

Summer 2008

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**The World Bank Group
Sana'a Office**



Yemen Economic Update

Yemen Economic Update is a quarterly report that consists of several sections. The first section highlights major political and social developments. The second covers the macroeconomic developments. The third section provides a summary on structural reforms and developments; it also covers conferences and donors activities in Yemen

SUMMARY

The government announced reaching an agreement with the Houthi rebel group to end the war. The long-running conflict with the rebel group in the Saada governorate in northern Yemen has resurfaced earlier this year after the breakdown of the Qatari mediation efforts. The conflict has also spread to the area of Bani-Hushaish tribe, on the northern outskirts of Sana'a. In the wake of the new peace deal, the government announced new measures to expedite the delivery of emergency humanitarian aid and reconstruction efforts to the war-torn area. Other unresolved security challenges facing Yemen are 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. In addition, sporadic demonstrations and violent protests in the south of the country have continued, thus adding to the tense political situation. These events come at a time when the ability of the government to use fiscal measures to placate public anger over low living standards is being eroded by the steady depletion of the country's oil reserves.

The global increase in food prices is aggravating the poverty situation. Yemen, which is a large net food importer (about 75% imported), is facing adverse political and social consequences as a result of rising global food inflation. With a large segment of the population already living below poverty line, the increase in domestic food prices, estimated by 37 percent since January 2007, is likely to worsen the poverty situation. Spiraling prices and increased poverty is also feeding into increased social tensions and instability in Yemen, with implications ranging from curtailed political freedoms to reactionary measures that will undermine the reform agenda, particularly with respect to reducing public spending on wages, and subsidies on food and fuel.



Macroeconomic performance was mixed in 2007. The performance largely reflects the falling crude oil output (by more than 12 percent) which affected overall growth, fiscal outturn, and balance of payments. Overall growth for 2007 is estimated at 3.6 percent, compared to 3.2 percent in the previous year. The non-oil output witnessed a relative improvement over the previous year to 5.5 percent supported by public spending and private investment. In the fiscal area, despite higher than budgeted tax revenue and earlier savings in spending, the budget has shown a widening deficit of about 6 percent of GDP. The external sector showed deterioration as the current account balance reverted to a deficit of more than 5 percent of GDP, and the reserve accumulation eased to US\$170 million, compared to US\$1,460 million in 2006. A reduction in the inflation rate was the main positive outcome in 2007 reflecting tighter public spending in the early part of the year and good seasonal rains. As result, the average inflation rate for 2007 fell to 12.5 percent, a significant drop from 18.5 percent in 2006.

The outlook for 2008 calls for moderate improvement. The slower decline in oil production combined with record high international oil prices are expected to help Yemen's growth rate to improve to 4.2 percent in 2008. Higher oil revenue is expected to reflect positively on the fiscal and external sectors, though some of these gains will be wiped away by rising inflation and higher cost of imported goods. On the fiscal side, higher oil revenue and improved tax are expected to bring a slight improvement in fiscal balance narrowing the deficit to 3.8 percent of GDP. Similarly, the current account deficit is expected to shrink to about 1 percent of GDP, compared to 5.6 percent in 2007. Needless to say, this outlook could worsen if oil production declined faster than the anticipated rate of 3 percent. Other negative factors include a further worsening in security conditions, which could affect public spending, private capital flows and growth in the non-oil sector.

Rising inflation will be the main concern in 2008. With the annualized rate for the first four months of the year approaching 27 percent, the average inflation for the year 2008 is expected to run above 20 percent, surpassing its 2007 and 2006 levels. The likelihood of high average inflation in 2008 is supported by expectations of continued global inflationary pressures, current dry local weather conditions, and the possibility of fiscal easing towards the year-end in association with upcoming elections. The exchange regime is not likely to see a sharp adjustment in order to curb inflation, as the government is expected to maintain the informal peg of the rial to the dollar at its current level of about 200 YR/US\$.

I. RECENT POLITICAL AND SOCIAL DEVELOPMENTS

The conflict in Saada, one of the main security challenges, was successfully resolved. In the mid July, the government announced a breakthrough agreement with the Houthi rebel group to end the war. The long-running conflict with the group in the Saada in northern Yemen has resurfaced earlier this year after the breakdown of the Qatari mediation efforts. The conflict also spread to the area of Bani-Hushaish tribe, on the northern outskirts of Sana'a. In the wake of the new peace deal, the government announced new measures to expedite the delivery of emergency humanitarian aid and reconstruction efforts to the war-torn area. Other unresolved security challenges facing Yemen are 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. In addition, sporadic demonstrations and violent protests in the south of the country have continued, thus adding to the tense political situation. These events come at a time when the ability of the government to use fiscal measures to placate public anger over low living standards is being eroded by the steady depletion of the country's oil reserves.

As part of the drive for decentralization, first-ever elections of provincial governors were held in May 2008. Following the amendment of the local authority Law in April, the elections were held in May amid a boycott from the main opposition parties who demanded the elections to be based on direct voting rather than being restricted to municipal council members. Because of the boycott, the elections, held for 21 governorates, were won mostly by members of the General People's Congress (GPC) (except of three). More than 7,000 members of municipal councils casted their votes in the 20 provinces including the capital Sana'a. Overall, the progress of implementing the decentralization plans in Yemen, which was initiated more than 7 years ago, has been very slow, partly reflecting the severe capacity constraints at the regional levels. In this respect, Local Government Ministry has recently announced that a comprehensive strategy for decentralization will be rolled out during the second half of this year. The proposed strategy aims to provide guidance and timeframe for broad legal and administrative reforms that will eventually help the local administration to gain more economic and administrative autonomy.

The Cabinet witnessed a partial reshuffle in May 2008. The reshuffle, that came one year after the major change in the Cabinet in March 2007, has emphasized changes in the domestic security command and the administration of the energy sector. The new cabinet has three ministers dealing with domestic security affairs, instead of only one. The new designations include the posts of the deputy prime minister for defense and security affairs, the interior minister, and new post of deputy prime minister for interior affairs. The change comes amid escalating violence, particularly on the northern province of Saada, and the attacks by a resurgent *al-Qaida* in Yemen. Other changes in the cabinet include the appointment of new ministers of oil and electricity. Moreover, as a result of the local governorates elections, the Cabinet witnessed the departure of the Minister of Civil Services who was elected as governor of Taiz.

Yemen is likely to miss the target on all MDG goals. Despite advancements on many development fronts, Yemen continues to face considerable development challenges. It ranked 153 out of 177 countries in the 2007 UNDP Human Development Index. Progress in human and other development

indicators, while steady, has been too slow to assure the attainment of the MDGs by 2015. Earlier reports have identified two areas where MDGs could possibly be achieved in Yemen: universal primary education and child mortality. However, despite the absence of more recent studies to revise these assessments, the slow progress on the poverty front support the view that MDG targets will be missed in Yemen. The slow progress in achieving the MDGs in Yemen stems from a number of structural and long-term development challenges that include the high rate of population growth, the scarcity of water resources, and, more recently, the rising global inflation. The public administration is weak with under-trained and under-paid civil service staff, making changes in the status quo subject to the presence of high political resolve and dedication of significant national resources. Recent studies based on 2004 household budget survey suggest that average poverty rate is around 35 percent (i.e. about 84 percent above the 2015 target of 19 percent). Access to basic education remains poor with more than 2 million children still not attending school. Rates of child malnutrition (46 percent) and maternal mortality (366 for 100,000 live births) remain high and might continue to grow if no concrete measures are put in place. Unemployment figures, which are poorly documented, indicate rising levels of at least 16 percent. Also, despite efforts to improve access to basic social needs, infrastructure remains weak, with limited electricity coverage (30 per cent), access to safe water (36 per cent), and telecommunications (4 fixed lines per 100 inhabitants).

Among the MDG targets where Yemen continues to make slow progress, is gender equality. The fact that Yemeni women continue to occupy a disadvantaged socio-economic status is reflected in their low scoring on almost all social and economic indicators. Among the factors contributing to this poor status is the lack of a legislation on minimum age for marriage, which in turn negatively reflects on issues such as school enrollment, fertility rates, and maternal mortality. A recent study revealed that more than 52 percent of women marry below the age of 15 (as compared to 7 percent of men), with 70 percent of these marriages occurring in rural areas. Factors contributing to this phenomenon include poverty and conservative social traditions, and the absence of civil laws on the minimum age for marriage. Also reflecting the poor status of Yemeni women, another recent study has revealed that female circumcision is on the rise. The study, conducted by a local think tank, concluded that this practice, which came to Yemen from African immigrants, is spreading throughout a number of governorates, including Hodeida, Al-Mahrah, Hadramout and Sana'a. According to the report, the rate of circumcision among Yemeni women went up to 23 percent. Despite efforts by officials, donor countries, organizations and others, female circumcision continues to rise and spread to other provinces compelling social organizations to focus their efforts towards addressing this alarming trend. The study recommends taking public awareness campaigns and enacting laws to criminalize this act in Yemen.

