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Trade Reform in Vietnam

Opportunities with Emerging Challenges

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Abstract

In 1986 Vietnam initiated a transition from a centrally planned economy to a market-oriented economy where the government would keep playing a leading role. These renovation (*doi moi*) policies were successful at generating economic growth and reducing poverty. In the ten-year socioeconomic strategy endorsed by the Ninth Party Congress in April 2001, the authorities further articulated their development objectives in terms of economic growth and poverty reduction. To reach these objectives, the government indicated that its structural reform priorities were to change Vietnam's trade and financial policies, liberalize the climate for private investment, increase the efficiency of public enterprises, and improve governance.

Auffret argues that the pace of implementation of trade reform—which has been impressive so far—is raising new challenges. On one side, fast liberalization of trade reform may soon conflict with the slow pace of implementation of other reforms, including restructuring of state-owned enterprises and state-owned commercial banks. On the other side, Vietnam would greatly benefit from fast implementation of trade reform and particularly fast accession to the World Trade Organization (WTO), especially after China's recent WTO accession. Auffret concludes that implementation of trade reform will be a testing ground to reveal the extent of Vietnam's commitment to a market-oriented economy.

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**TRADE REFORM IN VIETNAM:
OPPORTUNITIES WITH EMERGING CHALLENGES¹**

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TRADE REFORM IN VIETNAM: OPPORTUNITIES WITH EMERGING CHALLENGES

A. Fast Pace of Implementation of Trade Reform

Pre-renovation Vietnam's trade regime was characterized by a small number of Foreign Trading Corporations (FTCs) with effective monopolies over imports and exports of their product range. Planned import volumes were determined by the projected differences between domestic demand and supply for particular goods, with export volumes set at levels necessary to finance planned imports. Prices served as an accounting function and had no real role in allocating resources.

The reform of Vietnam's trade policy which was at the cornerstone of the 1986 renovation policy had two main objectives. The first objective of the trade reform was to make the transition from a centrally-planned to a market-based economy by: (i) liberalizing domestic prices and linking them to world prices so that they play a role in guiding resource; (ii) increasing the number of trading entities beyond the initial number of centrally controlled FTCs to avoid that price signals are distorted through anti-competitive behavior by monopoly state traders or through *de facto* quantitative restrictions; (iii) developing trade policy instruments such as tariffs, quotas and licenses; and (iv) removing exchange rate distortions. These reforms of the trading system were inextricably linked with reform of the enterprise sector to allow indirect regulation through market-determined prices to replace direct regulation of enterprise outputs. The second objective was to promote export-oriented industries--by redressing the anti-export bias embodied in the protectionist regime--while simultaneously protect the manufacturing sector developed during the centrally-planned era.

Since the introduction of *doi moi* in 1986, progress to reform trade has been impressive (Table 1 summarizes recent changes. Annex 1 describes major changes in trade policy since

doi moi). Measures that have been taken include: (i) relaxation of the restrictions to establish FTCs, allowing for a rapid increase in the number of enterprises allowed to engage in trade from about 30 in 1988² to over 1,200 by the end of 1994³ and 16,200 in 2001⁴; (ii) introduction of trade policy instruments including quantitative restrictions (QRs) and tariffs followed by a gradual significant liberalization, with a gradual reduction in import barriers and improvements in export incentives; and (iii) liberalization of foreign exchange regime. Reform measures have been motivated by the overall reform efforts of the World Bank and the International Monetary Fund (IMF) as well as a number of regional and multilateral trading arrangements.

Table 1: Major Changes in Trade Policy since 2000

Year	Objectives			
	Increase numbers of FTCs	Develop trade policy instruments	Remove exchange rate distortions	Become a member of international trading arrangements
2000		<ul style="list-style-type: none"> Removed quantitative import restrictions on 8 out of remaining 19 groups of products i.e. including fertilizer, liquid soda, ceramic goods, plastic packaging, DOP plasticizer, ceramic sanitary ware, electric fans, and bicycle 		<ul style="list-style-type: none"> Signed a bilateral trade agreement with the US in July paving the way for MFN access of Vietnamese exports to the US market, gradual opening up of Vietnam's economy, for goods and services as well as investments
2001	<ul style="list-style-type: none"> Permitted all legal entities (companies and individuals) to export most goods without having to acquire a special license by revising the implementing decree of the Trade law 	<ul style="list-style-type: none"> Removed QRs multilaterally on all tariff lines of the following groups of products: liquor, clinker, paper, floor tiles, construction glass, some types of steel, and vegetable oil 	<ul style="list-style-type: none"> Reduced the foreign exchange surrender requirement from 50 to 40 percent 	<ul style="list-style-type: none"> Moved 713 tariff lines from the Temporary Exclusion List (TEL) to the Inclusion List (IL)
2002			<ul style="list-style-type: none"> Reduced the foreign exchange surrender requirement from 40 to 30 percent (May) 	<ul style="list-style-type: none"> Detailed a list of goods and tax rates for implementing the Agreement on the Common Effect Preferential Tariffs (CEPT) Scheme of ASEAN countries for the year 2002. Issued the implementing decision for the USBTA, including guidelines for responsibilities and actions (March) A Government negotiation team started working sessions on WTO accession in Geneva (April)

Quantitative restrictions: Since 1986, the quotas and targets, which were at the base of the central planning system, have been progressively eliminated. By early 2003, all QRs on imports will be abolished with the exception of sugar (to be kept until 2005) and petroleum products.⁵ With the exception of textile and garment (whose quotas⁶ are currently allocated

