



Priorities for Private Sector Recovery in Yemen:

REFORMING THE BUSINESS AND INVESTMENT CLIMATE

EXECUTIVE SUMMARY

The business and investment climate for private sector actors in Yemen has long been challenging. The current conflict has expanded and magnified these changes such that today Yemen is last or near last in a host of global business competitiveness indexes. Many businesses across the country have closed and moved their capital elsewhere, while many of those that remain open have had to make drastic cuts to their workforces. However, relative to the public sector – which has seen the near collapse of most government institutions – the private sector has shown a far greater degree of resilience. Businesses have stepped in to replace absent government services in many areas, allowing access to basic commodities and providing livelihoods for millions of Yemenis.

The surest means of laying the foundations for private sector recovery in Yemen, and indeed recovery for the country overall, is to end the ongoing conflict and reunify public institutions and governance mechanisms. While the conflict is ongoing, however, there are still practical, realistic steps national and international stakeholders can take to support the Yemeni private sector. Doing so would in turn help spur economic growth and job creation for a destitute population. It would also potentially initiate a cascade of positive developments in Yemen: easing the humanitarian crisis, bolstering socio-economic and political stability, and restarting formal financial cycles, among others. ▶

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On April 27-29, 2019, a group of Yemen's leading socioeconomic experts convened the fifth Development Champions Forum in Amman, Jordan, as part of the Rethinking Yemen's Economy initiative. The Development Champions' in-depth discussions regarding the challenges facing the business and investment climate in Yemen resulted in the recommendations below for the internationally recognized Government of Yemen and international stakeholders. These include:

- Address the urgent challenges facing the processing of traders' letters of credit (LCs) applications for the importation of basic commodities.
- Review and revise the list of prohibited import goods.
- Prepare a quick action plan to support exports and remove bureaucratic obstacles.
- Reactivate and support government bodies that help facilitate international trade.
- Prepare a list of priority investment projects that can increase the effectiveness of vital sectors.
- Adopt Private Sector Participation (PSP) as a first step toward Public-Private Partnerships (PPPs).
- Accept international arbitration in any signed contracts due to the present weakness of the legal system in Yemen.
- Support investments in Yemen's various regions.
- Prioritize the maintenance of existing investments.
- Decentralize and support alternative means of power production.

BACKGROUND

There are many challenges that local and foreign investors face in Yemen. At the forefront of these is the difficulty of doing business. The business environment and overall investment climate in Yemen have been on a downward trend since the beginning of this decade. Since the ongoing conflict began, it has deteriorated tremendously.

Yemen's Global Business Rankings: Near the Bottom in Every Category

Today, Yemen's position in global business rankings draws a dreary image of the country's fragile business environment and its decades of fruitless reform initiatives. In the World Bank's Doing Business 2019 report, Yemen was ranked the fourth worst place in the world to do business among 190 countries (Venezuela ranked 188, Eritrea 189, and Somalia 190), dropping by 22 ranks compared to 2015.⁽¹⁾ In particular, the report placed Yemen among the worst five countries worldwide in trading across borders, obtaining electricity, getting credit and dealing with construction permits.

Other global indicators draw the same bleak picture of Yemen's overall business environment and investment climate. In 2018, Yemen ranked second to last in the Global Competitiveness Index, among a total of 140 economies, and third to last in the Legatum Prosperity Index, among a total of 149 economies.⁽²⁾ The last available Index of Economic Freedom ranking of Yemen is from 2015 when it was placed in the 133rd rank among 178 economies, which was within the lower end of the range of rankings for mostly unfree economies. On the Corruption Perceptions Index (CPI), Yemen was perceived as the fifth most corrupt country in the world in 2017—among 180 countries.⁽³⁾

Failed Reforms, FDI Outflows and Oil Dependence

Preceding the conflict, Yemen had taken steps ostensibly aimed at developing a competitive private sector, through launching several reform programs and development plans. In 1995, and with support from the World Bank and the International Monetary Fund (IMF), the Yemeni government initiated the Economic Reform Program (ERP) to promote the private sector's role in the Yemeni economy, which prioritized the development of all areas of the private sector as well as development at the governorate level.

