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INTERNATIONAL DEVELOPMENT ASSOCIATION

PROGRAM DOCUMENT

FOR A PROPOSED GRANT

IN THE AMOUNT OF SDR 32.8 MILLION
(US$50.93 MILLION EQUIVALENT)

TO THE

REPUBLIC OF YEMEN

FOR AN

INSTITUTIONAL REFORM DEVELOPMENT POLICY GRANT

November 6, 2007

Finance and Private Sector Development
Social and Economic Development Department
Middle East North Africa Region

REPUBLIC OF YEMEN - GOVERNMENT FISCAL YEAR
January 1 – December 31

CURRENCY EQUIVALENTS
(Exchange Rate Effective as of September 2007)

Currency Unit	Yemeni Rial (YR)
US$1.00	198.2
US$1.55	SDR 1

WEIGHTS AND MEASURES
Metric System

ABBREVIATION AND ACRONYMS

CAS	Country Assistance Strategy
CSMP	Civil Service Modernization Project
DPPR	Socio-economic Development Plan for Poverty Reduction
DPR	Development Policy Review
EITI	Extractive Industries Transparency Initiative
GDP	Gross Domestic Product
GNP	Gross National Product
IBRD	International Bank for Reconstruction and Development
ICA	Investment Climate Assessment
IDA	International Development Association
IFC	International Finance Corporation
IMF	International Monetary Fund
IR DPG	Institutional Reform Development Policy Grant
LDP	Letter of Development Policy
MGGM	Matrix of Good Governance Measures
MDGs	Millennium Development Goals
MCSI	Ministry of Civil Service and Insurance
MOF	Ministry of Finance
MOPIC	Ministry of Planning and International Cooperation
MTEF	Medium-Term Expenditure Framework
NRA	National Reform Agenda
PEFA	Public Expenditure and Financial Accountability
PIP	Public Investment Program
PRSP	Poverty Reduction Strategy Paper
PRSC	Poverty Reduction Support Credit
SDR	Special Drawing Rights
UNDP	United Nations Development Program

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YEMEN INSTITUTIONAL REFORM DEVELOPMENT POLICY GRANT

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Acknowledgments

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GRANT AND PROGRAM SUMMARY

Republic of Yemen
INSTITUTIONAL REFORM DEVELOPMENT POLICY GRANT

Borrower	Republic of Yemen
Implementing Agency	Ministry of Planning and International Cooperation
Amount	SDR 32.8 million (approximately US$50.93 million equivalent)
Terms	IDA Grant
Tranching	Two equal tranches of SDR 16.4 million (approximately US$25.47 million equivalent) each. The first tranche to be disbursed upon effectiveness and the second one at the latest 18 months after effectiveness, which is the period over which agreed measures are expected to be finalized as per the financing agreement.
Description	The Institutional Reform Development Policy Grant (IR DPG) will support the Government's Reform Strategy, as discussed in the country assistance strategy (CAS). It emphasizes two key elements: • Supporting non-oil growth through investment climate reforms through: ➢ Rationalizing the incentive framework (by harmonizing treatment of income, expenses and investment with international standards) ➢ Strengthening property rights (by reducing ambiguity of land titling and improving public management of land registration). • Strengthening governance and public financial management through: ➢ Reforming procurement as part of public financial management reforms to increase transparency and accountability and to separate the policy-making functions from the administrative function. ➢ Supporting the public administration reform strategy, in particular through wage policy, retrenchments and a biometric database on public employees as part of broader civil service reform. ➢ Increasing revenue transparency through Yemen's accession to the Extractive Industries Transparency Initiative (EITI).
Benefits	The project should contribute to accelerate growth, poverty alleviation and improved governance through its provisions, which comprise key parts of the Government's overall growth strategy.
Risks	The key risks are: (i) A risk of policy reversals or loss of momentum due to changes in Government or domestic political conflict. (ii) Failure to implement key policies supported by the loan due to weak institutional capacity. (iii) Fiscal and macroeconomic risks due to exogenous shocks, such as regional conflict or a decline in oil prices, which could create fiduciary risks. Other risks include the potential for deficits from poor enforcement of taxes or weak expenditure management.
Operation ID Number	P101453

INTERNATIONAL DEVELOPMENT ASSOCIATION
PROGRAM DOCUMENT FOR A PROPOSED
INSTITUTIONAL REFORM DEVELOPMENT POLICY GRANT
TO THE REPUBLIC OF YEMEN

I. INTRODUCTION

1. Yemen's extreme poverty demands an urgent response. Yemen is a World Bank Group IDA recipient country, with per capita GNI of US$760. It has a population of 21 million, with nearly half age 15 or below. The recently concluded poverty assessment estimated 34.8 percent of the population as living in poverty, sharply divided between an urban rate of 20.7 percent and a rural rate of 40.1 percent.[1] Yet, growth has been slow, barely outpacing population. The investment climate remains constrained, while the economy remains vulnerable to energy prices and regional political insecurity. Also, Yemen's energy, transport, and water and sanitation infrastructure are underdeveloped. The economy is highly dependent on a dwindling oil sector that is weakly linked to local industry and capacities, yet accounts for almost 93 percent of all exports. Unemployment is estimated to be 16.3 percent,[2] while agriculture (comprising only 10 percent of GDP) continues as the main source of income for the vast majority of the population. At the same time, Yemen, with signifcant water-scarcity, continues to rapidly deplete its groundwater. The Government, in recognition of the urgency of reform, launched a comprehensive program with the third five-year development plan (PRSP) and subsequent National Reform Agenda. Donor support is critical to the success of these reforms. The Institutional Reform Development Policy Grant (IR DPG) forms one part of the Bank's overall strategy to support poverty reduction, specifically by supporting reforms aimed at stimulating non-oil growth and strengthening governance.

II. COUNTRY CONTEXT

RECENT MACROECONOMIC DEVELOPMENTS

High oil prices underpinned the favorable macroeconomic outcomes in recent years. The fiscal deficit narrowed and the current account stayed in surplus. GDP growth has been sustained at about 4 percent per year (higher than the population growth rate of about 3 percent) despite falling oil production because of offsetting growth in non-oil sectors. But, inflation and long-term fiscal sustainability have emerged as key policy concerns. The percentage of the poor has dropped from 40.1 in 1998 to 34.8 in 2005/06.

2. **Declining oil production restrained GDP growth in 2006.** Real GDP grew at 4 percent in 2006, slightly less than the 4.6 percent increase in 2005. The slowdown largely reflected the sharp loss in oil output, estimated at more than 8 percent. Oil production had hit a peak in 2003 and has

[1] The CAS refers to the results of the 1998 household budget survey, which placed the poverty rate at 42% of the population.
[2] Based on census 2004.

been declining except for a brief pause in 2005. Increasingly Yemen has had to rely on promising non-oil sectors for growth. On the expenditure side, growth was primarily sustained by the expansion in public final consumption. Investment spending, on the other hand, remained stagnant, with the bulk of activity taking place in the energy and infrastructure sectors.

3. **Dynamism in promising non-oil sectors such as fisheries and tourism helped to sustain non-oil growth**. Fisheries and trade sectors showed improvement, with the former expanding by 16.4 percent (compared to 10.1 percent in 2005) and the latter by 8.3 percent (compared to 3.5 percent a year ago). Tourist arrivals have increased greatly since 2003, as the number of arrivals more than doubled to 382,000. Revenues have also doubled since 2003, from $139 million to $309 million in 2006. Growth in manufacturing, however, slowed to 5 percent from 8.1 percent.

4. **Inflation in 2006 surged to 18.4 percent, driven primarily by higher food prices.** After staying in the range of 10-12 percent for many years, inflation surged in the aftermath of an increase in the administered prices of petroleum products. The jump in food prices, however estimated at 28.6 percent, has largely reflected the 45 percent price escalation in fruit and vegetable prices. This increase was sustained by domestic supply factors, the surge in international food prices, and higher domestic demand linked to the award of a pay rise in the public sector in 2006. The effect of the partial removal of domestic-oil price subsidies in July 2005 has also continued to ripple through various sectors in the economy in 2006, including agriculture, which is heavily dependant on diesel fuel for irrigation.

5. **High international oil prices helped to create a small surplus in the fiscal balance in 2006 for the first time since 2001.** Preliminary data for 2006 indicate improved fiscal position relative to the 2005 outcome and in relation to the forecasted budget. The improvement was sustained by a higher-than-expected rise in revenue to 38.3 percent of GDP and moderate growth in expenditure to 37.4 percent of GDP. Revenue was boosted by strong oil income, which despite declining production, increased by some 35 percent on account of higher prices and a larger government share in total output. Meanwhile, expenditure witnessed a 20 percent increase boosted by rising expenditure on wages and salaries and subsidies. As a result, the overall fiscal balance recorded a small surplus of 0.9 percent of GDP compared to a deficit of 1.8 percent a year before. However, the non-oil primary balance, the major indicator of fiscal sustainability, continued to show deterioration, reaching about 25 percent of GDP in 2006, up from about 15 percent in 2000.

6. **The current account balance for 2006 recorded a surplus of about US$200 million, equivalent to 1 percent of GDP.** The surplus was sustained by record oil revenues, which increased by 14 percent to US$6.7 billion despite an 8 percent fall in production. With the continuing current account surplus for the eighth consecutive year and large inflows of direct investment in recent years, the country's foreign reserves climbed by end of 2006 to US$7.6 billion equivalent to 11 months of imports.

Table 1: Recent Macroeconomic Indicators, 2004-06

	2004	2005	Preliminary 2006
	(Percent change; unless otherwise indicated)		
Real GDP	4.0	4.6	4.0
Oil	-5.0	-0.8	-8.3
Non-oil sectors	5.4	5.3	5.7
Inflation (CPI, Period Change)	12.5	11.4	18.4
Crude oil production (In thousand barrels per day)	396	394	357
Average oil export price (US$ per barrel)	36.6	51.5	63.0
General government finances	(Percent of GDP)		
Revenue	31.7	34.7	38.3
Of which : oil	19.7	23.5	28.9
Expenditure	33.8	36.5	37.4
Current	24.1	26.6	28.4
Of which : wages and salaries	9.2	9.1	10.3
Subsidies	5.9	8.9	8.2
Capital	9.8	9.8	9.1
Overall fiscal balance (deficit -)	-2.2	-1.8	0.9
Primary non-oil balance	-19.8	-23.2	-25.7
Balance of payments	(Billions of U.S. dollars)		
Exports of goods	4.7	6.4	7.3
Of which: petroleum	4.3	5.9	6.7
Imports of goods	3.9	4.7	5.9
Services balance	-0.7	-0.9	-1.3
Current account balance	0.2	0.6	0.2
Current account (as percent of GDP)	1.6	3.8	1.0
Net direct investment	-0.1	0.3	-1.1
Reserves	(Billions of U.S. dollars)		
Gross official reserves (end period)	5.7	6.1	7.5
In months of imports of goods & non-factor services	11.5	9.4	11.1
Exchange rates			
Exchange rate (per US$, period average)	184.8	191.4	197.1

Source: Yemen, Live Data Base, October, 2007.

7. **The nominal exchange rate continued to depreciate; while high domestic inflation caused a real appreciation.** In 2006, the rial depreciated by 2.9 percent, below the 3.6 percent recorded in 2005, and the near 4 percent average rate during the period 2000-2004. The real appreciation that has occurred is not indicative any serious misalignment of the exchange rate (as per IMF Article IV consultation, August 2007) in the current circumstances. However, in the future when oil is depleted completely, the exchange rate will have to depreciate.

Box 1: Progress in Poverty and Social Outcomes

Poverty in Yemen reduced: the percentage of poor fell from 40.1 in 1998 to 34.8 in 2005/06. It is creditable that this reduction has been achieved in the context of a high population growth of 3 percent per year. Most of the improvement has occurred in the urban areas, with poverty rate falling from 32.2 to 20.7 percent. In rural areas, where 73 percent of the total population lives, the decline was much less noticeable as poverty headcount declined from 42 to 40.1 percent.

Yemen has made great strides in improving access to education, but it has a long way to go to achieve universal primary completion and gender parity. In 2003, gross primary enrollment was 83.5 percent (up from about 65 percent in 1990), and net primary enrollment reached 72 percent (compared with 52 percent in 1990). Between 1995 and 2000, total enrollment rates in basic education increased by 30 percent, while secondary education rates increased by 50 percent. However, the primary completion rate was only about 65 percent and had fallen short of the two-thirds of population of the relevant age group by 2003. The adult literacy rate was only 49 percent, and more than 70 percent of women were illiterate.

The health status of the Yemeni population has improved but is still very low. Women have increased their life expectancy from 52.6 years in 1990 to 58.1 in 2002. The infant mortality rate for every 1,000 births decreased from 98 in 1990 to 83 in 2002. However, maternal mortality rate (570 per 100,000 live births) and total fertility rate (6.0 children per woman) are the highest in the Middle East and North Africa region. Child malnutrition is also the highest in the region, and almost half of the Yemeni children suffer from stunting.

High rates of gender inequality stubbornly persist, although some progress has been made. Yemen ranks 121 out of 140 countries on the Gender Development Index (UNDP, 2005). Female gross primary enrollment rate has doubled from 34 percent in 1990 to 68 percent in 2002. Female net primary enrollment has also shot up from 28 percent to 59 percent over the same period. This increase compares favorably to the male percentage, which has moved up from 74 percent to 84 percent. Although in 1990 female literacy was as low as 12.9 percent, compared with 55.2 for males, by 2002 the female rate had increased to 28.5 percent, compared with 69.5 percent for males. Only 33 percent of rural girls were enrolled in school, compared with 73 percent of rural boys and 78 percent of urban girls. Female adult illiteracy (at 78 percent in rural areas and 40 percent in urban areas) is more than twice that of males (32 percent in rural areas and 15 percent in urban areas). Young and relatively educated women (age 15–29) have a higher rate of unemployment than their male counterparts: 56 percent of all female unemployment is among young women compared with 47 percent for young men (World Bank 2004).

MACROECONOMIC OUTLOOK AND DEBT SUSTAINABILITY

Yemen faces formidable challenges in the medium to long-term as known oil reserves are exhausted and the already scarce water resources deplete even as demand mounts. The government has indicated its commitment to carry out difficult reforms to restore fiscal sustainability and spur alternative sources of growth in its PRSP and national reform agenda. Unfortunately, Yemen will face high external debt stress even if it carries out all the identified reforms and borrows on concessional terms. Donor support is thus critical to sustain long-term development in impoverished Yemen.

8. **The current year (2007) outlook is mixed.** While GDP growth is expected to be about the same as the last year, inflation is expected to decline to the 12-14 percent range following active use of monetary policy instruments and reining in of public expenditures on wages and salaries. The signs of active monetary policy are already evident as the use of T-Bills for mopping up liquidity has resumed and the inflation in the first half of 2007 has declined. Internal and external balances are, however, expected to turn to a deficit. The declining oil production (down by 10 percent from the previous year) and high import requirements for the YemLNG plant are the factors behind the swing to deficits.

9. **Yemen faces daunting challenges as oil and water resources continue to deplete even as the population grows briskly at 3 percent annually.** At current rates of crude-oil production and domestic consumption, Yemen could be a net importer by 2015, and will cease production by 2018. Since exports and public finances rely heavily on oil, the impending oil depletion will stress macroeconomic management.

10. **The medium-term outlook suggests that GDP growth will gradually improve to secure a 5 percent growth per year until 2012.** Though GDP growth in the current year is expected to be around 4 percent, the same as the last year, the outlook is modestly positive (Table 2). Rising non-oil GDP growth to about 6 percent by 2012 will offset the contraction in the oil output. The commencing of LNG production and exports in 2009 will temporarily create a growth spike in that year. Growth in the non-oil sector (fisheries, tourism, agricultural products) will be sustained by new public investment projects, supported by pledges from Consultative Group donors, and ongoing projects (including Yemen Liquid Natural Gas (YLNG), Marib Power, and the first private-sector refinery). Private investment is also expected to start picking up in response to recent legislative and administrative reforms aimed at improving the investment climate.

11. **The medium-tem outlook is optimistic despite the continuing depletion of oil, conditional on the government implementing significant reforms**. Hydrocarbon export revenues of the government are set to decline by 30 percent between 2006 and 2012, even after allowing for the new source of gas exports which is expected to come on stream in 2009. To keep the fiscal deficit capped below 3 percent a year in the wake of shrinking hydro-carbon revenues will require strong adjustments efforts that will result in slashing expenditures every year by one percentage of GDP. The macroeconomic framework also requires strict monetary discipline to contain inflation under 10 percent by 2012 despite the cost-push coming from fuel subsidy removal and application of indirect taxes. The adverse impact on poverty (Box 2) is expected to be cushioned by effective social transfers through a reformed social welfare fund. The non-oil primary deficit should be cut nearly by 10 percent points improving long-term fiscal sustainability.

12. **The medium-term outlook builds on several policy assumptions**. The key adjustment efforts envisaged in the medium-term are shared by the World Bank and IMF. The proposed reforms are: ending of fuel subsidies by 2010 and in-lieu imposing of a fuel tax, full implementation of the General Sales Tax (GST) with the doubling of the rate to 10 percent in 2009, curtailing wages and salaries by 1.6 percent of GDP, putting in place a social transfer

mechanism that will protect the poor from adverse effects of fuel price reforms. Helped in part by foreign financing, public capital spending will increase in this period to 9 percent of GDP supporting an overall GDP growth of 5 percent a year.

13. **Implementing measures to secure fiscal sustainability require strong political will.** The authorities understand the importance of securing fiscal sustainability but there could be difficulties in implementation in the political context of Yemen. In the past, fuel prices have been raised infrequently (1999, 2001, and 2005) and painfully, causing violent riots. The World Bank and IMF have proposed to the government a gradual, pre-announced, but not abrupt, increase in fuel prices, accompanied by cash-transfers to the poor. The increase in GST also faces tough opposition from the private sector. The successful introduction of GST in 2005 followed a decade long process.

