

Spring 2007

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The World Bank
Group
Sana'a Office



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.

SUMMARY:

Macroeconomic performance was mixed in 2006. Oil production declined 8.8 percent, leading to a modest reduction in overall growth to 3.9 percent, compared to 4.3 percent the previous year. Meanwhile, 2006 prices of Yemeni crude exports increased by 22 percent. This helped boost the current account to record levels and push foreign reserves to the equivalent of about 12 months of imports. Similarly, government-related oil and gas income notably increased by more than 40 percent, leading to a small fiscal surplus for the first time in many years. The rise in government oil revenues in 2006 partly reflects changes in concession terms with one of the major operators. Oil accounts for nearly three-quarters of fiscal revenues and more than 90 percent of exports.



Inflation in 2006 climbed to 18.4 percent, with food and transport cost leading the way. The jump in food prices, estimated at 28.6 percent, was driven largely by the 45 percent rise in fruits and vegetables. Supply factors resulting from reducing diesel subsidies in 2005 and rising international food prices have been major driving forces for the food price increase. Rising public expenditure and wages also powered the inflationary surge. The inflationary peak occurred during the second quarter, when the all-items price index jumped by nearly 22 percent on a year-to-year basis. Since then, rate gradually eased, retreating to 17 percent in the third quarter and 16 percent in the final quarter. Surging inflation is expected to affect the poor adversely, particularly when social protection mechanisms are inadequate. Meanwhile, the Rial's exchange rate with the U.S. dollar depreciated slowly, by less than 3 percent a year, which given the presence of high inflation, is expected to lead to a further appreciation of the REER.

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Monetary policy has not been effective in bringing inflation under control. Money supply growth accelerated steadily to reach a 28 percent annual rate by the end of 2006, exceeding the previous year's average of 13 percent. For most part, the government relied on T-bills and foreign exchange interventions to mop up liquidity, making little use of other indirect instruments such as reserve requirements or certificates of deposit. The Central Bank has shown cautious attitude towards adopting tighter monetary policy. The authorities argued that, under current circumstances characterized by underdeveloped financial markets and strong exogenous inflationary pressures, further increase in interest rates would be, on its own, of limited use. In relation to beginning money stock, banking sector credit to the private sector has slowed from 3.3 percent to 3.1 percent, but there is little evidence of crowding-out.

The outlook for Yemen's economy in 2007 calls for a slight improvement. In the petroleum sector, prices are expected to remain stable in the lower US\$60 range while output continues to decline. As a result, oil's contribution to growth and to fiscal and current accounts is expected to fall. Yet Yemen is also likely to witness some improvement in non-oil growth because of increased investment. Local economic activity is expected to benefit from current investments such as Yemen LNG, Marib power, the Ras Issa refinery, and cement companies (which account for about US\$5 billion, a third of GDP). Yemen's inflation rate is projected to moderate from its 2006 highs, reflecting smaller rises in food and fuel prices.

Despite relative improvement of the fiscal position in 2006, the primary non-oil balance continued to deteriorate. The primary non-oil deficit, the major indicator of fiscal sustainability, increased from 23.1 in 2005 to 25.7 percent of GDP in 2006 and is projected to widen further in 2007. At the current production rate, oil reserves will be depleted within 12–14 years. Some improvement in the non-oil balance is expected to occur beginning from 2008, as fuller implementation of reforms in civil service administration, taxation, and other areas of public financial management kick in. However, serious progress depends on the government adopting a longer-term view by formally incorporating fiscal sustainability as a basis for its fiscal policy.

Overall, recent economic outcomes and policies have been encouraging on the structural and governance fronts. The authorities undertook a series of reforms to improve governance, public financial management, and civil services administration. Anticorruption legislation was enacted and an autonomous anticorruption authority is being established. A new procurement law was prepared and a national procurement manual approved. Work also began to implement various reforms in the public financial management. A biometric identification of government's workforce (civil, police, the military and the judiciary) is under implementation with about 100,000 out of 900,000 finger prints already taken. Good progress was made toward joining the Extractive Industry Transparency Initiative (EITI), securing the independence of the central auditing agency (COCA), and restructuring the High Tender Board.

Encouraged by the government's commitment to reforms, the donors have responded positively to support Yemen's poverty reduction plan. The Consultative Group meeting in November yielded financial aid pledges of some US\$4.7 billion. In view of the significant increase in donor support, Yemen is expected to continue its commitment to reforms. Since the November meeting, some progress has been made in allocating the GCC pledges among a number of investment projects.

RECENT ECONOMIC DEVELOPMENT

The September 2006 presidential election results revalidated continuation for the next seven years of the current power balance led by President Ali Abdullah Saleh and the ruling General People’s Congress (GPC). Six months after reelection, the government continues to adhere to its campaign promises of fighting corruption, reforming the public sector, and awarding greater power to the regions. However, there is public concern over the lack of progress in creating jobs and reducing inflation.

The long-running conflict between the Yemeni government and the radical Houthi group in the Saada governorate in northern Yemen has received more attention recently, following the killing of several soldiers in January 2007. The conflict dates to September 2004, and has been mostly localized and low-key, but signs of intensification have grown in recent months.

Owing to its recent policy reforms, Yemen was reinstated in February 2007 to the Threshold Program of the Millennium Challenge Account (MCA). First admitted to the program in 2004, Yemen was suspended in November 2005 following slippage in its policy performance against MCA threshold indicators. Under the program procedures, Yemen, following readmission to the Threshold Program and the fulfillment of agreed policy actions, stands to receive \$30–35 million over the next 18–24 months. 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 Millennium Challenge Corporation (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. In the case of Yemen, the 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.

Yemen’s integration into the Gulf Cooperation Council is becoming a step closer. In November 2006, the GCC member states met with other international donors in London to discuss and coordinate assistance strategies toward Yemen. Some US\$4.7 billion was pledged to support Yemen’s development efforts, of which US\$2.4 came from GCC members. The event underscores the rapid progress in relations between the Council and Yemen and the likelihood of formalizing an accession deal for Yemeni membership. Formal cooperation between the two parties goes back to 2001, when Yemen joined GCC bodies specializing in education and training, labor and social affairs, sports, and health. Later, at the Qatar summit in 2002, several leaders expressed a wish to bring Yemen onboard. In Abu-Dhabi in 2005, the GCC summit formally recommended qualifying Yemen for membership within 10 years. Early the next year a technical committee was formed to study Yemen’s development and investment needs and design a work plan for 2006–15. Since the London Consultative Group meeting in November 2006, discussions have taken place between the Government and GCC donors to allocate GCC pledges to projects identified in the PIP. Yemen is also planning a major investment conference in April 2007, which primarily will target private capital from the GCC. Despite these recent successes, however, there is still no formal agreement on accession between the two sides.

