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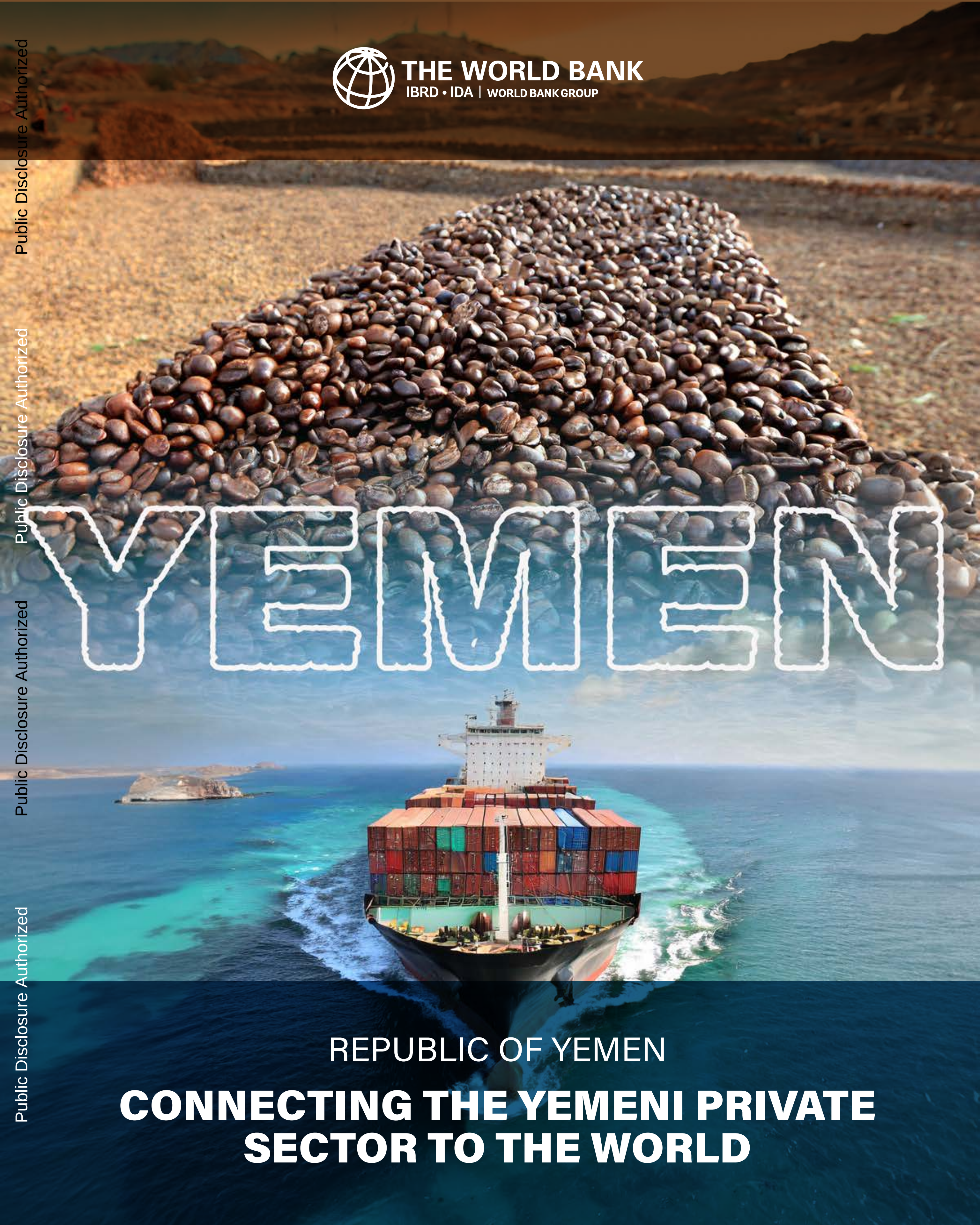

YEMEN

REPUBLIC OF YEMEN

CONNECTING THE YEMENI PRIVATE SECTOR TO THE WORLD

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Acknowledgments

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Acronym	Description
CBY	Central Bank of Yemen
CISG	Convention on Contracts for the International Sale of Goods
DFA	de facto authority
EU	European Union
FDI	foreign direct investment
GDP	gross domestic product
ICT	information and communication technology
IEC	integrated economic community
IFC	International Finance Corporation
IMF	International Monetary Fund
INSOL	International Federation of Insolvency Professionals
IRG	Internationally Recognized Government of the Republic of Yemen
LDC	least-developed country
LGA	local government authority
MENA	Middle East and North Africa
MFB	microfinance bank
MFI	microfinance institution
MLETR	Model Law on Electronic Transferrable Records
MSME	micro, small, and medium enterprise
NGO	nongovernmental organization
OECD	Organisation for Economic Co-operation and Development
SFD	Social Fund for Development
SMEPS	Small and Micro Enterprise Promotion Service
UNCITRAL	United Nations Commission on International Trade Law

UNDP	United Nations Development Program
UNIDROIT	International Institute for the Unification of Private Law
WTO	World Trade Organization

Chapter 1.
Executive Summary

INTRODUCTION

This Private Sector Assessment Report on the Republic of Yemen is delivered as part of the Private Sector Technical Assistance project.[1] The goal of the project is to understand the dynamics of the country's private sector during conflict; identify constraints to trade, investment, and finance; and propose recommendations for inclusive private sector entry, survival, and growth.

The report also includes an overview of the financial sector's impact on the private sector, especially on the latter's resilience during conflict. Finally, the report provides structural and policy recommendations that, once implemented by the authorities on both national and subnational levels, would prepare the Yemeni private sector to participate in the country's post-conflict recovery and reconstruction. Most of the recommendations focus on subnational activities, hence their implementation could start immediately, while the conflict is still ongoing. Therefore, this report advocates that in the case of the Republic of Yemen, the classic reform sequencing from conflict-affected countries—peace to recovery to development—could be triggered in parallel, whereby subnational reforms would contribute to the peace goal (Noumba Um 2023).

This report grows from public-private dialogue, regulatory review, and policy dialogue with active private-sector inputs. It presents a framework through which the Yemeni authorities and the international community should consider financial, structural, and policy interventions to support the Republic of Yemen's private sector reintegration into the global trade, investment, and financial system. It will also address long-standing barriers to inclusive private sector growth, especially for small and medium enterprises, as well as women- and youth-led businesses.

In addition to recommending direct financial support to such key sectors as social protection, food security, energy, agriculture, and transport, the report identifies policy and regulatory reforms that will immediately elevate the status of the Yemeni private and financial sector players as the backbone of the Yemeni economy. It thereby prepares them for opportunities during the rebuilding phase. It also identifies measures to address structural and regulatory problems. This knowledge will help prepare the three distinct segments of the Republic of Yemen's private sector for inclusion in the reconstruction phase: the large formal companies; the 95 percent informal micro, small, and medium enterprises (MSMEs); and the sizeable Yemeni private sector diaspora around the world.

1 The project number is P177361.

The report also proposes measures to address long-delayed reforms that, before the conflict, historically hindered the Republic of Yemen's private sector development and contributed to the country's development as a cash economy with significant economic and financial inclusion gaps. The exclusion, marginalization, and informality within huge parts of the private sector are particularly severe in the Republic of Yemen, where only 5 percent of the population and firms are banked and registered, and only 1 percent of women have bank accounts.

Furthermore, this report explores in depth the impact of the conflict on the entire Yemeni economy, with a particular focus on the private and financial sectors. The conflict's impact on imports and exports, markets, investment climate, business environment, and firm capabilities among key sectors is explored in chapter 2. Chapter 3 proposes reform recommendations to address structural and policy constraints. On the policy recommendation side, the emphasis is on reforms that will prepare large firms from the Yemeni private sector to fully integrate into the international trade, investment, and financial systems and allow for their full participation in the recovery and reconstruction phase. At the same time, the reform recommendations advocate for greater economic and financial inclusion of the vast majority of informal, unbanked, and excluded smaller private sector players—MSMEs and women- and youth-led (micro) firms. Considering the financial cost of policy and regulatory reforms, the report emphasizes cost-free policy reforms—ratifying and adopting international agreements, conventions, and model laws that do not require any funding from the internationally recognized government (IRG) of the Republic of Yemen or donors but would provide tremendous opportunities for the Yemeni private sector. These, in turn, would trigger more technical assistance and capacity building from the United Nations, the International Monetary Fund (IMF), the World Trade Organization (WTO), the World Bank and other development financial institutions.

Considering the direct impact of the financial sector on the private sector of the Republic of Yemen, appendix A of the report provides the first comprehensive financial sector overview of the Republic of Yemen since the conflict and proposes specific reform actions. This foundational financial sector work will be used as a basis and analytical underpinning for a follow-on full financial sector assessment of the Republic of Yemen during the conflict, which will be delivered under the Yemen Central Bank technical assistance effort led by the World Bank.

As an output of a thorough regulatory review, appendix B of the report proposes a comprehensive list of key private-sector UNCITRAL instruments for adoption by the Yemeni authorities. These international conventions, agreements, and model laws will immediately allow the reintegration of the Yemeni private sector into the global trade, investment, and financial system. This is a very high priority considering that 90 percent of the food and essential commodities are imported. The lack of basic legal frameworks prevents quick and reliable food imports, payments, and movement of goods and capital as it increases the time and cost of delivery, which is eventually borne by the Yemeni population.

Considering the fragmentation of reliable government data, the lack of World Bank presence on the ground, and the overall difficulties of data gathering in highly informal economies like the Republic of Yemen, the team has invoked and enlisted innovative data-gathering sources, including from private sector associations on the ground, semigovernment Yemeni authorities, and the Yemeni diaspora. It has also engaged with a broad range of developing partners, including the Yemeni nationals working for the World Bank, IMF, and the International Finance Corporation. On the regulatory review side, the project has conducted data-gathering exercises with key international players in private sector regulations, such as the UN Commission for International Trade Law (UNCITRAL), the UN Conference on Trade and Development (UNCTAD), the International Institute for the Unification of Private Law (UNIDROIT), and the WTO.

The report's storyline is centered around the following key sections:

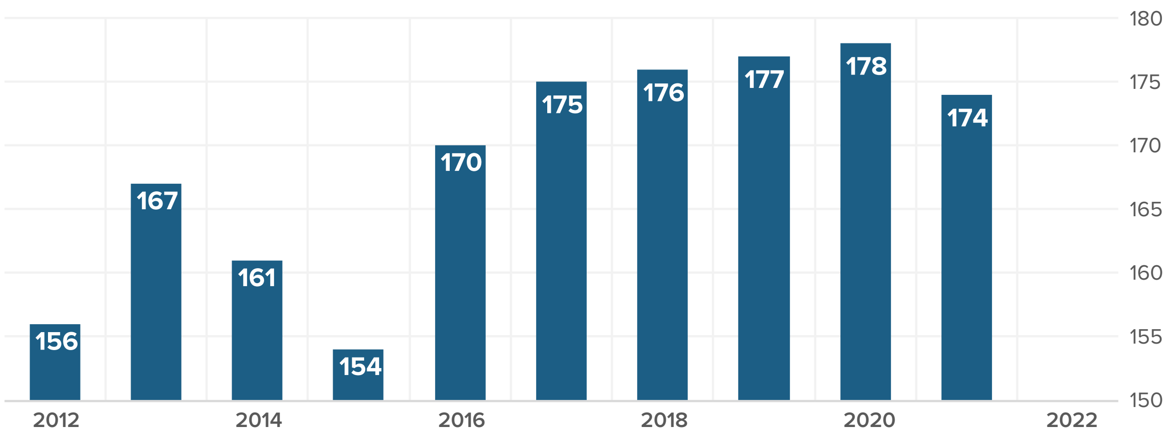
- The uniqueness of the Yemeni private sector context before and during the conflict
- Assessment of the conflict's impact on the private sector by comparatively analyzing key indicators before and after the conflict—economywide and for specific key sectors
- Identification of key structural and policy constraints for inclusive private sector growth and reforms to support the resilience of the private sector
- List of immediate reform actions to prepare the Yemeni private sector for the reconstruction phase by addressing major regulatory barriers in trade, finance, and investment that impede the whole private sector in the Republic of Yemen—from the biggest to the smallest players.

COUNTRY CONTEXT

The Republic of Yemen is at the southern end of the Arabian Peninsula. It shares land borders with Saudi Arabia to the North and Oman to the northeast, and maritime borders with Eritrea, Djibouti, and Somalia. The country's population of more than 30 million covers an area of 555,000 square kilometers (214,000 square miles) with a coastline stretching about 2,000 kilometers (1,200 miles).

Today, the Republic of Yemen is one of the world's poorest and most fragile countries. It ranked highest on the 2020 Fragile State Index, the second lowest on the Global Hunger Index, and the lowest on the Human Development Index (UNDP 2022). In addition, over several years, the country has recorded a dire performance in development indicators such as corruption (figure 1.1), economic competitiveness, inclusion (particularly along gender lines), and the quality of its business environment and investment climate (Transparency International n.d.).

Figure 1.1 The Republic of Yemen's Corruption Perceptions



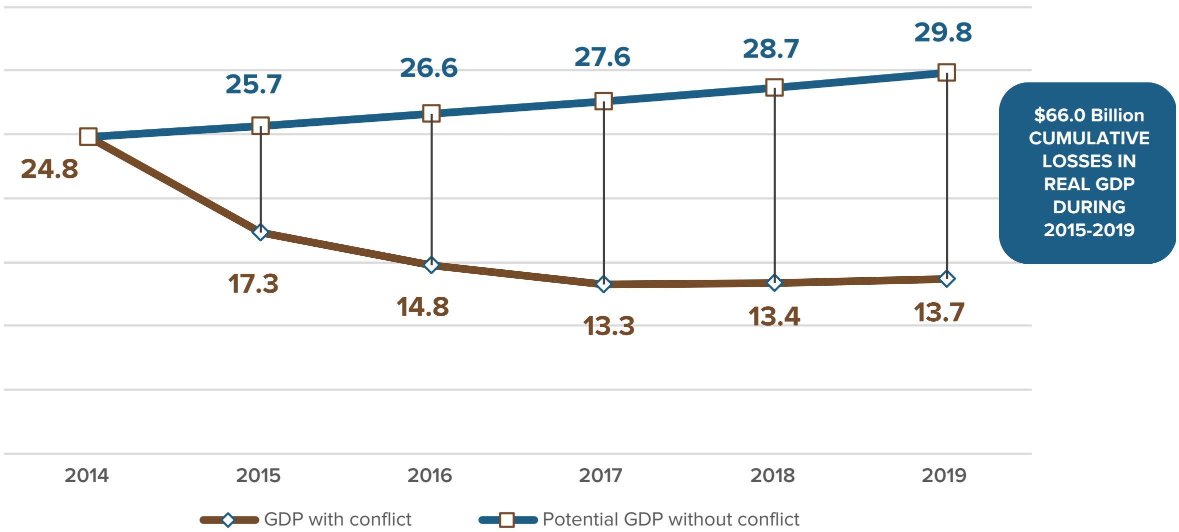
Source: Tradingeconomics.com, Transparency International.

Following the 1990 unification of North and South Yemen, the country has functioned as a complex, multilayered society with predominantly informal economic behaviors and hierarchies. This context favors traditional, tribal allegiances and institutions of governance, especially in the vast rural areas. In parallel, urban elites and pockets of civil structures carry the rest of the society to greater modernization in terms of access to formal education, better infrastructure, and more cosmopolitan influences.

Since 2011, the Republic of Yemen has been in a state of political crisis, which culminated in a conflict that started in 2014. The conflict's key players mirror the country's geopolitical contrast. First, the northern highlands-based socioeconomic ecosystem is ruled by Houthis (also known as the de-facto authority or DFA), who control a large portion of the population and economy. The middle and coastal regions in some of the west, south, and desert areas toward Oman are officially ruled by the IRG of the Republic of Yemen.

The World Food Program estimates that the Republic of Yemen's gross domestic product (GDP) has cumulatively contracted by 50 percent since 2015 (WFP 2018). The accumulated loss in real GDP from 2015 to 2019 is estimated at US$66 billion (MOPIC 2020) (see Figure 1.2). In addition, the ongoing conflict, including blockades, has halted the country's exports, put pressure on the currency exchange rate, accelerated inflation, severely limited food and fuel imports, and caused widespread damage to the infrastructure and economy. As a result, the per capita share of GDP decreased from US$1,191 in 2014 to just US$364 in 2019 (equivalent market exchange rate), representing a cumulative decrease of 69.5 percent (MOPIC 2020).

Figure 1.2 Lost Opportunity Cost in Real GDP (US$ billions) 2015–19



Source: MOPIC, Economic Studies, and Forecasting Sector, 2019.

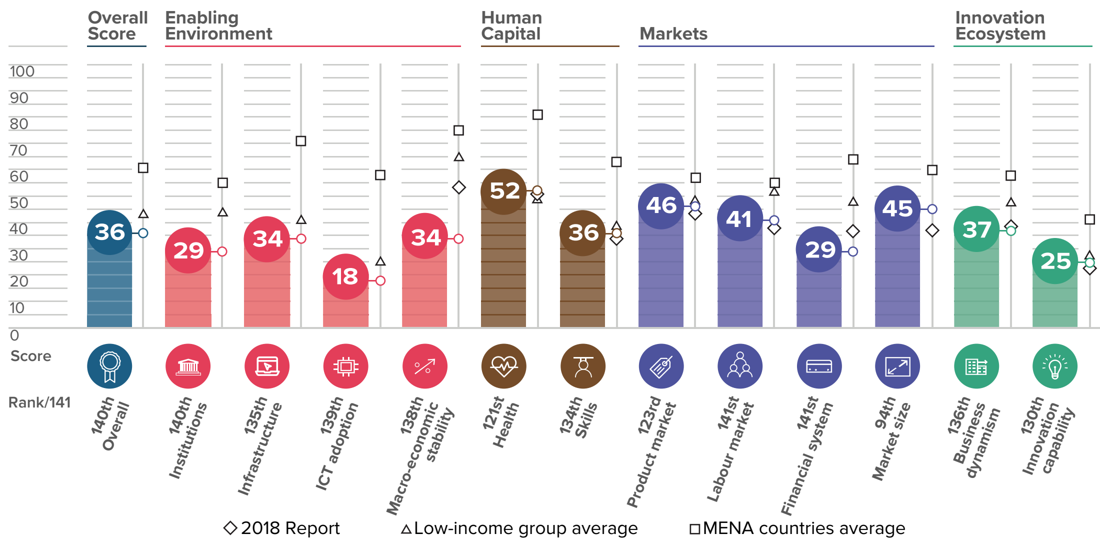
Other indicators also show the impact of the decade-long shortcomings of the Republic of Yemen's business environment and investment climate on the economy's competitiveness. The Human Development Index for the Republic of Yemen was 0.470 in 2019, placing the country in the low human development category and positioning it 179th out of 189 countries and territories (Figure 1.3).