Table 2: Medium-term Projections, 2007-12
(Share of GDP unless stated otherwise)

	2006	2007	2008	2009	2010	2011	2012	Average 2007-12
Real GDP Growth, percent per year								
	4.0	3.6	4.3	8.0	5.3	4.7	4.9	5.0
Non-hydrocarbon	5.7	5.2	4.9	5.0	5.1	5.7	5.8	5.3
Hydrocarbon	-8.3	-10.1	-1.2	39.7	7.0	-3.2	-3.1	4.9
Inflation (consumer price index), percent per year	18.2	12.5	12.1	10.5	9.5	8.8	8.3	10.3
General Government Revenue and grants	36.4	30.9	30.7	30.2	28.9	27.8	26.6	29.2
Hydrocarbon export revenue	27.5	11.3	10.2	7.8	6.6	5.4	4.3	8.3
Tax revenue (non hydrocarbon)	8.9	7.1	7.6	10.2	10.4	10.7	10.9	9.5
General Government Expenditure and net lending	35.6	35.6	35.2	33.1	31.5	30.0	29.3	32.5
Subsidies	7.8	7.6	6.4	4.2	2.3	0.1	0.1	3.5
Wages and salaries	9.3	9.0	9.0	8.1	7.8	7.6	7.4	8.2
Capital spending	7.3	8.1	8.0	8.9	8.9	9.4	9.0	8.7
Social spending	7.0	8.1	9.0	9.8	10.5	10.9	10.9	9.9
Overall Fiscal balance	2.1	-2.6	-2.5	-1.4	-0.8	-0.6	-1.1	-3.3
Non-oil primary balance	-25.4	-24.9	-23.4	-19.4	-17.2	-15.5	-14.6	-19.2
Trade Balance (f.o.b in millions of US$)	1,395	-741	-193	691	401	-386	-1,217	-240.8
Exports,	7,285	6,377	6,740	7,688	7,760	7,334	6,895	7,132.3
Hydrocarbon exports	6,733	5,814	6,144	7,056	7,089	6,617	6,128	6,474.7
Imports	5,890	7,118	6,933	6,997	7,359	7,720	8,112	7,373.2
Current account balance (% of GDP)	1.0	-3.8	-1.3	0.6	0.0	-2.2	-3.8	1.8

Source: IMF Article IV consultations, August 2007.

14. **The government's reform commitments are in the right direction.** The authorities agree with the need to reform the Social Welfare Fund to improve targeting of the poor, eliminate fuel subsidies, raise more non-oil revenue by higher GST, and implement the National Wage Strategy only after cleaning up the payroll and other institutional reforms. The commitment given

by the authorities on inflation management by active use of monetary and exchange rate policies is also reassuring. Unswerving commitment to inflation containment will be critical in the medium-term. Further, the reforms supported by the proposed IRG in the area of governance and anti-corruption, public administration, and private and financial sector development will also help in creating an environment conducive to public trust in reforms, a leaner and more efficient bureaucracy and a better business environment for the private sector.

Box 2: Subsidies and the Poor in Yemen

Subsidies to petroleum products burden the budget and benefit mostly the non-poor. Yemen subsidizes retail prices of petroleum products between 16 percent (petrol) and 70 percent (LPG). The subsidy outlay is, however, highest on diesel which is subsidized at a rate of about 50 percent.[3] In 2006, these subsidies amounted to about 8 percent of GDP and 22 percent of general government expenditure. The outlay on subsidies exceeded government's capital spending and its social spending. The direct benefits of subsidies on final petroleum products are reaped mostly (about 80 percent) by the non-poor. In the past ten years, the authorities have revised the petroleum prices infrequently (1999, 2001, and 2005).

Poverty rates in Yemen would be significantly higher without petroleum subsidies. Without the current petroleum subsidy (taking into account only the price increase on gas, LPG and kerosene), the poverty rate would have been roughly 2.5 percentage points higher. The impact would have been higher for urban areas, where poverty would go up by 3.6 percentage points, versus 1.5 percentage points for rural areas. Petroleum subsidies have a spillover effect by keeping the price of other goods low. When this indirect effect of petroleum subsidies is accounted for, the poverty rate without subsidies would be 9.2 percentage points higher. The rates are 7.6 percentage points for the urban versus 9 percentage points for the rural. Therefore, accounting for indirect affect, the impact of current petroleum subsidy removal will be higher on rural areas than urban ones. Current petroleum subsidies are keeping roughly 1.5 million people from slipping into poverty.

Yemen can protect the poor while eliminating the untargeted petroleum subsidies. The reform of the government's cash-transfer program currently underway with the help of EU is a step in the right direction. By moving to proxy means testing to identify the poor instead of categorical targeting at present, as done in the EU supported pilot project in three governorates, the impact on poverty can be improved significantly. Also, by using district level poverty rather than the governorate level poverty to allocate funds, the impact on poverty is more equitable between the rural and urban areas. For poverty not to increase when subsidies are eliminated, roughly half the saved budget on subsidies may have to be redistributed to the cash-transfer mechanisms.

DEBT SUSTAINABILITY

15. **Yemen's total outstanding external public debt was about US$5 billion (26 percent of GDP) by year-end 2006, a significant reduction from the US$11.4 billion in 1996.** Three

[3] As of January, 2007. Since then, the rates of subsidies have gone up higher as international prices have risen but domestic prices have remained unchanged.

Paris club restructuring rounds have helped Yemen secure external debt relief in the past (1996, 1997 and 2001). All official debt is concessional, reflecting a grant element of about 65 percent.

16. **Yemen debt management policy has been consistently sound.** Yemen publishes monthly and quarterly updates on external debt using DMFAS (Debt Management and Financial System) and a yearly update regarding Debt Sustainability using DSM+ (Debt Sustainability Model). Yemen scores the highest rating in the World Bank's Debtor Reporting System. The increase in debt risk is beyond the control of government as oil resources deplete. Reflecting the long-term concerns, the cabinet has approved and sent to the parliament a new debt law with a ceiling on total public sector debt (external and internal) set at 80 percent of GDP, with either component not to exceed 60 percent of GDP.

17. **The recent debt sustainability analysis carried out jointly by the Bank and the Fund in August 2007 found Yemen to face a high risk of external debt stress.** Even with the baseline scenario that assumed full implementation of a comprehensive set of reforms, one of the four performance appropriate[4] thresholds – NPV of external debt-to-exports ratio – will be breached by 2018 exceeding the threshold level of 150 percent, and the threshold of NPV of debt-to-GDP approached. The risks are exacerbated if either the oil price falls or debt-terms harden.

18. **Macroeconomic risk factors.** The main downside risk is the ability of the authorities to improve fiscal sustainability in time. If the proposed gradual elimination of fuel subsidies is not initiated for reasons of political expediency, the fiscal deficit will widen considerably putting pressure on inflation, curtailing capital expenditures and harming long-term growth and worsening poverty. Another downside risk is a lower than expected production of oil, which could precipitate a revenue crisis for the government. On the upside, if the oil prices stay consistently higher in the coming years, the government will have more resources to promote non-oil growth and make the path of adjustment less painful.

III. THE GOVERNMENT'S PROGRAM

19. The Government's medium-term strategy is embodied in the Yemen Third Socio-economic Development Plan for Poverty Reduction (2006-10) (DPPR), which also serves as its PRSP. In this document, the Government identifies its strategic goals (or "pillars"), namely to:

- Achieve a steady improvement in economic growth;
- Reduce poverty and raise the quality of life;
- Promote good governance;
- Reduce regional and gender disparities;
- Enhance decentralization; and
- Broaden the participation of civil society.

[4]For a medium performer under the World Bank's Country Policy and Institutional Assessment rating, the indicative thresholds are: NPV of debt –to-exports of 150 percent, NPV of debt-to-GDP of 40 percent and a debt-to-export ratio of 20 percent, and debt-service to revenue ratio of 30 percent[4]

20. It also identifies several "priorities" for achieving poverty reduction and growth, including:

- Reforming the economic structure;
- Improving the investment climate;
- Boosting the private sector; and
- Integrating Yemen speedily into the global market through accession to the Gulf Cooperation Council and the World Trade Organization.

21. The DPPR identifies a number of broad reforms to macroeconomic policy, governance practices, trade policy, infrastructure development, and sectoral policies to realize poverty reduction. It also lays out an ambitious agenda for human resource development, including measures to improve education and health, improve and augment public services, and strengthen social protection. Finally, the DPPR broadly lays out measures to improve and conserve water supply, protect the environment and strengthen basic infrastructure.

22. By all accounts, government commitment to and progress on reforms has strengthened in the recent past. To operationalize its growth and poverty reduction goals in the short-run, in early 2006 the Government (with strong donor support) put into place its National Reform Agenda (NRA), an ambitious reform program aimed to address a number of the key development challenges. The stated overall objective of this agenda is to improve Yemen's investment climate and strengthening its governance and democratic institutions. It was done in explicit recognition of key priorities:

> *"Effective development requires high and sustained economic growth, and in the face of declining oil revenues, Yemen must urgently reorient its economy to non oil-based sectors, thus promoting export diversification and labour-intensive segments of the economy. This hinges on Yemen's ability to stimulate domestic private investment as well as foreign direct investment by improving its overall business environment. Bolstering investments, in turn, is conditional on enhancing the governance structure, fighting corruption and removing significant obstacles to investment and growth."*

23. To make the reform agenda concrete, in January 2006, the Government approved a six month "Action Plan" and a "Matrix of Good Governance Measures" (MGGM) which together mapped out a set of discrete, short- and medium-term activities for advancing the reform agenda. The action plan described concrete measures designed to reform procurement, public audit, corruption, debt policy, fiscal policy, the financial sector, public financial management, and the business regulatory environment. The Good Governance Measures organizes concrete measures thematically under the headings of (i) establish rule of law, (ii) fight corruption, (iii) improve business enabling environment and government effectiveness, and (iv) increase political participation.

24. Since the approval of these key elements of the National Reform Agenda, significant progress has been realized on the planned activities, including a number of measures designed to strengthen governance and public service delivery, ease regulation and tax burden as a

disincentive to investment, and strengthen infrastructure. Table 3 summarizes some of the key accomplishments within the "good governance" agenda and makes clear the impressive pace and scope of reform compared to that of first half of the decade:

Table 3: Summary of Matrix of Good Governance Measures and Achievements		
Objective	**Targeted Activity**	**Achievements/Status**
	Establish Rule of Law	
Improving Courts Efficiency and Effectiveness	• Achieve separation of powers (functional and budgetary), independence of Supreme Judicial Council from Executive; strengthened criteria for selection of judges; improved accountability. • Establish Administrative Courts • Develop an action plan to achieve improved court performance, increase transparency to ensure more public access to justice services and boost public confidence.	Government of Yemen has amended the law of Judicial Authority to replace the President of the Republic as head of Supreme Judicial Council (SJC) and instead establish a separation of powers. Judicial independence was strengthened and reforms in the judiciary gained considerable momentum. The SJC was restructured and is now headed by the head of the Yemeni Supreme Court. In addition, judicial accountability was emphasized as 22 Judges were retired and 4 were referred to the Accountability and were ultimately suspended for judicial misconduct. Two new commercial appeals courts were established. A networked, computerized case monitoring system was established in 25 courts (5 appeals, 10 commercial, 10 public funds) which was to be launched in November 2006.
Enhance the protection of property rights	Harmonize the functions of agencies dealing with lands by consolidating these agencies into one government authority.	To improve land management, Government recently consolidated three public bodies into a single General Authority for Lands, Survey and Urban Planning (GALSUP).
	Fight Corruption	
Institutional and legislative reforms	Introduce law on anti-corruption setting up an independent national entity empowered to: • Reduce conflict of interest. • Enforce commitments under the UN Convention Against Corruption. • Introduce a National Corruption Record and implement an information system. • Establish a "Hot Line" to report corruption; protect "whistle blowers".	Anti-corruption law was ratified by Parliament in December 2006. It establishes a National Supreme Anti-Corruption Authority made up of figures from the public sector, private sector and civil society, and having political and financial independence, investigatory powers and the authority to seize and confiscate corrupt proceeds. A national corruption awareness campaign was launched. Ample donor support is available for implementation.

Table 3: Summary of Matrix of Good Governance Measures and Achievements		
Objective	**Targeted Activity**	**Achievements/Status**
	Restructure Central Organization for Control and Audit (COCA), expand its mandate and upgrade its mechanisms to ensure its independence; enhance the role of control and audit offices in the ministries and government agencies under COCA. Establish the Higher Council for Accounting & Audit. Amend Public Tenders Law in order to: • Restructure the High Tender Board (HTB) to redefine its role as an independent entity and separate its policy and regulatory functions from its oversight role. • Disclose all information on public procurement online. • Require disclosure of income and assets of individuals who have any role to play in Yemen's public procurement. • Require all bidders to disclose existing relationship with relevant decision-makers in public procurement process. • Establish in the HTB and line ministries a tender monitoring and tracking system. • Submit to the Cabinet the National Procurement Manual and Standardized Bidding Documents	Removed President as head of COCA to enhance its independence and constituted a working group to design measures to improve it. Work on strengthening COCA is proceeding on schedule under CSMP, as well as implementation of the accounting and financial management system In 2006, Government approved a national procurement manual and standard bidding documents; created a system for online disclosure of procurement-related information and submitted a new procurement law for parliamentary approval removing all ministerial representation from the High Tender Board, establishing a new procurement monitoring board made up of technical experts and civil society and allowing non-voting observers to attend board meetings. A procurement management information system was being introduced, requiring online disclosure of procurement-related information.
Transparency	Publish manuals/guides for government services and fees related to these services through the different means of publication including the websites of each government agency.	In June 2006, under CSMP, 23 government agencies published Manuals of Government Services providing a list of their services and including: a. requirements to obtain services; b. procedures required to obtain the services; c. length of processing time and d. required fees The manuals were approved by Cabinet in May 2006, and an

Table 3: Summary of Matrix of Good Governance Measures and Achievements		
Objective	**Targeted Activity**	**Achievements/Status**
		electronic version was published on the website of Ministry of Planning & International Cooperation (http://www.mpic-yemen.org).
	Passage of Financial Disclosure Bill by the Parliament.	Parliamentary ratification in July 2006 of a Financial Disclosure Law requiring high-ranking public officials (including the President, the Vice-President and the Prime Minister) and public officials overseeing large financial transactions to file a financial disclosure statement.
	Take necessary actions for Yemen to join the Extractive Industries Transparency Initiative (EITI)	In December 2006, the President committed Yemen to join the EITI. In early 2007, the Cabinet followed this up with its own commitment and formal notification was made by the Minister of Planning (now DPM).
Strengthening Public Administration	Prepare an action plan that aims to: • Put in place well-defined requirements for public posts and increase focus on performance evaluation • Continue civil service modernization according to adopted strategies.	As part of its progress on Civil Service Modernization, in May 2006 the Government began implementation of a biometric identification system aimed to eliminate "ghost workers" and "double dippers". The first phase started in Sana'a, Hodeidah and Aden and the second phase, launched early October, included Taiz and Mukalla. The process will continue through 2007, and has already identified a number of ineligible workers. In addition, internal reviews have identified thousands of double dippers who have already been eliminated from the public payroll.
Improving Financial Management	Start implementation of Public Finance Management strategy. Complete work on Accounting and Financial Management Information System (AFMIS). Design a system for a simple publication of the budget. Draft a new bill for debt management which should indicate ceilings for public external and internal debt.	In May 2006, the Ministry of Finance initiated the first phase of the Public Finance Management Strategy. An Action Plan and a Partnership Agreement were signed between the government and donors, outlining a clear agenda with specific requirements for full implementation.

Table 3: Summary of Matrix of Good Governance Measures and Achievements		
Objective	**Targeted Activity**	**Achievements/Status**
Strengthening Services: Improving Business Enabling Environment and Government Effectiveness		
Strengthen Tax Administration		By replacing hidden turnover taxes with a 5% sales tax, Yemen has reduced the total tax that businesses pay from 170% of gross profit to 48% of gross profit.
Improve Public Services and Partnership with the Private Sector		The Government has launched a project with PEP-MENA (IFC) to simplify, accelerate and reduce the cost of business registration.
Take actions required to cut in half the time taken for customs clearance and inspection, i.e. from 8 to 4 days	Revise and change the existing procedures and submit a report to the Cabinet.	The unweighted tariff rate has fallen and the number of tariff bands has been reduced from 4 to 3. An Automated System for Customs Data (ASYCUDA) has been expanded to almost all entry points covering 90% of imports. The CSMP subcomponent on civil service has reviewed customs procedures and efficiency. Procedural simplification in context of reengineering of Customs Agency under CSMP.
Increase Political Participation		
Enhance the role of the press in raising transparency		The Government of Yemen has suspended a controversial draft Press law, initiated consultations with civil society on a new draft press law that seeks to protect journalists' rights, and lifted the suspension of three newspapers.

25. However, soon after launching this initiative the Government realized that the time frame for implementing these ambitious plans would have to be extended, and that supplemental assistance would be required to implement them. The IR DPG encourages and rewards key selected actions associated with this recently initiated and dynamic reform effort.[5]

[5] In January 2007 the Cabinet considered a further *Executive Matrix of the Required Short-term Policies and Procedures to Improve Investment Environment* in Yemen which was expected to be approved. This matrix and the accompanying report embodied a number of measures identified through consultation with the private sector aimed to increase investment and non-oil growth.

IV. BANK SUPPORT TO THE GOVERNMENT'S STRATEGY

LINK TO THE CAS

26. The Bank's Country Assistance Strategy for 2006-09 is explicitly based on the Government's PRSP for 2006-10. The CAS pillars are consistent with the key focal areas in the PRSP (i.e. diversifying growth; human development; and fiscal sustainability). Further, the CAS emphasized the issue of resource sustainability by elevating it to be a fourth pillar. Each pillar associated with a set of outcomes arising from the Bank's experience, analytic work and policy dialogue:

CAS Pillar One: Diversifying growth through better governance and better delivery of public services focuses on four outcomes:

i. Improving the business regulatory environment including: new business registration, tax policy and administration, customs and inspections, and land titling and registration;
ii. Improving road and power infrastructure – this outcome would also support the human development pillar;
iii. Improving skills through technical education and vocational training and higher education; and
iv. Improving regulatory frameworks and making appropriate public investments in key sectors (rainfed and irrigated agriculture; fisheries; manufacturing; and gas sector).

CAS Pillar Two: Improving human development through more efficient service delivery and improved safety nets focuses on four outcomes:

i. Improving access, equity and quality of basic education;
ii. Improving access and quality of health;
iii. Improving safety net programs; and
iv. Improving water supply and sanitation.