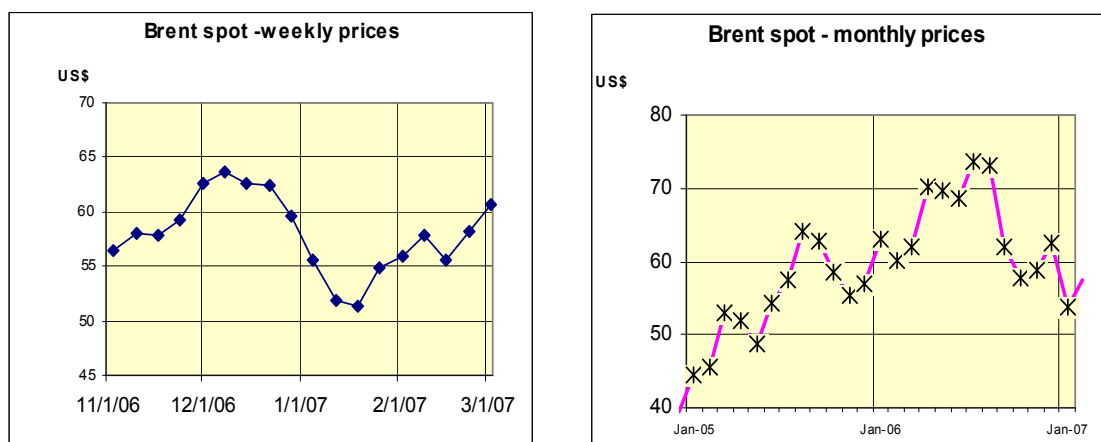
Yemen’s is building strong economic ties with China. Bilateral trade between Yemen and China has risen significantly, increasing tenfold since 1998. China is now Yemen’s largest trading partner, buying 37 percent of Yemeni exports. Although most of this is oil, China also is interested in

Yemen’s liquefied natural gas project, which is scheduled to come on-stream around year’s end 2008. China also has poured significant investment into the country, amounting to at least US\$400 million in the past three years alone, helping to develop infrastructure (cement and telecommunications) as well as the oil sector. The burgeoning bilateral relationship is related to China’s desire to diversify its supply of oil as its energy needs have risen exponentially in recent years.

III. MACROECONOMIC DEVELOPMENTS AND OUTLOOK

World oil markets exhibited strong volatility in 2006 (Figure 1). Oil prices peaked in early August at above US\$75 per barrel, then quickly fell by 25 percent to below \$60 per barrel in October. Responding to the sharp decline, OPEC decided to reduce production by 1.2 million barrels per day in November. Prices slid through December, but beginning in January 2007, OPEC cuts and rising tension in the Gulf stabilized prices in the lower US\$60 range. For 2006, Brent oil prices averaged US\$65.16 per barrel, about 19 percent above the 2005 average. Oil prices are expected stabilize at their current level in 2007 since weakening global oil demand is expected to be offset by continued supply management from OPEC and rising tension over the Iranian nuclear standoff.

Figure 1: Tracking Recent Crude Oil Prices (\$US per barrel)



In 2006, YEMENI crude oil export prices increased by 22 percent to US\$63 per barrel. The price increase was partly offset by an 8.8 percent output drop in output that renews a longer trend. Production started to slide in 2001, but the pace temporarily slowed in 2005 because of the discovery of new reserves in existing wells and concerted secondary recovery efforts. Based on the current investment plan in the sector, estimated crude production in 2007 is pegged at 341 thousand barrels per day, down by 7 percent from 2006. Yemen is thought to have reserves estimated at 3 billion barrels. Oil accounts for nearly three-quarters of fiscal revenues and about 90 percent of exports. Government receives about 80 percent of oil export revenues, while the rest goes to operating companies.

Yemen’s GDP growth in 2006 decelerated slightly. Preliminary estimates suggest a growth rate of around 3.9 percent, versus the 4.4 percent recorded in 2005 (Figure 2a). Growth was hampered by the near 8 percent drop in the oil sector and a half-percent deceleration in the non-oil sector to 4.9 percent. Manufacturing and finance were among the main non-oil sectors that underperformed in relation to 2005 (Figure 2b). On the other hand, fisheries, and to a lesser extent, mining and

quarrying, and trade improved over the previous year. Yemen does not maintain data on the composition of real growth by expenditure type. However, judging from nominal changes, growth seems to have been sustained primarily by rising government consumption (22 percent nominal increase), while gross investment inched up a scanty 3 percent. The 2007 outlook suggests that growth will improve slightly as oil prices remain firm and output experiences partial recovery. Growth will benefit from new investment projects (supported by pledges from Consultative Group donors) and ongoing projects (including Yemen LNG, Marib Power, and the first private sector refinery). Projected GDP growth for 2007 is 4.3 percent, staying above the population growth rate but falling significantly short of the 7.1 percent target set under the current development plan.

Figure 2a: Real GDP Growth in Yemen, 2002-06 (Percent)

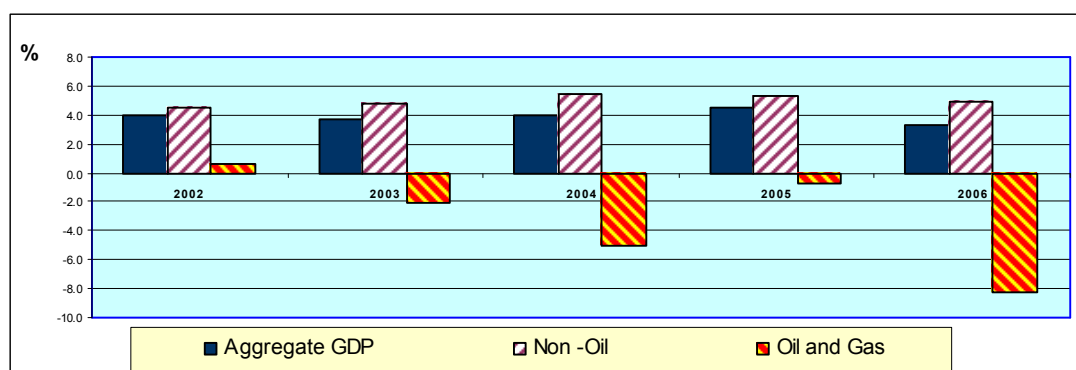
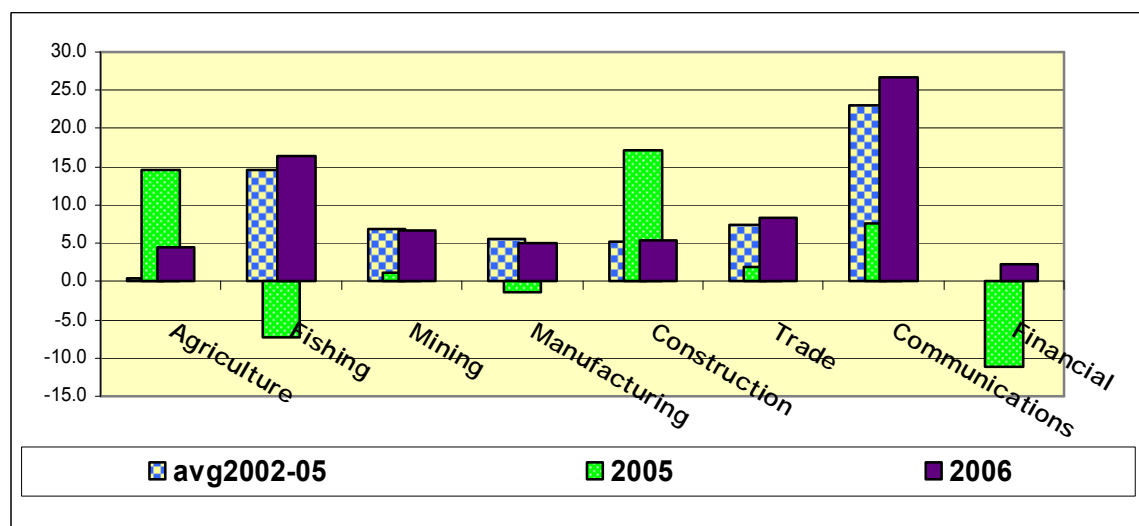