Box 1. The Millennium Development Goals

- 1. Extreme Poverty and Hunger**
 - Halve the proportion of people living below national poverty line by 2015
 - Halve the proportion of underweight, under-five year olds by 2015
- 2. Universal primary education**
 - Achieve universal primary education by 2015
- 3. Gender equality**
 - Equal access for boys and girls to primary and secondary schooling by 2005
- 4. Child mortality**
 - Reduce under-five mortality by two-thirds by 2015
- 5. Reproductive and maternal health**
 - Reduce maternal mortality ratio by three-quarters by 2015
- 6. HIV/AIDS, malaria and major diseases**
 - Halt and reverse the spread of HIV/AIDS by 2015
 - Halt and begin reverse on malaria and other major diseases by 2015
- 7. Environmental sustainability**
 - Reverse loss of environmental resources by 2015
 - Halve the proportion of people without access to safe drinking water
- 8. Global partnership for Development**

Table1. Yemen main socioeconomic indicators

Indicator	value	Year
Poverty rate		
Overall	34.78	2005
Urban	20.70	2005
Rural	40.09	2005
Net primary schools enrollment		
Male	74.7	2005
Female	55.3	2005
Overall	65.5	2005
Primary schools completion (%)		
Male	79.7	2005
Female	56.4	2005
Overall	68.5	2005
Literacy rate (15-24 yrs old)	71	2005
Education fiscal spending (%)	4.26	2006
Gender parity index		
Primary education	68	2006
Secondary education	48.9	2006
University	37.5	2006
Ratio of literate women to men	61.4	2006
seats held by women in national parliament	0.33	2007
Share of women in wage employment	6.3	2006
Under-five mortality rate (per 1000)	92.3	2004
Infant mortality rate (per 1000)	77.2	2004
Maternal mortality ratio (per 100,000)	365	2003
Births attended by skilled health personnel	27.3	2003
Proportion of 1-year old immunized against measles	66	2003
HIV/AIDS new cases	530	2007
Malaria infection (per 100000)	263	2006
Proportion of land area covered by forest	1.0	2005
Protected areas	0.001	2004
Energy use (kilogram oil equivalent) per \$1000 GDP)	371	2004

Source: CSO

Recent global increase in food prices is jeopardizing political stability and aggravating the poverty situation in Yemen. Yemen, which is a large net food importer (about 75% of food is imported), is facing severe political and social consequences as a result of rising global food inflation. With an estimated 35% of Yemen population living below poverty line, the increase in global food prices, estimated by 60 percent between 2007 and 2008, is likely to have aggravated the poverty situation, particularly for the poor in urban areas, and the landless and small and marginal farmers. Estimates put the number Yemeni who have fallen below the poverty level as a result of recent price increase by at least 6 percent. Spiraling prices and increased poverty is also feeding into increased social tensions

and instability in Yemen, with implications ranging from curtailed political freedoms to reactionary measures that will undermine the reform agenda, particularly with respect to reducing public spending on wages, and subsidies on food and fuel.

International donors are increasing their support to Yemen in dealing with soaring food prices. In the wake of the current global food price inflation, a number of bilateral and multilateral donors announced new aid packages to support Yemen. These measures include in-kind provision of food (UAE), cash to support the poor and social welfare institutions (WB), support to small farmers in the agricultural sector (FAO), and general support to the agricultural sector (EU and IDB). The crisis is also straining the resources of the donors, such as WFP, who are already engaged in food support programs in Yemen. To enhance coordination among various donors, a Joint Task Force on Food Crises in Yemen was established. Among the recently announced measures to support Yemen are the following:

- **United Arab Emirates.** The UAE announced in May 2008 plans to buy 500,000 tones of wheat to be donated directly to the government of Yemen.
- **WB.** As a part of US\$1.2 billion Fast-Track Facility for Food Crisis, the WB granted Yemen US\$10 million in June. The grant will be used to support community-based labor intensive work program and strengthen capacity of the Social Welfare Fund (SWF) in its operations to help the poor population to alleviate the impact of rising domestic food prices.
- **EU.** On June, 08, the EU announced plans to support agricultural sector in Yemen. Recent meetings that has held in Sana'a, indicate commitments to support the agricultural sector but the details remain sketchy.
- **IDB.** The Islamic Development Bank announced in June the allocation of US\$1.5 billion to support Yemen, among 25 other states, on food crisis. The program, which lasts five years, will focus on supporting the member States of the bank as well as other affected countries.
- **UN/FAO/UNICEF.** Yemen is one of 48 countries that will receive technical aid from FAO to support agricultural productivity (focusing on small farmers) and help vulnerable households. More recently, UNICEF announced the allocation of \$2.5 mln to support children nutrition program.
- **Other bilateral donors.** Following the G8 meetings in Tokyo, several bilateral donors announced plans to provide additional support to Yemen in the form of nutrition interventions, social protection activities and measures to increase agricultural output. These donors include Germany (Euro4 mln), Netherlands (Euro3.7 mln), United Kingdom (\$2 mln), USA (\$1.7 mln), and Saudi Arabia (\$1.7 mln).

II. MACROECONOMIC DEVELOPMENTS

Oil prices witnessed a sharp rise during the first half of 2008, reaching a record high of more than US\$145 per bbl in early July. Rising oil prices to these levels, which in real terms exceed the historical highs of 1981, has led to mounting global inflation and concerns for world-wide economic slowdown.¹ The steady price increase, particularly in the second quarter of 2008 was supported by continued tensions in the Gulf and tight supply conditions, which were reflected on low inventories in major consuming countries. As a result, average future prices in July also increased for 2008 and 2009 to US\$122.7 and US\$138.4, respectively. Upside risks in these projections include factors such as the lack of surplus capacity, low inventories, accelerated reserve depletion, higher cost of production (due to credit crisis, extraction from unconventional sources), unexpected growth in demand supported by fuel subsidies, US dollar weakness, increased speculation, lower interest rates, shortage of investment in developing new oil fields and expanding or maintaining refineries and pipelines. Meanwhile, downside risks include easing of political tensions in the Gulf, deepening global recession, increased refinery capacity, rising inventories, cuts in fuel subsidies, and increased non-OPEC production. Based on official data, the price of Yemeni crude exports averaged US\$73.4 per bbl in 2007, compared to US\$84 per bbl projected for 2008.

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

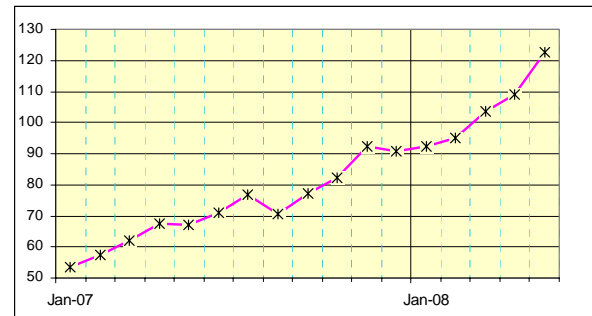


Table 2 - Oil Production, Trade and Consumption (in million bbls unless otherwise indicated) 2006-07

	2006	2007	2008*	% change 06/07	% change 07/08
Crude oil output (gross)	133.3	116.7	113.1	-12.5	-3.1
Crude oil output (net)	130.4	113.3	109.7	-13.1	-3.2
State's share inc. royalties	85.7	72.6	71.4	-15.2	-1.8
Companies share inc. cost oil	44.7	40.7	38.3	-9.0	-5.7
Exports of crude oil	105.5	82.1	77.0	-22.2	-6.2
of which: government share	50.9	36.7	35	-27.9	-4.6
Domestic refinery consumption of crude oil	26.0	31.2	33.5	20.0	7.5
Consumption of refined products (million tons)	5.3	5.7	6.0	7.1	6.0

Source: Ministry of Oil and Minerals and MOPIC

The value of oil exports for the first five months of 2008 has more than doubled in relation to the same period a year ago. Yemen does not publish comprehensive monthly data on oil transactions. Data in the monthly publication of the Central Bank pertain to three items: government share of exports (in bbls) (including exports of crude by Marib Refinery and the share of state oil companies), domestic consumption of crude in Aden and Marib refineries (in bbls), and value of exports (in US\$). According the CBY report, Jan-May figures for government exports, domestic refined products consumption and total exports value show changes over the same period of last year by about 16, -20, and 107 percent, respectively.

¹ July record prices obliterate, not only nominal highs, but also inflation-adjusted highs of \$100-111/b reached in 1981.

Yemen experienced a notable shortage in diesel fuel in May, with the owners of agricultural machinery, trucks and bakeries suffering the most. In the capital city, trucks and cars using diesel had to form long lines at fuel stations. Prices shot up in some regions with a premium of 50% above its official price. The recent diesel crisis in Yemen reflects the limited refining capacity (and subsequent reliance on imported diesel) and the growing domestic demand (which includes smuggling to neighboring countries) fueled by subsidized domestic prices². The recent shortage episode was caused by management shortfalls and logistical delays of imported diesel consignments, and further aggravated by speculations that the government was preparing to raise the domestic prices. The crisis, though later resolved, served to highlight the vulnerability of the country to fuel disruptions despite being a net oil exporter. Yemen has oil refining capacity of 120,000 b/d from two ageing plants, Aden Refinery with a capacity of 110,000 b/d and Ma'rib refinery of 10,000 b/d capacity. Much of the local production is exported by Aden refinery, which, owing to the mismatch between the production and domestic consumption profiles, also imports some products to satisfy domestic needs. Among the chief items imported is diesel (and fuel oil), which is used for electric power generation, agriculture, and transport. Both refineries are publicly owned and under the control of the Ministry of Oil and

Table 3. Aden Refinery imports and exports of products in 2006 (in 1000 M.T.)

