

YEMEN ECONOMIC UPDATE

Yemen Economic Update is a quarterly report that consists of five sections. The first section highlights major economic and policy developments. The second section provides a special topic on the Yemeni Economy. The third section summarizes new legislation, publications, data, conferences, and donor activities in Yemen. The fourth section describes World Bank operations in Yemen and summarizes ongoing operations. The fifth section gives detailed information on World Bank publications and provides contact information.

Fall 2007

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The World Bank Group
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SUMMARY

Progress was made in resolving some areas of internal conflicts, but new fissures are opening up. The long-running conflict between the Yemeni government and the radical Houthi group in the Saada governorate, northern Yemen, is moving closer to a peaceful resolution, with the government already announcing plans and financial aid packages for the reconstruction of the war-damaged areas in the North. The government is taking serious measures towards controlling the spread of personal arms. Holding a fair election process for the president and the local councils is widely viewed as a good sign in political stability. However, failures in managing short-term costs of civil service reforms and inflation have sown seeds of discontent mainly in the southern parts of Yemen, where riots are repeatedly breaking out.

Yemen's macroeconomic performance showed mixed results in 2006. Oil production declined by 8.8 percent, while non-oil growth continued at a fair pace of about 5 percent, leading to an overall growth rate of 4 percent, slightly less than the 4.6 percent of the previous year. Meanwhile, 2006 prices of Yemeni crude exports increased by 22 percent, helping to sustain a positive—albeit a small—current account balance and push foreign reserves to the equivalent of about 11 months of imports. Similarly, government-related oil and gas income increased by more than 40 percent, leading to a small fiscal surplus for the first time in many years. On the negative side, inflation soared by 18.4 percent, due to demand pressures and a significant jump in the cost of food and transport.

The outlook for 2007 calls for a slight deterioration. In the oil sector, while prices are expected to remain unchanged from the previous years, crude oil output and exports are expected to fall by about 10 percent, following the 8.8 fall in the pervious year. As a result, oil's contribution to growth in fiscal and current accounts will fall. Therefore, average growth will slightly decline to 3.8 percent, with the non-oil output remaining relatively stable, sustained capital spending both from private and public sources. Owing to rising expenditure and shrinking oil revenue, the fiscal balance is projected to result in a relatively large deficit of more than 5 percent. Similarly, the current account balance is expected to turn into deficit (about 4 percent of GDP), for the first time in many years. On the positive side, the trend of inflation for the first half shows promising a decline in the average rate for the year as a whole.

Inflation cooled off for most of the first half of 2007, but started to edge up again in June and July. In 2006, the inflationary peak occurred during the months of September and October when the all-items price index jumped by nearly 12 percent. Since then, the inflation rate has gradually been easing, with the average rate increase in the first half of the year dropping to 3 percent over the previous period. The restraint in public spending in the early part of the year and good seasonal rains are factors behind the slowing of inflation. Higher food prices led by imported wheat and the expected surge in public spending in the later part of the year are expected to push inflation higher for the rest of the year. Overall, the inflation rate is projected to moderate from its 2006 highs, reflecting smaller rises in food prices during the first half of the year. Meanwhile, the rial's exchange rate with the U.S. dollar continued to depreciate, but at a much slower rate, falling by less than 0.4 percent since the beginning of the year.

The authorities have embarked on an extensive set of structural reforms since early 2006, although outcomes have yet to materialize. These reforms covered areas such as governance, public financial management, civil services administration, and general investment climate. The formation of the Supreme National Anti-corruption Commission (SNACC) was finalized when Parliament gave its approval to the selected board members. The government has officially joined the Extractive Industry Transparency Initiative (EITI), while steps are continuing to increase the effectiveness of internal and external auditing. A public procurement law, procurement manual and a restructured High Tender Board are now in place. A new land registration law was recently passed by the Cabinet, and the Land Registration Authority is undergoing restructuring. Work has also proceeded satisfactorily in various areas of public financial management, including the Automated Financial Management Information System (AFMIS) project, income tax system modernization, budget classification and reporting and preparation of financial law. In the area of civil services reform, good progress has been made towards establishing a biometric identification system (with current rate of completion nearing 80 percent of civil servants) and the Civil Service Fund (CSF).

Donor response to progress on reforms has been positive. Owing to policy reforms in 2006, Yemen was reinstated to the Threshold Program of the Millennium Challenge Account (MCA) in February 2007. Recently, the MCC announced its overall approval of Yemen's reform program, and the subsequent allocation of about \$21 million. The first post-consultative group meeting in June 2007 noted that good progress has been made in the allocation of pledges, with about \$3.1 billion (or 62 percent) already having been allocated to specific projects.

Yemen continues to face daunting challenges as oil and water resources continue to deplete and as the population grows at 3 percent annually. At current rates of crude-oil production and domestic consumption, Yemen could be a net importer by 2015, and will cease production by 2018. Since exports and public finances rely heavily on oil, the impending oil depletion and the slow adjustment on the fiscal and production sides will saddle the government with heavy debts and cause deterioration in external accounts, accompanied with rising inflation and political instability. Examining the prospects of future debt sustainability, depletion, and the slow adjustment on the fiscal and production sides will saddle the government with heavy debts and cause deterioration in external accounts, accompanied with rising inflation and political instability. To examine the prospects of future debt sustainability, a recent Debt Sustainability Analysis (DSA) exercise shows that the probability of debt distress is particularly high if the authorities do not undertake a major fiscal adjustment effort in light of the dwindling oil reserves. With unchanged policies, major debt indicators are expected to breach the sustainability thresholds between the years 2012–18. However, even under the baseline scenario that assumes full implementation of a comprehensive set of fiscal and structural reforms, Yemen will be at risk of breaching at least one of the debt thresholds within the next 20 years. To avoid debt distress, Yemen would need to take strong fiscal and structural reforms, as well as to rely on highly concessional financing.

According to the recent poverty assessment study conducted by the World Bank, Yemen has reduced poverty with the percentage of poor falling from 40.1 to 34.8 percent over the period 1998-2005. It is creditable that this reduction has been achieved in the context of a high population growth of 3 percent per year. Most of the improvement has occurred in the urban areas, with poverty rate falling from 32.2 to 20.7 percent. In rural areas, where 73 percent of the total population lives, the decline was much less noticeable as poverty headcount declined from 42 to 40.1 percent.

However, at the current pace of poverty reduction, Yemen is likely to fall short of meeting most of its MDG goals by 2015. According to the poverty assessment study, the goal of reaching the first MDG adopted by the government will require quadrupling of the one percent per year rate of growth in per-capita consumption achieved over the last seven years. Overall poverty gap index of 8.9 percent implies a monthly poverty deficit per capita of about YR497. Therefore, on average a poor person should, receive YR1431 a

month to be lifted out of poverty¹ - about a third of the mean consumption of the poor. In addition, the recent poverty data also cast doubt on the ability to meet the Development Plan for Policy Reduction (DPPR) target of lowering the country's poverty rate to 19.8 percent by the end of the decade.

I. RECENT POLITICAL DEVELOPMENT

The long-running conflict between the Yemeni government and the radical Houthi group in the Saada governorate, northern Yemen, is moving closer to a peaceful resolution. The conflict dates to September 2004, and has been mostly localized and low key, but conflict has escalated in recent months, after the killing of a number of Yemeni soldiers. Various mediation efforts were attempted in order to bring the two sides to negotiate. The most recent reconciliation effort, led by Qatar, seems to have succeeded in maintaining a cease-fire and an agreement to settle the issue peacefully. Already, the Yemeni government has announced plans and financial aid packages for the reconstruction of the war damaged areas in the North.

The government is making serious efforts to control the spread of personal arms. In January 2007, the government issued a decree setting stringent requirements (such as training and the wearing of special uniforms) for carrying arms by bodyguards who are escorting senior officials and tribal sheikhs. The decree also set limits on the number of bodyguards who could be assigned to every official (and paid for by the government). Later in April, the Cabinet made another decision to close temporarily stores trading in arms, ammunition, and fireworks throughout Yemen, and required traders to undergo formal licensing procedures by the Ministry of Interior. In most recent developments, in August the government issued a decree banning the carrying of personal arms in all major cities. Under the new rule, which became effective immediately, carrying arms in public places in the designated cities is regarded as a punishable offense. The rule has also introduced further restrictions on the bearing of arms for bodyguards and security forces accompanying officials and tribal sheikhs.

Yemen made improvement in its institutional and political stance over the last four years, but signs of fragility in some areas continue to be present. Under the classification shared by the World Bank, the Organization for Economic Co-operation and Development (OECD) and the United Nations (UN), Yemen has graduated from the list of Low Income Countries under Stress (LICUS) in 2003. The current list involves around 30 countries, most of which are in Africa. Although Yemen is no longer in the list, it continues to manifest symptoms of fragility in a number of specific sectors and sub-regions. Related to the issue of state fragility, the Fund for Peace, and the Foreign Policy magazine prepare the "the Failed States Index." Yemen's ranking on this index in 2007 has witnessed some improvement over the last year, rising from 16th to 19th position among

¹ Per-capita poverty deficit is calculated for the population as a whole. While per capita deficit per month is YR 497, average deficit per poor person is YR **1,431**.

146 countries.² The index ranks countries according to 12 social, economic, political, and military indicators. Yemeni government officials downplayed the findings of the report, citing its lack of rigor and its outdated survey results, which do not take into account many of the achievements made under the National Reform Agenda (NRA) over the last 12 months.

A deadly blast in early July in a popular tourist center in the North left eight Spanish tourists and two Yemenis dead. The event, which is believed to be Al-Qaida related, occurred when a suicide bomber attacked a busload of tourists in the Marib area. The incident has negative implications for Yemen's image as a country with weak security preparations and a breeding ground for fundamentalists. It is likely to have a short-term affect on tourism, particularly from European countries.

Riots erupted in July in some of the major cities in the South, such as Abyan and Aden, leading to violent clashes and the arrest of some demonstrators. The riots started when army retirees from the South demonstrated to protest economic hardships resulting from their early dismissal after the end of the civil war and the subsequent inappropriate application of the retirement law to their cases. There were also protests over the perceived delays in the implementation of the salaries and wages strategy. Protests broadened to touch other issues, such as high inflation, unemployment, and shortages of power supply.

Following the July riots, the Yemeni president took a number of political decisions aimed at addressing grievances and calming down emotions. He issued instructions to bring back army retirees from the South to their workplaces, compensate them for the elapsed period, and give them the promotions and other benefits for which they were eligible. He also instructed the government, through the Yemen Economic Corporation (YER), to directly import and sell wheat and wheat flour. Others measures included granting a one-month salary to all public-sector employees, to coincide with the month of Ramadan, and issuing instructions to the Cabinet to devise new plans to create jobs, increase national power supply, and speedily implement the second phase of the wage strategy.