Figure 1.3 The Republic of Yemen's Human Development Index

		Human Development Index (HDI)	Inequality-adjusted HDI (IHDI)			Coefficient of human inequality	Inequality in life expectancy	Inequality-adjusted life expectancy index	Inequality in education[f]	Inequality-adjusted education index	Inequality in income[f]	Inequality-adjusted income index	SDG 10.1 Income shares held by (%)			Gini coefficient
		Value	Value	Overall loss (%)	Difference from HDI rank		(%)	Value	(%)	Value	(%)	Value	Poorest 40 percent	Richest 10 percent	Richest 1 percent	
HDI RANK		2019	2019	2019	2019	2019	2015–2020	2019	2019	2019	2019	2019	2010–2018	2010–2018	2010–2017	2010–2018
170	Sudan	0.510	0.333	34.7	–3	34.3	27.4	0.506	42.5	0.198	33.0	0.369	19.9	27.8	11.2	34.2
172	Gambia	0.496	0.335	32.5	1	31.2	28.5	0.463	47.7	0.213	17.5	0.384	19.0	28.7	13.4	35.9
173	Ethiopia	0.485	0.348	28.2	8	27.3	24.9	0.538	43.5	0.193	13.4	0.405	19.4	28.5	14.3	35.0
174	Malawi	0.483	0.345	28.6	5	28.6	25.1	0.510	28.4	0.336	32.4	0.239	16.2	38.1	31.1	44.7
175	Congo (Democratic Republic of the)	0.480	0.335	30.2	4	30.2	36.1	0.400	26.8	0.363	27.6	0.258	15.5	32.0	18.1	42.1
175	Guinea-Bissau	0.480	0.300	37.5	–7	37.4	32.3	0.399	41.9	0.240	37.9	0.281	12.8	42.0	19.3	50.7
175	Liberia	0.480	0.325	32.3	1	31.8	29.8	0.476	42.9	0.243	22.7	0.296	18.8	27.1	12.0	35.3
178	Guinea	0.477	0.313	34.4	0	33.1	31.3	0.440	50.1	0.176	17.8	0.395	19.8	26.4	12.4	33.7
179	Yemen	**0.470**	0.321	31.7	4	30.9	24.7	0.534	46.1	0.189	21.8	0.327	18.8	29.4	15.7	36.7
180	Eritrea	0.459	..	..	..	..	21.4	0.560	..	..	..	..	..	..	14.3	..
181	Mozambique	0.456	0.316	30.7	4	30.7	29.8	0.441	33.8	0.262	28.4	0.273	11.8	45.5	30.9	54.0
182	Burkina Faso	0.452	0.316	30.1	5	29.5	32.0	0.435	39.2	0.190	17.3	0.382	20.0	29.6	14.3	35.3
182	Sierra Leone	0.452	0.291	35.6	–2	34.5	39.0	0.326	46.9	0.216	17.7	0.350	19.6	29.4	10.5	35.7
184	Mali	0.434	0.289	33.4	–1	32.4	36.7	0.383	43.9	0.160	16.6	0.393	20.1[f]	25.7[f]	9.5	33.0[f]
185	Burundi	0.433	0.303	30.0	5	29.6	28.5	0.457	39.5	0.252	20.9	0.241	17.9	31.0	14.6	38.6
185	South Sudan	0.433	0.276	36.3	–2	36.0	36.2	0.372	39.6	0.185	32.3	0.307	12.5[f]	33.2[f]	14.1	46.3[f]
187	Chad	0.398	0.248	37.7	–1	37.4	40.9	0.311	43.0	0.164	28.4	0.297	14.6	32.4	15.6	43.3
188	Central African Republic	0.397	0.232	41.6	–1	41.3	40.1	0.307	34.5	0.231	49.2	0.176	10.3[g]	46.2	30.9	56.2[g]
189	Niger	0.394	0.284	27.9	3	27.4	30.9	0.451	35.0	0.162	16.4	0.314	19.6	27.0	11.4	34.3

Source: Human Development Report 2020, Copyright @ 2020 By the United Nations Development Programme 1 UN Plaza, New York, NY 10017 USA

Figure 1.4 The Republic of Yemen's Global Competitiveness Ranking (140/141 in 2019)



Source: Global Competitiveness Index 2019.

On the public sector side, the conflict has devastated the country's institutions, resulting in fragmentation and a lack of coordination on all local and national executive levels. The bifurcation of the administration, political instability, insecurity, and disruption of service delivery have also undermined the already inadequate business environment. Furthermore, the absence of unified macroeconomic policy implementation, significant revenue underperformance, and continued monetization of the fiscal deficit have undermined macroeconomic stability and aggravated market distortions. This has resulted in considerable variation in the exchange rate between the IRG-controlled areas and areas under the control of Houthis, leading to differences in cash and check transactions. Finally, the conflict has resulted in a humanitarian crisis rife with famine and disease, causing an almost total dependency on food imports and massive humanitarian aid.

On the private sector side, the Republic of Yemen's firms and entrepreneurs face several challenges, including macroeconomic issues, weak institutions, an unfavorable business environment, and additional structural vulnerabilities. The preponderance of family businesses and MSMEs renders the business environment less resilient to shocks and crises than a formal sector would normally be. Moreover, the private sector faces a fragile and inadequate supportive infrastructure, including low electricity coverage, insufficient water distribution networks, and inadequate transportation and telecommunication services. The absence of a robust financial market and innovation and the minimal use of information and communication technology (ICT) tools exacerbate the situation.

The Republic of Yemen's private sector can also be viewed as a dual-economy model, partitioned along enterprise size, formality, self-bankability, political affiliation or financial innovation. These are highly correlated and historically determined by deeply entrenched cultural characteristics prioritizing tribal loyalties and regional allegiances. The creation of large, formal, highly successful, and sophisticated business enterprises, most of them highly integrated turnkey conglomerates, which are few but overwhelmingly powerful and successful even during the conflict, began with the establishment of large trading houses along tribal and regional lines in the southern and northern parts of the Republic of Yemen and in diaspora communities, especially in Africa and among the Arab Gulf countries.

Ninety percent of private enterprises in the Republic of Yemen operate in the service industry. This includes retail and wholesale trade, hospitality, ICT, construction, transport, health, education, and other professional and vocational services. Only 10 percent of MSMEs operate in the production or infrastructure-oriented "real" and "tradeable" sectors such as agriculture, fishing, manufacturing, mining, and utilities like water and energy. The retail trade sector alone accounts for about 40 percent of total private enterprises, followed by personal service and office workers, including hairdressers, tailors, librarians, stationery store workers, and so forth (11.8 percent); health care facilities (10.8 percent); wholesale trade (8.9 percent); education (5.9 percent); manufacturing (5.8 percent); and business services (4.4 percent).

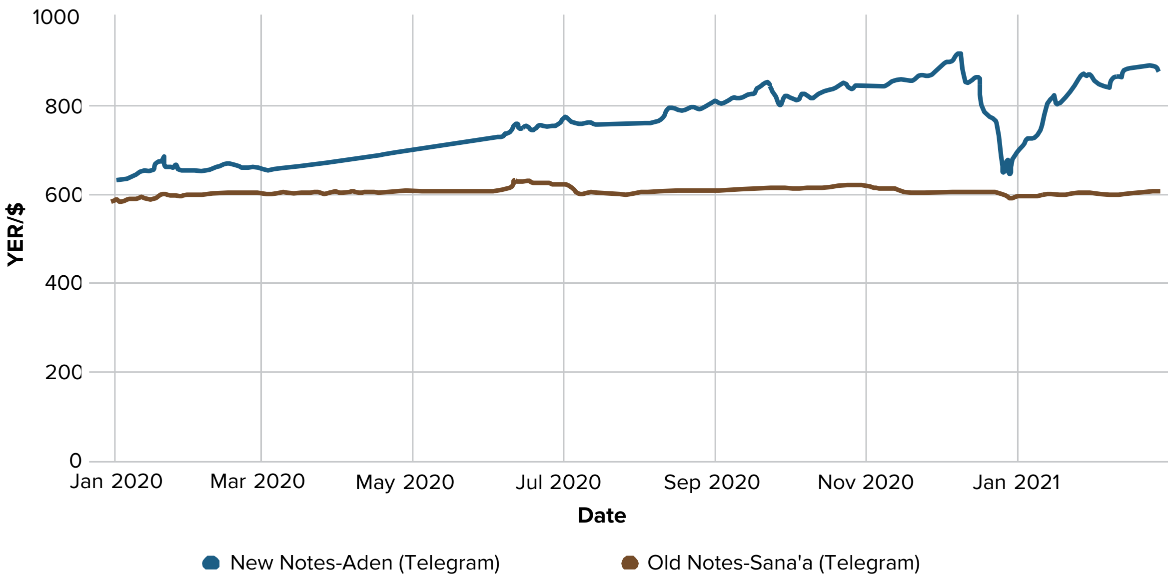
Less than 4 percent of private enterprises are large. MSMEs comprise micro (46 percent), small (36 percent), and medium (14 percent) enterprises. Medium and large enterprises are concentrated in the following four governorates: the capital city of Sana'a at 41 percent and 36 percent, respectively, followed by Aden at 13 percent and 22 percent, Hadhramout at 18 percent and 11.6 percent, and finally Taiz at 8.1 percent and 11.6 percent.

The low level of industrialization in the Republic of Yemen also accounts for its unfavorable terms of trade. The predominant exports are raw materials (from agrarian and maritime products to mining ore and hydrocarbons and to waste or scrap materials), which are reprocessed overseas by more technologically advanced countries (with greater availability of electric power, ICT capacity, a skilled workforce, more favorable industrial and competition policies, and more stable and peaceful governance). These countries sell the finished products back to the Republic of Yemen at highly marked-up prices. However, the continued operation of some light manufacturing by artisans and small machining factories, even under challenging conditions, indicates the potential for the Republic of Yemen to build on this initial base for the accelerated scaling-up of domestic industrialization and import substitution under more conducive conditions.

In 2020, the COVID-19 pandemic and an exceptional rainy season in the Republic of Yemen compounded the situation with additional challenges. Non-oil economic activity suffered significantly from the pandemic-related trade slowdown. Foreign exchange shortages deepened further with the near depletion of Saudi Arabia's primary import finance fund, reducing oil exports and downsizing humanitarian assistance. The only other external source for foreign currency inflows, remittances from Yemeni expatriate workers, also declined during the pandemic.

The situation has been further complicated by growing internal displacement and migration and the long-standing marginalization of women. Additional displacement has resulted from conflict, cyclones, flooding, deteriorating public services, and economic necessity, and has become a driver for poverty (see Figure 1.5). As a result, the Republic of Yemen ranked 155 out of 156 countries in the 2021 World Economic Forum's Global Gender Gap Index and was not included in the 2022 ranking WEF 2021, 2022). The conflict has further constrained women's already limited opportunities to access economic activities, as their mobility and participation in the public sphere have decreased. About 76 percent of internally displaced people are women and children (World Bank 2020).

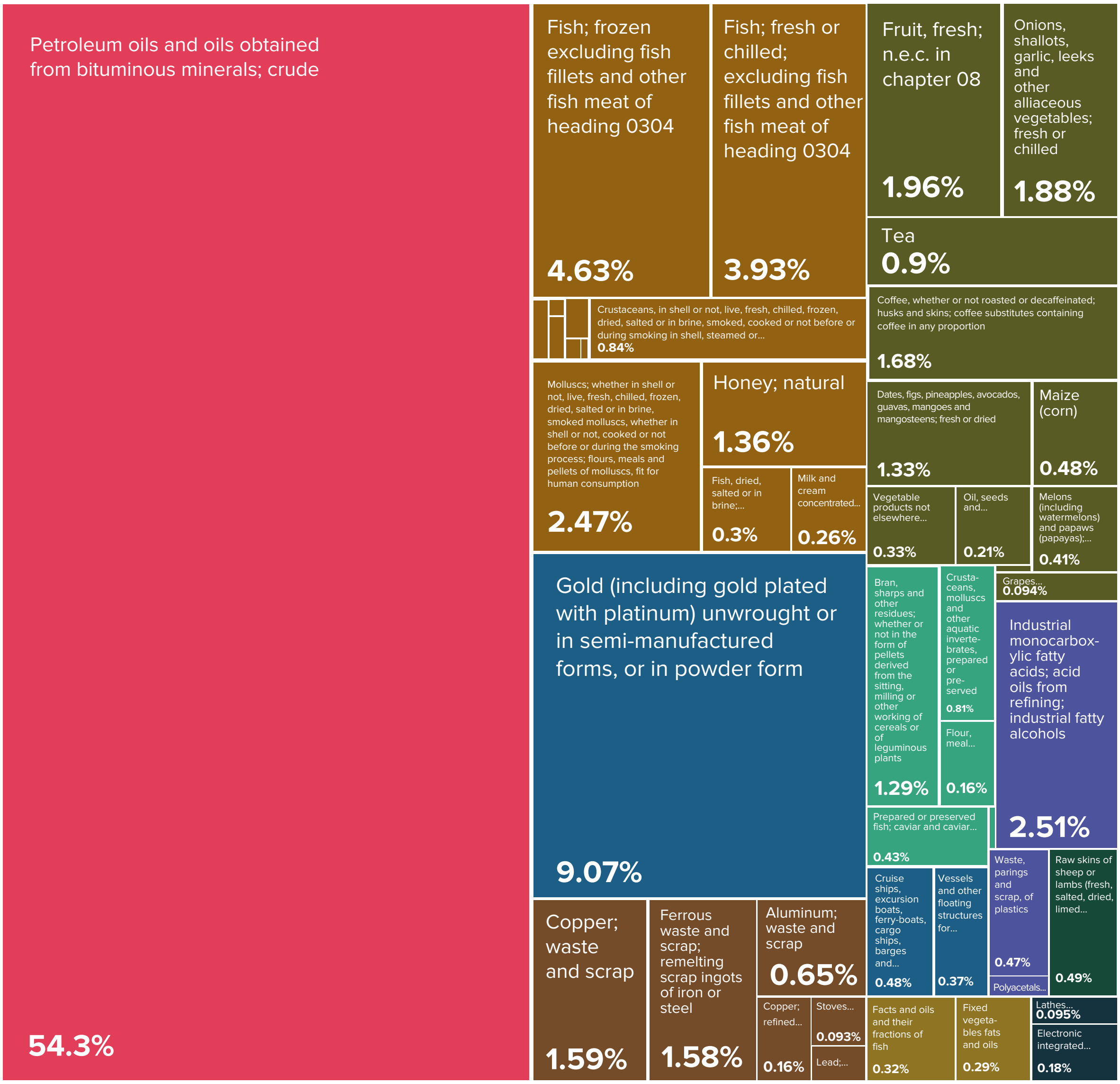
Figure 1.5 The Republic of Yemen Economy Tracker



Source: Yemen Economy Tracker Initiative, https://yemen.yeti.acaps.org.

In 2020, the Republic of Yemen's total exports reached US$1.26 billion, with the most significant export categories as follows: crude petroleum (US$682 million), gold (US$114 million), non-fillet frozen fish (US$58.1 million), non-fillet fresh fish (US$49.4 million), and industrial fatty acids, oils and alcohols (US$31.6 million). (See Figure 1.6).

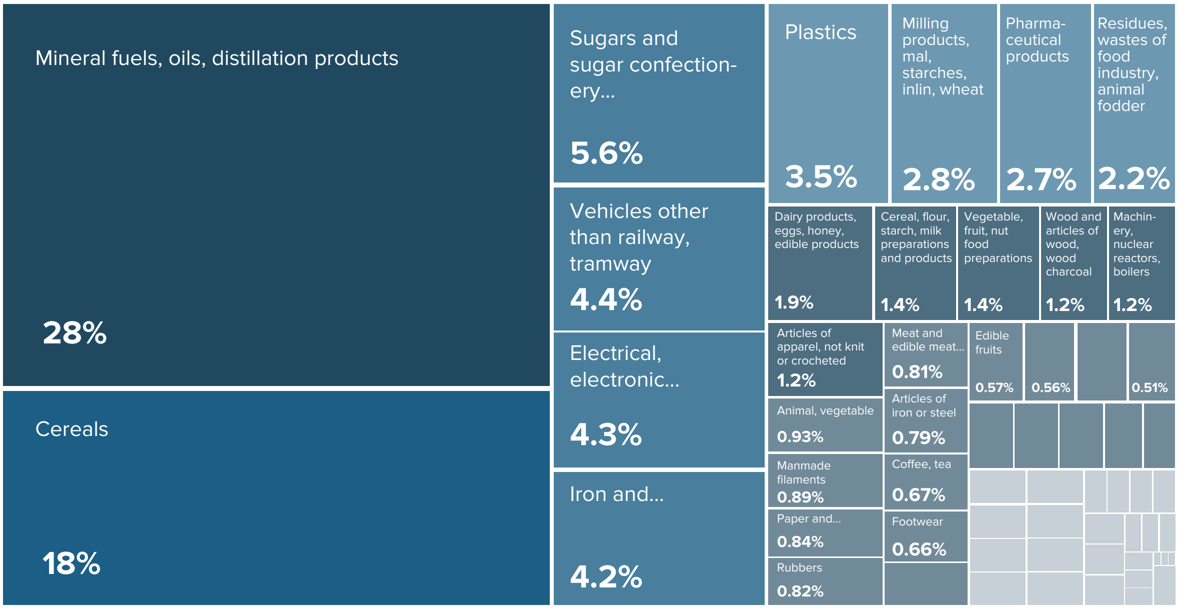
Figure 1.6 The Republic of Yemen's Exports in 2020 by Share Product Category



Source: Yemen (YEM) Exports, Imports, and Trade Partners | The Observatory of Economic Complexity (oec.world).

In 2020, the country's total imports reached US$10.5 billion, with the largest input categories as follows: wheat (US$674 million), rice (US$395 million), raw iron bars (US$363 million), cars (US$354 million), and raw sugar (US$342 million). (See Figure 1.7).