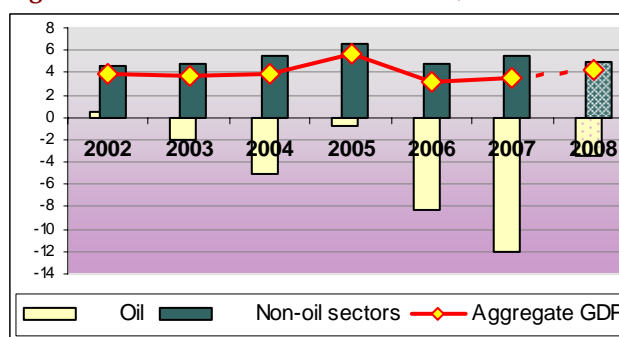
	<i>Gasoline</i>	<i>Diesel</i>	<i>Kerosene</i>	<i>Fuel oil</i>	<i>Naphtha</i>	<i>LPG</i>	<i>Total</i>
Imports	226.4	1746.1	0.0	1332.0	8.2	0.0	3312.7
Exports	0.0	0.0	297.2	577.3	164.6	21.6	1060.7
Net	-226.4	-1746.1	297.2	-754.7	156.4	21.6	-2252.1

Source: MOMR

Mineral Resources (MOMR). The government has backed away from a 2001 plan to privatize the Aden refinery. Plans to establish private-owned refineries, such as in Ras-Essa and in Hadramout, seem to be put on-hold due to lack of progress in negotiations. In this regard, Yemen continues to suffer from the lack a comprehensive strategy for the downstream petroleum sector, with respect to both public owned operations and the role of the private sector. Efforts to encourage international private investors continue to be hampered by the inadequate policy framework, weak regulatory capacity, and insufficient transparency.

Preliminary estimates indicate that GDP growth in 2007 reached 3.6 percent, a slight improvement from 3.2 percent in the year before. This came with the backdrop of good performance in the non-oil GDP at 5.5 percent (compared to 4.7 percent in 2006) which offset the sharp contraction in the oil output estimated at more than 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.

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



² Currently, domestic diesel prices in Yemen are set at two levels: for general users at 0.36 \$/liter and for power generation purposes at 0.17 \$/liter. Current international reference price is more than 1.40 \$/liter.

Yemen's inflation rate rose sharply in the first four months of 2008. For the period January-April 2008, all-items price index increased by 9 percent (or about 27 percent on annualized basis) over the previous four months (i.e. Sept-Dec 2007) and by about 20 percent over the same period last year. The sharp turnaround in inflation in 2008, follows a relative slow-down in 2007 to 12.6 percent. The resurfacing of inflation in 2008 has been propelled by global factors such as rising food and fuel prices, a weakening US dollar, and by local factors such as drought conditions, and possibly the weakened effects of earlier government intervention in the wheat market through direct marketing. The high inflation rate in Yemen, though largely imported, needs to be augmented with an active monetary policy to maintain sufficiently high positive real interest rates (nominal deposit interest rates are fixed but lending rates are not). Otherwise, low or negative real interest rates could intensify credit growth and raise demand in the economy, thus ratcheting up inflationary pressure further.³

Figure 3. Yemen: monthly price indices, 2007– 2008

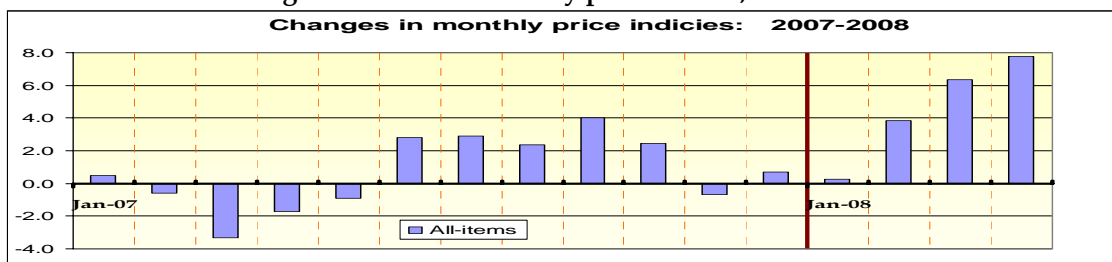


Table 4 Government Finances 2006-08 (In percent of GDP)

Item	Budget	Prelim.*	Budget	Proj*
	2007	2007	2008	2008
Tax Revenues	6.0	7.0	6.2	6.5
Grants	0.5	0.1	1.2	0.7
Property Income,	24.7	24.9	18.7	29.3
<i>Of which: oil revenue</i>	22.2	22.1	16.6	27.3
Capital Rev	0.01	0.01	0.01	0.01
Total Revenues and Grants	31.2	32.0	26.1	36.6
I : Current Expenditures	27.7	30.6	24.0	32.2
1. compensation of employees	10.5	11.1	9.3	10.7
2. Goods and services	3.4	3.7	3.1	3.3
3. Maintenance	0.5	0.8	0.5	0.5
4. Current Transfers and Loan Interests	12.7	14.5	10.5	17.1
a) Loan Interests:	2.2	2.3	1.9	2.2
b) Subsidies:	7.6	9.3	5.9	12.1
c) Current Transfers of which:	3.0	2.9	2.8	2.8
5. Other Current Expenditures	0.5	0.6	0.5	0.6
II : Capital Expenditures	6.8	7.7	8.3	7.3
III :Net Lending	1.8	1.4	1.3	0.9
Total Expenditures and Net lending	36.4	39.7	33.6	40.4
Deficit /Surplus (Overall)	-5.2	-7.7	-7.6	-3.8
GDP at Market Prices (bill YR)	4400	4400	5395	5395

* Revised fiscal data (and GDP)

The fiscal outturn for 2007 shows a deficit of about 7.7 percent of GDP, higher than the 5.2 percent originally projected under the budget. In part, the increase reflects additional expenditure passed

³ The monetary authorities in Yemen do not compile and publish data on bank lending rates to various class of borrowers. Meanwhile, bank deposit rates have been fixed since December 2000.

under the supplementary budget towards the end of the previous fiscal year (which mostly covers military wages and spending, subsidies and security related matters). Strong tax revenue of about 16 percent over the budget estimates has mitigated the effect of the rising expenditure under the supplementary budget. Meanwhile, oil revenue remained largely unchanged, with higher oil prices offsetting losses associated with falling production. For 2008, revised projections call for a narrowing of the deficit to 3.8 percent as a result of higher oil revenues, which will be partially offset by rising spending on subsidies and other current items. To this effect, the government passed in March 2008 unbudgeted increase wages that are expected to add about YR 62 billion (or 4.8 percent increase in current expenditure) in 2008 alone.

The Yemeni rial exchange rate versus the US dollar continued to hold steady during the first four months of 2008, reaching 199.7 per US dollar at the end of April. Under the current “managed float” exchange rate system, the Yemeni rial has witnessed steady depreciation versus the US dollar of about 3 percent per annum over the past few years. The depreciation of the rial slowed to a virtual standstill in 2007, at around 199 rials per dollar, as the authorities struggled to lessen the inflationary impact of the weakening dollar value against other major currencies. Yemeni monetary authorities are expected to continue to manage the rial exchange rate with the aim of striking a balance between controlling inflation and maintaining competitiveness of non-oil exports.

Revised estimates indicate a larger than expected current account deficit in 2007. The current account balance in 2007 is estimated, under most recent revision, to have deteriorated into a deficit of 5.6 percent of GDP (as compared to earlier estimates of less than 4 percent). The deficit in 2007 is caused by falling oil exports by about 9 percent (oil has more than 90 percent share in commodity exports) and the large surge in the imports payments owing to rising global inflation and increased imports of capital equipment for the ongoing LNG project. This deterioration comes after a long trend of positive current account balances and steady growth in the country’s foreign reserves (see figures below). In 2008, and on the strength of oil export revenues, the current-account deficit is likely to narrow to about 1 percent of GDP.

Figure 4. Current account balance (in percent of GDP) 1999-2008

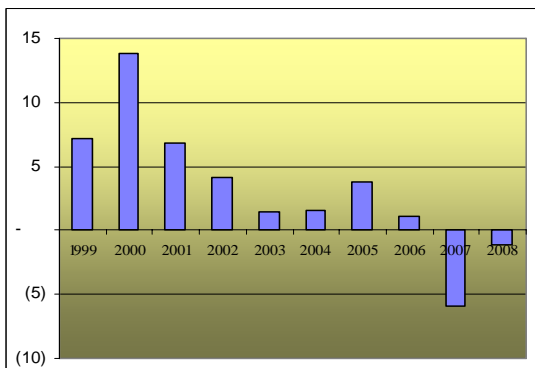
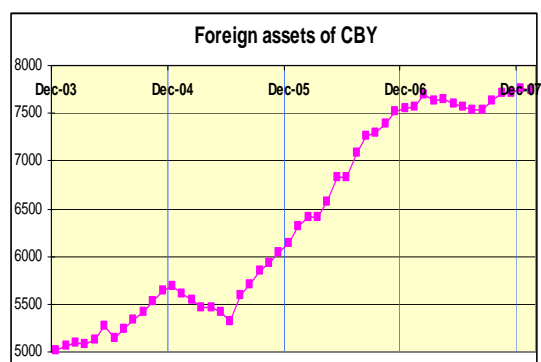


Figure 5 - Foreign Assets of the CBY 2003-07



Yemen's external debt amounted to about US\$6 billion at the end of April 2008, up by 2.6 percent from the end of 2007. Relative to GDP, Yemen's overall external debt has been showing steady a decline in recent years, reaching 24.6 percent of GDP at the end of 2007. However, the country faces fiscal sustainability challenges ahead, as its oil output continues to fall, particularly with regards to

developing alternative non-oil revenue and expediting structural reforms that could help to reduce budget expenditure. It is noteworthy in this regard to mention that a proposal for a new law on public sector debt has been awaiting parliamentary approval for more than two years. The proposed law limits the size of public debt (external and internal) to 80 percent of GDP, and sets new administrative procedures for national debt management. One noteworthy point is the recent decision by the World Bank to finance its operations in Yemen for FY09 through grants. This will help in reducing the debt service obligation in the future.