Figure 2a: Growth in Yemen's Main Non-oil sectors, 2006 (Percent change)



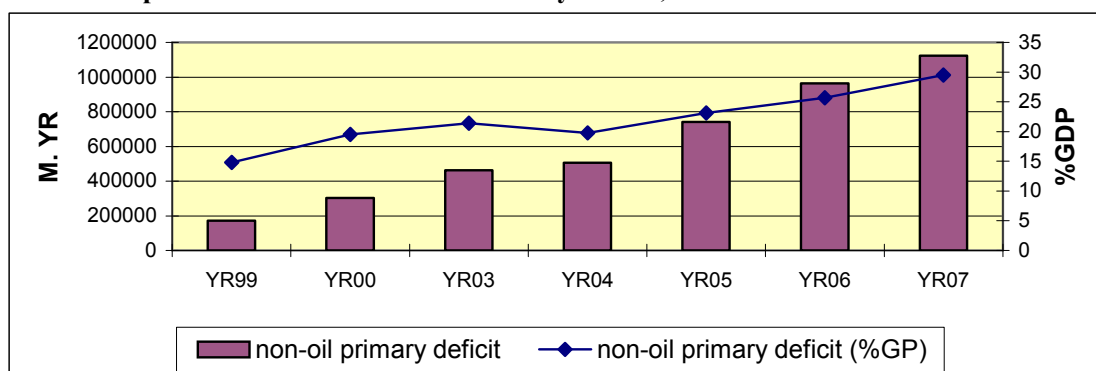
Preliminary data for 2006 indicate a better overall fiscal position than the budget forecast (Table 1). A higher-than-expected leap in oil-related income and moderate growth in expenditure combined to create a small surplus in the fiscal balance for the first time since 2001. Bolstered by higher oil income, total revenue increased 47 percent over budget projections (and nearly 30 percent over the 2005 performance). Meanwhile, expenditure exceeded the budget by some 22 percent and

rose 20 percent compared to 2005 outlays. Measured in terms of GDP, public spending increased to 37.8 percent, up one point from 2005. Benchmarking actual performance against the budget, public expenditure management in 2006 is deemed generally satisfactory since major spending items such as salaries and goods and services were kept closely in line with estimates, while most of the increase stemmed from the revaluation of fuel subsidies and security-related outlays.

Table 1: Central Government Finances, 2005–06 (million YR)

	2005 Actual	2006 Budget	2006		
			Actual - prelim	% change over budget	% change over 2005
Total current revenue and grants	1,121.3	986.0	1,450.9	47	29
Total current revenue	1,107.6	965.8	1,449	50	31
Oil and gas revenue	752.7	587.5	1,085	85	44
Non-oil revenue	354.9	378.3	364.2	-4	3
Tax	234.9	256.4	266.1	4	13
Direct	94.2	105.6	131.4	24	39
Indirect	140.7	150.8	134.7	-11	-4
Non-tax	120.0	121.9	98.1	-20	-18
Grants	13.7	20.2	1.5	-93	-89
Total expenditure and net lending	1,179.3	1,161.8	1,418.6	22	20
Current expenditure	890.7	898.1	1,119.4	25	26
Civilian wages and salaries	195.9	257.4	266.3	3	36
Materials and services	69.5	73.2	95.0	30	37
Operation and maintenance	8.7	10.5	8.1	-23	-7
Defense	156.2	161.7	211.2	31	35
Interest obligations	69.1	84.8	88.9	5	29
Transfers and subsidies	372.8	290.7	427.4	47	15
Subsidies	286.3	181.7	309.0	70	8
Current transfers	86.5	109.0	118.4	9	37
Others	18.5	19.8	22.5	14	22
Development capita expenditure	225.7	208.9	248.1	19	10
Net lending	62.9	54.8	51.1	-7	-19
Overall balance	- 58.0	-175.8	32.3	-118	-156

Figure 3: Development of Yemen’s Non-oil Primary Deficit, 1999–



2007

Note: Currency is in millions of Yemeni Rials.

Despite relative improvement of the fiscal position in 2006, the longer trend in fiscal sustainability remains unsatisfactory. The primary non-oil balance, the major indicator of fiscal sustainability, continued to deteriorate in 2006, with the deficit rising from 23.1 percent to 25.7 percent of GDP. At the current production rate, estimates call for oil reserves to be depleted within 12–14 years. Some progress in the fiscal position 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.

In relation to the historical trend (Table 2), the 2006 fiscal outturn indicates some structural deterioration due mostly to transitory factors. On the revenue side, tax income decreased from 7.3 percent to 7.1 percent, reflecting the underlying sharp drop in customs charges associated with tariff rate reductions. On the expenditure side, civilian wages and salaries increased by one full percentage point to 7.1 percent of GDP owing to the broad increase in basic workforce pay following implementation of the national wage strategy.

Table 2: Composition of Central Government Finances (Percent of GDP)

	2003	2004	2005	2006
Revenue	26.3	26.4	35.0	38.6
<i>Of which: oil</i>	14.2	14.1	23.5	28.9
<i>Of which: tax</i>	7.1	7.3	7.3	7.1
Expenditure	35.3	34.2	36.8	37.8
Current	26.2	25.5	27.8	29.8
<i>Of which: civilian wages and salaries</i>	6.6	6.2	6.1	7.1
Capital	7.4	7.0	7.0	6.6
Overall fiscal balance	(4.2)	(2.1)	(1.8)	0.9
Domestic	4.1	2.0	1.2	(1.7)
External	0.1	0.1	0.6	0.9

Note: Figures in parentheses indicate a deficit.

The newly released 2007 budget indicates moderate expenditure growth to about YR1,600 billion, equivalent to 12.5 percent more than 2006, and a widening of the fiscal deficit. Budget revenue shows a modest decline of some 5 percent, primarily reflecting a cut in oil revenue based on assumptions of a 7 percent drop in production and lower oil prices of US\$55 per barrel. Among the few expected sources of increased revenue in 2007 is the 2.7 percent rise in indirect taxes, assuming fuller implementation of the new General Sales Tax (GST) system. Of the projected rise in expenditures, about 40 percent is attributed to higher wages and salaries from increased hiring—largely related to ongoing efforts to decentralize government services—and from a selective pay raise in specific sectors and skill categories consistent with implementing the new national wage strategy approved in 2005. Inflationary pressure from the projected 26 percent increase in wages and salaries in 2007 could still be a source of concern, but it is more moderate than the 35 percent boost in 2006. Projected expenditures are also pushed higher by rising subsidies and transfers, partly attributable to expanded valuation of fuel subsidies. The 17 percent increase in capital spending to YR290 billion represents the largest second source of growth in overall expenditure. The 2007 increase in capital projects reflects larger allocations to roads and social infrastructure in accordance with the

commitments made earlier at the Consultative Group conference in London. The overall deficit is expected to widen from YR176 billion in the 2006 budget to around YR224 billion in 2007, which is 5.8 percent of projected GDP and slightly above the deficit limit set out in the latest five-year plan.

