

YEMEN ECONOMIC UPDATE

Yemen Economic Update is a quarterly report that consists of five sections. The first section highlights major economic and policy developments. The second section provides "flash indicators" for key economic variables that are available on a monthly or quarterly basis from the Government of Yemen. The third section uses different data sources to compare one development indicator in Yemen with other countries in the MENA region and countries with similar GDP per capita and population. The fourth section summarizes new legislation, publications, data, conferences, and donor activities. The fifth section provides contact information and recent World Bank operations and activities in Yemen. Occasionally, special topics are featured in the Update.

FALL 2003

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<http://www.worldbank.org/ye/>
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Economic and Policy Developments

(i) Key Policy Developments:

The third quarter of 2003 witnessed strong efforts by Yemen to strengthen *economic cooperation*. The 15th session of the Yemeni-Saudi Coordination Council concluded in Sana'a, in July 2002, with the signing of seven agreements and executive programs. The agreements covered areas such as tourism, education and vocational training, export promotion and investment protection, foreign policy and security. Areas for future cooperation were also discussed covering issues such as electricity connections, customs, taxation, oil and minerals.

Following two visits by the Iranian President and the Emir of Qatar earlier in the year, *President Saleh visited France and Germany* to foster cooperation with the European countries. He also paid a visit to Ethiopia in late July for the promotion of the *tripartite regional group* (Yemen, Ethiopia and Sudan). The main objective of the newly established regional group is to enhance security and stability in addition to consolidating economic and political cooperation.

In August 2003, Yemen launched its *initiative to overhaul the Arab League*. The Yemeni initiative calls for the establishment of the Arab Union with a supreme council, ministerial councils, a parliament and a justice court.

On the domestic front, the third quarter of the current year was marked by extensive work on the *preparation of the 2004 budget and the finalization of the Government program* for the short- and medium-terms following Parliamentary approval of the overall program. Strong reform measures are widely expected to be implemented in the last quarter of 2003.



Prince Sultan with PM Ba-Jammal in Sana'a.
Photo by M. Al-Qadhi
<http://www.yementimes.com/>

On judicial reforms, President Saleh issued two decrees (No. 18/2003 and 19/2003) to establish two specialized tax courts in Sana'a and Aden and several specialized commercial courts in the capitals of Sana'a, Aden, Taiz, Al-Hodeidah and Hadhramout governorates.

Parliament debated in September 2003 amendments to the Civil Service Fund Law. The proposed amendments aim to speed up implementation of the ongoing *Civil Service Reform program*. The proposed amendments focus the role of the fund on retrenchment and reallocation of civil servants after completion of re-engineering and restructuring of the civil service departments. The fund will not be required to take part in training activities of excess labor.

The Government has also made progress in accelerating *private provision of infrastructure*. In September 2003, the Ministry of Electricity started the process of selecting a private company that will generate electricity, using gas turbines, in Safir district (Marib Governorate) with a capacity of 300 megawatts. About 8 companies submitted their bids this year.

President Saleh inaugurated the opening session of the general conference for the *Yemeni National Women's Union*, which took place in Sana'a during 8-10 September. The President praised the union and its role as an essential component of Yemen's civil society.

(ii) Economic Developments:

The Central Statistical Organization (CSO) has recently updated national accounts. Based on these estimates, *GDP growth decelerated in 2002 to 3.6%* (down from 4.4% in 2000 and 4.7% in 2001). Slower economic growth in 2002 was mainly due to a small decline in the value added of the oil sector, a large decline in the value added of financial services, and a deceleration in agricultural output. The leading sectors in GDP growth in 2002 were construction, manufacturing, public utilities, transport, domestic trade, dwellings and government services.

The end of year inflation rate declined markedly to 4.3% in 2002 (while average monthly inflation stood at 12.6%). Inflationary pressures, however, intensified in the first quarter of 2003 (averaging 12.3% in the first three months). The easing of fiscal and monetary policies and seasonal factors were behind price increases. *Inflation rates, however, returned to single digits during April-July 2003 but picked-up to 10.5% in August 2003.*

In 2003, relatively higher oil prices are expected to have favorable effects on the balance of payments. In the first quarter of 2003, *the current account surplus was US\$ 78 million* (with merchandise exports totaling US\$ 1 billion and imports rising to US\$ 0.86 billion). The deficit of the services balance, however, widened due to increase in transport and insurance payments. Unrequited transfers grew slightly in the quarter reaching US\$ 317 million up from US\$ 302 million. During the same quarter, *the capital and financial account turned to a small surplus* (US\$ 24 million) in comparison with a deficit of US\$ 22 million in the same quarter last year. *The overall balance of payment in the first quarter of 2003 was US\$ 178 million in comparison with US\$ 6 million during the same quarter in the previous year.*

The fiscal deficit in 2002 was estimated at 0.3% of GDP (on a cash basis) and 2.1% on a commitment basis following two years of high fiscal surplus. The budget deficit in the first half of 2003 was smaller than projected, thanks to high oil prices (See Flash Indicators). The fiscal stance, however, is likely to deteriorate in 2003 and beyond unless fiscal adjustment starts in earnest.

Interest rates on savings and deposits remained unchanged at 13% since July 2000. Lending rates, however, rose slightly from 15-20% range in the last two years to 15-21% range since October 2002. The 3-month treasury bill rate averaged 12% during January-June 2003.

Foreign reserves continued to build up in 2002 and the first three quarters of 2003. They increased from US\$ 4.4 billion by end of 2002 to US\$ 4.9 billion by July 2003. The exchange rate, which depreciated by about 4% in 2002, depreciated sharply in January 2003 but has since then

stabilized at about US\$/YR 183 in February and March 2003. *During the second and third quarters of 2003, the exchange rate has remained stable at about the rate of US\$/YR 184* (see the Flash Indicators Section).

Tourism activities picked up in the summer of 2003. The number of visitors was estimated to have increased by about 7.5% in comparison with last year. Most of the visitors to Yemen in 2003 have been from neighboring countries.

(iii) Other Economic News:

- On August 19th, the Government signed an agreement with the Korean Development Fund for Economic Cooperation (represented by the Korean Export and Import Bank) by which Yemen will receive US\$ 30 million credit to finance the expansion of the rural telecommunication network. The Public Telecommunications Corporation will contribute US\$ 9.4 million towards the project;
- Bids for building Marib Electricity station and electricity transfer lines to Sana'a were received from more than 30 international companies. Selection is expected to be made this month. Estimated time for constructing the station is 24 months (with an expected cost of about US\$ 152 million), and estimated time for erecting power lines is 32 months;
- An agreement was signed between the Ministry of Public Works and the Chinese Company for Road and Bridge Constructions for implementation of the third phase of the Sana'a-Marib highway maintenance for the total cost of YR 400 million;
- Preparations for establishing the new oil refinery in Mukallah City of the Arab Sea coast are underway. It will be managed by the Hadhramout Oil Refineries and will start its production at the capacity of 50,000 barrels per day in 2006. Estimated construction cost of the project is US\$ 450 million;
- Hadhramout Oil Refineries, the first private refinery in Yemen, and the South Korean Samsung company have signed an agreement according to which Samsung will market 8.8 million tons of oil from the refinery over 10 years worth US\$ 1.2 billion;
- Aden Oil refinery produced total of 2.39 million tons of oil during the past seven months. The refined oil was produced from 3.83 million tons of local and foreign crude oil unloaded at the refinery docks during January-July 2003;
- On August 25th, the Supreme Tender Board held a meeting that approved a number of tenders related to development and service projects for the total amount of YR 968.5 million, □ 419,522 and US\$ 904,017.

