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The World Bank Group
Sana'a Office

Yemen Economic Update

Yemen Economic Update is a quarterly report produced by the World Bank Country Office in Sana'a. It consists of several section covering major political, social and economic developments. It also provides information on ongoing World Bank operations in Yemen, and a list of conferences and donor activities.

SUMMARY

The government announced reaching an agreement with the Houthi rebel group to end the war that has been running since 2004. In the wake of the new peace deal, the Government announced measures to expedite the delivery of emergency and humanitarian aid and the reconstruction of the war-torn area. However, the stability of the peace deal continues to be challenged by intermittent clashes and mutual accusations among the two parties. Other unresolved security challenge facing Yemen is associated with the rising profile of *Al-Qaida* in Yemen, a fundamentalist group that has stepped up its activity in recent months, targeting oil infrastructure and foreign interests. Efforts to combat Al-Qaida have had some success in curbing the group's activity in recent months. Other sources of tension relate to the sporadic demonstrations and violent protests in various parts of the country, which are primarily linked to economic hardships and unemployment. These events come at a time when public revenue from oil continue to be eroded by falling prices and production.

Yemen parliamentary election is set for April 2009. The main opposition party has announced its intention to boycott the coming elections as they did with the governorate elections in May 2008. As in the past, the elections are expected to lead to rising domestic tensions.

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Macroeconomic performance was mixed in 2007. Gross domestic product (GDP) growth improved and inflation moderated while the fiscal and current account deficits widened. The economy grew by 4.7 percent in 2007, compared to 4.5 percent in the previous year. Non-oil output rose by 9.6 percent, offsetting a decline in the oil sector of more than 12 percent. In the fiscal domain, the budget deficit widened to more than 7 percent of GDP despite improvements in tax revenue. On the external side, the current account recorded a deficit of about 6 percent of GDP, largely reflecting the decline in oil export revenues and the increase in the import bill associated with foodgrains and capital equipment for the Yemen Liquid Natural Gas plant.

Structural reforms have continued. Under the National Reform Agenda, measures have been taken to improve the rule of law, public administration, the business environment, and political participation. In the area of anticorruption, measures to implement the Financial Disclosure Law and strengthen the legal framework has lead to the establishment of the Supreme National Anti-Corruption Committee (SNACC). Some corruption cases were prosecuted and two ministers were removed from the cabinet. In the public financial management area, the 2009 budget will for the first time link its capital expenditure with the public investment plan (PIP) of the National Development Plan (DPPR). Under the biometric identification project, coverage of civil service employees was completed and steps are being taken to include the military and security forces. Finally, Yemen rose by 25 ranks in the latest Doing Business Survey due to notable improvements in the business start-up process.

The outlook for 2008 is positive. GDP growth and the fiscal and current account positions should witness some improvement. The economy is expected to grow by 4.9 percent in 2008 due to the high international oil prices that have prevailed in the early part of the year, combined with a slower rate of decline in domestic oil output. On the fiscal side, higher oil and non-oil tax revenues should help to narrow the fiscal deficit to 5 percent of GDP. Similarly, the current account deficit should shrink to less than 2 percent of GDP, compared to 5.6 percent in 2007. Inflation is expected to ease in the second half, therefore stabilizing the annual average rate of less than 15 percent.

The economic performance in 2009 will be subject to a number of uncertainties. Yemen is facing a number of economic and political uncertainties in the year ahead. These are related to global and regional issues such as the level of international oil prices, the current turmoil in the world financial markets, and the instability in the horn of Africa with its ramifications in terms of increased influx of refugees and increased incidents of sea piracy. Domestically, the Government is facing a number of political challenges related to the forthcoming parliamentary elections, the peace process in Sa'ada, and the rising threat from Al-Qaeda. The upcoming on-stream of LNG production in mid 2009 will mitigate the impact of falling oil production and prices, thus helping to sustain the GDP growth rate to about 8 percent and easing the impact on the fiscal and external accounts. Inflation rate is expected to drop to less than 10 percent as headwinds from the global economic recession will maintain commodity prices depressed. With the projected moderation in global inflation and the cost of imports, the external current account is expected to remain largely unchanged, resulting in a deficit of less than 2 percent of GDP.

I. RECENT POLITICAL AND SOCIAL DEVELOPMENTS

The peace agreement between the Government and the Houthi rebel group continues to hold despite occasional flare-ups. The conflict with the rebel group in the Sa'ada governorate in northern Yemen which dates back to 2004 resurfaced in early 2008 and spread to the area of the Bani-Hushaish tribe on the northern outskirts of Sana'a. In July, the Government announced reaching a peace deal (with no specific disclosed details) with the rebels to end the conflict. In the wake of the new peace deal, the Government announced new measures to expedite the delivery of emergency humanitarian aid and the allocation of YR10 billon for reconstructing damaged areas in the governorate. The conflict has destroyed civilian infrastructure like schools, clinics and houses in the large Sa'ada province. In addition to this, during the height of the conflict this summer some 100 thousand people were displaced from their homes. Thus, despite positive developments, intermittent clashes and exchanged accusations of breaching the terms-of-the-agreement continue to cast doubt on the permanence of the peace deal. The unstable situation is also undermining the efforts to mobilize resources from international donors, bring effective delivery of emergency aid and start reconstruction plans.

Other rising security challenges facing Yemen are associated with Al-Qaida. Al-Qaida stepped up attacks in 2007–08, targeting oil infrastructure, foreign interests, and military installations. In their latest attacks, the group targeted the US embassy and some of the security installations. In response, the Government initiated a large-scale counteroffensive campaign, leading to the capture and killing of a large number of key operatives of the group. In parallel with the military efforts, the Government recently launched an ambitious nationwide program to control mosques and close some religious schools. The program includes hiring new Imams known for their moderation, allocating monthly wages for thousands of mosque Imams in a bid to buy their loyalty, and sacking Imams suspected of spreading fanatic rhetoric. However, the threat of Islamic fundamentalism in Yemen is not likely to diminish soon. In addition to the Al-Qaida threat, sporadic demonstrations continue to take place in the south of the country, although with lesser frequency.

Yemen will hold a new round of parliamentary elections in April 2009. Steps have already been taken steps towards establishing administrative committees, voter's registration process, and inviting international observers. However, there are increasing signs of tension between the Government and the opposition parties that could, if escalated, undermine the efforts to hold smooth elections. In recent weeks, main opposition parties, gathered under the Joint Meeting Parties coalition (JMP) have organized several demonstrations around the country following the failure to reach a compromise with the Government. The JMP announced its intention to boycott the next elections on the grounds of irregularities in the voting registration process. In an effort to minimize tensions, the Government has recently passed a bill that will postpone the holding of the local council elections (which are normally held at the same time as the parliamentary elections) for another four years. The opposition occupies 63 seats in parliament that has in total 301 members and is dominated by the General People's Congress which is headed by President Ali Abdullah Saleh. The next elections for the president, which were last held in 2006, will not be due until 2013.

Maritime navigation in the southern part of the Red Sea is coming under increased threat of sea piracy. Since the beginning of 2008, the rate of attacks by Somali pirates has increased significantly totaling to about 100 attacks on freight and passenger vessels navigating in waters adjacent to Yemen.

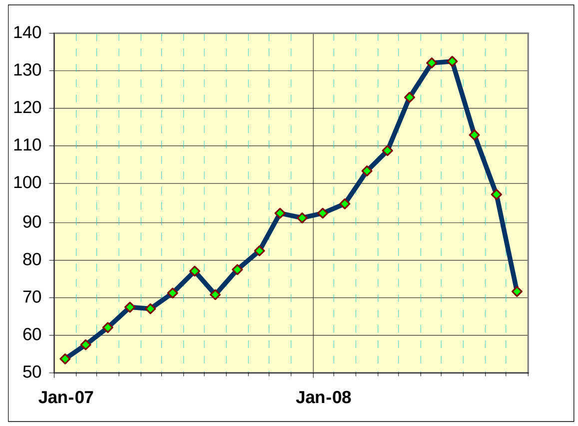
The Government of Yemen recently decided to establish a counter-piracy regional center in the southern part of the Red Sea, and asked for further international cooperation and action to combat this phenomenon. Yemen lacks the ability to police its 2000 Km coastline effectively. It has a tiny coastguard and navy (with some nine operational ships) that are ill equipped and trained. A number of countries including the United States, France, Russia, and India have sent naval forces to patrol the waters of the Gulf of Aden in an attempt to curb piracy attacks. Because of the attacks some vessels have already begun taking other routes as freight and insurance cost to the region have increased. If not curbed these attacks could potentially damage Yemen's efforts to attract foreign investment, particularly in the South which exports hydrocarbons and has ongoing plans for offshore exploration.

In late October, floods and heavy rains hit Yemen, causing one of the most serious natural disasters to the country in the last decade. Wadi Hadramout valley and Al-Mahra were the hardest hit areas by recent floods which killed almost 100 people and displaced an additional 20,000 to 25,000 others. About 3,500 predominantly mud-brick houses were totally destroyed or damaged beyond repair, while hundreds of others are uninhabitable. This damage is of particular concern in several villages in Wadi Hadramout that are listed by the UN as World Heritage Sites. In addition to houses, several health facilities and an estimated 181 schools were damaged or destroyed. Overall, the flooding has seriously impacted the livelihoods of an estimated 650,000 people (half of Hadramout Governorate's population), causing considerable damage to the local agriculture and honey production as well as washing away crops, palm trees and soil from the fields. Prompt and generous assistance from the Government, neighboring countries and the humanitarian community provided directly to Yemen has prevented a high number of deaths and suffering among the survivors. A number of UN agencies, regional donors and humanitarian non-governmental organizations (NGOs) have quickly responded to meet the humanitarian needs of those most affected by the floods, providing temporary shelter to some 20,000 to 25,000 persons. Recently, the World Bank conducted comprehensive damage assessment to begin the preparations for reconstruction efforts. Preliminary estimates suggest that although the floods have had minimal impacts on non-oil growth, they will have significant localized aftereffects in some of the poorest areas and potentially significant fiscal impacts on capital budget for reconstruction needs. In total, the damage to physical assets is estimated to have reached about US $1.7 billion, of which 22 percent is tied to restoring public infrastructure.