Table 3: Consolidated Budget for 2007

	2007 budget (Million RL)	Change over 2006 outturn (%)	Contribution to change in revenue and expenditure (%)
Total current revenue and grants	1,372.2	-5.4	100.0
Total current revenue	1,352.3	-6.7	123.4
Oil and gas revenue	1,005.5	-7.3	101.3
Non-oil revenue	346.8	-4.8	22.1
Tax	265.4	-0.3	0.9
Direct	127.4	-3.0	5.1
Indirect	138	2.4	-4.2
Non-tax	81.4	-17.0	21.2
Grants	19.9	1,226.7	-23.4
Total expenditure and net lending	1,596.2	12.5	100.0
Current expenditure	1,220.2	9.0	56.8
Civilian wages and salaries	337.6	26.8	40.1
Materials and services	85.9	-9.6	-5.1
Operation and maintenance	12.3	51.9	2.4
Defense	193	-8.6	-10.2
Interest obligations	96.2	8.2	4.1
Transfers and subsidies	452.8	5.9	14.3
Subsidies	334.6	8.3	14.4
Current transfers	328.6	8.3	14.2
Others	118.2	-0.2	-0.1
Development capita expenditure	23.4	4.0	0.5
Net lending	290.4	17.0	23.8
Current expenditure	74.6	46.0	13.2
Overall balance	-224	-793.5	—

Inflation continued to climb to worrying levels in 2006. Annual inflation in 2006 jumped to about 18 percent, noticeably higher than the 11.8 percent average of the previous year. On year-to-year basis, the largest increase from 2005 to 2006 occurred during the first and second quarters, reflecting the lingering impact of rising fuel subsidies in the second half of 2005. However, toward year's end, impact from the fuel price hike seems to have waned, leaving rising food costs as the dominant force. Food prices play a significant role in determining the overall level of inflation in Yemen with a weight of 43 percent in the CPI basket. The main drivers for food prices, according to the authorities, were depreciation of the Yemeni Rial (and the U.S. dollar) and rising international prices. With food prices climbing at a pace that exceeds 25 percent annually, the adverse effects on the poor are raising special concern. International prices for food commodities are expected to ease in 2007, therefore, likely reducing inflationary pressures in Yemen as well.

Figure 4: CPI Changes in 2006 by Major Expenditure Component

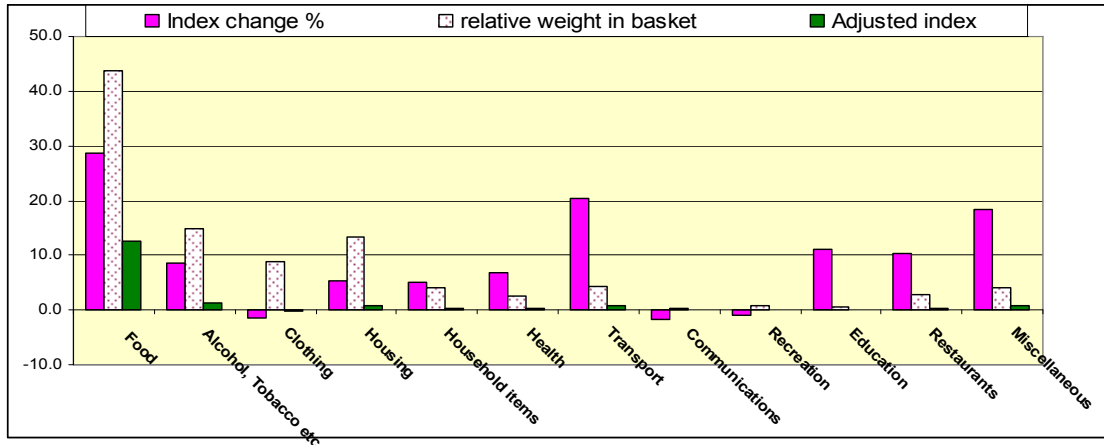


Figure 5: Quarterly Change in the CPI and its Main Components in 2005–06 (Percent)

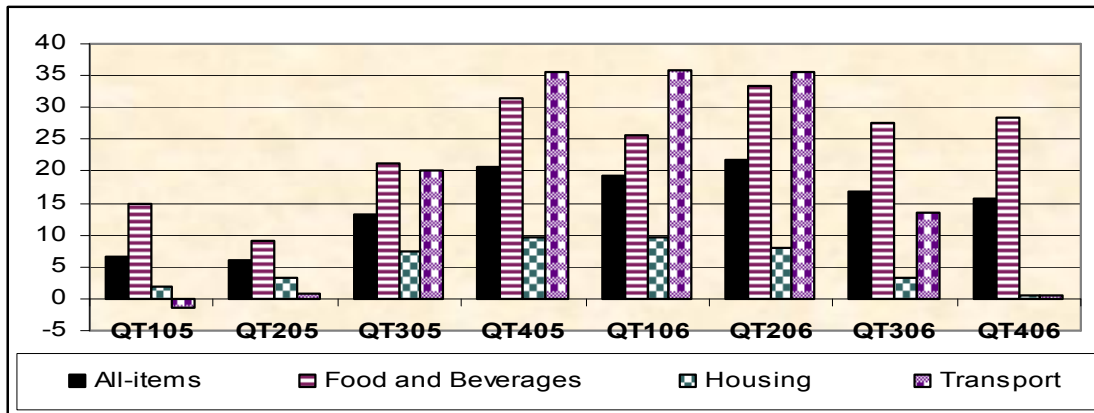
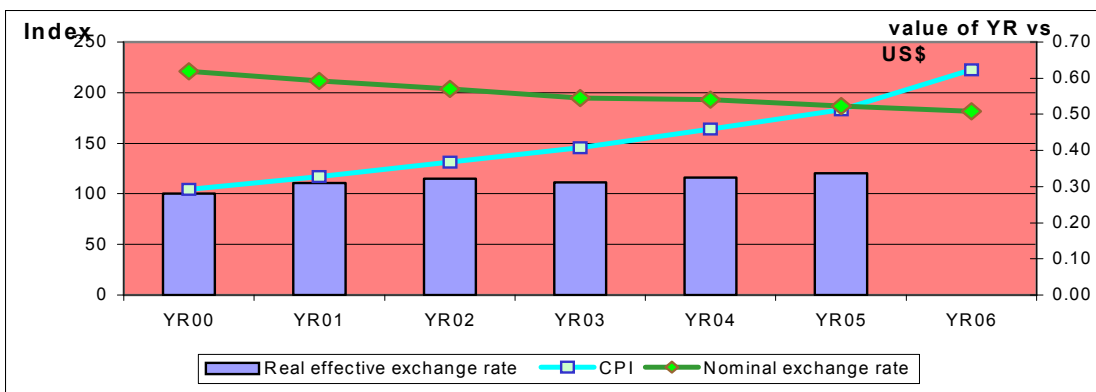


Figure 6: Changes in Yemen’s Nominal Exchange Rate, CPI and REER, 2000– 06



The Rial exchange rate with the U.S. dollar depreciated 2.9 percent, below the 3.6 percent recorded in 2005 and the 5 percent trend of recent years. Strong foreign exchange inflows and the Central Bank of Yemen’s desire to lessen the inflationary impact of strong devaluation —particularly as the dollar continued to wane versus other major currencies—are reasons for the slowing trend.