Flash Indicators

(i) GDP:

The GoY re-estimated GDP growth in 2002 to have reached 3.6%. The CSO recently released national accounts that revised GDP figures for the period 1999-2002. According to these figures, GDP grew by 4.4% in 2000 and 4.7% in 2001 before decelerating in 2002. The leading sectors in GDP growth in 2002 were construction, manufacturing and public utilities (in industrial sector with each recording a growth rate of more than 4%) and transport, domestic trade, dwellings, government services and other services (in the services sector with each recording a growth rate of more than 4%). Agriculture value added decelerated from 6% in 2001 to 3.4% in 2002 (mainly due to lower rainfall). The value added of the mining and quarrying (mainly oil) sector declined by 0.2% in 2002. Financial services also witnessed a decline in value added of about 10% in 2002.

TABLE 1: YEMEN: GDP GROWTH ESTIMATES, 2000-2002 (%)

	2000	2001	2002
	<i>Estimates</i>		
Agricultural Sector	4.2	5.9	3.6
Industrial Sector	6.8	2.5	1.7
Construction	3.8	2.4	4.5
Gas, Electricity & Water	4.5	7.3	4.3
Mining & Quarrying	9.4	1.9	-0.2
Manufacturing	2.3	3.3	4.8
Services Sector	3.4	5.3	4.5
GDP	4.4	4.7	3.6

Source: Central Statistical Organization (CSO), August 2003.

The updated national accounts show that the structure of GDP has changed in the period between 1990 and 2002. The share of the agricultural sector in GDP has declined from about a quarter to about one-sixth of GDP. The share of the industrial sector rose sharply from 25% to about 40% (mainly due to increase in the oil value added) while the manufacturing sector shrunk from 8% to 5% of GDP during the same period. With the increase in oil production, the services sector share in GDP declined from half to about 44% during the same period.

(ii) Government Finance:

Initial figures from the Ministry of Finance (MoF) indicate that actual budgetary performance in 2003 was better than planned with total actual deficit in the first half of the year reaching YR 19 billion compared to a planned deficit of YR 40 billion (Table 2).

TABLE 2: FISCAL STANCE IN THE FIRST HALF OF 2003 (Millions of YR)

	Q1		Q2		Total Projected (Q1 & Q2)	Total Actual (Q1 & Q2)	Difference
	Projected	Actual	Projected	Actual			
Current Revenues	137,731	150,944	137,730	166,840	275,461	317,784	42,323
Capital Revenues	71	324	72	98	143	422	279
Grants	3,861	1,969	3,861	0	7,722	1,969	-5,753
Total Revenues	141,663	153,237	141,663	166,938	283,326	320,175	36,849
Current Spending	116,085	112,731	116,086	129,018	232,171	241,749	9,578
Capital Spending	37,220	36,042	38,593	48,940	75,813	84,982	9,169
Net Lending	7,628	3,381	7,627	9,391	15,255	12,772	-2,483
Total Spending	160,933	152,154	162,306	187,349	323,239	339,503	16,264
Fiscal Balance	-19,270	1,083	-20,643	-20,411	-39,913	-19,328	20,585

Preliminary Data obtained from the Ministry of Finance (MoF).

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While total spending exceeded planned targets by about YR 16 billion in the first half of the year, the improved budgetary performance was solely attributed to increases in revenues by about YR 37 billion over planned targets. Grants fell below those planned by about YR 6 billion while capital revenues were higher than the planned targets. With regard to spending allocations, both current and capital spending were higher than those targeted in the 2003 budget by about YR 9 billion each. On the other hand, net lending was YR 2.5 billion lower than planned targets in the first half of 2003.

In late September 2003, the Cabinet approved a budget supplement for the 2003 budget amounting to YR 108 billion mainly for investment spending. Therefore, expected deficit for the whole of 2003 is likely to be larger than earlier planned despite increases in fiscal revenues. It should be noted that most of the government spending takes place in the second half of the year as evidenced in comparing actual fiscal performance during first half of the year in the previous years (see previous issues of the update).

(iii) External Sector

Based on new figures on the Balance of Payments, the overall balance of payment recorded a surplus of about US\$ 0.6 billion in 2002 (down from US\$ 0.7 billion in 2001 and US\$ 1.4 billion in 2000). Merchandise exports increased markedly in 2002 (about US\$ 3.6 billion of which oil exports were US\$ 3.2). However, merchandise imports also rose by about US\$ 0.3 billion reaching about US\$ 3.0 billion in 2002. The service balance deficit widened in 2002 to US\$ 0.75 billion (in comparison of US\$ 0.67 billion in 2001) and the income balance also deteriorated by about US\$ 75 million in 2002 due to the increase in transportation and insurance payments (See Table 3).

TABLE 3: BOP IN YEMEN, 1998-2003 (US\$ MN)

	1998	1999	2000	2001	2002	Q1 2003
I- Current Account	-318	550	1337	671	410	78
1. Trade Balance	-785	358	1313	767	687	158
Exports	1504	2478	3797	3367	3619	1018
Non-oil exports	275.	347	398	462	473	166
Crude Oil	1229	2131	3399	2905	3147	852
Imports	-2289	-2121	-2484	-2600	-2932	-860
2. Services balance	-519	-536	-599	-678	-751	-205
Service Receipts	174	183	211	170	165	38
Service Payments	-693	-719	-809	-848	-916	-243
Transportation, net	-262	-243	-318	-329	-372	-108
Travel, net	-46	-75	3	-40.7	-40	-12
Communications, net	18	41	45	40.2	40	9
Construction, net	-94	-125	-51	-38.7	-30	-5
Insurance, net	-52	-48	-57	-59.1	-67	-20
Other net business services	-79	-80	-205	-233.6	-269	-60
Other net Government services	-3	-5	-16	-16.5	-15	-9
3. Income balance	-344.4	-695.6	-777.1	-690.9	-765.6	-191.2
Income Receipts	69.0	56.7	149.6	178.5	135.0	27.6
Income Payments	-413.4	-752.3	-926.7	-869.4	-900.6	-218.8
4. Current transfers balance	1329.7	1422.9	1399.5	1273.0	1239.1	316.6
II- Capital and Financial account	-415.0	-391.4	-233.7	96.5	57.4	23.6
1. Financial account balance	-415.0	-391.4	-233.7	96.6	57.6	23.6
1.1 Direct investment	-219.4	-307.6	6.4	135.5	64.3	-23.4
Of which Oil company investment	-214.1	-233.9	6.4	135.5	64.3	-23.4
1.2. Other investment	-195.6	-83.8	-240.1	-38.9	-6.9	47.0
1.2.1. Government Loans (net)	-63.3	27.1	-55.5	-33.1	39.1	0.4
1.2.2. Trade Credits	-116.5	-119.4	-17.7	75.6	-57.6	-37.9
1.2.3. Commercial Banks	-15.8	8.5	-166.9	-101.1	-161.6	41.2
1.2.4. Other Sectors	0.0	0.0	0.0	19.7	173.2	43.3
III- Errors and Omissions	277.8	110.6	285.6	-114.2	129.7	76.4
Overall balance	-455.5	268.9	1388.5	653.2	597.4	178.4

Source: CBY, August 2003.

