



RETHINKING
YEMEN'S ECONOMY

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Addressing Yemen's Most Critical Challenges

PRACTICAL SHORT-TERM RECOMMENDATIONS

INTRODUCTION

Over the past six years Yemen has been experiencing a period of widespread destabilization, which intensified in September 2014 and resulted in full-blown civil war and international military intervention in early 2015. While the violence has been vicious and destructive, by far the most damaging consequences for the wider Yemeni population have been how the conflict has undermined the systems by which the country functions – devastating the economy, social integration, the humanitarian situation and developmental progress. The result is that millions of people in Yemen are now enduring severe economic deprivation and near-starvation.

In an effort to identify practical and realistic interventions to address the most critical challenges currently facing Yemen, a diverse array of Yemeni social and economic development experts from the public, private, and academic fields gathered for the first Development Champions Forum in Amman, Jordan from April 29 until May 1, 2017. The Forum was part of the “Rethinking Yemen’s Economy” initiative, which aims to identify the country’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 recommendations from the Forum are intended to guide the policy interventions of the international community, regional powers, the Yemeni government and all relevant stakeholders in Yemen.

This brief outlines the priorities identified by participants of the Development Champions Forum as the most critical issues facing Yemen today, and their recommendations for addressing these priorities in the short term. It should be noted, however, that participants widely acknowledged that the underlying cause of the immense suffering facing Yemenis is the ongoing war, and without an end to the war all of the following recommendations will be limited in effect and ultimately unsustainable.

* This policy brief was prepared by the Sana’a Center for Strategic Studies, in coordination with the project partners DeepRoot Consulting and CARPO - Center for Applied Research in Partnership with the Orient.

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EXECUTIVE SUMMARY

As part of the “Rethinking Yemen’s Economy” initiative, the Development Champions Forum met in Amman, Jordan, between April 29 and May 1, 2017, to discuss practical interventions necessary to address the multiple and varied economic challenges facing Yemen. These challenges were identified within three main, if overlapping, categories; the food security crisis, the problems faced by the banking industry, and the collapse of basic service delivery.

In regards to the food crisis, the Development Champions’ recommendations called on the international community to move quickly in fulfilling all aid pledges. The champions also emphasized that aid should be cash-based rather than in-kind assistance whenever possible. They called on all parties to the conflict to work towards removing the logistical and financial obstacles affecting the importation and distribution of food and medical supplies, and to urgently improve the management of major commercial entry points, such as the ports of Hudaydah and Aden.

Regarding the banking sector, the Development Champions’ called on all parties to work towards a united and functioning Central Bank of Yemen (CBY), and stressed on depositing all public revenues in CBY accounts. The champions recommended that international aid funds should be directed to support Yemen’s foreign exchange holdings, in order to facilitate food and medicine imports.

Regarding public service delivery, the champions recommended to focus support on empowering local authorities and building their capacity in service delivery, as well as engaging the Yemeni diaspora in supporting critical service sectors and encouraging international and local NGOs to provide key services where required.

THE FOOD CRISIS

Background

Prior to the current crisis Yemen was already the poorest country in the Middle East and North Africa and highly food insecure, with imports accounting for almost 90% of the country's staple foods. The ongoing conflict has severely curtailed commercial imports and humanitarian aid deliveries from reaching Yemen, while violence within the country and widespread fuel shortages have disrupted internal food distribution networks. These obstacles to food delivery have decreased food availability and dramatically increased food costs, while the conflict has simultaneously devastated per capita purchasing power through the almost complete suspension of normal economic activity, and the consequent increased unemployment and loss of income.

The cumulative result is that in February 2017 the United Nation's Food and Agriculture Organization (FAO) declared Yemen the "largest food security emergency in the world";¹ as of May 2017, the United Nations Office for the Coordination of Humanitarian Affairs (OCHA) stated that 17 million people in Yemen required food assistance, with 7 million of these facing a "food security emergency"² – this is the Phase 4 classification on the UN's Integrated Food Security Phase Classification (IPC) index and the last step before the declaration of famine and humanitarian catastrophe. There are 2.2 million children suffering severe acute malnourishment, with one child dying every ten minutes of preventable causes. Almost every governorate along Yemen's western and southern coast is suffering a food security emergency.