The Cabinet approved the National Strategy for Local Governance. An important milestone towards implementing the decentralization vision, the National Strategy for Local Governance was finalized after more than three years of preparations and intensive consultations with various stakeholders in the Yemeni Society and abroad. The current governance system established in 2000 is a combination of de-concentrated administrative units and elected local councils. It marks the starting point of a gradual process of decentralizing powers to sub-national levels and has provided the GoY with guidance about the requirements for moving ahead with decentralization and local governance. The Strategy proposes to move from the current system of Local Authorities to a new one with elected councils and chief executives being fully accountable to them. These governments shall have administrations of their own with substantial autonomy, responsibilities and resources for service delivery and local development promotion. The ratification of the document will be followed by preparations of the National Implementation Program for the Decentralization Strategy, which is expected to be ready in the second quarter of 2009. Implementing the Strategy should bring changes in the sub-national system of governance and public administration and restructure intergovernmental relations. It requires channeling increased domestic and external resources through such system for investment in services delivery and local economic development. This complex national effort has been receiving continued technical support from various international donors. Local governance is hoped to catalyze local development and ultimately contribute to the national development effort and reduction of poverty, that will ultimately help reducing political discontent.

II. MACROECONOMIC DEVELOPMENTS

Figure 1. Brent– Europe Spot Prices (US$/bbl)



Oil prices fell sharply in the second half of 2008. After reaching a record high of more than US$146 per bbl in July, prices tumbled, reaching to about US$60 per bbl in late October. The near 60 percent decline is due to falling global demand, with the U.S. consumption down 5.6 percent or nearly 1.2 mob/d for the first 10 months of this year. Oil prices are expected to continue facing downward pressures in 2009 with the projections of continued global recession and pick up in non-OPEC supplies by more than 1 mb/d. Notwithstanding the sharp fall in recent months, the average price of Yemeni crude oil exports in 2008 is expected to average about US$94 per bbl as compared to US$73 per bbl in 2007.

The value of government oil exports for the first nine months of 2008 has increased by about 90 percent over the same period a year ago. Yemen does not publish comprehensive monthly data on oil transactions. The Central Bank monthly publication reports on three items: government share of exports (in bbls) (including exports of crude by Aden Refinery and the share of state oil companies) and sales of crude to Aden and Marib refineries (in bbls) for processing purposes, and the value of government exports (in US$). According to latest CBY report, government share of exports, shipments for domestic refining purposes and total exports value are showing changes over the same period of last year by about 11, -14, and 86 percent, respectively. According to unofficial sources, Yemen's crude oil production is likely to witness some 4 percent decline, slightly higher than the 3.3 percent projected earlier in the year.

Table 1. Oil Production, Trade, and Consumption *(in million bbls unless otherwise indicated)*

	2006	2007	2008 Proj.	Percent change 07	Percent change 08
Crude oil output (gross)	133.3	116.7	111.4	-5.5	-4.5
Crude oil output (net)	130.4	113.3	108.8	-13.1	-4.0
State's share inc. royalties	85.7	72.6	70.0	-15.3	-3.6
Companies share inc. cost oil	44.7	40.7	38.8	-8.9	-4.7
Exports of crude oil 1/	105.5	83.1	85.3	-21.2	2.6
of which: Government share	63.7	42.4	46.5	-33.4	9.7
Domestic refinery consumption of crude oil	22.5	27	23.5	20.0	-13.0
Consumption of refined products (million tons)	5.3	5.7	6.0	7.5	5.3

Source: Ministry of Oil and Minerals, CBY, and WB projections.
1/ sum of companies share of production and government share in exports as published by CBY

Table 2. Government Share of Crude Oil Exports, and Sales for Domestic Refining

Year	(million barrels			Value of exports (million US$)	Implicit export price (US$)
	Exports 1/	Domestic	Total		
2000	71.9	31.1	103.0	1969	27.4
2001	68.9	30.0	98.9	1585	23.0
2002	65.1	26.2	91.3	1600	24.6
2003	65.4	26.9	92.3	1828	27.9
2004	61.7	24.8	86.5	2260	36.6
2005	60.5	26.1	86.6	3115	51.5
2006	63.7	22.5	86.2	4013	63.0
2007	42.4	27.0	69.4	3088	72.9
Jan -Sep 07	31.4	20.4	51.8	2089	66.5
Jan -Sep 08	34.8	17.6	52.4	3887	111.7
% change	*10.6*	*-13.7*	*1.1*	*86.1*	*67.9*

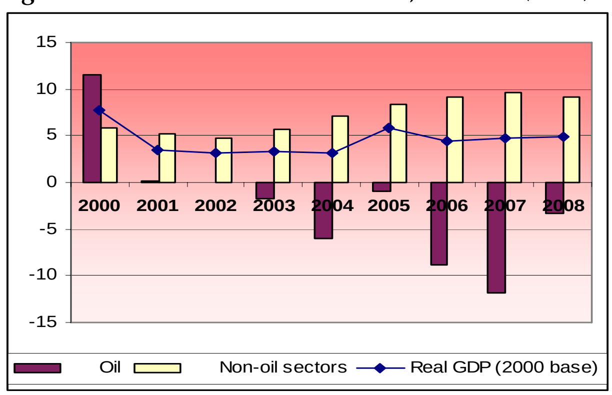
Source: The CBY Monthly Review

1/ Share of government including YCOI and Aden refinery.

2/ Includes oil transferred to Aden and Marib refineries (does not represent total domestic consumption).

Preliminary estimates released by the Central Statistical Office (CSO) indicate that GDP growth in 2007 has reached 4.7 percent, a slight improvement from the 4.5 percent a year ago. This came with the backdrop of good performance in the non-oil GDP at 9.6 percent (compared to 9.2 percent in 2006) which offset the sharp contraction in the oil output estimated at about 12 percent. New public investment projects supported by pledges from CG donors, ongoing projects including Yemen Liquid Natural Gas (YLNG), Marib Power, and investments in housing and tourism projects sustained growth in the non-oil sector. For 2008, nominal GDP is estimated at about US$27 billion, while in real terms, this will represent a growth rate of 4.9 percent. According to the CSO, the 2008 growth rate underlines a 3 percent decline in oil GDP that will be offset by some 9 percent growth in non-oil activities. It should be emphasized that the current GDP estimates for Yemen are undergoing major revisions which include rebasing from 1990 to 2000, changing the estimation methodology for the contribution of the informal non-oil, and revising the GDP deflators.

Fig 2. Real GDP Growth in Yemen, 2002-08 (in %)



Inflationary pressures eased in the second half of the year. For the period January–June 2008, the all-items price index increased by about 13 percent over the previous six months, and by about 20 percent over the same period last year. For the following three months (i.e. July-September), data shows the inflation rate moderating, albeit slowly, particularly for items such as food and building materials. With expectations of continued slowdown for the rest of the year, the inflation rate in 2008 should settle at about 15 percent. Overall, the inflation pattern in Yemen seems to reflect the trends in global price indices, which have leveled off during the second half of the year (figure 4). The months August-October witnessed consecutive decline in global commodity indices, which ranged on cumulative basis, about 30 percent for agriculture products and metals and about 50 percent for energy. The recent global trends are influenced by the appreciation of the dollar, improved supply prospects and weakening demand following the credit crunch.

Figure 3. Yemen: Monthly Price Indices, 2007–08
(% change)

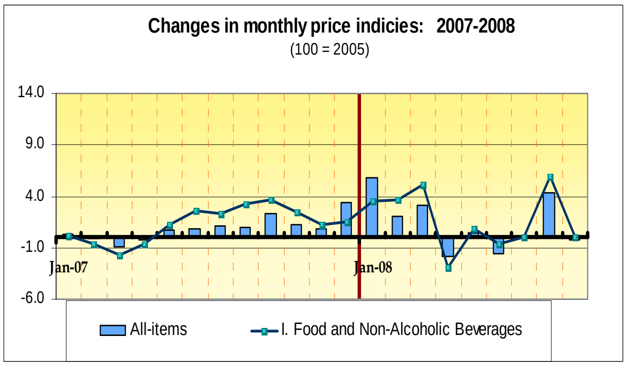
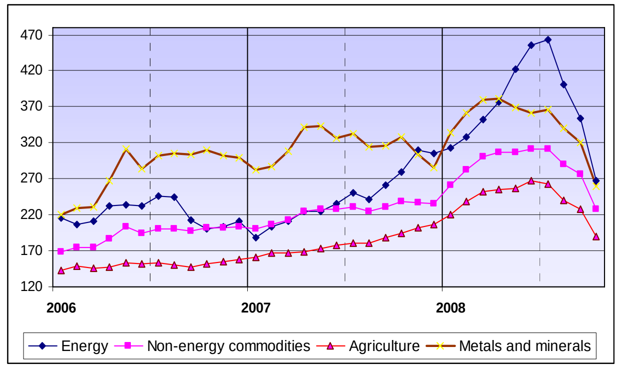


Figure 4. Major Global Price Indices
(in nominal US$ [2000 = 100])



