

Chapter III

Developments in the Economy

During the last 15 years, the Yemeni economy passed through three stages. The first from 1990-1994 had been characterized by a recession and low rates of economic growth due to fiscal and monetary imbalances resulting from the political squabbling that led to the outbreak of the 1994 war for defending unity. The Gulf War of 1991 had also negative economic impacts with the repatriation of approximately one million Yemeni emigrants from the Gulf States. This led to declining remittances which the Yemeni economy depended on. The second phase, from 1995-2000 had been characterized by improving economic performance and higher growth rates in view of the Government's action in implementing a package of reform policies including liberalizing the exchange rate and trade, and the gradual lifting of subsidies, etc. The reforms brought about significant transformation in economic policies. Yemen also adopted a free market approach. The private sector was designated to play the major role in the economy. The third stage (2001-2005) focused on alleviating poverty, curbing unemployment, carrying forward administrative reforms, good governance, administrative and financial decentralization and maintaining commitment to transparency and fighting corruption.

Economic Performance (1990-1994)

Gross Domestic Product

Economic growth during this period fluctuated due to domestic and foreign economic imbalances. Despite growth in GDP in real terms, amounting to 4.1% on average during the period, it was not generated by productive economic sectors. On the contrary, it resulted from increased oil production and public expenditures needed for institutional capacity building of the unified state. Non-oil GDP achieved a negative growth of -0.5% in 1994.

Fiscal and Monetary Policy

The fiscal policy during this period had been expansionary, where public expenditures made significant growth exceeding growth in revenues. This led to a rise in the budget deficit reaching 14.9% of GDP by end of 1994. The monetary policy for financing the deficit relied on issuing new currency, which in turn led to a rise in money supply to 31.6% and inflation to 49.4% in the same year. The monetary measures resulted in declining purchasing power of the local currency and disturbances in the exchange rate (which exceeded the rate of YR 165 = \$1 in 1995). Currency and real estate speculation also led to the deterioration of the foreign currency reserves to \$300 million, sufficient to barely cover Yemen's import needs for no more than a month.

External Debt

Yemen's external debt rose from \$8.2 billion in 1990 to \$9.9 billion in 1995 (an average growth of 4% per annum). External debt jumped from 114% of GDP to 176%. The debt burden multiplied from 30% of total non-oil exports to 73.7% during the same period. The government was incapable of servicing its external debt, as interest reached 241.4% of total outstanding interest in 1995. Economic disruptions

during the period had led to imbalances in the gross external balances. The gross deficit in the balance of payments rose to \$709.7 million in 1994 due to the sharp decline in emigrant remittances, the suspension of external assistance and transfers, a high external debt service, and an increase in the value of imports.

Economic, Financial and Administrative Reform Program

The above economic indicators led to the deterioration of the economy and the decline of per capita income due to low GDP growth, high inflation and population growth. The Government adopted a set of measures to address the situation and to stimulate the economy and development through an Economic, Financial and Administrative Reform Program, with the aim of achieving economic stability, curbing inflationary pressures and remedying domestic and external imbalances. It also adopted the indicative planning to focus on setting objectives, policies, measures and tools that will achieve economic and administrative efficiency, as well as ensure better performance and development of the private sector.

The government adopted the First Five Year Plan for Economic and Social Development (1996-2000) according to the constitutional requirements. The plan followed an approach to dealing with the economy and investment according to available economic resources. The Government also began the implementation of the economic reform program in collaboration with the World Bank and the International Monetary Fund. A set of policies and measures for economic stabilization and structural adjustment were the main pillars of the economic reform program. The Government aimed to halt the deterioration of economic indicators and to gradually control the budget and balance of payments' deficits and reduce inflation, through fiscal and monetary policies and measures. It looked at regulating public revenues and improving the efficiency of custom and tax collections in a bid to curb evasion and introduce new taxes. The structure of public expenditures was revised, current expenditures were rationalized, increases in salaries and wages were frozen, subsidies were gradually lifted on basic commodities and petroleum derivatives and currency exchange rates were liberalized including the custom exchange rate. In addition, financing of the budget deficit diverted towards real resources, by means of issuing treasury bills to regulate money supply and absorb excess liquidity.