Between 2000 and 2010, the government attempted to enact institutional, legislative, privatization and financial reforms to stimulate and improve the business environment. For instance, in 2007 the government initiated the Institutional Reform Development Policy Grant to stimulate the non-hydrocarbon private sector, which

1) "Doing Business 2019", World Bank Group, https://www.worldbank.org/content/dam/doingBusiness/media/Annual-Reports/English/DB2019-report_web-version.pdf. Accessed July 19, 2019.

2) "Global Competitiveness Report 2018", The World Economic Forum, <http://reports.weforum.org/global-competitiveness-report-2018/country-economy-profiles/#economy=YEM>, accessed July 19, 2019. The Legatum Prosperity Index 2018, Legatum Institute <https://www.prosperity.com/rankings>. Accessed July 19, 2019.

3) "Corruption Perceptions Index 2017", Transparency International, https://www.transparency.org/news/feature/corruption_perceptions_index_2017#table. Accessed July 19, 2019.

involved two central elements: (1) tax reforms to rationalize private investment incentives, and (2) reforming property registration and ownership rights. In 2008, the government introduced reforms to improve access to financial services and credit facilities and, accordingly, issued the Microfinance Banking Law the following year. By 2010, the microfinance market was serving some 51,000 clients. In evaluating whether these reforms have met the desired goals, the World Bank revealed that the ambitious initiatives fell short of their goals.⁽⁴⁾ This stemmed from the rampant political interference, government bureaucratic obstructions, lack of coordination and implementation of plans across the intergovernmental ministries and across public-private structures, weak accountability and governance mechanisms, and the absence of a clear vision to address the challenges facing the business environment in Yemen.

Yemen's poor investment climate is exemplified by the extent to which resources are being drained out of the economy, effectively negating money flowing the other way in the form of international aid. Between 1990 and 2008, Yemen was the world's fifth largest source of illicit capital outflows among least developed countries, with US\$12 billion leaving the country during that period; according to a Chatham House report: "For every dollar spent on aid in Yemen between 1990 and 2008, another \$2.70 left the country".⁽⁵⁾

Furthermore, since 2011, net foreign direct investment (FDI) in Yemen has been negative. Historically, Yemen has not been an attractive destination for FDI. It was not until 2006 that reported FDI inflows into the country reached a record US\$1.1 billion. Over the following two years, Yemen continued to attract FDI, reaching US\$1.6 billion in 2008, but it plummeted thereafter.⁽⁶⁾

In addition, a major developmental barrier has also been the government's inability to diversify away from oil dependence and expand the non-oil private sector. As oil prices were increasing through the 2000s, until 2008, oil exports accounted for some 85 percent of Yemen's total exports on average, while non-oil private sector exports contributed the remaining 15 percent.⁽⁷⁾ Revenues from oil accounted for 65 percent of total government revenues during the same period.⁽⁸⁾

The World Bank noted in 2010 that decreasing the state budget deficit and reducing the pressure on the local financial market is vital for preparing the ground to develop the private sector.⁽⁹⁾ Increased public borrowing has pushed interest rates up to over 20 percent and thus restricted any potential growth of investment.⁽¹⁰⁾

4) Amal Nasser, ed. Spencer Osberg, "Beyond the Business as Usual Approach: Private Sector Engagement in Post-Conflict Yemen", Rethinking Yemen's Economy, August 29, 2018, https://devchampions.org/files/Rethinking_Yemens_Economy_No3_En.pdf. Accessed July 19, 2019.

5) Ginny Hill, Peter Salisbury, Léonie Northedge and Jane Kinninmont, "Yemen Corruption, Capital Flight and Global Drivers of Conflict", Chatham House, September 2013, https://www.chathamhouse.org/sites/default/files/public/Research/Middle%20East/0913r_yemen.pdf. Accessed July 19, 2019.