² CIE, 1998, p.10

³ CIE, 1998, p.10

⁴ World Bank, 2002, p. 35

⁵ QRs on imports of cement, motorbikes and vehicles for fewer than nine passengers are scheduled to be abolished by end-2002

⁶ Textile quotas under the Multi-Fiber Agreement (MFA) of the WTO are scheduled to be phased out by end-2004. A WTO Agreement on Textile and Clothing (ATC) is expected to take effect starting in 2005. Since

through an auction process) and a list of sensitive items, all QRs on exports have been already eliminated. Importantly, the schedule to phase out QRs was announced in the Five-year Import-Export Program (2000-05), allowing the private sector to anticipate and adjust to the new trade regime.

Tariffs: The 1988 *Law on Import and Export Duties* represented the first step to put a trade tax system in place. This original tariff schedule was rationalized in 1992 and simplified in 1999 following Vietnam's accession to AFTA and in preparation for the WTO. Duty exemptions and refunds for imports used to produce exports were a central part of this reform package and Vietnam currently has a well functioning duty drawbacks system.⁷ The current tariff structure has three sets of rates⁸: (i) Most Favored Nation (MFN) tariff rates applicable to imports from countries with which Vietnam enjoys MFN status (about 75 percent of imports in 2000); (ii) Common Effective Preferential Tariff (CEPT) rates applicable to imports from ASEAN countries (about 25 percent of imports in 2000 of which about half benefits from CEPT rates following the country-of-origin rule); and (iii) General rates (50 percent above MFN rates) applicable to imports from countries that do not fall under the MFN and CEPT rates (imports from these countries is negligible). The (unweighted) average MFN tariff rate has been increasing partially due to the conversion of QRs into tariff-equivalent. However, both the number of tariff lines (13 at beginning 2002) and the maximum tariff rate (120 percent at beginning 2002) have been decreasing. The (unweighted) CEPT tariff rate has declined to 10.7 percent in 2002.

Table 2: Tariff Rates with Roadmap for the Future

Years	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
MFN Tariff Rate (%) 1/											
Average (unweighted)	12.3	13.4	13.6	na	na	15.1	15.7				
Range		0-200					0-120				
CEPT Implementation 2/											
Number of Items											
Inclusion List	856	1,496	1,996	3,590	4,230	4,830	5,430	6,030	6,030	6,030	6,030
Temporary Exclusion List	2,123	1,483	983	2,440	1,800	1,200	600	0	0	0	0
Sensitive List	26	26	26	51	51	51	51	51	51	51	51
General Exceptions List	213	213	213	202	202	202	202	202	202	202	202
Total	3,218	3,218	3,218	6,283	6,283	6,283	6,283	6,283	6,283	6,283	6,283
Tariff Rate (%)											
Average (unweighted)											
Inclusion List	7.0	6.8	5.8	5.6	4.7	3.9	3.8	2.8	2.6	2.5	2.3
Temporary Exclusion List	19.9	19.9	19.9	19.9	19.8	19.6	19.4	17.5	13.4	8.9	3.9
Average	12.7	12.6	12.1	11.9	11.4	10.9	10.7	9.3	7.4	5.3	3.0
USBTA 3/											

Note:

1/ MFN rates imposed on goods imported from countries having MFN status in trade relation with Vietnam

2/ Common Effective Preferential tariff (CEPT) imposed on goods imported from ASEAN countries.

3/ USBTA agreed to reduce current tariff rates on a limited range of industrial and agricultural items (about 250) by 30 to 50 percent by 2004.

Source: Athukorala (2002); Kazi and Duc (2000), CIE (1997)

Vietnam is not a member of WTO, it is expected to retain bilateral quotas with various countries. Textile quotas with the US have not yet been set.

⁷ For more on this issue, see Ianchovichina, 2001.

⁸ A third set of rates (50 percent above preferential rates) is applied to countries that do not fall under the preferential and special preferential rates. However, trade with these countries is negligible.

External payments: Major steps have been taken to liberalize the foreign exchange market including a gradual phasing out of the foreign exchange surrender requirement (reduced to 30 percent in May 2002) by end-2003.⁹ The tax on profit remittances from Foreign Invested Enterprises (FIEs) will be eliminated by end-2002 consistent with efforts to harmonize tax treatment between foreign and domestic enterprises. However, there are still some restrictions on current international transfers and payments.¹⁰

Regional and Multilateral Trading Arrangements: Reform measures have been motivated by the overall reform efforts of the World Bank and the IMF as well as a number of regional and multilateral trading arrangements including the 1992 preferential trade agreement with the European Economic Community, the 1995 membership in the ASEAN Free Trade Area (AFTA) and the 2001 Bilateral Trade Agreement with the US (US BTA). In 1995, Vietnam submitted an application to join the World Trade Organization (WTO) and has started the process of negotiating the conditions of accession.

Outside these trade agreements, the Government retains *de jure* control over a number of instruments that could affect trade. For example, in October 2002, the Government decided to limit the number of motorcycle parts which foreign motorbike assemblers could import in Vietnam in 2002. In December 2002, the Government made plans to raise import taxes on complete knocked-down (CKD) component kits for car without previous consultation with the industry. Pressure from the industry eventually prevented the plans to be carried forward.