The structural adjustment phase focused on implementing structural reforms to the national economy and adopts legislations relevant to the economy, investment, the banking sector and administration. It meant to reduce the role of the Government in the economy and the transformation to a free market economy and liberalized trade. It demanded the removal of administrative and quantitative restrictions on imports, and restructuring the custom tariff in limited bundles that do not exceed four categories. It also meant the removal of restrictions on foreign exchange and permitting the transfer of capital and profits. Liberalizing capital transactions, the privatization of public enterprises, freeing interest rates and addressing external debt were among the measures that had been taken.

Social Safety Net

The Government established a Social Safety Net (SSN) in the wake of the adoption of the 1995 economic reform program in order to alleviate the adverse effects of the reforms on the poor. Under the Social Safety Net, the government created special funds, i.e., the Social Welfare Fund (SWF), the Social Fund for Development (SFD) and the Public Works Project (PWP). Other similar programs had also existed like the Productive Family Program and specialized funds for financing small and micro enterprises. The social safety net was further enhanced by means of cash assistance and development projects and services that provided permanent and temporary job opportunities, training and rehabilitation opportunities in income generation and the provision of loans, exemptions, social care and different social insurance schemes.

Administrative Reforms

The Government carried out an administrative reform program to remedy oversized civil service that resulted from the merger of two former independent administrative apparatuses of government. This led to a high wage and salaries bill, the reduction of real wages and salaries and the inability of the organizational and staffing structure of government to carry out its functions effectively and efficiently. In 1998, the Government approved a Civil Service Modernization Strategy. This strategy aimed at restructuring the public administration system, provision of high quality and efficient government basic services, setting up the appropriate climate for the development of the private sector and stimulating investment to generate new job opportunities. A package of measures was implemented including an Employment Survey, which formed a foundation for building a network of an integrated data base of civil servants working in public and mixed sectors.

The Government also adopted a new policy for recruitment based on vacancy announcements, competition and competence. The policy aimed to establish equal opportunities for applicants and provide government organs with the best qualified personnel. In 2004, the Higher Civil Service Council approved the results and directions of a study on the simplification of procedures in government services that are provided to the public and to the private sector. This comes within the efforts of the government for reforming administration and upgrading its mechanisms and procedures, adopting a modernization program that targets the dissemination of innovative concepts and work procedures that lead to improved government delivery in a high quality manner with little cost, time and effort.

A Civil Service Fund was set up to cater for surplus labor through paying salaries, referral to retirement, payment of compensations for those who wish to leave public employment or providing rehabilitation and training with a view towards having staff redistributed. So far around 35,000 civil servants have been sent to retirement. Similarly 15,000 employees have been taken out of the payrolls for duplicate employment. The Ministry of Civil Service and Pensions (MCSP) continues to remove deficiencies in the payroll until it achieves a single uniform payroll in all units of the administrative apparatus of government and the public and mixed sector enterprises. This is done in preparation for merging civil servants codes with biometric ID system (as part of the implementation of Republican Decree No. 1 for 2004).

In 2005, the Government presented the draft National Strategy for Wages and the draft Employment Positions and Wages Scheme to Parliament for ratification. The strategy aims to improve the conditions of government employees and administrative efficiency. It also seeks to eliminate the existing deficiencies in the wage structures in preparation for a transformation into a uniform structure for wages in order to achieve equality, transparency, employment stability, improvement in the quality of public service delivery, keeping pace with rising cost of living, control corruption and addressing relevant opportunities and causes. Administrative corruption has been the result of low wages and income.

The First Five Year Development Plan (1996-2000)

The implementation of comprehensive reform program (EFARP) coincided with the preparation of the First Five Year Plan for Economic and Social Development, which underlined three primary pillars, i.e., reform economic and financial imbalances, achieve significant increases in economic growth and maximize the comparative advantages of available economic and human resources.

Economic Performance (1995-2000)

The concurrent implementation of reforms (EFARP) and the First Five Year Development Plan helped achieve the respective underlying objectives of the program and the plan. Evident improvements in national economic performance during the period 1995-2000 were made. Fiscal and monetary imbalances were eliminated and economic stability and growth were achieved.