Table 5. Yemen outstanding external public debt (in million US\$ at period end)

	2005	2006	2007	April -2008
Paris Club Countries	1,743.0	1,728.8	1,736.9	1,761.2
Non-Paris Club Countries	911.0	959.7	1,007.0	1,019.2
Multilateral	2,514.7	2,781.7	3,075.1	3,189.6
Grand Total	5,168.7	5,470.3	5,819.0	5,970.0
% change	...	5.8	6.4	2.6 (7.8% annual)
In percent of GDP	30.8	28.7	24.6	24.1

Money supply growth was tamed during the first five months of 2008, with M2 rising by 2.7 percent by the end of May. This comes to about 6.5 percent annual growth as compared to 17.5 percent for 2007. Growth in net domestic credit during the months of February–May has largely underlined lending to the government sector (which includes the pension fund under CBY classification) and public enterprises, with the expansion in the latter possibly reflecting the needs to finance the purchases of subsidized wheat by Yemen Economic Corporation. Credit to the private sector remained modest at an annual rate of 12 percent.

Figure 6. Monthly Money Supply (M2) in 2007-08

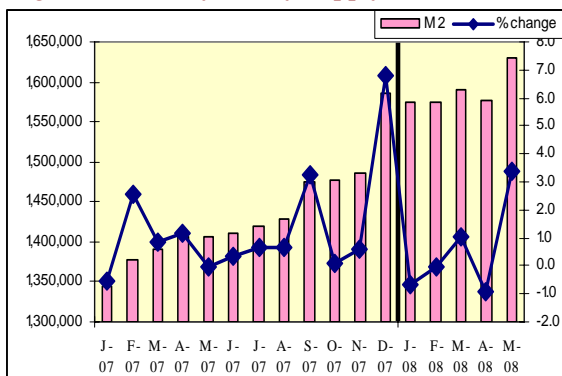
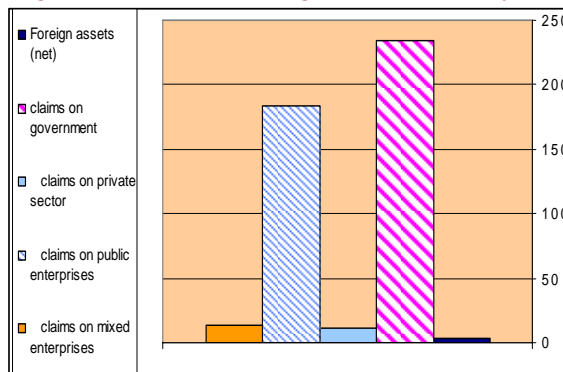


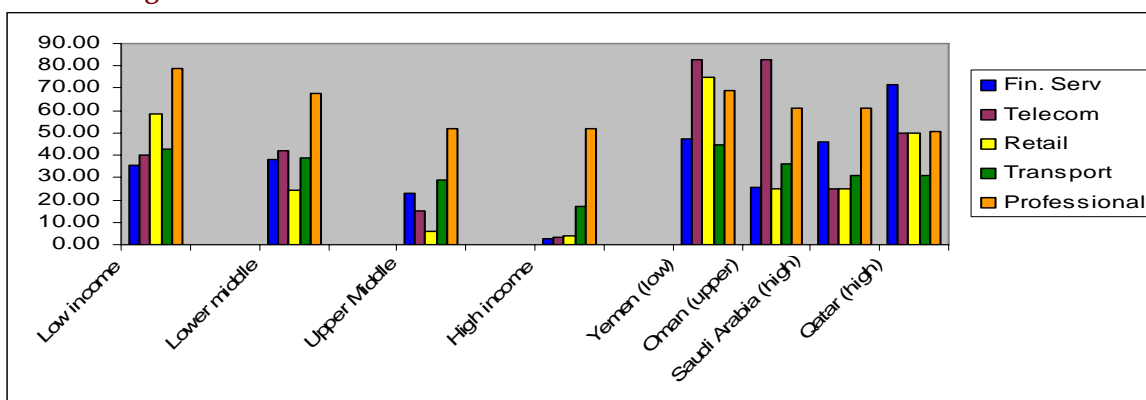
Figure 7. Domestic credit growth in Feb.-May 2008



III. STRUCTURAL REFORMS AND POLICIES

Foreign direct investment in Yemen's services sectors continues to face a number of legal restrictions. According to a recent World Bank survey, current policies with respect to foreign competition in the provision of services in Yemen appear to be highly restrictive. In most sectors, majority-owned FDI is not permitted and there are limitations on the ability of investors to employ foreign workers (including at management level). In the area of internal transport services, only joint ventures are allowed, and foreign firms are not permitted to own facilities to provide maritime auxiliary services. Fixed line telecommunications is closed to competition, while mobile services are limited to minority ownership. Compared to other low-income countries, with the exception of professional services, Yemen has a more restrictive regime towards foreign competition on services markets. Yemen also has a more restrictive policy stance than the neighboring GCC.⁴ Distribution (retail), transport and professional services are more restrictive than in Saudi Arabia, Oman and Qatar. The GCC countries in turn tend to have more restrictive policies on foreign participation in services markets than do countries with similar levels of per capita incomes in the rest of the world. The surveys focus primarily on policy barriers to cross border trade in services and commercial presence or FDI and cover five key sectors: finance, telecom, retail distribution, transportation, and professional services. Some of the sectoral restrictions apply equally to both local and foreign investors (e.g. the public monopoly of fixed lines in telecom), while others aim specifically towards foreign investors. Yemeni legislations related to foreign investment in services sectors fall primarily under the Investment Law 22 of 2002.⁵ The Law does not cover sectors such as finance, trade, importing, wholesale and retail trade, which are governed by separate laws, (e.g. banking and commercial companies' laws). Other relevant legislations include the Land Law, and FDI-related provisions of the Customs and Tax Laws.

Figure 8. Index of restrictiveness of services in Yemen and selected countries

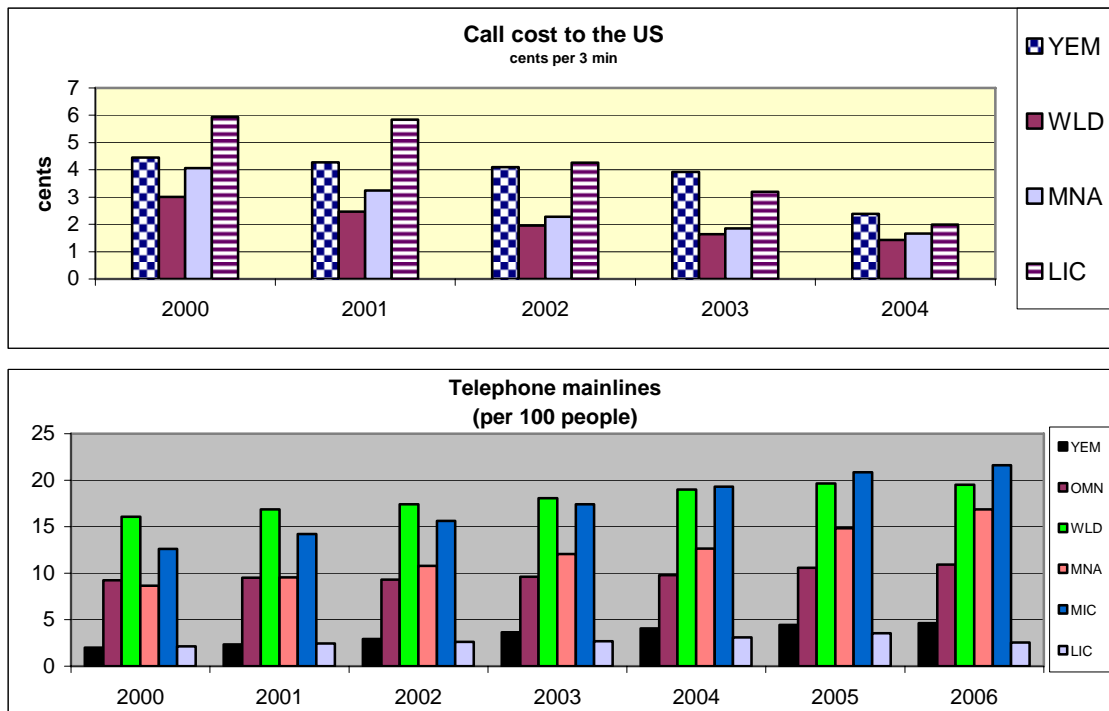


Source: WB "Gootiiz, Mattoo (2008)"

⁴ data available for three GCC countries only

⁵ Law 22 is currently undergoing revisions.

Figure 9. The telecom sector of Yemen : some comparative indicators



Source: WDR database

The Yemeni telecom sector is constrained by outdated infrastructure and an inefficient regulatory framework. Yemen is currently one of the least developed telecoms markets in the Middle East, serving approximately 1.1 million fixed-line and 3.1 million mobile subscribers, as well as 300,000 internet users, at the end of 2007. The sector faces many challenges unique to the geographic and demographic landscape of the country. Obstacles facing operators include coverage of remote areas, low GDP per capita, high illiteracy, and a vague regulatory framework. The fixed line market is currently a monopoly of the government-owned Public Telecommunications Corporation (PTC), while another government owned company, TeleYemen, provides international direct dialing, leased lines, and cellular service (along with three private operators). The regulatory function is entrusted to the Ministry of Communications and Information Technology (MCIT). The restricted market structure and existing regulatory framework has negatively affected the quality, efficiency and cost to users in Yemen. In a recent announcement, MCIT announced plans to restructure the PTC and the postal services. Other features of the Yemeni telecom sector include:

- A fast growing (though from low base) mobile market, with four mobile phone operators (YemenTel (public private partnership), Sabafon, MTN, and “Y mobile phone”). The estimated number of mobile line users at the end of 2007 is about three million.
- Limited connectivity to global Infrastructure fiber and is therefore relying on expensive satellite connectivity for all
- international communications. This resulted in an underdeveloped internet sector putting Yemen at a disadvantage for innovative application like e-health, e-education and e-government applications. This shortcoming forces all providers of internet services to seek connectivity independently, directing all traffic to be transported via satellite through international networks. The lack of a cable

landing station means that international internet traffic is transmitted by VSAT and subject to high packet loss.