Unrequited transfers in 2002 (US\$ 1.2 billion) were basically at the same level as in 2001. Therefore, the current account balance declined from US\$ 0.67 in 2001 to US\$ 0.4 billion in 2002.

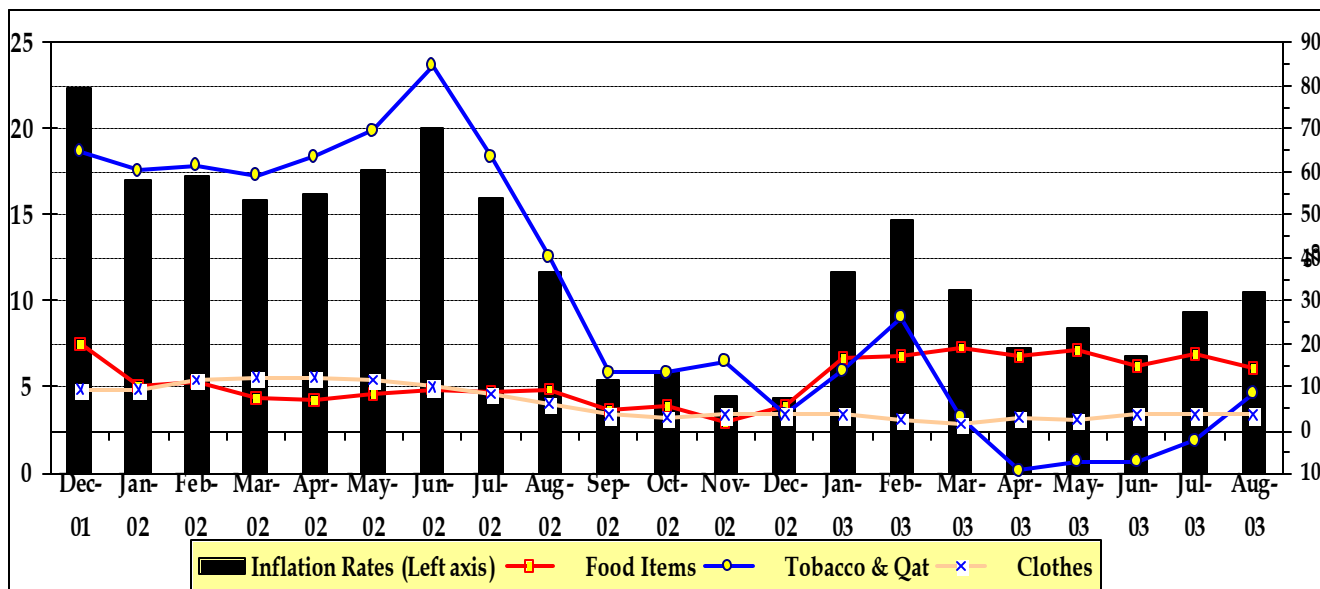
The surplus of the financial and capital accounts declined from US\$ 97 million to only US\$ 57 million, mainly as a result of a decline in direct investments (FDI). Repayments of government loans continued to decline from about US\$ 225 million in 1998, to US\$ 190 million in 2000, and further to US\$ 110 million in 2002.

In 2003, relatively higher oil prices are expected to have favorable effects on the balance of payments. Based on preliminary data of the first quarter of 2003, the current account surplus was US\$ 78 million. Merchandise exports totaled US\$ 1 billion in the quarter in comparison with US\$ 0.77 billion in Q1 2002. Imports also continued to pick up reaching US\$ 0.86 billion (compared with US\$ 0.68 billion in Q1 2002). The deficit of the services balance, however, widened in Q1 2003 to US\$ 205 million (compared with US\$ 174 million in Q1 2002) due to increase in transport and insurance payments. Unrequited transfers grew up slightly in Q1 2003 reaching US\$ 317 million up from US\$ 302 million in Q1 2002. During the same quarter, the capital and financial account turned to a small surplus (US\$ 24 million) in comparison with a deficit of US\$ 22 million in Q1 2002. The overall balance of payment in the first quarter of 2003 was US\$ 178 million in comparison with US\$ 6 million during the same quarter in the previous year.

(iv) Inflation:

Inflationary pressures eased in the third quarter of 2002 and returned to single digit starting September 2002 until the end of the year. For the whole year, average monthly inflation rate increased slightly from 11.9% to 12.6%. End of year inflation rate, however, declined to 4.3%.

FIGURE 2: MONTHLY INFLATION RATES, 2002-2003



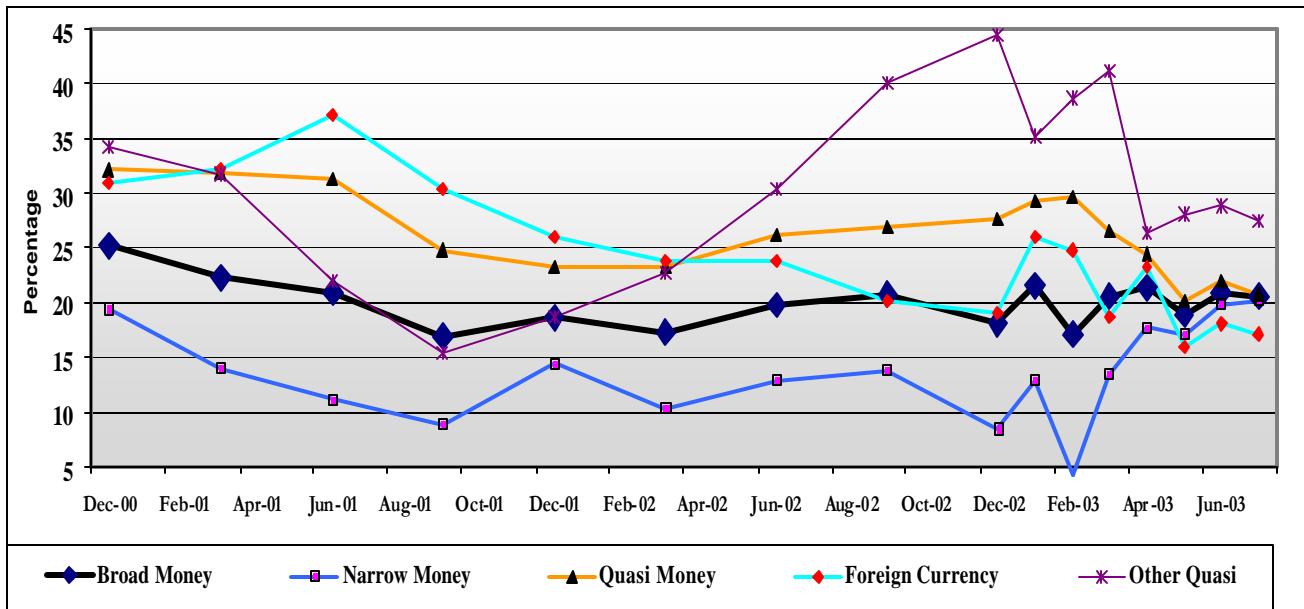
In the first quarter of 2003, inflation rates rose to double digits (averaging 12.3% a month) mainly due to expansion of monetary and fiscal aggregates before Parliamentary elections. In particular, rapid increase in the prices of food items (particularly imported ones) and Qat took place. A number of factors contributed to the increase in price levels. These include among others: (i) the easing of

monetary policy in the last half of 2002 and the budgetary supplement approved by end of 2002; (ii) high increases in the price of Qat due to low precipitations; (iii) the depreciation of the exchange rate; (iv) seasonal factors (e.g., Hajj and Eid) and end of financial year; (v) international prices for many imported food items (e.g., wheat) rose since early 2002; (vi) speculative behaviors to benefit from the war in Iraq; and (vii) as a result of the attack on the French Limburg oil tanker, insurance premiums for ships docking at Yemeni seaports have increased and consequently transportation costs have increased. CPI inflation rates (year-on-year) for the months of January, February and March 2003 were 11.6%, 14.7% and 10.6% respectively (Figure 2).