B. The Road Ahead: Growing Challenges

The fast pace of implementation of trade reform is raising new challenges:

- Challenges in terms of coordination with other structural reforms: faster liberalization of trade reform may soon conflict with the slower pace of implementation of other reforms including restructuring of State-Owned Enterprises (SOEs), State-Owned Commercial Banks (SOCBs) and tax administration reform;
- Challenges related to the pace of accession to the WTO: Vietnam would greatly benefit from fast accession to the World Trade Organization (WTO); particularly in the context of China's recent WTO accession.

B.1. Coordination of Trade Reform with Other Structural Reforms

Vietnam has been so far able to liberalize the trade regime while maintaining a policy bias in favor of domestic-market oriented industries, particularly those dominated by state-owned enterprises (SOEs). In fact, so far, line ministries and other agencies have been able to comply with the trade liberalization commitments made by the Government while still protecting the SOEs under their dependence. First, although from a legal standpoint, all registered firms, regardless of ownership, can trade, there exist barriers which discourage trading by non-state enterprises, thereby protecting SOEs. For example, stringent regulatory requirements demanded by line ministries *de facto* prevent private firms from participating in rice exports and fertilizer imports. Also, monopoly in production may translate in monopoly in trading as in the case of coal, a major traditional export of Vietnam. Second, the tariff

⁹ Surrender requirement on foreign exchange was introduced in 1998.

¹⁰ For more details, see IMF, July 2002, p.41.

structure embodies a policy bias in favor of domestic industries, particularly those dominated by SOEs. Most low tariff rates are on items predominantly used by SOEs as inputs in the production of intermediate goods or final goods for the domestic market. Also, although Vietnam has taken steps to meet its AFTA commitments on tariff reductions, it has been able to differ their impacts by declaring goods that are already at zero or low rates and importantly to maintain a number of key products in the General Exception List (GEL) thereby excluding them from any tariff reduction schemes.¹¹ Third, although in principle all firms can buy foreign exchange from banks, in practice, only large firms, mostly SOEs are able to secure foreign exchange from state-owned commercial banks (SOCBs).

However, the policy bias in favor of domestic-market oriented industries and SOE in particular could have considerable welfare costs, in particular because of its impact on investment decisions. It leads to inefficient allocations of resources by all types of investors (public, foreign invested and private) in all sectors of the economy by creating a bias in favor of the manufacturing sector (and a corresponding bias against agriculture) and, within the manufacturing sector, in favor of some industries like motor vehicles and motorbikes, wearing apparels and plastic products (Table 3).¹² A large share of public¹³ and foreign investments¹⁴ are directed toward sectors with relatively high levels of protection. In addition, the policy emphasis to build up joint ventures between foreign investors and state firms (instead of private firms) so that physical capital levels of output grow rapidly does not encourage the emergence of a market-oriented economy.

Table 3: Effective Rates of Protection by Sectors, 2002

Sector	Effective Rate of Protection (ERP) 1/ (%)	
	1997	2002
Agriculture	7.7	7.4
Mining	6.1	16.4
Manufacturing	121.5	96.0
Average (Simple)	59.5	54.1
Memo:		
Tradables	72.2	58.5

1/ QR inclusive estimates.

Source: Athukorala (2002)

¹¹ Items in the GEL include among others alcoholic beverages, vehicles with fewer than 15 seats and motorbikes with capacity less than 250cc and kits. Vietnam has yet to announce a schedule to reduce tariffs on products included in the GEL.

¹² The Effective Rate of Protection (ERP) (defined as the percentage change in producers' value-added, as a result of taxes on trade, over the level of value-added that would have prevailed in the absence of those taxes) is estimated at 7 percent for agriculture compared to 96 percent for manufacturing. It is particularly high for motor vehicles and motorbikes (559 percent), sugar (366 percent), tea (241 percent), wearing apparel (181 percent) and plastic products (163 percent). However, the market is segmented between domestic-oriented production and export competing production. ERPs for export-competing production are drastically different: motor vehicles and motorbikes (-501 percent), sugar (-28 percent), wearing apparel (-31 percent) and plastic products (-43 percent) which helps explain booming exports in these sectors (For more details, see Athukorala, 2002).

¹³ For example, under the Public Investment Program (2001-05), the public sector will continue to invest in construction materials (11 percent of total investment in industry) and food processing (11 percent) which both benefit from high levels of protection.

¹⁴ McCarty (1998) observes that among the five highest sectors recipients of FDI (in the traded-goods sector) cement, fuels, vehicles, electrical machinery, and beverages, all the sectors except fuels are producing import-substituting goods (reported in Fukase and Martin, 1999, p. 14).