In the monetary sector, broad money growth accelerated significantly to about 28 percent in 2006. This rate is nearly double the previous year and is much higher than the 16 percent average recorded during 1995–2005. The strong growth in broad money supply largely mirrors the banking system’s 29 percent increase in net foreign assets from expanding oil export revenues. Meanwhile domestic credit to the private sector increased by a modest 3.1 percent, while it declined 4.2 percent for government credit.

The rapid rise in liquidity in 2006 highlights the limitations of current monetary policy framework in controlling inflation. The current approach conducted by the Central bank of Yemen (CBY) is based on discretionary targeting of the money supply without any disclosed target for inflation. In doing so, the Bank relies on the issuance of T-bills as a primary instrument and foreign currency auctions as a secondary tool. Meanwhile, other indirect instruments are either nonexistent (such as standing facilities and reverse transactions of open market operations) or used on a limited scale (such as issuance of certificates of deposits and changes in reserves requirements). Since 2000, the CBY maintained fixed reserves requirement ratio of 10% on domestic currency and 20% on foreign currency. Furthermore, the CBY has maintained since 2000 a floor on domestic currency deposits of 13 percent. The CBY views the policy of setting a floor interest rate on time deposits as necessary to prevent rates from falling so low that savers will be discouraged from holding Yemeni Rial deposits. Expanding the mix of monetary instruments is thought to be circumvented by the central bank’s limited capacity and the underdeveloped nature of the financial sector. On a broader level, the central bank’s capacity limitations are attributable, in part, to inadequate staffing and the large burden of carrying out the country’s treasury function. In view of growing inflation, the CBY is urged to adopt a more explicit inflation targeting policy with interest rates (as opposed to broad money supply) as the main operating target. This would require, among others, full liberalization of interest rates and building capacity in inflation forecasting techniques. It should be noted, however, that the overall effectiveness of monetary policy in controlling inflation in Yemen would continue to be undermined by the noncompetitive structure of its banking sector and the underdevelopment of its financial markets.

Overall, Yemen’s current account has maintained a positive balance for the past six years. After registering a small deficit in 2003, the current account reverted to a sizeable surplus of about 4 percent of GDP in 2005 despite a slight dip in crude oil exports. In 2006, preliminary estimates suggest that the current account surplus strengthened further to more than 9 percent of GDP.¹ The improvement underlines the sizable increase in oil export revenues by 13 percent to more than US\$6.7 billion. Non-oil exports have also grown to about 10 percent, but their share in commodity sales remains insignificant at less than 9 percent. International reserves increased by 21 percent to nearly US\$6.2 billion by the end of 2005, the equivalent of 12 months of imports. For 2006, estimated international reserves increased by 24 percent to US\$7.7 billion.

Private foreign investment is increasing. Foreign investment, primarily in the energy sector, has been strong during 2005 and 2006, and signed contracts promise significant inflows during the next two years. Though Yemen LNG, the country’s first natural gas export project, is a major reason (US\$3.7 billion), private foreign investors also have chosen to invest in Yemen’s second refinery (US\$450 million) and in cement (US\$260 million).

¹ Balance-of-payment data for 2006 are based on Central Bank of Yemen presentations. Data prior to 2006 are modified according to standard BOPM5 presentation.

IV. STRUCTURAL REFORMS AND POLICIES

The government’s economic strategy will focus on implementing the Socioeconomic Development Plan for Poverty Reduction (2006–10), which targets a reduction in the country’s poverty rate from 35.5 percent in 2005 to 19.8 percent by the end of the decade. In order to meet this goal, the plan aims to boost average annual growth to 7.1 percent over the period by concentrating on promising sectors such as gas, tourism, trade and fisheries, and infrastructure, and through overhauling the public sector.

Yemen undertook a series of impressive reforms in 2006. In February 2006, Yemen’s president signaled the start of an aggressive reform effort with a cabinet shuffle. Simultaneously the government introduced and began implementing a new national agenda for reform that identified four action areas—governing by rule of law, fighting corruption, improving the business environment, and increasing political participation. Among the reforms completed or launched during the year are the following:

- Passing financial disclosure legislation
- Launching a large national anticorruption awareness campaign
- Passing a law to establish an autonomous National Supreme Anticorruption Authority
- Eliminating the influence of the Executive Branch from the Supreme Judicial Council
- Retiring, sanctioning, suspending, and prosecuting more than 30 judges
- Approving a national procurement manual and standard bidding documents
- Approving (by the Cabinet) a new procurement law that removes all ministerial representation from the High Tender Board, establishes a new procurement monitoring board of technical experts and civil society representatives, and allows nonvoting observers to attend board meetings
- Initiating online disclosure of procurement-related information
- Beginning implementation of the first phase of a public finance management strategy
- Creating a biometric civil servant identification system designed to eliminate “ghost workers” and “double dippers”
- Suspending a controversial draft press law and initiating consultations with civil society on a new one
- Starting a project to simplify business start-up procedures
- Strengthening the tax authority in preparation for full implementation of the General Sales Tax in 2007
- Taking steps towards joining the Extractive Industry Transparency Initiative
- Securing the independence of the central auditing agency (COCA).

In January 2007, the General Sales Tax Law went into full effect. The current sales tax law dates back to July 2005, when it replaced the system introduced in 1991 under the Production, Consumption, and Services Tax Law and its subsequent amendments. In comparison to the 1991 system, the current law lowers the tax rate from 10 percent to 5 percent (applicable to both imports and domestic goods and services) while significantly reducing the number of exempted items and services from more than 300 to 6 commodities and 12 services categories. Until December 2006, the new law was implemented partially, shielding the retail and wholesale trade sector from full compliance with procedural and registration requirements while imposing an interim tax rate of 8 percent. The new GST system covers businesses whose annual sales exceed YR50 million (US\$250,000), which currently includes some 1,500 of the largest establishments in Yemen. Although smaller companies are currently exempt from the GST tax system, plans call for lowering the sales threshold to increase business coverage. To be eligible for tax rebates on purchases of production inputs, companies must

register first, and then maintain full accounting records and provide annual statements detailing their financial operations. The new law also requires firms to undertake voluntary tax self-assessments, which will be subject to official audit. Despite the lowering of the tax rate, however, the new law was met with resistance from the larger business community, which argues that the new tax not only involves extra administrative burdens but is excessive given the existing 35 percent corporate income tax. In January, business owners instigated a partial strike and held a sit-in in front of the headquarters of the Sana'a Chamber of Commerce to pressure the government to amend the legislation, and more recently brought the case to the Constitutional Court. The government, however, is standing firm, reminding that it will take tough measures after passage of the initial three-month grace period (which ends March 21), including imposition of penalties and subjective assessment of tax arrears. Indications are that the government has the resolve and means to enforce the new GST. However, it is also widely expected, in view of the resistance shown by the business community, that the corporate income tax will be reduced to less than 20 percent.