Gross Domestic Product

GDP registered an average growth of 5.5% due to retraction in the population growth rate from 3.7% to 3.5%. Per capita share of GDP rose from YR 32,000 in 1995 to YR 77,400 in 2000. The commodity and service economic productive sectors contributed to achieving such growth during the period at a rate of 5.6% for the commodity sectors and 6.3% for the service sectors. Gross domestic demand to the GDP dropped from 120% to 91% during the same period. This led to obvious macro economic improvements.

Fiscal and Monetary Policy

Fiscal policy during this period encountered a downswing in order to reduce current expenditures, and to gradually lift subsidies for basic commodities until they were completely cancelled in 1999. This saved \$ 300 million for the public budget, which was allocated to subsidize these commodities. The budget deficit was reduced to 0.1% of GDP in 1996, it then rose to 6.7% in 1998 due to the decline of Yemen's proceeds from oil exports resulting from the drop in world oil prices. The deficit changed to surplus reaching 6.4% of GDP in 2000. Fiscal policy was able to reduce current expenditures to 76% and to increase capital investment expenditures to 18.1% in 2000. Monetary policy, exemplified by unifying and floating the exchange rate

was able to achieve stability of the riyal against the foreign currencies. The Central Bank of Yemen took several liberalizing measures, including allowing transactions in foreign currency and removal of all administrative restrictions on foreign currencies. A parallel package of measures that aimed for the development of Yemen's foreign currency reserves was also adopted, thus raising foreign currency reserves to \$ 3.6 billion at year end 2000. This was enough to cover imports for 12 months. The implementation of indirect monetary instruments, such as the issuance of treasury bills to finance the budget deficit, had a significant effect on absorbing liquidity and reducing the growth of money supply by 25% and inflation down to 4.6% in 2000.

External Sector

External balances improved during this period, due to a rise in oil export revenues. Deficits of the balance of trade and of balance of payments went down to \$ 132.5 million and \$ 152 million respectively in 1997. In 1998, both increased to \$ 785 million and \$ 455.5 million respectively, because of falling world oil prices. The deficits turned into surplus that peaked in 2000. The surplus of the balance of trade amounted to \$ 1,312 million and the gross balance of payments amounted to \$ 1,388 million arising from higher oil prices. Such situation reveals imbalances resulting from the structure of exports due to the predominance of oil exports by 92% against only 8% for non-oil exports. The Government has exerted persistent efforts to reduce external debt through negotiations with the Paris Club, which agreed to reduce Yemen's external debt balance to \$ 5 billion (constituting 60% of GDP in 2000 compared with \$ 9.9 billion in 1995, constituting 176% of GDP).

Strategic Vision

Yemen has realized that overcoming economic difficulties would not be accomplished unless a review of development strategies and policies is done. The need for a long term vision became imperative. This vision would display the ambitions and goals, and define the advantages and resources that may be utilized during the coming decades, within a framework of indicative planning that is based on market mechanisms. In this context, the Government prepared in a transparent and consultative process "Yemen's Strategic Vision 2025" with the participation of political parties, NGOs and local communities. Such vision reflects the hopes and aspirations of the Yemeni people across the spectrum to enhance the performance of economic sectors and develop society and individuals in all spheres and levels. The Vision defined the course for comprehensive development over the next 25 years. It aims at moving Yemen from the list of countries with middle human development indicators to a diversified economy with social, intellectual, cultural and political development. To realize such long term ambitions and objectives, the Vision has set focus on the following:

- Achievement of economic growth that ensures reduction of unemployment and poverty;
- Rejuvenation of coastal regions and investment taking into account the comparative advantages of the geographic location and economic role of free zones;

- Acceleration of industrial activities, promotion and export of extraction (mining) industries;
- Development and rationalization of agriculture and balanced exploitation of fish resources;
- Investment in tourism and protection of the environment;
- Modernization of the administrative apparatus of government with emphasis on the partnership between the government and the private sector.