Commitments to implement already ratified international trade agreements provide an opportunity to revitalize and deepen the SOE and banking reforms. Implementation of commitments under AFTA and the USBTA will decrease SOEs' level of protection. Under AFTA, most QRs are being abolished while items in the Temporary Exclusion List (TEL) are expected to be transferred to the Inclusion List (IL) by 2003 with tariffs to be reduced to 0-5 percent by 2006 (Table 2). In addition, the Sensitive List (SL) is expected to be phased out by 2010. As a result, the (unweighted) average CEPT tariff rate applicable to imports from the ASEAN region (except those in the SL and the GEL) is expected to decline sharply from 10.7 percent in 2002 to 3 percent by 2006. Most industries and SOEs in particular will be affected by a decline in protection level. Under increasing pressure from the SOEs (and SOE management in particular), the authorities may decide to postpone SOE restructuring, which can be achieved by increasing the level of fiscal transfers to SOEs. This is not recommendable for two reasons. First, there are substantial welfare costs associated with the provision of subsidies to non-efficient SOEs. Second, subsidizing SOEs would de facto lead to a redistribution of fiscal resources to SOE employees who are mostly non-poor, thereby reducing resources available to finance poverty-reduction programs. The authorities may also request SOCBs to make loans to the failing SOEs. This would only (momentarily) transfer the burden associated with keeping afloat non-efficient SOEs to the banking sector. International experiences invariably show that such a strategy eventually leads to extremely costly banking crises. Instead, an appropriate strategy would be for the authorities to take advantage of the pressure brought about by the trade reforms to: (i) restructure SOEs, equitizing those in the competitive sector while regulating natural monopolies, and (ii) curtail the relation of inter-dependence between SOEs and SOCBs as agreed under the IMF Poverty Reduction and Growth Facility (PRGF).

Vietnam also committed to open important services, including banking and insurance, under the USBTA (Box 1). This is expected to lead to a slightly more competitive banking and insurance sectors starting in three years which will have a direct bearing on banking reform. The authorities could take advantage of the pressure brought about by the USBTA to reinforce regulation and make SOCBs independent from both the regulator and Government's interference possibly through equitization.

Box 1: Joining Regional and Multilateral Trading Agreements

AFTA

- **Overall tariff reductions.** Tariffs on the vast majority of tariff lines (95 percent, according to preliminary estimates) on ASEAN imports will be reduced to at most 20 percent by the start of 2003, and to 0-5 percent by beginning of 2006.
- **Tariff reductions on manufactures.** By early 2004 average tariffs on manufactures from ASEAN countries will be cut by 50 percent.
- **Reduced average tariffs** By early 2004, average tariffs on ASEAN imports of textiles, leather, wood products, non-metallic mineral products (e.g. glass and ceramic products), and food products will fall by more than 60 percent.

USBTA

- **Liberalizing trading rights** for U.S. firms in three to six years.
- **Reducing current tariff rates** on a limited range of industrial and agricultural items (about 250) by 30 to 50 percent over three years.
- **Removing QRs** on most products in three to seven years -- steel and cement after six years and petroleum products after seven years.
- **Opening the services sector.** Vietnam will be providing more market access than low and middle income countries under the Uruguay round and only slightly less than the larger transition economies.
- **Banking sector:** (i) permit majority US ownership of banks after three years; (ii) grant national treatment in the possible equitization of SOCBs; and (iii) phase in national treatment of deposit taking activities after eight years.
- **Leasing sector:** 100 percent U.S. equity in financial leasing and in other leasing will be introduced after three years.
- **Insurance sector:** : (i) permit majority US ownership of firms after three years; (ii) eliminate restrictions on the operations of joint ventures after three years (and wholly US-owned companies after six years); and (iii) permit wholly US-owned firm after five years.
- **Other services.** Immediate introduction of 100 percent U.S. equity in a range of technical services, including in legal, accounting, engineering, computer-related, and construction areas.
- **Trade-related investment measures.** All WTO-inconsistent measures (e.g. local content requirements) will be phased out within five years
- **Intellectual property rights.** WTO-consistent protection of intellectual property rights are to be introduced in 12-18 months.
- **Transparency.** All laws and decisions governing issues in the agreement will be published; administrative or judicial tribunals for review will be established, as will the right of appeal.

WTO

- Vietnam made its initial offer on specific commitments in services in January 2002
- Fifth meeting of the Working Party on accession of Vietnam held in April 2002, to review the status of Vietnam's bilateral access negotiations and action plans for implementation of a number of WTO agreements, including those related to investment and intellectual property rights.
- Sixth meeting held in December 2002; start of the bilateral negotiations.

Commitments to implement international trade agreements also provide an opportunity to deepen the tax administration reform. A major consideration in the reductions in tariffs from AFTA, the USBTA and future trade agreements is their medium-term fiscal implications. International evidence suggests that significant tariff reduction can in fact lead to increase government revenue by both increasing total import duty collection and broadening the domestic tax base.¹⁵ There is a need to develop a long-term tax revenue

¹⁵ Athukorala (2002, p. 30) provides examples and references.

strategy that fully incorporates the impact of trade agreements as part of the tax administration reform.

Finally, commitments to implement international trade agreements provides opportunities to improve trade-related infrastructure. Vietnam's infrastructure for trade has been improving slowly. For example, the modification of port facilities and operations in response to containerization has increased efficiency and reliability of container handling operation. Also, the adoption of the new Custom Law in October 2001 has improved customs operations drastically. Customs clearance has already been streamlined while the modification of custom valuation to transaction values in compliance with WTO rules, to be implemented by end-2003 as agreed under the USBTA, will further increase efficiency. Ratification of the FAL Convention (Convention on Facilitation of International Maritime Traffic) of the International Maritime Organization (IMO) will further streamline the documentation process relevant to ship calls thereby further increasing productivity. However, further improvements are required to make the current system meet existing needs and keep up with future rise in trade volumes. Important issues are the high price and low efficiency of SOE cartel in ports -- with negative impact on the efficiency of sea-freight provided by the private sector -- and airports; and the low efficiency and high prices associated with SOE monopoly in air cargo, coastal shipping, railways, power and telecommunication. Key elements in the modern logistics of trade, including e-commerce and web pages, face stringent regulation that are difficult to justify from an economic perspective. Transport by land by the private sector is also constrained by low rural accessibility and poor road maintenance (Table 4).¹⁶ There is an urgent need for further deregulation and standardization of logistics industry and greater private participation in infrastructure services.