The Central Statistical Office (CSO) is preparing to launch a new Consumer Price Index (CPI) in the start of 2009. The CPI index, which constitutes the basis for measuring inflation and GDP deflator in Yemen, will soon be rebased to weights derived from the 2005 household budget survey (as opposed to 1999 survey) and will also benefit from methodological improvements in sampling, coverage, and aggregation and computation algorithms. With the help from an independent consultant, the current methodology for constructing the index was found to be causing significant upward bias and volatility in the measured value of CPI, especially in periods of strong seasonal trends. Based on 1999 weights, figure (5) shows a comparison between estimated (old) and the real (new) rate of annual change in the CPI for the years 2000-08. The revised CPI series seems to point to inflation rates for Yemen that are more in line – despite remaining higher – with those of other countries in the region (see figure (6))

Figure 5. Old and revised CPI index 2000-08

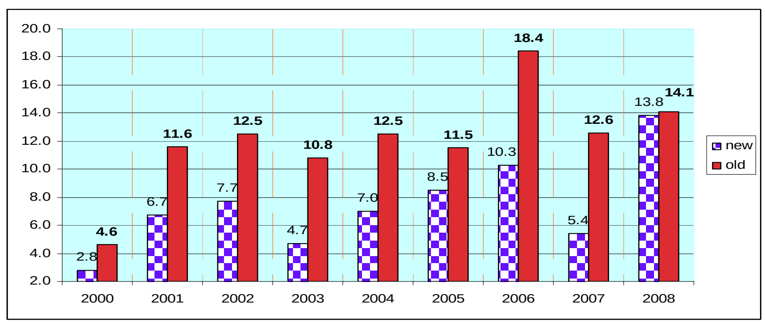
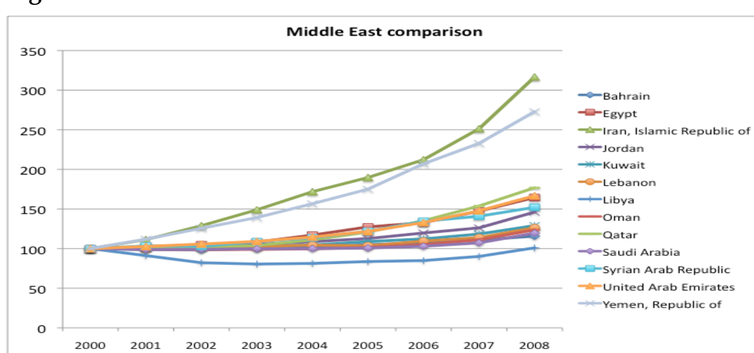


Fig 6. Inflation rates in Yemen and other countries in the Middle East



The fiscal account showed significant deterioration in 2007. The fiscal deficit, equivalent to about 7.2 percent of GDP, was the highest recorded in more than a decade. It primarily reflects the increase in current spending items such as wages and subsidies. This additional expenditure was passed under the supplementary budget toward the end of the previous fiscal year (covering mainly military wages and spending, subsidies, and security-related matters). Oil revenue remained largely unchanged, with higher oil prices offsetting losses associated with falling production.

Because of strong oil revenue, the fiscal deficit in 2008 is expected to narrow from 7.2 to about 5 percent of GDP. Towards the year end, the Government passed a supplementary budget to account for additional expenditure that were largely influenced by rising fuel subsides caused by higher than budgeted prices, and, to a lesser extent, by hikes in wages and salaries, which overall have gone up by 16 percent in 2008. New expenditure under the supplementary budget (amounting to about 12.5 percent of GDP) was largely covered by the windfall from higher oil prices earlier in the year. Current estimates for the budget deficit in 2008 range from 3 to 5 percent.

Table 3. Yemen's 2008 Supplementary Budget
(% of GDP)

Total additional expenditures	12.5
Of which:	
Wages & salaries (% GDP)	1.7
Fuel subsidies (% GDP)	9.1
Total additional revenues (% GDP)	12.0

Table 4. Government Finances 2007-09 (In percent of GDP)

	2007	2008			2009	
	Prel.	Budget 1/	Supp.	Proj.	Budget 1/	Proj.
Total revenue and grants	**33.2**	**25.3**	**12.0**	**37.0**	**23.0**	**25.5**
Hydrocarbon revenue	22.6	16.1	11.4	27.2	13.3	15.6
Of which:						
Crude oil exports	11.8	4.6		10.8	4.0	5.0
LNG exports	0.0	0.0		0.0	0.8	0.8
Non-hydrocarbon revenue	10.3	8.0	0.5	9.5	8.5	9.5
Tax revenue	7.3	6.0		7.0	6.3	7.2
Income taxes	3.4	2.8		3.4	3.1	3.5
Taxes on goods & services	2.7	2.2		2.6	2.2	2.9
Custom taxes	1.0	0.8		0.9	0.8	0.7
Other taxes	0.2	0.2		0.2	0.2	0.2
Non-tax	2.9	2.0		2.5	2.2	2.2
Grants	0.3	1.2		0.3	1.3	0.4
Total expenditure & net lending	**40.3**	**32.7**	**12.5**	**42.0**	**30.8**	**31.6**
Current expenditure	31.4	23.4	12.2	33.7	22.7	24.4
Wages and salaries	10.9	9.1	1.7	10.0	8.9	9.3
Goods and services	3.9	3.0		2.9	2.9	2.8
Operations and maintenance	0.8	0.5		0.5	0.4	0.4
Interest obligations	2.3	1.8	0.5	2.1	1.7	2.2
Subsidies and transfers	12.4	8.5	9.9	17.7	8.4	9.1
Subsidies	9.5	5.7	9.1	14.4	5.5	5.4
Transfers	2.9	2.7	0.8	3.3	2.9	3.8
Other	1.2	0.5	0.0	0.5	0.5	0.5
Capital expenditure	7.2	8.0	0.4	7.1	6.6	6.2
Net lending	1.8	1.2		1.2	1.4	1.0
Overall balance	**-7.2**	**-7.4**	**-0.6**	**-5.0**	**-7.8**	**-6.1**
Memorandum items:						
Primary balance	-4.9	-5.6		-2.9	-6.1	-3.9
Non-hydrocarbon prim. balance	-27.5	-21.7		-30.1	-19.4	-19.5
GDP in billions of YR	4,309	5,510	5,510	5,510	6,274	6,274

Sources: Ministry of Finance for budget and preliminary data
1/ The 2008 and 2009 budget estimates are based on the oil price of US$55

Under the 2009 budget, the deficit will widen again to about 8 percent of GDP. The new budget, which was prepared amid a period of rapidly declining oil prices, focuses the bulk of adjustment efforts on cuts in current spending related to the fuel subsidy bill. Lower subsidy bill in 2009 budget is likely to reflect the anticipated savings from falling benchmark international energy prices, and from new reforms aimed at improving energy efficiency and narrowing the gap between the domestic and international prices. The share of capital spending in total expenditure shows little change from its level in 2008 at about 21 percent (although in GDP terms it shows a slight decline to about 7 percent). The new budget is based on the assumptions of oil prices of US$55 per bbl, and a growth rate in the economy of about 9 percent. The actual fiscal balance for 2009 could see improvements over the budget estimates if tax reform efforts are successful. However, should oil prices witness further deterioration or should production from YLNG be delayed, the fiscal outcome could also deteriorate.[1]

The current account balance is expected to show some improvement in 2008, following the notable deterioration in 2007. The current account deficit in 2007 which was estimated at 6 percent, came after a long trend of positive current account balances and steady growth in the country's foreign reserves. The deterioration was largely influenced by falling oil exports by about 9 percent (oil has more than a 90 percent share in commodity exports) and the surge in imports bill. The latter reflects rising global inflation and increased imports of equipment for the ongoing liquefied natural gas project. In 2008, and on the strength of oil export revenues and the moderation in imports growth, the current-account deficit is expected to narrow to about 2 percent of GDP.

Table 5. Current Account (in million US$)

	2006 1/	**2007** 1/	**2008** 2/
Trade balance	1390	-440	1280
Exports of Goods	*7316*	*7050*	*8809*
Hydrocarbons	*6733*	*6264*	*7953*
Imports of Goods, f.o.b.	*5926*	*7490*	*7529*
Services Balance	-1306	-1144	-1025
Exports of Services	*549*	*723*	*399.6*
Imports of Services	*1855*	*1867*	*1425*
Net Income receipts	-1234	-1350	-2189
Net current transfers	1382	1426	1492
Current Account Balance	**231.5**	**-1508.3**	**-441.5**
Current Account (% GDP)	1.1	-6.1	-1.6

1/ preliminary 2/ Projected

Figure 7. Current account balance 1999-2008
(% of GDP)

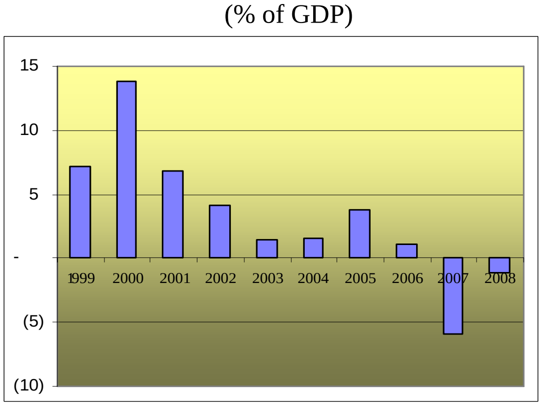
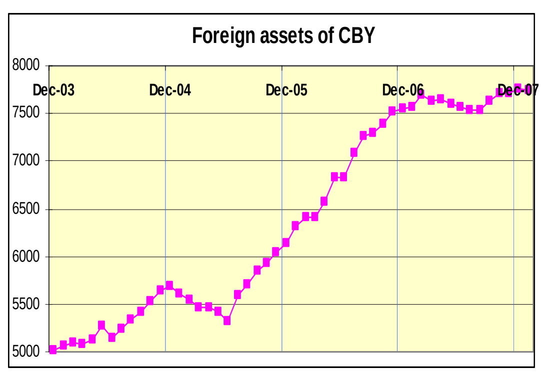


Figure 8. Foreign Assets of the CBY 2003-07
(million US$)



[1] Recently, it was announced that production from YLNG will commence in May instead of April 2009.