In response to recent political unrest in some parts of the country, the government is placing some restrictions on political freedoms. According to Human Rights Watch, there are growing signs that human rights and freedom of expression in Yemen are deteriorating, with incidents of political activists and journalists being harassed and detained by security forces. In May, the authorities closed the Socialist Party-run Web site. More recently, the government announced plans to introduce a new law banning direct criticism of the president, and unauthorized public demonstrations.

Owing to policy reforms in 2006, Yemen was reinstated to the Threshold Program of the Millennium Challenge Account (MCA) in February 2007. First admitted to the program in 2004, Yemen was suspended in November 2005 following slippage in its

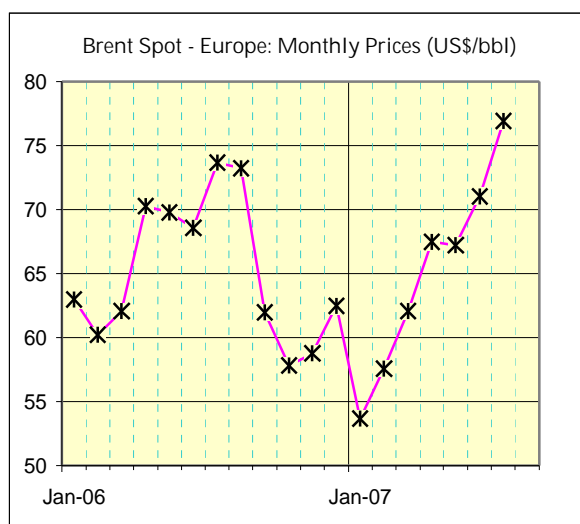
² Ranking normalized in 2007 to reflect the same number of countries as in 2006.

policy performance against MCA threshold indicators..³ In the case of Yemen, the Millennium Challenge Committee (MCC) listed a number of reasons for the reinstatement, including the “free and fair elections” in September, as well as a series of anticorruption reforms, including financial disclosure laws. Having reviewed the reform program document submitted by the government, the MCC has recently announced its overall approval and the allocation of about \$21 million.

II. MACROECONOMIC DEVELOPMENTS

World oil markets continued to build strength during the first half of 2007. After falling sharply to below \$55 per barrel (Brent- Europe) in January 2007, prices resumed recovery from February 2007 onwards, supported by earlier cuts in OPEC production, and continued tensions in the Gulf. Oil prices for Brent crude averaged \$71 and \$77 per barrel in June, and July, respectively. Oil prices are expected to continue to hold firm for the rest of 2007 as growth in global demand continue at its current moderate pace of 1 % per annum, and non-OPEC supply remain tight.⁴

Figure 1. Crude Oil Prices



Supported by buoyant international oil markets, the price of Yemeni crude exports firmed up during the first half of 2007, rising by 11 percent since the beginning of the year to reach \$71.2 per barrel by June 2007, or \$62 per bbl average for the first six months. Despite the firming trend, average Yemeni crude prices for the first six months remain slightly below the 2006 average of \$63 per bbl⁵. Meanwhile, in terms of monthly volume, the first half of 2007 witnessed a 9.5 percent decline in production and about a 12 percent decline in exports. For 2007 as a whole, and with average prices expected to remain close to their 2006 levels, the value of output and

³ The Threshold Program is designed to assist eligible countries (those that have demonstrated significant commitment to undertake reforms) to speed up their reform process to qualify for full MCA membership, known as Compact Status. MCA eligibility is based on three broad policy categories—ruling justly, investing in people, and promoting economic freedom, as measured by 16 performance indicators. Under the MCC policy, the board of directors may reinstate a suspended country to the program if the country has taken corrective action or has demonstrated sufficient commitment to correcting each condition for which assistance eligibility was suspended.

⁴ Based on actual prices for the first 8 months and the forward prices prevailing at end of August, average Brent for 2007 is expected to be \$65.9 per bbl, about 1 percent above the 2006 level.

⁵ Implicit price based on CBY reported oil exports quantities and revenue.

exports will mirror the physical decline in quantities, which is expected to be between 9 and 12 percent.

Table 1. Average Production and Exports (in thousand bbls per day)

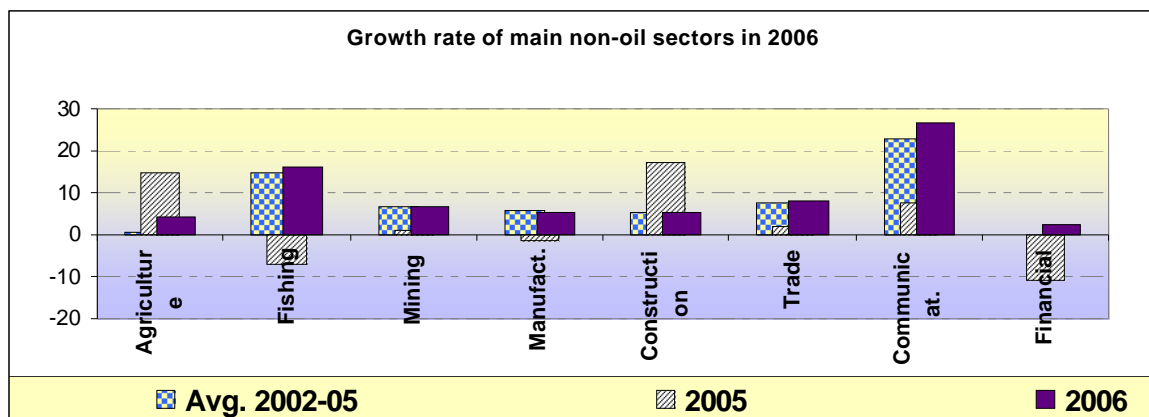
	2006	2007 *	% change
Crude oil output	357	324	-9.4
of which: State's share	235	210	-10.4
Exports of crude oil	293	258	-11.9
of which: State's share	171	145	-15.1

* Projected based on first half year data

Source: Ministry of Oil and the IMF estimates

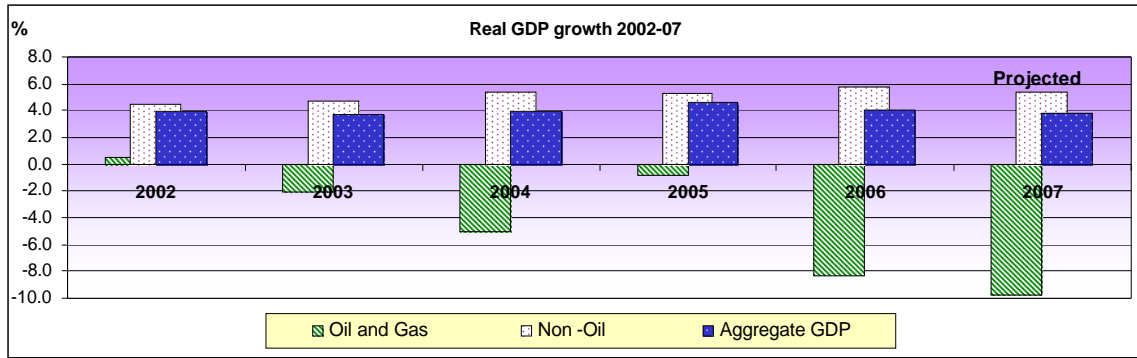
Economic growth witnessed a slight deceleration in 2006. Real GDP grew at 4 percent, slipping by less than one percentage point from the previous year. The slowdown largely reflected the sharp loss in oil output, estimated at more than 8 percent. Growth momentum in the non-oil sector, however, remained stable at about 5 percent⁶. Manufacturing-sector production slowed from 8.1 percent to 5 percent. Meanwhile, fisheries and trade sectors showed improvement in 2006, with the former expanding by 16.4 percent (compared to 10.1 percent in 2005) and the latter by 8.3 percent (compared to 3.5 percent a year ago). On the expenditure side, growth was primarily sustained by the expansion in public final consumption. Investment spending, on the other hand, remained stagnant, with the bulk of activity taking place in the energy and infrastructure sectors.

Figure 2. Growth in Yemen's Main Non-Oil Sectors, 2006 (in percent)



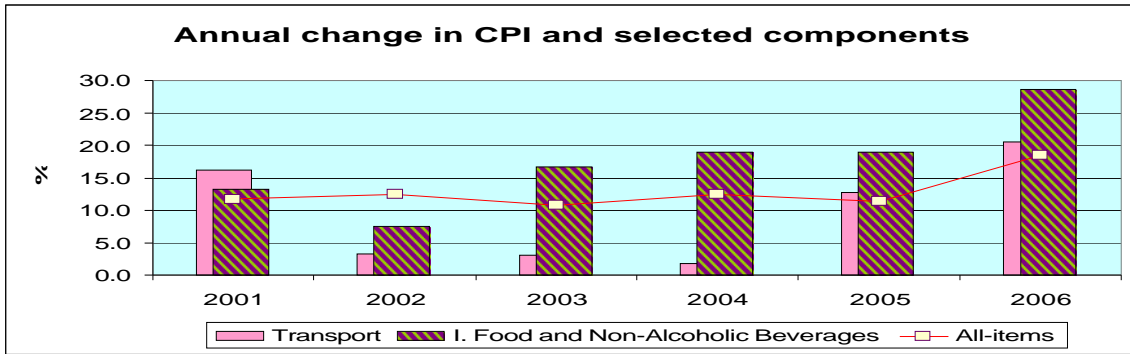
⁶ A recent IMF mission revised 2006 growth estimates upwards, from 3.3 to 4 percent for total GDP and from 5.0 to 5.8 percent for non-oil GDP. The revision seems to reflect the omission by the Central Statistics Office (CSO) of capital spending on some large projects, in preparing the 2006 preliminary GDP estimates

Figure 3. Real GDP Growth in Yemen, 2002-07 (in percent)



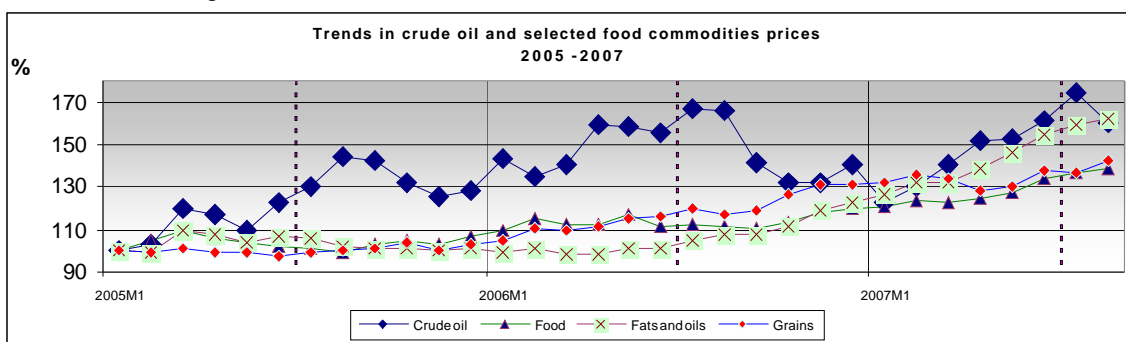
The 2007 outlook suggests that GDP growth will show a further—albeit small—decline to 3.8 percent. A stable non-oil GDP growth of about 5.5 percent will partially offset the contraction in the oil output estimated at about 10 percent. Growth in the non-oil sector will be sustained by new public investment projects, supported by pledges from Consultative Group donors, and ongoing projects (including Yemen Liquid Natural Gas (YLNG), Marib Power, and the first private-sector refinery). Private investment is also expected to start picking up in response to recent legislative and administrative reforms aimed at improving the investment climate.