Despite the High-Level Pledging Event for the Humanitarian Crisis in Yemen in Geneva in April – during which various countries and organizations made pledges amounting to \$1.1 billion – as of May 9, 2017, donors had delivered funds amounting to only 18.3% of the United Nation's \$2.1 billion humanitarian appeal for Yemen for 2017.

In light of these circumstances, the Development Champions recommend the following:

1. Countries and organizations that made pledges at the high-level pledging event in April must quickly honor these pledges and deliver the funds to the UN.
2. In conjunction with the need for immediate humanitarian aid and the distribution of food and medicine to the neediest and poorest sections of society, the international humanitarian response must integrate a development lens into humanitarian assistance: supporting the economy, sustaining livelihoods, creating new job opportunities (while preserving existing ones), and promoting entrepreneurship.
3. There is a need for the international community to support functional national development and welfare institutions – such as the Social Fund for Development, the Public Works Project, the Social Welfare Fund and active civil society organizations – and ensure that these institutions, and any funds they receive, are protected from political polarization by the current conflict.
4. When providing humanitarian aid, cash transfers should be given priority whenever possible, rather than the distribution of in-kind items that distort local market

1) FAO (February 2017): Yemen: Situation report, available online at <http://www.fao.org/resilience/resources/resources-detail/en/c/470413/> (accessed May 21, 2017).

2) YOCHA (May 2017): Yemen: Humanitarian snapshot - food insecurity and population displacement, available online at http://reliefweb.int/sites/reliefweb.int/files/resources/20170502_yemen_hum_snapshot_final_en.pdf (accessed May 21, 2017).

mechanisms. In this context, participants would like to remind the donors and INGOs of the recommendations of the High Level Panel on Humanitarian Cash Transfers.³ If in-kind humanitarian distribution is necessary, priority should be given to purchasing these in-kind items from local manufacturers and suppliers to ensure sustaining local job opportunities and mitigating the collapse of the Yemeni private sector.

5. Modern technology should be utilized in the distribution of cash aid, as it can help minimize costs, corruption and/or the duplication of aid delivery. These technologies could include mobile E-Money and fingerprint technologies.
6. Women should be specifically targeted and empowered when providing cash transfers, as participants believe that Yemeni women are more cautious spenders, as per the survival needs and priorities of their families, than men.
7. Platforms and mechanisms for coordination, consultation and experience sharing between the Yemeni private sector, donors and the organizations working in the relief sector should be established. There is as yet no mechanism for such collaboration and coordination, and such could rapidly and significantly benefit humanitarian efforts in Yemen.
8. Transparency, monitoring and evaluation capacities of civil society organizations need to be promoted to ensure that humanitarian aid is delivered effectively and efficiently to those in need.
9. Innovative mechanisms should be explored through which donors can help reduce the costs borne by food importers, in turn helping to lower the market price of food. To this end the Development Champions recommend:
 - Accelerating the setup of the Trade Finance Facility for Food Imports announced by the World Bank Group in April 2017 to assist importers in securing foreign currency for food imports to Yemen.
 - Creating a mechanism or a facility by the donors to cover the costs of Country and War Risk Insurance for shipments to Yemen.
10. The management of the ports of al-Hudaydah and Aden need to be improved in order to increase the efficiency of their operations. Challenges facing importers at the ports also need to be addressed, such as the monopoly over transportation and trucking services, and the need for new cranes to increase offloading capacity.
11. Freedom of mobility between major cities needs to be ensured by pressuring the various warring parties to secure the main roads and control checkpoints, in turn facilitating commercial and civilian movement.

CHALLENGES FACING THE BANKING SECTOR

Background

Security and political instability in Yemen since the early 2000s, the country's association with terrorism and arms smuggling, as well as weak governance and judicial structures, made Yemen a "high-risk" country for the global financial system. Shortly after 2010, American banks then began closing the accounts of Yemeni banks in the United States, which increased

3) ODI (2015): Doing cash differently: How cash transfers can transform humanitarian aid. Report of the High Level Panel on Humanitarian Cash Transfers, London, available online at <https://www.odi.org/sites/odi.org.uk/files/odi-assets/publications-opinion-files/9828.pdf> (accessed May 21, 2017).

the burden and costs foreign banks sustained when dealing with Yemeni banks. With the start of the current conflict and Yemen coming under UN Chapter 7 jurisdiction, large European and American banks ceased to interact with Yemeni banks completely, compounding the burden and costs of international transfers to and from Yemen.