Figure 1.7 The Republic of Yemen's Imports in 2020 by Share of Product Categories



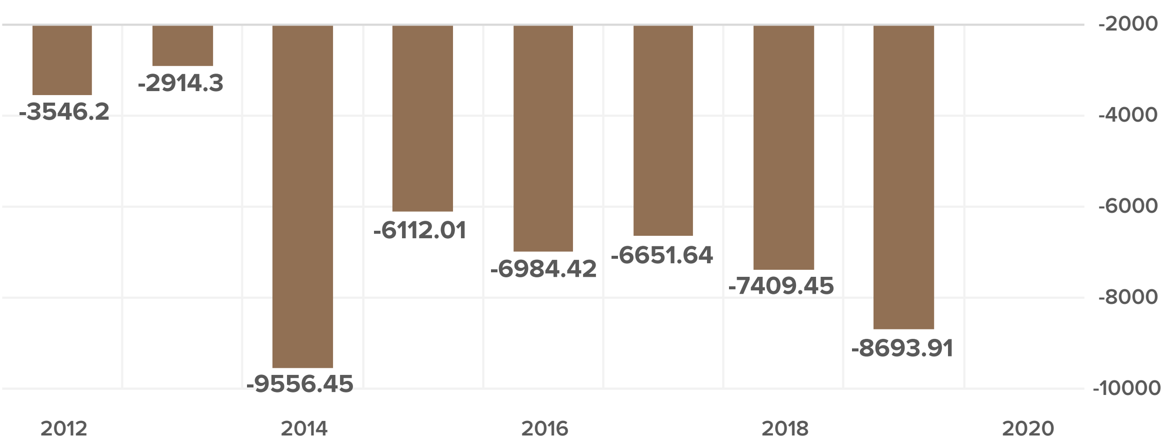
Source: Yemen (YEM) Exports, Imports, and Trade Partners | The Observatory of Economic Complexity (oec.world).

THE CONFLICT'S IMPACT ON THE PRIVATE SECTOR (STRUCTURAL CONSTRAINTS)

The ongoing conflict has disrupted supply chains and trade routes, making it difficult for the private sector to import and export goods. In addition, ports, roads, and other infrastructure have been damaged or destroyed, and the checkpoints established by various armed groups have led to delays and increased costs. It has also made it difficult for businesses to access the inputs they need to operate, resulting in decreased production and reduced competitiveness.

The destruction of infrastructure and trade roads has had an unprecedented impact on the Republic of Yemen's balance of trade (figure 1.8). For example, the military confrontations that led to the closure of the land borders with Saudi Arabia have primarily affected local agriculture and fisheries, resulting in a cumulative 80.3 percent decline in exports. This includes 88.2 percent for fisheries, 81.1 percent for vegetables and fruits, and 88.5 percent for honey and coffee combined.

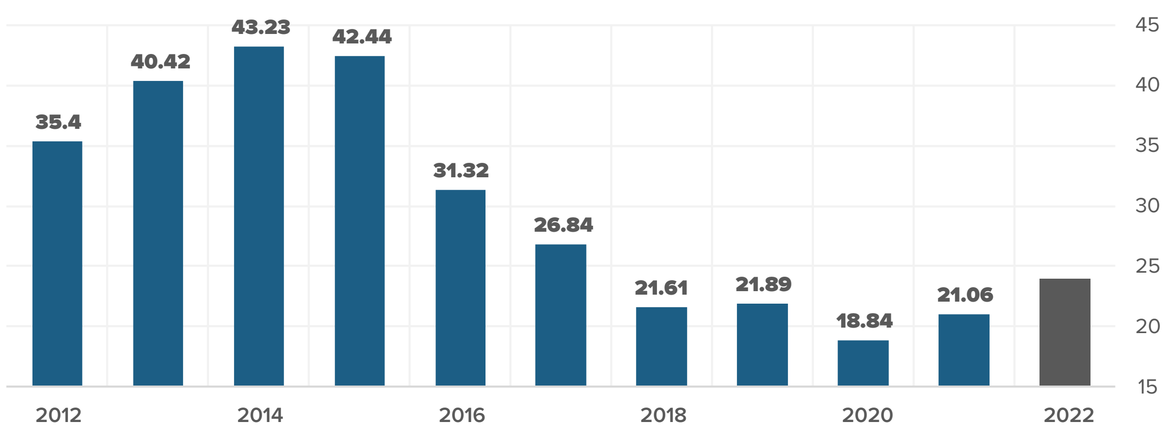
Figure 1.8 The Republic of Yemen's Balance of Trade (US$ millions)



Source: Tradingeconomics.com, Transparency International.

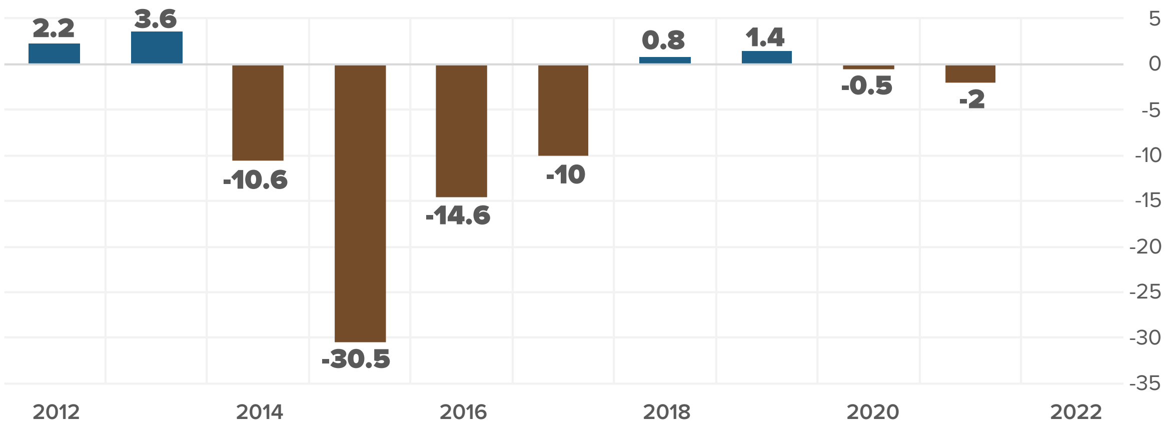
The conflict has devastated the Yemeni economy, leading to dramatic reductions in GDP. However, the most significant decline occurred in 2020 due to the impact of the COVID-19 pandemic, when the annual GDP reached less than half the 2014 level (Figure 1.9 and Figure 1.10).

Figure 1.9 The Republic of Yemen's Annual GDP (US$ Millions)



Source: Tradingeconomics.com, Transparency International.

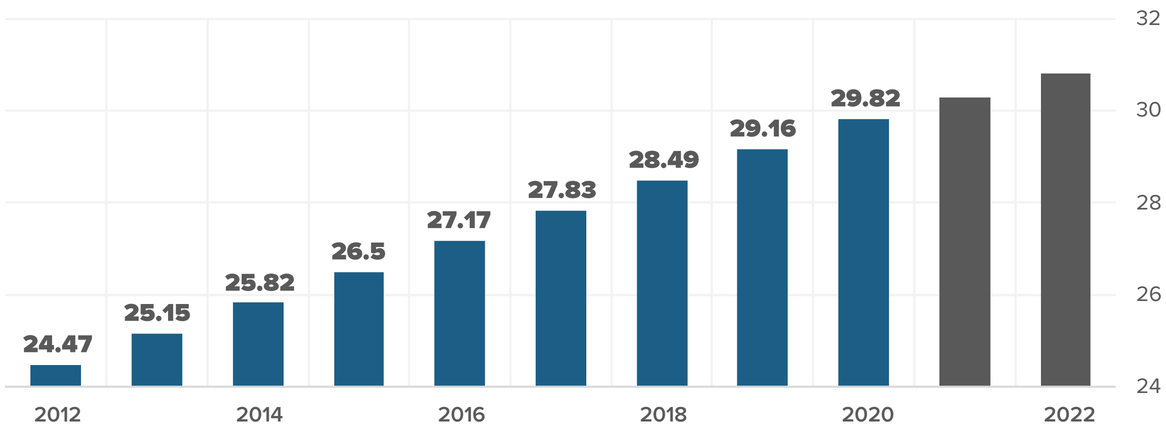
Figure 1.10 The Republic of Yemen's Annual GDP Growth



Source: Tradingeconomics.com, Transparency International.

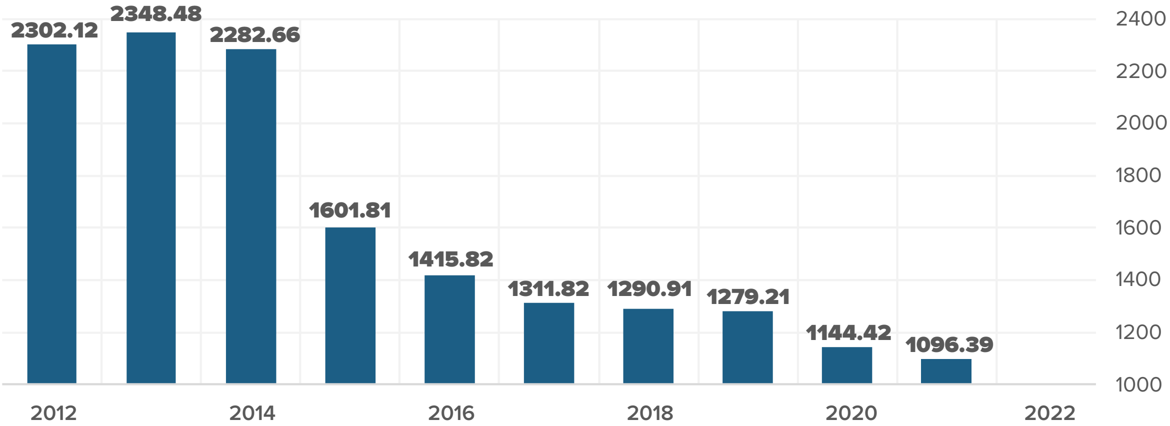
Despite increased mortality and emigration due to the armed conflict, the annual birth rates in the country remained robust. This resulted in significant population growth of 6 million over the past 10 years (figure 1.11), leading to a precipitous collapse in per capita GDP (Figure 1.12) of over 60 percent when compared with pre-conflict levels.

Figure 1.11 The Republic of Yemen's Population Growth



Source: Tradingeconomics.com, Transparency International.

Figure 1.12 The Republic of Yemen's Annual GDP Per Capita (US$)



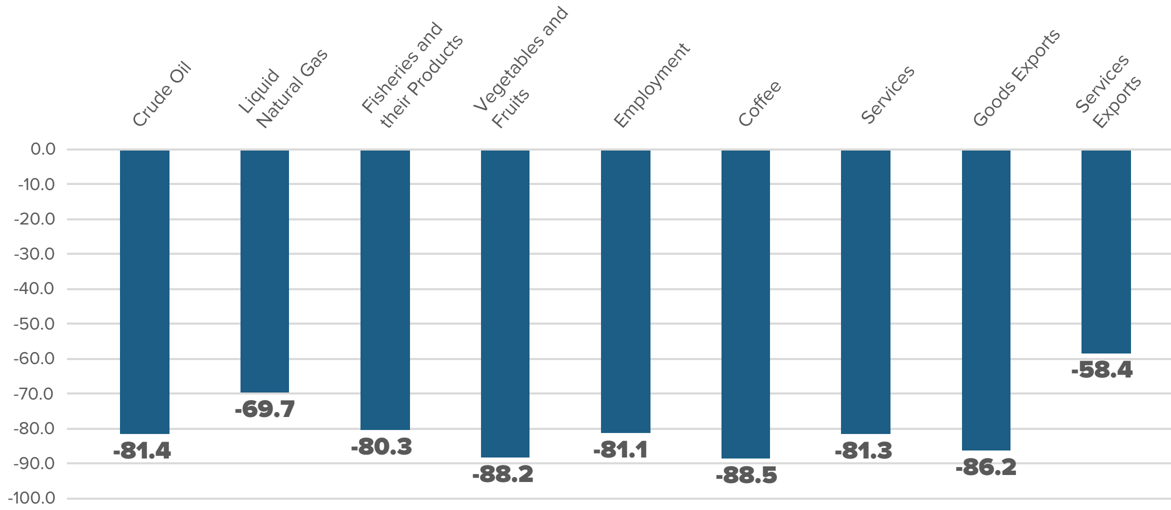
Source: Tradingeconomics.com, Transparency International.

The past decade of conflict has negatively impacted most sectors of the Republic of Yemen's economy, including earnings, employment, and outputs, hindering further development and reinvestment opportunities. However, some sectors have shown resilience.

The agriculture sector, including livestock and fisheries, is diminishing steadily due to higher input prices and difficulties accessing markets because of the conflict. In addition, farmland is increasingly being converted to produce khat, which is in high demand but has low productivity and requires significant water consumption. Moreover, most of the khat output, as with the trade and small light manufacturing sectors, is sold domestically. In sharp contrast, most of the country's demand for food, fuel, and manufactured products is met by an overwhelming dependence on imports.

The conflict conditions and deliberate efforts by each side to deny the other's ability to profit from oil and gas income have led to a decline in oil and gas exports from 81.4 percent in 2014 to 69.7 percent in 2020. As a result, oil and gas exports declined from 81.4 percent in 2014 to 69.7 percent in 2020. This has also led to a cumulative decline in exported goods and services by about 81.3 percent in 2020 compared to 2014 (Figure 1.13).

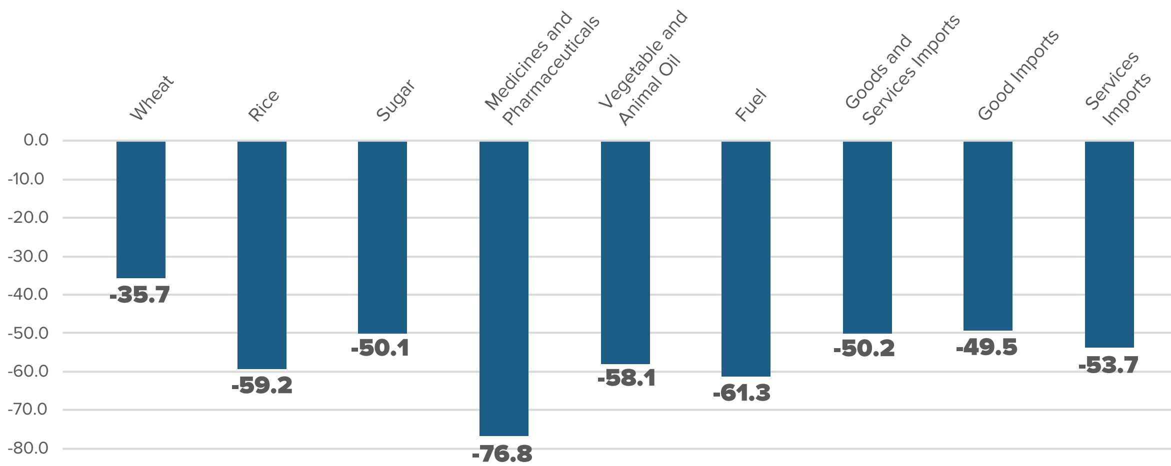
Figure 1.13 The Impact of Conflict and War on Key Commercial Exports: Cumulative Change in 2020 Compared to 2014



Source: Central Statistical Organization, Statistical Yearbook 2014; National Accounts Bulletin 2020.

Similarly, conflict-induced conditions and additional difficulties with trade finance and payment systems have caused the imports of goods and services to decline by over half since pre-conflict time, with a cumulative decline of 50.5 percent in 2020 compared to 2014 (Figure 1.14)

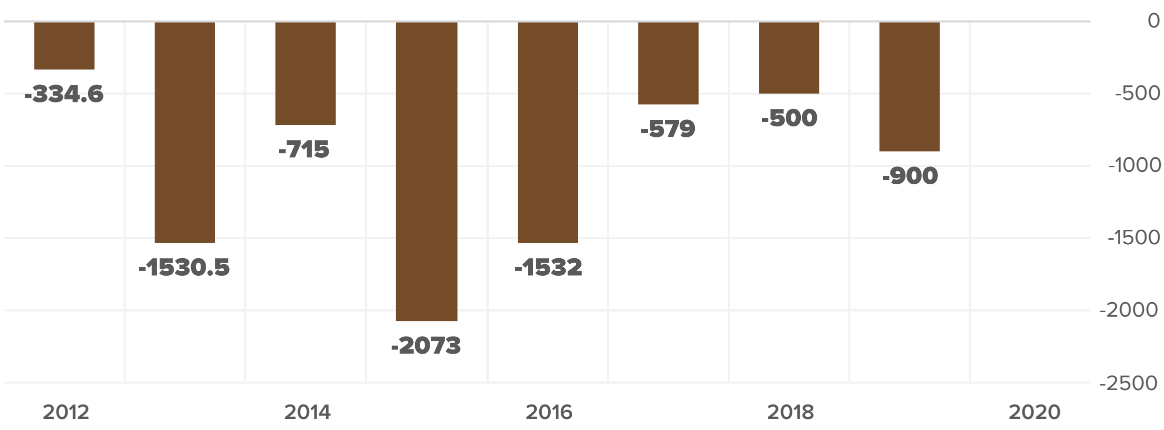
Figure 1.14 The Impact of Conflict on Key Commercial Imports: Cumulative Change in 2020 Compared to 2014



Source: Central Statistical Organization, Statistical Yearbook, 2014; National Accounts Bulletin 2020.

The Republic of Yemen's current account has also been running large deficits due to the conflict. However, these deficits have been much smaller than the negative trade balances due to the large currency inflows from remittances from the Yemeni diaspora and foreign aid donors (Figure 1.15).

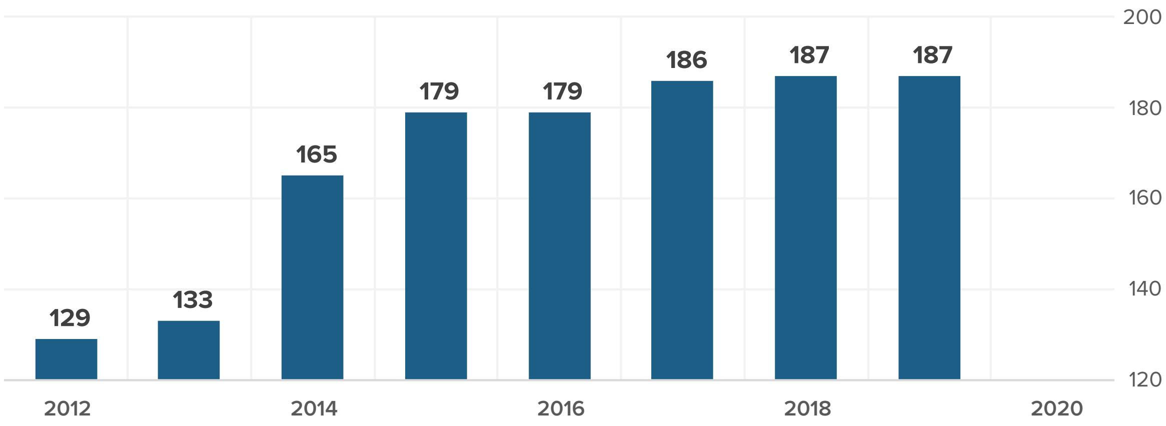
Figure 1.15 Current Account Deficits (US$ millions)



Source: Tradingeconomics.com, Transparency International.