Major reengineering efforts to improve public financial management (PFM) continued in 2007. The PFM Reform Strategy, initiated in 2005, is being implemented through annual public financial management reform action plans agreed upon by the government and concerned donors. As a part of the 2007 action plan, the following activities are under way:

- Reviewing current budget practices, utilizing a public expenditure and financial accountability (PEFA) framework
- Embarking on the development of Medium Term Expenditure Framework (MTEF)
- Establishing a treasury function in the Ministry of Finance
- Strengthening internal financial controls
- Establishing a Public Financial Management Advisory Unit
- Drafting a new organic budget law designed to set broad regulations for preparing and implementing the budget.

Box 1: Public Financial Management (PFM) in Yemen

The government initiated PFM reform under Cabinet Resolution No. 253 of 2005. A committee assumed responsibility for overseeing the Public Finance Management Agenda in the following areas:

- General budget reform—including preparation, execution, and information systems
- Improvements in control and financial accountability
- Reform of the bidding and procurement system
- Competence and skills improvement

The PFM Reform Strategy is being implemented through annual public financial management action plans agreed upon by the government and a group of concerned donors. The consortium of donors includes the United Kingdom, the Netherlands, Germany, the United States, and the UNDP, which provide technical assistance. An action plan was formulated in mid-2006 to cover several years, based on an agreed-upon strategy. It consists of two phases. The first, covering 2006–08, includes the following components:

- Improved budget classification and preparation and introduction of forward estimates
- Improved budget execution
- Roll out of a public finance management information system (AFMIS)
- Improvements in budgeting, procurement, and auditing capacity
- Adoption of internal control concepts and framework
- Improved compliance
- Improved financial reporting, including budget coverage
- Adoption of systemic bidding and procurement reforms.

The work of short- and medium-term implementation of internal controls and auditing recently hit a snag. An international consulting firm was asked to review the situation on the ground and recommend steps for establishing effective internal controls. A steering committee from all the concerned agencies piloted the study, and the consultant’s recommendations are being reviewed and internalized. The consulting firm is also to provide training for all staff and stakeholders before implementation of recommendations begins in early 2008. Despite the initial progress, some setbacks occurred when conflicts recently arose between the Ministry of Finance and the Central Control and Auditing Agency (COCA) about oversight jurisdiction of internal auditing.

External auditing has been improved by increasing the effective independence of the Central Control and Auditing Agency from the executive. In July 2006, the president issued a directive to the Cabinet approving recommendations to amend clauses within the law that governs audits. COCA would conform to international standards by not having to report directly to the president. Work on strengthening COCA is proceeding on schedule, as well as implementation of the accounting and financial management system.

Complementary to public financial management reform is civil service and public administrative reform. Yemen’s public administration is overstaffed and underpaid. A large, underpaid civil service creates widespread opportunities and incentives for corruption, with little means to motivate high-quality public service delivery. As part of its public administration reforms, the government introduced the National Wage Strategy in 2005. Significant pay hikes were granted across the board in the civil service late that year. However, the raises were tied to agency implementation of reforms. As part of its Civil Service Modernization campaign, the government in May 2006 began implementing a biometric identification system to eliminate “ghost workers” and “double dippers.” The first phase identified a large number of double dippers who have been struck from the public payroll. The program continues in 2007, with efforts under way to cover all civilian and military employees, estimated at one million, by the end of June. Meanwhile, the government continued its efforts to retrench excess labor, which was reflected on increasing the number of beneficiaries from the Civil Service Fund to about 4000 persons.

The government has launched a project with PEP-MENA (IFC) to simplify, accelerate, and reduce the cost of business registration. According to the World Bank’s Doing Business 2007, Yemen ranks 91st among 175 countries in ease of conducting commercial activity. It is among the most difficult countries in which to start a business, ranking 171st. Hence, PEP-MENA, capitalizing on the opportunities provided by Yemen’s key port cities, launched its Business Start-up Simplification project to jumpstart private sector expansion by creating a transparent process that significantly reduces the cost and time of business registration. Launched in partnership with the Port Cities Development Program, the project covers both Aden and Sana’a. The project has four main stages: mapping, reengineering, implementation, and automation. The first stage would examine registration procedures in detail to determine the main bottlenecks within the system. The second stage would present global best practices and help tailor simplified procedures to make the investment climate more attractive. The third stage would implement the new procedures after making sure they comply and do not create conflicts with current law and after conducting workshops to insure stakeholder acceptance and understanding. In the final stage, pilot program for automating business registration would be tested in Aden. The project formally got under way at the start of November 2006. In a related move aimed at boosting private sector performance, the government in early 2007 introduced a project for restructuring the General Investment Authority and the General Authority for Free Zones.

With the prospects of receiving large inflows of assistance from the GCC, the government adopted a series of measures designed to improve its capacity to manage and absorb foreign aid. In November 2006, ahead of the Consultative Group meeting in London, the government released its first public investment plan (PIP) for the next four years. The PIP plan, which covered projects worth more

than US\$16.8 billion, was prepared in support of the third five-year development plan for 2006-2010. In further developments, the government is currently undertaking additional efforts to update the public investment plan and to establish a more systematic approach at the Ministry of Planning to identify/prioritize capital projects and improve linkage to the fiscal budget. In related efforts to improve aid absorption, the Cabinet in March 2007 issued a decree calling for establishment of Project Implementation Units (PIUs) in the Ministries of Electricity, Public Works, and Highways to follow the successful path achieved by other PIUs.

VI. OUTLOOK

Oil prices are likely to stabilize at current levels, leading to continued overall support to the economy in 2007. However in view of the expected decline in production, estimated at 7 percent, oil's contribution to growth, fiscal revenue and exports will fall. Therefore, the current account surplus is likely to shrink to less than 4 percent of GDP. Similarly, the fiscal balance will revert to a deficit of about 5 percent of GDP, particularly in the wake of rising expenditures, arising in part from costs associated with instituting civil service reforms and from increased spending on capital projects.

The growth outlook for the Yemeni economy calls for a slight improvement in 2007. While oil sector output is expected to fall by some 7 percent, growth in the non-oil sector will improve from increased capital spending. Local economic activity is expected to benefit from current investments such as Yemen LNG, Marib power, the Ras Issa refinery, and cement companies (cumulatively totaling about US\$5 billion, a third of GDP). In addition, the inflation rate is projected to moderate from its 2006 highs, reflecting smaller rises in food prices and the waning effects of earlier fuel price increases.