In the second quarter of 2003, inflation rates returned to single digits (7.4% in April, 8.4% in May and 6.7% in June 2003). In addition to the developments on the monetary aggregates, the decline in Qat prices was the major determinant of the decline in CPI inflation. In July 2003, inflation rate rose slightly to 9.3% and picked up in August at 10.5%.

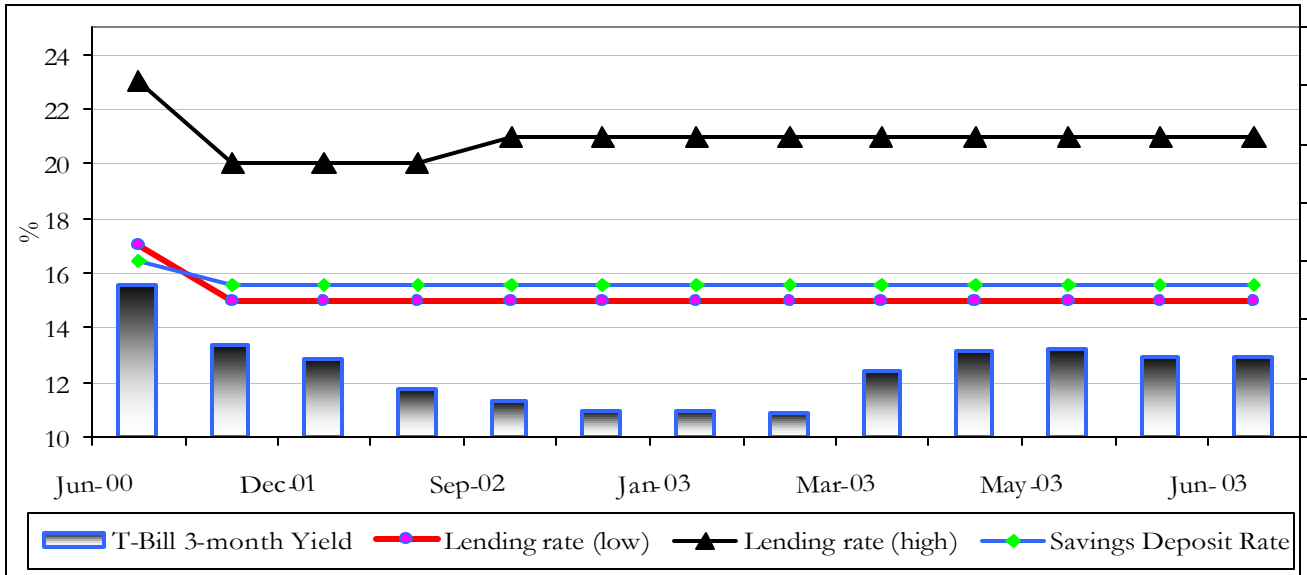
(v) Monetary Aggregates and Domestic Credit:

Monetary aggregates continued to increase rapidly in the third quarter of 2003. The rate of increase of total liquidity (M2) was 21% in July 2003 compared with 21% in June and 19% in May 2003. The rate of increase in narrow money picked up from 17.2% in May to 19.8% in June and further to 20.1% in July 2003. The increase in monetary aggregates could be attributed to fiscal expansion in 2003 and is mostly responsible for the increase in inflation rates observed in the second and third quarters of 2003 (see figure below). Domestic credit also increased from YR 665 billion by the end of 2002 to YR 702 billion by end of the second quarter of 2003.



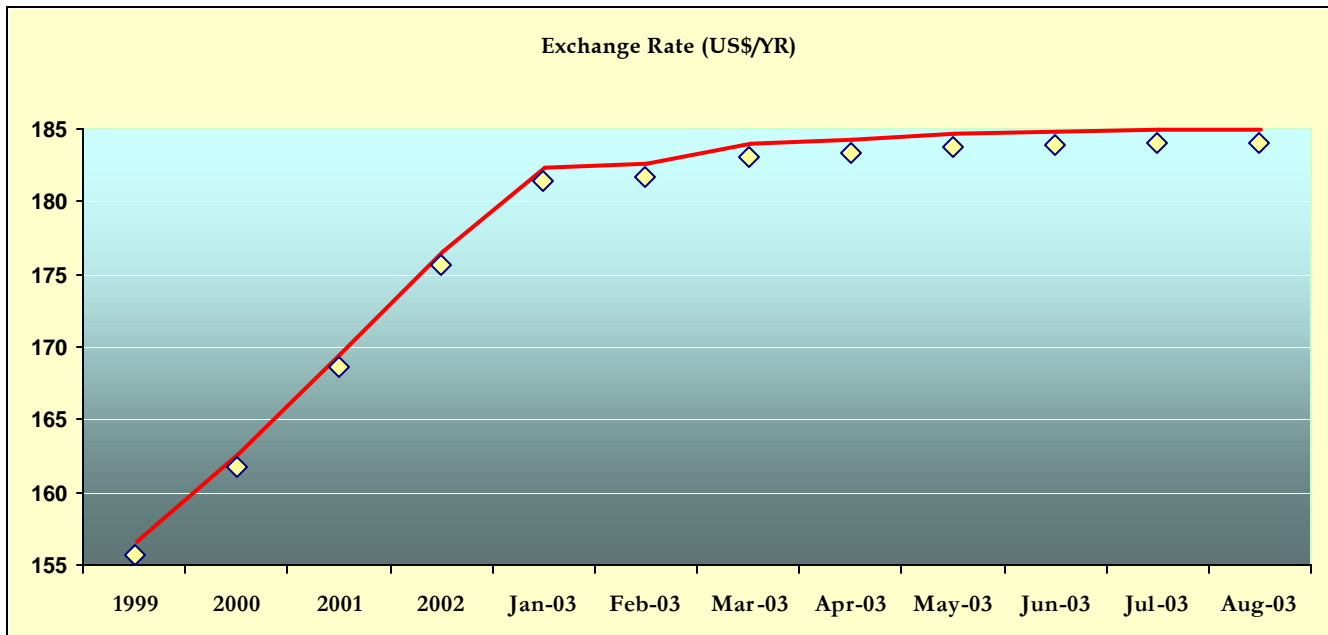
(vi) Interest Rates:

Interest rates on savings and (3 month, 6 month and 1 year) deposits remained unchanged at 13% since July 2000. Lending rates, however, stepped up slightly from 15-20% range in the last two years to 15-21% range since October 2002. The 3-month Treasury bill rate is averaged around 11% during the last six months.



(vii) Exchange Rate and Foreign Reserves:

The exchange rate stabilized at about US\$/YR 184 during March-September 2003. This followed a rapid depreciation in the first quarter of the year (from US\$ 178 in December 2002 to US\$/YR 183 in January-February 2003).