Figure 4. Annual Change in CPI and Main Components



Inflation in 2006 surged to 18.4 percent, driven primarily by higher food prices. The jump in food prices, estimated at 28.6 percent, has largely reflected the 45 percent price escalation in fruit and vegetable prices. This increase was sustained by domestic supply factors, the continued increase in international food prices, and higher domestic demand linked to the award of a pay rise in the public sector in 2006. The effect of the partial removal of domestic-oil price subsidies in late 2005 has also continued to ripple through various sectors in the economy in 2006, including agriculture, which is heavily dependant on diesel fuel for irrigation.

Figure 5. Trends in Crude Oil and Selected Food Commodities



Source: World Bank data

Box 1. The Impact of Soaring Wheat Prices on the Yemeni Economy

World wheat prices have soared to historic heights in recent months due to poor harvests, and the outlook for the next six months is grim for consumers. Benchmark U.S. wheat prices⁷ have risen by about 40 percent during the year ending August 2007, reaching US\$6.84 per bushel in August 2007. The future prices for March 2008 are quoted between US\$8.45 and US\$8.81 per bushel, implying market expectations of a further surge in prices of about 23–28 percent in the coming six months before the new harvest arrives.

The rising prices of wheat, has profound impact on poverty levels in Yemen. A typical Yemeni family of 8 members consumes about 100 kg of wheat per month. The retail price wheat has spiked, reaching YR 6,000 for 50 kg bag in Sept 07, and coming on top of a year of record inflation at 18 percent. Since wheat is the staple food for most Yemenis—the rich and poor—, and almost all of it is imported, high wheat prices have adverse effects on welfare. Yemen is the 15th-largest importer of wheat in the world, buying about two million metric tones. On average, before the price surge, a Yemeni family spent 7 percent of its consumption expenditure on wheat and flour. The poorer families spent more (12 percent) and the food-poor spent as much as 15 percent. A doubling of wheat and product prices would increase poverty by six percentage points, reversing the gains in poverty reduction achieved between 1998 and 2005.

With high wheat prices feeding political discontent, the government has responded with ad hoc interventions, which could have adverse long-term consequences. In a reversal of policy, the government has authorized Yemen Economic Corporation (YEC), a public entity, to import 600,000 tones of wheat and directly market to the public at cost, in direct competition with the four major private traders. Though this is intended as a temporary move, the private traders may lose the incentive to invest in marketing and distribution, and the gains may not all go to the poor. There is no conclusive evidence that the private wheat traders were indulging in collusive behavior by profiteering on wheat prices. It is welcome that at the same time, the government is taking steps to increase the contestability of the market by allowing foreign companies to enter wheat trading. The fiscal cost of the implicit subsidy is estimated to be small. In addition, the government must examine ways to increase cash-transfers to the poor through the Social Welfare Fund. The food-poor families spent on average about YR 4,900 on wheat and products, whereas the ceiling of assistance under cash-transfer was only YR 2,000.

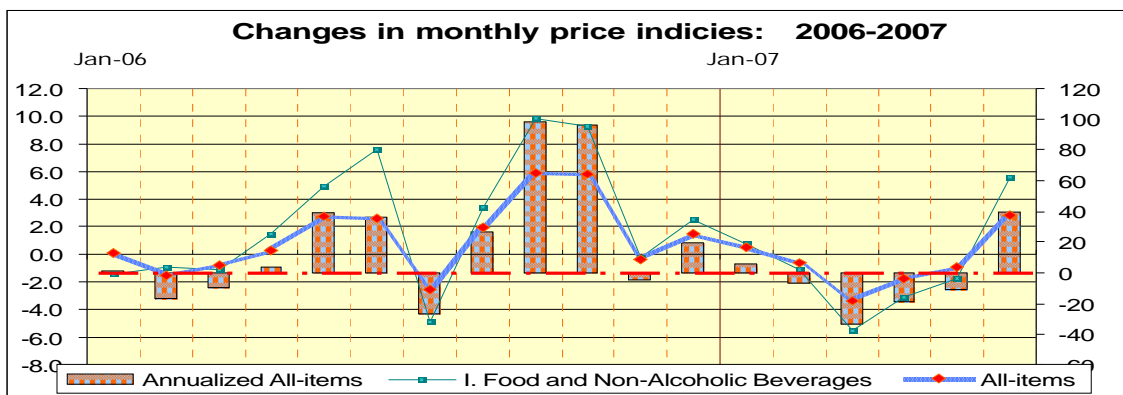
⁷ U.S. wheat, Hard Red Winter No. 1, ordinary protein, export price delivered at the Gulf port for prompt or 30 days shipment

Recent episodes of food price inflation in Yemen are closely associated with the trend of rising oil prices. Food prices in Yemen have increased rapidly in recent years, accounting for about two-thirds of total inflation during 2005–06. The link between the two could be established through a number of local, regional, and international channels. On the local level, higher oil prices contributed directly to rising domestic demand through their effects on current public spending. On the regional level, higher oil prices and booming conditions in the neighboring Gulf countries helped Yemen to attract more remittances and capital flows, particularly to nontradable sectors, while also increasing demand for exports of food crops such as fruits and vegetables. On an international level, rising fuel prices contributed directly to the cost of producing agricultural commodities worldwide, and indirectly through its effects on freight cost. Additionally, it increased the demand for bio-fuels derived from the conversion of grains and other agriculture by-products, thus helping to tighten the supply of grains and edible oil and pushing their prices further up. In 2006, the increases in food prices in Yemen have come primarily from food categories that are domestically produced, such as vegetables, fruits, and meats. In 2007, while good seasonal rains helped to somewhat moderate inflation in local agricultural produce, prices of imported foods such as cereals and edible oils have shown a strong increase. Other possible factors that could have helped to push food-price inflation in Yemen are the shift in the pattern of domestic crop production towards Oat, and the subsequent shortage of agricultural land and irrigation water.

Despite the surge in June, CPI data for the first six months of 2007 indicate inflation continuing to stay below last year's record level of 18.5 percent. Following the big surge in September and October of 2006, where the all-items price index (raw data) jumped by nearly 6 percent (about 100 percent on an annualized basis) in each month, inflation has been gradually easing. In semiannual terms, the inflation rate averaged about 3 percent for the first half of 2007, compared to about 10 percent in the second half of 2006, and about 6 percent for the first half of 2006. It is expected that for the rest of 2007, seasonal factors and rising international food and oil prices will push inflation further up, with the likely outcome for the whole year reaching about 14 percent.⁸ The latest surge in inflation in June—about 2.8 percent over the previous month—is primarily attributed to recent increases in international food prices, particularly grains and edible oils.

⁸ Another factor that will likely cause the annual inflation rate to exceed the current annualized monthly rates relates to the survey methodology used to construct the consumer price index (CPI). Surveys of food and vegetables are taken on weekly and monthly basis, depending on individual items. For other categories in the CPI, surveys also vary from monthly to annual intervals. Thus, for some items like housing and some services, which are expected to show increase in 2007, the effect on the CPI will not show until later in the year.

Figure 6. Changes in Monthly Price Indices, 2006-2007



In response to recent surge food prices, the government is expanding the role of the Yemen Economic Corporation in supplying imported wheat and flour. YEC is the trading arm of the military establishment, which in the past has been engaged in trading a wide range of consumer products, including wheat and flour, directly to the military. In support of these efforts, the government announced the allocation of a \$50 million credit facility for YEC, enabling it to expand its operations and increase its storage capacity in different parts of the country. Meanwhile, the government maintains that YEC will continue to sell flour and wheat at cost and without any subsidy. The new measures were accompanied by increased efforts to persuade local grain merchants to limit their profit margins under current conditions of rising international grain prices. The Ministry of Industry and Trade (MOIT) increased its monitoring of international food prices and the levels of national inventory stockpiles of wheat and other grains. At times, it also warned traders against price collusion and threatened to take legal action under the competition law. Over the longer run, the government claims that this action will be superseded with measures to increase domestic production of grains, encourage more domestic players in the trading sector, and strengthen the targeting of cash transfers to the poor. On the supply side, the Cabinet has already amended the Commercial Law (Article 28) to extend the right of importation of basic food commodities to foreign firms. The government has also initiated studies on the feasibility and cost-effectiveness of various options to support local production of wheat in areas with good agricultural potential.

Table 2. Consolidated Budget for 2007

	2007*	% change over	Contribution to
	(Million YR)	2006	incremental revenue and expenditure (%)
Total revenue and grants	1372180	-4.6	100
Total revenue	1352287	-5.9	128
Oil and gas revenue	977752	-9.9	164
Non-oil revenue	374204	7.6	-40
Tax	265404	-0.3	1
Direct	127378	-3.1	6
Indirect	138026	2.5	-5
Nontax	108800	33.4	-41
Grants	19893	1253.3	-28
Total expenditure and net	1596474	13.6	100
I. Current expenditure	1220461	14.6	81
Wages and salaries	463284	20.1	41
Materials and services	152061	17.6	12
Operation and maintenance	21298	7.8	1
Interest obligations	96226	8.2	4
Transfers and subsidies	464213	10.8	24
of which : Subsidies	334568	8.3	13
unclassified current	23379	3.9	0
II. Development capital	301387	4.2	6
III. Net lending	74626	46.0	12
IV. Loan repayment	22548	12.4	1
Overall balance –Cash	-224,294	-793.0	-134

* Based on revised budget estimates and reclassification using GFS2001

After recording a small surplus in 2006, the fiscal balance under the 2007 budget is expected to revert to a deficit of more than 5 percent of GDP. The widening deficit underlies the continued loss of oil revenue, and continued —albeit moderating— growth in expenditure. Current revenue is projected to decline by some 6 percent, primarily reflecting the cut in oil revenue projections by 10 percent, and to a lesser extent, the shortfall in taxes due to the adoption of transitional measures related to tax reforms. On the expenditure side, about 40 percent of projected increase comes from higher wages and salaries, which reflects the continued implementation of the national wage strategy, and some increase in hiring—largely related to ongoing efforts to decentralize government services. Other major sources of increase in current expenditure come from higher subsidies and transfers, primarily resulting from higher valuation of fuel subsidies. Capital spending represents the second-largest source of growth in public expenditure, with an increase of 17 percent to YR1 290 billion. However, budgetary figures on capital projects could be much higher if the entire government commitments to cofinance pledges made earlier at the Consultative Group conference in London were included. The overall deficit in 2007 is expected to reach YR1 224 billion, equivalent to 5.8 percent of GDP, and slightly above the deficit limit set out under the DPPR.