The government is showing willingness to continue the reform process that was restarted in July 2005. The six-month action plan, which was developed in consultation with donors, has achieved satisfactory progress. More than two thirds of the 20 agenda items have been completed and several others are in progress. Among the main issues that remain outstanding are: a) the introduction of an automatic pricing formula for domestic sales of petroleum products, b) joining the Extractive Industries Transparency Initiative (EITI), and c) setting up rules and policies to ensure sound debt management and long-term fiscal sustainability. The government is keen on widening and deepening the reform agenda and the new government is expected to do just that. 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 US with Yemen's access to the Millennium Challenge Account.

While the short-term outlook seems manageable, concerns about longer-term prospects remain troubling. Yemen faces daunting challenges as oil and water resources continue to deplete and as the population grows briskly at 3 percent annually. Fiscal and debt sustainability will be vulnerable to hydrocarbon prices and slower growth. The country's progress in implementing reforms will depend greatly on continued donor support and interest. The CG meeting in late 2006 provided an important stimulus for continued commitment to long-term reforms.

V. *ECONOMIC AND SECTOR DIALOGUE*

Simplification of business start-up procedures project. The International Finance Corporation has signed in July 17, 2006 an agreement with the Government of Yemen, represented by the Ministry of Planning & International Cooperation, to simplify business start-up procedures in Yemen. The project is organized by IFC's technical assistance facility in the Middle East and North Africa, PEP-MENA.

Yemen Leasing Project was launched by IFC in October 2005 with initial objectives to establish partner relationships with the Government of Yemen and develop an effective legislative framework for leasing in Yemen. This phase of the Project has progressed well, resulting in the Draft Law on Leasing being agreed on among key stakeholders and approved by the Cabinet of Ministers of Yemen. The Draft Law has now been approved by the Parliament's finance committee and is expected to be ratified in April 2007.

Health Sector Review mission. A health sector mission visited Yemen from December 9, 2006 to December 20, 2006 to continue discussions on the ongoing donor harmonization and health sector review program; and supervise the Health Reform Support Project.

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 preliminary analysis on immunization resource tracking. There is interest from the EPI stakeholders for the second phase of study. The MOPHP would like to see more information provided to the Ministry of Finance to enhance their understanding of the technical requirements of EPI and to facilitate timely routine disbursement of immunization funds

Fast Track Initiative, Education sector. In November 12-15, the FTI agreement, third phase was signed with the Government of Yemen in which the amount of the fund increased from US\$10 Million to US\$20 Million.

Rain-fed Agriculture and Livestock Project The main objective of this project, signed 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.

New & Noteworthy

Laws, Decrees and Agreements (January-March)

March

- The Cabinet
 - approved financial and administrative decentralization in the water and sanitation sector and increased role of the local councils
 - discussed draft executive by-law proposed by the Ministry of Legal Affairs for the Law 22/1995 concerning Road Maintenance Fund
 - approved an international agreement concerning protection and strengthening the rights of the disabled and giving them a chance to participate in policy-making
 - discussed the program for reform of the water and sanitation sector in rural areas proposed by the Ministry of Water and environment aiming at improving services provision meeting beneficiaries needs;
 - discussed the memo by the Ministry of Agriculture and Irrigation regarding improving the situation of the Marib Poultry Company and decided to transfer administration of the Company to the Yemen Economic Corporation;

February

- The Cabinet
 - approved draft decree proposed by the Minister of Civil Service and Insurance to grant allowances to education workers in accordance with the nature of their job in compliance with the Law 43/2005 and the National Remuneration Strategy;
 - approved draft strategy regarding Development of Agricultural Exports aimed at enhancing production, quality control, harvesting and marketing methods of Yemeni agricultural products;
 - approved Tourism Classification Bylaw aimed at setting national standards for categorizing tourism establishments and facilities;
 - discussed Skills Development Fund draft law presented by the Ministry of Technical Education and Vocational Training and the Ministry of Planning; the cabinet approved SDF establishment and referred the draft to the specialized committee for review;
 - approved the proposal by the Ministry of Social Affairs and Insurance regarding the monthly allowances for education workers which ranged between:
 - YR 12,540 and YR 7,700 for teachers,
 - YR 11,286 and YR 6,930 for teaching assistants,
 - YR 10,032 and YR 6,160 for inspectors;
 - YR 6,270 and YR 3,850 for secretarial and archive employees;
- The Ministry of Finance stipulates that all companies competing for public tenders should present certificate of compliance with the General Sales Tax.

January

- The Cabinet
 - reviewed the memo regarding Cabinet agenda for the coming year and urged all the Ministries to focus on its priorities and encompass implementation matrix of the Presidential elections program;
 - approved a draft law on bodyguards for VIP submitted by the Ministry of Interior aimed to systematize VIP security;
 - discussed the measures to avoid absenteeism from work in all administrative units upon perusal of the report from the Ministry of Civil Service and Insurance.
 - Meeting of the Preparatory Committee for the First Conference on Discovering Investment Opportunities in Yemen under the chairmanship of the PM and Secretary General of GCC took place. Timing of the Conference was rescheduled from February to April 2007 to ensure good preparation.
 - The Ministry of Finance held the first consultative meeting where importance of applying transparency and accountability principles in all public finance dealings was emphasized.

Workshops:

- A seminar entitled "GCC Transformation, Investment and Business Opportunities in Qatar" was organized by the CAC Bank in cooperation with Doha Bank on March 22.
- A symposium on Financial Leasing was organized by the Central Bank of Yemen in cooperation with the International Financial Corporation on March 22.
- A workshop on Economic, Social and Cultural Rights for NGOs was organized by the Human Rights Information and Training Center in cooperation with Amnesty International on March 21-23.
- A discussion session about UNDP 2007-2011 Action Plan was organized by UNDP with participation of major stakeholders on February 7.
- A workshop on Yemeni Anticorruption Legislation was organized by the National Democratic Institute for International Affairs on February 8.
- A workshop on "Exchanging Arab Experiences and Building Capacities" was organized by the Ministry of Social Affairs and Labour in cooperation with ILO on February 11-12.

SPRING 2007

- An Illiteracy Experts Meeting under the motto "New Partnership for Existing Learning for All" was organized by the Yemeni Illiteracy Eradication and Adult's Education Organization during February 12-14.
- Training course on benefits of technical education was organized in Aden by the Technical and Vocational Training Office with support from the Dutch Program during January 7-9.
- Governance and Anticorruption Consultations with different stakeholders were organized by the World Bank during January 14-15.
- 25th Regional Conference on Customs was organized by Yemeni Customs Authority in cooperation with World Customs Organization during January 15-16.