CAS Pillar Three: Increasing fiscal sustainability through improved public expenditure management focuses on five outcomes:

i. Improving revenue transparency;
ii. Improving expenditure management (including through reducing fuel subsidies);
iii. Public Sector Reform;
iv. Improving public procurement; and
v. Improving public financial management.

CAS Pillar Four: Increasing resource sustainability through improved management of water resources and reduced population pressure focuses on two outcomes:

i. Improved water resource management; and
ii. Improved control over population growth.

27. The CAS places short-term priority on economic governance, in order to create the basis for medium-term actions. In particular it highlights:

- Improved oil revenue transparency to ensure better use of oil revenues and also lead to increase willingness to be taxed.
- Improved expenditure management - to ensure efficient expenditure management that upholds safety nets, the delivery of basic services and public investments needed to support private sector development while controlling waste.
- Improved business regulatory environment including improving predictability in macro-economic management, regulation, taxation and inspections.
- Improved institutional arrangements and public service delivery mechanisms for groundwater resource management and controlling population growth.

28. The CAS identifies thirteen instruments of lending assistance for the 2006-09 period, including the proposed institutional reform grant. It identifies the IR DPG as addressing two of the four pillars: accelerating non-oil growth and increasing fiscal sustainability. The IR DPG is strategically sequenced as part of an effort to strengthen economic management in anticipation of a subsequent sector wide or programmatic type of operation (e.g. PRSC). The CAS envisions the IR DPG as reinitiating policy-based lending to Yemen and helping to establish the conditions for a subsequent three-part programmatic PRSC, intended to launch in the third year of the CAS. In this context, it envisions the IR DPG as follows:

"To assist the Government in dealing with the immediate reform agenda, the Institutional Reform Grant would primarily support the Government's National Agenda for Reform (including actions on governance, public sector reform and private sector development actions) as well as sector-specific actions supporting improved governance. The emphasis will be on a credible program of prior actions and establishment of specific financing needs for the program (e.g. with regard to the costs of retrenchment in support of the civil service reform program)".

29. The CAS further emphasizes four sources of fiduciary risks in Government systems that Yemen should work to reduce: budget transparency; internal auditing; preparation of final accounts; and external auditing. The ongoing public financial management strategy (see paragraph 39) is working to strengthen all of these elements, and the IR DPG is specifically designed to complement the existing Government partnership with donors. Further, work to strengthen public administration reform and the investment climate under the IR DPG should contribute to reducing fiduciary risk, both by helping to contain the overall wage bill and strengthen service delivery, and by contributing to non-oil growth, hence medium- and long-term revenue. To inform decisions about the readiness for subsequent programmatic lending, upcoming economic and sector work (the PER, CFAA and CPAR) would assess progress and challenges in public financial management.

COLLABORATION WITH THE IMF AND OTHER DONORS

30. The International Monetary Fund has been the leading actor in advising the Government on reform of its tax system and stabilizing revenue in the face of declining oil revenues. It has

earlier focused technical assistance primarily on the implementation of the General Sales Tax and the collection of taxes from large taxpayers. The IMF's recent Article IV mission concluded in June provided an up-to-date view on inflation and macroeconomic policy. Its conclusions formed the basis for renewed Government attention to both fiscal and monetary policy, and a working agreement between the Government and the Bank on actions that will help to restore an acceptable macroeconomic policy framework. The task team and country economic team have consulted the IMF team on inflation, monetary and fiscal policies, and this dialogue will continue. Clearly, there is concern about the elevated inflation, but measures already agreed to are projected to restrain it to 12-14 percent for 2007. In addition, the IMF has advised the Government that corporate income tax reform should only take place within the context of broader tax incentive reform, so that lower rates can be compensated for by a broader tax base. This advice has been embraced by the Ministry of Finance. The Bank collaborated with the IMF on updating its Debt Sustainability Assessment (DSA). The task team has also met with other key donors to coordinate the investment climate and governance elements, including UNDP, GTZ, DFID, EU and DFID. These meetings have been positive and highly constructive and a number of complementarities between the IR DPG and ongoing or planned donor activities have been identified.

RELATIONSHIP TO OTHER BANK OPERATIONS

31. The IR DPG is one project in a program of lending and non-lending assistance defined in the CAS to support the Government's PRSP. This agenda includes the IR DPG, the future programmatic operation, and a number of other operations summarized in the table below (from the CAS) that support each of the four pillars. While the IR DPG focuses on the pillars of non-oil growth and fiscal sustainability/governance; a number of other operations complement it in attaining these goals, while still other operations focus on human development and resource sustainability. In all, 13 operations are envisioned for the CAS period (Figure 1).

Figure 1: From Country Assistance Strategy: Republic of Yemen (2006)

		Country Development Goals: 2006-09 CAS			
Lending assistance under 2006-09 CAS	**FY**	**Non-oil growth**	**Human Development**	**Fiscal Sustainability**	**Resource Sustainability**
Fisheries	2006	X			
Rural Access Improvement APL II	2006	X	X		
Power Sector	2006	X			
Rainfed Agriculture & Livestock	2007	X			X
Second Vocational Training	2007	X	X		
Social Development	2007		X		
Institutional Reform Credit (DPL)	2007	X		X	
Urban Water Supply APL II	2008		X	X	
Rural Energy	2008	X	X		
Girls Secondary Education	2008		X		X
Population II	2009		X		X
Port Cities APL II	2009	X		X	
Poverty Reduction Support Credit I	2009			X	X

LESSONS LEARNED

32. The Country Assistance Evaluation for the period FY99-2005 reported in the CAS drew a series of lessons and recommendations from that experience.[6] These include that future Bank program should:

- Learn local conditions by conducting adequate research and developing issue-specific knowledge to have country specific solutions (e.g. as in the water sector);
- Moderate optimism by making more realistic assessments of ownership, speed of implementation and likely outcomes;
- Upgrade governance as a central constraint to delivering public services and as a cross-cutting theme in its program[7];

33. As noted below, the IR DPG is based on considerable prior analysis and dialogue, including about the realism of its objectives. Governance is a central theme.

34. The CAS completion report added lessons on selectivity, long-term partnerships, strengthening state capacity and accountability, and a greater focus on implementation. The IR DPG builds on the growing and successful reform partnership established between the Government and donors. Great selectivity was required to find a valuable, attainable and realistic set of actions associated with its two tranches. The second tranche focuses entirely on implementation of policy reforms.

35. The 2006 DPL Retrospective drew specific lessons and conclusions applicable to future development policy lending. Paraphrased, the major findings include the following:

(i) The need to express clearly the Bank staff's assessment of the macroeconomic policy framework and growth estimates for the short and medium-term, as part of the debt sustainability and risk analysis.
(ii) The need to clearly document the analytical underpinnings of selected policy actions supported by the operation or the expected results.
(iii) The need to systematically document the participatory processes used by Governments to define their programs.
(iv) The need to document the distributional effects of the operation.
(v) The need for upstream screening for potential negative environmental impact.
(vi) The need to systematically track progress in PFM (including procurement), including with PEFA indicators, as a means to monitor the fiduciary environment.
(vii) The need to carefully monitor the size of the policy matrix and number of benchmarks, and the need to motivate Governments to take the lead in setting out the details of their policy program.

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[6] The limited progress achieved during this period was reflected in the Bank's program under the previous two CASs being rated as moderately unsatisfactory by the Independent Evaluation Group (IEG).
[7] Country Assistance Strategy, Op. Cit., p. 19. The list also included the need to save water, counteract Qat and improve population policy.

(viii) The need to make consistent use of a results framework, choosing results that are possible to influence in the short-to-medium term yet not trivial, associated with quantifiable outcomes, and in line with the CAS.[8]

36. Development Policy finance starts from a satisfactory macroeconomic policy framework. Both the Bank's country economic team and the IMF were consulted or engaged in its preparation. Through broad consultations, the preparation process countered some of the weaknesses in existing participatory processes. The analytic underpinnings are discussed below. In the consideration of social and environmental safeguards, potential adverse social and environmental consequences were carefully considered. Improved Public Financial Management (PFM) is actively promoted by the project and its policy matrix. The policy matrix, while ambitious, is limited and will be actively monitored. The actions associated with the operation are believed to be closely associated with positive results, and the elements of the results framework are identified in this Program Document.

ANALYTICAL UNDERPINNINGS

37. The IR DPG components are based on both prior analytic work and extensive dialogue with key Government counterparts, local stakeholders (including members of civil society), country experts, and other donors. Key analytic underpinnings to the IR DPG include the following:

- Republic of Yemen, Ministry of Planning and International Cooperation. *The Socio-Economic Development Plan for Poverty Reduction (2006-2010) October 2006.*
- The World Bank. *Yemen Economic Monitoring Report* (Washington: August 2006)
- World Bank. *Country Assistance Strategy -- Republic of Yemen* (May 17, 2006).
- World Bank. *Republic of Yemen -- Investment Climate Assessment: Priorities and Recommendations for Accelerating Private-Led Growth* (May 12, 2006)
- World Bank. *Development Policy Review* (March 2006)
- World Bank Group, *Doing Business 2007* (Washington: World Bank Group, 2006)
- World Bank. *Yemen Urban Land Policy and Administration Policy Note* (2006)
- United States Department of Commerce U.S. Department of State, *Investment Climate Statement -- Yemen* (Washington, DC: 2006)
- World Bank. *Economic Growth in the Republic of Yemen: Sources, Constraints and Potentials* (Washington, DC: World Bank. 2002)
- World Bank. *Comprehensive Development Framework for Yemen* (2000)
- World Bank. *Project Appraisal Document for a Civil Service Modernization Project* (March 23, 2000)
- World Bank. Country Financial Accountability Assessment (CFAA) (2003)

38. The IR DPG builds on these underpinnings and on the ongoing dialogue on the investment climate, fiscal reform, land policy, governance, public financial management, and public administrative (civil service) reform. A final analytic input, recommended by the ICA, is

[8] Development Policy Lending Retrospective: Key Findings And Recommendations (World Bank, 2006)

the FIAS tax incentive study[9], conducted in January and delivered to the Government in May, which provides important context for the corporate tax reform component.

V. THE PROPOSED INSTITUTIONAL REFORM DEVELOPMENT POLICY GRANT

OPERATION DESCRIPTION

39. The Institutional Reform Development Policy Grant (IR DPG) is a development policy operation intended to support the implementation of key elements of the Government's reform program as specified in the Yemen Country Assistance Strategy (CAS). As specified in the CAS, the IR DPG focuses on two pillars of the broader country strategy: (i) increasing non-oil growth (with special attention to recommendations included from the recent investment climate assessment); and (ii) strengthening governance. Actions were selected for support by the IR DPG due to three criteria:

- They should have a substantial beneficial impact on their designated objective (either non-oil growth or strengthened governance).
- There should be a high likelihood of success in achieving prior actions as indicated by Government commitment and progress towards completion of each designated action.
- They should be readily monitorable, short-term actions that can be achieved within the one-year lifespan of the IR DPG.

40. The team believes that the grant will need to be disbursed over two tranches, with a first tranche requiring legislative achievements as prior actions, and the second focused on the implementation of approved reform measures within 12 months of signing to assure that supported measures are implemented. The potential components and actions associated with each tranche are discussed in the following sections.

POLICY AREAS

A. Strengthening Property Rights and the Incentive Framework to encourage Non-Oil Growth

41. The first two components of the IR DPG address two key challenges to private investment and non-oil growth: (i) the structure of incentives confronting investors; and (ii) the security of property rights underpinning markets are each critical to a sound investment climate.[10] These elements were selected from a range of recommendations in the 2006 Investment Climate

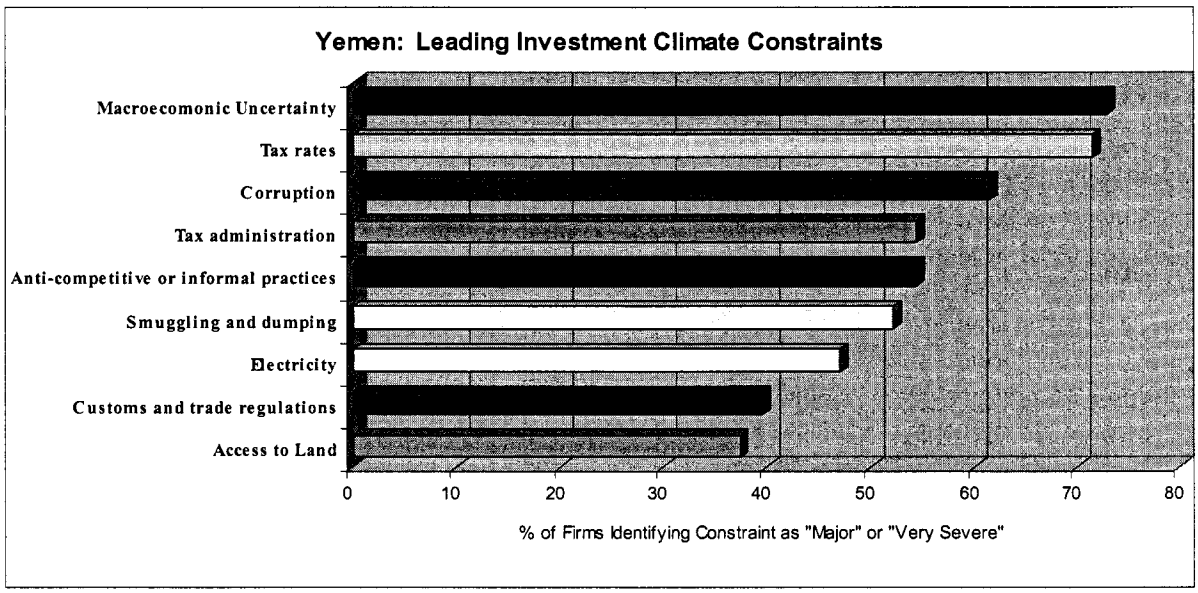
[9] FIAS. *Yemen: A Study into the Impact of Tax Policy and Tax Administration on the Investment Climate* 2007.

[10] It is important to note that a number of other investment climate reforms are underway, including streamlining of business start-up procedures (with IFC/PEP-MENA support), process reviews of tax and customs administration under the CSMP, and support for customs and tax administrative reform under the PFM Action Plan, from the IMF, and from other donors.

Assessment, based on the experience and priorities of investors. It is important to note why some other key constraints identified in the ICA (Figure 2) are not addressed here:

- Macroeconomic policy is addressed through country dialogue and as a precondition for the entire IR DPG and subsequently planned programmatic PRSC.
- Trade regulation and customs performance was investigated during identification but were not pursued due to the likely lengthy timeframe of policy reforms and the sensitive stage of public administration reform within the Customs Authority under the Civil Service Modernization Project (CSMP).
- Electricity supply issues are being addressed by the 2006 Power Sector Project.

Figure 2: Top constraints (of 18 categories) identified by Yemeni enterprises in ICA enterprise survey



42. **Component 1: Income Tax Reform.** Taxation is central to the incentive regime for investment which, in the past, has served as a deterrent to efficient investment in non-oil activities. The ICA found that companies in Yemen face high marginal income tax rates; nonstandard treatment of income, investment and expenses, and discretionary implementation mar the incentives and add uncertainty for firms operating in Yemen. An ongoing FIAS review of incentives created by the Yemeni tax system shows tremendous distortions created by the tax and investment incentive system, substantial disincentives for formality and formal bookkeeping, nonstandard treatment of investments (exemplified by the depreciation rules) and pervasive corruption and irregularities in tax administration. With the guidance of the IMF, the Government has introduced a value added tax as of January 1, 2007, which replaces the general sales tax that had been in place the previous two years. (It has also been building the capacity of tax administration, creating a large taxpayers unit.) However, the introduction of the value added tax provoked a strong reaction from the private sector, both because it extends the tax to a large number of firms and activities that formerly did not need to comply and because it requires

accounting which the private sector finds onerous, exposes it to the 35 percent corporate income tax, and could leave it exposed to unreasonable demands and harassment from the tax authority. To address these concerns, the Government agreed to ease initial implementation of the VAT and to lower the income tax rate.

43. The Government's Matrix of Good Governance Measures under the National Reform Agenda (NRA) includes a plan to "review and amend [the] tax code to be in conformity with international norms and the outcomes of adopted relevant studies."[11] The output is specified as the submission of draft legislation. The IR DPG team found during identification missions that the Tax Authority has drafted the elements of a new corporate income tax law. The Government proposal encompasses many of the provisions generally sought in good tax systems – low rates, elimination of many exceptions, more standardized treatment of investment and costs, and self-assessment enforced through risk-based audits. In order to assure that the provisions of the new law are in compliance with international norms and that they facilitate improved administration and compliance, the Tax Authority agreed that an international expert could review its provisions and advise the authority on the law, as part of preparation for the IR DPG. This occurred in March and the final draft was reviewed in May 2007. Among key measures associated with the project, this component would support:

- Preparation, approval by the Ministry of Finance and submission to Cabinet of a new corporate income tax law, reflecting international norms of treatment of income, investments and expenses, as a prior action.
- Implementation of the new corporate income tax law as a second tranche release action, as indicated by the issuance of executive regulations in accordance with international norms.

44. To follow up, the team recruited appropriate regional expertise and reviewed and contributed to the Yemeni draft law, working carefully with the Yemeni Tax Authority to bring the treatment of income, expenses and investment, into conformity with international norms. As part of this work, a workshop was organized with the Tax Authority on the Egyptian experience in corporate tax reform and features of international good practice. At the same time, it is recognized that for the tax system to be sustainable, lower rates must be accompanied by fewer exceptions. This will require Government to carefully consider the recommendations of the recently-completed FIAS tax incentive study, including the unification tax incentives (some of which exist under the investment law or the customs code) under the tax code and Tax Authority. The existing structure of sector-specific tax holidays and incentives has created substantial distortions and an inefficient system perceived by many taxpayers as unfair. Other features of the tax system may encourage evasion or administrative discretion. The FIAS report lays out suggestions for a simplified and unified system relying on broad incentives (such as accelerated depreciation and a possible investment tax credit) that would encourage investment but remove distortions, and allow for lower rates while preserving the tax base.