The Second Five Year Development Plan (2001-2005)

Based on Yemen's Strategic Vision 2025, the Second Five Year Development Plan was drawn up as a reference framework for macro economic policies and development plans for the different sectors and governorates. The Plan underlines eight primary foundations that aim to develop human resource, achieve economic stability, and diversify the economic structure. It also underlines the importance of strengthening partnership and the expansion of the role of the private sector, directing the economy towards exports, strengthening good governance and decentralization and the development of the national scientific and technological capacities and preservation of the environment.

Poverty Reduction Strategy (2003-2005)

The government finalized a Poverty Reduction Strategy (2003-2005), in close consultation with segments of society and development partners. The underlying objective was linking development policies with poverty alleviation and reduction of unemployment. The PRS document focuses on the policies and measures that help improve the conditions of the poor to enable them to obtain minimum income and nutrition requirements and access to education, health services, safe water and other basic services. The strategy is a joint cooperation program with five basic pillars. These pillars are the Economic Development, Human Development, Infrastructure Improvement, Securing Social Protection, and Strengthening Management and Good Governance.

The Millennium Development Goals

Yemen recognizes its commitment to achieving the Millennium Development Goals, which were approved by the Millennium Summit held at the United Nations in September 2000. To achieve these goals, the Government prepared a national report that looked into Yemen's ability to achieve the MDGs and the volume of financial resources required up to 2015. The report estimated that Yemen would need \$ 29.9 billion. This reflects the volume of external assistance and financing for achieving the eight MDGs, including elimination of severe poverty and hunger, making basic education generic for all, improve gender equality, empowering women, reducing child mortality, improving maternal health, combating AIDS, Malaria and other communicative diseases, and finally securing a sustainable environment and an international partnership for development.

Economic Performance (2001-2005)

The Yemeni economy was adversely affected during 2001-2005 due to local, regional and international developments topped by the tragic event of 11/9/2001 and the invasion of Iraq. These factors have had an impact on economic performance. GDP grew by an average of 4.2% during the period 2001-2004, where average non-oil growth was 4.9%. The Government was able to achieve a budget surplus of 2.4% in 2001 and control the deficit at safe levels of no more than 3% of GDP in other years.

The fiscal policy meanwhile focused on reinforcing decentralization in the governorates and districts as part of the implementation of local authority budgets and adherence to the principles and rules of financial and accounting system, and in keeping with provisions under the Local Authority Law and bylaws. The completion of setting up the accounting units at the district level and the rehabilitation of their staff to ensure the enhancement of performance and efficiency of the local authorities were an integral part. In addition, computerization of the financial system and the implementation of the ESCUDA Customs System and the DEMFAS System for External Debt Management and Accounting took place, with a view towards establishing data bases and increasing transparency. On the legislative side, the government referred proposed amendments to the General Sales Tax to Parliament. This tax aims to remove distortions in early legal texts and to achieve tax equity. It will also replace the Law for the Production and Consumption Tax. The government also approved the proposed new Customs Tariff Law, which was prepared in light of the principles and objectives of EFARP.

During this period, the Central Bank of Yemen maintained stability in the exchange rate by means of imposing controls, and increasing transparency in setting the rates in accordance with market mechanisms in order to ensure a real exchange rate based on competition. The monetary policy was able to confine the growth of money supply at 16% and inflation at 10 % in 2004. Money in circulation outside the banking system was reduced from 37% in 2001 to 32% in 2004. This reinforces the confidence of banks and their ability to attract deposits and savings, and re-lend them to sectors and development projects. Foreign currency reserves rose to \$ 5.7 billion by end of 2004 covering about 17 months of imports.

Surplus in external balances fluctuated according to oil prices movement in the international market. The trade balance maintained a surplus ranging between \$ 766.5 million and \$ 936.8 million during 2001–2004. The gross balance of payments fluctuated between \$ 653.2 million and \$ 532.3 million during the same period. Outstanding external debt went down to 42% of GDP by the end of 2004.

The Third Five Year Plan for Development and Poverty Reduction (2006-2010)

The government has merged its national plans, strategies and programs into one national document instead of having several separate documents. The government is

merging the Third Five Year Plan, the PRSP and the Millennium Development Goals into one single document i.e., the Third Five Year Development Plan and Poverty Reduction (2006-2010). Actual implementation of the Plan will begin in 2006. The Plan aims to reinforce commitment to reforms, achievement of economic growth, and reduction of unemployment and poverty. It also aims to create an effective partnership with the private sector, civil society and development partners regionally and internationally. The MDGs will be an integrated part of the new Plan.