Yemen continued to build strong foreign currency reserves. Due to high oil prices and increased oil production, the level of reserves increased to US\$ 4.9 billion by the end of August 2003 (compared with US\$ 3.7 billion and US\$ 4.4 billion by end of 2001 and end of 2002 respectively). Oil exports (from the government’s share) during January-July 2003 surpassed US\$ 1.0 billion compared with US\$ 1.6 billion for the whole of 2002. This level of foreign reserves covers now more than 16 months of imports of good and services.

Developments in Fiscal Policy and Stance in Yemen

Macroeconomic disequilibria characterized both parts of Yemen (North and South) in the 1980s, mainly due to increasing fiscal deficits. In the southern Peoples Democratic Republic of Yemen (PDRY), government spending as a ratio of GDP increased from an average of 49% in the 1970s to 77% in the 1980s without corresponding increases in government revenues and consequently average fiscal deficit increased from 20% of GDP to 36% over the same period. Similarly, government spending in the northern Yemen Arab Republic (YAR) increased from 16% of GDP in the 1970s to 35% in the 1980s and the fiscal deficit increased from 3% of GDP to 13% over the same period. Most of the deficit in both countries was financed by the central banks, which kept inflation in double digits. External debt also increased in both countries to unsustainable levels. Furthermore, both countries had by the late 1980s, large civil service, loss-making public enterprisers, restrictive trade regimes and overvalued exchange rates.

After unification, the macroeconomic policy mix and outcomes differed radically between the first and the second halves of the 1990s. With the achievement of political stability in mid-1990s, GoY started on an ambitious program for economic reforms and stabilization in early 1995. The program aimed to enhance the foundations of a market-based and private sector led economy. It focused on stabilization, price and trade liberalization, fiscal adjustments and reform of the exchange rate regime. Interest rates were liberalized and monetary policy was tightened. The Yemeni Rial (YR) was devalued substantially, a market exchange regime was introduced and a floating rate regime was adopted in 1996. A number of structural reforms were also implemented. Tariffs were reduced and their structure was simplified. Investment regulations were also streamlined and stricter prudential regulations for banks were introduced. Furthermore, the period 1995-1997 witnessed significant reduction in external debt. Following the rescheduling of Paris Club in 1996, external debt was reduced from 173% of GDP in 1996 to 80% by end-1999 and debt services declined from about 32% of exports earnings to 11% (Table B.1).

TABLE B.1: FISCAL STANCE IN YEMEN, 1990-2002.

(Ratio to GDP, % unless otherwise stated)

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002
Overall Fiscal Balance	-8.6	-3.5	-11.8	-12.8	-14.5	-5.2	-0.9	-1.5	-7.9	0.1	6.2	2.9	-2.1
Total Government Revenues and Grants	19.4	25.3	17.4	15.5	13.4	17.7	30.1	32.9	27.0	29.1	38.7	34.4	33.9
Current Fiscal Revenues	19.0	25.1	16.8	15.2	13.2	17.3	29.1	32.6	26.3	28.1	38.3	33.9	33.5
Capital Revenues	0.4	0.2	0.5	0.3	0.2	0.4	1.0	0.3	0.7	0.9	0.4	0.4	0.4
Tax Revenues	9.0	10.3	9.1	8.8	7.2	8.3	8.9	8.9	9.6	7.8	7.3	7.6	7.5
Direct Taxes	2.3	2.7	2.7	2.8	2.6	2.2	2.3	2.5	3.4	3.0	2.8	3.2	3.6
Indirect Taxes on Goods and Services	4.6	4.0	3.2	2.9	3.2	3.8	4.3	4.9	4.5	4.0	4.1	3.4	2.6
Total Government Expenditure	28.0	28.8	29.2	28.3	28.0	22.9	31.0	34.4	34.9	29.0	32.4	31.5	35.9
Capital Expenditures	5.8	4.4	4.8	3.6	3.4	3.6	6.8	6.7	7.5	6.0	7.4	7.0	8.9
Memo Item: Government Debt	136	174	193	218	252	189	134	81	116	97	67	69	64

The fiscal deficit was very high in the early 1990 reaching 15% of GDP in 1994. With the initiation of fiscal reforms in 1995, the fiscal deficit declined sharply in 1995 to 5% of GDP and was very low during 1996-1997. The decline in oil prices in 1998 pushed the fiscal deficit to 8% of GDP in that year. The deficit, however, turned to small surplus in 1999 and the surplus reached 6% of GDP by 2000. A smaller surplus was realized in 2001 but the budget recorded a deficit of 2% in 2002 following three consecutive years of fiscal surplus.

The observed fiscal stance, and major reduction in fiscal deficit, since the second half of 1990s reflected the following: (i) significant reduction in debt services following the Paris Club rescheduling; (ii) marked increase in fiscal revenues as a result of high oil prices and production levels; and (iii) Government policies to reduce total spending particularly on subsidies and transfers. Fiscal revenues increased from about 19% of GDP in 1990 to 37% of GDP in 2000 mainly due to increase in non-tax revenues (oil revenues). At the same time, the ratio of taxes to GDP has remained stable and indeed declined in the late 1990s and since 2000. The scope for increasing tax revenues in Yemen is very large particularly if a Generalized Sales Tax (GST) is implemented as planned this year.

TABLE B.2: YEMEN'S FISCAL STANCE, 2000-2004 (% OF GDP)

	2000	2001	2002	2003 Plan	2004 Proj.
Total Fiscal Revenues and Grants	38.7	34.4	33.8	34.4	31.1
Fiscal Revenues	37.7	34.1	32.2	33.1	30.7
Oil Revenues	27.7	24.2	22.3	23.3	19.8
Non-Oil Revenues	10.0	9.7	9.9	9.8	10.9
Grants	1.0	0.3	1.6	1.3	0.5
Total Fiscal Expenditures	32.5	31.5	35.9	33.3	32.4
Current Expenditure	27.0	24.4	27.1	27.1	25.0
Development Expenditure	5.4	7.5	8.9	6.2	7.4
Fiscal Balance (Cash basis)	6.2	2.9	-2.1	-1.8	-1.3

The other important development in Yemen has been the large increases in total fiscal spending from 28% of GDP in early 1990s to 36% of GDP in 2002. While there has been modest increase in capital and investment spending, the bulk of the increase was in current spending (wages and salaries, increased allocations for diesel subsidy, defense spending, etc). Diesel subsidy has reached 2.2% of GDP in 2002 and consumption of diesel doubled between 1997 and 2003 (reaching 15 million barrels a year) indicating considerable smuggling to neighboring countries.

In the light of expected decline in oil production in Yemen starting in 2004 (by an average annual rate of 5%) and the weak outlook for oil prices in the short and medium terms, Yemen faces an enormous challenge to maintain fiscal sustainability. This would require more efforts to mobilize non-oil fiscal revenues and to rationalize fiscal spending. This means that non-oil fiscal deficit (which is about 22% of GDP) has to be reducing gradually to ensure fiscal sustainability in the medium and long-terms. Reduction of the diesel subsidy, introduction of the GST tax, improving custom and tax administration, civil service reform and rationalization of non-wage current spending are among the key priorities in the short and medium terms.