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[11] The simultaneous "Action Plan" had a near identical provision to "harmonize corporate tax code to be in conformity with international norms."

45. **Component 2: Land Titling and Registration Regulatory and Institutional Reform.** The property rights regime is a fundamental underpinning of any market economy. Access to land is a key constraint to new investors locating a business, given pervasive insecurity of property rights. It is estimated that no more than 5-10 percent of all urban land and property is registered, using a process that is highly ineffective. The supply of commercial land with secure legal title has been very constrained, with many investors having to pay twice for land (to the State and to individual or tribal claimants). According to a recently-completed World Bank Policy Note, up to half of all licensed investment projects in cities such as Mukalla and Aden did not materialize due to land-related problems. A recent General Investment Authority study found that 2,330 licensed investment projects (roughly 45% of the total) did not materialize, and land availability was the most important reason (electricity and other institutional constraints came second and third).[12] The land registration law is rudimentary, and the deed registration system relying on a person-based approach (called sejel shakhsee in Arabic) is imprecise; the result is that land titles are subject to much fraud and land disputes clutter the courts (some 50% of the caseload in primary courts is over land and property rights, and most require over 5 years to settle). The weakness of administrative title registration procedures contributes to a widespread perception that registration is a complex and costly process with little benefit, which inherently limits the use of the registry. This in turn distorts the land market, since buyers of land tend to acquire land only from trusted sources and thus pay a significant premium due to high risks and transaction costs. Buyers also resort to the courts to authenticate transfer deeds, a process which does not offer secure title.

46. The Matrix of Good Governance Measures (MGGM) calls for steps to "enhance the protection of property rights" as a key measure to strengthen the rule of law. In parallel, the Yemen 2006-09 CAS recommends revision of the land registration law to make the act of registration legally conclusive, strengthening the administration of land registration (and allocation of public land), and pilot efforts to systematically title land in specified areas. The Bank has been advising the Government since 2004 in the land sector to strengthen the administration of property rights and the management of public land assets, working with a government-designated Land Policy Task Force comprised of senior officials from all concerned ministries and agencies, private sector representatives (federation of chambers of commerce and industry, lawyers syndicate, and notary publics), as well as members from the Parliament and the judiciary. The resulting detailed recommendations including to strengthen the regulatory framework for land registration, and implementation action plan are found in the "Urban Land Policy and Administration Policy Note" (World Bank, 2006).

47. In an attempt to better coordinate public authorities with responsibility for land, the Government recently consolidated three public bodies into a single General Authority for Lands, Survey and Urban Planning (GALSUP). To make this structural consolidation effective in the area of land registration, it is understood that further reform is needed to revise the land registration law to make it legally conclusive and to strengthen the administration of land registration. A new land registration law (and executing regulations) will help to remove ambiguity and reduce conflict about land ownership and to authorize improved administrative

[12] As reported in Sabanet, February 27, 2007.

mechanisms for regulating land ownership and use. Further, by creating a legally independent registrar, political influence and discretion can be reduced in the establishment and transfer of property rights. This measure is also critical to address the perceived conflict of interest resulting from placing under one roof the registry—as adjudicator of property rights to land, and State land management—one of the land owners and thus a potential party in property rights disputes. It is proposed that the IRC support two further measures:

- The development and presentation to Parliament of a **new land registration law** as a prior action for the release of the first tranche. The basis for the revision of the land registration law is the draft prepared in 2004 by the Ministry of Legal Affairs (MOLA), which represents a significant improvement over the current law of 1991. The revised law, based on the 2004 draft by MOLA, takes into account the recommendations of the Land Policy Task Force (LPTF), as detailed in the World Bank's "Yemen Urban Land Policy and Administration Policy Note", as well as the implications of the institutional reorganization. Dialogue concluded by the Bank with the Government assured that specific provisions were incorporated to reflect these recommendations.[13] On September 11, the Council of Ministers approved the draft law and forwarded the revisions to Parliament.
- In the recent dialogue with the Government, it was agreed that by second tranche release, several actions would be complete to ensure that the land registration law can be effectively implemented and the implementing authority can function effectively to execute its full mandate. The following are all critical measures to enable the achievement of these objectives:
  - Approval and implementation of the executing regulations of the new land registration law in accordance with the underlying principles and recommendations of the LPTF and the Policy Note.
  - Appointment of a legally independent registrar.
  - Completion and endorsement by Cabinet of an organizational decree for the authority that organizes and clarifies its mandate and functions vis-à-vis other authorities and agencies. This especially important since the creation of the new authority has brought about a confusion regarding land use planning responsibilities and the respective roles of central and local government.

48. The specific prior action associated with the second tranche release would be the third of these actions – completion of an organizational decree to clarify the mandate and functions of the land authority. The policy matrix would also support the other two actions.

49. The Bank has been deeply engaged in policy dialogue with the Government as well as the private sector and civil society (through the LPTF) on land issues over the past two years. For this component it has mobilized top international legal expertise on land and property law, to advise the Government on finalizing the draft land registration law and on the Executive Regulations.

[13] Sameh Wahba, Institutional Reform Credit (IRC), Aide Mémoire for the Land Component Mission, February 3-13, 2007, and Aide Memoire of IRC Appraisal Mission, March 24-28, 2007.

B. Strengthening Governance through improved public financial management and public administrative reform.

50. Governance poses a substantial challenge in Yemen. Without good governance, government credibility is weak and other reforms are hard to enact and implement. Yet, international and survey indicators suggest governance quality in Yemen is low. In the Investment Climate Assessment (ICA) survey and interviews, businesses reported frequent requests for bribes and corruption in public procurement and reports of arbitrary administrative behavior. The PRSP puts strengthened governance at the top of its priorities. A number of analyses have concluded that Government cannot deliver the economic reforms and social services required to fulfill its Poverty Reduction Strategy without substantial public sector reform. As noted in Table 3, under its Good Governance Matrix, the government has committed to a broad agenda of reforms to strengthen governance and has made significant progress on many fronts.

51. Two central components of governance reform where the Bank and other donors are focusing attention are strengthening public financial management (PFM) and conducting broad-based civil service/public administrative reform. With regard to the first of these, earlier work on public financial management suggests serious weaknesses in Government oversight of public resources.

52. The 2004 Country Financial Accountability Assessment (CFAA) and the Public Expenditure Management (PEM) reports included a number of recommendations to reduce fiduciary risk and improve PFM. These recommendations were discussed and agreed with the Ministry of Finance and provided the basis of the PFM Action Plan approved by the Cabinet (Cabinet Decree, Resolution 9 August 2005, No. 253) in 2005 with the endorsement of all active donors in Yemen. The Cabinet later approved the PFM Reform Strategy and resolved to establish a Ministerial committee chaired by the Deputy Prime Minister to oversee PFM reform. Then, in January 2006, the President approved a PFM Policy Matrix with an action plan tackling short term reforms. In 2005, the Government approved, in consultation with key donors, a Public Financial Management Action Plan (Cabinet Decree, Resolution 9 August 2005 # 253). Multiple donors then entered a partnership agreement to assure coordinated support through a program of technical assistance and capacity building to underpin the Government's plan. Among the aims of this technical assistance are to:

- Modernize internal fiscal oversight, by strengthening budget procedures, revenue administration (including tax and customs) and transparency, and pension administration.
- Strengthen management of macroeconomic policy, including the balance of payments, debt management, and foreign reserve management.
- Strengthen monetary and financial systems by improving the use of monetary policy instruments, strengthening banking supervision and restructuring public sector banks.
- Create capacity to produce and use high quality statistical information for economic policy making.

53. The Government's PFM Reform Strategy is being operationalized through the vehicle of annual PFM reform action plans agreed between the GoY and the PFM donor group. The 2007 Action Plan comprises the following main components:

- Reviewing current budget practices, utilizing a public expenditure and financial accountability (PEFA) framework.
- Embarking on the development of a Medium Term Expenditure Framework (MTEF) to improve financial planning and resource allocation.
- Strengthening public internal financial control, including the internal audit function.
- Establishing and strengthening the treasury function within the Ministry of Finance.
- Strengthening the public procurement function, including by establishing a Public Financial Management Advisory Unit.
- Drafting a new organic budget law designed to set broad regulations for preparing and implementing the budget.

54. This Action Plan is being supported by a consortium of donors that includes the UK, the Netherlands, Germany, the US and the UNDP, who provide supportive technical assistance. Also in 2007, the World Bank will be financing an assessment of the performance of the PFM system employing the Public Expenditure and Financial Accountability (PEFA) framework. This will provide the baseline against which progress in PFM reform will be tracked.

55. Complementary to public financial management reform is civil service and public administrative reform. Without a well-skilled, well motivated, and adequately paid staff to underpin improved systems, the benefits of improved public financial management and the goal of improved service delivery will not be achieved. Currently, Yemen's public administration is overstaffed and inefficient. Proportional to its economy, its wage bill is high by international standards, yet the individual compensation of civil servants is inadequate, with monthly wages for some employees near the poverty line. Average civil service wages have declined by over 90 percent in real terms since 1990. The existence of a large, underpaid civil service creates widespread opportunities and incentives for corruption, with little means to motivate high quality delivery of public services. The large size of the corps creates fiscal constraints to improving incentives.

56. The country's unification compounded staffing problems in the Civil Service and in public administration. The administrations of North and South Yemen were united without rationalizing its structure and staff. The civil service is suffering from severe excesses in certain geographic areas and functions (e.g. high administrator to teacher ratios) and severe shortages in other areas, such as information technology.

57. In this context, public administration reform has become central to the Government's reform program. Over the past several years, the government has worked on developing a multi-faceted strategy aimed at moving to a more performance-based, professional civil service through the development of development of clear processes, procedures, and policies for the

government's core systems. The Bank, through its Civil Service Modernization Program, has led the dialogue on these reforms.[14] As noted under Component 5, Government has progressed on several fronts in developing and beginning to implement a comprehensive human resource management strategy. The IR DPG will support actions which are, at this stage, critical to the credibility and further progress of this initiative.

Box 3: The Civil Service Modernization Project

The context for the civil service component of the IR DPG is an ongoing effort at public administrative reform. The Government strategy supported by the Civil Service Modernization Project focuses on the creation of institutions, capacity, and systems, for sustained human and financial resources development. The project has five components:

i. Improvements in core systems required technical assistance for the selection, and preparation of priority reforms, to be implemented later in the project. Computerization of core systems was to be established, and extensive training provided, through specific modular courses on new core systems and skills. Sub-components include financing and training for human resources, and personnel information management development, including payroll, and accounting information management best practices;
ii. Technical assistance has been provided to create a civil service fund, and establish its policy framework regarding retirement, redundancy, and severance options;
iii. A re-engineering process is aimed to streamline, and rationalize organizational structures, simplify business processes, and establish basic information systems;
iv. A capacity building component is focused on the a) skills needed to sustain the reform program, and, b) management skills to administer civil service; and
v. A program management structure component uses technical support to accomplish standard supervision, and performance audits.

58. Thus to strengthen governance, components three, four and five of the IR DPG support critical actions under the Public Financial Management (PFM) plan and public administration reform. They include strengthening public procurement, improving revenue transparency and key elements of public administration reform focusing on human resource management. These were elements found during identification both to make a strong contribution and to complement other work under the PFM action plan, CSMP and other donor-financed initiatives.

Component 3: Strengthening Public Procurement

59. Strengthening public procurement forms a central part of the public financial management and governance challenge. This aspect is central to building the capacity of Government to manage public resources in support of private-led growth. The MGGM calls for a series of measures to strengthen governance, including already approved financial disclosure and anti-corruption laws, and a variety of procurement reforms. As noted, a substantial

[14] The CSMP has also supported key PFM-related reforms, including the introduction of AFMIS, a computerized accounting and financial management information system; implementation of internal audit across Government ministries; and re-engineering of the Government's external audit office, COCA.

partnership with donors is already in place to support PFM reform. Under the first pillar of the NRA, procurement reform is identified as a central component of measures to enhance transparency and fight corruption. The Bank has led donor dialogue about and support of procurement reform and it is appropriate to continue this role through the IR DPG. As one part of its procurement reform, the Government has already approved a standard procurement manual and procurement documents to be used in public sector transactions. The next centerpiece of relevant reform is the new procurement law[15] and executing regulations. Another key part of this reform is the strengthening of institutional capacity to oversee and monitor procurement. The MGGM describes two key actions in this regard:

- Submit to Parliament a new Procurement draft law consistent with international standards after consultations with the Bank and Cabinet endorsement
- Restructure the High Tender Board (HTB) by redefining its role as an independent institution. Separate the HTB's policy and regulatory functions from its oversight role as the apex body of procurement operations in Yemen's public procurement system

60. To do this, within the framework of the draft procurement law, the Government is planning to restructure the High Tender Board (HTB) by redefining its role as an independent technical institution. The legislation would also move HTB's policy and regulatory functions to a newly established Procurement Policy Monitoring Board with a procurement tracking system under its authority. The tracking system has already been introduced, and would be transferred from the High Tender Board to the Procurement Policy Monitoring Board once it is established. This would give the Government a systematic means of overseeing and regulating procurement, and a dedicated body handling policy and monitoring. The Government's reform program calls for several measures to strengthen public procurement, including:

- Submit to Parliament a new Procurement draft law consistent with international standards.
- Restructure the High Tender Board (HTB) by redefining its role as an independent institution. Separate the HTB's policy and regulatory functions from its oversight role as the apex body of procurement operations in Yemen's public procurement system.

The new Procurement Law was approved by Parliament in July.

61. The program further calls for the introduction of a tender monitoring system, approval by Cabinet of a National Procurement Manual to be used across all line ministries, and new requirements for disclosure. The Government has been working closely with donors to develop all of these elements and is close to introducing a new public tender law. To support this work the IR DPG would support two actions, as first and second tranche measures, respectively:

- Approval of the executing regulation for the new procurement (public tender law) as a prior action.

[15] This legislation was explicitly identified as the next step in procurement reform in the Government's update on the National Reform Agenda delivered at the Donors' Consultative Group meeting in London in November 2006.

- The establishment of a separate Procurement Policy Monitoring Board with a procurement tracking system under its authority as a second tranche release action.

62. The accompanying IR DPG policy matrix will describe complementary actions to strengthen public financial management. The Bank has actively engaged in dialogue with the Government on its reform of procurement and tender procedures, is coordinating the dialogue on these actions.

Box 4: AFMIS

Under the Bank-financed CSMP, the Government of Yemen is introducing a computerized Financial and Accounting Management Information System (AFMIS) that is supervised by the Ministry of Finance (MOF), through a Project Implementation Unit (PIU). AFMIS is designed to address three major parts of public finance management reform; those are budget preparation, budget execution and accounting. AFMIS supports of reforms in the public expenditure process, both at the Central and Local Authority Levels. In its first stage, the system will be rolled out to three large government spending units, and ultimately to all other governmental spending units.

Component 4: Improving Revenue Transparency

63. Strengthening revenue transparency has been a major objective of Public Financial Management reform efforts. Given the centrality of oil and, now, natural gas revenue to the budget, transparency about these revenues is a vital part of achieving this objective. The first action listed under the MGGM to fight corruption is "join the Extractive Industries Transparency Initiative (EITI) to improve accountability in the oil and gas sector." Government's reform strategy (NRA) also calls for Yemen to join the EITI, an international compact of resource-exporting nations willing to abide by agreed international standards.

Box 5: The EITI Criteria

1. Regular publication of all material oil, gas and mining payments by companies to governments ("payments") and all material revenues received by governments from oil, gas and mining companies ("revenues") to a wide audience in a publicly accessible, comprehensive and comprehensible manner.
2. Where such audits do not already exist, payments and revenues are the subject of a credible, independent audit, applying international auditing standards.
3. Payments and revenues are reconciled by a credible, independent administrator, applying international auditing standards and with publication of the administrator's opinion regarding that reconciliation including discrepancies, should any be identified.
4. This approach is extended to all companies including state-owned enterprises.
5. Civil society is actively engaged as a participant in the design, monitoring and evaluation of this process and contributes towards public debate.
6. A public, financially sustainable work plan for all the above is developed by the host government, with assistance from the international financial institutions where required, including measurable targets, a timetable for implementation, and an assessment of potential capacity constraints.

64. In the Bank's view, the Government has already published most of the required information for compliance with the initiative and a number of cabinet officials have approved of accession to EITI. In November 2006, the President confirmed Government's intention to join the EITI. Taking the necessary steps for Yemen to join the EITI would therefore be identified as a prior action for the IR DPG. The mission determined that a great deal of preparatory work has already been achieved. The work of the country team and two missions by the World Bank's Oil, Gas and Mining Policy and Operations Unit EITI team have established a high quality dialogue and technical assistance relationship with Government's designated counterparts, focusing on the Ministry of Oil and Minerals (MOM). In May, a World Bank mission concluded that there is a "high degree of commitment of the Government of Yemen to implement EITI" and laid out five initial implementation steps to take place in coming months: (i) establishing EITI secretariat functions within MOM; (ii) completing EITI sign-up steps; (iii) convening EITI stakeholders; (iv) assuring that there are no legal obstacles; and (v) convening an EITI workshop/launch event with relevant stakeholders. Following these steps, additional actions would be taken to fulfill EITI data reporting and reconciliation requirements, public dissemination, and other aspects.

65. The first tranche condition requires Yemen to formally declare its adherence to the Initiative's principles and specify the procedures it will follow to implement those principles (see Box 5). This has been achieved by two means: (i) the President has already announced Yemen's adherence, and (ii) the Cabinet approved accession and notified all 3 partners (the Bank, the IMF and DFID) of Yemen's adherence to EITI, with a copy sent to the International EITI Secretariat for inclusion on its website. Compliance will next require adherence to EITI's principles, including:

- Publication of independently audited accounts documenting all material oil, gas and mining payments by companies to governments ("payments") and all material revenues received by governments from oil, gas and mining companies ("revenues") in a publicly accessible, comprehensive and comprehensible manner.
- Payments and revenues are reconciled by a credible, independent administrator, applying international auditing standards and with publication of the administrator's opinion regarding that reconciliation including discrepancies, should any be identified.
- This approach is extended to all companies including state-owned enterprises.
- Civil society is actively engaged as a participant in the design, monitoring and evaluation of this process and contributes towards public debate.
- A public, financially sustainable work plan for all the above is developed by the host government, with assistance from the international financial institutions where required, including measurable targets, a timetable for implementation, and an assessment of potential capacity constraints.