6) "UNCTADStat, General Profile: Yemen," United Nations, United Nations Conference on Trade and Development (UNCTAD), Development Statistics and Information Branch (DSIB), 2017, <https://unctadstat.unctad.org/CountryProfile/GeneralProfile/en-GB/887/index.html>. Accessed July 19, 2019.

7) "Yemen – Development Policy Grant for the Private Sector Growth and Social Protection Development Policy Grant", December 14, 2010, <http://www.worldbank.org/en/news/loans-credits/2010/12/14/yemen-development-policy-grant-for-the-private-sector-growth-and-social-protection-development-policy-grant>. Accessed July 19, 2019.

8) Ibid.

9) Ibid.

10) Ibid.

Post-2011: Existing Private Sector Challenges Expanded and Magnified

As the 2011 political crisis intensified, leading to a civil war and regional military intervention in March 2015, the business environment became highly unwelcoming. The private sector entered a new era of increasing political, economic, and security challenges. Between 2010 and 2011 alone, Yemen's gross domestic product (GDP) growth dropped from 7.7 percent to -12.7 percent, and a 2012 World Bank survey on Yemeni businesses found that more than 40 percent of businesses had laid off more than 40 percent of their workforce, while their revenues shrank by half.⁽¹¹⁾ The impact was felt across all business sectors, though small businesses were more adversely affected than medium and large businesses, which likely reflected the structural weaknesses and shallow financial resources of small businesses to adopt coping mechanisms and survive shocks.

In 2012, the US\$3 billion of Saudi cash and fuel grants injected into Yemen's economy helped the country's GDP rebound to 4.8 percent growth in 2013 and offered a greater opportunity for the private sector to recover. The private sector contributed approximately 54 percent of the GDP and 65 percent of the gross investment in 2013, while providing jobs to around 20 percent of the total employed population in 2013-2014 (this percentage is closer to 70 percent if all non-government employees are considered as private sector employees).⁽¹²⁾ In addition, the private sector contributes considerably in social service provision: prior to the conflict, more than 50 percent of healthcare services were provided by the private sector.⁽¹³⁾

Following political instability in 2011, electricity has also been one of the major challenges hindering private sector business activities. In an average month, private sector firms experience nearly 40 power outages; these outages result in losses of more than 16 percent of their annual sales, according to a report by the European Investment Bank.⁽¹⁴⁾ As the Marib power plant, which feeds the national grid, began failing in 2014, and collapsed completely in 2015, businesses and private firms became heavily reliant on expensive electricity services provided by private generators and vulnerable to widespread fuel shortages that regularly hit the country, which render generators inoperable and curtail transportation and distribution networks. One coping strategy the private sector adopted was to import solar power equipment that helped address the urgent needs of households and supported the operations of small and medium enterprises.

11) "The plight of Yemeni private enterprises since the 2011 crisis: A rapid assessment (English)," The World Bank, September 1, 2012, <http://documents.worldbank.org/curated/en/819671468169454863/The-plight-of-Yemeni-private-enterprises-since-the-2011-crisis-a-rapid-assessment>. Accessed July 19, 2019.

12) "Yemen's Private Sector - In Search of a Lifeline", Yemen Socio-Economic Update Issue 11, Ministry of Planning & International Cooperation, February 2016, https://reliefweb.int/sites/reliefweb.int/files/resources/yseu11_english_final.pdf. Accessed July 19, 2019.

13) Ibid.

14) Pedro de Lima, Debora Revoltella, Jorge Luis Rodriguez Meza, Helena Schweiger, "What's holding back the private sector in MENA? lessons from the enterprise survey (English)," . Washington, D.C.: World Bank Group, 2016, <http://documents.worldbank.org/curated/en/170531469775655994/Whats-holding-back-the-private-sector-in-MENA-lessons-from-the-enterprise-survey>. Accessed July 19, 2019.

