil and crude oil (but not salt and tobacco) were to be eliminated within five years after accession (or by December 11, 2006).

As previously reported, China fell behind in implementing its commitments regarding wholesaling services and commission agents' services insofar as they related to joint ventures

with minority foreign ownership (scheduled for implementation by December 11, 2002) and joint ventures with majority foreign ownership (scheduled for implementation by December 11, 2003). It was not until April 2004, after the United States had made distribution services – including wholesale services – one of its priority issues during the run-up to the April 2004 JCCT meeting, that China finally began to take steps to implement its commitments more fully. Shortly before that meeting, MOFCOM issued the *Measures on the Management of Foreign Investment in the Commercial Sector*, superseding the *Procedures for Pilot Projects for Commercial Enterprises with Foreign Investment*, which had been in force since June 1999. These regulations belatedly lifted market access and national treatment restrictions on joint ventures engaging in wholesale services effective June 2004. In addition, the regulations extended this liberalization to wholly foreign-owned enterprises and removed product exceptions for books, newspapers, magazines, pesticides and mulching films as of the scheduled phase-in date of December 11, 2004, and provided that a separate measure would be issued to remove the product exception for pharmaceuticals. The regulations also required enterprises to obtain central or provincial-level MOFCOM approval before providing wholesale services, and they appeared to set relatively low qualifying requirements, as enterprises needed only to satisfy the relatively modest capital requirements of the *Company Law* rather than the high capital requirements found in many other services sectors.

Initially, MOFCOM's application and approval process remained opaque and was beset with problems, as the central and local approving authorities were still in the process of determining the appropriate procedures and documentation requirements. Large backlogs of distribution licenses developed, and the approving authorities imposed a variety of restrictions on the scope of products and services that could be supplied when they did grant licenses. Meanwhile, a separate set of problems plagued existing enterprises seeking to expand their business scope to include wholesale distribution, in part because the Chinese authorities were still trying to sort out historical tax treatment and Free Trade Zone (FTZ) issues.

During the run-up to the July 2005 JCCT meeting, as the United States made full implementation of China's wholesale (and retail) distribution services commitments an issue of high priority, the Chinese authorities reduced much of the backlog of distribution license applications. In addition, in July 2005, MOFCOM and the General Administration of Customs (Customs Administration) issued the *Circular on Issues Concerning the Trade Administration of Bonded Zones and Bonded Logistics Parks*, which clarified the handling of applications from enterprises located in FTZs. At the July 2005 JCCT meeting, China committed to improve the transparency of the application and approval process. Consistent with this commitment, in September 2005, MOFCOM issued the *Application and Approval Guidelines for Foreign Investments*, which clarified many aspects of the application and approval process. Some improvements subsequently took place in the application and approval process, but it was not until MOFCOM issued the *Notice on Entrusting National Economic and Technological Development Zones with the Authority to Approve Foreign-Funded Distribution Firms and International Forwarding Agents* in February 2006 that the problems with the application and approval process largely disappeared. These developments have made the application and approval process more efficient and less time-consuming and have enabled U.S. companies to improve the efficiency of their China supply

chain management, and as a result many of them have been able to restructure their legal entities to integrate their China operations into their global business more fully and efficiently.

At the same time, U.S. companies in some industries continue to have concerns with regard to product and services restrictions that China has yet to remove.

As in the area of trading rights, China continues to impose restrictions on foreign enterprises' distribution of copyright-intensive products such as theatrical films, DVDs, music, books and journals, despite its commitments to remove most market access and national treatment restrictions applicable to the distribution of these products by no later than December 11, 2004. China's continuing restrictions are set forth in a number of different measures, including the *Administrative Regulations on Publishing*, issued by the State Council in December 2001, the *Administrative Regulations on Audiovisual Products*, issued by the State Council in December 2001, the *Provisions on Guiding the Orientation of Foreign Investment*, issued by the State Council in February 2002, the *Catalogue for Guidance of Foreign Investment Industries*, issued by NDRC and MOFCOM in November 2004, the *Several Opinions on Introducing Foreign Investment into the Cultural Sector*, issued by of the Ministry of Culture, SARFT, GAPP, NDRC and MOFCOM in July 2005, the *Administrative Regulations on Management of Foreign-Invested Book, Magazine and Newspaper Distribution Enterprises*, issued by GAPP and MOFTEC in March 2003, the *Administrative Regulations on the Publication Market*, issued by GAPP in July 2003 and revised in June 2004, the *Administrative Regulations on Electronic Publications*, issued by GAPP in December 1997, the *Administrative Measures on Subscription of Imported Publications*, issued by GAPP in December 2004, the *Procedure for Examination and Approval of Establishment of Chinese-Foreign Entities, Cooperative Joint Ventures, and Wholly Foreign Owned Publication Distribution Enterprises*, issued by GAPP in December 2005, and the *Measures for Administration of Chinese Foreign Contractual Distribution Ventures of Audiovisual Products*, issued by the Ministry of Culture and MOFCOM in February 2004. After raising this matter and China's related restrictions on importation in numerous bilateral meetings with China and at the WTO during the annual transitional reviews before the Council for Trade in Services since 2005, the United States initiated a WTO dispute settlement case against China in April 2006 covering the importation and distribution restrictions applicable to copyright-intensive products such as theatrical films, DVDs, music, books and journals, as discussed above in the Trading Rights section.

With regard to the distribution of automobiles by foreign enterprises, China began to implement several measures in 2005, including the *Implementing Rules for the Administration of Brand-Specific Automobile Dealerships*, jointly issued by MOFCOM, the NDRC and the State Administration for Industry and Commerce (SAIC) in February 2005. In November 2005 the NDRC followed up with the *Rules for Auto External Marks*, and in January 2006 MOFCOM issued the *Implementing Rules for the Evaluation of Eligibility of Auto General Distributors and Brand-specific Dealers*. While U.S. industry has generally welcomed these measures, they do contain some restrictions on foreign enterprises that may not be applied to domestic enterprises. As in 2007, the United States will closely monitor how China applies these measures in 2008 in an effort to ensure that foreign enterprises are not adversely affected by these restrictions.