The dramatic reduction of the country's tax base and the inability of the government to collect taxes has led to a rapid increase in government debt despite the reduction of government services and investment. The Republic of Yemen's World Bank Doing Business country ranking dropped from 129 to 187 (Figure 1.16), while the "perceived corruption" (Transparency International n.d.) ranking went from 156 to 174. The conflict has also caused many foreign investors to pull out of the Republic of Yemen's key sectors, such as oil and gas and telecoms. This has led to a sharp decrease in foreign direct investment (FDI) in the country, making it more difficult for Yemeni businesses to access the capital they need to grow and expand.

Figure 1.16 The Republic of Yemen's World Bank Doing Business country ranking



Source: Tradingeconomics.com, Transparency International using World Bank Doing Business data.

The conflict has also significantly damaged the country's physical infrastructure, including factories, ports, and roads. According to the World Bank, more than half of the Republic of Yemen's manufacturing capacity has been destroyed, and many key ports and transportation routes have been damaged or rendered inoperable. The World Bank Dynamic Needs Assessment shows that the conflict has caused extensive damage to various sectors. This is most visible in the housing sector, where units have either been partially damaged (39 percent) or destroyed (1 percent). The education, health, transport, and water, sanitation, and hygiene sectors have also been severely affected, with damage levels ranging from 29 percent for transport, to 39 percent for health. The power sector has fared somewhat better, with damage levels of 10 percent. Sa'ada, the ancient capital in the northwest region of the Republic of Yemen, has the highest proportion of damaged physical assets, with 67 percent of facilities affected. The housing and health sectors in Sa'ada have been particularly hard hit by the conflict (World Bank 2020c).

Since the Central Bank of Yemen (CBY) moved from Sana'a to Aden in 2016, the Republic of Yemen's economy has been split into two competing areas: one controlled by the Houthis and the other nominally by the IRG (Yemen Economic Bulletin 2020). Both sides have introduced laws and policies that have negatively impacted the private sector's ability to transact business. These include exchange rate instability, a ban on banknotes, and difficulties accessing hard currency. These factors, along with de-risking measures that have cut off Yemeni banks and their clients from clients overseas, have led many businesses to resort to informal financial networks, such as money exchange companies and informal money exchange (hawala) agents. This trend has resulted in the increased use of cash and a decreased trust in the formal banking system, posing additional challenges for the struggling economy.

The ongoing conflict has also disrupted access to finance and the supply of hard currency for many Yemeni businesses, as banks and other financial institutions have become more hesitant to lend money due to the increased risk of default. The Republic of Yemen's Small and Micro Enterprise Promotion Service (SMEPS) surveyed the conflict's impact. It found that 28.7 percent of respondents cited restrictions in access to finance as a factor that made it difficult for businesses to obtain funding needed to operate and grow (SMEPS 2020). In addition, since 2015, the decline in oil and gas exports has led to a shortage in hard currency, limiting the private sector's ability to import essential commodities.

THE IMPACT OF THE CONFLICT ON SELECTED ECONOMIC SECTORS

Manufacturing

The conflict has had a crippling impact on the country's manufacturing sector by destroying facilities, assets, and infrastructure. This has resulted in a cumulative contraction of GDP by 55.3 percent. Sectoral value-added has experienced a cumulative contraction of around 20 percent from the 2001 levels. The sector also suffered from restricted imports of essential equipment, spare parts, and raw materials, as well as dramatic price shocks and prohibitive import taxes, which increased the cost of many other inputs, such as fuel and transport, by 100 to 400 percent. However, some local industries (such as cement plants) were sheltered by import restrictions on aluminum, paints, gas extension tubes, carbon, steel galvanized pipes, fiber, and other materials.

The conflict's effect on manufacturing is also seen in the Republic of Yemen's massive trade deficit in manufactured goods. Injecting private sector expertise and investment could help develop the weak manufacturing sector. The industry contains many private-sector players, yet it is still a minor contributor to the country's GDP (6 percent) and employment (5.5 percent of the workforce). It is also heavily dominated by micro-sized enterprises (approximately 78 percent) and small enterprises (roughly 20 percent), with the vast majority producing food and beverage products (about 60 percent), followed by construction materials (7.5 percent), metal processing (6.1 percent), and dressmaking and fur dyeing industries (6 percent).

The Republic of Yemen has an informal artisan industrial culture currently dominated by family-centered enterprises. This presents obstacles to inclusive growth unless conditions change to encourage more innovative partnerships between large companies (engaged in value-added processing and high-value export markets) and the numerous MSMEs. Partnerships with large companies can help MSMEs participate in the formal economy, perform at higher standards, and access requisite knowledge, markets, and financing.

Agriculture

The conflict severely disrupted agricultural production, markets, transportation, and distribution. While productivity has always been low, the conflict has exacerbated the situation. There has been a significant decrease in locally grown food compared with pre-conflict levels. This is primarily because of reduced land available for cultivation, which has decreased food availability and household food stocks. The agricultural sector has also experienced a shortage of seeds, fertilizer, and fuel. There has been damage to agricultural machinery, irrigation systems, and storage facilities and a deterioration of water and electricity services, resulting in the breakdown of logistical chains. The absence of electricity and fuel and the damage to production facilities have disrupted locally manufactured agricultural production inputs.

Additional factors directly attributed to the conflict include the limited availability and high cost of agricultural inputs, such as animal feed, the inability to control plant and animal pests and diseases, and the increased production of khat (Catha edulis) as a cash crop, which, as previously highlighted, reduces the amount of land available for food production and contributes to the depletion of the water table. Other contributing factors are the emigration of the workforce and limited public resources allocated to the sector. Furthermore, many farms in the areas where violent conflict has occurred have been abandoned.

The dominance of small and fragmented plots (an average of one hectare) prevents the sector from contributing more to rural incomes and addressing trade imbalances in food items. Furthermore, underdeveloped rural institutions need more leverage on policy making and resource allocation. Limited access to formal credit and inadequate application of modern agricultural technologies hinder productive asset creation and MSME development. Weak farm support services and a poorly developed infrastructure also lower farm productivity.

Livestock and Fisheries

Livestock raising (notably sheep, goats, cattle, camels, and poultry) is a primary source of income for smallholder farmers under a mixed farming system. Grazing land is estimated at over 20 million hectares and is grazed by about 14 million sheep and 1.4 million cattle. The ongoing conflict has decimated the livestock herds of many farmers and displaced pastoral and agropastoral households. In addition, limited veterinary services and the scarcity and high cost of animal vaccines and drugs are causing the spread of endemic diseases. These shortages and soaring animal feed prices have led to poor livestock productivity and high animal mortality levels. The industrial poultry sector, the primary provider of protein and income to poor people, is seriously threatened because poultry vaccines and feed need to be imported.

Before the conflict, the fisheries subsector was the third most important agricultural subsector, playing a critical role in the Republic of Yemen's food security. The subsector contributed 2 percent to the country's GDP, ranking second in exports, and provided job opportunities for more than half a million individuals, supporting 1.7 million people. The conflict heavily impacted the fishing community due to restricted sea access, increased fuel prices, disruption of fish exports, destruction of fishing equipment and landing sites, and inadequate cold storage facilities. The governorates of Taiz and Hudaydah have seen an estimated 75 percent decrease in traditional fishing, while fishing in other governorates has halved since 2014. The COVID-19 pandemic has also negatively affected employment among retailers, restaurants, and street vendors who are the most affected actors in the fishery value chain. Almost half of the workers were laid off or suspended. Moreover, the cessation of fish exports has resulted in enormous losses for the fishery associations, as export is their primary source of income.

Most MSMEs in the fisheries industry are family businesses. Private sector firms employ around 18,000 people, primarily in domestic wholesale and retail trade and exports. Women's employment is minimal and concentrated in fish-processing plants. However, other parts of the post-catch operations value chain, such as marketing and exporting, are considered suitable for women. In addition, capacity building and strengthening of all the sectoral stakeholders is vital for economic growth. The job creation potential in the fisheries industry is attractive for both men and women but requires investments in cold storage facilities, fishing equipment, boats, and docks. These investments would enable the demand from traditional markets and exports to recover to pre-conflict levels or higher.

Construction

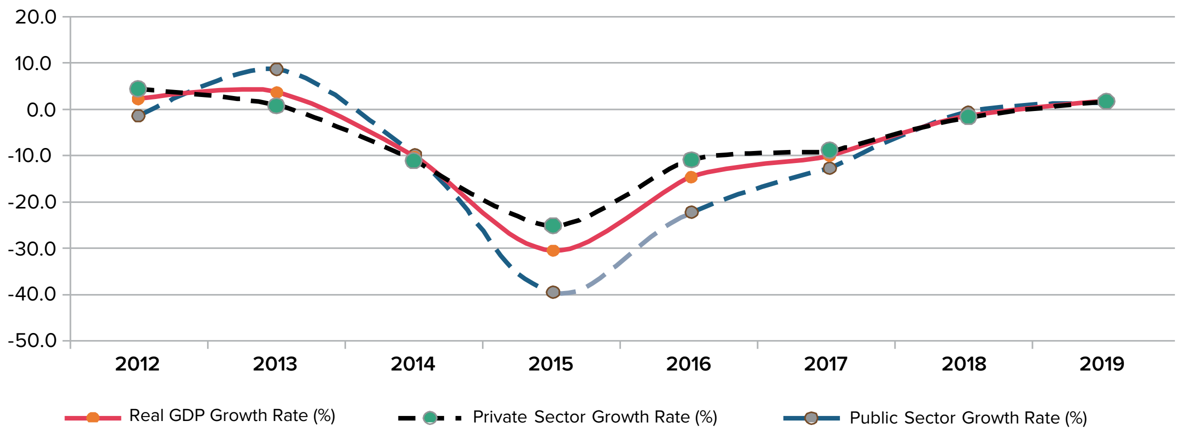
The construction sector is a significant contributor to the economy and has the potential to stimulate growth, boost production, and create jobs across numerous economic sectors. In 2013, the construction sector contributed an estimated 5 percent of the country's GDP and employed 10.6 percent of the national workforce, or about 441,000 workers, making it the fourth largest employer. There are 1,360 registered contractors, comprising micro-enterprises (59 percent), medium-sized enterprises (22 percent), and large enterprises (19 percent). The latter accounted for the majority (78 percent) of sector employment but has been significantly reduced since the conflict.

Yemenis in the diaspora have shown tremendous interest in investing in the construction sector, particularly in developing the infrastructure (roads, ports, and energy production) needed to exploit and connect undeveloped limestone deposits and quarries to cement production supply chains, including for export. These potential investors have predicated their investments on developing these integrated value chains, associated industrial estates, and special economic zones on the presumption of a stable and conducive business environment with security guarantees for their investments.

THE PRIVATE SECTOR'S RESILIENCY DESPITE THE CONFLICT

The private sector cushioned the impact of the economic contraction from 2015 to 2019. The average real GDP in the sector dropped by only 8.9 percent compared to -14.7 percent for the public sector, limiting the contraction of the real GDP by about -11 percent. In 2019, the private sector achieved a growth rate of 1.7 percent, higher than 1.3 percent for the public sector, resulting in a nearly 1.6 percent increase in the total GDP (Figure 1.17).

Figure 1.17 The Role of the Private Sector in Limiting Economic Contraction during the War and Conflict



Source: CSO, National Accounts Bulletin 2019.

The private sector, particularly animal husbandry and agriculture, has contributed to economic resilience by achieving self-sufficiency for several agricultural and livestock products (Table 1.1).

Table 1.1 Farming Produce Self-Sufficiency Rate (Agricultural and Livestock) in 2018

Corn and Sorghum	Barley	Potatoes	Legumes	Vegetables	Fruits	Meet	Eggs	Dairy Products
99%	103%	95.3%	66%	100%	94%	107%	99%	91%

Source: Ministry of Agriculture and Irrigation, Unpublished Data, November 2020

In addition to domestic food production, the private sector plays a significant role by importing life-saving goods for Yemenis. According to the United Nations Logistics Cluster, the private sector delivers 96.5 percent of all food imports (World Bank 2017) and facilitates the bulk of fuel imports to the Republic of Yemen.

The wide range of services the private sector provides helps offset the missing or fragmented basic government-to-citizens and government-to-business services: infrastructure, energy, food, water, health, and education. It also contributes to the resilience of other economic activities. For example, electricity generation through solar-powered systems or private commercial generators has experienced remarkable growth. It is driven by public grid supply shortage, decreased cost of renewable energy solutions, and financial support from private donors. As a result, by 2019, the solar energy rate reached about 75 percent versus 12 percent for the public grid (World Bank 2020d).

The private sector has helped reduce unemployment and alleviate poverty during the conflict. It has retained most of its workforce through coping strategies such as adding new products and services, adapting to the new normal, partially suspending activity, reducing working hours, or relocating to other regions (SMEPS 2020). It has maintained private employment and absorbed a significant proportion of public sector servants (69.4 percent), mitigating the impact of salary suspensions.

Some sectors, with primarily large firms, have shown resilience. For example, the energy sector has seen some growth, particularly in privately produced solar power. The ICT sector has introduced a faster broadband network. There has been a significant increase in mobile phone and internet usage. Unsurprisingly, the sectors that suffered the least were those that relied mainly on skilled human labor to provide services, with access to informal finance and local markets, compared with those that depended heavily on foreign trade for imports or exports to generate hard currency that could be reinvested or pay off debts.

The past three decades have also witnessed the private sector's prominent role in providing social services, such as education and health. Before the conflict, the private sector provided more than 60 percent of health care services. It was also responsible for 100 percent of agricultural output, which provides about 20–25 percent of domestic food consumption. Moreover, humanitarian organizations relied on Yemeni businesses to provide logistics and supply intermediate goods and services, including vital medical supplies, during a cholera outbreak in April–September 2017 (CSO 2018a). In 2016, the private sector oversaw 899 basic and secondary schools and 101 higher education institutions with 83,177 students.

Most of the private sector's contribution to emergency humanitarian, health, and relief assistance was provided as part of its corporate social responsibility. A survey covering 53 small, medium, and large-scale private businesses in the Republic of Yemen found that 80 percent were engaged in helping people affected by the conflict (Humanitarian Response 2017) through informal networks of families, friends, and neighbors.

The private sector has also established many charitable institutions, such as the Yemen Food Bank[2] and the Yemen Medicine Bank,[3] targeting the poor, the marginalized, displaced children, mothers, and pregnant and lactating mothers.

The Yemeni private sector facilitates distribution, storage, and logistical services for humanitarian and relief actors, thus contributing to community resilience. It is also partnering with international agencies through the International Initiative on COVID-19 in the Republic of Yemen,[4] in addition to international organizations such as the World Health Organization. The private sector has also facilitated cash transfers from donors to beneficiaries (representing mostly vulnerable groups) in collaboration with international organizations such as the World Bank, UNICEF, and the World Food Programme.

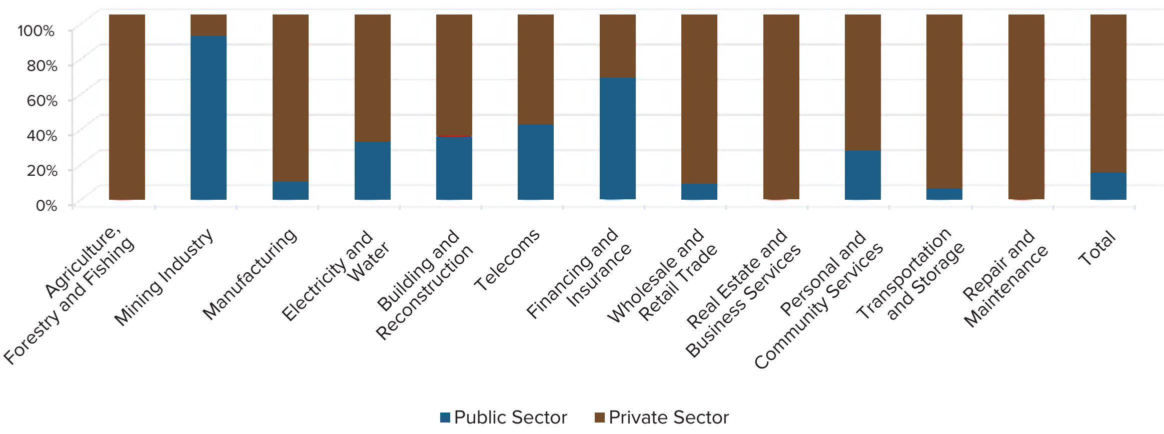
However, not all private sector firms share equal resilience and prosperity. Private sector resilience is linked to firm size and market share, which has been true in the Republic of Yemen before and during the conflict. The reality of the country's dual economy is historically enshrined in the significant importance of the large formal firms that, while monopolizing some industries and sectors, have been indispensable pillars of societal order and Yemeni nationhood. In today's Republic of Yemen, almost every large enterprise is owned by long-established trading houses individually or in partnership with other large trading houses and diaspora entrepreneurs. This partnership pattern between entrepreneurs from the southern and northern parts of the Republic of Yemen and the diaspora, and the resulting resilience, is most notable in the ownership structure of the country's private commercial banks and other large enterprises.

The market and sector resilience and dominance of these large firms, virtual industrial empires, and sector-leading mega-enterprises are critical. They are considered potential engines for future improvement in private sector performance and sustainable and inclusive growth of the Yemeni economy. However, their very existence makes competition difficult as they are intertwined with the political establishment and thus can protect their interest against smaller or newer firms. Such firms, however, are among the few who have enough knowledge and experience to navigate the country's politics and scattered, often unclear or missing institutional and regulatory frameworks in trade, finance, and investment, so they are indispensable in sustaining, mitigating, and overcoming the impacts of war.

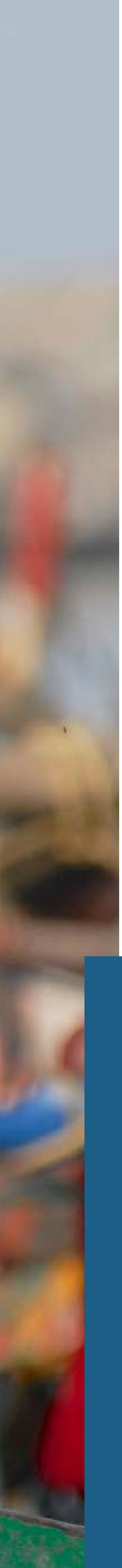
The private sector showed extraordinary resiliency during the conflict. With the Yemeni economy contracting by 50 percent and the public sector suspending a large part of its economic activities, especially oil and gas, the share of the private sector in the country's GDP increased dramatically. In 2018, the private sector represented 79 percent of the Republic of Yemen's GDP and dominated all sectors of the economy except the mining industries (Figure 1.18).

2 https://yemenfoodbank.org/?page_id=17.
3 https://yemenmedicinebank.org/.
4 http://www.emro.who.int/yemen/news/public-and-private-sectors-join-forces-to-deliver-lifesaving-covid-19-supplies-in-yemen.html.

Figure 1.18 GDP Public and Private Share by Sectors in 2018



Source: CSO 2018b.