The Yemeni rial exchange rate vis-à-vis the U.S. dollar continued to hold steady during the first nine months of 2008, averaging to about YR199.7 per U.S. dollar. The depreciation of the rial slowed considerably in 2007 and 2008, as the authorities aimed to lessen the inflationary impact of the weakening dollar value against other major currencies. However, this has come at a large cost to the CBY in terms of foreign reserves interventions. Yemeni monetary authorities are expected to resume the slow depreciation trend of the rial exchange rate versus the dollar in the near future with the aim of maintaining competitiveness of non-oil exports and minimizing the drain of foreign reserves.

Yemen's external debt amounted to about US$5.8 billion at the end of Sept 2008. Relative to GDP, Yemen's overall external debt has been showing steady decline in recent years, reaching about 22 percent at the end of September 2008. Among the largest new sources of external financing in 2008 are Arab donors (such as AFSED and Saudi Arabia) and China. Notwithstanding the moderate financial needs in the short term, Yemen faces fiscal sustainability challenges in the longer run, as its oil output continues to fall and as alternative non-oil revenue remain underdeveloped. This would call for expediting structural reforms to diversify the sources of revenues and reduce unproductive expenditure. Towards this end, the country needs to adopt a stringent Fiscal Responsibility Act that would place a ceiling on public debt as well as on the annual increments and/or fiscal deficits. A proposal for a new law on public sector debt has been awaiting parliamentary approval for more than two years, and it is now expected to be submitted for ratification in the first quarter of 2009. The proposed law goes only as far as limiting the size of overall public debt (external and internal) to 80 percent of GDP.

Table 6. Yemen outstanding external public debt (in million US$)

	balance as end of Sept 08	% chg. from the beginning of the year
Bilateral	2,575	-0.2
Paris Club Countries	1,720	-1
Non-Paris Club Countries	855	1.2
Saudi Arabia	356	5
China	181	4.1
Multilateral	3,070	0.8
AFSED	654	15.3
Others	197	3.5
Grand TOTAL	**5,842**	**0.4**
Total as % of GDP	**21.7**	**-12.0**

Figure 9. Factors affecting money Supply (M2) in 2008

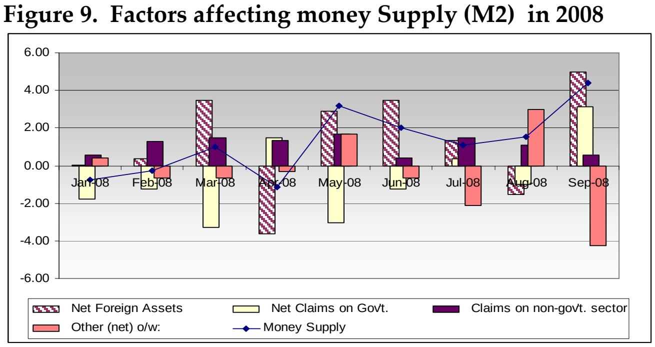
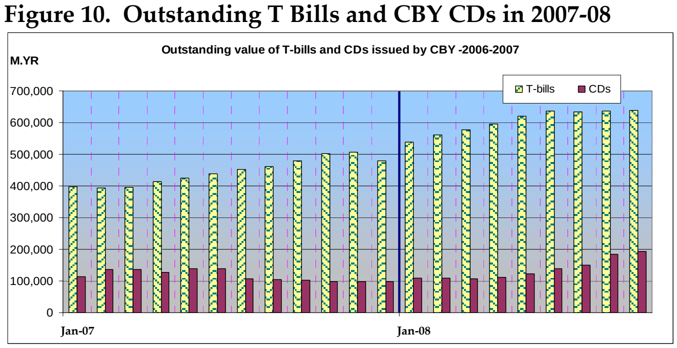


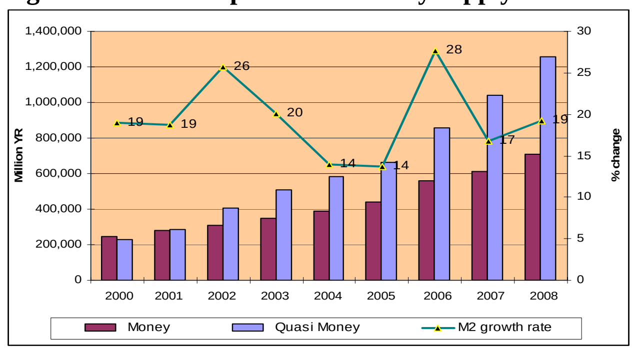
Figure 10. Outstanding T Bills and CBY CDs in 2007-08



Following the relative moderation earlier in the year, money supply growth rate witnessed some acceleration in the second half. Money Supply (M2) increased by 11 percent by the end of September, or about 15 percent on annual basis as compared to 17.5 percent for 2007. Growth in money supply during the first nine months underlined the increase in net foreign assets, particularly of the Central Bank, which increased of more than 13 percent. The pace of growth in credit to the private sector during this period remained positive at about 5 percent. In a rare move, the CBY eased in April the reserves requirement on domestic currency deposits from 10 to 7 percent, and eliminated the 13 percent remuneration on reserves. Meanwhile, the reserves requirements for foreign currency deposits remained unchanged at 20 percent. Finally, towards June, the outstanding value of Treasury bills has stabilized as the full allowance set in advance by the Ministry of Finance was exhausted, subsequently causing the CBY to increase its issuance of CDs for the purpose of absorbing domestic liquidity.

Despite its general underdevelopment, the financial market in Yemen has shown progressive signs of deepening over the last few years. This is evident by the increased share of quasi money (i.e. savings and other time deposits) in money supply over the past few years, as shown in the graph.[2] This conclusion is also supported by the recent World Bank review of the financial sector in Yemen: "financial deepening and intermediation has grown [over the last five years]: deposits have increased 160 percent, and private sector credits 225 percent, compared to a rise of 120 percent in nominal GDP".

Figure 11. The composition of money supply 2000-08



Yemen is likely to weather the immediate impact of the current financial crisis, while in the longer run the impacts remain uncertain. The implications of the current crisis for Yemen can be viewed from three possible channels. (i) Direct exposure to foreign banks and risks of sudden stop of capital flows; (ii) external financing vulnerability; and (iii) vulnerability through real sector economic activities. Yemen has a relatively a small exposure to foreign banks and its domestic financial market remains underdeveloped, therefore, the short term impact is expected to be limited. Yemen also has small financing need for 2008 at about 5% of GDP, which is expected to grow in 2009 to about 7% respectively. With substantial foreign reserves ($7.5 billion or 12 months of import), Yemen could also weather moderate decline in oil revenue in 2009. Since Yemen relies on official lending rather international capital markets, it is not directly vulnerable to the swings in international capital markets. However, securing financing among bilateral donors in an environment where most donor countries are also hit by the global crisis might be a challenge for Yemen. Beyond short term financial contagion and vulnerability to external financing, the global financial crisis could affect Yemen through trade as well as FDI and remittances. This second round effect, unlike financial contagion and external financing risks, could be substantial if the global financial crisis deepens and protract. In addition, this second round effect would affect domestic banks, the real estate sector, jobs and people's livelihood more visibly. The decline in oil price from its peak of over $140/bbl in July 2008 to current levels of around $60/bbl has already reduced Yemen's revenue intake significantly, particularly as the country is facing a decline of the volume of its oil exports.

[2] It is worth mentioning the current monetary survey series published by the CBY was amended recently to reclassify the item " Pension Fund deposits in the CBY" as quasi- money.

Box 1. Should Yemen Switch to Inflation Targeting?

Yemen experienced rising inflation levels in recent years, which averaged 3 percent for the last seven years, and about 16 percent in the last two. This trend has raised some concerns over the central bank's handling of inflation and suggested that a more active intervention is needed to slow down inflationary pressures[3]. At present, Yemen Central Bank (CBY) seems to be following a monetary policy that could be described as discretionary and reactive with no explicit goals in terms of inflation, monetary aggregates, or exchange rate targets. Compared to other countries, Yemen seems to be lagging behind in efforts to use intermediate policy targets and set up specialized analytical units to determine and implement short-term monetary policy.

One approach to fight inflation, which increased in popularity beginning from the last decade, is inflation targeting (IT). Under this framework, the central bank conducts proactive monetary policy with the exclusive (and explicit) purpose of controlling inflation. Evidence that the IT framework succeed in controlling inflation has been established. The process involves three basic steps. The central bank sets explicit inflation targets (at rates that are believed to be appropriate for the economy); forecasts the future path of inflation (using a forecasting model); and then adjust interest rates, using choice monetary instruments, to close the gap between the targeted and projected inflation rates.

To be effective, IT requires two basic conditions. The first is a central bank with some degree of independence about the choice of the instruments and the level of intervention (i.e. intervention is not dictated by the borrowing needs of the government). This implies that domestic financial markets must have enough depth to absorb placements of public debt, such as treasury bills, and it implies that the government has a broad revenue base and does not have to rely systematically and significantly on revenues from seigniorage. The second requirement is that the monetary authorities should restrict their goals to controlling inflation and not have other targets such as growth, wages, the level of employment, or the exchange rate. In this regard, inflation targeting requires a high degree of exchange rate flexibility. Under fixed exchange rate, system monetary policy will be subordinated to other objectives and in this sense cannot effectively target the rate of inflation.