Nevertheless, the impacts of the ongoing conflict, which began in 2014 and intensified significantly in 2015, have been devastating. Just six months into the regional military intervention, it was reported that 26 percent of businesses closed their doors and lost more than 70 percent of their clientele in the most conflict-affected areas — 95 percent of the closed enterprises sustained partial or total physical damage; some 41 percent of enterprises had reported laying off more than half of their workforce by October 2015.⁽¹⁵⁾ Private businesses operating in governorates such as Sa’ada, Taiz, and Aden had sustained significant physical damage due to the conflict. In May 2017, the World Bank estimated the amount required to fund reconstruction and recovery in Yemen at about US\$88 billion, of which US\$25 billion was physical asset reconstruction.⁽¹⁶⁾

The major obstacles arising due to the conflict have been political instability, poor security, economic blockade, financial and monetary imbalance, and the proliferation of war economy and informal business actors that have dominated the market. According to the Yemeni Ministry of Planning and International Cooperation, the large contractions of economic output — a 17.6 percent contraction in GDP in 2015, 15.3 percent in 2016, and 14.4 percent in 2017 — have resulted in a cumulative 40.5 percent drop in GDP over these three years.

The liquidity crisis witnessed by the banking sector has adversely affected the activities of private firms, and it hinders their investments. In 2018, the banking sector could not access roughly 65 percent of its total assets due to the severe liquidity crisis sweeping the country since mid-2016. These assets included those invested in the form of loans that were offered to the private sector (non-performing loans reached 52.5 percent of the total loans in December 2017) and in the form of government securities and balances frozen at the Central Bank of Yemen (CBY). Many clients and businesses have lost confidence in the banking sector and have decided to move their liquidity from the formal banking system to the unregulated market. This situation has increased the risks of money laundering and the costs of doing business, hindered trade, and made it difficult to conduct financial transactions with the global financial system, given that international banks largely refrain from interacting with the Yemeni banking system. The fragmentation of the CBY between Sana’a and Aden has made doing business, especially the importation of goods from abroad, more difficult.⁽¹⁷⁾ The banking sector has been overwhelmingly challenged to cope with contradicting regulations and directions issued by the opposing central bank branches. Additionally, the absence of unified fiscal authorities has caused the private sector to face duplicated tariffs, customs fees and taxes.

15) “Yemen’s Private Sector - In Search of a Lifeline”, Yemen Socio-Economic Update Issue 11, Ministry of Planning & International Cooperation, February 2016, https://reliefweb.int/sites/reliefweb.int/files/resources/yseu11_english_final.pdf. Accessed July 19, 2019.

16) “Private Sector: Vital Role in Times of War”, Yemen Socio-Economic Update Issue 35, Ministry of Planning & International Cooperation, July 31, 2018, https://reliefweb.int/sites/reliefweb.int/files/resources/YSEU35_English_Final.pdf. Accessed July 19, 2019.

17) M. Rageh, A. Nasser and F. Al-Muslimi, “Yemen Without a Functioning Central Bank: The Loss of Basic Economic Stabilization and Accelerating Famine”, Sana’a Center for Strategic Studies, November 2, 2016, <http://sanaacenter.org/publications/main-publications/55>. Accessed July 19, 2019.

The economic blockade has made operations extremely difficult for businesses as well as humanitarian organizations working on the ground in Yemen. Access is slow and costs are high: it can take weeks of inspections before a ship reaches port, with this idle time at sea creating significant costs for traders.⁽¹⁸⁾ The depreciation of the Yemeni rial has negatively impacted Yemeni businesses as the rial plummeted in value from YR215 in early 2015 to about YR800 per US\$1 at the end of September 2018. Intervention by the central bank in Aden helped the rial rebound in the last quarter of 2018, and it was trading in the range of YR525 per US\$1 as 2019 began.