The key *pending reforms* that the GoY needs to pursue so as to ensure sustained GDP growth and macroeconomic stability include the following: (i) broadening the tax base through introduction of the GST and improving tax administration; (ii) improving management of public resources and reallocation of resources for pro-growth activities (*e.g.*, investment spending, operations and maintenance, infrastructure and economic sectors, *etc.*); (iv) elimination of diesel and other distorting subsidies; (v) pursuing vigorously civil service reforms. Allocations for investment spending, social sector, maintenance and operations need to be protected and enhanced during the period of fiscal adjustment. The success of the Government program should be judged against progress under the above-mentioned areas. Any delay in pursuing the above reforms will undermine fiscal sustainability and will jeopardize the enormous reforms that Yemen undertook since the mid-1990s. Yemen face the risk of returning back to macroeconomic disequilibria, of the sort that prevailed before unification and the in the early 1990s, unless structural reforms regain their momentum in earnest.

Yemen Compares: Merchandise Exports

The Middle East and North African Region (MENA) of the World Bank published in September 2003 the book entitled “Trade, Investment, and Development in the Middle East and North Africa: Engaging with the World”. The book reviewed the trends and factors that led the MENA region to lag behind other regions in the wave of accelerating trade and exchange. More importantly, the region remains dependent on oil and natural resource exports, tourism, and labor migration while other regions have become essential links in global production chains in manufacturing, technology and other dynamic factors. The Book argues that that expanding trade and investment offers the best hope for generating the requisite growth and jobs. This efforts, however, requires moving decisively away from relying on the public sector and protected national economies as the main engine of growth to relying on more open economies and a competitive private sector.

While on aggregate the MENA region outperformed other regions in terms of exports as a ratio of GDP (29% in 1998), this performance was mainly dominated by oil exports. Non-oil exports in the MENA region represented only 6% of GDP in 1998 compared with 9.4% for South Asia (SAS), 15% for Latin America and Caribbean (LAC), 23% for Europe and Central Asia (ECA) and 31% for East Asia and the Pacific (EAP). Throughout the 1990s, MENA region was the only region to experience stagnant or declining trade and investment flows (See Table A.1).

There are marked differences within the MENA region. In the Maghreb countries (Algeria, Egypt, Morocco and Tunisia), total merchandise exports averaged 16.3% of GDP while non-oil exports stood at 8% of GDP during 1998-2000. This compares with 20% and 5% respectively for the Mashreq countries (Djibouti, Iran, Jordan Lebanon, Syria and Yemen) and with 41% and 5% for the Gulf Cooperation Council (GCC) countries (Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and the United Arab Emirates).

Yemen is among the MENA countries with high ratios of oil exports (32.2% of GDP in 1998-200). Indeed, Yemen comes only after a few GCC countries (Qatar, Oman and Kuwait). The contribution of oil exports to Yemeni GDP exceeded that of Saudi Arabia, Algeria, and Iran. More importantly, the ratio of non-oil exports in Yemen to GDP (at 2.4%) was the lowest in the MENA region (only after Algeria) and in comparison with other countries in other regions of the World.

Agricultural exports as a ratio of GDP in Yemen (1% during 1998-2000) compares with the regional average for the same period. However, a number of Middle Eastern countries outperformed Yemen in terms of agricultural exports despite the countries natural endowments in agriculture and fisheries. The Maghreb countries have high share of agricultural exports to GDP (1.5% in 1998-2000) with Morocco and Tunisia exceeding that average. Countries in the Mashreq region also outperformed Yemen as a group with agricultural exports standing at about 1.4% of GDP with Jordan and Syria having higher rates than the group’s average. Even within the GCC countries, Oman agricultural exports as a ratio of GDP were as twice as those of Yemen during 1998-2000.

The Book suggests that countries like Yemen (labor-abundant and resource-rich) face the challenge of shifting from state-dominated and to open and market-led systems. These countries need to achieve macroeconomic stability at a reasonable price of oil. They need to deal with the distortionary effects of oil rents on traded goods and services. This means managing the booms and bust cycles, avoiding the stop-go cycle of structural reforms and backtracking and progressively reducing the rent seeking effects of oil.

TABLE A.1: MERCHANDISE EXPORTS, 1998-2000

Region/country	Total Merchandise Exports			Oil Exports		Non-Oil Exports			Natural Resources Exports		Agricultural Exports	
	US\$ Bn; 1998 - 2000	US\$ per capita 1998-2000	% to GDP 1998-2000	US\$ Bn; 1998 - 2000	% to GDP 1998-2000	US\$ Bn; 1998 - 2000	US\$ per capita 1998-2000	% to GDP 1998-2000	US\$ Bn; 1998 - 2000	% to GDP 1998-2000	US\$ Bn; 1998 - 2000	% to GDP 1998-2000
MENA	186	704	28.7	112.3	19.8	33.7	132	5.9	114.3	19.6	5.9	1
Maghreb	32	243	16.3	16.3	8.4	15.4	118	7.9	17.3	8.9	2.9	1.5
Algeria	15	494	29.9	14.3	28.9	0.5	17	1	14.4	29.1	0	0.1
Egypt	4	60	4.2	1.3	1.4	2.5	40	2.8	1.5	1.6	0.5	0.6
Morocco	7	259	21	0.2	0.5	7.1	252	20.5	0.9	2.5	1.7	4.9
Tunisia	6	616	29	0.5	2.5	5.3	563	26.5	0.6	2.9	0.6	3
Mashreq	30	282	19.8	22.6	16.9	6.5	64.4	4.9	23.2	15.5	2.1	1.4
Djibouti	0	34	3.9									
Iran	21	332	20.6	17.6	17.4	3.2	52	3.2	17.8	17.6	1	0.9
Jordan	2	389	22.5	0	0	1.8	389	22.5	0.4	5.1	0.2	2.6
Lebanon	1	160	4.2						0.04	0.2	0.1	0.9
Syria.	4	232	22.6	2.5	15.2	1.2	76	7.4	2.5	15.5	0.7	4.3
Yemen, Rep.	3	157	34.6	2.5	32.2	0.2	11	2.4	2.5	32.3	0.1	1
GCC	125	4,366	41.1	73.5	30.6	11.8	472	4.9	73.8	30.7	0.9	0.4
Bahrain	4	6,554	63.1								0	0.2
Kuwait	14	7,156	44.4	10.9	35.1	2.9	1,506	9.4	10.9	35.2	0	0.1
Oman	8	3,349	43.8	6	33.2	1.9	808	10.6	6.1	33.7	0.3	1.9
Qatar	8	1,406	64.6	7.2	58.2	0.8	1,387	6.4	7.2	58.3	0	0
Saudi Arabia	56	2,758	31.2	49.5	27.7	6.3	309	3.5	49.6	27.8	0.5	0.3
U.A.E	35	1,239	62.5									
Non-MENA	1,154	312	23.6	98.4	2	1,055.60	285	21.6	144.7	3	136.1	2.8
LAC	263	654	15.9	20.8	1.3	242.1	602	14.6	36.5	2.2	53.9	3.2
Bolivia	1	139	13.5	0.1	1.2	1	126	12.3	0.4	4.5	0.4	5.1
Chile	15	1,079	23	0.1	0.2	16.1	1,072	22.9	7.2	10.2	5.8	8.3
Colombia	12	285	13.3	4.4	4.9	7.4	179	8.4	4.5	5	3.5	3.9
Costa Rica	6	1,604	39.2	0	0.2	6	1,596	39	0.1	0.5	2	13.4
Ecuador	5	365	26	1.6	9	3	239	17	1.6	9	2.5	14.1
Jamaica	1	493	17.2	0	0	1.3	492	17.1	0.1	1	0.3	4
EAP	593	357	32.9	32.4	1.8	560.8	337	31.1	43.4	2.4	49.4	2.7
Philippines	35	475	49	0.3	0.4	35	471	48.5	0.9	1.2	2	2.8
Thailand	61	1,007	51	1.3	1.1	59.4	986	49.9	1.9	1.6	11.8	9.9
SAS	51	41	9.4	0.2	0	51.3	41	9.4	1.1	0.2	7.9	1.4
Bangladesh	6	44	12.3	0	0	5.6	44	12.3	0.01	0	0.5	1
India	37	37	8.5	0.1	0	37	37	8.4	1	0.2	6.2	1.4
Pakistan	9	64	14.3	0.1	0.1	8.6	64	14.1	0.1	0.2	1.2	2
ECA	209	739	28.7	41.1	5.6	168.1	593	23	55.7	7.6	17.3	2.4
Bulgaria	4	532	35.7	0.3	2.6	4	493	33.1	0.8	6.3	0.7	5.8
Czech Rep.	27	2,629	50	0.8	1.5	26.2	2,552	48.5	1.3	2.5	1.9	3.5
Hungary	25	2,482	54.1	0.4	0.9	24.9	2,440	53.2	1	2	2.6	5.4
Poland	29	753	18.5	1.5	0.9	27.6	714	17.6	2.9	1.8	3.2	2
Turkey	27	421	14	0.3	0.2	26.8	417	13.8	1	0.5	4.4	2.3
Africa	37	402	22.8	3.8	2.4	33.2	360	20.4	8	4.9	7.7	4.7
Cameroon	2	117	19.1	0.6	6.4	1.1	78	12.7	0.7	7.5	0.8	8.5
Cote d'Ivoire	4	280	36.5	0.6	5.2	3.7	240	31.2	0.6	5.3	2.7	22.8
Ghana	2	93	26.2	0.1	1.4	1.7	88	24.8	0.3	4.5	0.7	10.7
Mauritius	2	1,332	36.8	0	0	1.6	1,332	36.8	0	0.1	0.4	8.6
South Africa	28	658	21.1	2.5	1.9	25.1	597	19.2	6.4	4.9	3.1	2.4