¹⁶ For more details, see Hopkins (2002), Nomura Research Institute (2002) and Almec Corporation (2000).

Table 4: Trade-Related Infrastructure

	Ports/ Airports	Air freight	Inland waterway shipping	Road freight	Railways freight	Power	Telecom- municati on
Market structure	State cartel	State monopoly	Large barge Public sector Small barge. Private sector	Private and public trucks	State monopoly	State monopoly	State monopoly
Availability of service	Reasonable	Good	Good	Good	Good	Unreliable with voltage fluctuatio n	<ul style="list-style-type: none"> • Delays in new line installation • Restrictions on internet-based business tools.
Price	High	Not available	Depends on location	Competitive	Adequate	Adequate	Very high
Productivity /Reason	Low Insufficient container handling capacity in ports. • Insufficient airfreight facility in airports	Low <ul style="list-style-type: none"> • Insufficient cold storage • Delays due to outdated security checks • Unsatisfactory facilities and handling techniques 	Low Insufficient management leading to insufficient dredging and lack of safety enforcement	Low Insufficient road development and maintenance	Very low Underused railways capacity	Very high losses	Low
Overall impact on trade	Varies by region and product	Negative	Varies by region and product	Neutral	Negative	Negative	Negative

Source: Adapted from Hopkins (2002) and Nomura Research Institute (2002).

B.2. Pace of Accession to the WTO

Vietnam would greatly benefit from fast accession to WTO. To the extent that WTO sets accepted rules of trade among its members, it de facto discriminates against non-member countries. As a consequence, Vietnam could gain enormously from WTO accession. As the experience of China indicates, accession to WTO generates considerable benefits in terms of improved legal framework and enabling environment which result in substantial productivity gains and incremental capital inflows (Box 2). Also, as a WTO member, Vietnam would be in a better position to defend its interest on the international scene. There is some evidence that, as tariff barriers and quantitative import restrictions are progressively dismantled as part of the on-going global liberalization process, importing countries tend to intensify the use of sanitary and phytosanitary standards (SPS) or allegations of price dumping or subsidies to protect the interests of their domestic producers. Indeed, Vietnamese exporters are increasingly facing these new trade barriers as evidenced in the exports of shrimps to the

EU¹⁷, frozen fish fillets to the US¹⁸, garlic¹⁹ and water-proof footwear²⁰ to Canada, and gas lighters to the EU.²¹ Because Vietnam is not yet a member of WTO and cannot thus take advantage of the dispute settlement mechanism, it must use separate and differing bilateral legal measures to resolve such disputes. In addition, dispute resolution may be very costly and require technical expertise which may not be readily available. It is important that Vietnam develops capacities to meet SPS standards for both exports and domestic purposes. In addition, this will help Vietnam prepare itself for effective participation in future reconsideration of SPS standards and the related implementation and dispute settlement procedures that have already been identified as key items on the WTO agenda for future multilateral trade negotiations.²² Finally, the cost of WTO accession will increase over time because the “terms of accession” into WTO will be increasingly demanding.²³ Consequently, to the extent possible, it is important that Vietnam accede WTO before the conclusion of the Doha Development Agenda--which will raise the “terms of accession”--scheduled for January 1, 2005. Interestingly, China decided to accelerate its accession to WTO in early 1999 in order to benefit from much lower “terms of accession” in application until the end of 1999 when the WTO started a new round of multilateral negotiations (Wang, 1999).

China’s accession to WTO creates additional incentives for Vietnam to become a member. Competition with China’s exports in third markets will intensify as a result of China’s accession to WTO. Vietnam is expected to be especially affected by the abolition of quotas on Chinese textile and apparel exports, starting in 2005. Also, China’s WTO accession will improve China’s business environment which could divert away Foreign Direct Investments (FDI) from countries with a similar comparative advantage, including Vietnam. Box 3 provides a more detailed analysis of the impacts of China’s WTO accession on Vietnam.

¹⁷ On September 2001, the EU unilaterally required chloreramphenicol tests for shrimps imported from Vietnam generating considerable losses to Vietnam shrimp exporters.

¹⁸ On June 2002, the Catfish Farmers of America and individual U.S. catfish processors filed a petition for an antidumping investigation on imports of certain frozen fish fillets from Vietnam. In November 2002, the U.S. Department of Commerce decided to classify Vietnam as a non-market economy for the purposes of antidumping and countervailing duty proceedings. As the result of this decision, in making the dumping determination, the U.S. Department of Commerce will not use prices and costs that prevail in Vietnam but instead use those which prevail in a surrogate country. Full ruling is available on the web-site: <http://www.ia.ita.doc.gov/download/vietnam-nme-status/vietnam-nme-status.htm>

¹⁹ Canada has classified Vietnam as a non-market economy in relation to the garlic dumping suit.

²⁰ On April 2002, the Shoe Manufacturers’ Association of Canada filed a suit against imports of waterproof footwear originating from Hong-Kong, China; Macao, China and Vietnam arguing that these items have caused or are threatening to cause injury. Canada classified Vietnam as a non-market economy in relation to the garlic dumping suit.