Chapter 2.
Policy and Regulatory Constraints to Inclusive Private Sector Development in the Republic of Yemen

Business environment and investment climate reforms crucial for private sector development have long been delayed or ignored in the Republic of Yemen. This has created impossible conditions for the local MSMEs and unfavorable and restrictive regimes for large Yemeni firms seeking to conduct cross-border business transactions, including as part of global value chains. Hydrocarbon earnings and increasing flows of remittances from the large Yemeni diaspora provided financial protection and lessened the need for policymakers to implement inclusive economic reforms. Similar factors have exacerbated the public sector's weak accountability and enabled poor governance. As a result, the government has overlooked opportunities to pursue reform strategies that could have reduced the Republic of Yemen's dependence on foreign aid and imports, promoted domestic private sector growth, increased productivity and inclusion, and created more favorable human development conditions.

CROSS-BORDER TRADE, INVESTMENT, AND FINANCE

The failure of Yemeni authorities to enact widely used international trade, finance, and investment frameworks persistently obstructs the private sector's ability to conduct international transactions, including importing food and essential commodities. According to UNCITRAL, the Republic of Yemen has never ratified or implemented a single United Nations convention or UNCITRAL model law on trade, investment, finance, or overall financial and private sector development.[5] In addition, while the Republic of Yemen joined the World Trade Organization (WTO) in 2014, the country has never taken full advantage of its membership. The most important constraints to food security and food import in the Republic of Yemen are the trade logistics barriers. According to the World Bank, the Republic of Yemen ranked 134 out of 140 countries in the World Bank Logistics Performance Index 2023 (World Bank 2023b). Implementation of the WTO Agreement on Trade Facilitation (WTO 2017) would provide the private sector more favorable import conditions and export competitiveness.

5 See, Appendix B, on the list of basic UN conventions and UNCITRAL model laws on trade, investment and finance that the Republic of Yemen has never ratified or implemented.

BUSINESS ENTRY, PRIVATE SECTOR INCLUSION, AND COMPETITION

The World Bank's Doing Business database shows the prohibitive time and cost associated with registering a firm in the Republic of Yemen over the years, under the "Starting a Business" indicator. In 2020, it took 40 days and cost 40.2 percent of income per capita (World Bank 2020a). Therefore, most businesses stay informal, and most transactions are cash based and not bank facilitated. The World Bank Enterprise Survey found that even before the conflict, one-fourth of businesses in the Republic of Yemen cited business licensing and permits as a major constraint (World Bank 2014). In 2012, the Republic of Yemen closed its one-stop shop for business registration, and the 2014 fragmentation and decentralization of the data across sectarian lines of the previously centralized Business Registry (like the fragmentation of the CBY) has made it difficult to establish the identity of private sector firms. As a result, the entire Yemeni market operates on a regional or subnational basis, mostly relying on trust, peer pressure, communal connections, and informal enforcement rather than on verified data from the publicly entrusted authority—the Business Registry of Yemen. This issue also persists in other public record systems.

ACCESS TO FINANCE

The 2015 SMEPS survey showed that the prevalent informality in the MSME sector has led to the lack of access to credit and trade (SMEPS 2015, p. 36). The same survey showed that while 73 percent of businesses needed access to finance, only 14 percent have managed to obtain it. The situation has worsened since the conflict; only 8.4 percent of private enterprises obtained credit loans between 2017 and 2019. In a 2019 survey, 42.1 percent of private sector respondents said they needed a loan (or trade credit) to sustain their business (SMEPS 2020, p.47). Regions with the most informal businesses were also the regions with the greatest number of businesses seeking access to credit. This reflects the difficulty that informal businesses have in securing credit. Most loans in the country are secured with land, and local MSMEs do not generally own land. Therefore, movable assets are the only possible collateral, yet the Yemeni legal framework for secured transactions and asset-based lending prevents MSMEs from effectively using them as collateral. According to the World Bank Enterprise Survey, only 4.7 percent of Yemeni firms had bank loans or lines of credit before the conflict, compared to 33 percent of firms worldwide. Moreover, 45.5 percent of Yemeni firms identified access to finance as a significant constraint compared to 22.6 percent worldwide (World Bank 2014). In 2020, the World Bank Doing Business Getting Credit index gave the Republic of Yemen a zero score on its legal rights index, which measures the level of secured transaction reform in an economy (World Bank 2020a).

REGISTERING LAND OWNERSHIP AND EXERCISING PROPERTY RIGHTS

Registered property rights are necessary to support investment, productivity, and growth. As land and buildings account for between one-half and three-quarters of the wealth in most economies, having a current land information system is vital (World Bank 2019b). In the Republic of Yemen, the deed registration process is inefficient, time consuming, untrustworthy, and primarily benefits those who are well connected (World Bank 2015, 79–81). The 2020 World Bank Doing Business, Quality of the Land Registration Index gave the Republic of Yemen a score of 7 out of 30, the lowest in the MENA region (World Bank 2020a).

E-COMMERCE, GOVERNMENT-TO-BUSINESS SERVICES, AND E-PAYMENT

The Republic of Yemen's incomplete e-commerce framework hinders transactions and payments between private sector participants, especially MSMEs. It also impedes cross-border trade, which is crucial for food security, health, and sanitation in a conflict-affected situation where the entire country depends on imports and remittances. The country's e-commerce law categorizes transactions, data, information, records, and signatures on the same legal basis as physical documents and handwritten signatures (ILO 2014). E-payments remain at very low levels and have been used primarily for small bill payments for water, electricity, internet, and mobile phone credit. One of the problems with the bank-led model used by the CBY Yemen is that only 6 percent of the Yemeni population has a bank account. However, the willingness of businesses to accept e-payments increased during the pandemic. A SMEPS survey found that before the pandemic, e-payments struggled to take off because of the two central banks' differences in approach (CBY Sana'a has established a minimally regulated, nonbank-led model for e-money service). Only 2.9 percent of businesses allowed customers to use e-payments. A subsequent survey during the pandemic revealed that 31.4 percent of businesses were willing to accept e-payments (SMEPS 2020 at 57).

ENFORCING CONTRACTS BETWEEN PRIVATE SECTOR–OWNED BUSINESSES

Commercial disputes in the Republic of Yemen are expensive, excessively contentious, complex, and lengthy. Moreover, there is no guarantee of a fair result. Data from the 2020 World Bank Doing Business, Enforcing Contracts Index illustrate that litigating a simple contract dispute in a Yemeni court takes 645 days on average at a cost of 30 percent of the claim's value (World Bank 2020a).

WOMEN'S PARTICIPATION IN THE ECONOMY

The Republic of Yemen ranks at the bottom of the Global Gender Gap (Hawkamah et al. n.d.) and the World Bank 2022 Women, Business, and the Law report. According to the World Bank report, "When it comes to constraints related to marriage, laws affecting women's work after having children, constraints on women starting and running a business, gender differences in property and inheritance, and laws affecting the size of a woman's pension, there are huge barriers to Yemeni women" (World Bank 2022 at 54). The Republic of Yemen has also ranked lowest in gender finance in the MENA region: only 2 percent of women over 15 have an account at a financial institution, and less than 1 percent of women of that age range have a loan from a financial institution. This lack of access to financial services is one of the main obstacles Yemeni women face in establishing small enterprises. Women are also disadvantaged by systemic legal, historical, cultural, and circumstantial biases that affect their ability to start or operate business enterprises, seek formal employment, or secure highly visible professional vocations. The conflict has served to exacerbate dire conditions by deepening the widespread poverty and social and economic insecurity that have forced much of the population to settle for minimal subsistence.

BUSINESS EXIT, INSOLVENCY, AND RESTRUCTURING

According to the analysis in a study conducted by the World Bank, the Organisation for Economic Co-operation and Development (OECD), and the International Federation of Insolvency Professionals (INSOL), the Republic of Yemen lacks a formal insolvency system for debtors and creditors (Hawkamah et al. n.d.). The Commercial Companies Law is inconsistent with international best practices. It is also ineffective and has limited provisions for companies terminating business operations, including state-owned enterprises. In addition, according to data collected by the 2020 World Bank Doing Business Report, resolving insolvencies in the Republic of Yemen is cumbersome and costly, taking up to three years compared with an average of fewer than two years in OECD economies and less than a year in the top economies. Resolving insolvencies cost 15 percent of the estate in the Republic of Yemen compared with an average cost of 9.3 percent in OECD economies and 1 percent in Norway, and with a recovery rate of 21 cents on the dollar, compared to 70.2 cents on the dollar in OECD economies and 92.9 cents on the dollar in Norway (World Bank 2020a).

THE ENTREPRENEURSHIP ECOSYSTEM

Significant institutional and regulatory barriers exist to developing a comprehensive private sector support ecosystem in the Republic of Yemen, despite donor-supported programs in all parts of the country. Plugging the gaps in the entrepreneurial ecosystem will be a daunting long-term challenge, but it will be crucial for fostering entrepreneurship and small business growth. The missing components must be addressed in order to develop the local entrepreneurial ecosystem.

Networking, finance, policy tools, support services, diversity and inclusion, and data and insights are crucial for creating new businesses. Therefore, interventions aimed at promoting entrepreneurship should shift focus from programs that address partial components, such as loan guarantees and training, to more broad-based approaches that target the development of the entire ecosystem.

Chapter 3.
Reform Recommendations

IMMEDIATE RECOMMENDATIONS AT THE SUBNATIONAL LEVEL

All local authorities should consider developing protected integrated economic communities (IECs) with industrial and housing estates or special economic zones. These could be in key strategic locations within each territory and controlled by a Local Governing Authority (LGA), at any subnational level which is deemed to have unchallengeable control and capacity to guarantee the catalytic authorizing environment for private sector operation. These IECs would be established at existing commercial or industrial hubs, deepwater ports, and trade corridor intersections. They would provide a platform with a package of requirements for the efficient operation of private sector-led community life. They would also generate investments in new housing constructions and provide all the necessary social services.

Such IECs would offer an effective, transparent, and predictable business environment. In order for the IECs to be effective, all MSMEs must be registered with the LGA and licensed or authorized to conduct business. There should also be protection and security against conflict, crime, and corruption and an LGA tax relief or other incentives in return for the provision of social or public goods, such as health and education facilities, solar power and water utilities, information and communication technology connectivity, and affordable public housing.

For this scenario to be effective, the following actions are recommended.

Develop enforceable, simple legal instruments (with provisions for out-of-court arbitration and settlements) to enable collaboration between the LGA and private MSMEs to provide the social services and public infrastructure that public authorities usually undertake. Private entities could be compensated through tax incentives, debt forgiveness, and/or other concessions and privileges to be negotiated.

Implement a methodical competitiveness-based approach to increase the outsourcing links and value chains between larger Yemeni enterprises and MSMEs in key sectors. This would consist of agreements on strategies between the key stakeholders for upgrading the competition of markets by developing and implementing value chains through the vertical and horizontal integration of enterprise networks. It will also engage all the relevant sector stakeholders, thereby providing a value chain analysis to identify the gaps and hindrances to market development and MSME access to opportunities and potential improvements in production and sales volumes.

Develop consultative and strategic planning platforms for inter-LGA cooperation and dialogue with external or international partners, especially Gulf Cooperation Council member states. It will be necessary to agree on the location and cooperative investment arrangements for the construction of new industrial and free-trade zones of international significance. For example, investors from the diaspora have already registered interest in investing in limestone quarries for cement production (and export to Asia), which would include the construction of dedicated deepwater seaports, access roads, and other infrastructure, including energy power plants, water supply, logistics hubs, and so forth.

MID-TERM PRIORITIES TO PREPARE THE PRIVATE SECTOR FOR THE RECONSTRUCTION PHASE

Compile an updated, accurate national or subnational database of potential private sector contractors for public works to be financed by the government or donors. The data would include specific vital industrial parameters, including the capacity and financial condition of the relevant enterprises.

Provide Yemeni business organizations with technical assistance and capacity building to construct updated databases and conduct logistic analysis of their constituent membership for the potential recipient of donor assistance.

Revitalize and boost the technical and financial capacities of existing programs and institutions supporting the private sector by providing business development services to help MSMEs improve their accounting and operations, quality, production, distribution, and marketing capacity. In addition, skilled training and advisory support would cover technical aspects and business skill capacity building to enable beneficiaries to produce higher-quality goods and services.

POLICY RECOMMENDATIONS TO PREPARE THE PRIVATE SECTOR FOR THE RECONSTRUCTION AND RECOVERY PHASE

Increase private sector participation and inclusion in the formal economy. As an immediate policy priority, the IRG and the DFA should consider increasing private-sector participation and inclusion in the economy through improving business entry (registration) and business licensing services for MSMEs on regional, sub-national, and city levels. Several global organizations, including the World Bank and UNCITRAL, have developed international standards and policies to assist MSME inclusion in developing countries, all of which are very relevant to the Republic of Yemen. Such policies would lower the country's market entry barriers to MSMEs and enable them to grow and prosper. As explained in the UNCITRAL Legislative Guide on Key Principles of a Business Registry, business registration should be performed electronically in a single step, using a single window, with a multi-purpose form and a single payment (UNCITRAL 2018).

Establish a modern credit infrastructure, including a credit bureau and collateral registry, to improve access to credit and financial inclusion. Banks typically do not lend to MSMEs if there is no database detailing the credit history or behavior of potential borrowers or sources of their creditworthiness, especially if the borrowers cannot provide enough collateral to cover the loan. In the Republic of Yemen, this credit infrastructure does not exist. A unified credit registry or credit bureau has yet to be established so that banks can determine borrowers' risk and creditworthiness. In addition, a collateral registry has yet to be implemented to provide information on using moveable property as collateral for loans. In the absence of a centralized and unified collateral registry and an underlying secured transaction legal framework, banks rely only on immoveable collateral (real estate or immovable property) and exclude moveable collateral such as equipment, machinery, vehicles, boats, livestock, produce, crops, and accounts receivable as a guarantee for a loan. Most MSMEs worldwide, including in the Republic of Yemen, possess more moveable collateral than immovable collateral or real estate. Therefore, if moveable assets are not accepted as collateral, most MSMEs are de facto and de jure excluded from formal access to finance.

Therefore, it is a top priority for IRG, DFA, and CBY to establish a modern credit infrastructure for MSME financial inclusion through a centralized credit registry and a collateral registry for moveable securities. The credit registry would need to be populated with credit information from a wide variety of financial and nonfinancial entities, including commercial banks, microfinance institutions, nonbank financial institutions, and utility companies, to allow borrowers to establish a credit history. The centralized collateral registry would provide the framework for protecting creditors' priority rights. UNCITRAL has developed an underlying Model Law on Secured Transactions (UNCITRAL 2016) that the CBY, IRG, and DFA could enact in the Republic of Yemen. Such a credit infrastructure would enable lenders (financial institutions and others) to secure loans with moveable assets such as vehicles, boats, livestock, inventory, and payments or obligations due from others.

Introduce warehouse finance for agricultural MSMEs to enhance food security. Warehouse financing is a type of inventory financing that involves a loan made by a financial institution to a company, manufacturer, or processor. It is the most important form of financing for agriculture and food security. For example, food producers in the Republic of Yemen could use this mechanism for their existing inventory, goods, or commodities (food, crops, livestock, and produce), which are transferred and stored in a warehouse as collateral for a bank loan. This is possible when the warehouse issues a receipt describing the inventory. Since the Republic of Yemen does not have a basic warehouse receipts law, such loans, which could benefit the local food producers, are currently unavailable.

UNCITRAL and UNIDROIT are finalizing international standards for warehouse finance and receipts. With World Bank and United Nations support, such standards could easily be transferred into regulation and implemented in the Republic of Yemen. UNCITRAL has recognized that a well-designed warehouse receipt system benefits all commodity market participants, including producers, warehouse operators, traders, and creditors. Notably, it can facilitate access to credit and lower its cost by creating secure collateral, thereby attracting private sector investments to a particular sector, especially the agriculture and food sectors. An effective warehouse receipt system also allows smallholders to participate in commodity markets by allowing them to consolidate their produce and sell jointly further down the value chain (UNCITRAL 2023).

Liberalize the import and export of food and goods by ratifying the WTO Agreement on Trade Facilitation (WTO 2017) and the United Nations Convention on Contracts for the International Sale of Goods (CISG) (United Nations 1980). There is a direct link between slow and expensive cargo movement and the Republic of Yemen's famine and humanitarian crisis. The slower and more expensive the Yemeni import-export regime, the higher the number of deaths from starvation and malnutrition. A contributing factor is the fact that the Republic of Yemen's contract law and ad hoc import procedures have never been harmonized with neighboring countries and other exporters of food and goods. The Republic of Yemen should consider immediately ratifying the CISG and the WTO Agreement on Trade Facilitation, which specifically targets supporting the import regimes of the least developed countries (LDCs).

The CISG is a key UNCITRAL instrument that would assist Yemeni businesses in cross-border trade. The contract of sale is the backbone of international trade in all countries, regardless of their legal tradition or level of economic development. The CISG benefits MSMEs trading across borders by allowing them to trade on neutral grounds without dealing with different legal systems, increased costs, and a lack of information. The 97 countries that ratified the CISG account for over three-fourths of world trade. The CISG has also significantly impacted contract legislation at the national and regional (such as the European Union) levels (Dennis 2014). In the MENA region, the CISG has been ratified by Bahrain, Egypt, Iraq, Lebanon, Syria, and most recently Saudi Arabia (2023).

Equally significant is the WTO Agreement on Trade Facilitation, which has been ratified by 156 out of 161 WTO members, including 32 out of 35 LDC members. As an LDC, the Republic of Yemen could benefit from WTO technical assistance and capacity building to help implement its accession commitments under the Agreement on Trade Facilitation and develop its trade-related skills and infrastructure. The biggest winners from trade facilitation will be MSMEs.

Modernize e-payment, e-commerce, and digital trade. Digital trade (e-commerce) is more secure from physical destruction and damage, could be very resilient, and could serve as a viable alternative to physical trade in conflict situations or during a global pandemic. In the MENA region, the value of e-commerce in 2020 amounted to an estimated US$17 billion, including US$5.5 billion in Saudi Arabia and US$4.5 billion in the United Arab Emirates (Statista 2023). Although e-commerce is still in its nascent phase in the Republic of Yemen, there is an increasing number of e-stores and e-markets selling a wide variety of products in the country (Al-Nasheri 2022; Harazi et al. 2023).

A key element of e-commerce is e-payment, in addition to e-signature and the e-document. To enable legally valid and binding e-payments, the Republic of Yemen needs to modernize its e-payments laws and harmonize the approach between the CBY Aden and CBY Sana'a. The Central Bank Circular no. 11 of 2014 endorsed a highly regulated market model that grants the right to provide e-money services to only banks. As a result of the conflict, the CBY was fragmented across the front lines. The CBY in Sana'a has taken steps to establish a minimally regulated, nonbank-led model for e-money services (SCEU 2022; IBS n.d.).