VI. 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-March, 2007, there were [17 projects] under implementation, and two projects in the pipeline with total commitments of US\$ 858.22 million of which US\$393.67 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 satisfacto., 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 March 31, 2007)

Project Name	Close Date	Loan \$	Cumulative Disbursement information					
			Disb. \$	Disb. %	Comtd \$	SOE Disb. \$	SOE Smple \$	% Revd
*Groundwater & Soil Conservation	31-Oct-09	41.0	13.44	33%	2.96	4.44	0.25	6%
Rural Water Supply and Sanitation	31-Dec-07	23.8	17.05	72%	3.85	14.88	0.92	6%
Irrigation Improvement	30-Jun-07	24.5	1.69	7%	4.3	3.55	0.13	4%
Sana'a Basin Water Management	30-Jun-09	26.6	8.81	33%	4.2	3.05	0.21	7%
*Fisheries Res. Mngmnt & Conserv.	30-Sep-11	25.0	1.00	4%	NA	0.03	0.00	0%
Urban Water Supply and Sanitation	31-Dec-07	157.7	60.85	39%	62.65	31.25	1.29	4%
Port Cities Development	30-Jun-07	26.8	11.41	43%	3.88	2.51	0.42	17%
Taiz Muni. Dev. and Flood Protection	31-Oct-07	53.9	45.87	85%	10.00	21.60	0.69	3%
*Third Public Works	30-Jun-09	47.4	23.49	50%	12.07	NA	0.00	0%
**Rural Access Improvement Program	30-Nov-06	53.6	53.54	100%	15.03	20.40	0.86	4%
*II Rural Access Project	30-Nov-10	40.0	2.80	7%	NA	0.00	NA	NA
*Rainfed Agriculture and Livestock project	30-Jun-12	20.0	NA	NA	NA	0.00	NA	NA
*Power Sector Project	31-Dec-11	50.0	NA	NA	NA	0.00	NA	NA
Civil Services Modernization	31-Dec-07	33.9	21.16	62%	7.63	3.90	0.52	13%
Basic Education Expansion	30-Jun-07	64.2	57.07	89%	7.68	51.48	6.92	13%
Health Reform Support	31-Dec-08	33.6	13.95	42%	0.63	7.16	0.00	0%
Higher Education	30-Jun-08	6.2	1.94	31%	0.84	0.47	0.04	10%
Third Social Fund for Dev.	31-Dec-08	63.1	54.87	87%	0.00	0.43	0.00	0%
Basic Education Dev.	30-Jun-10	67.0	4.73	7%	153.13	2.65	0.00	0%
		858.22	393.67	46%	288.82	167.79	12.26	7%

UPDATED ODA PLEDGE TABLE²

March 23, 2007

		million \$US	grant	soft loan
I. GCC				
1	Bahrain			
2	Kuwait	200.0		200.0
3	Oman	100.0	100.0	
4	Qatar	500.0	350.0	150.0
5	Saudi Arabia	1000.0	1000.0	
6	United Arab Emirates	500.0	500.0	
<i>Subtotal I</i>		2300.0	1950.0	350.0
II. Multilaterals				
7	Arab Fund for Economic & Social Dev.	700.0		700.0
8	Arab Monetary Fund	220.0		220.0
9*	European Commission/4	100.0	100.0	
10	IFAD	70.0		70.0
11	Islamic Development Bank	200.0		200.0
12	OPEC Fund for International Dev	20.0		20.0
13	United Nations Dev. Program (UNSystem)**	90.0	90.0	
14	World Bank	400.0		400.0
15*	Global Fund (TB.HIV)/3	32.0	32.0	
<i>Subtotal II</i>		1832.0	222.0	1610.0
III. Other Bilaterals				
16	Germany/4	190.0	190.0	
17*	France/5	130.0	65.0	65.0
18	Japan	60.0	60.0	
19	Korea /3	40.0	40.0	
20*	Denmark/2	9.0	9.0	
21	Netherlands/4	114.0	114.0	
22*	Spain/p1	26.0	26.0	
23	Italy	12.0	12.0	
24	United Kingdom	224.0	224.0	
25*	United States/1	45.0	45.0	
<i>Subtotal III</i>		850.0	785.0	65.0
TOTAL (I+II+III)		4982.0	2957.0	2025.0

* Pledges that were made post CG meeting.

** Commitments by UN agencies from core resources, exclusive of extra-budgetary cost-sharing

² Source: MOPIC

VII. World Bank Publications

Atlas of Global Development: A Visual Guide to the World's Greatest Challenges
by World Bank

English Paperback 144 pages 7.5 x 9.75
Published February 2007 by HarperCollins, World Bank ISBN: 0-8213-6856-7 ISBN-13: 978-0-8213-6856-5 SKU: 16856

Published in association with Harper Collins, the Atlas of Global Development vividly illustrates the key development challenges facing our world today. Social, economic, and environmental issues that are facing the planet are presented by easy-to read, colorful world maps, tables, graphs, text and photographs. Drawing on data from the World Bank's authoritative World Development Indicators, the book brings to life country comparisons of social indicators like life expectancy, infant mortality, safe water, population, growth, poverty and energy efficiency. Issues that have been hitting the headlines such as AIDS, population living below \$1 a day, freshwater, trade are presented giving an unbiased view of the state of the world we live in.

This title builds on and replaces the existing World Bank Atlas which has been published by the World Bank for almost four decades.

Global Issues for Global Citizens: An Introduction to Key Development Challenges

Edited by Vinay K. Bhargava

English Paperback 482 pages 6.125 x 9.25
Published August 2006
ISBN: 0-8213-6731-5 ISBN-13: 978-0-8213-6731-5 SKU: 16731

Written by 27 World Bank experts, this book draws on the Bank's unique global capabilities and experience to promote an understanding of key global issues that cannot be solved by any one nation alone in an increasingly interconnected world. It describes the forces that are shaping public and private action to address these issues and highlights the Bank's own work in these areas. Covering four broad themes (global economy, global human development, global environment, and global governance), this comprehensive volume provides an introduction to today's most pressing global issues -- from poverty, conflict, and migration to climate change, international trade, education, health, and corruption.

With its straightforward presentation of complex topics, use of real world examples, and suggestions for further reading on-line and in the literature, this unique volume will be an invaluable resource for students in international relations, global business, public policy, international development studies, sociology as well as other interested readers.

Global Economic Prospects 2007: Managing the Next Wave of Globalization

by World Bank

Over the next 25 years developing countries will move to center stage in the global economy. Global Economic Prospects 2007 analyzes the opportunities - and stresses - this will create. While rich and poor countries alike stand to benefit, the integration process will make more

acute stresses already apparent today - in income inequality, in labor markets, and in the environment.

Over the next 25 years, rapid technological progress, burgeoning trade in goods and services, and integration of financial markets create the opportunity for faster long-term growth. However, some regions, notably Africa, are at risk of being left behind.

The coming globalization will also see intensified stresses on the "global commons". Addressing global warming, preserving marine fisheries, and containing infectious diseases will require effective multilateral collaboration to ensure that economic growth and poverty reduction proceed without causing irreparable harm to future generations.

Dancing with Giants: China, India, and the Global Economy

Edited by Alan Winters , Shahid Yusuf

English Paperback 288 pages 6 x 9

Published January 2007 by Institute of Policy Studies (Singapore) , World Bank ISBN: 0-8213-6749-8 ISBN-13: 978-0-8213-6749-0 SKU: 16749

China is now the world's fourth largest economy and growing very fast. India's economic salience is also on the rise. Together these two countries will profoundly influence the pace and nature of global economic change. Drawing upon the latest research, this volume analyzes the influences on the rapid future development of these two countries and examines how their growth is likely to impinge upon other countries. It considers international trade, industrialization, foreign investment and capital flows, and the implications of their broadening environmental footprints. It also discusses how the two countries have tackled poverty, inequality and governance issues and whether progress in these areas will be a key to rapid and stable growth.