Source: the World Bank (2003) "Trade, Investment and Development in the Middle East and North Africa: Engaging with the World", Annex Table 2, Page 195. The World Bank, MENA Development Report, May 2003.

Note: All the indicators are three-year averages for 1998-2000 unless indicated.

In addition, these countries need to establish fiscal rules that insulate government spending from windfalls and down-turns by setting up explicit rules-based mechanisms for saving or drawing down

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temporary oil funds; set aside an increasing portion of oil revenues as longer-term surpluses for future generations; and adopt appropriate macroeconomic policies to reduce misaligned exchange rates.

While Yemen undertook a number of critical reforms to stabilize the economy and to liberalize its trade regime and the exchange rate, the challenge of diversifying its export away from oil remains a daunting task and may require deeper structural reforms to tap on the potentials of the Yemeni resource-rich economy.

What's New?

Laws, Decrees and Agreements (July - September 2003):

- On July 9, Yemen and Saudi Arabia signed a loan agreement (totaling US\$ 38 million) for a project to build a modern transportation highway to link the two countries.
- On July 9, Yemen and Saudi Arabia signed cooperation agreements in the field of tourism, education, technical education and vocational training and for developing exports.
- On July 24, Yemen and Syria signed an overland transportation agreement establishing joint mechanism for implementation of passengers and goods.
- On August 3, Yemen and Djibouti signed a cooperation agreement in the field of education.
- On July 29, Yemen and Oman signed a cooperation agreement in the field of media.
- On August 10, Yemen, Ethiopia and Sudan signed an agreement regarding the formation of specialized businessmen council for the trade sector.
- On August 17, Iran and Yemen signed a Memorandum of Understanding on economic and financial cooperation and a cooperation agreement in the field of trade.
- On August 31, a Republican Decree No. 18, 2003 was issued regarding establishing two specialized primary tax courts, one in Sana'a and one in Aden.

Publications:

- The Ministry of Oil and Mineral Resources released Issue No. 24 of the bimonthly "Oil and Minerals Magazine".
- The 17th Annual Report of the Arab Organization for Human Rights covering the second half of 2002 and the first half of 2003 was released.
- Issue No. 76 of "Al-Mara" ("The Woman") magazine was published in July.
- The Yemeni Journalists Syndicate released Yemeni Press Encyclopedia.
- The 2003 mid-term Basic Education Expansion Project report was released.
- The 2003 Yemen Banking Guide was published in September 2003.

Data and Statistical Information:

- Foreign assets in the banking sector reached YR 917.2 billion by the end of May 2003 compared to YR 894.5 billion in the previous year (an increase of YR 22.7 billion, or 2.5%).
- Agricultural production from 1990 to 2002 increased as follows: sesame (from 80,133 tons to 200,152 tons); cotton (from 130,036 tons to 300,472 tons); coffee (from 60,807 tons to 115,906 tons); wheat (from 990,913 tons to 1,430,577 tones); maize (from 2,720,886 tons to 3,380,287 tons); barley (from 280,912 tons to 410,379 tons); beans (from 430,566 tons to 630,042 tons); and cattle (form 8,178,000 heads to 11,443,096 heads).
- A book "Democratic Transition in Yemen: Challenge and Response" published by the Yemeni Institute for Democratic Development revealed that 30% of the 301-seat Yemeni Parliament was filled by tribesmen, 26% by businessmen, 8% by military, 13% by "new-traditional elite" representing sons of tribal and political leaders, 12% by employees, 4% by academicians and 7% by others.

Economic News:

- The Cabinet liquidated the "Public Corporation for Construction and Housing" and transferred its assets to the Public Corporation for Roads.

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- Cement prices rose by 30% from YR 700 to YR 1,000 per bag prompting the Ammran Factory to increase its annual production to 1 million tons per year through inaugurating the new YR 22 million production line.
- The General Investment Authority (GIA) approved 45 industrial projects worth YR 5.9 billion during April – July 2003 that will provide 1,132 job opportunities.
- Final account indicators show that actual state revenues in 2002 reached YR 579 billion and total public expenditure reached YR 597 billion.
- Yemeni foreign currency reserves at CBY increased to US\$ 4.8 billion in the first half of 2003, with volume of deposits amounting to YR 423 billion and economic investments of Yemeni banks reaching YR 127 billion.