66. The first of these actions, the publication of independently audited accounts, would constitute the prior action for second tranche release.

Component 5: Reforming Central Government – Public Administration Reform

67. As noted above, public administration reform is regarded both as a fiscal necessity (due to the huge burden of the wage bill and related obligations) and as a vital component of reforms to promote good governance. The existence of a large, unfocused administration and a bloated yet underpaid civil service creates widespread opportunities and incentives for corruption, with little means to motivate high quality delivery of public services. The MGGM envisions continuing the reforms aimed at achieving a modern, professionalized and well-performing civil service. Since 2000, the Government's reform efforts have been supported by a Bank-funded Civil Service Modernization Project (CSMP) supporting institutional, procedural and incentive reforms.

68. The Government of Yemen has made Human Resource Management a central pillar of its multifaceted public administrative reform. The Government's strategy is centered on four mutually reinforcing objectives. They are:

(i) Create an adequate Human Resource Management System capable to adequately track and oversee the evolution of its workforce and reduce the incidence of ghost workers and double dippers;
(ii) Develop a medium term strategy regarding new employment to ensure that new employees address specific needs of public administration;
(iii) Implement a wage strategy to improve compensation of its civil servants in a fiscally sustainable manner; and
(iv) Operationalize the Civil Service Fund, a redundancy scheme aimed to process redundant civil servants.

69. To achieve the first of these, with the support of the IDA-financed CSMP Project, the Government has undertaken a Civil Service Census, which enabled the Government for the first time to get an accurate count of its Human Resources in the aftermath of unification and the Civil War. With this data, the Government has developed a Civil Service database which has captured for each individual civil servant all the required data to accurately track its HR evolution. Data includes vital information, academic credentials, current functions, career development, and training received. This data base will be strengthened with the inclusion of biometric data which will enable matching of every HR file with one employee and thus reduce the incidence of double dippers and Ghost workers. Impressive strides have been made in biometric identification over the past year. This has included extending the biometric system to the Military, the Judiciary and the Police to ensure that there will remain no opportunity for double dippers to perceive two government salaries. Under the biometric identification program, almost 200,000 employees have been fingerprinted. The development of this database has allowed the government to move forward in rationalizing its labor force, by: (i) enforcing its retirement rules; and (ii) removing payroll entries for persons that do not exist (ghost workers) and those collecting multiple salaries. According to Government records, payroll entries for the civil service have been reduced by over 34,000 entries in 2006 alone. (An impressive 14,000 people have come out so far and voluntarily relinquished jobs for fear of being identified through the biometric technology.) In the final phase of the Civil Service Modernization Project (CSMP), the pace of biometric identification is being rapidly accelerated with a goal of complete coverage

by the end of calendar year 2007. If the current pace were maintained for the entirety of public employees, as many as 135,000 payroll entries could be removed from the payroll.

70. On the second objective, development of a medium-term strategy for new employment, over the past year the Government has worked on the one hand to decentralize public sector employment to the governorate level and on the other hand maintain tight control of the hiring process under the responsibility of the Ministry of Civil Service and Insurance. A Government decree passed on May 15, 2007 further strengthened control of new hiring, by linking new hiring to departure of employees from public employment starting with the 2008 budget. This measure will encourage public agencies to more aggressively work to identify ghost workers and more carefully assess their new hiring needs prior to advancing requests for new employees. The Government decree is targeted to further discourage the hiring of unskilled new workers and to significantly limit discretionary hiring by ministers and heads of agencies.

71. Additionally, it has moved forward on developing job descriptions and job classifications for each position in the Government, thus defining specific academic profiles for each position and also specifying levels of experience and career paths for individual employees in each ministry. Thanks to these tools the Government was able to produce a medium-term hiring strategy for the period 2005 -2010 which has identified skill based needs within the Government and has focused its hiring on these specific needs. As a result of these measures, new hiring in the Government has declined from 34,000 in 2004 to 10,000 in 2007, a level only slightly above the attrition rate in the Government. It is expected that as a result of the hiring procedures encompassed in from the new government decree, the levels of new hiring will be below the attrition rate starting in 2008.

72. The Government's wage strategy, adopted in 2005, links wage increases to systemic reform. It has focused on improving base salaries for civil servants, rationalizing allowances to increase transparency in the salaries of the public servants, decompressing the salary scale (to motivate performance and recruitment of skilled workers) and tying new wages to compliance on the part of individual agencies with the new HR measures undertaken by the Government. This strategy is articulated in four phases. For example, the first phase has increased the minimum base salary of public servants from YR 11,000 per month to YR 20,000 per month (the poverty line), while reducing the number of allowances from over ninety to just three. As a result of this first wage increase, public servants have a starting salary closer to the poverty line and the compression ratio between the minimum and the maximum salary has been improved to three to one. The reduction of allowances partially mitigated the budgetary impact, while increasing the transparency of the wage scale.

73. Further mitigating the budgetary impact of the wage increases, accessing the new salary scale for phase 1 has been connected to the identification on the part of individual agencies in the government of those people who are actually coming to work every day and are known by their supervisors. The first phase of the wage strategy allowed identification of ghost workers, double dippers and employees due for retirement in advance of biometric identification. This reduction in employees has meant a YR 10 billion savings from budgeted wage increases.

74. Subsequent phases are tied in the law to other forms of compliance, and no salary increases are permitted to occur outside of this framework. Any wage increase outside of this framework will negate the very purpose of this important reform agenda, so the IR DPG supports Government adherence. For 2007, the Government has allocated an additional YR 80 billion to wage increases. This corresponds to the allocation for Phase II of the reform program, associated with agencies fulfilling the Phase I conditions specified by the law. The Minister of Civil Service has confirmed that unless the actions identified in the law are achieved, no wage increase will be given.

75. Finally, the Government has focused on redundancies. The magnitude of the personnel problem in Yemen is such that the Government will not be able to rely exclusively on the identification of ghost workers and double dippers to bring it into control. It must utilize a retrenchment and pre-retirement scheme as an additional instrument in this endeavor. To achieve this aim, through the Civil Service Modernization Project, the Government has created the Civil Service Fund. The Fund enables the Government to sever its ties with redundant employees. Work in this area has focused on the identification of surplus workers, the transfer of these workers to the Civil Service Fund and the design of assistance packages, taking into account targeting, the level and nature of compensation, and implementation regulations governing the payment of such compensation. The creation of the Civil Service Fund, its policy framework regarding retirement, redundancy, and severance options are all embodied in the Civil Service Fund Law approved by Parliament in 2003. The Civil Service Fund began accepting redundant workers in the middle of 2005 and by early 2007 had received over 14,000 applications. The pace of the reforms is likely to increase over the next several years, accordingly it is important that the fund's budgetary allocations remain consistent with its work stream in order to achieve the ambitious results sought by the government

76. To support this process, the Government, in close cooperation with the Bank has developed a work program for the Civil Service Fund. The work program takes a comprehensive look at the Government Human Resource actions and evaluates their impact in terms of redundancies. This plan provides the framework which will contribute to better manage the Government's public resources.

77. To support the achievement of public administrative reform goals, the IR DPG would support the following actions:

- The first tranche prior action is the approval, by the Council of Ministers, of a Civil Service Fund (CSF) program for 2007-10 and alignment of the budgetary allocation for 2008 to that program. This program already exists in draft and highlights the number of people that are coming out as redundant as a result of the different ongoing workstreams. In accordance with this action, the letter of development policy will incorporate the quantitative targets established in the program.
- The second tranche action would require, consistent with government mandate studies, reengineering studies, and other analyses, continuing implementation of the CSF program and quantitative fulfillment of Civil Service Fund workstream by transferring the programmed number of staff from selected line departments to the CSF.

- Another second tranche action is the continued adherence, throughout 2007 and 2008 (until the release of the second tranche) to the 2005 wage law requiring agencies to meet defined reform criteria before making any future salary increases.
- A final second tranche action is the completion of the biometric identification system and computerized employee databases, so that they are fully populated and functioning, with coverage extended to all civil servants, military, police and judiciary employees. This, by law, requires the redundancy of all identified "double dippers".

78. The idea of these conditions is first, to encourage the Government to base personnel actions on a clear and fully financed plan; second, to ensure that the Government's wage policy remains consistent with the framework reflected in the wage law; and third, that the government complete the process of creating the information basis for human resource management. The Bank, through the preparation of IR DPG and through the CSMP, has been a key advisor to Government on this component.

VI. OPERATION IMPLEMENTATION

POVERTY AND SOCIAL IMPACTS

79. The IR DPG should have a generally beneficial impact by encouraging investment and improving the management of public resources. Generally, the initiatives supported are aimed at encouraging growth and employment, which have been identified repeatedly as necessary concomitants to poverty alleviation. Nonetheless, some project preparation explored two potential social safeguard concerns with potential distributional impacts of reforms envisioned.

80. A first concern is the potential negative impact of land registration for the poor and powerless. This concern is especially associated with large-scale, systematic land-titling initiatives that have sometimes dispossessed the poor of land to which they held traditional tenure or on which they were squatting. The IR DPG does not envision or support such a program and the team is not aware of any Government plans to implement one.

81. The intention of the reform is in fact the opposite – to establish rule of law to defend claims of the less influential and wealthy against those who can now use power and corruption to challenge and undermine legitimate land claims. This reduces the transactions costs and risks associated with new investment. Further, having a clear law and politically independent (and institutionally capable) registrar of lands should have a positive effect to minimize the impact of opportunities for corruption and political meddling (in which the poor tend to lose). Currently, very high transaction costs and risks puts investable land at a premium, making land markets dysfunctional and segmented, to the detriment of all, but especially disadvantaging the poor. Improved titling could be anticipated to greatly broaden formal land markets, and to reduce legal and violent conflict over property rights (again where the poor and the politically weak would usually be expected to lose).

82. The major innovation in the proposed new law on land registration would be provision of

an adequate legal framework for systematic recognition and registration of property rights. Under such an approach, the state provides tenure to rich and poor alike (at no cost in the case of systematic registration and at a minimal cost to cover administrative expenses in the case of voluntary registration). It has been used in many countries and many World Bank projects to regularize the informal occupation of state land by the poor. It can reduce the ambit of informal, non-transparent transactions in land rights, in which the poor are usually disadvantaged. In Yemen, there is substantial informal occupation of state land by the poor, and some customary land occupation. The potential of the law for poverty-alleviation in this respect is substantial. Further, appointment of an independent registrar and an organization degree for GALSUP that organizes and clarifies its mandate and functions should have an indirect but generally positive effect upon the quality and transparency of land administration through a reduction of corruption and political interference in land administration and through greater clarity and less confusion regarding the responsibility of public sector agencies dealing with land.

83. This positive result depends entirely on the policy and law of the state toward regularization of informal and customary occupation of land. Registration itself does not create or change the nature of rights; it simply records and confirms those which exist. But where regularization is desired, it can be implemented through the systematic registration process.

84. The Civil Code sets out the framework governing property rights. The Islamic Shari'a-inspired Code recognizes the regularization of property rights to land based on adverse possession through the notions of "Ehyaa" (i.e. valorization through building, planting, etc, of "moyat" land, non-valorized or literally dead land, such as desert lands, etc) and "Tahagor" (i.e. demarcation of land, which grants the demarcating person a three-year window to valorize land). The state can therefore regularize the cases of land occupation, possession and valorization, should it chose to do so. The State Land and Real Estate Law of 1995, promulgated by Republican Decree, defines desert (normally moyat) land as State-owned, and does not permit adverse possession on state land. This contradicts with the Civil Code; both from a legal basis and in terms of what the courts apply in practice, it is the Civil Code's provisions governing adverse possession that apply. At the same time, the State Land Law sets out basic norms and procedures regarding State land allocation, which give government the authority to recognize and regularize such land occupation, should it choose to do so.

85. There is a further issue concerning the land rights of women. The experience in other countries has shown that in practice, existing rights of women can be lost in the process of land registration through faulty implementation; pro-active strategies are needed to ensure that their rights are in fact registered. There have also been instances noted in some countries where in the context of systematic registration either the state or powerful individuals have secured registration for themselves of communal land resources, such as pasture or wetlands. This usually occurs because the legal system does not recognize the communities involved as legal personalities with the capacity to hold registered land rights.

86. In the development policy reform context, these issues require an authoritative clarification of government policy. The Letter of Development Policy (LDP) commits the Government to carefully monitor any negative social impacts and take "proper safeguards against

associated negative social consequences." The Letter clearly states that Government intends to "take measures to mitigate the impact of the new land titling system on poor people, and women in particular, who might not possess the adequate means and resources to access formal registration. For this, we will seek to facilitate their registration and to amend the State Land and Real Estate Law and other laws the extent that it is necessary to eliminate any disadvantages to this segment of the society." In consultations with Government, the project team has discussed with Government how it could pursue systematic registration in a fashion and at a cost to beneficiaries that will allow for the broad regularization of informal and customary occupations in accordance with the Civil Code provisions. Where occupations violate fundamental public policies, such as environmental regulations (e.g. occupancy of landslide or flood-prone areas), they may be legitimately refused registration; in this case, the situation of those occupants will be neither improved nor worsened by systematic registration. In terms of cost, the revised draft Law exempts beneficiaries from payment of registration and surveying fees in case of systematic land registration, which ensures that systematic registration, does not constitute a financial burden on poor people. The team also discussed with Government the need for studies to develop strategies for gender-sensitive systematic registration and for registration of communal land rights.

87. The development of the implementing regulations for the new land low pose an opportunity to mitigate any risk of its use to undermine customary or tribal land claims. The procedures adopted should address settlement of customary land rights disputes through a transparent and rule-based process to ensure that land registration does not adversely affect tribal groups with legitimate claims. The process and procedures for making such claims and the basis on which these claims would be need to be made explicit, particularly in executing regulations relating to the section of the law relating to "sigel shakhsi" clause.

88. A second social concern raised by the operation concerns the reform of the corporate income tax. In this regard, it must be noted that the reach of the corporate income tax system is not broad, leaving most poor people outside its ambit. On the other hand, many of the key beneficiaries of the existing system's exceptions are influential and/or well-financed investors. The FIAS study suggests that reform of the existing system by lowering rates and reducing exceptions could prove beneficial to groups which may include many lower income participants – including SME traders. In the LDP, Government commits to monitoring the impact of reforms on vulnerable groups, so that any negative impact can be addressed by appropriate safeguards.

89. Finally, perhaps the clearest potential for distributional impact lies in the public administration reform. Clearly, wage reform, which improves wages for all public employees, benefits poverty reduction. The first phase of the implementation of the wage strategy provided a one-time increase of 55 percent to the minimum wage of public employees.

90. However, implementing the Civil Service Fund work program will entail retrenchment of civil servants, hence the loss a steady source of revenue for many individuals. The appraisal mission reviewed the provisions of this program, including its poverty mitigation features. The retrenchment package, estimated on average at roughly seven years of salary (i.e. US$11,000 per person) is quite generous by international standards. By providing a large enough package, the Government intends to mitigate the likelihood that civil servants will succumb to poverty.

91. The Civil Service Fund work program provides that a certain number of employees identified through approved procedures be transferred to it. If the employee is close to retirement age, as described in the law, the Fund will transfer the employee to the Pension Authority and compensate the Authority for those years of service for which the employee did not contribute. In the event the employee falls in the category below this, where the employee is eligible for pensioning but is between 5 and 10 years from retirement, the employee may either opt for the retrenchment package or for the pre-retirement. To date, most employees have chosen the pension option, which provides them their last year's salary in perpetuity (without allowances). For an employee beyond ten years of service from eligibility for the pension, the civil servant is only eligible for the package.

92. Initial retrenchments have indicated that, to date, only six percent of public employees have chosen the package. On average, public employees who have been terminated through the civil service fund appear to have lost 13 to 15 percent of their purchasing power as a result of retrenchment/pre retirement. Those individuals who have opted for the package seem to be able to maintain an adequate level of revenue just from the interest that banks will provide on the package. It appears therefore that the retrenchment scheme, through generous benefits, substantially mitigates its potential to create poverty. The project requires full budgetary commitment for these benefits.

93. The Civil Service Fund has developed a system to monitor samples of civil servants and follow them through time to ensure that the Government keeps track of the impact of this program on poverty. In addition, the ongoing poverty assessment is evaluating the potential poverty impact of civil service redundancies, which will inform the Government and project team of the implications and any need for further mitigation of negative impact. In the LDP, Government commits to "maintain the severance payments at levels that will ensure adequate compensation to retrenched employees and establish a monitoring system to follow up on their economic and social status afterwards."

IMPLEMENTATION, MONITORING AND EVALUATION

94. Overall implementation, coordination and monitoring for the proposed IR DPG program will be done by the Ministry of Planning and International Cooperation (MOPIC). The Bank will request the Government to form a core IR DPG team, to be chaired by the Deputy Minister of Planning and International Cooperation (Deputy Prime Minister). He will be supported by a technical committee from concerned Ministries and Agencies. This team will be responsible for ensuring that key actions occur in accordance with the agreed prior and subsequent actions under the IR DPG.

95. In the medium-term, several indicators may be useful in monitoring impact:

Component	Indicators
Income Tax Reform.	Enterprise survey: frequency of identification of taxation as a constraint; reported percent of sales reported for tax purposes; reported number of tax inspections and related level of corruption in future ICA enterprise survey. Doing Business indicators for "paying taxes". (Impact: Increased investment and employment; improved efficiency of tax collection, increase in tax base.)
Land Titling and Registration Reform	Rate of realization of investment projects; identification of land as a constraint in investor surveys; number of land transactions and titles issued; incidence of court disputes on land title. (Impact: increased investment and more efficient land use.)
Strengthening Public Procurement	Appointment of Procurement Policy Monitoring Board; transfer of procurement tracking system from the High Tender Board to the Policy Monitoring Board, number and percentage of procurement transactions included in tracking system, level of monitoring and enforcement activities by the two boards. (Impact: reduction in incidence of corruption, improvement in efficiency of public expenditure.)
Improving Revenue Transparency	Receipt of letter declaring adherence to EITI, publication of externally audited accounts of oil and natural gas revenues. (Impact: Greater government credibility, higher public evaluation of Government, and reduced "leakage" of revenues.)
Public Administrative Reform	Quantitative fulfillment of Civil Service Fund workstream; monitoring of incidences of agency wage increases; physical evidence of completion of biometric identification system and public employee database. (Impact: Leaner and more effective public workforce, resulting in improved public service delivery.)