Yemeni banks were then prohibited from sending physical cash to foreign correspondent banks, leading to a large decline in the accounts of Yemeni banks at these foreign correspondent banks. Yemeni commercial banks became unable to meet the needs of Yemeni importers, in turn driving importers to the black market and money exchangers to buy and sell currency and make international payments, drawing liquidity out of the Yemeni banking sector. Yemeni banks became both unable to honor customer requests to withdraw cash – leading to further hoarding outside the banking system – and had no domestic currency to deposit at the Central Bank of Yemen. These multiple, interrelated and mutually reinforcing factors helped instigate a severe public sector cash liquidity crisis in mid-2016.

A further central challenge facing Yemen's banking sector is the deterioration of the Central Bank of Yemen's (CBY) ability to steward the economy. As a result of the armed conflict the Yemeni government lost the vast majority of its revenue resources – such as oil exports, which had been the government's main source of foreign currency – leading to the depletion of foreign reserves through two years of war. Following the relocation of the CBY headquarters from Sana'a to Aden in September 2016, the CBY also lost the capacity to perform most central bank functions.

In light of these circumstances, the Development Champions recommend the following:

1. Priority should be given to the rapid restoration of oil and gas production and export, as it is the main source of revenue for Yemen, while ensuring that all state and public sector revenues across Yemen (revenues of oil and gas sales, taxes, customs, revenues of public companies, etc.) must be directed to the CBY and its branches in all governorates (as has been the case historically).
2. The central bank has to be re-established as a single, cohesive institution. All parties thus need to recognize the relocation of the CBY headquarters to Aden, where the functions of government accounts management, liquidity management, and the management of external reserves should be administered. The remaining CBY functions should be under the supervision of the CBY leadership but remain in Sana'a, where long-invested-in human resources and institutional capacity reside. Such a separation of duties is necessary due to the fact that the current legitimate seat of the CBY is in Aden, but it is unable to fulfill most functions of a central bank, and building a new institution in Aden with the required capacities would take years. To this end the Development Champions recommend:
 - Taking urgent steps to rebuild trust between the two CBY units in Sana'a and Aden. These steps could include efforts by economics experts respected by all local sides to support the work of the CBY, build consensus, and propose solutions that could restore the CBY's stewardship of the Yemeni economy. For these efforts to succeed, it is critical that the CBY leadership is permanently based inside Yemen where it can effectively communicate with banks and various economic sectors, and fully administer its functions.
 - Allowing the technical management to exercise its functions independently and free from interference, political or otherwise, in its work.

- Urging donors, especially GCC countries, to boost the external reserves of the CBY by depositing foreign currency in its accounts and provide direct support to finance the state budget deficit, which would allow the government to avoid financing the budget from inflationary resources that could exacerbate Yemen's humanitarian crisis.
 - Urgently reactivating the CBY's clearing house functions.
 - Urging members of the Saudi-led coalition to allow Yemeni banks to transfer surplus cash in foreign currency abroad.
 - Taking steps to secure CBY transfers of physical cash between cities either by plane or land.
3. INGOs currently receive aid money in foreign currency, but need to disburse it in Yemeni rials for their local operations in Yemen. The banks can only provide them with Yemeni rials at the official exchange rate, which is currently at least 45% lower than the black market rate. In effect this means the end beneficiaries receive only 55% of aid money while some banks benefit from the difference. On the other hand, food importers face extreme challenges in securing foreign currency to pay for their food imports. Therefore, the Champions recommend:
 - Establishing a special exchange rate by the CBY for INGOs operating in the country that is lower than the black market rate but higher than the official exchange rate.
 - Establishing a special fund to deposit transfers of humanitarian and development aid grants in foreign currency, and have these funds accessible by importers of basic commodities in Yemen, while INGOs have access to the equivalent amounts in YER at the agreed exchange rate with the CBY in Yemen. The special fund can be managed by an international institution in close coordination with the CBY in order to direct it towards the importation of basic commodities (food, medicine...etc).
 4. The Financial Information Unit (FIU) at the CBY has to be re-activated and a technical team appointed to attend the international Financial Action Task Force (FATF) meetings. Such measures are important to begin the process of removing Yemen from the "high-risk" category, which would reduce the obstacles Yemeni banks face when interacting with the global financial system
 5. At least some commercial bank deposits currently held at the CBY need to be released to allow commercial banks to pay the interest on customer deposits in cash, thus restoring confidence in the banking sector.