Private Sector Resilience

Despite the challenges created by the conflict, the private sector has shown resilience and a better ability to cope with the war than the public sector, which has experienced a major collapse in service provision and state institutions. Between 2015 and 2016, the private sector's contribution to the GDP contracted 18 percent compared to the public sector's 31 percent contraction over the same period.⁽¹⁹⁾ The contribution of the private sector to the real GDP increased from 62.3 percent in 2014 to 70 percent in 2016.⁽²⁰⁾ With the fragmentation of the state institutions – such as the Ministry of Finance and the central bank – across frontlines, the private sector became a vital player on the ground, helping to fill the vacuum in basic service delivery. A mid-2017 survey of businesses, conducted to measure their humanitarian response found that four out of five were involved in humanitarian relief efforts of food, healthcare and food assistance.⁽²¹⁾ In addition, the private sector has been a key partner of international humanitarian organizations working on the ground, facilitating the movement of goods and cash transfers from donors to targeted beneficiaries, as well as providing warehousing and logistics for humanitarian actors. By continuing to operate, albeit at a reduced level, the private sector has remained an important source of income to millions of Yemenis, while many of Yemen's hundreds of thousands of public sector employees have not received a salary regularly since 2016.

18) "Private sector engagement in complex emergencies: case studies from," ODI, February 9, 2017, <https://www.odi.org/publications/10720-private-sector-engagement-complex-emergencies-case-studies-yemen-and-southern-somalia>. Accessed July 19, 2019.

19) "Private Sector: Vital Role in Times of War", Yemen Socio-Economic Update Issue 35, Ministry of Planning & International Cooperation, July 31, 2018, https://reliefweb.int/sites/reliefweb.int/files/resources/YSEU35_English_Final.pdf. Accessed July 19, 2019.

20) Ibid.

21) Amal Nasser, ed. Spencer Osberg, "Beyond the Business as Usual Approach: Private Sector Engagement in Post-Conflict Yemen", Rethinking Yemen's Economy, August 29, 2018, https://devchampions.org/files/Rethinking_Yemens_Economy_No3_En.pdf. Accessed July 19, 2019.

LOOKING AHEAD

Extremely poor global rankings indicate that Yemen is not only hindered in attracting foreign investments but is also having difficulty bringing back the national capital and foreign firms that have fled the country to search for safer business environments. Taking steps to enhance the national business environment must be seen as critical to drawing investment back to Yemen and helping to start private sector recovery.

Recommendations

For the internationally recognized Government of Yemen and international stakeholders, the general priorities the Development Champions identified were the facilitation of trade – both imports and exports – and the maintenance of current levels of investment in the country, with the aim of increasing investments through improving the business environment. To this end, the Development Champions recommended the following:

- **Address the urgent challenges facing the processing of traders' letters of credit (LCs) applications for the importation of basic commodities.** While the Central Bank of Yemen (CBY) in Aden and the associated Economic Committee have a mechanism to provide import financing for basic commodities, the Development Champions noted that this has become almost paralyzed due to a conflict between the CBY in Aden (which is recognized internationally) and the CBY in Sana'a (controlled by the Houthi authorities and not internationally recognized). The core of the dispute relates to the Aden CBY's requirement that LCs be paid for using cash, not checks. The CBY in Sana'a – where most major importers and bank headquarters are based – opposes this policy as they claim it would drain hard currency liquidity from Houthi-controlled areas, and has thus taken steps to oblige traders and banks not to comply with the Aden CBY policy. The Development Champions stressed that resolving this dispute and resuming the issuance of LCs is critical to avoiding nationwide shortages in basic commodities.
- **Review and revise the list of prohibited import goods.** The Development Champions noted that the list of items which the Saudi-led coalition currently prohibits from importation is excessively long, strict and punitive. Banning these goods prevents consumers in Yemen from being able to purchase many day-to-day manufactured food and household products, while also preventing many factories from obtaining the raw material inputs they need to make their products. Thus, the list of prohibited goods should be reviewed with the aim of allowing more products – those with little to no potential for dual-use in the military field – to be imported.
- **Prepare a quick action plan to support exports and remove bureaucratic obstacles.** For example, in the fisheries sector many companies have recently gone out of business and the rest remain hamstrung by government bureaucracy and inaction to support the industry. Bureaucratic obstacles range from multiple, overlapping fees from various levels of government to burdensome and contradictory regulations. The Yemeni government has made essentially no effort to promote Yemeni products abroad, and senior officials have left international trade agreements – prepared for them in order to facilitate European nations' ability to import Yemeni products – unsigned on their desks for months.