Table 3. Budget Estimates versus Actual Results for First Half of 2007

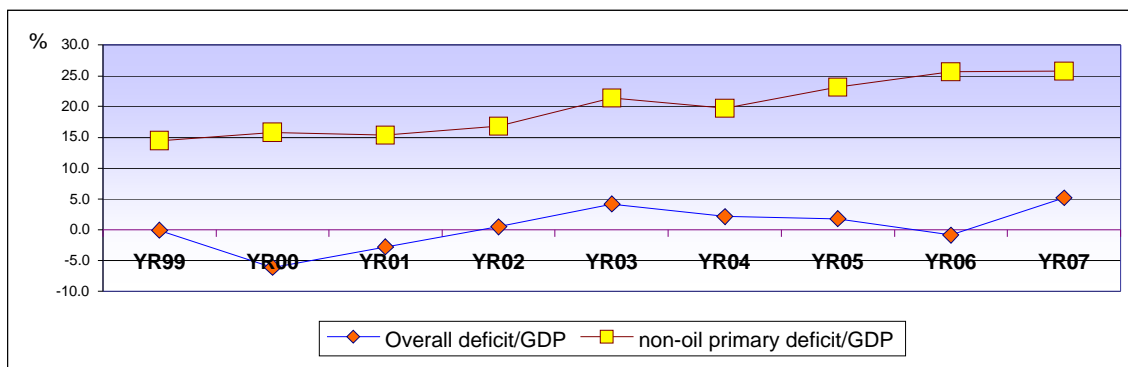
Million YR	Budget	Actual	% Change
Grand Total Revenue	676,281	640,399	-5
1) Tax Revenues	132,702	138,403	-24
Income & profit tax	60,304	70,688	17
Goods & Services tax	47,872	44,879	-6
customs	21,142	19,472	-8
Other Tax Rev	3,386	3,364	-27
2) Property Income & Charges	543,276	498,913	-8
oil and gas	499,009	422,706	-8
Crude oil export	221,546	217,574	-2
Domestic oil and gas	277,463	205,132	-26
Other property Income	44,267	76,207	72
3) Grants	138	2,767	1,911
4) Disposal of non financial assets	166	316	91
Grand total of expenses	772,122	667,839	-14
Current Expenditure	609,160	537,212	-76
1) Compensation of Employees	231,642	184,333	-40
Civil Wages & Salaries	217,942	173,276	-20
Others	13,700	11,057	-19
2) Operations and maintenance	86,679	75,871	-12
Goods & services	75,885	66,207	-13
Maintenance	10,648	9,659	-9
Others	146	5	-97
3) Interest Payment	48,113	43,201	-10
4) Subsidies & Transfers	231,036	223,260	-3
Oil subsidy	164,284	168,308	2
Electricity subsidy	3,000	6,000	100
Other social transfers	38,722	29,096	-25
Others	25,030	19,856	-21
5) Non-classified Items	11,690	10,547	-10
Development and Capital Expend.	112,641	111,539	-1
Gain of Fixed Assets	107,734	110,610	3
Gain of Produced Assets	4,907	929	-81
Net Lending & loan repayment	50,321	19,088	-62
*Local Lending & Gain of local Fin. Assets	38,578	10,280	-73
Foreign Lending & Gain of Foreign Assets	469	205	-56
Loan Repayment	11,274	8,620	-24
Disposal of financial assets	-	17	
Overall	-95,841	-27,440	-71

Data released on the first half of 2007 indicate some improvement in the fiscal position. Compared to budget estimates, actual revenue shows a shortfall of about 5 percent, matched by savings in expenditure of about 14 percent, therefore causing a reduction in the overall deficit of about 70 percent. Major sources of the decline in revenue are the lower income from oil and gas owing to declining production and lower share of government from exports, and to a lesser extent, the shortfall in tax revenue. On the expenditure side, savings are primarily related to the delayed implementation of the second stage of the wage strategy, which is now expected to be gradually implemented beginning from the fourth quarter of the year. Overall, the fiscal outcome for the year will

be affected by a number of factors that could result in substantial divergence from the budget. On the up side, oil prices are now likely to continue firming up for the rest of the year, narrowing the gap between actual and expected income. In addition, the second half of the year is likely to see stronger tax revenue, due to the settling of disputes related to the new sales-tax system. Other favorable factors relate to lower expenditure on defense, as the cease-fire with the rebels in the North continues to hold. On the down side, rising oil prices will affect expenditure directly through higher fuel subsidies and could indirectly lead, through their global inflationary impacts, to heightening pressures on the government to increase public-sector wages and other transfers.

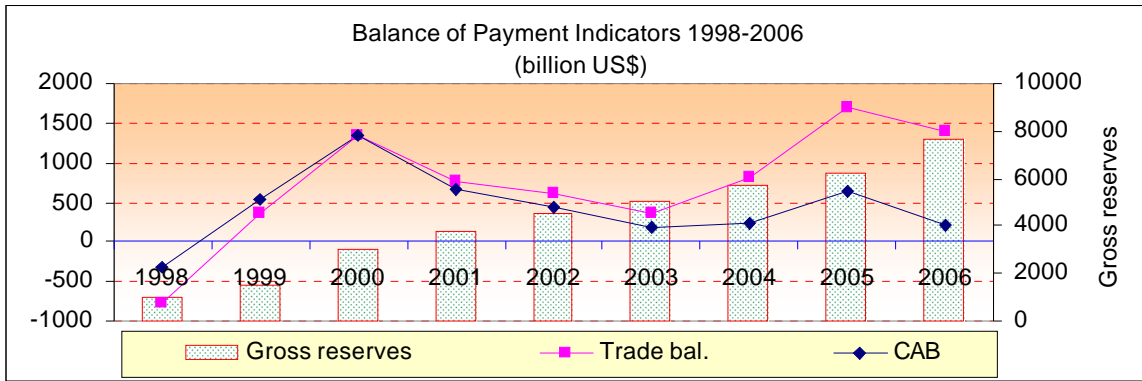
Despite the manageable fiscal position in recent years, fiscal policy continued to be on an unsustainable track. Strong oil revenues over the past six years helped to maintain the average fiscal balance with a small surplus. However, the non-oil primary balance, the major indicator of fiscal sustainability, continued to show deterioration, reaching about 25 percent of GDP in 2006, up from about 15 percent in 2000. Some progress in this regard is expected in 2008 as reforms in civil service administration, taxation, and other areas of public financial management are implemented more fully. Yet to achieve sustainability, the government must address longer-term, structural fiscal-policy measures and adopt explicit policy objectives and time-bound plans to restore balance between non-oil resources and domestic expenditure.

Figure 7. Fiscal Sustainability Indicators, 1999–2007 (in percent of GDP)



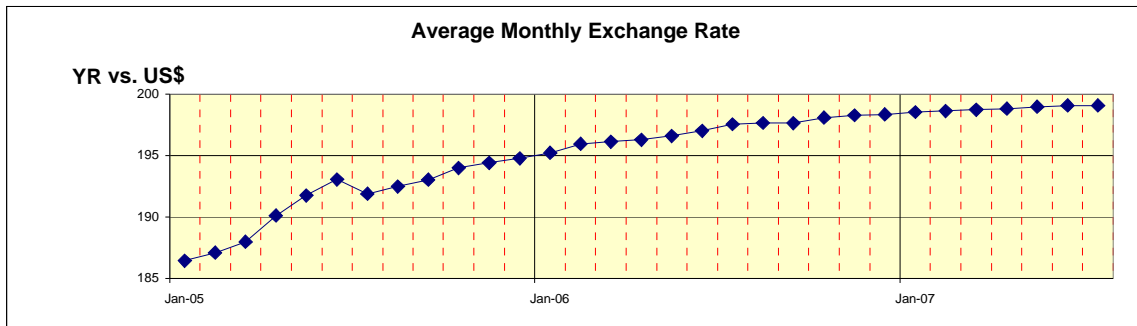
The current account balance for 2006 recorded a surplus of about US\$200 million, equivalent to 1 percent of GDP. This represents a sharp downward revision from earlier official estimates of a surplus of about 10 percent of GDP, which came in light of new data regarding capital equipment imports related to the Yemen LNG project. The current account surplus in 2006 was sustained by record oil revenues, which increased by 14 percent to US\$6.7 billion despite having an 8 percent fall in production. With the continuing current account surplus for the eighth consecutive year and large inflows of direct investment in recent years, the country’s foreign reserves climbed by end of 2006 to US\$7.6 billion equivalent to 11 months of imports.

Figure 8. BOP indicators, 1998–2006



The rate of depreciation of the Yemeni rial versus the U.S. dollar has been slowing down in recent months. In 2006, the rial depreciated by 2.9 percent, below the 3.6 percent recorded in 2005, and the near 4 percent average rate during the period 2000-2004. The slowdown in depreciation continued in 2007, with the rial reaching to YR1 199.06 per US dollar by the end of June, equivalent to 0.36 percent on a year-to-date basis (or to 0.7 percent on an annualized basis). The recent stabilization in the exchange rate versus the dollar, which was brought about by active intervention of the monetary authorities in the foreign-exchange market, seems to have been prompted by the desire to lessen the inflationary impact of the weaker rial—particularly as the dollar continues to wane against other major currencies.