The Private Sector

Economic and political developments in Yemen during the 1990s, especially following the adoption of the 1995 reform program witnessed a change in the structure of the economic system. The economy was transformed into a free economy based on market mechanisms and supporting a more enhanced role for the private sector. The role of the government in the economy was re-defined as directional and setting legislation and institutional and social structures, removal of constraints confronting the private sector, development of market mechanisms, and securing economic stability.

The government took a series of fiscal, monetary and administrative policies and measures to support the market mechanism and to encourage trade liberalization. The Government also made a review of tax, customs, administrative, commercial, investment and judicial laws in order to improve the general climate for investment. It also maintained the implementation of a privatization program to expand economic activities of the private sector through the transfer of ownership of public enterprises to the private sector and curbing government monopolies. National and foreign capital was able to invest in the development of enterprises that were put up for privatization.

Strengthening Partnership

The government sought to reinforce partnership with the private sector through involving the sector in higher committees and boards of directors of government authorities and funds. The private sector was introduced into committees that were designated to consider various legislations, plans and programs and to take part in official negotiations with fraternal and friendly states within Yemen and abroad. Numerous joint committees were also formed between the government and the private sector to address problems that hinder the sector's activities and to ensure its competitive capacity. The government also undertook the implementation of a number of measures and policies that aim to promote the private sector and its ability to maximize available productive capacities and economic resources. Among the measures taken were:

- Reinforcement of the economic approach that relies on a leading role for the private sector in the economy;
- Giving more attention and encouragement to the private sector to invest;
- Improvement in performance and expansion of services of the banking system;
- Promotion of the idea of turning commercial banks into full service banks that work towards financing investment activities;

- Promotion of the integration and consolidation of small separate companies within a framework of large shareholding companies to take advantage of the economies of scale and enhance their ability to compete;
- Building up an economic data base and undertake field surveys and studies that improve the ability of the private sector to make investment decisions.

The Participation of the Private Sector in Development and Investment

The private sector has contributed significantly to economic and social development through diversifying and expanding industrial, agricultural, fisheries and services activities. Such role resulted in increasing private sector contribution to GDP by 79-80%. Yemen's Strategic Vision 2025 envisages an increase in private sector share by means of improving the investment environment and increasing the sector's investments in promising sectors. The government is working towards strengthening institutional frameworks of the private sector in order to enable the sector to formulate its plans and requirements, and to influence domestic and international economic activities. In addition, the sector will be able to mobilize its capabilities towards stimulating the wheel of development. Law No. 18 of 1999 on Chambers of Commerce and Industries and their General Federation was issued. The Law was amended by Law No. 28 for 2002, to stipulate in Article (5) that the Chambers of Commerce and Industry are economic and professional organizations that represent their members and cater to commercial and industrial interests.

The General Federation of Chambers of Commerce and Industry during the past years was the sole representative of businessmen irrespective of types of business. The Federation contributed to filling a vacuum that arose due to the absence of other organizations. The Federation also provided some services that businessmen were in dire need of. However, political and economic developments that coincided with the establishment of the unified state of Yemen also contributed to the creation of other associations and federations for the private sector like the Association of Yemeni Industrialists, the Businessmen Club and the Yemeni Council for Businessmen. These organizations participate in economic activities and functions, seminars, conferences and take part in several other programs. These organizations seek to strengthen their presence and activities through:

- Preparation of studies on economic activities related to the private sector and keeping abreast with the rapid regional and international economic transformations;
- Working on coordinating efforts and cooperation among organizations formulating common vision for the private sector towards all issues;
- Contribution to solidify Yemen's relations with the outside world by means of participating in overseas conferences and seminars and signing partnership agreements with organizations and federations of fraternal and friendly states;
- Organization of seminars and conferences related to economic, commercial and industrial activities.
- Setting up promotional exhibitions for Yemeni products and participation in overseas exhibitions;
- Promotion of investment opportunities in Yemen, by means of seminars and consultative meetings between Yemeni businessmen and their Arab and foreign counterparts.