²¹ On May 2002, the European Federation of Lighter Manufacturers filed an anti-dumping suit against cheap imports of disposable gas-fueled pocket lighters from China, Indonesia, Malaysia and Vietnam.

²² The Uruguay round reform commitments in the area of agriculture are embodied in two related agreements: the Uruguay round Agreement on Agriculture (URAA) and the Sanitary and Phytosanitary Agreement (SPSA). The URAA contains the new rules and commitments in the key areas of export subsidies, domestic support and market access while the SPSA establishes general guidelines for animal and plant health regulations as they related to international trade in agricultural products. Although the SPSA reaffirms the right of countries to set their own safety and health standards, it aims to minimize the likely trade-impeding impact of SPS regulations. A new WTO Committee on SPS measures for speedy settlement of disputes that arise in the implementation of the SPSA has been established.

²³ The present WTO member countries determine the “terms of accession.” In order to develop the global trade system new members have to adopt the highest standards when liberalizing their trade regime. Therefore, the expected commitments usually exceed by far those of the established WTO-members.

Consequently, Vietnam may want to make special efforts to accelerate WTO accession. Currently, Vietnam accession process seems stalled.²⁴ This may appear as surprising given the fact that (i) Vietnam's political leadership seems to indicate that WTO accession is a key priority, (ii) Vietnam would greatly benefit from rapid WTO membership, particularly in the context of China's recent accession, and (iii) USBTA negotiations have exposed Vietnam policy makers to a process similar to that of the WTO.

In the end, implementation of trade reform is a testing ground that reveals the extent of Vietnam's commitment to a market economy. Vietnam is faced with competing pressures. On one side, proponents of the status-quo resist the implementation of trade reform because of its implications on other segments of the economy including SOEs and SOCBs. On the other side, proponents of a market economy encourage expedited implementation of trade reform including accession to WTO. The large cohort of young Vietnamese that join the labor force each year will, in the end, make the balance tilt.

²⁴ The initial offer on specific commitments in services made in January 2002 fell short of key commitments under the USBTA. Bilateral negotiations are scheduled to begin with the EU and Japan in 2002 but negotiators in Geneva seem little optimistic about the process outcome.

Box 2: China: One Year into the WTO Process

This Box contains excerpts from a speech "China: One Year into the WTO Process" by People's Republic of China's Vice Minister of Finance, Jin Liquan, delivered at the World Bank on October 22, 2002 (Video and full text of the Vice Minister's remarks are now available on-line at: <http://www.worldbank.org/wbi/B-SPAN/>). This speech which describes the opportunities and challenges faced by China may be of interest to Vietnam in its accession to WTO.

"Since accession, the government has taken a number of actions required of a WTO-member.

The past year has been a year of improving the legal framework. The Congress has made or amended new laws and the government has done the same with its ordinances.

The past year has been a year of training. A series of training courses have been arranged for senior officials at the central and local levels to learn about WTO and China's rights and obligations as a member.

The past year has been a year of implementing the commitments.

- Upon accession, the government took prompt actions to implement tariff reductions and to abolish a number of non-tariff barriers for 2002 as pledged. As of January 1st 2002, a reduction in average tariffs from 15.3 percent to 12 percent became effective, involving 5,300 tariff items, covering 73 percent of the tariff schedule.
- The government has done a great amount of work to open the services market in accordance with the WTO commitments. Some foreign banks have started to negotiate with the Chinese banks for M&A deals. And foreign financial institutions have been invited to form joint ventures to dispose NPLs taken away from the four major commercial banks.
- In some areas, the openness of the services market is even ahead of the timetable for the first year of membership. For example, foreign insurance companies are allowed to open business in Beijing and Tianjing. Some foreign retail branches are negotiating with their Chinese counterparts to take a majority share in their equity. From July this year, foreign travel agents have started to form joint ventures or set-up wholly-owned subsidiaries in Shanghai.
- Laws and regulations on the protection of intellectual property rights have been reviewed or amended in line with the TRIP Agreement.

The past year has been a year of improving the enabling environment for the country to function as a WTO member.

- China has joined the General Data Dissemination System (GDDS) of the IMF, and is taking concrete measures to improve the accounting standards and information disclosure in related sectors.
- To enhance transparency, a new office, WTO Notification and Enquiry Center, has been established, whose duty is to report on the implementation of WTO protocols and answer inquiries on WTO-related matters.

We are encouraged to see that the head-on competition has spurred technological upgrading and restructuring in many sectors such as the auto sector, resulting in marked improvement in efficiency.

However, tough challenges remain to be tackled.

- Since the beginning of this year, a number of sectors and products began to feel the pressure of WTO obligations, particularly in steel, petrochemicals and agriculture.
- We are faced with a resurgence of protectionism in industrialized countries.
- Implementing WTO tariff schedules has led to a decline in our state revenues. In the first six months of this year, revenues from custom duties and import-related VAT taxes decreased by 7.5 percent.

Although these policies [may] not seem directly relevant to WTO obligations, the major policy responses to meet the challenges are:

- Deepening the public finance reform including delinking revenues from expenditures to eradicate abuses or even outright corruption.
- Accelerating financial sector reform.
- Accelerating the restructuring of the agriculture and rural economy.
- Investing in people and creating job opportunities. Intensifying protection of eco-environment.