- **Reactivate and support government bodies that help facilitate international trade.** These include the Supreme Economic Council and the Supreme Council for Export Development.
- **Prepare a list of priority investment projects that can increase the effectiveness of vital sectors.** Such should include infrastructure investments in ports or sea lanes to help expedite imports and exports via ocean cargo. This list can be shopped around to potential regional and international donors and financiers.
- **Adopt Private Sector Participation (PSP) as a first step toward Public-Private Partnerships (PPPs).** Given the massive scale of Yemen's infrastructure investment needs and the poor state of government revenues, it is inconceivable that the financing of the former can be met by the latter. Thus, along with donor grants, a significant level of private-sector financing will be required to meet the investment needs. However, the Yemeni government lacks experience in implementing such deals, while the current state of the government would likely make private sector actors extremely cautious – and demanding of huge concessions – in order to enter fully fledged PPP agreements. Thus, a more gradual approach of employing PSP, to build government experience and private sector trust, is advisable.
- **Accept international arbitration in any signed contracts due to the present weakness of the legal system in Yemen.** This will almost certainly be a condition of any international financier negotiating an investment in Yemen. It is best to accept this as a necessary condition until trust in the Yemeni judicial system's ability to adjudicate major international trade deals fairly and objectively has been established.
- **Support investments in Yemen's various regions.** This process should include conducting studies and surveys to assess the competitive advantages of different regions around Yemen. It should also include devolving greater powers to the governorates in terms of promoting and attracting international investments and managing local investment portfolios.
- **Prioritize the maintenance of existing investments.** This can be done by granting tax incentives and duty exemptions for specified periods of time. Also, adequate resources for Business Continuity Support programs to maintain small and medium-sized enterprises should be provided.
- **Decentralize and support alternative means of power production.** An area where this has potential for significant impact is agriculture. The Yemeni government and the international community should support projects to deploy solar energy units to pump water in areas where water is available, in parallel with supporting the use of modern irrigation methods.

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ABOUT THE “RETHINKING YEMEN’S ECONOMY” INITIATIVE

This two-year project, which was launched in March 2017, is an initiative to identify Yemen’s economic, humanitarian, social and developmental priorities in light of the ongoing conflict in Yemen and to prepare for the post-conflict recovery period. The project aims to build consensus in crucial policy areas through engaging and promoting informed Yemeni voices in the public discourse, and to positively influence local, regional and international development agendas.

The project has four components: (1) in the Development Champions Forums, Yemeni experts and professionals in social and economic development will identify key issues for intervention and provide recommendations towards tackling these issues; (2) in the Research

Hive, the project consortium will – based on the issues and recommendations of the Development Champions – conduct research and identify best practices and lessons learned from international experiences to create knowledge capital for the Rethinking Yemen’s Economy initiative; (3) in the public outreach component, the consortium will implement consultation workshops with local stakeholders, including the private sector, youth and civil society organizations; moreover, campaigns through both traditional and social media outlets will be conducted to engage the wider Yemeni public; (4) and through regional and international engagement the consortium will inform stakeholders of project outcomes and aim to motivate and guide the international community’s policy interventions to the greatest benefit of the people of Yemen.

For more information and previous publications: www.devchampions.org

Implementing Partners

The project is implemented by a consortium of the following three partners:



The Sana’a Center for Strategic Studies is an independent think-tank that seeks to foster change through knowledge production with a focus on Yemen and the surrounding region. The Center’s publications and programs, offered in both Arabic and English, cover political, social, economic and security related developments, aiming to impact policy locally, regionally, and internationally.
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