The IT framework, which was first adopted by a number of industrial countries came in response to earlier difficulties of using intermediate targets such as exchange rate pegs or some other monetary aggregates, became also the choice approach for a number of developing countries that sought active monetary intervention. Currently IT is adopted by 7 industrial countries and 17 developing countries, while 27 other countries are considered as good candidates. However, for most developing countries, compliance with the basic prerequisites for successful IT seems to be challenging, particularly under current conditions of global increase in commodity prices. In the case of Yemen, the adoption of IT framework requires far reaching reforms that go beyond strengthening the technical capacity of the Central Bank in forecasting inflation and assessing the impact of changes in its instruments on future inflation path and other main macroeconomic variables. Factors hindering successful implementation in Yemen include the continued fiscal dominance, shallow financial markets and fragile banking system. In fact, gaining effective independence of the central bank in Yemen will not come by legislative reforms alone, but will also require comprehensive public sector reform that broaden the tax base, reduce the government's reliance on revenues from financial repression, adopt more stringent conditions for fiscal discipline, and revamp the banking and financial systems. Other factors that currently hinder an effective IT in Yemen is the managed exchange regime, which does not allow full flexibility of the nominal rate. [4]

Aside from the difficulties of meeting the prerequisites of the IT in developing countries, many have raised concerns about the desirability of the framework. This opinion became particularly visible in recent times with the sharp increase in global commodity and food prices. In a recent article, J. Stiglitz wrote "[The inflation targeting] recipe is based on little economic theory or empirical evidence; there is no reason to expect that regardless of the source of inflation, the best response is to increase interest rates…. Today, inflation targeting is being put to the test – and it will almost certainly fail. Developing countries currently face higher rates of inflation not because of poorer macro-management, but because oil and food prices are soaring and these items represent a much larger share of the average household budget than in rich countries." It must be emphasized, however, that the underlying criticisms of IT is not about its effectiveness in controlling inflation, but rather directed toward its costs in terms of other macro and social objectives.

Notwithstanding the above objections (which relate primarily to transitory global economic conditions), and the existing structural constraints facing the implementation of IT, Yemen should seek to improve its monetary and inflation performance, relying at first on simpler and less demanding monetary policy frameworks. Over time, and given its situation marked by fast depletion of oil resources, Yemen should seek to adopt IT as medium term objective. This move should put in action through measures to increase the market orientation of the financial system, strengthen the capacity of the Central Bank and other institutions. It also implies seeking to accelerate reforms in the fiscal system by broadening the sources of revenues and imposing more stringent fiscal sustainability rules while increasing efforts to diversify the economy away from oil.

3 See for example IMF Article IV on Yemen (2007)

[4] Some experts believe that a crawling peg system could coexist with an IT framework so long as it is clear, and central bank actions show, that the latter has priority if a conflict arises, and that the CB refrains from making strong commitments about the exchange rate's level or its evolution over time.

III. STRUCTURAL REFORMS AND POLICIES

A recent World Bank study on the country's social protection strategy has concluded that reforming existing social safety nets could bring significant improvements. [5] This conclusion comes despite the wide array of programs and institutions, including four that are fully funded by the government and at least another two that are supported by international donors. Overall, complementarities and coordination among these programs need to be reinforced to avoid duplicating efforts. Additionally, government-funded social protection programs in particular, need to strengthening their capacity and increase human and financial resources. Often, many of these programs are plagued by poor governance and weak institutional base, and are therefore unable to address the critical risks of disadvantaged children and women in difficult circumstances. The gaps in terms of the development of a credible targeting system, a framework for monitoring and evaluation, inappropriate spending and under-spending, inability to reach critical vulnerable groups, and an institutional inertia that prevented the emergence of an approach to reform in the domain of social protection needs to be corrected within the appropriate framework for Social Protection.

Adequate funding and better targeting are the main challenges facing government-sponsored programs. The programs include four major schemes: the Social Welfare Fund (SWF), the Disability Fund, The Fund for Productive Families and the Agricultural and Fish Production Promotion Fund (AFPPF) (see table for details). The expenditures of these programs add up to less that 1% of GDP. In the case of SWF, the largest government sponsored fund, estimates suggest that nearly one-half of beneficiaries belong to non-poor households, while substantial numbers of the poor do not receive benefits. Because of these weaknesses, SWF is currently reviewing its targeting mechanism, helped by a technical assistance from the WB and the EC. Additionally, the Government has recently decided to double the maximum cash transfer benefit under SWF to YR4,000 per case per month, and announced further plans to increase coverage up to 7 millions recipients. The role of other government-sponsored institutions (the Disability Fund and the Fund for Productive Families) is negligible in terms of actual expenditure levels and is equally problematic in terms of ability to reach the poor cost-effectively. Taken together, government transfers do not seem to make a significant difference to poverty reduction. Meanwhile, the two donor-funded institutions -- the Social Fund for Development (SFD) and the Public Works Project (PWP) -- has a better track record of implementation. However, it one should bear in mind that the SFD is not designed primarily to perform the role of a safety net in terms of providing social assistance and cash transfer to the poor, but more as a development institution promoting access to health, education and water. PWP on the other hand, is serving as a safety net providing short-term jobs to those in need, thus performing the role of "unemployment insurance". However, the current design, while clearly useful in creating assets, is probably less amenable to self-targeting and to wider participation of the poor. Overall, household-level impacts of both initiatives need to be estimated and retargeted towards the poor.

Enhancing social safety nets in Yemen requires further consolidation within a comprehensive and strategic framework. Overall efforts --of both the government and the donors – are still small relative to needs, and in comparison with similarly placed developing countries. Moreover, there is no overall

[5] Social Protection Strategy – Phase II (2008)

strategic framework within which programs have to be designed and implemented. An integrated approach to social protection would need reconfiguration of some of the agencies involved in it as well as their functions. Furthermore, consideration of consolidation of some funds (e.g. in the areas of disability, productive families, agriculture, fisheries, and so on) under the SWF would be beneficial. The study recommends the consolidation of government funded operations under a reformed and expanded SWF on a well-targeted geographical and household-based cash assistance and on greater synergies with other developmental interventions in the areas of children, education, youth, employment (public works) and disability. It also recommends developing an accurate and timely monitoring and evaluation system that would support a poverty-based database for targeting interventions.

Table 7. Social safety nets in Yemen

Institution	Objective	Establishment and funding	Main challenges/ Performance	Current/ recommended reforms
Social Welfare Fund (SWF)	Provides cash transfers and loans/advice to the poor	In 1996. Funded directly from the budget	Poor targeting (50% leakage), insufficient coverage, and low levels of assistance.	Currently being reformed by: a) improving targeting using PMT, b) increasing the no of recipients
The Disability Fund	Provides financial support to government programs targeting disability and to relevant NGOs.	In 2002. Funded from central budget as well as from a surcharge of YR5 per packet of cigarettes	High administrative cost. Lack of monitoring mechanism. Small coverage of eligible beneficiaries	Merger with SWF
The Fund for Productive Families	Provides training for poor families, mostly women using subsidies from Ministry of Social Affairs	Funded from the budget.	Weak organizational skills. Poor targeting. Too many objectives.	Merger with SWF
The Agricultural and Fish Production Promotion Fund	Supporting agricultural, plant, animal and fish production and improve the cost efficiency. Promote efficient use of water.	Found in 1994. Funded by fuel taxes. Transfers 30% of its revenues to local authorities	Non-transparent operations.	Merger with SWF
Social Fund for Development (SFD)	Provides social services and projects to the poor under 3 programs: community development, capacity building, and small and micro enterprise.	In 1997 with support of the World Bank and other international donors.	Good track record but not designed specifically to the ultra poor households.	Improvement in targeting, enhanced capacity in monitoring and evaluation
Public Works Project (PWP)	Creating jobs for skilled and unskilled workers improve the infrastructure and enhance community participation in the development process.	Founded in 1996. Supported by the World Bank.	Some overlap with SFD projects. Wage seems to be above normal rates for poor in Yemen	Improve coordination with SFD. Set wages at adequate levels that will not cause displacement from normal work activities

According the latest Doing Business Report (2009) from the World Bank, Yemen has witnessed notable improvement in the business environment in 2008. Yemen's overall ranking has improved from 128 to 98, mainly owing to improvements in the business start-up process (Table 5). The report covers the results of surveys for 181 countries and bases the overall ranking on progress in reforms in 10 main business-related areas; including licensing, financing, hiring of labor, and legal protection among others. According to the survey, some of the main factors that continue to affect the ease of doing business in Yemen are those related to capital requirements, financing, trading across borders, and legal protection of investors rights. Regionally, Yemen occupies the eighth rank, trailing the six Gulf Cooperation Council countries and Tunisia. Among the countries in the region, Saudi Arabia ranks the highest, at 16th globally, followed by Bahrain, at 18th.

Table 8: Yemen's Ranking in Doing Business Survey (2009)

Ease of...	Doing Business 2009 Rank	Doing Business 2008 Rank	Change in Rank
Doing Business	**98**	**123**	**25**
Starting a Business	50	178	128
Dealing with Construction Permits	33	33	0
Employing Workers	69	68	-1
Registering Property	48	45	-3
Getting Credit	172	171	-1
Protecting Investors	126	125	-1
Paying Taxes	138	129	-9
Trading Across Borders	126	126	0
Enforcing Contracts	41	40	-1
Closing a Business	87	86	-1

Source: Doing Business 2009.