Figure 9. Average Monthly Exchange Rate



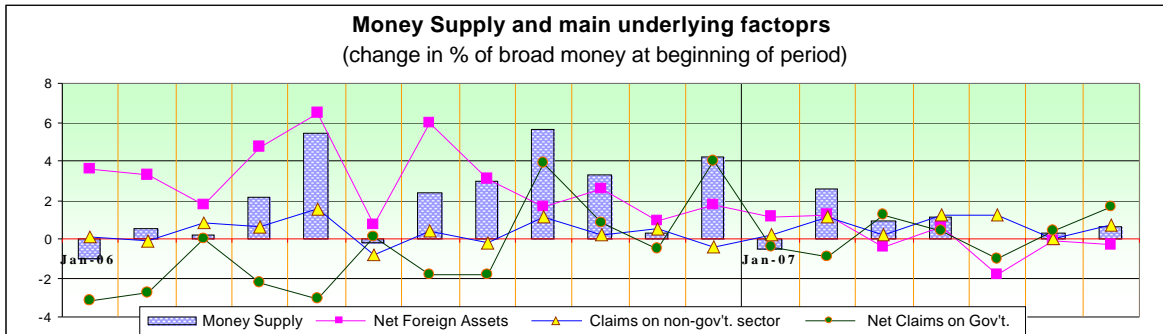
In the monetary sector, broad money growth witnessed noticeable moderation during the first seven months of 2007.⁹ After sharply increasing by some 29 percent in 2006, money-supply growth began to moderate beginning early this year. By the end of July 2007, the money supply increased by only 5 percent (year to date), or about 9 percent on an annualized basis. This represents about a 23 percent increase over the last 12 months.¹⁰ The moderation in growth comes on of considerable deceleration in the growth of net foreign

⁹ Analysis is based on comparing recent months' figures with the stand at the end of 2006.

¹⁰ The relatively large increase over July 2006 mirrors the sharp increase that occurred in August through October and in December of 2006.

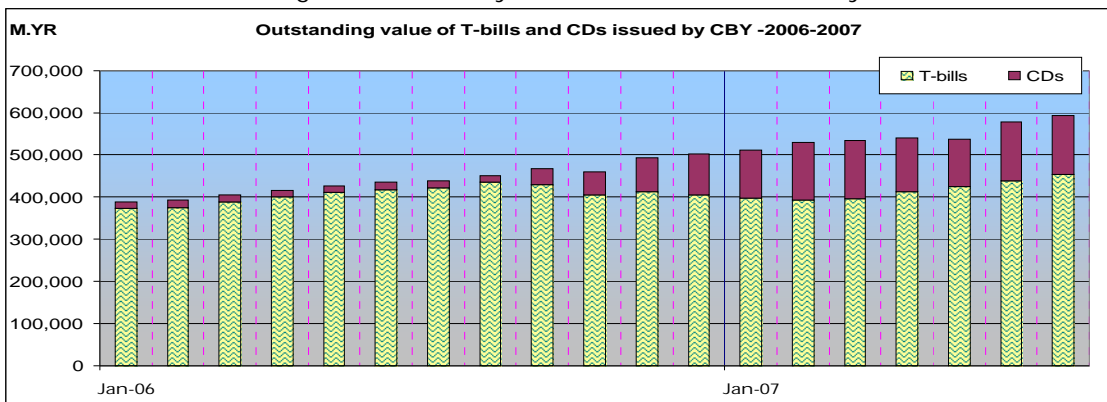
assets, which have increased by less than 1 percent since the beginning of the year (or 1.1 percent on an annualized bases for 2007 as compared to 38 percent for 2006), owing to the decline in oil export revenues. Growth in money supply during the first seven months of 2007 was primarily sustained by the expansion in credit to the private sector, which has grown by about 38 percent on an annualized basis, and to a lesser extent by the claims on government, which went up by 12 percent on an annualized basis.

Figure 10. Factors Affecting Money Supply



The slowdown in liquidity in 2007 comes on top of increased use of certificates of deposits (CDs) by the Central Bank of Yemen (CBY). The expansive use of CDs to control liquidity is relatively new to the CBY, which until recently was relying primarily on treasury bills. Towards the end of 2006, and under the conditions of positive fiscal balance in that year, the bank shifted its focus to the use of CDs for controlling liquidity. During the first half 2007, and as shown in Figure 11, the increasing use of CDs kept its growth momentum, while new issues of T-bills remained stable for the first few months, then picked up as deficit-financing needs increased.

Figure 11. Monthly Issues of T-Bills and CDs by the CBY



Yemen's total external public debt stood at about US\$5 billion (26 percent of GDP) by year-end 2006, a significant reduction from the US\$11.4 billion in 1996. Some 50 percent of current external debt is owed to multilateral agencies, with the International Development Association (IDA) accounting for about 38 percent. Major bilateral creditors

include Russia (about 30 percent), followed by Kuwait and Saudi Arabia (6 percent each). Meanwhile, net domestic government debt stood at 4 percent of GDP at year-end 2006, resulting in a total net public debt stock of about 30 percent of GDP at the end of 2006.

The outlook for 2007 calls for slight deterioration. In the oil sector, while prices are expected to remain unchanged from previous years, crude oil output and exports are likely to continue falling by about 10 percent, following the 8.8 fall in the previous year. As a result, oil's contribution to growth, fiscal and current accounts will fall. Therefore, average growth will slightly decline to 3.8 percent, with the non-oil output remaining relatively stable, owing to sustained capital spending both from private and public sources. In the fiscal area, budget estimates already put the deficit at about 5.8 percent of GDP. Despite the improved outlook for oil and tax revenue, spending is also expected to exceed budget targets, hence causing the actual fiscal deficit to remain close to budget projections. Public expenditure is expected to rise due to higher fuel subsidies and possible increases in wages and transfers in response to rising pressures on the government to relief hardship. Similarly, the current account balance is expected to turn into deficit (about 4 percent of GDP) for the first time in many years. One positive outlook relates to inflation, with the trend for the first six months pointing to an average rate for the whole year below that of 2006.

III. STRUCTURAL REFORMS AND POLICIES

In early 2006, the government introduced a series of economic and political reforms under the banner of the National Reform Agenda (NRA). The NRA focuses on four key areas: increasing political participation, improving governance and fighting corruption, enhancing public administration, and improving the business environment. The program encompasses concrete measures designed to reform public financial management, civil services, procurement, public audit, judicial system, debt policy, fiscal policy, and the business regulatory environment. Since its launch in early 2006, the NRA made significant progress in implementing its key items, while the few remaining elements are progressing satisfactorily.

Concerning governance, national reforms are categorized into three major areas: general corruption, the judicial system, and revenue transparency. While some progress has been achieved on the judiciary-system front over the last 16 months—particularly concerning increasing system’s independence —major breakthroughs did not come until recently, with the ratification of the Anti-corruption and the Extractive Industries Transparency Initiative (EITI) laws. A third milestone that could also serve the same purpose, but has been discussed within the context of the public finance reform agenda, is passage of the Procurement Law by Parliament in late July. With these three important legislations in place, the ground for improvement in governance is largely paved. However, final progress in the coming stage will depend on implementation of the laws and the political will to carry out the reforms.

At the end of June, the Yemeni Parliament, after more than two months of scrutiny, has approved the selection of the board members for the Supreme National Anti-Corruption Committee (SNACC) from the list of candidates proposed by the Shura Council. Under the new anticorruption legislation, the commission is an autonomous body with an independent budget. The 11-member body will be responsible for establishing a national anticorruption strategy (which is expected to be finalized during the first half of 2008), monitoring all government agencies for corruption, and sending suspected officials to court when necessary. Among the first priorities declared by the board is establishing the agency’s executive by-laws and strengthening its institutional framework. The board also declared its intention to conduct a baseline survey on public perception of corruption in Yemen and to activate the recently approved Financial Disclosure Law by being first public agency in Yemen to piloting the legislation to its members.

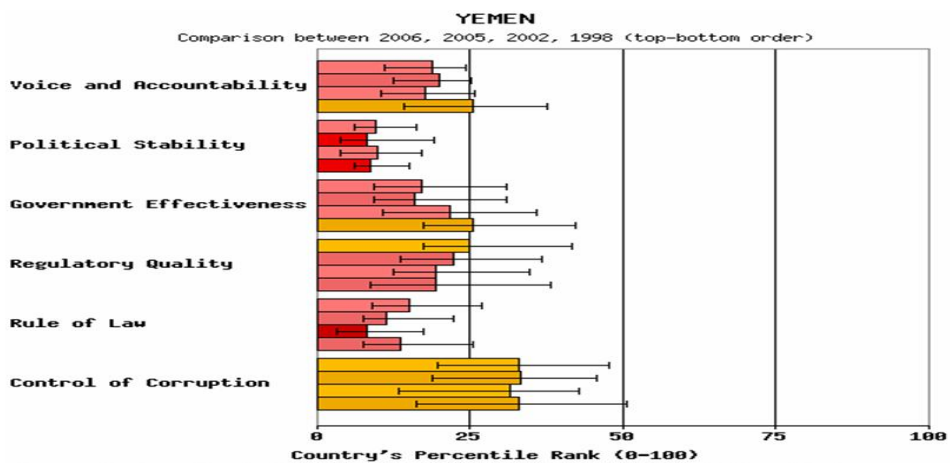
In August 2007, the government officially announced the joining the EITI. The announcement was accompanied by the establishment of the Yemeni Council for EITI, comprising representatives from government, oil and gas companies, and civil society

organizations. The role of the council is to ensure adherence to the principles of EITI¹¹ to improve transparency and accountability in managing hydrocarbon resources. Given the significance of hydrocarbon revenue to the budget, the move is a major contribution to enhanced transparency, better governance and accountability, and improved performance of public financial management.

Box 2. Yemen's Progress on Governance—the Kaufman, Kray and Mastruzzi Indicators

The latest governance report published by the World Bank, "Governance Matters 2007," shows Yemen scoring a slight improvement from last year. The report, compiled by Kaufman et. al. by aggregating reviews made by various think tanks and NGOs, presents governance indicators for 212 countries and territories over the period 1996–2006, covering six dimensions of governance: (1) voice and accountability, (2) political stability, (3) government effectiveness, (4) regulatory quality, (5) rule of law, and (6) control of corruption. These indicators measure the perceptions of corruption and not necessarily governance itself. Furthermore, the report, though published by the Bank, does not represent its official views. Among these six dimensions, Yemen in 2006 scored best in control of corruption and regulatory quality. Compared to other countries, Yemen has attained 9.6 to 33.0 percentile ranks on the six dimensions, indicating a low rank. However, Yemen showed some improvement in 2006, particularly in regulatory quality and rule of law, and to a lesser extent in voice and accountability and government effectiveness. Meanwhile, two areas—voice and accountability and control of corruption—have witnessed slight deterioration in 2006.