- Limited internet penetration: Yemen is characterized by poor and expensive internet service sector. The subscriber's base is estimated at 300,000 thousand users at the end of 2007, or 1.4 percent, one of the lowest in the Middle East. Major cities such as Sana'a Taiz and Aden have numerous Internet Cafés or Communication centers, but the reliability and the speed of their service are very low.
- A significant digital divide between rural and urban areas. Despite rapid growth in Mobile subscribers since 2004, penetration is mainly concentrated in big cities of Yemen, leaving vast areas of the country unconnected with any means of communications network. The low coverage and relatively high cost of providing telecommunications services to rural communities in Yemen remains a major constraint to private sector led growth and the success of the decentralization policy.

Yemen is moving ahead with plans to liberalize the air transport sector. Overall, enabling competition in the air transport services to regional and international carriers would help to increase competition, and reduce costs to Yemeni businesses and recreational travelers, thus contributing to increased visitor flows, movement of goods, and generally better business climate. Liberalizing air transport would be especially beneficial to the fish exports industry, which has been hindered by limited and unreliable air cargo services.⁶ Yemen announced the decision to enter the open skies agreement passenger and air cargo traffic with Arab countries in 2006, but the legal ratification has taken place only in recent months of 2008.⁷ Under the new legislation, all major airports in Yemen, such as those of the port cities of Aden, Hodeidah and Mukalla, are subject to the terms of the open skies agreement. The only exception is Sana'a airport, which will be brought under the agreement in 2009. So far, and despite the passage of the law in early 2008, Yemen major airports have not witnessed any noticeable increase in passenger traffic and number of the airline carriers. Among the cited reasons for the continuing slow growth in international traffic to Yemen are the high local charges for fuel and airport services (compared to other regional airports), the inadequate infrastructure, and the current political situation, which negatively affects the flow of tourism. In this regard, a recent official report indicates the appropriation of more than US\$64 million of donor's funds during the current fiscal year to modernize the infrastructure and navigational facilities of the major airports in the country.

Yemen's financial sector plays a limited role in the economy. According to a recent World Bank study, weaknesses in the legal and judicial framework, lack of proper accounting standards and disclosure practices, and scarcity of banking and financial skills remain major impediments to the development of an effective financial sector. The banking system dominates Yemen's small financial systems, although some non-bank initiatives are underway, such as leasing and microfinance.

⁶ The fishing and fish processing industries are important sectors in terms of employment generation, with estimated 60,000 local artisanal fishermen operate along Yemen's coastal areas, of which over one-third in the two Governorates of Hodeidah and Hadramout. With annual production increasing by 18% over 2001-2005, fish currently represents 64% of total food exports.

⁷ An Open Skies agreement, signed either bilaterally or multilaterally, allows both sides unrestricted landing rights on each others' soil. Carriers can make decisions on routes, capacity, and pricing, and fully liberalizes conditions for charters and other aviation activities including unrestricted code sharing rights. Normally landing rights are granted for a fixed number of flights per week to a fixed destination. Each adjustment takes lengthy negotiations, often between governments rather than between the companies involved. By allowing air carriers unlimited access points and unlimited access to intermediate and beyond points, such agreements provide maximum operational flexibility for airlines.

Outside the banking sector, key supporting institutions are either nonexistent or play a very limited role. Leasing is beginning, but needs appropriate tax treatment and a registry for leased properties.

Box 2. The role of the Banking Sector in Yemen

The assets of the banking system are about 30 percent of GDP, much less than comparable countries. Intermediation between depositors and borrowers, an important factor in growth, is less than 10 percent of GDP, again much lower than comparators countries. Many Yemeni banks are also small, reflecting the large number of banks relative to the system. This contributes to potential risks and problems of concentrated and individual-connected lending. The state banks, despite some restructuring, remain relatively large. Islamic banks have been playing an increasing role in the Yemeni economy and they have increased competition for deposits. A key development challenge in the Yemeni banking sector is to broaden access and increase penetration, where the vast majority of the population does not use formal financial services. Improving access will require further efforts to increase deposits, encourage banks to make more private loans, develop the framework for microfinance and continue the ongoing improvement in the basic information and collateral framework for credit, as well as the payments system. The government should also consider their amount of issue of debt and liabilities so as not to crowd-out resources available to the private sector. In addition, development of the legislation for *sukuk* transactions would help Islamic institutions participate more in longer-term finance.

The financial sector is undergoing important reforms. Recent reforms in the financial sector include the introduction of the Leasing Law in 2007, which aims to increase access to finance, particularly for micro and SME enterprises, and more recently the establishment of an independent insurance agency to protect small depositors. Legislation, currently under preparation, is the Micro financing Law that provides the legal framework for the operation of non-banking financial institutions in offering services to the poor. Other current plans call for the establishment of a credit bureau, a corporate governance code, and a stock exchange and a securities and exchange commission.

The government is taking new steps to enhance microfinance. In a country like Yemen, where the vast majority of the population does not use formal financial services, microfinance development may represent an effective approach to enhance access to the banking system. A recent study noted that there are 13 active microfinance institutions in Yemen, most of which were created by the government's Social Fund for Development (SFD).⁸ Total outreach was estimated at approximately 31,000 clients, a combined loan portfolio of US\$ 6.9 million, and an average loan size of US\$ 97. Efforts to promote microfinance in Yemen are spearheaded by SFD, which in 2003 began providing financial and technical assistance to the Small Enterprise Development Fund (SEDF), as the only specialized institution to finance small enterprises. The SFD also took charge of formulating The National Strategy for the Development of Small and Micro, which was finalized in 2005. The Strategy was further revised in 2007 with the sole focus on microfinance business.

Efforts to promote microfinance has led to the establishment of one specialized microfinance bank while another is under consideration. Al-Amal Bank, the country's first microfinance bank for the poor, was established in July 2007, with a capital of US\$ 10 million. The Bank is expected to begin operations in summer 2008. Currently, the government is undertaking another initiative to establish another microfinance bank by inviting an experienced microfinance operator to join in the establishment of a green-field commercial microfinance bank. In tandem with the efforts to establish microfinance banks, the government is introducing the Law on Microfinance Banks that would

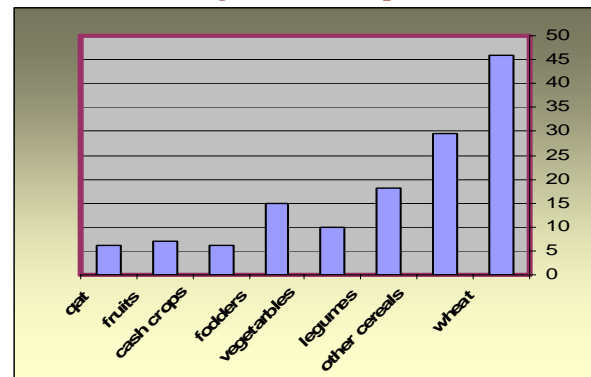
⁸ IFC (2007)

facilitate the establishment and the licensing by CBY of microfinance banks. Legislation in the area of microfinance, however, needs to be supplemented with other measures to addresses constraints to starting a business, as well as accessing licenses, resources and information so that small enterprises can flourish. In the absence of large numbers of credible enterprises to lend to, increased supplies of finance may not result in the desired increase in economic activity. One particular measure that will ensure success of microfinance credit is brining improvements the credit registry. Efforts by the CBY to upgrade and automate its credit registry appear to be proceeding satisfactorily, with the revised registry expected to exempt the microfinance banks from the US\$2500 fee imposed on beneficiary firms.

The recent increase in global food prices is bringing agricultural sector policies under renewed scrutiny.

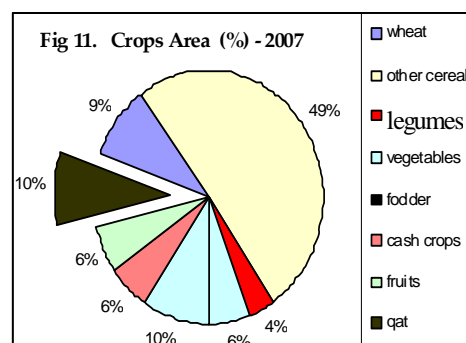
Traditionally, Yemen agriculture sector has been an important source of growth, employment and foreign exchange earning. During the period 2000-2005, for example, the sector was the main direct source of income for 74 percent of the population, making up 21 percent of the GDP, 30 percent of employment and 57 percent of non-oil exports. However, there are evidence that this role has been gradually diminishing over the last few years owing to a number of factors that include the scarcity of water resources, the insufficient public investment in the sector, and the growing cultivation of water intensive crops such as qat. The recent increase in global food prices and the need to enhance domestic food security has revived interests in the sector, both from the public and private sectors. Yemen relies heavily on food imports for domestic consumption. In 2007, Yemen imported close to 3.7 million tons (MT) of cereals to support domestic needs. Cereal imports included three main items: wheat (2.8 MT), rice and corn (with 0.4 MT each). Locally produced wheat accounts for a small proportion of domestic needs. In 2007, despite the 47 percent increase over the pervious year, local production of wheat could only cover 7 percent of domestic consumption. To encourage the expansion of food production, the government announced at late 2007 a new initiative under the National Program for the Expansion of Cereal Crops. The Program includes the allocation of new investment funds of about YR1 bln (through the Fund for Agricultural Development), measures to strengthen capacity for agricultural extension and research and plans to issue new legislations to limit the cultivation of qat.