Efforts to reform the income tax system are progressing satisfactorily. Last year, the authorities embarked on a revision of the income tax law in response to problems with the existing legislation in terms of low efficiency of revenue generation, high rate of evasion, and significant disincentives for investment. A new law has been prepared and awaiting parliamentary approval. It covers income resulting from commercial, industrial, services, and real estate activities that would accrue to individuals, corporations, and small businesses, while reducing exemptions drastically. The new law seeks to lower the effective corporate tax rate from 35 percent to 20 percent. Currently, the Government is negotiating with the private sector to reach consensus on the details of the law, before its final submission to Parliament in the first quarter of 2009. In anticipation of this approval by the legislative branch, the Government has already drafted a set of executive bylaws compliant with international norms that are ready for implementation. The authorities have also embarked on a three-year plan to strengthen the capacity of tax administration. In this area, the FIAS team has been working actively with Government. In other related developments, the Tax Authority announced its intention to stick to its plans and enforce the full implementation of the GST system as of the beginning of 2009.

The Arab League extended the grace period for Yemen's tariff reductions until 2012. Yemen became an effective member of the Greater Arab Free Trade Agreement (GAFTA) in early 2005, which in its present state focuses on the elimination of tariffs among the member states.[6] Under the original terms of the membership agreement, Yemen, admitted on special terms as an LDC, was awarded preferential treatment in the form of a grace period of 5 years. During this period, Yemen, while gaining free access to other members' markets, was allowed a phased reduction of its tariffs on imports of other members. At present, Yemen tariff concessions to other GAFTA members amount to

[6] GAFTA has an ambitious agenda to remove monetary, administrative, and quantitative non-trade barriers in the future. It also provides for the trade liberalization in services, research and technological cooperation, as well as intellectual property. However, owing to its limited resources and a lack of an effective monitoring mechanism, it has showed limited role in trade liberalization.

48 percent of its prevailing rates. In mid-September, the Ministry of Trade and Industry announced that the Arab League Economic had accepted Yemen's request to roll back the date for full tariff removal from 2010 to 2012. Yemen's extension is intended to provide a higher level of income from tariffs to government over a longer period, and to give some Yemeni sectors, such as industry, agriculture and fisheries, a chance to be more competitive at the regional level.

The operation of Aden Port Container Terminal (APCT) was officially handed over to Dubai Ports World (DPW in November. Under the agreement signed earlier in the year, DPW and Aden's port have set up a joint-venture company to develop and operate the container terminals in both Aden and nearby Ma'alla. The agreement includes a commitment to invest around 220 million dollars in further developing the port. This includes building a new 400-metre (yard) berth extension to Aden Container Terminal and doubling its capacity to around 1.5 million TEU by 2012. In 2005, Yemen awarded Dubai Ports International (DPI), DP World's predecessor, a contract to develop and manage the Aden container terminal. Yemen later suspended the contract after Parliament criticized the deal as unfair and subject to conflicts of interest, partially because the Aden facility is in competition with Dubai's Jebel Ali port, also run by DP World. Under the new arrangement, Yemen will be receiving 49 percent of the terminal's net profits instead of the previous terms of US$6 per container. The deal was originally signed about three years ago but was delayed by the Parliament for fear of conflict of interest due to DP's ownership of Dubai's Jebel Ali. The timing of the new deal comes at a time when piracy attacks in the Gulf of Aden are increasing in frequency and causing maritime insurance rates to the region to hike.

The Government of Yemen is boosting efforts to enhance rural electrification (RE). Yemen is the least electrified country in the MENA region, with only about 40 percent of the total population having access to electricity. In rural areas, the situation is even worse with electrification rate at only about 20 percent. The state owned Public Electricity Corporation (PEC) owns and manages generation plants which are old and in need of significant rehabilitation. The tariff structure provides a subsidy to a large part of the consumers and tariffs have not increased regularly in the past years. In addition to the low tariff, PEC cost recovery suffers from significant under collection and nonpayment. In the Power Sector Development Strategy Note of 1997, the Government placed the objective of a nationwide rural electrification (RE) as a priority issue. Similarly, in the Poverty Reduction Strategy Paper (PRSP), RE is highlighted as one of the challenges that needs to dealt with by increasing electricity supply and selecting the most suitable alternative power sources including new and renewable energy resources, such as solar and wind energy. Despite these efforts, not much progress has been made in rural access to energy. Past efforts to enhance RE were weak and uncoordinated, particularly in the area of renewable energy. Progress has been hampered by the absence of strategic vision and necessary legal/regulatory support. Lack of necessary institutional support, transparency in subsidy mechanism and absence of comprehensive policy has rendered most of the past schemes unsustainable and weakened the sector finances. Moreover, the financial difficulties facing the PEC has significantly affected its ability to effectively execute the RE schemes. With the help of the World Bank and other international donors, the Government is currently undertaking a comprehensive review of the RE efforts and programs and aiming to revitalize these efforts. Current efforts to modernize the institutional framework include new legislations such as the Electricity law, the Rural Electrification Policy Statement (REPS) and the Ministerial Decree for establishment of an independent Rural Electrification Authority (REA). The new Electricity law, which will be submitted to Parliament in the coming months, will facilitate the ownership of electricity assets and their commercial operation by Rural Electricity Service Providers (RESP). Further program details such as role of the existing institutions, operational procedures, staffing details will be worked out during the coming period. In particular, the role of the Rural Electrification Sector (RES) as a part of the PEC, which in reality operates as a quasi-independent institution, will be clarified in context of the new institutional framework.

Near-term efforts are also expected to focus to developing the domestic gas sector. The development of the gas sector is seen as a top national priority that could be justified on three grounds: (1) to diversify the economy away from rapidly-depleting oil resources, (2) to reduce the cost of energy subsidies by shifting electricity production away from the more costly oil products, and (3) to respond to the rapidly growing electricity demand, which is already facing sever shortages. Yemen has limited proven natural gas resources, which are estimated at about 18 Tcf in 2008. Already, YLNG project has secured an off take totaling 9 Tcf of natural gas reserves over its 25 years life. The remaining reserves could be used for the domestic market or for extending the YLNG capacity. At least 5.2 Tcf of gas were said to be allocated to domestic gas market development. The power sector is expected to the largest potential consumer of natural gas, with total demand expected to reach close to 2,500 MW by 2020. Current plans for developing the domestic gas market call for a two-phase approach: the first involves a constructing a pipeline between Marib and Ma'bar, and the second continues the pipeline southward to Aden. To develop the domestic gas market in Yemen, at least three issues need to be resolved. The first pertains to developing domestic gas pipeline infrastructure to provide access to the power sector (and other potential customer groups), which, given its large capital needs, could be approached as a joint venture with the private sector or in the form of public private partnership agreement. A second issue pertains to the modality of financing future investment needs in upstream and downstream (power generation) expansion projects in Yemen. A third issue relates to establishing an appropriate regulatory framework and an incentive framework conducive to attracting private investment at all the stages of the gas industry chain. On these efforts, the World Bank is currently helping the GoY with a technical assistance that focuses in particular on the development of the first segment of the National Gas Pipeline (NGP) from Marib to Ma'bar and its associated power plant in Ma'bar, which will create the backbone infrastructure for gas delivery and market development in Yemen.

IV. OUTLOOK

Yemen's economic outlook in 2008 calls for moderate overall improvement. Yemen's growth rate in 2008 is likely to improve by less than 1 percentage point, to 4.9 percent, reflecting the continued good performance in the non-oil sector of about 9 percent and the slow decline of oil production by about 4 percent (compared to 12.6 percent in the previous year). The non-oil sector should benefit from reforms taken in the previous two years and the higher flows of foreign capital, particularly from the Gulf. Improved conditions in the oil sector is expected to reflect positively on the fiscal and external sectors. The government fiscal revenue should see modest improvement owing to higher oil revenue and continued progress in tax collection efforts. In the external sector, the current account deficit is expected to shrink to about 1.6 percent of GDP compared to 6 percent in 2007. Meanwhile, inflation rate is likely to moderate to less than 15 percent , reflecting the easing of global inflation in the second half of the year in the wake of improved supply conditions and weakening demand in industrial countries.

The economic performance in 2009 will be mixed, with a number of uncertainties. Yemen is facing a number of economic and political uncertainties in the year ahead. These are related to global and regional issues such as the level of international oil prices, the current turmoil in the world financial markets, and the instability in the horn of Africa with its ramifications in terms of increased influx of refugees and increased incidents of sea piracy. Domestically, the Government is facing a number of political challenges related to the forthcoming parliamentary elections, the peace process in Saada, and the rising threat from Al-Qaeda. The coming on-stream of LNG production in mid 2009 will mitigate the impact of falling oil production and prices, thus helping to sustain the GDP growth rate to about 8 percent and easing the impact on the fiscal and external accounts. Inflation rate is expected to drop to less than 10 percent as headwinds from the global economic recession will maintain commodity prices depressed. The Central Bank of Yemen is expected to resume its policy of slow depreciation of the Yemeni riyal versus the dollar, but this will not have significant effect on pushing up the inflation rate as the dollar is expected to maintain strength against other major currencies in 2009. With the projected moderation in global inflation and the cost of imports, the external current account is expected to remain largely unchanged, resulting in a deficit of less than 2 percent of GDP.

The fiscal balance in 2009 is expected to deteriorate to about 8 percent of GDP. The new budget assumes large cuts in the fuel subsidy bill, which reflect anticipated savings from lower international energy prices, and new reforms aimed at raising prices to domestic consumers. The budget is based on the assumptions of oil prices of US$55 per bbl, and a growth rate in the economy of about 9 percent. Despite the coming on stream of Yemen's first liquefied natural gas (LNG) project in mid 2009, the fiscal balance is expected to widen to about 7 percent of GDP as compared to 5 percent in 2008.