Inter-temporal comparison of Governance Indicators



Source: Kaufmann D., A. Kraay, and M. Mastruzzi 2007: Governance Matters VI: Governance Indicators for 1996–2006

Efforts to improve public financial management (PFM) continued in the second half of 2007. The PFM Reform Strategy, initiated in 2005, is being implemented through annual public financial management reform action plans. The agenda includes reforms related to

¹¹ The principles and criteria of EITI are described in EITI website: <http://www.eitransparency.org/section/abouteiti/principlescriteria>

budget preparation, execution, and implementation, particularly in the areas of budget classification and reporting, information systems, bidding and procurement, financial accountability, and budget decentralization. As a part of the 2007 action plan, the following activities are underway:

- Modernizing the budget classification and reporting system. Efforts are underway to develop a functional classification of expenditure under the GFS 2001 system and consolidate the extrabudgetary accounts into the budget.
- Benchmarking the performance of the public financial management system under a Public Expenditure and Financial Accountability (PEFA) framework. This task is expected to be completed in the fourth quarter of 2007.
- Embarking on the development of a Medium Term Expenditure Framework (MTEF), which establishes a three-year rolling budgetary framework closely integrated with the longer-term development plans.
- Establishing a treasury and debt management functions within the Ministry of Finance, with technical assistance received from the U.S. Treasury department and, later, the International Monetary Fund (IMF).
- Strengthening the internal financial controls and internal audits and implementing the new internal audit manual. In addition, work is underway to finalize the new Financial Law.
- Building capacity in the Ministries of Finance and Planning to improve macroeconomic projections and analysis.
- Continuing efforts with budget decentralization. Local councils have recently been required to collect their own revenue and manage their expenditure.

A revised version of Procurement Law, consistent with international standards, was passed by Parliament in July 2007. The revision amends some weaknesses in the original law passed by Parliament earlier in the year. The law, comprising 114 articles in 10 chapters, aims to ensure transparency, equity in government bids, and standardized and efficient process. It calls for the establishment of an independent agency under the title High Tender Board (HTB) to monitor government purchasing and bidding operations. New measures are already underway to finalize the details of organizational structure at the High Tender Board, and to implement the National Procurement Manual and Standard Bidding Documents (SBDs) by various government agencies, after their introduction last April. Other steps taken include training in pilot spending ministries, and the circulation of instructions by the HTB and Ministry of Finance (MOF) to spending ministries to request their compliance. Work in progress also includes building capacity and training in various line ministries to use the new procurement and bidding documents.

The government is undertaking major revisions of the income tax law. A revised income tax law, which is currently before the Cabinet for approval, was initiated 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. The new law will cover income resulting from commercial, industrial, services, and real estate

activities that would accrue to individuals, corporations, and small businesses. Exempted categories under the new law will be reduced, which will primarily affect nonprofit and cooperative organizations, agricultural and farming activities, and technical training institutes. Exemptions also apply to an individual's income from dividends, interest payments, and other financial transactions. In general, the new law is expected to eventually lower the effective corporate tax rate from 35 percent to 20 percent. Once the law passed by Parliament, its executive bylaws are expected to be issued in the next few months. The authorities also announced plans to strengthen the capacity of tax administration in preparation for the new law's implementation.

Reforms are progressing at moderate pace in the areas of civil service and public administration. To deal with the large and inefficient public sector, the government introduced the National Wage Strategy in 2005, which was to be implemented in two phases: the first provides basic increase in wages across the board, and the second links further salary hikes to sector reforms and performance. As supplementary measures, it also established the Civil Service Fund (CSF) in order to help retrench excess labor in the public sector, and introduced a biometric identification system with the objective of eliminating "ghost workers" and "double dippers". In 2006, the first phase was implemented, resulting in an across-the-board wage increase and a doubling of minimum wages. The second phase, which has yet to be implemented, requires a number of prior reforms that include the completion of the biometric ID system, and reforms at individual agency levels, such as re-engineering studies and job descriptions. Progress on the biometric identification system has been satisfactory, with the current reported completion rate approaching 80 percent of civil service and the judiciary. The wages of some 60,000 potential double-dippers and ghost-workers (who have not submitted to the biometric identification) have been frozen and planned to be removed from the system by November 15, 2007, resulting in potential savings to the government of about US\$97 million a year. Other reforms that were concluded recently include the establishment of a budgetary program for CSF for 2007–2010. Under the CSF, the government has retrenched and benefited about 4,000 employees. However, efforts to contain the wage bill and adhere to the implementation plan of the wage strategy's second phase have seen some impediments in recent months. As it faced increased pressures during recent riots, the government has resorted to awarding a one-month salary bonus for the month of Ramadan, and expressed intentions to expedite the implementation of the second phase, possibly ahead of the completion of all required prior actions.

As a part of efforts to improve the enabling business environment, a new land registration law that takes into account the recommendations of the Land Policy Task Force was approved by the Cabinet in September 2007. The bill is expected to be referred to the Parliament soon for final approval, which will be followed by the appointment of an independent registrar, and the establishment of an organizational structure for the authority that sets up its mandate and functions vis-à-vis other authorities and agencies. The law takes into account a number of environmental safeguard measures, including undertaking a clear classification, demarcation, and

registration of environmentally sensitive areas. It also includes measures to mitigate the impact on vulnerable social groups, such as the poor and women.

Reforms in the in the financial sector are expected to be stepped up. The need for comprehensive reforms in the sector has been increasingly voiced in recent months, particularly in the wake of the modest macroeconomic results of 2006, and in the context of the investors' conference in April 2007. More recently, and following the July riots, a presidential directive was issued requesting to declare the issues of financial sector, monetary policy, and interest rates to be of maximum urgency in government reform agenda.¹² This was followed by CBY announcements that it was initiating a process to change the banking law in order to ease entry conditions for foreign banks and strengthen the oversight of Islamic banks. Efforts are also underway to expedite the establishment of a stock exchange; a specialized committee is preparing a draft law that could lead to the establishment of a private stock exchange and a securities and exchange commission in 2008. The rush to expedite reforms in the financial sector emanates from the need to foster growth in the non-oil sector, attract and mobilize foreign and domestic capital, improve general transparency and corporate governance standards, and increase the efficiency and size of government tax revenues.¹³

Privatization of public enterprise has slowed in recent years. Privatization efforts date back to early 1995, following the end of the civil war. Right after unification Yemen had more 200 SOEs, employing over 86,500 employees (more than 25 percent of all civil servants at the time). These enterprises, which were inefficiently run, imposed a heavy burden on the budget, as operational losses had to be covered by budget transfers or accumulation of arrears. Table 7 shows some of the milestones in privatization efforts in recent history. Since 2000, efforts have been focused on smaller enterprises in various sectors, with an estimated 35 firms being privatized. The government continues to maintain ownership of a number of major enterprises in the areas of land transport, refining, cement, pharmaceuticals, port handling, and financial services, with efforts focusing so far on market liberalization and rehabilitation and restructuring. The slow progress was ascribed to the lengthy time and high investments needed for the rehabilitation of remaining state owned enterprises, and the absence of the equity market. In recent weeks, the Cabinet has decided to revitalize the process and issued instructions for an updated report on the situation, to be completed before the year's end.

¹² *Al-Thawra* newspaper, August 22, 2007.

¹³ Currently, the sector is dominated by the CBY and retail banks, which include 15 commercial banks and two specialized banks. There are also a number of non-bank financial institutions with limited roles, such as insurance companies, money exchangers, pension funds, the Postal Savings System, and the Social Fund for Development. Meanwhile, other financial institutions such as stock exchanges, investment companies, and other types of financial and capital market intermediary firms are absent. The banking system, despite its relatively large number of institutions, suffers from a number of weaknesses related to asset quality, capitalization, and operating and staffing efficiencies. Foreign ownership in banks is restricted to 20 percent. Reflecting this environment, banks in Yemen have a very low penetration ratio and the number of Yemeni citizens who have access to their services remains very low. Various reform efforts were attempted in the past, but without tangible results.

Table 4. Main Milestones in Yemen’s Privatization Reforms

Year	Measures Taken
1996	Establishing of the Technical Privatization Office (TPO)
1996	Compiling a census in mid-listing 192 enterprises, of which more than 110 were located in the former socialist South.
1997	Completing the privatization of 60 small enterprises by mid-1997 (16 tourism and 53 other mostly agricultural units privatized primarily through restitution to their original owners).
1999	-Promulgating the Privatization Law, which organizes and unifies procedures for privatization across state owned economic units. The law stipulates the establishment of a High Commission (HC) and a Technical Privatization Office (TPO) to ensure the implementation of standardized and transparent privatization procedures. It also calls for the establishment of various committees at ministerial levels to carry out the privatization of some of the small enterprises in collaboration with the TPO. -With the help of the World Bank, formulating the privatization strategy and program. The program includes three components: (1) the privatization of five large enterprises, (2) the privatization strategy work on three other large enterprises, ¹⁴ and (3) financial and legal assistance in the privatization of about 50 of the remaining 70 small- and medium-sized enterprises, including the financial sector.
2000	Restructuring the TPO as secretariat to the HC coordinating the privatization program, with the latter in charge of approving the privatization program, and appointing temporary executive board members to the state-owned units approved for privatization.
2001-present	Focusing government privatization efforts on smaller enterprises in various sectors with an estimated 35 firms privatized, while efforts regarding major enterprises focus on market liberalization, rehabilitation, and restructuring.

¹⁴ Port of Nashtoun, Public Telecommunications Company, and Yemenia Airlines

IV. OUTLOOK

The government is continuing the reform process that was restarted in July 2005. The implementation of the National Reform Agenda has been progressing satisfactorily, with the bulk of the agenda items completed or adequately on track. The government is currently drafting its second program of reforms, with key focuses on the areas of political and economic liberalization and improving the investment climate. Currently, donors are actively supporting the government reform program. For instance, the bank is supporting the government with an Institutional Reform Development Policy Credit (IRDPC) —a quick disbursing operation—and the U.S. doing the same, with Yemen’s access to the Millennium Challenge Account.