Box 3: Impact of China's WTO Accession on Vietnam

China's accession to WTO presents both opportunities and challenges for East Asian economies and Vietnam in particular. Its impacts will be felt through a number of channels:

1. Increased overall welfare. A decline in China's protection would push the production possibility frontier outward leading to an overall gain in welfare. However, China's large size may also shift the terms of trade with possibly negative impact on third countries including Vietnam. Also, factor price equalization is expected to put a downward pressure on unskilled wages in third countries including Vietnam which may increase inequality.
2. Insignificant impact on Vietnam's aggregate export level. China's commitments to abolish non-tariff barriers and reduce tariffs (from an average of 13.3 percent in 2001 to 6.8 percent at the end of the implementation period) will fuel trade with the rest of the world. However, China's accession to WTO is expected to have an insignificant overall impact on Vietnam's exports: the increase in Vietnam's exports to China is expected to be more than offset by substitution of third-country imports away from Vietnam.
3. Significant impact on Vietnam's export level and composition to China. Increased access to China's market is expected to stimulate exports from Vietnam across most industries including rice production, food processing industry, light manufacturing, metals and petrochemicals, and electronics.
4. Significant impact on Vietnam's export composition to third markets. Competition with China's exports in third markets will intensify as a result of China's accession to the WTO. This will hold especially for countries like Vietnam that have similar comparative advantage in labor intensive products. Vietnam exports level to third countries is expected to decline. For example, Vietnam's textile and garment industry (16 percent of total exports) will be directed affected by the abolition of quotas on Chinese textiles and apparel exports to the US and the EU starting in 2005, which leaves Vietnam with only 3 years to establish itself in the US market for apparel. China's WTO accession is expected to lead to a substantial decline in Vietnam's apparel exports and production by 2010 (the most significant decline is expected to occur around 2005 when quotas on Chinese apparel are removed).
5. Increased transparency and predictability of China's trade policy. As general WTO policy rules require member countries to publish trade rules and regulations, China's trading partners will benefit from the increased transparency and predictability of China's trade policy. The specific commitments involve uniform application of the trade regime, independent judicial review and a mechanism to bring problems of local protectionism to the attention of the central government. Access to China's market will be more secured and disputes will be resolved following international standards, an important benefit to China's trading partners including Vietnam.
6. Increased China's attractiveness as a destination for Foreign Direct Investment (FDI). The opening of the service sector including telecommunication, distribution, banking, insurance, asset management, and securities to foreign direct investment as well as the provision of national treatment to foreign funded enterprises may represent the most significant part of China's accession to WTO. Entry into the WTO will require China to amend its laws, regulations and practices to align them with a number of international investment-related rules: the General Agreement of Trade in Services (GATS), the Agreement on Trade-Related Investment Measures (TRIMS), and the Agreement on Trade-Related Intellectual Property Rights (TRIPS). The GATS, for example, requires members to provide MFN treatment and transparency on trade in services. China will also be required to abide by international standards in the protection of intellectual property and increase transparency in legislation formulation and justice practice, which should encourage further FDI into China. As China improves its business environment, FDI may be diverted away from other countries including Vietnam. Foreign investment to Vietnam may decline by as much as 30 percent by 2010 as the result of China's accession with negative impacts on economic growth.
7. Increased bargaining power of developing countries in the WTO. China's accession to the WTO will strengthen the voice of developing countries and East Asian countries in particular in this international forum. Also, Vietnam can learn from China's experience in accessing the WTO which could facilitate its own accession.

Source: Adapted from Ianchovichina, Suthiwart-Narueput and Zhao (2002)

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Annex 1: Major Changes in Trade Policy since *doi moi*

Year	Objectives			
	Increase numbers of FTCs	Develop trade policy instruments	Remove exchange rate distortions	Become a member of international trading arrangements
1988	<ul style="list-style-type: none"> Restrictions on establishment of foreign trading organizations relaxed and central government monopoly of foreign trade terminated 	<ul style="list-style-type: none"> Adoption of the Law on Import and Export Duties 	<ul style="list-style-type: none"> Foreign exchange control decree liberalizes retention foreign exchange, opening of foreign currency accounts, use of transfers to pay for imports and repay foreign loans 	
1989	<ul style="list-style-type: none"> Requirement that SOEs fulfill CMEA export targets before exporting to convertible currency area removed Producers of exportable goods allowed to sell them to any appropriately licensed foreign trade company 	<ul style="list-style-type: none"> Quotas removed on all but ten export and 14 import commodities (subsequently reduced to seven export and 12 import commodities) Number of export commodities subject to export duties reduced from 30 to 12 and most rates reduced Number of import commodities subject to duties reduced from 124 to 80, range of rates expanded from 5-50 percent to 5-120 percent All budgetary export subsidies removed 	<ul style="list-style-type: none"> Foreign exchange rate system unified 	
1990	<ul style="list-style-type: none"> General export-import companies required to register with regulatory organization for individual commodities Exports of certain commodities limited to members of relevant exporters associations 	<ul style="list-style-type: none"> Special import duties imposed on selected goods such as mopeds and tourist vehicles 		
1991	<ul style="list-style-type: none"> Private companies allowed to directly engage in international trade 	<ul style="list-style-type: none"> Export duty on rice reduced from 10 percent to 1 percent Imported inputs used to produce exports exempted from duty 	<ul style="list-style-type: none"> Foreign exchange trading floors opened at SBVN 	
1992		<ul style="list-style-type: none"> Harmonized System (HS) of tariff nomenclature introduction 		<ul style="list-style-type: none"> Trade agreement signed with European Union (EU) establishes quota on exports of textile and clothing to EU and grants tariff preference on selected imports from EU
1993		<ul style="list-style-type: none"> Export shipment licensing relaxed – six monthly licenses issued for 22 export commodities 90 day duty suspension system for inputs into export production introduced Tariff and revenue laws amended to add 		<ul style="list-style-type: none"> Vietnam joins Customs Cooperation Council