96. The Bank team will focus on monitoring outcomes. It will directly verify that required actions for first and second tranche release have taken place. The set of six prior actions for first tranche release have been fully achieved. At the same time, the policy matrix sets out actions for the subsequent tranche release, to assure that policy reforms are implemented and the momentum of reform progress is maintained. Appropriate impact indicators for each of the components of the IR DPG will be applied so that the effect of reforms (which is likely to be realized fully only after the brief lifespan of the operation) can be appropriately evaluated.

FIDUCIARY ASPECTS

Fiduciary Risk

97. As noted above, the GOY has been actively engaged in improving its Public Financial Management (PFM) systems since 2005. A number of key PFM weaknesses have been addressed while many are still pending, including some measures supported by the IR DPG. The 2004 Country Financial Accountability Assessment (CFAA) and the Public Expenditure Management (PEM) reports included recommendations that, when implemented, will help improve the assessment of the fiduciary risk in Yemen that is currently rated as "high". The PFM Action Plan measures (supported by the partnership agreement) that can help to reduce fiduciary risk include:

(i) Reforming budgeting, which includes (a) improving the level of priority setting and the basis of budget decision making (Budget Preparation), (b) improving Budget Execution, and (c) developing PFM information system-AFMIS;
(ii) Enhancing control and financial accountability;
(iii) Reforming the system of bids and procurement; and
(iv) Improving competence and skills of Public Finance staff, and the other staff in government.

98. The CFAA report emphasized four pillars of the PFM system: internal controls; internal audit, accounting and reporting and external audit. Each has been the subject of reform actions.

(i) - Internal Control.

CFAA: The existing internal control framework is highly centralized, with substantial and strong ex ante and ex post controls exercised by the MOF over all spending. The focus, however, is on compliance with the legal use of appropriations, with little recognition of the other risks present in current PFM processes. These risks include a weak management environment, complex and opaque financial approval processes, poorly documented financial procedures, and a lack of administrative penalties.

Recent Actions Taken: Much of the background work which will form the basic foundation for implementing the PFM Reform Program has already begun and is on going. Notably, the AFMIS project which will soon become operational, the introduction of a comprehensive GFS 2001 based on functional and economic classification in the preparation of the 2007 budget, development of New Procurement Manuals (NPM) and Standard Bidding Documents (SBDs) to improve the procurement process. A Project document that spells out government support by UNDP, DFID and the Netherlands was signed on September 11th, 2006 and became operational, effective February 2007.

(ii) - Internal Audit.

CFAA: There is no effective internal audit function present in the GOY today. At

present, there are two separate ex post internal control and inspection functions operating in MOF and in all budget entities, and there is considerable confusion in the ministries about the conflicting roles and responsibilities of these two units. Neither of them meets the requirements of a modern internal audit function. The only audit feedback management now receives is compliance audit information from the internal control units and the external auditor.

Recent Actions Taken: An extension has been granted to complete this study under the present arrangements of the Civil Service Modernization Project. The steering committee, in charge of this study, has been strengthened and now includes four members representing the Ministry of Finance. The report from the Consulting firm (PWC) finalizing the process work has been received, but to date, no agreement has been reached on some of the thorniest issues, including who is responsible for this function and under whose authority.

(iii) - Accounting and Reporting.

CFAA: The GOY does not have an automated financial management information system in operation today. One is under development (AFMIS), however, until AFMIS is fully functional, MOF will not have accurate and timely budget execution information from its budget entities. Full adoption of GFS 2001, Commitment accounting, non-tax revenue accruals and cash management activities will be challenging. The nature and extent of the arrears situation will remain unknown. It was also noted that extra-budgetary and special funds pose risks.

Recent Actions Taken: AFMIS activities related to Final Accounts are now identified in the Budget Execution portion, Cash Management activities have not yet been identified. Additionally, specific activities related to the Accounts Payable, Final Accounts and Cash Management had not been specifically identified in the plan. Training is being provided to users on the AFMIS Budget Preparation and Budget Execution in the Financial Training Institute. Almost half of the staff of the people who are scheduled to receive training has completed the training. The Institute is housed in a new building and is well equipped to provide continuing benefit to the project as well as to others in the MOF and to other government department and agencies.

(iv) - External Audit.

CFAA: The Central Organization for Control and Auditing (COCA) performs the function of external auditor for the Government. COCA constitutes another important element in contributing to effective internal controls and in detecting fraud and corruption. COCA and the Government should move quickly to comply fully with all INTOSAI standards for its independence and for the conduct of its audits.

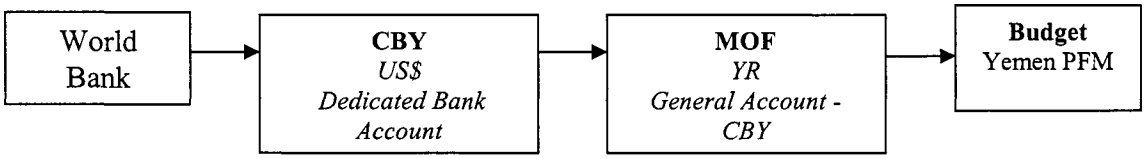
Recent Actions Taken: In this context and as part of the Civil Service Modernization Project a consulting firm (PWC) was hired to assess in the re-engineering process of

COCA. The consultant has finalized the work pertaining to COCA's Procedures and Standards Manual, needed changes in bylaws 26 and 39 pertaining to the Audit Profession and COCA respectively, amended hierarchy restructure as well as COCA's job descriptions and institutional capacity reform.

DISBURSEMENT AND AUDITING

99. The proposed IR DPG will follow the Bank's disbursement procedures for development policy lending. The Recipient is the Republic of Yemen, represented by the Central Bank of Yemen (CBY), which currently carries out its treasury functions. The proceeds of the grant will be made available to Yemen following the enactment of the Financing Agreement. This operation is a two-tranche grant of SDR 16.4million each (approximately US$25.47 million equivalent). The first tranche of grant proceeds would be made available to the Borrower upon the effectiveness of the Financing Agreement between the Bank and Yemen, while the second would be made available upon certification of the fulfillment of second tranche conditions, at the latest 18 months after effectiveness, which is the period over which agreed measures are expected to be finalized.

100. **Flow of funds** (including foreign exchange) is subject to normal FM processes. It is not possible to track the ultimate use of the foreign exchange provided by the IR DPG proceeds, but the grant proceeds flow into a sub-account at the CBY and from it to Yemen's budget, and are thus subject to normal public financial management processes and CBY procedures. By way of a letter, the Government will provide confirmation to the Bank when the grant amount has been credited to an account used to finance budgeted expenditures. The diagram below depicts the envisaged flow of funds arrangements:



101. The IMF's most recent safeguards assessment report goes back to May 2001 which significantly limits its value to this exercise specially that it mainly focused on the external audit mechanism for the CBY (risk at the time was found to be "low"). Saying that, some of the significant issues identified in the IMF report match those included in the external auditor's latest Management Letter.

102. An audit of the financial statements of the CBY for the year ending December 31, 2005 was conducted by Deloitte & Touche. The auditors rendered a clean/unqualified opinion on the Financial Statements. The auditors also issued a Management Letter (ML) that included various accountability issues. The quality and the level of details in the ML clearly show that the external auditors did a comprehensive assessment of CBY's internal control systems. The ML observations range from those relating to the soundness of the bank's internal controls, staff capacity to handle the bank's MIS, reliability of the chart of accounts to issues that do not have a

direct impact on the IRC. The ML did not identify issues in relation to Foreign Exchange Management at the CBY. The team met with CBY staff and agreed on arrangements to ensure that the IRC proceeds will have special arrangements in terms of recording and reporting.

103. The Bank will request the auditors of the CBY, Deloitte and Touche, to conduct an audit of the dedicated account established in the CBY. The audit will cover the accuracy of the summary of transactions of the dedicated account, including accuracy of exchange rate conversions; including obtaining confirmations from corresponding banks involved in the funds flow. The first audit should be conducted and delivered to the Bank before the release of the second tranche. An additional audit is to be conducted no later than one year after the release of the second tranche. The time period for submission of the audit report to the Bank is three months.

ENVIRONMENTAL ASPECTS

104. The team's determination was that the IR DPG will not have significant effects on the country's environment, forest and other natural resources. However, some potential risks were identified in consultation with the regional safeguards team. The two elements of first pillar of the project have been identified as having a potential for adverse environmental impact. First, reform of tax policy was identified as having the potential for adverse impact if it encouraged investment in sectors especially associated with environmental degradation (e.g. mining). The recent FIAS study has looked at the sectoral impact of the existing tax regime and concluded that existing incentives heavily favor investment in the mining sector while (relative to other sectors) discouraging tourism. In simulations of the effect of reducing the corporate income tax rate from 35 percent (whether to 15%, 20% or 25%), the impact is to reduce the distortion of the incentive regime by somewhat lowering the burden on tourism and sharply reducing the effective subsidy for mining investments.[16] Such a reduction is projected to have a neutral marginal incentive effect with regard to agriculture and have a slightly positive incentive effect for manufacturing. In addition to this analytic reassurance, the Government, in its Letter of Development Policy, has reassured the Bank that [environmental] considerations will be given in the design of income tax reform, whereby we intend to ensure that the new system will not provide incentives for the rapid development environmentally harmful projects."

105. A second concern relates to land titling reform. Environmental concerns include the possibility that such a reform would encourage rapid conversion of agricultural land to industrial use, or the development in environmentally fragile areas. In this regard, it should first be noted that international experience suggests that, if systematic land registration ensue the reform of the registration law, it should have a generally positive impact on sustainable land use, since it makes more effective the incentives for good husbandry provided by property rights, increasing security of tenure and minimizing externalities. This is true regarding both private and public lands. Further, an improved land registration law will reduce the haphazard occupation of environmentally sensitive land due to ambiguous property rights. Nonetheless, to ensure mitigation against the negative environmental impacts that could result from better land titling,

[16] Foreign Investment Advisory Service. *Yemen: A Study into the Impact of Tax Policy and Tax Administration on the Investment Climate: Background document* (Washington: March 2007)

better land use planning and regulations are also needed. The Government's letter of development policy takes explicit cognizance of these risks. It expressed the Government's commitment to "protect environmentally sensitive land by undertaking a clear classification, demarcation and registration of these areas as communal land resources (where appropriate such as pastures or wetlands) or as part of the State's public domain that is inalienable." It also commits Government to protect the rights of poor people, those with informal occupancy-based rights and women, who may hold customary or informal claims to land but not possess the means to attain formal registration, all users who may make less intensive use of land than those who might otherwise usurp those claims.

RISKS AND RISK MITIGATION

106. **Risks of reversal or loss of momentum:** As with any reform strategy, there is always a risk of policy reversals or loss of momentum. Changes in Government always bring uncertainty. Negative public reaction to certain reform moves (like the reaction to the 2005 diesel fuel subsidy reduction) can change the political calculus. The ongoing conflict in the north risks diverting Government attention from reforms, and may contribute to higher spending. Nonetheless, the Government's relatively recent focus on reform does appear firm, and was reinforced by the Cabinet shuffle earlier this year. The Government has affirmed its commitment to IR DPG goals and actions. The Government's recent reform achievements signal a sea change in favor of rapid reform and a real sense of urgency to put the country on a firmer financial and fiscal footing as oil revenues decline. The newly appointed Cabinet further reinforces the Government's commitment to reform and improves the confidence of Parliament.

107. The risk of reversal is primarily a risk for the second tranche actions, since the first tranche actions have been achieved prior to final negotiations. Changes in key counterparts, public reaction, parliamentary opposition, domestic conflict, civil strife or exogenous regional events could each detract from full commitment to the reform program. These risks will be mitigated by strong dialogue throughout the life cycle of the financing to assure the maximum understanding, ownership and engagement with the reforms supported by the project, donor coordination in support of the project, and civil society understanding of the project. Careful monitoring will further mitigate risk by sounding alarms if progress waivers on any key action.

108. **Capacity concerns:** A central danger for achievement of the prior actions for second tranche release is the relatively weak administrative capacity in the Yemeni Government. Since several of the second tranche actions concern implementation of supported policy reforms, it is here that capacity weaknesses may pose a threat. To help mitigate this risk, the project team will mobilize appropriate technical assistance resources as required, either directly or through donor coordination, to strengthen and supplement Government capacity.

109. **Macroeconomic stability:** Macroeconomic instability is clearly a potential risk. One key factor is the price of oil which, if it falls below projections, may limit the Government's ability to finance key reforms. Another is tax policy and collections, which has been the subject of contention between the Government and private sector in recent months. The introduction of the VAT (known as the General Sales Tax) in January 2007 brought a strong adverse reaction

from the business community, and required Government to agree to a grace period in its enforcement and a lowering of the corporate income tax rate. While these measures may enhance ultimate compliance and sustainability and broaden the tax base, in the short run they may dampen revenue collection. A final concern is expenditure discipline. It is hoped that the PFM measures, which are designed to dramatically strengthen both revenue and expenditure management will contribute to the solution. Government's demonstrated commitment to implementation of the NRA is another mitigating factor. In some dimensions, budget and expenditure planning and discipline are improving already. The Government shared with donors in November 2006 its first Public Investment Program (PIP), now under revision to account for donor commitments. Under the PFM, a process for preparing a Medium-Term Expenditure Framework[17] has been drafted, and procedures are expected to be approved in the first half of 2007. After a suitable period of piloting, the Government will develop the capacity to apply the MTEF under the guidance of the Ministry of Finance. These internal reforms, along with continued careful macroeconomic monitoring by the country economist and the IMF, and agreed actions following the Article IV consultations, will help to mitigate this risk.

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[17] The MTEF also encompasses the Medium-Term Fiscal Framework and the Medium-Term Budget Framework.

ANNEX 1: LETTER OF DEVELOPMENT POLICY[18]

بسم الله الرحمن الرحيم

الرقم: P.M/50/4541

التاريخ: .....

الموافق: 6 Oct. 2007

الجمهورية اليمنية
رئاسة مجلس الوزراء

Letter of Development Policy

Mr. Robert Zoellick
The President -The World Bank
Washington, D.C., USA

Dear Mr. Zoellick

Since 1995, Yemen has been implementing a comprehensive macroeconomic and structural reform program with support from the World Bank and the International Monetary Fund, to strengthen fiscal discipline and create a market economy conducive to investment and growth. The proposed **Institutional Reform Development Policy Credit (IRDPC)** is another instance where the Bank's support could play an instrumental role in ensuring the continuity and success of our structural reforms program.

Structural Reform Program: Objectives and Progress

Following a period of slow-down caused by internal and external security challenges, our reform efforts accelerated beginning in late 2005, as underscored by the adoption of the **Third Socio-Economic Development Plan for Poverty Reduction** (DPPR) for 2006-10 (which is also our PRSP). The government's reform program, as articulated by the DPPR, focuses on six core areas: bringing steady improvement in economic growth; reducing poverty and raising the quality of life; promoting good governance; reducing regional and gender disparities; enhancing decentralization; and broadening the participation of civil society. In addition, it emphasizes efficient mobilization of resources; stressing the need for the completion of the Economic, Financial, and Administrative Reform Program (EFARP); combating corruption; limiting the role of the state; and enhancing the regulatory environment for the private sector to take a lead. In the financial sector, it sets focus on promoting open market policies and strengthening the intermediating role of the financial institutions. It also intends to support and modernize the banking sector and financial institutions at central and local levels.

To tackle poverty, the DPPR identifies a number of reforms in the areas of macroeconomic policy, governance practices, trade policy, and sectoral policies. It also lays out an ambitious agenda for human resource development, including measures to improve education and health, improve and augment public services, and strengthen social protection. Finally, the DPPR broadly lays out measures to improve and conserve water supply, protect the environment and strengthen basic infrastructure.

To attain our growth and poverty reduction goals in the short-run, in early 2006 the Government (with strong support from donors) put into place its **National Reform Agenda** (NRA), an ambitious reform program aimed to address a number of the key development

[18] In a letter dated November 5, 2007, the government confirmed that all references in the Letter of Development Policy associated with the IR DPC should be understood as now referring to IR DPG and any references to the financing as a credit should be understood as referring to the grant.

challenges. The stated overall objective of this agenda is to improve Yemen's investment climate and strengthen its governance and democratic institutions.

The NRA encompasses concrete measures designed to improve public financial management and reform procurement, public audit, governance, debt management, fiscal policy, and the business regulatory environment. Since the adoption of the NRA, we have embarked on and accomplished reforms in the many areas, some of which have been directly supported by the **Institutional Reform Development Policy Credit** (IRDPC). These reforms include:

- Simplification and reduction of tariffs, and the introduction of ASYCUDA.
- Simplification of the tax system and introduction of a General Sales Tax.
- Separation of the judiciary from the executive branch
- Introduction of various anti-corruption measures, including an anti-corruption law, a national anticorruption authority (Supreme National Authority to Combat Corruption--SNACC), and a financial disclosure bill for public officials.
- Introduction of a national procurement manual, standard bidding documents governing public tenders, and a new public procurement law consistent with international standards.
- Strengthening our Public Financial Management through the launch of a comprehensive strategy (PFM Action Plan) and Partnership Agreement with donors.
- Initiating a Public Administrative Reform program, including a re-engineering program in pilot Ministries, a strategy to rationalize wages and link them to institutional reforms and a biometric identification program aimed to eliminate ghost workers and double dippers.
- Strengthening of electoral democracy and press freedom.
- Accession to the Extractive Industries Transparency Initiative.

I am pleased to say that our efforts have been successful in addressing either fully or partially some of the most difficult and unpopular issues, particularly with regards to implementing the new sales tax system, reducing fuel subsidies, reforming trade tariffs, and moving ahead with the biometric identification system of civil servants, which can ensure a smooth transition to a sustainable development path. A significant number of the items on the NRA agenda have been completed, while others are progressing satisfactorily. The annex table highlights our current reform program, covering measures completed over the last two years, and those planned over the next twelve months

The IRDPC will come at a critical time by providing the government with the resources and flexibility needed to ensure that the momentum for reform is sustained and rapid progress can continue. It will signal the World Bank's confidence in our reform program to investors, donors and our citizens.