Yemen faces daunting challenges as oil, water resources continue to deplete, and the population grow briskly at 3 percent annually. At current rates of crude oil production and domestic consumption, Yemen could be a net importer by 2015, and will cease production by 2018. As exports and public finances rely heavily on oil, the impending oil depletion and the slow adjustment on the fiscal and production sides will saddle the government with heavy debts and cause deterioration in external accounts accompanied by rising inflation and political instability. To examine the prospects of future debt sustainability, a recent Debt Sustainability Analysis (DSA) exercise carried jointly by the World Bank/IMF, shows that the probability of debt distress is particularly high if the authorities do not undertake major fiscal adjustment efforts in light of the dwindling oil reserves. With unchanged policies, particularly with regard to improving growth in the non-oil sector, higher tax revenue and reductions in current expenditure, major debt indicators (ratios of NPV of debt to GDP and to exports, and of debt service to exports) are expected to breach the sustainability thresholds between 2012 and 2018. However, even under the baseline scenario that assumes full implementation of a comprehensive set of fiscal and structural reforms, Yemen will be at risk of breaching at least one of the debt thresholds (NPV of external debt-to-exports ratio) within the next 20 years. This situation would be amplified in the standard DSA stress tests, especially if financing would only be available on moderately concessional terms. In other words, if Yemen is to avoid debt distress, this will require strong fiscal and structural reforms, as well as highly concessional financing.

At the current pace of poverty reduction, Yemen is likely fall short of meeting most of its MDG goals by 2015. The goal of reaching the first MDG adopted by the government will require quadrupling of the 1 percent per year rate of growth in per-capita consumption achieved over the last seven years. According to the recent poverty assessment study, the overall poverty gap index of 8.9 percent implies a monthly poverty deficit per capita of about YR1 497. On average, a poor person should receive YR1 1,431 a month to be lifted out of

poverty¹⁵—about a third of the mean consumption of the poor. Perfect targeting of the poor would have required only about YR1 124.4 billion per year (about 4 percent of GDP) to fill the gap between the actual spending of poor households and the poverty line in order to lift everyone out of poverty. The severity of the poverty index (which attaches greater weight to the poverty gaps of poorer families) at 3.3 percent is relatively high by the standard of Middle East and North Africa countries. The food poverty gap averages about YR1 2,100 for the food-poor, some 75 percent of the average consumption of the food-poor. To see this gap in perspective, the cash-transfer program currently has a maximum transfer of YR1 2,000 per family, not per person. The recent poverty data also cast doubt on the ability to meet the DPPR target of lowering the country's poverty rate to 19.8 percent by the end of the decade.

¹⁵ Per-capita poverty deficit is calculated for the population as a whole. While per capita deficit per month is YR1 497, average deficit per poor person is YR1 1,431.

V. ECONOMIC AND SECTOR DIALOGUE

I. Private Sector Development

[Business Start-Up Simplification, Yemen](#). The IFC PEP-MENA's Business Start-Up Simplification Project in Yemen seeks 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 will be a comprehensive restructuring of the relevant business start-up procedures, resulting in reduced cost and time of business registration for start-ups, thus encouraging more local and foreign investment. This project is working in Sana'a to ensure that all simplifications are in line with national policy and applicable across the country as well as, at the sub-national level in Aden where it will serve as the pilot case where these simplifications would be implemented first as part of the Administrative Modernization and Simplification project financed by the World Bank's PCDDP. IFC PEP-MENA is working closely with the Ministry of Planning and International Cooperation, the Ministry of Industry and Trade, the GIA, the Free Zone Authority and the Governorate of Aden to improve and streamline business start-up procedures in Yemen. The project consists of four phases, the mapping and Survey phase with the help of private sector, Re-engineering phase, the Implementation phase, and then The Automation phase in Aden. So far, the business start-up simplification project team (along with a consulting team) has concluded the first phase of the project (The Mapping phase) in both Sana'a and Aden. The project team is currently planning to conduct many workgroup discussions and workshops to demonstrate and draft a reform agenda based on the results of the mapping phase in both Sana'a and Aden.

[Mining Policy Reform Project in Yemen](#). In September 2006, IFC, PEP-MENA signed an agreement jointly with the Ministry of Oil and Minerals, represented by the Geological Survey and Mineral Resources, to support the government further in its efforts to develop the country's mining industry through targeted support in the area of policy reform. The Project is divided into three key phases: Diagnostic Assessment, Change / Re-designing, and Implementation. The project has progressed well as the first phase has been completed successfully. In order to present the findings and recommendations of the assessment of Phase I to high level decision makers as well as to a broader audience, workshops and a series of high-level client and stakeholders meetings were held in early September 2007. The objective of these events is to finalize with stakeholders the reform agenda of the mining legal policy and fiscal regime and create momentum for the planned reforms. It will also help develop a national policy and reengineer administrative procedures. With these events it is intended to transit into Phase II of the project. The advisory project will partner with international experts with the government to reform the mining codes according to international best practices. The government is sustaining

the project, as it will help in reforming a new mining policy, which will facilitate in attracting the private sector including major mining companies to invest in Yemen's mineral resources as well as diverse Yemen's economy currently dependent on Oil & Gas.

Yemen Leasing Project: The Parliament of Yemen and the President of the Republic enacted the Law # 11 on April 27, 2007. The law was sponsored by the Central Bank of Yemen; it was drafted in coordination with the International Finance Corporation, member of the World Bank Group. The Law is based on international best practices including the Model Law on Leasing developed by the International Institute for the Unification of Private Law (UNIDROIT). (UNIDROIT is an independent inter-governmental organization based in Rome. Its purpose is to study needs and methods for modernizing, harmonizing and coordinating private and in particular commercial law as between States and groups of States). Importantly, the Law was specifically developed to incorporate the legal principles and traditions existing in Yemen.

The IFC is now assisting in the development of associated tax legislation, as well as the establishment of a leased asset registry and related secondary legislation.

The Leasing Program works in Yemen with both governmental agencies and the private sector, IFC:

- Advises policy makers seeking to create legal and regulatory environments favorable to the development of leasing. This involves comprehensive diagnostics to identify legislative and other constraints, drafting legislation and raising awareness of legal and regulatory best practice.
- Builds capacity of local financial institutions (e.g., banks, leasing companies, MFIs, etc.), equipment suppliers, investors, etc. to create and expand leasing markets on a sustainable and profitable basis.
- Raises awareness of the benefits of leasing to MSMEs as a means to finance business assets; and,
- Promotes and facilitates leasing investments, both for its own account and for other investors.

Small & Medium Enterprise management Training program (Business Edge): In order to address the gap in the supply of management training in Yemen, IFC's management training program, Business Edge contributed to catalyzing structural change in the Yemeni market for management training. With its comprehensive training package, the program has built the capacity of 6 training providers and trained 70 of their trainers, helping them to generate demand, and to make a profitable line of business out of SME-management training. Whereas the notion of SMEs paying for training did not exist, owners/managers of SMEs are now willing to invest in management training as is evident from the high numbers of trainees that enroll in Business Edge workshops. In the span of a year, 2616 owners/managers of SMEs have been trained and certified by Business Edge. Significant repeat rates are also an indication of the popularity of the workshops. To help stimulate the market, a declining subsidy scheme was set up in cooperation with the

Royal Netherlands Embassy and the Social Fund for Development in January 2006. Encouragingly, demand has increased despite the gradual reduction in subsidy levels. In fact, the number of trainees reached 1030 owners/managers in April with the subsidy at only 50%, in comparison to the 159 owners/managers who enrolled in February at subsidy rates as high as 80%. Currently Business Edge is provided without any subsidies since April of 2007.

II. Education and Health and Social Policy

[Girls Secondary Education Project](#) A joint World Bank, Netherlands, DFID, KfW and GTZ mission was undertaken in Yemen in July 2007 to review preparation of the project and to agree on detailed project components. The mission highlighted that, in close to forty years of World Bank/IDA support to the education sector in Yemen, this is the first time that a fully owned project preparation process has taken place by the GoY through the MOE from the early stages of project design. The appraisal mission is planned for late October 2007.

[Conditional Cash Transfer for Girls in Grades 4-9](#) Under the Conditional Cash Transfer (CCT) scheme of the Basic Education Development Project (BEDP), the first cash transfer was made to girls in 8 operational pilot schools in Lahej Governorate. Preliminary findings of the operational pilot have shown parents' strong preference of CCT to any other schemes since they feel this is the first time that their needs are addressed most adequately by a government scheme. After the successful completion of the operational pilot, the MOE launched the CCT in 210 schools in Lahej in September 2007.

[Basic Education Development Project, Mid-Term Review](#) Supervision mission in July has found that considerable progress has been made in the implementation of the BEDP during this year which has helped to overcome the shortfalls that resulted from delays in implementation during the first two years of the Project. Mid-Term Review mission is planned for January 2008.

[School Health and Nutrition Mission](#) A School Health and Nutrition (SHN) mission visited Yemen in early September to organize a workshop jointly with the Ministry of Education, the Ministry of Health and World Health Organization. Recognizing that effective SHN programs require strong and effective collaboration, both the ministries of Education and Health agreed to establish an Inter-sectoral Steering Committee and an Inter-sectoral Technical Committee. The MOE is considering using the third phase of the EFA-FTI Catalytic Fund grant to support these activities in 2007-2008.

[Immunization Resource Tracking](#): The Bank is leading a dialogue with the MOPHP on the impact of financial resources planning, budgeting, and the flows of funds on program outcomes. In partnership with the USAID-financed Health Systems project (managed by Abt Associates, Inc), the Bank carried out in 2006 preliminary analysis on immunization resource tracking. As a follow up from the recommendations of the preliminary analysis,

the MOPHP with Bank support is preparing for the implementation of an in-depth resource tracking study of the National Immunization Program.

Health Sector review (HSR) The World Bank is involved in extensive discussions with MOPHP and its development partners (donors) on the health sector review/donor harmonization initiative. The development partners, including the Bank are supporting the initiative that was launched in 2006. The HSR is expected to be finalized mid 2008 with a Health Sector Reform Strategy, which will set sector policies and strategic priorities, as well as provide the framework for aid harmonization in the sector..

Rapid Result Approach (RRA): Given the success of the Rapid Result Approach methodology in supporting project implementation of the HRSP, GOY requested Bank support to institutionalize the use of RRA and scale up its use. The Bank is discussing with the Ministries of Health and Planning the scope and potential of this process. A national team is in place and the dialogue on applying the RRA for the Health Sector Reform Strategy is in progress.

National Population Conference: The Bank is working closely with UNFPA, the National Population Council and the Ministry of Planning and International Cooperation on the preparation of the upcoming National Population Conference, planned for early December 2007. The Bank is contributing technical assistance. Extensive discussions are underway for how to ensure that this Conference, the fifth of its kind, will ensure sufficient high-level support to have measurable impact on the ground.

III. Agriculture and Rural Development

Rain-fed Agriculture and Livestock Project. The main objective of this project, signed in July 6, 2006, is to support the Ministry of Agriculture and Irrigation to improve the services to farmers in five governorates. The project will also provide support to the General Directorate for Animal Resources' to fulfill its core functions and to improve livestock owners' access to quality services and goods to enhance the health and productivity of their animals.