The Republic of Yemen should also consider ratifying two foundational UN instruments that would enhance the Yemeni digital economy in cross-border trade. The 2005 United Nations Convention on the Use of Electronic Communications in International Contracts (United Nations 2005) is a critical framework for the Yemeni private sector and should be adopted immediately.[6] The convention ensures that e-signatures and contracts concluded electronically across borders are as valid and enforceable as paper contracts signed in ink. It provides a modern and efficient legal framework for the digital economy.

Another significant legal instrument that would help reintegrate the Yemeni private sector into the international trade system is the 2017 UNCITRAL Model Law on Electronic Transferrable Records (MLETR) (UNCITRAL 2017). The law addresses a crucial gap for the digital economy and paperless trade in the Republic of Yemen's legal framework. The MLETR enables the use of transferable documents and instruments in electronic format, including across borders.[7]

Improve dispute resolution of commercial contracts between Yemeni MSMEs and provide basic protection to foreign direct investment (FDI). Since the 2014 fragmentation and decentralization of the Business Registry data across sectarian lines, private sector operators have been unable to verify the identity of third parties, including banks, during transactions. In addition, contract enforcement is difficult because of a weak and decapacitated judicial system, which leads to informal transactions based on trust, patronage, and family networks. While such extra-legal and traditional forms allow rudimentary forms of private sector transactions (retail and limited wholesale) at local levels, these are insufficient when trading across borders, working with financial institutions and foreign investors, or interacting with United Nations agencies and other donors who provide funding for local MSMEs.

To overcome this business environment policy gap, the IRG, DFA, and local authorities should consider immediately enhancing the dispute resolution framework in the Republic of Yemen specifically related to MSME commercial disputes and FDI disputes, including by arbitration and

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6 Eighteen countries, including Bahrain, have ratified the Convention. Several other countries have signed the convention and are considering ratification, including China, Saudi Arabia, and the United States.

7 Bahrain (2016) and the United Arab Emirates (2021) have recently implemented the MLETR. Transferable documents or instruments are paper or electronically-based documents or instruments that entitle the holder to claim the performance of the obligation indicated therein. They allow the transfer of the claim to that performance by transferring possession of the document or instrument. Transferable documents and instruments typically include bills of lading, warehouse receipts, bills of exchange, promissory notes, and cheques. They allow delivery of goods and payment of money based on possession of the document or instrument. Existing laws in the Republic of Yemen and many other economies do not address how to control a transferable document or instrument in an electronic form.

online dispute resolution. There is no FDI without basic protection and recourse for enforcement of contracts and dispute resolution between foreign investors and local partners, and between foreign investors and the Yemeni authorities (Investor-state dispute resolution).

Yemeni authorities should ratify the Convention on the Recognition and Enforcement of Foreign Arbitral Awards, also known as the New York Convention (New York 1958), and implement the UNCITRAL Model Law on International Commercial Arbitration (UNCITRAL 2006). The Republic of Yemen is the only country in the MENA region that has not ratified the New York Convention. The UNCITRAL Model Law has been implemented by 9 out of the 16 countries in the MENA region, including Bahrain, Egypt, Iran, Jordan, Oman, Qatar, Saudi Arabia, Tunisia, and the United Arab Emirates. Such reform requires only negotiations and signing agreements with no need for funding or long-term capital investment. However, it would signal to the world that the Yemeni authorities are ready to join the international trade and finance system.

Review and improve competition laws and provide a legal framework for MSME insolvency. In 2013, the country disclosed to the WTO that a new law on monopolistic and anticompetitive behavior was under preparation (WTO 2013, para. 47). Strengthening and modernizing MSME business exit and recycling business assets is crucial for the Yemeni private sector and facilitating access to finance for local MSMEs. Solid insolvency laws would also mitigate the risk and effects of the ongoing conflict and the pandemic on businesses in the country. UNCITRAL offers a series of instruments that would assist the Republic of Yemen in improving its insolvency laws, including the UNCITRAL Legislative Guide on Insolvency Law (last amended in 2021 with a new section on insolvency for micro and small enterprises) (UNCITRAL 2021) and the UNCITRAL Model Law on Cross-Border Insolvency with Guide to Enactment and Interpretation (UNCITAL 2013). The MENA region has historically been behind other regions in insolvency reforms, But more recently, the UNCITRAL Model Law has been implemented by several countries in the region, including Bahrain (2018), Jordan (2018), Morocco (2018), United Arab Emirates (2019), and Saudi Arabia (2022).

Appendix A.

Overview of the Financial Sector and Its Impact on the Private Sector

Inadequate finance and working capital are some of the factors that hinder the progress of the Republic of Yemen's private sector. There is an urgent need for support from financial intermediaries and new instruments even under the current conflict-affected conditions.

This appendix provides an overview of the country's financial sector, as it relates to private sector development.

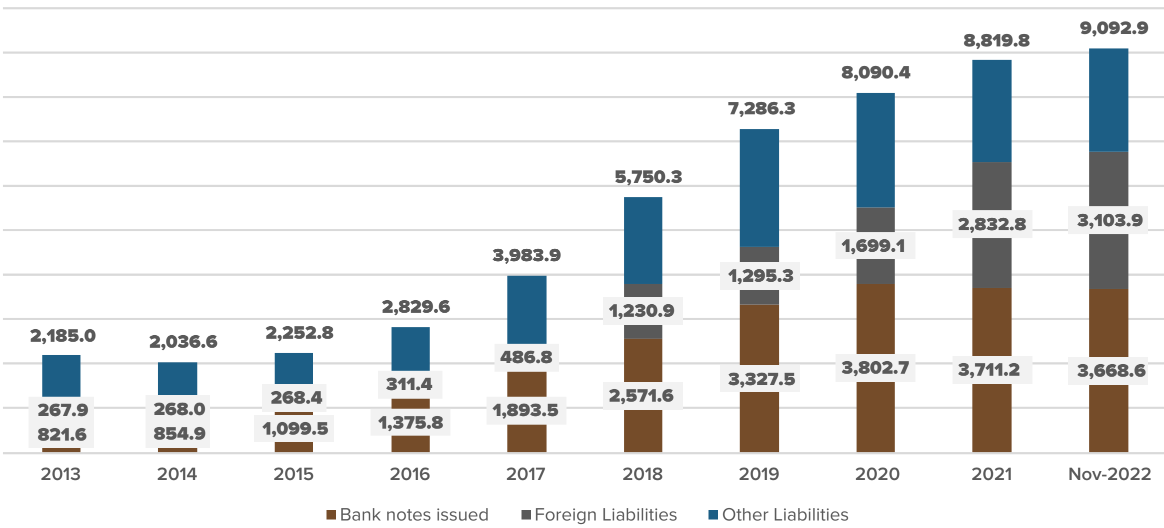
THE CENTRAL BANK OF YEMEN

The Central Bank of Yemen (CBY) is divided into two central competing authorities, which has created considerable restrictions on the private sector's operation and growth. The CBY's expansionary monetary policy, particularly in the IRG territory, has caused significant inflation and exacerbated business economic conditions. In addition, the CBY's uneven lending policies have limited the banking sector's capacity to provide financing and compete with money exchange networks. Consequently, the CBY is unable to perform its monetary and supervisory duties to regulate the Yemeni financial ecosystem and Yemeni banks (which tend to be family owned) and do not offer much value to most Yemeni enterprises.

The CBY coordinates the country's monetary policy and currency matters. It also regulates, guarantees, and safeguards the integrity and stability of the banking system and services the country's balance of payments by issuing the public debt, which the government uses to finance budget deficits. The two latter functions impact the cost and value of the Yemeni currency and the economy's terms of trade, price inflation, and several additional macroeconomic indicators. However, under the current conditions, it is not realistic to expect the CBY to efficiently perform these duties: for example, as discussed below, printing additional banknotes was one of the core drivers of hyperinflation and the significant depreciation of the local currency. This is an issue that may not be resolved in the foreseeable future, as it would take at least three years to stabilize the country's banking system and improve operational capacity even after a central banking authority is reinstituted. Moreover, it will probably take a long period of rehabilitation, requiring considerable external technical assistance, to restore the CBY to a robust institution with the requisite capacity to support the Republic of Yemen's economy.

Over the past five years, the CBY in Aden has carried out expansive monetary policy adjustments that have increased its balance sheet from YRl 3,984 billion in 2017 to YRl 9,093 billion by November 2022. The major factor driving this expansion has been the issuance of banknotes, which have increased from YRl 1,894 to YRl 3,669 billion during the same period (see Figure A.1). There has also been an increase in borrowing and foreign liabilities, which rose from YRl 407 to YRl 3,104 billion between 2017 and 2022.

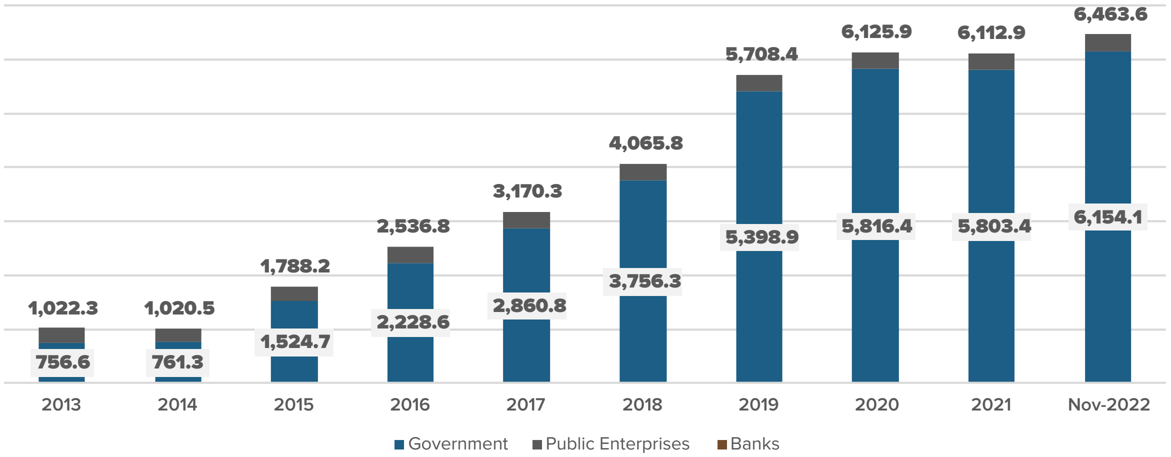
Figure A.1 Expansion of Central Bank of Yemen's Balance Sheet (2013 through November 2022)



Source: Monetary and Financial Developments, CBY November 2022.

The CBY has used these additional financial resources to extend its lending operations. From 2017 to 2022, the loans and advances portfolio have more than doubled from YRl 3,172 to YRl 6,464 billion (see Figure A.2). Unfortunately, none of the increased lending has been made available to the country's banking sector and extended to the private sector through bank lending and investing. The bulk of the CBY's lending has been government loans, which have more than doubled between 2017 and 2022, from YRl 2,861 to YRl 6,154 billion. The remainder of the loans have been provided to public enterprises. The CBY's balance sheet for the past 10 years shows no evidence of lending to private banks. On the contrary, over the same period, private banks have kept significant deposits at the CBY (this includes YRl 810 billion in 2021). The CBY does not function as a lender of last resort to the banks and drains a significant part of its liquidity.

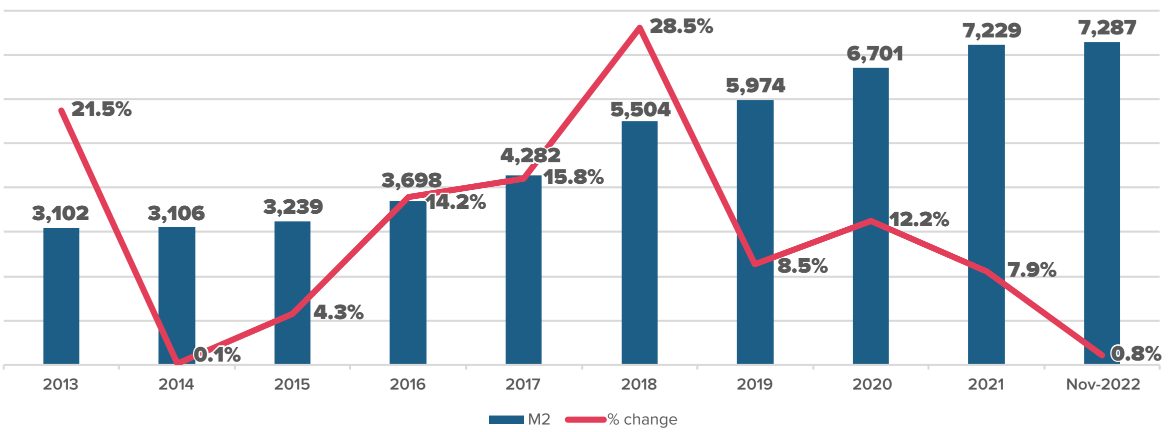
Figure A.2 Expansion of the Central Bank of Yemen's Loans and Advances Portfolio (2013 through November 2022)



Source: Monetary and Financial Developments, CBY November 2022

The expanding central bank lending to the government and the public sector has increased the cash supply in the economy and particularly the broad money supply (M2). Since 2016, M2 has more than doubled, from YRI 3,698 to YRI 7,287 billion, far outpacing the growth in the real economy (see Figure A.3). Since 2018, there has been a positive trend of reducing the growth of monetary expansion.

Figure A.3 Growth of Broad Money Supply (M2) (2013 through November 2022)

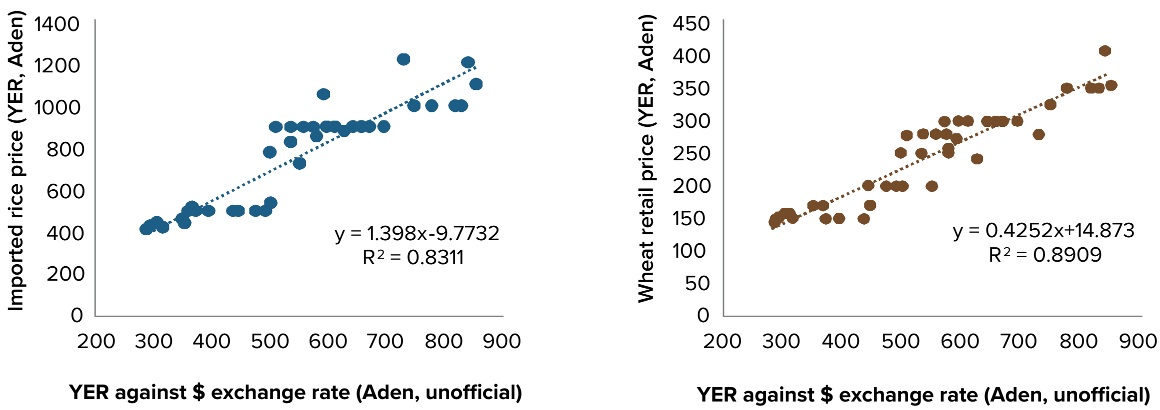


Source: Monetary and Financial Developments, CBY November 2022

The fact that the cash supply's growth has outpaced the real economy has predictably caused significant inflation. The CBY in Aden has been issuing banknotes in large denominations that have been in circulation only in IRG-controlled territories. This has created an inflation rate divergence between the two parts of the country.

The bifurcation of monetary policy and foreign exchange flows, coupled with the monetization of fiscal deficits, have driven the steep depreciation of the Yemeni rial since the beginning of the conflict, and the rising real cost of living has played a major role in pushing the Republic of Yemen's population into a humanitarian crisis. International and internal barriers to movement have further increased the cost of living.

Figure A.4 Correlations of Exchange Rates and Food Staple Prices in Aden (July 2016–December 2020)



Source: Impact of Conflict on the Financial Sector in Yemen: Implications for Food Security, December 2021.

The overall monetary and lending policies of the CBY inflation aggravated the financial conditions for the banking sector and private enterprises while depriving them of the necessary financial resources to borrow and grow.

COMMERCIAL BANKS

The formal banking sector in the Republic of Yemen operates like the CBY, with investment and lending policies that have created significant constraints for the private sector. The considerable increase in domestic and foreign currency deposits has either been kept as reserves or invested abroad. The government benefits from most of the lending operations, and private loans do not exceed a quarter of the total loan portfolio. Despite the challenges facing the formal banking sector, 19 banks are currently operating in the Republic of Yemen: 11 commercial banks, 4 Islamic banks, and 4 microfinance banks. The Cooperative and Agricultural Credit (CAC) Bank and the National Bank of Yemen are the two state-run banks. However, both have become divided, with competing branches in Aden and Sana'a, operating under IRG and DFA supervision (see table A.1).

Table A.1 Banks Currently Operating in the Republic of Yemen

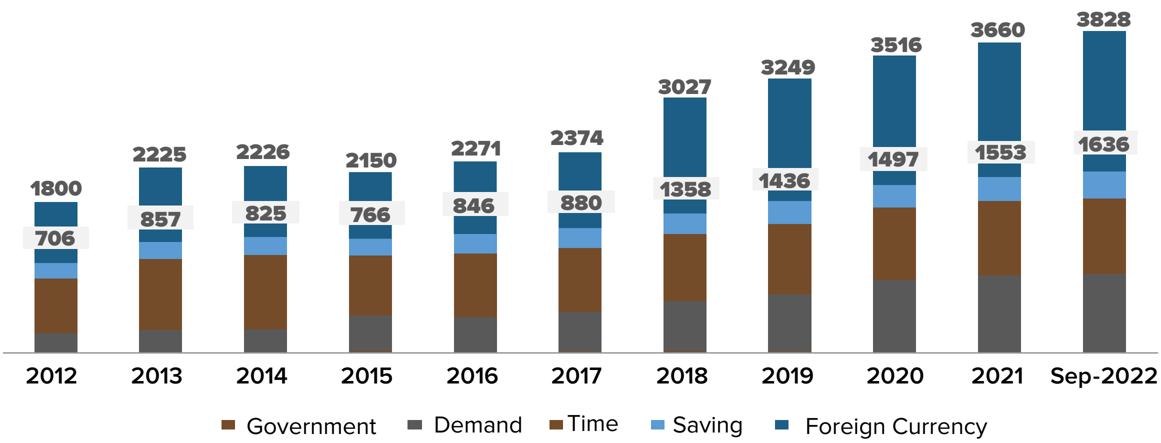
Name	Ownership	Type	HQ	Country of Origin	Number of Branches
Arab Bank Limited	Foreign	Commercial	Sana's	Jordan	9
Cooperative and Agricultural Credit Bank	Public	Commercial	Sana's	Yemen	51
International Bank of Yemen	Local private	Commercial	Sana's	Yemen	23
National Bank of Yemen (Al Ahli Bank)	Public	Commercial	Aden	Yemen	27
Rafidain Bank	Foreign	Commercial	Sana's	Iraq	1
United Bank Limited	Foreign	Commercial	Sana's	Pakistan	3
Yemen Bank for Reconstruction and Development	Mixed public and local private	Commercial	Sana's	Yemen	44
Yemen Gulf Bank	Local private	Commercial	Sana's	Yemen	2
Yemen Kuwait Bank	Local private	Commercial	Sana's	Yemen	12
Saba Islamic Bank	Local private	Islamic	Sana's	Yemen	16
Shamil Bank of Yemen and Bahrain	Local private	Islamic	Sana's	Yemen	9
Tadhamon International Islamic Bank	Local private	Islamic	Sana's	Yemen	21
Yemen Islamic Bank for Finance and Investment	Local private	Islamic	Sana's	Yemen	5
Al Amal Microfinance Bank	Mixed public and private	Microfinance	Sana's	Yemen	18
Al Kuraimi Islamic Microfinance Bank	Local private	Microfinance	Sana's	Yemen	23
Al Qutaibi Exchange	Local private	Microfinance	Aden	Yemen	No data

Source: CBY 2022.