Macroeconomic Framework

The Government's PRSP establishes ambitious goals for macroeconomic policy, including:

- An annual average rate of economic growth of 7.1% (10.1% for the non-oil GDP).
- Maintaining monetary stability with the annual inflation rate below 13.8% and the broad money supply growth below 22% on average.
- Maintaining the fiscal deficit at less than 3% of the GDP; while raising public non-oil revenues on the order of 40-45% of total revenues; and increasing investment spending to reach 30% of total public expenditure.
- Reducing poverty rates at the end of the planning period to about 19.8%, lowering unemployment to 12%, and increasing the share of female labor to 15% of the total.

Macroeconomic performance in 2006, the first year of the Plan, fell short of these objectives. Several factors negatively influenced performance, including a sharper-than-expected decline in domestic oil production, continued geopolitical tensions in the region, regional drought conditions that drove up the price of some agricultural commodities, and continued internal conflicts in the North of Yemen. As a result, GDP grew by a moderate 4% during 2006, while inflation increased unexpectedly well beyond our target. On the other hand, the year 2006 witnessed an improvement in our overall fiscal position, where we realized a small surplus for the first time since 2001. In addition, the balance of payments recorded a surplus of about 1 percent of GDP, despite a surge in imports of capital goods.

In 2007, we expect real GDP growth to slow to 3.3 percent, owing to a sharp fall in oil production of more than 12 percent. Despite the overall moderation in growth, the non-oil sector will maintain its strength at about a 5.5 percent growth rate, reflecting the sustained increase in capital spending, both from private and public sources. Meanwhile, inflation is expected to ease to less than 13 percent, which despite the improvement, remains above the average for the years 2000-2005 of 10.6 percent and raises concerns over its negative implications for growth and the standards of living of the poor. The fiscal balance for 2007 is expected to show a deficit of around 5 percent of GDP, primarily reflecting the continued decline in oil production and the rising cost of remaining fuel subsidies.

Controlling inflation and improving fiscal sustainability. Macroeconomic stability is critical to reaping the benefits of the Government's ongoing reform program. With inflation in 2006 and 2007 climbing well above our targeted level, and the primary non-oil deficit exceeding 25 percent of GDP, the Government agrees with the Bank and Fund that Yemen today faces two key macroeconomic challenges:

- Controlling inflation;
- Ensuring fiscal sustainability.

The Government is committed to tackle these challenges through tighter fiscal and monetary policies. On the monetary side, this will require more active policies and with more diverse instruments. On the fiscal side, it will necessitate prudence in expenditures policies, particularly subsidies and wages, and increase non-oil revenues.

To control inflation, and in consultation with the IMF Article IV mission of June 2007, the Government will take the following steps:

- Resume the issuance of T-bills, beyond the needs to finance the government's budget deficit, in order to absorb excess liquidity. This will help to moderate money supply growth.
- Continue to issue Central Bank CDs, as an additional measure, to control money supply growth.
- Adhere strictly to the National Wage Strategy Phase II, which requires completion of specified public administrative reforms as a prerequisite to the next round of salary increases.
- Explore options to streamline budgeted capital spending following the start of (off-budget) development projects financed from last year's CG donors' pledges.
- Finally, the Central Bank will review international experience and consider the use of foreign exchange interventions as an instrument to curb inflation while preserving long-term competitiveness and building reserves.

To meet the challenge of fiscal sustainability and prepare for the impending depletion of our oil reserves, we will need to make large adjustments in terms of both expenditures and revenues, including the following steps:

- Re-engineer and reform the Social Welfare Fund, and merge other funds with similar mandates, to improve its targeting of the poor. .
- Once the redesign of the social safety net is completed, gradually move to eliminate the petroleum subsidy.
- Modernize tax administration to improve compliance and efficiency.
- Use tax policy to increase non-oil revenues substantially, including through the gradual increase of the GST in the medium term.
- Substantially reduce exemptions and tax holidays from the corporate income tax, while lowering the rate to 20 percent, so that it could be made broader and more equitable.

With these measures, we will establish a stable and sustainable basis for growth and poverty alleviation. Additional measures, supported by the IRDPC, will further enhance conditions for growth through investment climate reforms, public administrative reforms and strengthened public financial management.

Commitments under the proposed Institutional Reform Credit

In specific relation to our current dialogue with the Bank, we would like to confirm that we will be undertaking measures aimed at improving public administration and enhancing the climate for private sector development, by pursuing following reforms:

Public financial management and public procurement. We have given central priority to the modernization of public financial management (PFM). In this area, we will undertake reforms to improve budget preparation and implementation, with related actions that will bring a new Financial Law and restructure the Ministry of Finance in line with international standards. We will also seek to strengthen the budgetary control through more effective internal and external auditing functions, with related actions including the establishment of a road map to implement internal audit in the GOY, and the passing of a new legislation to improve the governance and transparency of COCA, the external audit body.

We recognize the continued reform of budget management and information systems is vital to reducing fiduciary risk and strengthening performance. New planning and management tools, including our first ever Public Investment Program (PIP) and the planned Medium-Term Expenditure Framework (MTEF), will strengthen coherence and discipline in the use of public resources. We will continue to strengthen the capacity of the Ministry of Finance's budget functions, as well as the institutional basis and functioning of external and internal audit functions.

In addition to the foregoing, we will undertake reforms to enhance the public procurement system in the following areas:

a. The Minister of Finance has already issued a directive requiring key spending ministries to use of the National Procurement Manual and Standard Bidding Documents (SBDs) for all public tenders. This will subsequently be extended to all public agencies.
b. Consistent with the Government's commitment, a new procurement law that conforms to international standards has been approved by Parliament in July 2007, and efforts are currently underway to draw and implement its executive by-laws.
c. To implement the provisions of the new procurement law, Government will restructure the High Tender Board (HTB) to assure its independence as a technical body overseeing government contracts above a defined threshold. In parallel, under the new law, we will create a separate procurement policy and monitoring board to address policy, monitoring, dispute resolution, and capacity building issues. It will utilize the new procurement tracking system (PMIS) as a monitoring tool. All these reforms are to be in place by Nov. 30, 2008

Public Administration Reform. Strengthening public administration, improving service delivery, and reducing corruption and waste form an integral part of our program. Under the Civil Service Modernization Program, good progress has been achieved. However, further reform and re-engineering of institutions, incentives, staffing and oversight systems will be required, both to motivate better performance and attract skilled workers, and to maintain fiscal restraint. Our agenda in this area will focus on the following issues:

a. Enact a civil service program, with adequate budget allocations to support the Civil Services Fund (CSF) over the period 2008-2010. This step has already been completed in July 2007, with the Cabinet approving the Civil Service Fund program and its necessary budget allocation.
b. Continue to implement, throughout the period to Nov. 30, 2008, the CSF work program, that includes the transfer of the programmed number of staff from selected line ministries to the Fund.
c. Continue rigorous adherenceto the National Wage Strategy (under the Wage Law of 2005), that requires agencies to meet defined institutional reform criteria before making future salary increases.
d. Continue efforts to build a comprehensive and operational computerized database for public sector employees based on the biometric civil servant identification system, by December 2007.

Hydrocarbon revenue transparency. Given the significance of hydrocarbon revenue to the budget, transparency in this area is a vital to achieving better governance and accountability and improving the general performance of public financial management. In this regard, we will seek to implement international standards through the following sequence of measures:

a. Join the Extractive Industries Transparency Initiative (EITI), which we have already announced our commitment to its principles, through a public letter to its management.

b. Achieve, with the support from international donors, the institutional and procedural measures prescribed by EITI that include:
    - Publishing, in publicly accessible, comprehensive, and understandable manner independently audited accounts that document all significant revenues and payments to the Government or State enteritis from oil, gas, and mining companies operating in Yemen.
    - Establishing, in consultation with the oil and gas companies and civil society organizations, an ongoing process for full verification and publication of payments and revenues related to extractive industries.
    - Reconciling payments and revenues data for extractive industries by a credible independent administrator that uses international audit standards, and subsequently publishing the reconciliation report, with any discrepancies identified.

Income tax and incentive reform. The Government of Yemen is committed to reforming the taxation system in order to create a better investment climate and strengthen non-oil fiscal revenues. We have already introduced a modern General Sales Tax (VAT), which is being phased in. We will now reform the corporate income tax system to lower rates and eliminate most exemptions; to apply international norms in the treatment of income, expenses, and investments; and to introduce self-assessment and risk-based auditing. To achieve these objectives, we are adopting a strategy that has three major components:

a. We have conducted, with the technical support of FIAS, a comprehensive review of our current tax and incentive system. This will improve tax efficiency and equity, and strengthen incentives for investment.
b. The Ministry of Finance has drafted and submitted to Cabinet a new Corporate Income Tax (CIT) Law that reflects international norms of treatment of income, investment, and expenses.
c. Upon its enactment, we will subsequently implement the CIT Law by Nov. 30, 2008, as evidence by issuance of its executive regulations. We plan to accompany this with a comprehensive review of investment incentives following the recommendations of the tax and incentive study.
d. We will continue to work to strengthen the capacity of the tax administration, in order to reduce discretion and abuse, and enhance revenue collection.

Land titling and registration reform. The weakness of property rights in Yemen is one of the most critical challenges to a better investment climate. We intend to create a system of secure and enforceable property rights, and remove ambiguity in titling which has led to investor uncertainty and legal conflict. Our efforts will target the following issues:

a. The Council of Ministers has approved and submitted to Parliament a new land registration law reflecting the recommendations of the Land Policy Task Force, by September 2007.
b. Pending Parliamentary approval of the Law, we expect to finalize the design and implementation of the executive by-laws by Nov. 30, 2008.
c. Next, we will appoint an independent Registrar of Land.
d. Finally, the Council of Ministers will issue an organizational decree defining the mandate and functions of the General Authority for Lands, Survey and Urban Plan (GALSUP).

Social and Environmental Safeguards

As we pursue the reforms described above, we recognize the importance of taking proper safeguards against any associated negative environmental and social consequences. Any negative impacts will be carefully monitored and further mitigating measures considered if results suggest the need for them.

For example, concerning land titling, we recognize that while a better land registration law will reduce the haphazard occupation of land, it could also bring some negative environmental impacts from more intensive land development or the conversion of agricultural and/or environmentally sensitive land. To this effect, we will seek to improve land use planning and regulations. We will protect environmentally sensitive land by undertaking a clear classification, demarcation and registration of these areas as communal land resources (where appropriate such as pastures or wetlands) or as part of the State's public domain that is inalienable, on the basis of environmental assessment procedures. We will also take measures to mitigate the impact of the new land titling system on vulnerable groups, including the poor, those with informal perspective acquisition, occupancy-based rights to public land, and women in particular, who may not possess the adequate means and resources to access formal registration. For this, we will facilitate their registration and will amend the State Land and Real Estate Law and other laws the extent that it is necessary to eliminate any disadvantages to this segment of the society. In addition, we will monitor the impact of changes in land registration on vulnerable groups, and, as required, take remedial measures to ensure their welfare. The executive regulations of the land registration law will include a requirement that any systematic registration effort be preceded by:

- an analysis of the social and environmental impacts -- including base line surveys as appropriate,
- an identification of environmentally sensitive areas, and
- an identification of land occupancy patterns and vulnerable and affected populations within those areas.

Then mitigation measures would be designed to protect environmentally sensitive areas and vulnerable and affected groups.

Similar considerations will be given to the design of income tax reform, whereby we intend to ensure that the new system will not provide incentives for the rapid development of environmentally harmful projects. We plan, in this respect, to carefully monitor the effect of tax reform on the pattern of investment and its environmental consequences, and, if required, take remedial measures to address any negative consequences.

Finally, concerning civil services reform, we will maintain the severance payments at levels that will ensure adequate compensation to retrenched employees and establish a monitoring system to follow up on their status afterwards. Already, the first phase of the implementation of the wage strategy has increased civil servant's minimum wages dramatically, lifting many out of poverty.

بسم الله الرحمن الرحيم

الجمهورية اليمنية
رئاسة مجلس الوزراء

الرقم: .....
التاريخ: .....
الموافق: .....

Conclusion

In conclusion, we would like to note that there is a new spirit in Yemen with a clear commitment to economic and institutional reforms that are necessary to achieve our development goals. In this respect, a new Cabinet was formed in April 2007 with the aim of accelerating and deepening reforms.

Overall, and as shown in the annex table, our efforts over the next two years will aim to achieve the following objectives:

- Monitoring the implementation of new laws that were passed, as well as expediting the ratification of laws under review.
- Continuing to deepen structural reforms, particularly in the areas of public financial management, regulatory business environment and competition, civil services and fiscal policy.
- Continuing to strengthen anti-corruption institutions and raise awareness on ethics and corruption issues amongst public officials and citizens as a whole.
- Improving political participation and public accountability by enacting elections of governors as well as members of the second chamber of the legislative branch.

In this regard, we remain firmly committed to implement the measures spelled out in the main body of this document - and in the attached policy matrix - by the specified dates. We also remain committed to maintain macroeconomic stability and fiscal sustainability over the medium-term through prudent fiscal and monetary management of the economy. Our commitment also means that we will not reverse policy reforms already achieved under the National Reform Agenda. We would like to ask the Bank's support, through this first development policy credit and beyond, so that our efforts continue and that the benefits of growth and good governance are shared by all the citizens of Yemen.

Yours sincerely,

Dr. Ali Mohamed Mojawar

Prime Minister

Annex 1. Current Reform Program in Yemen: Objectives and Progress

(As of 09/30/07)

Reform Area	Structural reforms that were done/ will be done	Status of implementation	Link to IRC
I. GOVERNANCE AND ANTI-CORRUPTION Yemen is placing strong emphasis on improving its ranking in governance indictors (WBI, TI), including rule of law, political stability and security. Targeting areas such as the rule of law, contract certainty, transparency in public procurement and the legal system, is expected to improve the investment climate and promote growth.			
Anti-Corruption	▪Conducting a national anti-corruption awareness campaign.	▪ ***Done.*** Campaign undertaken in June 06.	
	▪Establishing an autonomous anti-corruption commission with broad mandates.	▪ ***Done.*** *Supreme National Authority to Combat Corruption* (SNACC) was established in June 07 following the selection of its members by Parliament	
	▪Adopting a new disclosure policy to address the perception of conflict of interest (COI) in the handling of public procurement in the country	▪ ***Done.*** Parliament passed a Disclosure Law in July 2006, but application has been delayed pending the formation of SNACC. The law, though a step in the right direction, requires further revision to meet international GAC standards	
Revenue Transparency	▪**Joining the Extractive Industries Transparency Initiative (EITI), through the establishment of firm commitments for adherence to its principles.**	▪***Done.*** GOY has formally joined the EITI in August 2007, and started to implement the initial required measures.	**Trigger /TR1**
	Adherence to the EIT principles, including: ▪**Publishing an independently reconciled report of all significant revenues and payments transactions from oil and gas between the government and companies, and in a publicly accessible, comprehensive, and comprehensible manner.**	▪***Ongoing.*** Ministry of Oil and Minerals has been designated to lead the EITI effort and a consultant has been appointed to help with the implementation issues. The publishing the first EITI Report is expected by Nov. 2008.	**Trigger /TR2**
	▪ Establishing, in consultation with the oil and gas companies and civil society organization, an ongoing process for full verification and publication of payments and revenues related to extractive industries.	▪ ***Ongoing.*** Process is under development by the newly formed multi-stakeholder group for Yemen EITI.	Action /TR2
	▪Reconciling payments and revenues data by a credible independent administrator, and using international standards. This approach to be extended to significant payments from all oil and gas companies including SOEs.	▪***Ongoing.*** A sustainable reconciliation process will be established by the Yemen EITI group.	Action /TR2

Judicial System	▪Eliminating the influence of the Executive Branch from the Supreme Judicial Council (SJC), and creating the Judicial Inspection Authority.	▪ ***Done.*** Amendments passed in June 2006	
	▪Strengthening the oversight role SJC.	▪ ***Ongoing.*** SJC brought several disciplinary actions against corrupt judges in 2006 and 2007.	
	▪Improving the capacity of the judges	▪***Done.*** Revised the law of the High Judicial Institute, and updated its curricula in 2006.	
	▪Improving court administration through automation	▪ ***Ongoing.*** Phased introduction of computerized court management system is underway.	
II. PUBLIC ADMINSTRATION			
Public administration needs strengthening in two major areas: public financial management (PFM) and civil service. In PFM, reforms aim to make the budget function more effectively; strengthen and decentralize the financial controls, and improve and increase the independence of the external auditing system. In the civil service sector, reforms aim to improve the delivery of public services and keep salaries within a range that is fiscally sustainable.			
Civil Services System	▪Establishing a Civil Services Fund (CSF)	▪***Done.*** Fund was established in 2005.	
	▪**Establishing for the Civil Service Fund (CSF) a program for 2007-2010, and aligning the budgetary allocation for 2008 to the proposed program.**	▪***Done.*** Completed and approved by Cabinet in June 2007.	**Trigger /TR1**
	▪**Establishing a computerized employee database including a biometric identification system, that covers all employees on the state payroll in all sectors**	▪***Ongoing.*** Work on track with 80% percent already covered. Completion expected by end of 2007.	**Trigger /TR2**
	▪**Continuing to implement the CSF by transferring of the programmed number of staff from selected line ministries to CSF, in accordance with existing studies on this issue.**	▪***Ongoing.*** Planned to continue implementation throughout 2007-2008	**Trigger /TR2**
	▪**Continuing to adhere to the 2005 Wage Law requiring agencies to meet defined reform criteria before making any future salary increases.**	▪***Ongoing.*** Planned to continue implementation throughout 2007- 2008	**Trigger /TR2**
External Audit System	▪Improving the governance of the Central Office of Control and Auditing (COCA) in accordance with the INTOSAI guidelines.	▪***Ongoing.*** A proposal was made for changes in COCA's law to comply with INTOSAI, including its reporting to Parliament and the terms of its president. A new law is expected to pass by Nov. 2008.	Action /TR2.
	▪Making COCA's audit reports publicly available.	▪***Done.***	
	▪Exposing COCA to peer reviews by reputable SAI	▪***Planned.*** Review is expected to take place by Nov. 2008.	Action /TR2