Fig 10. Growth rate of domestic production for various agricultural crops in 2007



Box 3. Qat and Agriculture Exports of Yemen

The main challenges facing agricultural exports in Yemen are water scarcity. Qat production competes with crop exports mainly through its high consumption of the scarce water resources. Qat is a heavy user water resources, with an estimated annual use for this purpose of about 800 million cubic meters, equivalent to 30 percent of water used for irrigation. Because qat is primarily grown in highlands, its expansion in terms of land usage has been less detrimental (than water consumption) to the production of export crops, which are mostly grown in lowlands. One



exception is coffee farming which share the same regions with qat. According to recent studies, land used for qat production has increased by 28 percent since 2002 to about 141 thousand hectares (Fig. 3). The recent major increases in world prices of food crops has created a potential opportunity to encourage an expansion of production of other agricultural crops, but this will require a mix of complementary legal reforms and improvements in water resource management. A major weakness of Yemeni agriculture is the lack of integration of the majority of farmers in efficient supply chains because of (i) the absence of a conducive institutional environment (most small farmers have no access to extension services and similar types of support) and (ii) the lack of enforcement of sanitary and environmental standards. These weaknesses discourage significant private national or international investment in agriculture that could bring the needed managerial and technical know-how to facilitate crop diversification, attainment of product standards and improved water efficiency.

Expenditures on fuel subsidies are becoming critically high. Petroleum subsidies in 2008 are estimated to reach US \$3.5 billion, about 12 percent of GDP, thus exceeding individual development spending, wage payments and social expenditures. With the expected continued high fuel cost and steady depletion of the country's oil reserves, saving on fuel subsidies is becoming vital to maintain the basic provision of public goods.⁹ In the case of Yemen, and given the current high levels of poverty and prevailing environment of high inflation, phasing-out fuel subsidies would require undertaking complementary measures in at least two areas: enhancing social safety nets and improving energy efficiency. Subsidy removal needs to be paired with improved (and larger) social protection schemes in order to mitigate the impact on the poor, who are currently estimated at more than 35 percent of the population. In Yemen, the Social Welfare Fund (SWF) plays pivotal role in designing and implementing social protection programs. To this effect, the role of SWF needs to be strengthened through improving: (i) its method of targeting; (ii) its application pool and processes; and (iii) its cash delivery mechanism. The EU and the World Bank are currently helping the SWF with devising an improved targeting mechanism based on "proxy means testing". The cash delivery mechanism is also under improvement through some innovative arrangements. The other area where complementary action is needed relates to improved fuel efficiency. Yemen could achieve substantial savings on fuel subsidy by introducing efficiency improvement in the areas of power generation and distribution (the most immediate savings can be achieved by switching from oil to gas-based power generation) and in petroleum refining sectors. Significant fuel efficiency savings could also be achieved among the final users in residential and commercial sectors of Yemen by adopting a mix of regulatory and monetary incentives.

⁹ see YEU Spring 2008 for further details of the fiscal implications of the continued subsidy

Enhancing the access of Yemeni workers to the GCC markets is gaining priority on the policy agenda. Yemen has rising unemployment and high fertility rates, whereas GCC countries have small populations and rely heavily on foreign guest workers.¹⁰ Yemeni workers have a natural advantage in terms of both relative proximity and culture and language skills while the economic boom in the GCC is creating high demands for labor. Despite the opportunities for both sides to gain, Yemeni workers continue to play a small role in the GCC labor markets. Because Yemen is not a GCC member, efforts to facilitate the movement of labor has been focused on signing of bilateral labor agreements with a number of the GCC countries.¹¹ However, such agreements did not materialize into significant outcomes, reflecting their lack of details and specific implementation mechanisms. To be successful, Yemen must address a number of issues that include the political concerns of the host country governments and satisfy the needs of their private employers. On the host government level, concerns include long-term changes in their demographic composition associated with large settlement of Yemeni workers, and, more recently, rising security concerns related to terrorist groups. Seeking to put in place a temporary migration program, backed by efficient and well-managed organizations in Yemen, could help to alleviate some of the fears. Expanding the possibilities for movement of workers from Yemen to the GCC would also require increased efforts to upgrade the skills of workers through training programs, as the GCC labor markets become more sophisticated and skill-oriented. In this regard, Yemen will have to undertake serious steps to improve its capacity of manage its labor resources, in general, and bolster training programs, in particular, with the final aim of identifying and equipping potential workers the skills desired by prospective employers. Yemen has moved one-step towards this objective by involving the private employment agencies and vocational colleges in the process. However, these efforts need to be further consolidated and backed with additional resources to enhance the legal framework and-set up and enforce better standards for the private vocational schools. Efforts are also needed to enhance the regulatory framework governing the private employment agencies and facilitate their coordination and cooperation in information gathering.

¹⁰ Yemen's official unemployment rate is 16 percent, with an estimated labor force of about 4 million. Already, about 1 million Yemeni workers are thought to be working in the Gulf.

¹¹ Various bilateral agreements and protocols were signed between Yemen and Saudi Arabia, Qatar and UAE, promising to ease the access of Yemeni workers to job markets of the latter. However, these agreements lack implementation mechanisms and performance targets, and do not constitute binding commitments.

IV. OUTLOOK

With expectations of continued high oil prices and modest decline in domestic crude output for the rest of the year, the economic outlook in 2008 calls for moderate improvement. Yemen's overall growth rate in 2008 is likely to improve by less than one percentage point to 4.2 percent, reflecting the continued good performance in the non-oil sector of about 5 percent and the slower decline oil production to about 3.3 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 outlook in the oil sector in Yemen 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 percent of GDP as compared to 5.6 percent in 2007. Needless to say, this outlook could worsen if oil production declined faster than the anticipated rate of 3 percent. Other negative factors include a further worsening in security conditions, which could affect public spending, private capital flows and growth in the non-oil sector.

Inflation will pose the main threat in 2008. With the annualized rate for the first four months of the year approaching 27 percent, the average inflation for the year 2008 is expected to run above 20 percent, surpassing its 2007 and 2006 levels. The likelihood of high inflation in 2008 is supported by expectations of continued global inflationary pressures, and the possibility of fiscal easing towards the year-end in association with upcoming elections. The exchange regime is not likely to see a sharp adjustment in order to curb inflation, as the government is expected to maintain the informal peg of the rial to the dollar at its current level of about 200 YR/\$. In order to minimize the political and social consequences of rising inflation, the government is likely to put more efforts on strengthening the social safety nets, while tackling the sources of inefficiency in some areas of public expenditure such as energy subsidies.

Reforms are expected to continue in 2008. 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 (i.e. until 2010). The revised plan will consider the changing circumstances that have emerged since the inception of the DPPR (such as the persistence of poverty incidence, 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.

Medium-term outlook will continue to be uncertain. Though the macroeconomic outcome in 2008 is expected to show some improvement, the medium-term outlook continues to face the same serious challenges, particularly in view of the fast decline in oil production, rapid population growth, and slow, uneven progress in reducing poverty. Rising global prices for food products, coupled with domestic supply bottlenecks in food production and distribution will continue to keep inflation high. These results reinforce the need to tackle the structural weaknesses of the economy, particularly fostering non-

oil growth that needs to be led by the private sector. It also calls for more efforts to enhance fiscal sustainability through increased reliance on non-oil revenue, as well as lower and better targeting of expenditures, which is currently burdened by inefficient fuel subsidies (about 11 percent of GDP) and a large wage bill.

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 rationalized. Next steps will involve redesigning of Administrative Procedures, Mining Law/Regulation, designing of National Mining Strategy and Review of GSMRB in parallel association with awareness raising activities and lobbying discussions with parliamentarians to push new laws and fiscal changes through legislative process. By the end of October, 2008, we expect to have a new Mining Policy Framework package promoted at an investor international conference by no later than December 2008.

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

Towards the Development of an Integrated Education Vision The first stage exercise for developing the national Integrated Education Vision, an exercise of writing Education Country Status Report (CSR) has officially been started with a mission from June 14 – 25. One week CSR training session was held for the government officials and development partners who would be engaged in the process. The CSR technical team will continue on conducting a technical analysis of the entire education sector.

Basic Education Development Project, Mid-Term Review A joint IDA, Netherlands, DFID, and KfW Mid-Term Review of the Basic Education Development Project (BEDP) took place from April 9 to 19, 2008. The mission has found that the pace of implementation has been 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.

Conditional Cash Transfer The first conditional cash transfer payments, financed by the BEDP, were made in 216 schools in Lahej in June 2008. About 27,000 girls in Grades 4-9 enjoyed the receipt of a semester payment that they achieved by attending more than 80% of the classes during the first semester. The field team has found significantly positive feedback from the beneficiaries that families are more enthusiastic and supportive on continuing girls' schooling.

Secondary Education Development and Girls Access Project: Project is expected to become effective in August 2008. As of today 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.

III. None Lending activities:

Country Portfolio Performance Review: The formal Country Portfolio Performance Review (CPPR) was conducted on June 23rd, 2008; the review provided a forum for the Government of Yemen (GoY) and the Bank to discuss key issues facing the implementation of Bank-funded projects in Yemen since the last such review was conducted, in 2005. The meetings were attended by over 100 high-level officials, including several members of the Yemeni Cabinet, all heads of Project Implementation and Project Monitoring Units (PIUs/PMUs), and other government officials, in addition to a number of parliamentarians, Task Team Leaders (TTLs), Bank staff, and other donors. The workshop was co-chaired by the Deputy Prime Minister and Minister of Planning and International Cooperation and by the World Bank Country Director (see Attachment 1 for a complete list of participants). The discussion was frank, lively, and widely covered by the media (see Attachment 2). Attachment 3 provides the agenda of the meeting.