Bank branches are located in the main urban areas, making banking services inaccessible for more than the 70 percent of Yemenis living in rural areas. Banking services are also scarce in the cities and only 6 percent of Yemeni adults have a bank account. The number of Yemenis with a bank account decreased from 2.4 million in 2014 to 1.4 million in 2016, highlighting the shift back to traditional cash-based transactions. E-rial transfers are typically made by wealthier households for utility and communications payments. More than 95 percent of the private sector is unbanked.

Regrettably, the banking sector is highly concentrated, with the International Bank of Yemen, Tadhamon Bank, and the CAC Bank holding about 50 percent of total banking assets. This severely limits competition. Despite the difficult economic conditions, deposits have increased from YRI 2,374 in 2017 to YRI 3,828 billion in 2022 (see Figure A.5). This growth has largely been due to the increase in foreign currency deposits, from YRI 880 to YRI 1,636 billion.

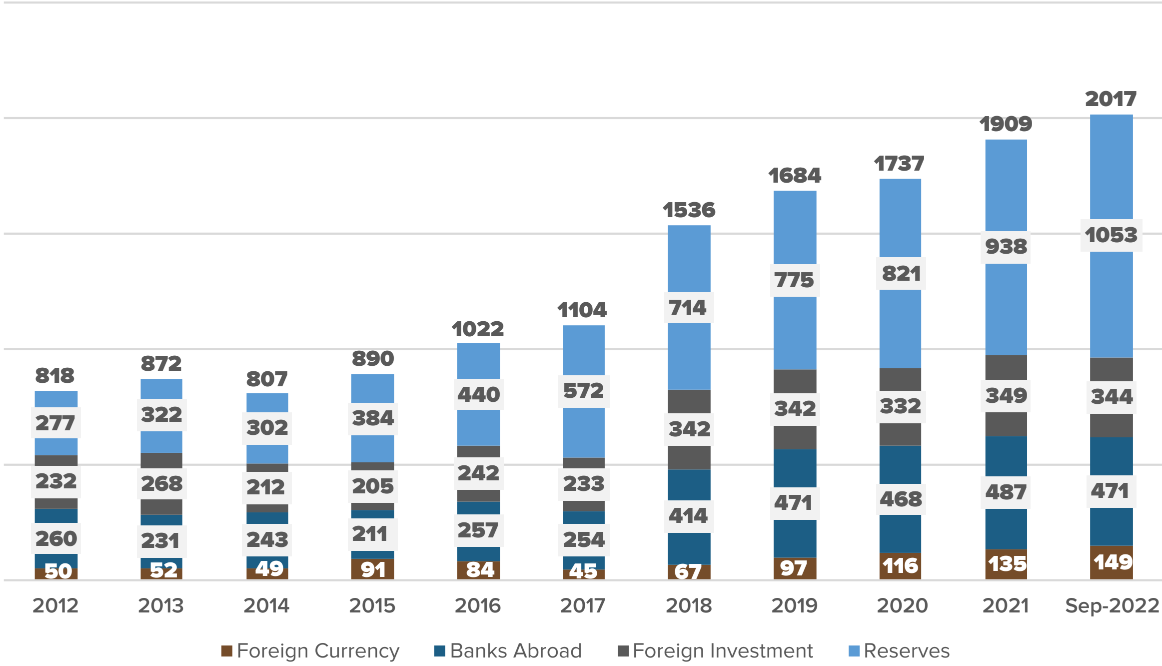
Figure A.5 Growth of CBY's Bank Deposits (2013 through November 2022)



Source: Monetary and Financial Developments, CBY November 2022

Disappointingly, most of the new deposits were not converted into loans to the private sector but were placed in domestic and foreign reserves and investments. During the same period, domestic reserves almost doubled, from YRI 572 to YRI 1,053 billion (see figure A.6). The CBY's deposits in overseas banks grew from YRI 254 billion to YRI 471 billion while foreign investments grew from YRI 233 to YRI 344 billion.

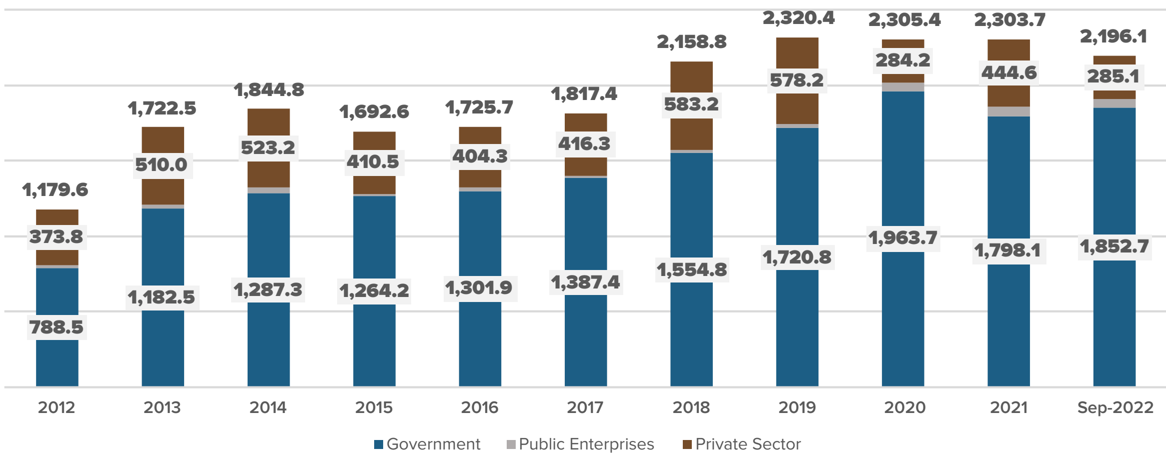
Figure A.6 Growth of CBY's Foreign and Domestic Reserves (2013 through September 2022)



Source: Monetary and Financial Developments, CBY November 2022

Private banks did not significantly increase their loan portfolios despite the significant increase in deposits and other financial assets. From 2017 to 2022, the loans and advances portfolio increased from YRI 1,817 to YRI 2,196 billion. The government is the largest beneficiary of bank lending and borrowing, which considerably limits the banks' contribution to the functioning and growth of the private sector and enables the development of alternative financial institutions (see figure A.7).

Figure A.7 Beneficiaries of Bank Loans and Advances (2012 through September 2022)



Source: Monetary and Financial Developments, CBY November 2022

In recent years, banks have faced multiple challenges, including a lack of liquidity and de-risking, which contribute to the inability to make direct bank-to-bank transfers to certain countries. In addition, most foreign and local currencies are circulating within the money exchange networks, which has prompted many wealthy customers to withdraw their cash balances.

The demand for formal financial services in the Republic of Yemen is severely constrained in rural areas. Most of the rural population is employed in agriculture and herding and has the highest national poverty and illiteracy levels. Forty-five percent of the population lives on less than US$2 per day, and an estimated 50 percent need to improve their literacy levels. In addition, 50 percent of the country's citizens do not have national identification documents. Financial constraints, lack of a national identity card, or insufficient literacy skills prevent many households and MSMEs in the Republic of Yemen from engaging with the formal banking system.

MONEY EXCHANGERS

Money exchangers play a dual role in the functioning of the private sector in the Republic of Yemen. Their well-established and broad networks play a key role in transferring remittances and providing trade financing in times of conflict. However, the informal nature of the money exchangers limits the development of a formal and transparent financial sector.

The "hawala" networks of money exchangers in the Republic of Yemen predate the existence of the banking system. During the conflict, there has been a sharp rise in the number of money exchange companies (both licensed and unlicensed). In 2014, there were 605 licensed and no unlicensed money exchangers. In 2017, money exchange businesses totaled more than 1,350, and 800 were unlicensed. The unlicensed shops operate under the umbrella of the larger licensed money exchange companies, either informally or as agents. Money exchangers play a central and critical role for a much broader section of the population than Yemeni banks because they are more accessible to the public, have maintained the flow of funds, and have broad networks.

The money exchangers of the hawala networks have grown both in numbers and the scope of their financial activities due to their strong advantages (see table A.2).

Table A.2 The Pros and Cons of the Formal Banking System and the Hawala Networks

Category	Formal banking system	Hawala networks
Access	Limited access to correspondent banks and, by extension, to the international financial system	Well-connected network with minimal conflict-related disruption Well-established networks in Gulf Cooperation Council countries, underpinned by tribal kinship and business partnerships
Process	Stringent national and international regulation and compliance procedures required for transfers, including sender and receiver identification	Documentation not required; transfers conducted based on trust and track record
Cost	Higher transfer costs caused by a lengthier process through intermediary institutions and risks associated with compliance and regulation requirements for institutions at each end	Relatively low cost because of minimal overhead and high competition
Transfer time	Longer processing and clearing times	Immediate transfer—only time outlays being agent correspondence and physical delivery or collection
Delivery	Longer travel time and costs for collection because of limited branches — generally available only in large cities Previously paid out Yemeni rials at the official rate, but conflict-related liquidity drain has led to payouts below market rate	Vast nationwide network of branches and agents, with coverage in rural areas Remittances paid out in the original currency; market exchange rate offered based on the beneficiary's willingness to exchange

Category	Formal banking system	Hawala networks
Functionality	Uncompetitive and vulnerable to the narrow client base, low reserve requirements, and no convincing lender of last resort The conflict has further eroded trust because of liquidity shortages	Perceived as more powerful than banks, with a high level of trust earned from resilience over time; well-connected to influential political figures Perform functions beyond transfers—many usually associated with the formal banking system (such as facilitating business transactions and investments) High levels of liquidity and healthy flow of the rial and foreign currencies—the latter largely from remittance inflows

Source: The Impact of Remittances on Yemen's Economy, ACAPS 2021.

After the beginning of the conflict, CBY Aden and CBY Sana'a issued separate licenses and regulations for the money exchange companies. As a result, both CBYs have limited capacity to regulate and collect data from money exchangers, preventing them from better understanding the sector's dynamics.

Table A.3 Major Money Exchange Companies in the Republic of Yemen

Name of Money Exchange Company	Headquarter
Aden Exchange Company	Aden
Ahmed Al-Ameri Exchange and Transfers	Sana'a
Al-Akwaa Exchange	Sana'a
Al-Busairi Exchange Company	Hadramawt
Al-Hitar Exchange Company	Sana'a
Al-Jazeera Bros. Exchange Co.	Sana'a
Al-Khader Exchange (also known as Mohsen al Khader Co)	Marib
Al-Morisi Exchange Company	Ad Dali
Al-Nasser Exchange Company	Taiz
Al-Noaman Exchange Company	Sana'a
Al-Omqy & Bros. Money Exchange	Hadramawt

Name of Money Exchange Company	Headquarter
Al-Qutaibi Exchange Company	Aden
Al-Thour Exchange	Al Mahrah
Al-Yabani Money Exchange & Transfer Company	Sana's
Bin Dowal Exchange Company	Hadramawt
Swaid & Sons Exchange Company	Sana's

Source: The Yemeni Financial Sector: Challenges and Opportunities for Recovery 2022

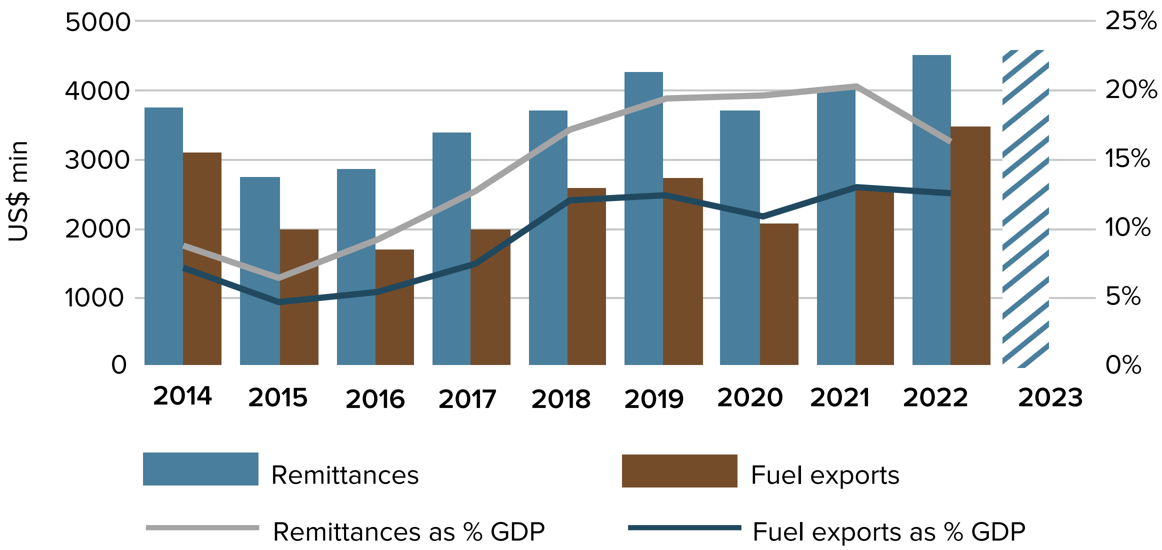
The money exchange companies are licensed to sell and purchase foreign currencies and process local and international money transfers. However, money exchange represents a semiformal sector since these companies provide services beyond the scope of their licenses. Their core business is to enable the informal inflows and outflows of import financing and remittance delivery. The money exchange companies are integrated with regional unregulated (hawala) networks and control parallel foreign exchange markets with other money exchange networks, banks, and the trade sector.

The money exchangers held public deposits illegally before the conflict and later accumulated a large share of the public savings. As a result, the banks have a diminished role in the money exchange sector. This is evident in the trade and services sectors, where money exchangers hold local and foreign currency in cash while the banks lack liquidity. Money exchangers also efficiently facilitate internal and external personal transfers and import financing. They offer credit and, therefore, operate as de facto, unregulated banks. According to Yemeni law, there are two types of money exchange entities based on business size: wholesale (large companies) and retail (sole proprietorship shops).

REMITTANCES

Remittances sent by expatriates provide income to meet the population's basic and essential needs and have become the country's largest source of foreign currencies. National accounts data indicate that remittances amounted to US$3.3 billion in 2017, about US$2.7 billion in 2018, and US$2.4 billion in 2019. In 2020, foreign currency remittances declined because of the pandemic- related economic consequences" to "because of pandemic-related economic difficulties. Yet despite the decline during that time, remittances reduced the conflict's humanitarian catastrophe. Since 70 percent of the population is based in DFA-controlled areas, most remittances are sent to recipients in the northern and northwestern governorates. According to official estimates, in 2021, remittances amounted to about US$4 billion. However, the Republic of Yemen's import bill for 2021 totaled approximately US$9.2 billion. Accounting for all other in-the-country expenses, the total value of remitted funds could exceed US$7 billion, especially since import volumes are likely undercalculated. Even at their officially reported levels, remittances over the past few years have become an equal or larger share of the Republic of Yemen's gross domestic product than revenues from fuel exports (see Figure A.8).

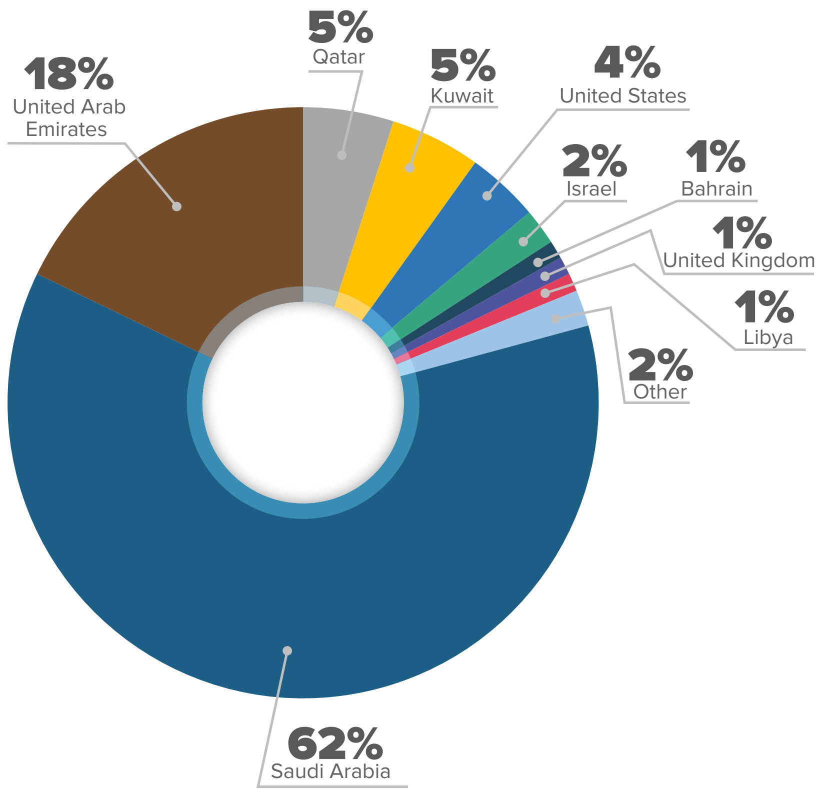
Figure A.8 Remittances and Fuel Exports (2014–23)



Source: Yemen Country Economic Memorandum – 2022, World Bank 2022.

Sixty-two percent of the remittances originate from Saudi Arabia, and 18 percent originate from the United Arab Emirates (see Figure A.9). The United Nations estimates that from 2010 to 2020, the number of Yemenis living in Saudi Arabia increased from 482,400 to 769,945. However, the 2021 figure might be higher, with an estimated 1.9 million Yemeni nationals in the country. Eighty percent of Yemenis in Saudi Arabia have a valid residency permit, and the other 20 percent have a visitor permit.

Figure A.9 Source of Remittances to the Republic of Yemen by Country



Source: World Bank and Global Knowledge Partnership on Migration and Development, "Migration and Development Brief 33, October 2020, Phase II: COVID-19 Crisis Through a Migration Lens," KNOMAD, October 2020.