Conferences and Workshops:

- The third annual training for journalists working in the field of gender and women’s rights was organized by the Women’s Forum for Training and Research in cooperation with Friedrich Ebert Stiftung Foundation in Taiz during June 29 – July 3.
- A training course for journalists on issues of refugees was organized by UNHCR in cooperation with UNIC and Yemen Times in Sana’a during July 5-7.
- The Chamber of Commerce and Industry organized a training course on “Vocational Safety and Security” in cooperation with the German Training Organization in Taiz during July 5-8.
- A workshop on “Restructuring and Reforming the Social Welfare Fund” was held in Sana’a during July 21-24.
- A training course on “Population for Media Cadres” was organized by the Saba News agency in Aden during July 19-12.
- The Arab meeting on “Fish Wealth” was held in Sana’a during July 27-29.
- The Friedrich Ebert Stiftung Foundation organized a one-month training on “NGO Management, Financing and Proposal Writing” in July 2003.
- The National Population Council in cooperation of the UNDP organized a workshop on “Integrating Population in Development” during July 22-24.
- A ten-day course on “Banking Basics” was organized by the Arab Academy for Financial and Banking Sciences in cooperation with Yemeni Banks Association during 19-28 July 2003.
- The 2nd National Conference for “Women and Sports” took place in Sana’a during July 28-30.
- The Aden Chamber of Commerce and Industry in Aden organized a symposium on “Micro-enterprises” during August 9-11.
- The Social Fund organized a training course on “Small Enterprises Planning and Development” in Taiz during August 9-25.
- A seminar to discuss the “US 2002 Human Rights Report” was organized by Civic Democratic Initiative Support Foundation on August 13th 2003.
- The “Rural Women Rights Program” training course took place in Taiz during August 20-21. It was organized by the Women’s Research and Training Center in cooperation with the Gender World Fund.
- The Central Bank of Yemen and the Institute of Banking Studies in Sana’a organized a workshop on “Fighting Money Laundering” during September 6-8.
- The Conference “Toward Better Involvement of Women in Development” was organized by the Yemeni Women Union in Sana’a during September 8-10.

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- Yemen Times organized the regional conference on “The Role of the Free Arab Media in Economic Development” in cooperation with Friedrich Ebert Stiftung Foundation in Sana’a during September 13-15.

Donor Activities:

- A program of support for “Disaster Preparedness, Management and Recovery” with a total budget of US\$ 1.77 million was signed between the UNDP, Ministry of Interior and Ministry of Planning and International Cooperation.
- A document was signed between UNDP, the Ministry of Local Administration and the Ministry of Planning and International Cooperation endorsing an agreement that UNDP, United Nations Capital Development Fund and the UN Dryland Development Center will contribute US\$ 1.62 million for decentralization and local governance projects, while other external sources will provide US\$ 350,000.
- A program of support for the “Implementation of the Automated System for Customs Data (ASYCUDA) Phase II” with a total budget of US\$ 2.1 million was signed between UNDP, the Ministry of Planning and International Cooperation and the Yemen Customs Authority, where UNDP will contribute US\$245,000; the UK with US\$790,000 and the government of Yemen will cover US\$ 250,000 cash and US\$ 800,000 in-kind.

World Bank Operations in Yemen

Ongoing World Bank Operations in Yemen on 18 September, 2003

#	Name of the Project	Effectiveness Date	IDA Amount (In million US\$)	Credit (In million US\$)	Disbursed (In million US\$)
1.	Education Sector	March 23, 1995	33		22.6
2.	Vocational Training	August 7, 1996	24.3		19.4
3.	Southern Governorates Agricultural Privatization	June 29, 1998	20.7		9.2
4.	Seeds and Agricultural Services	September 2, 1998	12.5		10.8
5.	Sana'a Emergency Power	January 14, 1999	54		37.8
6.	Sana'a Water Supply and Sanitation	June 30, 1999	25		22.4
7.	Legal and Judicial Reform	January 24, 2000	2.5		1.8
8.	Port Cities Development Program	January 23, 2003	23.4		0.5
9.	Civil Service Modernization	November 29, 2000	30		4.1
10.	Child Development	December 19, 2000	28.9		12.2
11.	Social Development Fund II	January 9, 2001	75		52.6
12.	Basic Education Expansion Project	January 16, 2001	56		10.4
13.	Irrigation Improvement	January 18, 2001	21.3		2.7
14.	Rural Water Supply and Sanitation	October 23, 2001	20		1.3
15.	Taiz Municipal Development and Flood Protection	February 26, 2002	45.2		7.2
16.	Rural Access Improvement	March 18, 2002	45		9.1
17.	Health Reform Support	July 22, 2002	27.5		0.8
18.	Higher Education Learning and Innovation	November 14, 2002	5		0.25
19.	Urban Water Supply and Sanitation	November 24, 2002	130		1.5
20.	Sana'a Basin Water Management	June 3, 2003 (Board Date)	24		0
	Total		703.3		226.7

To get more information about these projects, please refer to the Yemen Economic Update No 10.

World Bank Missions to Yemen (July-September)

Human Resources Development Sector:

- Mira Hong, Operations Analyst, visited Yemen, during July 12 – August 1 and during September 18-30, to work on the Health Reform Support Project Launching Workshop, the Social Fund for Development ICR preparation and supervision of the Vocational Training Project.
- For preparation of Social Fund for Development ICR and supervision of the Vocational Training Project, Yasser El-Gammal, Sr. Operations Officer, visited Yemen during September 11-26.
- To assist in preparation of Vocational Training Strategy and for supervision of the Vocational Training Project, Roger Pearson, Consultant, visited Yemen during September 11-28.

Natural Resources Sector:

- Collier John Bryant, Operations Officer, visited Yemen during July 1-14 to supervise environment issues of the Port Cities, Taiz Municipal and Social Fund for Development III projects.
- To participate in the pre-appraisal of the Social Fund for Development Project III, and to prepare District and Community Development Project, John Macgregor, Sr. Operations Officer, visited Yemen during July 7-24 and during September 6-17.
- To participate in pre-appraisal of the Social Fund for Development Project III, and to supervise Energy Survey and Port Cities Project, Meskerem Brhane, Social Development Specialist, visited Yemen during July 12-25.
- Marie Helen Collion, Lead Agriculture Services Specialist, visited Yemen during September 5-12 to participate in the work on the Rural Development Strategy.
- To discuss the Rural Development Strategy with the Ministry of Agriculture, Petros Aklilu, Sector Manager, visited Yemen during September 5-13.
- Marie-Laura Lajaunie, Water Resources Specialist, and Robert Boydell, Consultant, visited Yemen during September 16-26, to supervise the Rural Water Supply and Sanitation Project.

Infrastructure Sector:

- To participate in supervision of Sana'a Emergency Power Project and in the pre-appraisal mission for the Public Works III project, Somin Mukherji, Sr. Financial Analyst visited Yemen during July 11-17, August 4-8, and September 16-30.
- Voravate Tuntivate, Consultant, visited Yemen during July 1-17 to complete preparations for the Household Energy Survey.
- To participate in supervision of Energy Poverty Access activity, Kyran O'Sullivan, Sr. Energy Specialist, visited Yemen during July 12-18.
- Tjaarda Storm Van Leeuwen, Lead Financial Analyst, visited Yemen during September 13-22 to participate in Core Team Country Retreat and to discuss energy issues.
- To supervise Urban Water Supply Project, Bouzaher Noureddine, Sr. Energy Economist, visited Yemen during September 14-20.
- Amir Al-Khafaji, Lead Operations Specialist, visited Yemen during September 14-20 to participate in the pre-appraisal of Public Works III Project.

Social and Economic Development Sector:

- To work on Yemen Economic Models, Masakazu Someya, Economist, visited Yemen during July 5-11.

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- Giulio De Tommaso, Sr. Public Sector Management Specialist visited Yemen during 14-19 September to participate in the Core Team Country Retreat.

Country Unit:

- To work on country office staff compensation, George Karam, Sr. Compensation and Benefits Specialist, visited Yemen during September 13-15.
- To get introduced to Yemen country office staff and to discuss human resources matters, Ms. Sahar Ramzy, Sr. Human Resources Officer, visited Yemen during September 12-15.
- Jochen Stange, from the Corporate Strategy Group, visited Yemen during September 10-20 to participate in Core Team Country Retreat.

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