VII. NEW & NOTEWORTHY LAWS, DECREES, AND AGREEMENTS

The Cabinet

- referred to the Parliament grant agreement for facing food crisis as an additional funding to the third phase of SFD signed between Yemen and IDA in the amount of US\$ 10 mln;
- approved the results of the 7th round of Yemen-Egypt Joint Supreme Committee during which cooperation agreement in the fields of education, culture, labor force and administrative reform were signed;
- approved the measures proposed by the special ministerial committee to address impact of price increase on iron and asphalt on projects under implementation;
- reviewed the recommendations by the special ministerial committee regarding use of optical fiber for TV services in different governorates;
- discussed the memo by the Ministry of Planning and International Cooperation regarding the mechanism of approval for the projects not endorsed under investment program and basic criteria for acceptance for project proposals;
- approved ideological and political awareness-raising plan for fighting terrorism, extremism and insurgence prepared by the special ministerial committee chaired by the Minister of Information;
- referred to the ministerial committee draft internal by-laws of the Higher Tender Committee which aims at strengthening its role in protecting public funds and preserving state properties and assets;
- referred to the ministerial committee draft decree proposed by the Ministry of Transportation regarding designating the site and area for Socotra port project;
- endorsed Arab Youth Treaty for 2007-2008 proposed by the Syrian Republic which aims at supporting youth programs and strengthening youths' identity and Arab and Islamic social and spiritual values;
- approved proposal by the Ministry of Justice regarding amending Article 1 of the Arab Anti-Terrorism Treaty defining acts of terrorism;
- approved draft agreement regarding land international passenger and goods transportation signed between Yemen and UAE;
- approved draft decree presented by the Minister of Transport regarding allocation of a required area (11,888,236 m²) for construction of Hadhramaut seaport in Brum district;
- approved the report by the Minister of Local Administration about the process and results of the first-ever Governors elections in Yemen;
- approved draft republican decree regarding setting up the Supreme Council for Road headed by the Prime Minister;
- approved draft Prime Minister's decree regarding the unified system of students' affairs in the government universities;
- approved Yemen's accession to the international treaty on Fighting Terrorism of 2005;
- reviewed the report by the Minister of Local Administration regarding training programs for local authorities and heads of tender committees;
- formed a joint committee headed by the Deputy Prime Minister for Local Affairs to review operational allocations to service sectors and executive bodies.
- discussed the draft Higher Education law proposed by the Minister of Higher Education and Scientific Research and referred it to the concerned working teams for final review;

- referred the memo from the Presidential Office regarding the quota system for women in the elected local councils to the Minister of Social Affairs and Labor;
- approved draft republican decree regarding setting up the Supreme Council for Road headed by the Prime Minister;
- approved draft Prime Minister's decree regarding the unified system of students' affairs in the government universities;
- approved Yemen's accession to the international treaty on Fighting Terrorism of 2005;
- reviewed the report by the Minister of Local Administration regarding training programs for local authorities and heads of tender committees;
- discussed the draft Higher Education law proposed by the Minister of Higher Education and Scientific Research and referred it to the concerned working teams for final review;
- approved draft organizational by-laws for the Ministry of Agriculture and Irrigation stipulating setting up three sectors: (i) for agricultural production development, (ii) for irrigation and land reclamation, (iii) for agricultural services;
- approved credit agreements signed between Yemen and Arab Fund for Social and Economic Development for contribution towards Taiz International airport modernization and towards Sana'a road intersection project;
- approved joining international transportation treaty for goods transportation to Arab East;
- approved the remedial measures suggested by the Ministry of Civil Service regarding insurance payments for workers of agricultural equipment lease stations in Hadhramaut;
- approved a number of measures aimed at improving current situation with oil derivatives supply in local market especially diesel including creating strategic reserve of oil derivatives to cover 2-month need of the country;
- approved the proposal for importing lead-free gasoline and selling this fuel at petrol stations at world prices;
- approved draft law presented by the Ministry of Trade and Industry regarding amendment of Law 22/1997 concerning company capital;
- approved draft decree presented by the Ministry of Water and Environment regarding identification and preservation of drinking water reservoirs in Dhala governorate ;
- approved the report by the Minister of Education regarding implementation of the National Basic Education Strategy including recommendations;
- discussed the report by the Mayor of Sana'a regarding improving the situation with classroom overcrowdness in Sana'a city.
- emphasized the decree by the Ministry of Defense regarding mobilization procedures to the armed forces;
- approved compensation procedures with regards to Natural Liquid Gas project in Balhaf and urged Ministry of Oil to complete the process;
- approved draft government procedures for implementation of the Presidential elections program for the period April - December 2008;
- reviewed the report by the Ministry of Finance regarding the foreign debt situation as of December 31, 2007, which revealed the cumulative external debt of Yemen amounted to US\$ 11.2 bln, of which US\$ 9.4 bln was utilized and US\$ 4.2 bln settled;
- approved draft decree presented by the Ministry of Transportation regarding Yemen's accession to Traffic Protocol adopted by other Arab countries;

- approved republican decree regarding establishing and reinstating internal audit position at the government units and public and mixed sector;
- endorsed the protocol signed between the Ministries of Civil Service, and of Finance and Yemeni General Confederation of Trade-Unions stipulating treating all professions equally for insurance and salary increase purposes;
- discussed the report by the Minister of Transport regarding carrying out the feasibility study for railroad project.

Other government

- The Supreme Economic Council approved the draft of its action plan for the coming period covering oil, financial and industrial sectors and restructuring the funds from foreign loans.
- The Central Bank of Yemen injected US\$ 93 mln into the local market to support Yemen's currency exchange rate.
- The Budget Supreme Committee has discussed the general frame for the State General Budget for 2009.
- The Ministry of Industry and Trade has launched establishment of three free industrial and trade zones, two at the border with Saudi Arabia and one at the border with Oman.
- The Ministry of Oil and Minerals has signed ten agreements for oil exploration, production and marketing in seven blocks.
- MOPIC established the Public Investment Program Unit to study feasibility of public investment proposals not listed in the Public Investment Program.

The Private Sector

- International Bank of Yemen decided to increase the paid up capital to YR 5.1 bln.
- The General Investment Authority licensed 9 projects in Al-Hodeidah governorate worth YR 3.4 bln in the fields of industry, tourism, health and other services.
- Yemen LNG obtained US\$ 2.8 bln for financing the gas plant in Gulf of Aden, Balhaf.
- A US\$ 100 mln joint venture between the General Authority for Development and Investment and the Insha Company for Development and Construction was inaugurated.
- The Arab Authority for Agricultural Investment and Development will be a shareholder of 30% of the capital in a poultry project in Mukalla city with the cost of US\$ 51 mln.
- Saudi Bawazir Trade Corporation, Yemen Ben Halabi Group and Salam Group, and Indonesian IndoFood are setting up silos and flour mills facilities in Mukalla at the cost of US\$ 30 mln.
- The Korean National Company started drilling first oil well at the block 70 in Shabwa governorate.
- Net profits of the International Bank of Yemen reached YR 2.38 bln in the end of 2007 compared to YR 1.67 bln in the end of 2006.
- Yemen Soft Ltd has won the tender for updating telecommunications systems in Egypt Telecommunications Company in a contest with 20 companies;
- Sixty-six industrial and trade companies were set up during the first quarter of 2008 with the total capital of YR 2.1. bln.
- A new coalition of companies was formed including USA KASB Group, Kuwaiti Eastern Group, Saudi Al-Hindi Group and Yemeni Al-Hamadani Group with the aim of facilitating housing and trade projects in the Arab region, Asia and North Africa.
- Net profits of all banks operating in Yemen reached around \$100 mln in 2007.

- A Saudi Investment Commercial Complex ("Shamsan Mall) at a cost of US\$ 20 mln was inaugurated in Aden.
- Seven international oil companies led by French Total will finance 25% of the final phase of the Yemen Liquefied Natural Gas Company in the amount of US\$ 2.8 bln.
- 10th Sana'a International Trade Exhibition took place during May 10-14 with participation of 80 Arab companies.
- Saudi Dar Al-Tahakom real estate company is finalising preparations for construction of two twin trade-housing towers in Aden at a cost of US\$ 50 mln.
- Cooperative and Agricultural Credit Bank has signed a membership agreement with American Express under which CAC has the right to issue silver, gold and platinum credit cards.
- Arrangements are being finalized to establish a joint Islamic Bank by the Cooperative and Agricultural Credit Bank of Yemen and the Doha Bank with initial capital of US\$ 100 mln.
- Chinese Sinochem Corporation has extended its activities to Yemen via purchasing UK-based Soco International PLC's unit for Yemen at a cost of US\$ 465 mln.
- Canadian Nexen Petroleum Company is financing health and educational projects in Yemen at a cost of US\$ 432,000
- The Asas Company for Manufacture and Marketing of Cement has presented a proposal to General Investment Authority for setting-up a cement factory in Radfan district of Lahej at a cost of YR 37 bln.

Development Cooperation

- Japan earmarked US\$ 1.5 mln as a contribution to UNHCR to help Yemen in hosting African refugees.
- Japan has extended US\$ 4 mln as a non-project aid to Yemen aimed to ease economic difficulties and improve Yemen's fiscal sustainability.
- Global Partnership on Output-Based Aid has granted US\$ 6.23 mln to Yemen's health institutions concerned with maternal care improvement in the poorest areas in Sana'a.
- DFID has committed US\$ 85 mln as a grant to Yemen for development projects to be implemented by the Social Fund for Development to reduce poverty and improve basic infrastructure.
- Yemen and the European Commission have signed an agreement regarding support for electoral systems and Parliament's capacity building in the amount of € 5.3 mln for 2008-2010.
- Dubai Care Organization is to build around 100 schools in Yemen in the framework of its basic education support program in 12 developing countries.
- Islamic Development Bank has allocated US\$ 1.5 bln to support 25 Islamic states including Yemen affected by the global food crisis.
- US Ministry of Labor pledged the amount of US\$ 3 mln to finance the third stage of combating child labor project in Yemen.
- The European Commission has increased its support to Yemen from € 17 mln to € 51 mln for the coming two years to support government reform efforts.
- United Arab Emirates granted 500,000 tons of wheat to Yemeni people to support Yemen's efforts in facing wheat price increase in the world market.
- Turkey granted Yemen US\$ 1 mln for construction of a technical training institute.
- An agreement was signed between Yemen and Japan for an amount of US\$ 7.2 mln for financing construction of the basic education schools in Sana'a city and the governorate.