Reforms are expected to continue in 2009. A midterm review of the DPPR is already underway. The revision will cover the first two years and set the planning targets for the remaining period (that is, until 2010). The revised plan will consider the changing circumstances that have emerged since the inception of the Development Plan for Poverty Reduction (such as the persistence of poverty, the outlook of oil production, and the continued rise of global inflation) and revise its scope accordingly. Special emphasis is expected to be placed on strengthening economic diversification, improving energy efficiency, and strengthening social safety nets. Reform efforts will particularly focus on the areas of financial sector development, governance and anticorruption, decentralization, and the general investment climate.

V. ECONOMIC AND SECTOR DIALOUGE

I. Private Sector Development

Mining Policy Reform Project: In September 2006, IFC, PEP-MENA signed an agreement jointly with the Ministry of Oil and Minerals to support the Government efforts to develop the country's mining industry. The Project is divided into three key phases: Diagnostic Assessment, Change / Re-designing, and Implementation. The first phase has been completed successfully. A Working groups (WGs) and sub-working groups has successfully been formed and identified from all relevant stakeholders for the second phase of the project to identify Legal and Fiscal texts, regulations, decrees, directives that need re-drafting. In early 2007, international and local consulting firms were contracted to carry out a variety of assignments. A year later (2008), the project had produced its first solid results, including an internationally competitive fiscal regime in the form of a mining tax section for the new Income Tax Act. In addition, a Mining Law is being drafted, and licensing procedures are being reengineered and put in place. A National Mining Policy for Yemen has been, also, drafted and endorsed by client. Next steps will involve submission of the Mining Code and Executive Regulations to the Yemeni Cabinet and to the parliament, afterwards, for approval. By the end of December, 2008, we expect to have a new Mining Policy Framework package approved by parliament and put in place for implementation.

Business Start-Up Simplification Project. The objective of the Business Start-Up Simplification Project is to help the Government at the national and sub-national level to establish simplified business start-up procedures to minimize bureaucratic obstacles for private investors. The aim is to support a comprehensive restructuring of the relevant business start-up procedures, resulting in reduced cost and time of business start-up requirements, thus encouraging more local and foreign investment. This technical assistance works in Sana'a to ensure that all simplifications are in line with national policy and applicable across the country. At the sub-national level, Aden is serving as the pilot case where these simplifications would be implemented first as part of the Administrative Modernization and Simplification project financed by the PCDP.

II. Education and Health and Social Policy

Secondary Education Development and Girls Access Project (SEDGAP): Project is expected to become effective in February 2009. Progress has been made in carrying out preparatory work such as technical analyses (population projections, school mapping, and school surveys) to determine the list of school sites for intervention and recruiting additional staff at MoE-PAU to be ready for implementation. The first group of schools for intervention was identified. The project agreement was approved by the Parliament on October 20, 2008.

Basic Education Development Project (BEDP): The pace of implementation has picked up to overcome some delays in the first year of the project. The Government of Yemen has been commended on the strong sense of ownership and commitment that is evident for the reform measures outlined under the Basic Education Development Strategy (BEDS), financed through the BEDP. The Credit Agreement has been amended to enable an innovative Whole School Improvement scheme (school grant scheme) to be launched in school year of 2008/09. A joint IDA, Netherlands, DFID, and KfW supervision mission is planned in February 2009.

Education For All – Fast Track Initiative: The Republic of Yemen has been one of the first 10 countries to meet the two criteria for the Education for All- Fast Track Initiative (EFA-FTI). Yemen was granted US$10 million during the launch of the FTI Catalytic Fund in Oslo, Norway in November 2003. Following successful implementation of the first phase, Yemen was allocated 2 successive phases of US$10 million and US$20 million for a total of $ 40 million from the Catalytic Fund (CF). The MOE and the Local Development Partners agreed on the Work Program for the Phase III Grant in October 2008, and an appraisal mission is planned in December 2008.

Towards the Development of an Integrated Education Vision The background studies for the Education Country Status Report (CSR) are under preparation. The CSR team will continue to conduct a technical analysis of the entire education sector. Next mission is planned in January 2009.

In health, the World Bank is providing finances to two new projects. As the current Health Reform Support Project ends on August 2009, the World Bank will finance two new health projects, to be implemented by MOPHP: 1) **The Schistosomiasis Project:** The proposed project would support the GoY's efforts towards the elimination of urinary and intestinal Schistosomiasis as a public health problem in Yemen. The project objective is to decrease the prevalence and intensity of infection of both urinary and intestinal Schistosomiasis among school-aged children by 2015 in endemic regions in Yemen. 2) **The Health and Population Project.** The project would support the GoY's efforts to achieve the 4th and the 5th Millennium Development Goals in reducing child and maternal morality, respectively. The project objective is to improve the quality and utilization of and integrated package of preventive, clinical, and public health services by 2015 in selected regions in Yemen.

The Cabinet

- approved draft law proposed by the Ministry of Finance regarding additional allocation for the general state budget for FY 2008 amounting to YR660.5 bln.
- approved two draft laws, first, regarding communications and information technology and second, regarding real estate possession by non-Yemenis.
- approved adding YR20 bln to the additional budget appropriation draft allocated by the President of the Republic for mitigating the impacts of rain floods in Al-Mahra and Hadhramaut governorates;
- approved two loan agreements signed between Yemen and Islamic Solidarity Fund for Development, first, for US$11.2 mln towards funding rural roads, and second, for US$10 mln for water and sanitation projects in Lahej governorate;
- approved cooperation agreement signed between Yemen and Hungary in the field of higher education and scientific research;
- approved amendment of Tourism Law No. 40/1999 in order to strengthen the role and performance of tourism sector;
- approved recommendations regarding hosting 20th Gulf Football Cup including security enhancement, hotel construction and other logistical arrangements;
- discussed draft Civil Defense Strategy proposed by the Ministry of Interior which incorporates a number of security measures for protecting civil objects;
- approved MoU between states of Indian Ocean, Gulf and Arab Sea coasts regarding combating piracy in regional waters;
- approved draft law proposed by the Minister of Interior regarding restructuring of the Police Academy;
- A financial agreement was signed between Yemen and Global Fund to Fight Aids, Tuberculosis and Malaria for the amount of US$27 mln to support Yemeni National Malaria Fighting Program.
- approved allocation of YR5 bln to the Fishery and Agricultural Production Promotion Fund for 2008-2009;
- approved additional funding agreement between Yemen and IDA for Civil Service Modernization Project signed on June 16 for the amount of SDR8.9 mln;
- approved the Memorandum of Understanding signed between the countries with coastal areas on Indian Ocean, Red Sea and Gulf of Aden regarding protection of sea tortoises.
- approved the results of work of joint Yemeni-Algerian committee during which cooperation agreements were signed in the field of economy, finance, culture, education, and others;
- approved Yemen's signing 2001 International Treaty on Coffee and ratification of 2007 International Agreement on Coffee and directed concerned parties to finalize constitutional procedures;
- Passed Law No. 46/2008 concerning Consumer Protection.
- approved starting preparation of the fourth Five-Year Development Plan for 2011-2015 by identifying general directions of the plan and pivotal development areas;
- approved allocation of YR5 bln to the Fishery and Agricultural Production Promotion Fund for 2008-2009;

Other government

- The Central Bank of Yemen has injected US$110 mln in the local market to cover foreign currency needs.
- Aden Free Zone signed an MOU with Raskhan International for setting up a US$60 mln commercial project including exhibition hall, conference hall, trade center and other facilities.
- Ministry of Civil Service and Insurance had completed procedures for increasing pensions of 41,344 retirees in compliance with national wages strategy.
- General Investment Authority has granted 22 project licenses in Aden at the cost of YR4.3 bln during the first half of 2008.
- The Higher Committee for Tenders approved eight service and development tenders at a cost of YR2.8 billion.
- An oil-production partnership agreement was signed between the Ministry of Oil and Minerals, Yemeni General Corporation for Oil and Gas and British Burn Energy Ltd. Co. for exploration works in Aden, Abyan and Lahej governorates.
- Aden branch of General Investment Authority has inaugurated One-Window System for facilitating investment procedures.
- Financing agreement was signed between Ministry of Education and Care International for funding of the primary education project at a cost of US$19.9 mln provided by Dubai Care Corporation.
- National exports via Al-Hodeidah port have reached YR15.7 bln during the first half of 2008 including sea products, agricultural and leather exports.
- General Investment Authority announced that the amount of Arab and foreign investments in Yemen for the first half of 2008 have reached YR54.3 bln via projects in industrial, service, tourism and agricultural sectors.
- The executive directors of the Social Fund for Development have approved its 2009 annual budget in the amount of YR25.4 bln.
- Central Bank of Yemen has injected US$118 mln into the local market to maintain exchange rate stability.
- The Higher Committee for Tenders approved eight service and development tenders at a cost of YR2.8 billion.
- An oil-production partnership agreement was signed between the Ministry of Oil and Minerals, Yemeni General Corporation for Oil and Gas and British Burn Energy Ltd. Co. for exploration works in Aden, Abyan and Lahej governorates.
- Aden branch of General Investment Authority has inaugurated One-Window System for facilitating investment procedures.
- The Supreme Commission for Elections and Referendum has approved 25% participation of female educationalists in the main elections committees and 50% in subcommittees.
- Yemenia Airways has signed a US$90 mln 10-year Fleet Management Agreement with Pratt and Whitney Global Services (US) Company.

The Private Sector

- Total E&P plans to invest US$1 bln in development of block # 10 in Shabwa and to increase its production to 60,000 bpd in 2009.
- The Commercial Bank of Kuwait has announced investment of US$30 mln in Yemen in partnership with Yemen-Gulf Bank and IFC.

- A German investment company has signed an agreement with Al-Zabi corporation regarding implementation of an aquaculture project in Hadharamaut at the amount of US$18 m shared 50%-50% between the partners.
- Yemen's fish product revenues reached US$120 mln during the first half of this year compared to US$101 mln during the corresponding period of last year signifying 18% growth rate.