Year	Objectives			
	Increase numbers of FTCs	Develop trade policy instruments	Remove exchange rate distortions	Become a member of international trading arrangements
		<ul style="list-style-type: none"> provisions for other than normal importation (such as, goods in transit) United Nations (UN) Layout key for customs declaration adopted 		
1994	<ul style="list-style-type: none"> Steps in process of licensing to engage in international trade reduced from three to two Export shipment licensing further relaxed – completely lifted for all commodities except rice, timber and petroleum 	<ul style="list-style-type: none"> Elimination of import permits for all but 15 products Duty exemption system for exports extended to suspend duty payments for 90 days 		<ul style="list-style-type: none"> Vietnam gains GATT observer status
1995	<ul style="list-style-type: none"> Requirement for importers to get import permits on a by shipment basis eliminated for a wide range of consumer and producer goods 	<ul style="list-style-type: none"> Coverage of export quotas reduced to one commodity – rice Export tax rates raised on 11 products Range of goods subject to management by import quota reduced to seven 		<ul style="list-style-type: none"> Vietnam joins ASEAN and accedes to protocols of membership of AFTA 1996 list of goods under the common effective preferential tariff (CEPT) for AFTA promulgated (involves no change in duties)
1996		<ul style="list-style-type: none"> Maximum tariff rate reduced to 80 percent special sales tax imposed at rates up to 100 percent on imported (but not locally produced) passenger cars following reduction in tariff rate Import-export policy decision for 1996 reduces number of goods managed by import quota to six 	<ul style="list-style-type: none"> Inward foreign exchange remittance tax lifted 	<ul style="list-style-type: none"> List of commodities under CEPT of AFTA for 1997 promulgated
1997		<ul style="list-style-type: none"> Imports of sugar prohibited. Number of goods subject to import quotas to achieve natural balances increases Temporary prohibitions imposed on imports of wide range of consumer goods then lifted 		
1998	<ul style="list-style-type: none"> Licensed exporters allowed to export any non-regulated export products, regardless of whether the goods are specified in their license Producers of all non-regulated export products allowed to export directly, rather than through a trading company 	<ul style="list-style-type: none"> Highest tariff rate reduced to 60 percent Management of imports of most consumer goods shifted to tariffs rather than quotas or licensing Restrictions imposed on imports of alcohol Use of minimum price list for valuation of imports by foreign invested enterprises terminated Amendment to import/export tax law introduces 3-schedule tariff, and provision 	<ul style="list-style-type: none"> Forward and swap foreign exchange transactions authorized Partial surrender requirements imposed on enterprises holding foreign exchange accounts 	<ul style="list-style-type: none"> Informal road map of CEPT tariff reductions to 2006 issued List of commodities under CEPT for 1998 promulgated, completing coverage of inclusion list

Year	Objectives			
	Increase numbers of FTCs	Develop trade policy instruments	Remove exchange rate distortions	Become a member of international trading arrangements
		for antidumping and countervailing duty		
1999			<ul style="list-style-type: none"> Encouraged trading activities by reducing the foreign exchange surrender requirement from 80 percent to 50 percent of foreign exchange earnings 	
2000		<ul style="list-style-type: none"> Removed quantitative import restrictions on 8 out of remaining 19 groups of products i.e. including fertilizer, liquid soda, ceramic goods, plastic packaging, DOP plasticizer, ceramic sanitary ware, electric fans, and bicycle 		<ul style="list-style-type: none"> Signed a bilateral trade agreement with the US in July paving the way for MFN access of Vietnamese exports to the US market, gradual opening up of Vietnam's economy, for goods and services as well as investments
2001	<ul style="list-style-type: none"> Permitted all legal entities (companies and individuals) to export most goods without having to acquire a special license by revising the implementing decree of the Trade law 	<ul style="list-style-type: none"> Removed QRs multilaterally on all tariff lines of the following groups of products liquor, clinker, paper, floor tiles, construction glass, some types of steel, and vegetable oil 	<ul style="list-style-type: none"> Reduced the foreign exchange surrender requirement from 50 to 40 percent 	<ul style="list-style-type: none"> Moved 713 tariff lines from the Temporary Exclusion List (TEL) to the Inclusion List (IL)
2002			<ul style="list-style-type: none"> Reduced the foreign exchange surrender requirement from 40 to 30 percent (May 2002) 	<ul style="list-style-type: none"> Detailed a list of goods and tax rates for implementing the Agreement on the Common Effect Preferential Tariffs (CEPT) Scheme of ASEAN countries for the year 2002 Based on the schedule, 481 items were moved in to Inclusion list with tariff lower than 20 percent. To date there are 5558 lines in the Inclusion List, 770 in the Temporary Exclusion List, 53 in the Sensitive Agricultural List and 139 in General Exclusion List Issued the implementing decision for the USBTA, including guidelines for responsibilities and actions (Decision no. 35/2002/QĐ-TTg March 12, 2002) A Government negotiation team started working sessions on WTO accession in Geneva (April 2002)

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