- Islamic Development Bank pledged US\$ 20 mln towards financing rural water and roads projects in Yemen.
- South Korea has raised its support to Yemen from US\$ 55 mln pledged during Donor Conference in 2006 to US\$ 100 mln for 2007-2010.
- Yemen and the European Union have signed an agreement for financing project for Tehama plain development at a cost of €19.5 mln.
- British Government has donated US\$ 1.4 mln to WFP to help displaced people in war-torn Saada governorate.
- The Government of Japan has allocated US\$ 10 mln for funding rural water projects in Yemen.
- A GCC delegation has made a feasibility study in Mahra governorate for a railway project to link Yemen and GCC countries
- A three-year (2008-2010) program for "Developing National Capacities to Address HIV/AIDS in Yemen - Phase II" was signed between Yemen and UNDP for the amount of US\$ 10.6 mln financed by the AIDS Global Fund;
- A project agreement for "Advisory Support to the Ministry of Planning and International Cooperation" for the amount of US\$ 1.9 mln was signed between Yemen and UNDP in addition to agreements on "Water Governance Programme for Arab States" and "Arab States Trade and Human Development Initiative".

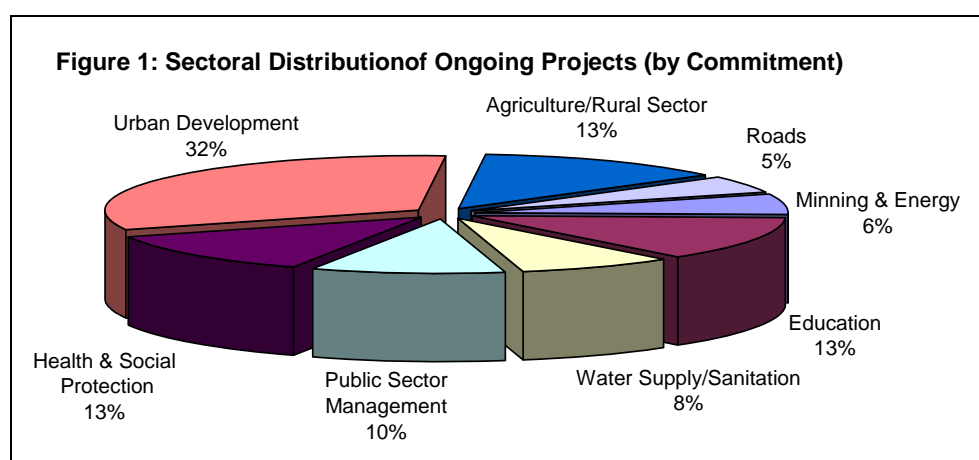
Seminars and workshops

- Second General Conference of the Yemen Women Union was held on June 16 with participation of 400 members representing 46,000 YWU membership in 22 governorates of Yemen with girls education as a top topic on the agenda.
- An academic workshop was organized in Ibb by the Higher Education Development Project in cooperation with Dutch University on June 19.
- A workshop on Prohibiting of Chemical Weapons was organized by the concerned Yemen's National Committee in cooperation with European Organization for Protection of Chemical Weapons during June 25-27.
- A workshop for Protecting Women's and Children's Rights was organized by the Organization to Combat Violence Against Women in cooperation with OXFAM, UNICEF and Save the Children on June 22-24.
- A Country Portfolio Performance Review Workshop was organized by the Ministry of Planning and World Bank on June 23
- A conference on "Improving the Economy of Arab Organic Agriculture" was organized by the Yemeni Agroeconomist Union on June 28.
- Social Welfare in cooperation with American Child Health Foundation during June 5-6.
- The First Management Forum for private and public sectors was organized by Cordova Association for Training and Consulting during June 7-8.
- A training program on International Accounting Standards for Banks was organized by the Central Bank of Yemen in cooperation with the Banking Studies Institute during June 11-15.
- 17th conference of Arab Agronomists Union under the motto "Developing Organic Agricultural Economy" was held during June 15-17.
- A workshop on the Investment Horizons in the Field of Electricity Generation was organized by the Minister of Electricity on May 19.

- A workshop on UN Anti-Corruption Treaty was organized by the Supreme National Anti-Corruption Commission in cooperation with GTZ during May 19-20.
- A workshop on the Manual on AIDS and Sexually Transmitted Diseases was organized by the National Program for Combating STD in cooperation with WHO during May 18.
- The Regional Conference on Refugee Protection and International Migration took place in Sana'a during May 20-21.
- A symposium on Price Hikes was organized by the Ministry of Industry and Trade during May 25-26.
- A media campaign on Family Planning was launched by the Ministry of Endowment in cooperation with UNFPA.
- 25th round of the UN Economic and Social Commission for Western Asia took place in Sana'a during May 26-29.
- MNA conference for Regional Agricultural Credit Associations was held on May 5-8.
- A training course for Galvanizing Women's Administration in the Governorates was organized by the Ministry of Social Affairs and Labour during May 5-7.
- A Seminar on Poverty and Its Measures in GCC Countries was organized by the Ministry of Social Affairs and Labour with cooperation with GCC during May 6-8.
- A Symposium on Immigration was organized by the Ministry of Social Affairs and Labour in collaboration with International Organization for Migration during May 11-12.
- The 19th Round of National Arab Conference under the motto "Arab Joint Work... Challenges and Horizons" took place in Sana'a during May 9-11
- A course on Enhancing Capacity of NGO and Civil Society was organized by the Media Women Forum on April 4-7.
- Country Consultations on Governance and Anti-Corruption was organized by the Supreme National Authority on Combating Corruption in cooperation with the World Bank on April 7-8.
- Celebration of the World Health Day focusing on the effects of global warming on health was organized by the WHO on April 7
- First International Medical Conference was organized by the Yemeni Charitable Medical Association during April 7-13.
- A training workshop for members of High Tender Board was organized by HTB in cooperation with USAID on April 12-14.
- A workshop on Investment Cooperation between Yemen and Japan was organized by General Investment Authority in cooperation with the Embassy of Japan on April 13-14.
- National Peer Education Workshop on HIV/AIDS was organized by the Higher Council for Motherhood and Childhood in cooperation with UNICEF, UNFPA, WB and GTZ on April 13-14.

VIII. WORLD BANK GROUP OPERATIONS IN YEMEN

The World Bank is currently financing 20 projects in Yemen, including supplemental financings, with a total commitment of USD 851 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 20 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 (see Figure 1).



Ongoing World Bank Operations in Yemen
(As of June 30, 2008)

Project Name	Close Date	Cumulative Disbursement		
		Loan \$	Disb. \$	Disb. %
Groundwater & Soil Conservation	31-Oct-09	40.0	21.84	55%
Rural Water Supply and Sanitation	31-Dec-07	40.0	22.49	56%
Irrigation Improvement	30-Jun-07	21.3	19.45	91%
Sana'a Basin Water Management	30-Jun-09	24.0	11.69	49%
*Fisheries Res. Mngmnt & Conserv.	30-Sep-11	25.0	1.10	4%
Urban Water Supply and Sanitation	31-Dec-07	125.3	89.14	71%
Port Cities Development	30-Jun-07	23.4	15.85	68%
Taiz Muni. Dev. and Flood Protection	31-Oct-07	65.2	52.04	80%
Third Public Works	30-Jun-09	74.8	41.30	55%
II Rural Access Project	30-Nov-10	40.5	14.29	35%
Rainfed Agriculture and Livestock project	30-Jun-12	20.0	0.98	5%
Power Sector Project	31-Dec-11	50.0	0.98	2%
Civil Services Modernization	31-Dec-07	44.0	25.12	57%
Institutional Reform Credit (DPL)	30-Jun-10	50.9	0.00	0%
Health Reform Support	31-Dec-08	27.53	25.12	91%
Higher Education	30-Jun-08	5.0	2.73	55%
Third Social Fund for Dev.	31-Dec-08	63.4	61.54	97%
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	20.13	31%
Sec. Educ. Dev. And Girls Access Program				
		835.33	427.79	51%

Donor Pledges for the PIP 2007-2010 in US\$ Million
(as of June 2008)

Donor Country/Agency	Pre- CG	During the CG	Post CG	Total	Grant	Soft Loans
1. GCC Bilaterals	331	2300	0	2631	1950	681
Saudi Arabia	181	1000		1181	1000	181
Oman		100		100	100	
Qatar		500		500	350	150
Kuwait		200		200		200
United Arab Emirates	150	500		650	500	150
Bahrain*		0		0		
2. Multilaterals	0	1732	85	1817	197	1620
Arab Fund for Socio-economic Development		700	85	785		785
Islamic Development Bank		200		200		200
World Bank (IDA)		400		400	75	325
OPEC Fund for International Development						20
		20		20		
UN System		90		90	90	
IFAD		70		70		70
Global Fund		32		32	32	
Arab Monetary Fund		220		220		220
3. Traditional Bilateral	0	695	186	881	781	100
European Commission		100		100	100	
United Kingdom		230		230	230	
South Korea		40		40	40	
Netherlands		91		91	91	
Germany		190		190	190	
France			130	130	30	100
Italy		12		12	12	
Japan**		23		23	23	
Spain			26	26	26	
USA			21	21	21	
Denmark		9	9	18	18	
Total	331	4727	271	5329	2928	2401

* Bahrain pledged support for Yemen in the form of TA

** pledge for the year 2007 only

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