Seminars and workshops

- Women National Committee has organized a training course on Fighting Gender Based Violence for journalists and media workers during October 24-28.
- A workshop on Capacity Building for police cadres working with juveniles was organized in Taiz by General Directorate for Women and Juvenile Affairs at Ministry of Interior in cooperation with UNICEF during October 18-20.
- Celebration of International Day of Anti Child Violence was organized in Aden by Safe Childhood Center in cooperation with Swedish Save the Children on October 18.
- An awareness campaign under the motto "Stand Up and Take Action" was launched by Yemeni Coalition for Global Campaign Against Poverty during October 17-19.
- A training workshop on Arab Coordinated Custom System was organized by Yemeni Industrialist Society in cooperation with GTZ on October 22.
- A workshop on Life Skills was organized by the Ministry of Education in cooperation with Arab Education Bureau during October 25-27.
- A workshop on Importance of Public Funds Declaration was organized by the Supreme National Authority for Combating Corruption on October 26.
- A workshop on Girls Education was organized in Amran by the Ministry of Education in cooperation with UNICEF during September 4-6.
- A symposium on Food Crisis and Common Responsibility Towards It was organized by the Ministry of Trade and Industry in cooperation with Future Movement during September 8-10.
- A symposium on Arab Nation between Terrorism and Religious Extremism was organized by the Yemeni Center for Historical Studies and Future Strategies during September 12-14.
- A regional symposium on The Role of Tribes was organized by the Yemeni Observatory of Human Rights in cooperation with Canadian International Development Research Center during October 6-8.
- A workshop on Girls Education for mosque preachers was organized in Al-Hodeidah by the Ministry of Endowment and Islamic Affairs in cooperation with UNICEF during October 8-9.
- Training on Opposing Violence Against Women for mosque preachers was organized in Aden by the Ministry of Endowment and Islamic Affairs in cooperation with UNFPA during October 13-14.
- A workshop on Health Education for NGOs was organized in Aden by the Reproductive Health Program supported by UNFPA during October 12-13.
- A discussion session on Women's Role in Public Life and Political and Civil Society Participation was organized by Aden Branch of Yemeni Women Union on September 22.
- A debate on Extremism and Terrorism was organized by the Yemeni Center for Human Rights Studies in cooperation with National Democratic Fund on September 27.
- Saudi Arabia has granted Yemen US$500,000 to the National Mine Action Committee.
- A training course on Combating HIV/AIDS was organized by Al-Firdous Women Development Association in cooperation with UNAIDS during August 1-15.

- A TOT workshop on Human Rights was organized in Al-Hodeidah by Life Makers Corporation in cooperation with Child and Youth Care Association during August 3-5.
- A workshop on the Role of Civil Society in Governance was organized by the Supreme National Anti-Corruption Committee in cooperation with the World Bank on August 12.
- A workshop on Psychological Effects of War in Sa'ada on Families was organized by the National Women Union in cooperation with UNFPA during August 13-15.

Development Cooperation

- AGFUND has donated 562,000 Saudi Rials to support victims of heavy rains in Hadhramaut and Al-Mahra Governorates.
- The German Government has offered €100,000 for alleviation of rain floods in eastern governorates in response to the appeal by the President of the Republic.
- The United States has pledge humanitarian aid to the floods affected areas for US$50,000 channeled via World Food Program.
- The Arab Fund for Economic and Social Development extended US$3 mln aid to rain-affected areas in eastern governorates.
- The Organization of Islamic Conference has offered Yemen a grant for US$250,000 to support flood-affected areas.
- The Islamic Development Bank as donated YR150 mln to support the people affected by the heavy rains in eastern governorates.
- The Government of Japan has provided relief materials worth US$200,000 to the people affected by the floods.
- Interax Petroleum Services Company has granted Yemen YR15 mln for mitigating damages in flood-affected areas.
- An agreement was signed between Yemen and Netherlands for the an additional support in the amount of US$36 mln to mother and child health programs.
- A grant agreement between Yemen and USAID was signed for the amount of US$3.1 mln to support Social Fund for Development, Al-Saleh Corporation for Vocational Training and other training centers.
- An Extension Agreement for Improvement of Yemeni Trade and Industry Registration Capacities for the amount of US$413,589 was signed with UNDP, Italy and the MOTI .
- The World Bank has approved additional finance for mln for the Groundwater and Soil Conservation Project.
- Japanese government has granted US$4 mln for purchase of 250 tractors for junior farmers.
- German government has granted € 16 mln in finance and technical assistance to support Yemen in fighting food crisis.
- Two loan agreements were signed between Yemen and IsDB for US$21 mln to finance rural roads and water supply and sanitation services in Taiz and Lahej governorates.
- Financing agreement was signed between Ministry of Education and Care International for funding of the primary education project at a cost of US$19.9 mln provided by Dubai Care Corporation.
- United Nations Population Fund (UNFPA) has granted US$117,000 to support rehabilitation of health sector in Sa'ada Governorate.

Pledge Allocations & Effectiveness By donor as of November 2008

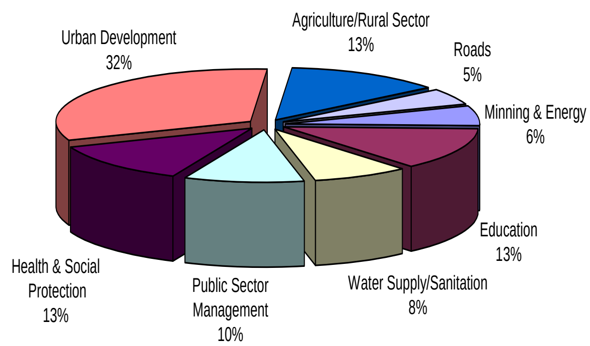
(in US$ million)

No	Donor	Pledge	Allocation		signed	
			Amount	%	Amount	%
GCC Bilaterals		**2677**	**1949**	**73**	**702**	**26**
1	Saudi Arabia	1227	1067	87	574	47
2	Oman	100	100	100	53	53
3	Untied Arab Emirates	650	500	77	75	12
4	Qatar	500	282	56	0	0
5	Kuwait	200	0	0	0	0
Multilaterals		**1918**	**1447**	**75**	**546.3**	**28**
6	Islamic Development Bank	200	200	100	31.3	16
7	Arab Fund for Socio-economic Development	786	786	100	331	42
8	World Bank (IDA)	400	199	50	125	31
9	IFAD	70	29	41	16	23
10	OPEC Fund for International Development	20	11	55	11	55
11	Arab Monetary Fund	220	0	0	0	0
12	European Commission	100	100	100	0	0
13	UN System	90	90	100	0	0
14	Global Fund	32	32	100	32	100
DAC Donors-OECD		**852**	**597.83**	**70**	**218**	**26**
15	United Kingdom	230	230	100	26	11
16	Germany	190	101.13	53	101	53
17	South Korea	100	24	24	24	24
18	Netherlands	91	91	100	0	0
19	Japan	69	38	55	7	10
20	USA	21	21	100	10	48
21	France	130	73	56	41	32
22	Italy	12	12	100	0	0
23	Denmark	9	7.7	86	9	100
24	China	0	0		0	
Total		**5447**	**3993.83**	**73**	**1466.3**	**27**

Source: MOPIC

The World Bank is currently financing 21 projects in Yemen, including supplemental financings, with a total commitment of USD 855 million. An additional USD 76 million in grants were committed by the Bank through 29 separate Trust Funds, 15 of which are Bank-administered. Most of the 21 lending operations are investment projects, covering a broad range of economic and social sectors, including urban development, health and social protection, education, infrastructure (energy, transport, water, and irrigation), agriculture and fisheries, environment, and public sector

Figure 1: Sectoral Distributionof Ongoing Projects (by Commitment)



Ongoing World Bank Operations in Yemen

(as of October 31, 2008)

Project Name	Close Date	Loan $	Disb. $	Disb. %
Groundwater & Soil Conservation	31-Oct-09	40.0	25.79	64%
Rural Water Supply and Sanitation	31-Dec-07	40.0	24.57	61%
Irrigation Improvement	30-Jun-07	21.3	20.13	95%
Sana'a Basin Water Management	30-Jun-09	24.0	12.66	53%
*Fisheries Res. Mngmnt & Conserv.	30-Sep-11	25.0	1.41	6%
Urban Water Supply and Sanitation	31-Dec-07	125.3	96.90	77%
Port Cities Development	30-Jun-07	23.4	17.02	73%
Taiz Muni. Dev. and Flood Protection	31-Oct-07	65.2	55.00	84%
Third Public Works	30-Jun-09	74.8	44.19	59%
II Rural Access Project	30-Nov-10	40.5	18.03	45%
Rainfed Agriculture and Livestock project	30-Jun-12	20.0	4.33	22%
Power Sector Project	31-Dec-11	50.0	0.98	2%
Civil Services Modernization	31-Dec-07	44.0	25.51	58%
Institutional Reform Credit (DPL)	30-Jun-10	50.9	26.99	53%
Health Reform Support	31-Dec-08	27.53	27.96	102%
Higher Education	30-Jun-08	5.0	2.73	55%
Third Social Fund for Dev.	31-Dec-08	63.4	70.11	111%
Social Fund for Dev. III (supplemental)	1-Jan-09	15.0	2.00	13%
Vocational Training II	31-May-13	15.0	0.00	0%
Basic Education Dev.	30-Jun-10	65.0	26.04	40%
Sec. Educ. Dev. And Girls Access Program		20.0	0.00	0%
		855.33	**502.35**	**59%**

* close date correspond to original date