THE COLLAPSE OF BASIC PUBLIC SERVICES

Background

Basic public service delivery in Yemen has long been inconsistent and focused on urban areas; for instance, even before the current conflict almost none of rural Yemen was connected to the national electricity grid. Since the beginning of the current crisis, however, two factors in particular have led to an almost complete erosion of most public services. First, the steep loss in public revenues: Oil exports – previously two-thirds of government revenue – have been stopped completely due to the conflict, with tax and tariff revenue also plummeting amidst general economic collapse; in response, the government authorities cut all non-essential spending in 2015 and focused expenditures on continuing to provide public sector salaries

only. Second, the discontinuation of public sector salaries in September 2016 due to a severe public sector cash liquidity crisis (mentioned above): as of May 2017, the vast majority of Yemen's 1.2 million public servants have not received their salaries for seven months.

Public service delivery has thus been decimated, helping to undermine many of the systems Yemenis depend upon. For instance: garbage has piled in the streets uncollected and waste management systems have broken down in many cities, helping to create a rapidly spreading cholera outbreak; roughly half of Yemen's public healthcare facilities are no longer operational, and major shortages in staff and medicine have left those still open only partially functioning; the UN has also reported that some 4.5 million school children may not finish the school year because of the disruption in public education.

In light of these circumstances, the Development Champions recommend the following:

1. Encourage and facilitate the work of local and international NGOs, as well as community initiatives, to provide basic services to the poorest and low-income citizens.
2. Find mechanisms to engage the Yemeni diaspora in supporting key sectors, such as healthcare and education.
3. Transfer more power from the central authorities to the municipalities regarding basic service provision and concentrate international support efforts on local authorities, as they are more effective bodies operating closer to beneficiaries.
4. Support public service delivery in stable governorates to create models for other governorates to aspire to; seeing that peace brings dividends in stable governorates can motivate other governorates towards peace.
5. Provide emergency solutions to address the chronic problems facing reliable electricity provision, taking into account the severe problems faced during the summer months in coastal areas. In addition, discourage government authorities from generating high-cost diesel electricity and encourage cheaper and more sustainable alternatives.
6. Provide mechanisms to finance and equip alternative energy (solar power) usage in agriculture, schools and households.
7. Monitor humanitarian and development aid to ensure the fullest possible coverage across the country, in particular prioritizing the most affected areas that donors often overlook or avoid.
8. Support the rejuvenation of Yemen's transportation networks. Specifically:
 - Maintain the Road Maintenance Fund and provide emergency support for the protection and maintenance of the central road network.
 - Reopen all airports, specifically Sana'a Airport, al-Hudaydah Airport and al-Mukalla Airport.
 - Increase the efficiency of seaports – such as Aden, al-Hudaydah, al-Mukalla and Mocha ports, as well as land border crossings, especially the highly important al-Wadi'a border crossing.

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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, we 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, we will implement consultation workshops with local stakeholders, including the private sector, youth and civil society organizations; moreover, we will conduct campaigns through both traditional and social media outlets to engage the wider Yemeni public; (4) and through regional and international engagement we 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.

Implementing Partners

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



The Sana'a Center for Strategic Studies (SCSS) is an independent policy and research think-tank that provides new approaches to understanding Yemen and the surrounding region, through balanced perspectives, in-depth studies and expert analysis. Founded in 2014, the SCSS conducts research and consultations in the fields of political, economic, civil and social development, in addition to providing technical and analytical advice regarding key issues of local, regional and international concern. www.sanaacenter.org



DeepRoot Consulting is a dynamic social enterprise passionate about Yemen’s development. DeepRoot aims to help international development actors, the private sector, local civil society organizations and the Yemeni Government anchor their interventions in a deep understanding of Yemen’s national and local contexts, and international best practices. Our leadership team and advisory board has decades of combined experience working in Yemen and internationally in the public, private and nonprofit sectors. www.deeproot.consulting



The Center for Applied Research in Partnership with the Orient (CARPO) is a Germany-based organization whose work is situated at the nexus of research, consultancy and exchange with a focus on implementing projects in close cooperation and partnership with stakeholders in the Middle East. The CARPO team has long-standing experience in the implementation of projects in cooperation with partners from the region and a deep understanding of the Yemeni context. www.carpo-bonn.org