TRADE FINANCING

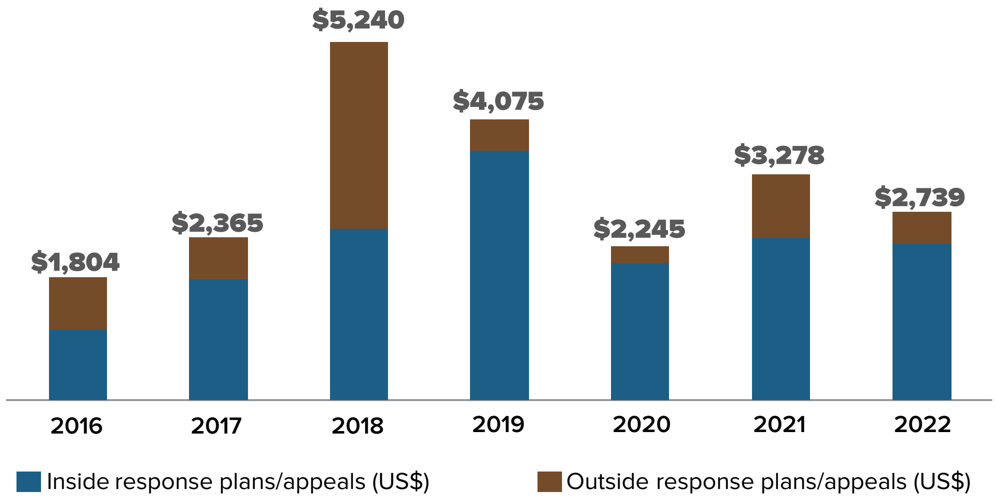
The conflict, lack of liquidity, and the international de-risking of Yemeni commercial banks have forced a shift from banks to money exchangers for international trade financing. International banks are reluctant to offer letters of credit—guaranteeing that a buyer's payment to a seller will be received on time—for cargo to a conflict-affected country. Yemeni banks stopped issuing letters of credit because foreign banks refused to transact with them. Today, Yemeni commercial banks make limited use of traditional letters of credit, bills of exchange, and letters of guarantee for trade financing. Financial service innovation has been minimal during the conflict and pandemic.

Money exchangers have become the primary recipients of deposits and sources of credit for traders (including importers). For example, retail hawala agents in Saudi Arabia and the Republic of Yemen are the focal points for physical currency arrangements. When importers in the Republic of Yemen need to renew their commercial stock, they make a deal for an import financing transfer that includes buying foreign exchange and transferring the funds abroad. The retail hawala agents in Saudi Arabia accumulate reserves in Saudi riyals from remittances and transfer them to wholesalers for import- and trade-financing purposes, while traders in the Republic of Yemen deposit their sale turnover into accounts with the hawala agents to then buy foreign exchange and make transfers to facilitate import financing.

DONOR COUNTRY FUNDING

According to the United Nations Office for the Coordination of Humanitarian Affairs, foreign donor funding peaked in 2018 at US$5.2 billion. However, it remained significantly lower in the region at only US$2.6 billion in 2021 (see Figure A.10). Donor funding covers internationally coordinated in-country response and external plan requirements (such as Red Cross or Red Crescent activities and bilateral funding to affected governments). The reduction in foreign donations over the past few years has been caused mainly by the decrease in outside response plan funds.

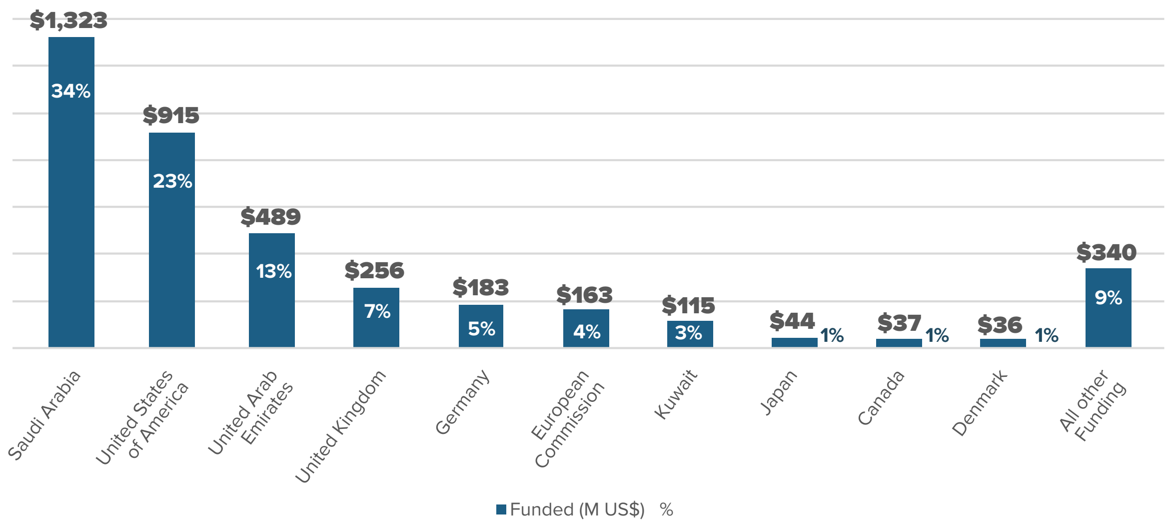
Figure A.10 Total Reported Funding to the Republic of Yemen (US$ millions)



Source: Financial Tracking Services, United Nations Office for the Coordination of Humanitarian Affairs, fts.unocha.org.

Most of the funding is provided by a few donor countries. For example, half of the total donor funds come from the governments of Saudi Arabia and the United States (see Figure A.11).

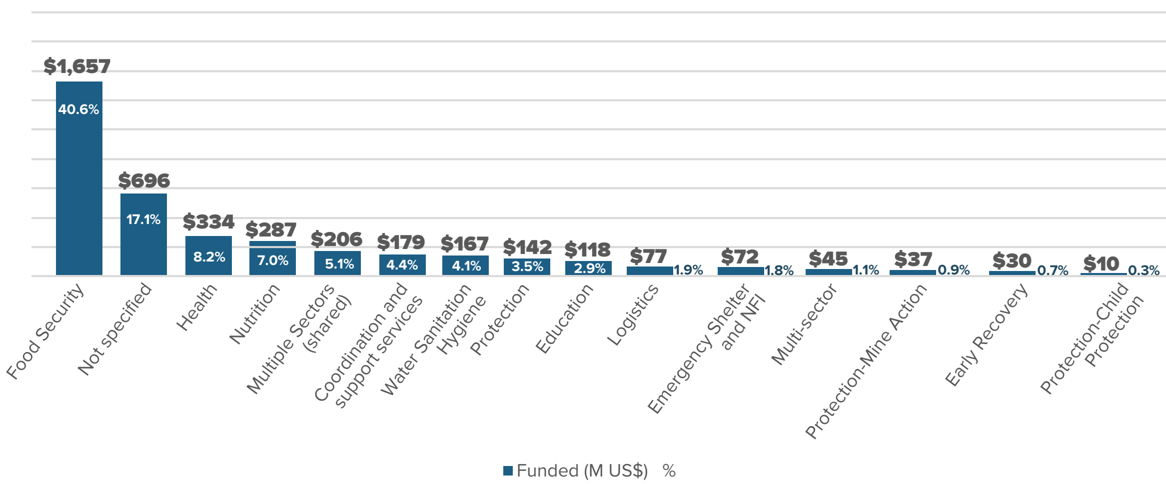
Figure A.11 Total Reported Funding to the Republic of Yemen by Donor Country (2021 US$ millions)



Source: Financial Tracking Services, United Nations Office for the Coordination of Humanitarian Affairs, fts.unocha.org

Donor funding covers financing for the most pressing humanitarian needs of the population groups affected by the conflict. Almost half of the funding is allocated to the food security and nutrition sectors (see Figure A.12).

Figure A.12 Total Reported Funding to the Republic of Yemen by Sector (2021 US$ billions)



Source: Financial Tracking Services, United Nations Office for the Coordination of Humanitarian Affairs, fts.unocha.org.

MICROFINANCE

Large segments of the Yemeni society depend on microfinance institutions (MFIs) during times of conflict and extraordinary hardship. MFIs play an important role in providing targeted financing to address some of the most pressing humanitarian needs. However, their extreme dependence on foreign donors and restrictive lending practices prevent them from functioning as full financial institutions to support the development of the private sector.

A microfinance support program in the Republic of Yemen was started in 1997 to pilot financial inclusion for low-income groups in rural areas. A governmental, semi-independent fund, the Social Fund for Development (SFD), was developed to execute and oversee the implementation of a microcredit program. In practice, the microfinance sector has shown limited financial inclusion success.

There are 10 MFIs in the Republic of Yemen, including three banks and seven core MFIs (see Table A.4). Ninety-three percent of their customers are in urban areas; only two MFIs provide services in rural areas where more than two-thirds of Yemenis reside.

Table A.4 Microfinance Institutions in the Republic of Yemen

NAME OF MFI	LICENSE TYPE	COVERAGE OF GOVERNORATE	NUMBER OF BRANCHES
Al-Amal Microfinance Bank	Bank		16
Al-Kuraimi Islamic Microfinance Bank	Bank		22
Tadhamon Microfinance	Bank	9	16
Al-Aweel Microfinance Company	Company	1	5
Aden Microfinance Foundation	NGO	3	8
Nama'a Microfinance Foundation	NGO	5	13
National Microfinance Foundation	NGO	10	17
Azal Islamic Microfinance Program	Program	4	7
Hadramawt Microfinance Program	Program	1	1
Union Microfinance Program – Abyan	Program	3	6

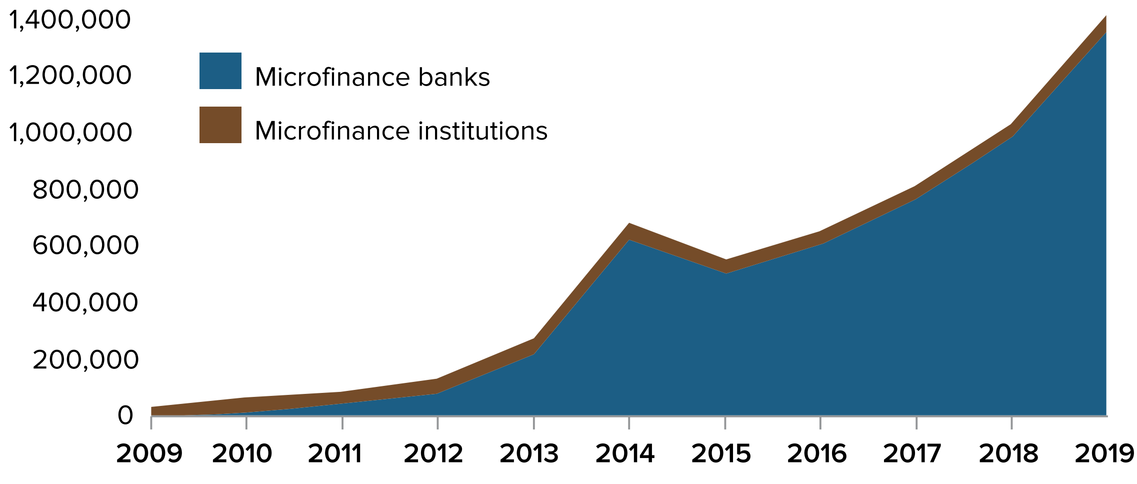
Source: The Yemeni Financial Sector: Challenges and Opportunities for Recovery 2022.

MFIs in the Republic of Yemen form two distinct groups: the formal sector of microfinance banks (MFBs) and the informal sector (MFIs). The central bank regulates the microfinance banks under the 2009 law governing microfinance activity. As a result, they can finance their activities by mobilizing public savings through deposits and can offer market-based loans. However, MFIs operate outside the central bank's governance and fall under NGO regulations. This makes them reliant on external funds and programs channeled through the SFD. Moreover, as MFIs are limited to donor funding, their options for offering credit are narrowed to groups and activities specified by donor support programming.

Over the past few years, microfinance banks have expanded their activities but still represent a small share of the banking sector in the Republic of Yemen. In 2020, the banking sector's total assets reached YRI 3.6 trillion. Conventional banks accounted for 31 percent of the total banking assets, followed by government banks (29 percent), Islamic banks (23 percent), foreign banks (10 percent), and microfinance banks (8 percent).

The number of active MFB savers increased after 2015. The number of depositors grew annually by 28 percent on average from 2016 to 2019, reaching 1.2 million in 2019 (Figure A.13). The Al-Kuraimi Islamic Microfinance Bank accounts for 82 percent of these savers. The perceived stability of Al-Kuraimi, compared to the loss of confidence in the commercial banks, led savers to shift their savings to MFBs.

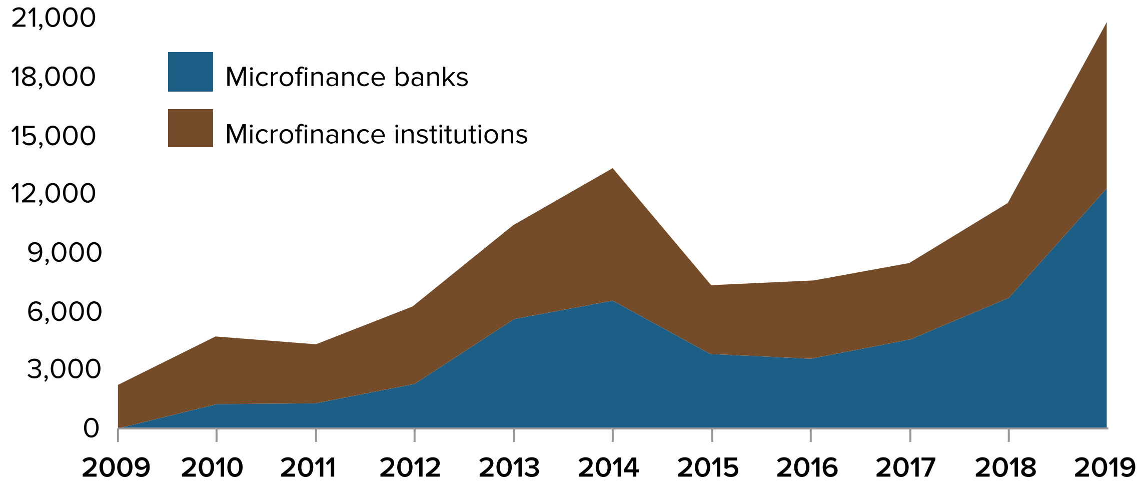
Figure A.13 Overview of Microfinance Banks and Institutions in the Republic of Yemen



Source: Al-Shaibani, M. (2020) 'Microfinance in Yemen: An overview of challenges and opportunities.' Rethinking Yemen's Economy (https://sanaacenter.org).

In addition, MFB loans increased by 28 percent in 2017, 43 percent in 2018, and 85 percent in 2019. However, the total size remains modest, reaching YRl 11.4 billion or about US$19 million (see Figure A.14). Consequently, the microfinance industry extends very small loans, with an average size of YRl 89,072 (about US$148) at an average interest rate of 18 percent, with women comprising 35.4 percent of loan recipients in 2019.

Figure A.14 Overview of Microfinance Banks and Institutions



Source: Al-Shaibani, M. (2020) 'Microfinance in Yemen: An overview of challenges and opportunities.' Rethinking Yemen's Economy (https://sanaacenter.org).

THE POST OFFICE SYSTEM

Before the conflict, the post office in the Republic of Yemen was part of the country's financial system, offering savings and cash transfer services. The post office also paid out social protection transfers from the social welfare fund and humanitarian cash transfers. Despite these financial functions, the CBY did not regulate the country's post office system. The post office has ceased to offer these services and is no longer a significant part of the country's financial system. As a result, depositors have lost access to their savings account balances, which the post office system had invested in treasury bills.

CONCLUSION

The ongoing conflict has severely affected the Republic of Yemen's financial sector, making it unable to perform its primary functions, which include providing credit and facilitating transactions for the private sector. The shortcomings of different financial institutions have put severe constraints on private sector operations and growth, particularly in the MSME sector in rural areas. Introducing new policies could strengthen the financial sector and enable it to contribute to the resilience and development of the Republic of Yemen's economy.

Appendix B.

List of Key International Conventions and Model Laws that Will Reintegrate the Yemeni Private Sector into the International Trade, Investment and Financial System

In addition to the recommendations in this report, the Yemeni authorities should consider adopting the United Nations conventions and UNCITRAL model laws presented in Table B.1 to improve cross-border trade, foreign direct investment, and the internal business environment and prepare the private sector for the reconstruction and recovery phase.

Table B.1 UN Conventions and UNCITRAL Model Laws

	List of Conventions and Model Laws
1.	Convention on Recognition and Enforcement of Foreign Arbitral Awards (1958) (New York Convention)
2.	UNCITRAL Model Law on International Commercial Arbitration (1985, with amendments adopted in 2006)
3.	United Nations Convention on International Settlement Agreements Resulting from Mediation (2018) (the "Singapore Convention on Mediation")
4.	UNCITRAL Model Law on International Commercial Mediation and International Settlement Agreements Resulting from Mediation (2018)
5.	United Nations Convention on Contracts for the International Sale of Goods (Vienna 1980)
6.	United Nations Convention on the Limitation Period in the International Sale of Goods (1974)
7.	UNCITRAL Model Law on Public Procurement (2011)
8.	United Nations Convention on the Use of Electronic Communications in International Contracts (2005)
9.	UNCITRAL Model Law on Electronic Transferable Records (2017)
10.	UNCITRAL Model Law on Electronic Signatures (2001)
11.	UNCITRAL Model Law on Electronic Commerce (1996, with additional article 5 bis as adopted in 1998)

List of Conventions and Model Laws	
12.	UNCITRAL Model Law on Cross-Border Insolvency (1997)
13.	United Nations Convention on the Assignment of Receivables in International Trade (2001)
14.	UNCITRAL Model Law on Secured Transactions (2016)
15.	United Nations Convention on Independent Guarantees and Standby Letters of Credit (1995)
16.	United Nations Convention on International Bills of Exchange and International Promissory Notes (1988)
17.	United Nations Convention on Contracts for the International Carriage of Goods Wholly or Partly by Sea (2008) (the “Rotterdam Rules”)
18.	United Nations Convention on the Liability of Operators of Transport Terminals in International Trade (1991)
19.	United Nations Convention on the Carriage of Goods by Sea (1978) (the “Hamburg Rules”)
20.	United Nations Convention on Transparency in Treaty-based Investor-State Arbitration (2014) (the “Mauritius Convention on Transparency”)

Source: United Nations Commission on International Trade Law (UNCITRAL), https://uncitral.un.org.

Note: None of these have been adopted in the Republic of Yemen, according to UNCITRAL. This table does not include legislative guides, since they provide guidance to countries and do not require ratification or accession (such as a treaty) or enactment in the domestic law (such as a model law).

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