IV. Public Administration

Establishment of the Internal Audit Function in Yemen, A dialogue with COCA, CSMP and the MOF regarding the establishment of the Internal Audit Function in Yemen and also the re-engineering of COCA to be in line with the international standards, is being carried out.

VII. New & Noteworthy Laws, Decrees and Agreements

The Cabinet

- approved formation of the Ministerial Committee for identifying practical steps for implementation of the second phase of National Salary and Wages Strategy;
- approved draft partnership agreement between the Ministry of Oil and Minerals and three foreign companies regarding oil exploration at blocks 34 and 37;
- approved financial statement of the Civil Aviation and Meteorology authority as of December 31, 2002 submitted by the Ministries of Transportation and Finance, COCA and the Authority;
- approved the mechanism suggested by the Ministerial Committee regarding taxes received on goods income and instructed the Minister of Finance to ensure necessary procedures including setting up specialized department at the Tax Authority;
- in the light of the Presidential directives, approved administrative and institutional reform matrix proposed by the Ministry of Civil Service and Insurance;
- approved restructuring of the Ministry of Civil Service and Insurance in the light of the study in the framework of the Civil Service Modernization Project;
- approved draft proposals by the Ministry of Civil Service aimed at resolving the situation related to retiree issues;
- referred to the Ministerial Committee draft Republican Decree presented by the Ministry of Transport regarding establishment of Land Transportation General Authority;
- Discussed aspects of technical cooperation were between the Central Bank of Yemen and IMF concerning preparing fiscal, monetary, and economic data.
- approved allowing foreign companies and commercial enterprise to import and market basic commodities;
- approved final accounts of the General State Budget 2006 and budgets of independent units;
- discussed the report by the Minister of Fisheries and approved supporting the following activities of the Ministry: traditional fishing, exports, quality monitoring and fishery information net;
- approved increasing the capital of the Yemeni Company for Oil and Minerals Investment from self-financing to YR 15 bln.
- approved draft law presented by the Ministry of Finance regarding supplementary allocation to General State Budget 2007 in the amount of YR 268 bln and referring it to the Parliament for finalizing constitutional procedures;
- approved the report by the Ministry of Local Administration regarding developmental needs of Al-Dhala'a governorate including agriculture, infrastructure and human development areas and instructed relevant ministries to take necessary actions

- approved distribution of central support in the amount of YR 22.8 bln to the local authority administrative units;
- approved a draft Land Registration Law and referred it to the Ministry of Legal Affairs and General Land, Survey and Urban Planning Authority for finalizing necessary procedures to transfer the Law to the Parliament;
- agreed to implement a one-room system at the Ministry of Finance for processing customs clearances, exemptions and visas for donor agencies in Yemen;
- discussed a report by the Minister of Planning and International Cooperation regarding results of negotiations with IFAD over a US\$ 16.6 million loan for rainfed agriculture project;

Other Government

- Yemen and Saudi Arabia are working on establishment of a joint economic zone at a cost of USD 500 million for exporting Yemeni agricultural products and livestock.
- The government has announced establishment of Yemeni Council for Extractive Industry Transparency Initiative.
- 29 local and international companies took part in international bidding for the second phase on Marib Gas Power Plant.
- General Investment Authority has registered a YR 3.6 billion project for construction of a soft drink factory in Lahej owned by the Aden Soft Drinks Co. Ltd (98%) and Shahir for Trade and Sana'a Soft Drinks Company (2%).
- Board of Directors of the Social Fund for Development approved 2008 budget amounting to YR 22.4 bln with an increase of 7.1% compared to 2007.
- An agreement was signed between Yemen and Syrian Establishment for Cereals to import 50,000 tons of wheat.
- A workshop on "Decent Workplace and Social Justice" for handicapped was organized by the Ministry of Social Affairs and Labor on September 21-22.

The Private Sector

- A Chinese company has initiated construction of Batis Cement Factory in Abyan at a cost of US\$ 240 million.
- An agreement was signed between Yemen and US Power Corporation to prepare a feasibility study with regards to construction of a nuclear power-generation plant in Yemen.
- International Finance Corporation and Yemen have launched a project for improvement of set up procedures for service and development projects especially in the field of mining which aims at attracting foreign investments.
- Ten local and international companies are competing for a US\$ 28-million tender for Batis road construction in Abyan governorate funded by the Qatar government.
- A workshop on Environment Protection was organized by the Environment Protection Authority during September 16-20.

Development Cooperation

- The World Bank aid allocations have increased to US\$ 194 million for FY 2008 signifying an increase by US\$ 59 million compared to last year.
- European Union has granted € 2 million to support de-mining activities under National Mine Action Program.
- A grant agreement was signed between Yemen and USAID for the amount of US\$ 648,000 to support agricultural sector productivity in Yemen.
- Islamic Relief Organization has granted foodstuff for the poor at the total cost of YR 5.3 million.
- A grant agreement was signed between Yemen and the US Embassy for the amount of US\$ 515,214 for electricity access improvement in rural areas.
- Millennium Challenge Corporation has approved US\$ 20 million grant for fighting corruption and improving rule of law in Yemen.
- World Health Organization has allocated US\$ 24 million for support during the coming two years.
- The Kingdom of Denmark has announced financial support to Yemen in the amount of US\$ 6.2 million for the coming two years to support decentralization, human rights, journalists syndicate and good governance.
- A credit agreement was signed between Yemen and OPEC Fund for International Development for the amount of US\$ 11 million towards public works project.
- A financing agreement was signed between Yemen and the Embassy of Japan for US\$ 7.5 million for building basic education schools in the framework of Realizing MDG scheme.
- A financial agreement was signed between Yemen and the Embassy of Japan for the amount of US\$ 250 thousand for support of rainfed agriculture.
- The Government of Japan has granted US\$ 120 thousand to support two community development projects in the field of basic education and health services.
- The Kingdom of Saudi Arabia has donated vehicles and chemical materials for anti-locust operations at the amount of US\$ 1.75 million.

Seminars and workshops

- A seminar on "Democracy in the Arab World" was organized by the Cultural Bridges Forum in cooperation with Jordanian Centre for Human Rights and Arab Women Union during August 22-23.
- A workshop on "Problems of People with Hearing Disabilities" was organized by Eman Center in cooperation with the Japanese Embassy during August 26-27.
- A training workshop on "Peer Education in Life Skills for HIV/AIDS Prevention" was organized by International Development Foundation in cooperation with UNICEF during August 12-21.
- A seminar on "Liberalizing Media in Yemen" was organized by the Women's Forum for Research and Training on August 26.

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- A workshop on "Integrated Framework: What Is It and How Yemen Can Benefit from It" was organized by the Ministry of Industry and Trade in cooperation with the Dutch Embassy on August 28.
- Launch of the World Good Governance Indicators was organized by the World Bank on August 29.
- A training course on Locust Combating was organized by the National Locust Control Center in cooperation with FAO during September 6-8.
- The Second Democracy Forum was organized by the Sisters' Arab Forum during September 8-9.
- A Gender Auditing Workshop was organized by the National Women's Committee in cooperation with UNFPA during September 8-9.

VIII. WORLD BANK GROUP OPERATIONS IN YEMEN

Knowledge Services. Bank's key non-lending support included of the following studies: public expenditure management, civil service modernization, country financial accountability assessment, petroleum price policy reform, household energy supply and use, development of national gender strategy, environmental safeguard requirements, and strategic plans for long-term development of coastal aquifers. Coordination among donors has become more regular and, with the establishment of subgroups dealing with key sectors and activities such public financial management, water and education. A number of partnership agreements are already in place, including, education, health, PFM and aid harmonization. Collaboration with, and support for, civil society organizations has also deepened, both directly (e.g., NGO capacity building grants) and indirectly (e.g., through projects using NGOs for implementation).

Lending Services: As of end of September, 2007, there were 19 projects under implementation, and three projects in the pipeline with total commitments of US\$ 814.25 million of which US\$395.1 million disbursed. About 20% of the portfolio, by value, was dedicated to the water sector, 20% to education, almost 21% to health and other social sectors, 15% urban development, 14% to agricultural/rural sector, 6% transportation, and 4% to public sector governance. Overall portfolio performance and management remain satisfactory. To improve further the implementation of Bank-supported project, a Country Portfolio Performance Review (CPPR) follow-up committee was established consisting of senior government officials from the Ministry of Planning and the Ministry of Finance as well as officials from the Bank. The committee meets regularly.

Ongoing World Bank Operations in Yemen
(As of September 30, 2007)

Project Name	Close Date	Loan \$	Cumulative Disbursement information				
			Disb. \$	Disb. %	SOE Disb. \$	SOE Smple \$	% Revd
Groundwater & Soil Conservation	31-Oct-09	41.2	20.20	49%	4.71	0.25	5%
Rural Water Supply and Sanitation	31-Dec-07	23.9	22.70	95%	16.86	0.92	5%
Irrigation Improvement	30-Jun-07	24.6	20.20	82%	3.69	0.13	3%
Sana'a Basin Water Management	30-Jun-09	26.8	11.30	42%	3.12	0.21	7%
*Fisheries Res. Mngmnt & Conserv.	30-Sep-11	26.3	3.00	11%	0.03	0.00	0%
Urban Water Supply and Sanitation	31-Dec-07	158.5	77.60	49%	31.51	1.29	4%
Port Cities Development	30-Jun-07	26.9	15.50	58%	2.65	0.42	16%
Taiz Muni. Dev. and Flood Protection	31-Oct-07	54.1	51.50	95%	22.74	0.69	3%
Third Public Works	30-Jun-09	47.6	35.80	75%	NA	0.00	0%
II Rural Access Project	30-Nov-10	40.5	9.20	23%	0.00	0.00	NA
Rainfed Agriculture and Livestock project	30-Jun-12	21.3	2.00	9%	0.00	NA	NA
Power Sector Project	31-Dec-11	53.2	3.00	6%	0.00	NA	NA
Civil Services Modernization	31-Dec-07	34.1	23.80	70%	3.94	0.52	13%
Health Reform Support	31-Dec-08	33.8	20.10	60%	7.16	0.00	0%
Higher Education	30-Jun-08	6.2	4.30	69%	0.45	0.04	10%
Third Social Fund for Dev.	31-Dec-08	63.4	59.80	94%	NA	0.00	0%
Social Fund for Dev. III (supplemental)	1-Jan-09	15.0	2.00	13%	0.00	0.00	0%
Vocational Training II	31-May-13	15.0	2.00	13%	0.00	0.00	0%
Basic Education Dev.	30-Jun-10	67.4	11.10	16%	3.42	0.00	0%
		779.77	395.10	51%	100.28	4.48	4%

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