Public Financial Management	▪Establishing a Public Financial Management Advisory Unit at MOF.	▪***Done.***	
	▪Issuing Budget Implementation guidelines for 2007 budget.	▪***Done.*** Guidelines issued in early 2007.	Action /TR1
	▪Monitoring the implementation of budget guidelines.	▪***Planned.*** A progress report will be issued by Nov. 2008.	Action /TR2
	▪Reviewing current budget practices, utilizing a public expenditure and financial accountability (PEFA) framework	▪***Ongoing.*** Work have commenced, and is expected to be completed by October 2007.	
	▪Improving budget classification and preparation and introducing forward estimates	▪***Ongoing.*** GFS2001 system adopted for economic classification.	
	▪Consolidating the Extra Budgetary Funds in the State Public Budget.	▪***Ongoing.*** Draft a law is expected to be approved by Nov. 2008.	Action /TR2
	▪Establishing a treasury function in the Ministry of Finance	▪***Ongoing.*** The IMF and US Treasury are providing technical assistance on this issue.	
	▪Introducing a new Financial Law to Parliament designed to set broad regulations for preparing and implementing the budget.	▪***Ongoing.*** Draft Law was prepared, and expected to be ratified in early 2008.	
	▪Reviewing the Public Investment Plan (PIP), and linking its process to the fiscal budge, in order to improve resources allocation.	▪***Done.*** MOPIC revised PIP in Aug. 2007, ensuring fuller reflection of the DPPR and establishing a systematic process for the regular updating of the rolling 4-year PIP.	Action /TR1
	▪Preparing a Medium Term Expenditure Framework (MTEF) to strengthen the allocation of resources in line with DPPR objectives.	▪***Ongoing.*** MOF is planning to introduce MTEF by Nov. 2008.	Action /TR2
	▪Improving public internal financial control and automation	▪***Ongoing.*** The government is expected to roll out AFMIS in the first quarter of 2008.	
	▪Improving internal audit functions	▪***Ongoing.*** GOY is expected to finalize plans to implement the new arrangements for internal audits function before the end of 2007.	
	▪Restructuring MOF in line with international norms.	▪***Ongoing.*** MOF has initiated a process to engage with the Ministry of Civil Service to restructure in line with international norms. Restructuring plans expected to be finalized by Nov. 2008.	Action /TR2

Public Procurement	▪**Enacting a new procurement law consistent with international standards.**	▪***Done.*** Completed. Revised law was passed by Parliament in July 2007.	**Trigger /TR1**
	▪Implementing the National Procurement Manual and standard bidding documents (SBDs), first on pilot level, and then by all government agencies.	▪***Done.*** Completed. Manual and SBDs were approved in April 2006. Training was held in July 2006 in pilot ministries. In Feb. 2007, HTB circulated instructions for compliance to spending ministries. MOF has issued similar circular for contracts below HTB threshold.	Action /TR1
	▪Establishing executive regulations for the new procurement law.	▪***Ongoing.*** Completion expected by Nov. 2008.	Action /TR2
	▪Restructuring the High Tender Board (HTB) by redefining its role as an independent institution with an oversight role over all government contracts,	▪ ***Ongoing.*** Restructuring plans have been provided for in the new Law. Full implementation is expected before Nov. 2008	Action /TR2
	▪Establishing the procurement and tracking system (PMIS) for transactions in the High Tender Board (HTB) and line ministries	▪***Ongoing.*** Feasibility /needs assessment study completed. Next phase requirements analysis on selected IT option to be completed by Nov.2007. Donors' funding for IT package earmarked	
	▪**Establishing Procurement Policy Monitoring Board to address policy, regulatory and capacity building issues, and apply and utilize the procurement tracking system (PMIS) for monitoring.**	▪***Ongoing.*** Restructuring plans have been provided for in the new Law. Full implementation is expected by Nov. 2008.	**Trigger /TR2**
	▪Initiating online disclosure of procurement-related information	▪***Ongoing.*** Website is under construction.	
III. MACROECONOMIC MANAGEMENT			
GOY is focusing on growth as a precondition for reducing poverty, and reducing inflation from its recent high level, through more prudent monetary and fiscal management. Budget deficits need to be maintained under control. Diversification is targeted to reduce dependence on oil, in the face of impending depletion of country's oil reserve.			
Fiscal Policy	▪Reducing fuel subsidies	▪***Planned.*** Domestic fuel subsidies were reduced once in July 2005. Further reductions are awaiting reforms to strengthen social protection schemes	
	▪Introducing a transparent formula for regular price adjustment of petroleum product and LPG.	▪***Planned.***	
	▪Setting up a clear goal to save on oil and gas revenues with the aim of controlling the primary non-oil deficit	▪ ***Planned.*** .	
Sales Tax And Tariffs	▪Replacing the sales tax system with a VAT system that lowers the rate to 5% and limits exemptions to a few basic consumption items.	▪***Done.*** The GST Law was passed in July 2005. Implementation has been gradual, but expected to be fully deployed by end of 2008.	
	▪Strengthening the tax authority.	▪***Ongoing.*** Increased staffing and training for tax authority was undertaken in 2006.	
	▪Simplifying and reducing custom tariffs to bring the average down to less than 7 %.	▪***Done.*** Changes made in July, 2005, reducing the bands from 4 to 3, with 71 percent of the commodities attracting only 5% tariff rate, and the un-weighted tariff rate falling to 6.6%	

Income Tax *	▪Conducting a comprehensive review of current corporate income tax with the aim of improving efficiency of revenue generation and strengthening incentives for investment	▪***Done.*** Completed in May 2007	Action /TR1
	▪**Formulating a new CIT Law that reflects international norms of treatment of income, investment, and expenses.**	▪***Done.*** Completed in May 2007, and currently before Cabinet for approval.	**Trigger /TR1**
	▪Strengthening the capacity of tax administration to reduce discretion and corruption	▪***Ongoing.***	Action /TR2
	▪**Implementing the new CIT law, through the issuance of executive by-laws that meet international standards.**	▪***Ongoing.*** Expected completion by Nov. 2008.	**Trigger /TR2**
Debt Policy	▪Introducing a new debt policy that sets ceilings for public external and internal debt.	▪***Planned.***	
IV. PRIVATE AND FINANCIAL SECTOR DEVELOPMENT The government continues to dominate economic activity in Yemen. There is a need to create a better enabling environment in order to allow the private sector to lead growth and employment creation.			
Land Titling *	▪**Enacting a new land registration law that takes into account the recommendations of the Land Policy Task Force.**	▪***Done.*** Law approved by Parliament in September 07.	**Trigger /TR1**
	▪Appointing an independent registrar	▪***Ongoing.*** Expected to finalize implementation by Nov. 2008.	Action /TR2
	▪Implementing the executive regulations of the Land Registration Law	▪***Ongoing.*** Expected to finalize implementation by Nov. 2008.	Action /TR2
	▪**Establishing an organizational structure for the authority that sets up its mandate and functions vis-à-vis other authorities and agencies.**	▪***Ongoing.*** An organizational decree is expected to be issued by Nov. 2008.	**Trigger /TR2**
Business Regulatory Environment	▪Improving the licensing and registration system of business establishments.	▪***Ongoing.*** An action plan based on the findings of the ICA study has been developed. Several measure were taken	
	▪Establishing a clear, consistent, fair system of inspections of business establishments.	▪***Ongoing.***	
	▪Reducing costs and delays of customs processing, through automation	▪***Ongoing.*** Introduced phased customs automation in May 2006	
Financial Sector *	▪Enforcing compliance of Basel prudential standards	▪***Ongoing.***	
	▪Establishing the Securities Market along with its legislative, institutional, regulatory, and technical requirement	▪***Ongoing.*** Expected to finalize in 2008	

Key: Action = Tranche action, Trigger = Tranche trigger, TR1 = Tranche 1, TR2= Tranche 2

* New reforms not included under NRA;

ANNEX 2: OPERATION POLICY MATRIX

Matrix of Actions Associated with Yemen Institutional Reform Grant (Actions in Bold are Mandatory for Tranche Release under the Legal Agreement)		
Govt. program/ DPG objective	**First Tranche Actions**	**Second Tranche Actions**
PILLAR 1: STRENGTHENING PROPERTY RIGHTS AND THE INCENTIVE FRAMEWORK TO ENCOURAGE NON-OIL GROWTH		
Component 1: Income Tax Reform.		
• Rationalized incentives facing private investors through standard treatment of income, investment and expenses, and a sharp reduction in the discretionary implementation that has marred the incentives and added uncertainty for firms operating in Yemen.	• A comprehensive review of corporate tax policy and incentives, with an aim to rationalizing taxes, improving the efficiency of revenue generation, strengthening incentives to invest and operate formally in Yemen, and reducing opportunities for discretionary application. • **A new corporate income tax law, reflecting international norms of treatment of corporate income, investments and expenses has been submitted to the Recipient's Council of Ministers.**	• **The Executive Regulations for the newly enacted corporate income tax law, compliant with international norms and satisfactory in substance to the Association, have been issued.** • Strengthening capacity of tax administration to reduce discretion, corruption.
Component 2: Land Titling and Registration Reform.		
Creation of a system of secure and enforceable property rights, with unambiguous title.	• **A new land registration law encompassing the recommendations of the Land Policy Task Force has been submitted to Parliament.**	• Approval and implementation of the executing regulations of the new land registration law in accordance with the underlying principles and recommendations of the Land Policy Task Force and the Policy Note. • Appointment of an independent registrar. • **The Council of Ministers of the Recipient has issued a decree whose substance is satisfactory to the Association, defining the mandate and functions of the General Authority for Lands, Survey and Urban Planning of the Recipient.**

Matrix of Actions Associated with Yemen Institutional Reform Grant (Actions in Bold are Mandatory for Tranche Release under the Legal Agreement)		
Govt. program/ DPG objective	**First Tranche Actions**	**Second Tranche Actions**
PILLAR 2: STRENGTHENING GOVERNANCE THROUGH IMPROVED PUBLIC FINANCIAL MANAGEMENT AND PUBLIC ADMINISTRATION REFORM.		
PFM: Reduce Fiduciary Risk		
Strengthening of the key areas of public financial management with better control environment and financial reporting quality.	• Issue budget implementation guidelines to ensure conformity and consistency in executing the annual budget. • Draft a law to allow for the consolidation of Extra Budgetary Funds in the State Public Budget. • MOF to initiate the formal process MOF to engage with Ministry of Civil Service to restructure MOF in line with international norms. • COCA to prepare a proposal to better comply with INTOSAI in terms of reporting to the Parliament, limiting the tenure of its president to 5 years renewable once and publishing its reform plans and annual report in COCA's magazine and /or website. • COCA to agree on undergoing a peer review by experienced SAI in conducting peer reviews and twinning arrangements. • Ministry of Planning has prepared a Public Investment Program (PIP)	• Issue implementation progress report on the budget implementation guidelines. • Submit for approval draft law on the consolidation of Extra Budgetary Funds in the State Budget. • Develop draft restructuring plans of MOF including goals and criteria of the restructuring. • Develop amended COCA's law to restrict the term of COCA's president to 5 years renewable only once and have COCA reporting to Parliament. • Engaging with an SAI to conduct a peer review as per INTOSAI standards and agree on a time frame for implementation. • Ministry of Finance to prepare a Medium Term Expenditure (MTEF) to strengthen alignment of allocation of resources for poverty reduction in the Budget 2008 (onwards) with the Socio-Economic Development Plan for Poverty Reduction (2006-2010) (PRSP)

Matrix of Actions Associated with Yemen Institutional Reform Grant (Actions in Bold are Mandatory for Tranche Release under the Legal Agreement)		
Govt. program/ DPG objective	**First Tranche Actions**	**Second Tranche Actions**
Component 3: Strengthening Public Financial Management -- Procurement		
Strengthened public financial management and governance with regard to public expenditure through procurement reform. As a first step, Government approved a standard procurement manual and procurement documents to be used in public sector transactions. New legislation professionalizes (de-politicize) the high tender board and creates a separate Procurement Policy Monitoring Board with a procurement tracking system under its authority. This gives the Government a systematic means of overseeing and regulating procurement, and a dedicated body handling policy and monitoring.	• **The procurement law has been revised to align it with international best practice, and has been submitted to Parliament by the Recipient's Council of Ministers.** • Ministry of Finance to require key spending Ministries to apply procurement manual and utilize standard bidding documents.	• Approve executing regulations to implement procurement law. • Restructure the High Tender Board (HTB) by redefining its role as an independent institution. • Focus HTB's on its oversight role as the apex body of procurement operations in Yemen's public procurement system. • **The Recipient has taken all action necessary, including regulatory action, to establish a procurement policy monitoring board to monitor procurement policy and undertake its regulatory functions utilizing a procurement management information system satisfactory to the Association.**
Component 4: Improving Revenue Transparency		
Committed to and achieving transparency with regard to revenues from oil and natural gas, which provide the largest share of the Government's income, though accession to and adherence to Extractive Industries Transparency Initiative (EITI), an international compact of resource-exporting	**The Recipient has declared its commitment to the Extractive Industries Transparency Initiative (EITI) principles by virtue of a letter submitted by the Recipient to the EITI Secretariat.**	**Adherence to EITI principles, including:** • **The Recipient has complied with the EITI principles and criteria by publishing the independently audited accounts of the Recipient documenting all material payments made to the Recipient by oil, gas and mining companies operating in the Republic of Yemen ("payments") and**

Matrix of Actions Associated with Yemen Institutional Reform Grant (Actions in Bold are Mandatory for Tranche Release under the Legal Agreement)		
Govt. program/ DPG objective	**First Tranche Actions**	**Second Tranche Actions**
nations willing to abide by agreed international standards for the full publication and verification of company payments and government revenues from oil, gas and mining..		**all material revenues received by the Recipient from such oil, gas and mining companies ("revenues") in a publicly accessible, comprehensive and comprehensible manner.** • Payments and revenues are reconciled by a credible, independent administrator, applying international auditing standards and with publication of the administrator's opinion regarding that reconciliation including discrepancies, should any be identified. • This approach is extended to all companies including state-owned enterprises. • Civil society is actively engaged as a participant in the design, monitoring and evaluation of this process and contributes towards public debate. • A public, financially sustainable work plan for all the above is developed by the host government, with assistance from the international financial institutions where required, including measurable targets, a timetable for implementation, and an assessment of potential capacity constraints.

Matrix of Actions Associated with Yemen Institutional Reform Grant (Actions in Bold are Mandatory for Tranche Release under the Legal Agreement)		
Govt. program/ DPG objective	**First Tranche Actions**	**Second Tranche Actions**
Component 5: Reforming Central Government – Public Administration Reform		
Reform of the civil service, both as a fiscal necessity (due to the huge burden of the wage bill and related obligations) and as a vital component of public administrative reforms to promote good governance and effective service delivery.	• **The Recipient's Council of Ministers has approved the Civil Service Fund program for 2008-2010 and the alignment of the budgetary allocation for 2008 to the said program.**	• **The Recipient has completed the implementation of the Recipient's civil service fund program for the period June 2007-May 2008.** • **The Recipient has consistently applied the provisions of the 2005 Wage Law which requires government agencies of the Recipient to meet defined reform criteria before making any future salary increases.** • **The Recipient has taken all action necessary for the establishment of a computerized employee database, including a biometric identification information system, all satisfactory to the Association with coverage extended to all employees on the state payroll in all sectors.**

ANNEX 3: FUND RELATIONS NOTE

IMF Executive Board Concludes 2007 Article IV Consultation with the Republic of Yemen

Public Information Notice (PIN) No. 07/120
September 27, 2007

On September 17, 2007, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with the Republic of Yemen.[1]

Background

Despite recent progress in poverty reduction, Yemen remains one of the poorest countries in the region and is far from achieving the Millennium Development Goals. Oil production has been declining since 2000, and in the absence of major discoveries, proven oil reserves could be depleted in some 10 years time. The start of a large liquefied natural gas project from 2009 will offer only partial compensation. Yemen faces considerable challenges to generate strong (nonhydrocarbon) growth to absorb the rapidly growing labor force and raise living standards, while ensuring fiscal and external stability in the context of declining oil reserves.

Economic performance in 2006 was generally favorable, but was accompanied by an increase in inflation. Overall real GDP growth reached 4 percent in 2006, with a 6 percent non-oil growth offsetting an 8 percent decline in oil production. After a decade of relatively stable rates in the 10-12 percent range, core inflation (excluding the volatile prices of the narcotic qat) increased to over 20 percent. This was partly due to higher world food prices, but buoyant domestic demand driven by increased government spending and rapid money growth, played a major role.

High oil prices helped reduce the overall budget deficit to about ½ percent of GDP in 2006, but spending remained high. As in previous years, a large supplementary budget was issued at the end of the year to validate spending overruns that had already taken place. Fuel subsidies continued to absorb a large part of the budget (8 percent of GDP) and the wage bill rose to over 9 percent of GDP, while the non-oil tax ratio fell further to less than 7 percent of GDP. Without corrective actions, the overall deficit would significantly widen in 2007 (to 5-7 percent of GDP) as the approved budget maintains high spending levels despite lower oil revenues due to declining production and prices.

Monetary policy was accommodative in 2006. With sizable government spending out of high oil revenues, the real exchange rate appreciated by 10 percent in 2006. The Central Bank of Yemen (CBY) continued its policy of targeting a slow and steady depreciation of the exchange rate, so the real appreciation manifested itself through higher inflation. Money growth accelerated to 28 percent in 2006, twice the rate of the previous two years.

The external account surplus remained broadly unchanged at over 3 percent of GDP in 2006, with record-high oil receipts partially offset by imports related to sizable investments in the gas sector. With the latter financed trough foreign direct investment, the high oil revenues resulted in a large reserve accumulation by the CBY. Gross reserves at the CBY increased by $1.5 billion to $6.8 billion by year end, the equivalent of about 11 months of imports.

Relations with the international community have strengthened. A Consultative Group meeting held in November 2006 in London succeeded in generating almost $5 billion in pledges (about one-fourth of 2006 GDP), underwriting a large part of Yemen's Public Investment Program for 2007-10. Half of the pledges came from Gulf Cooperation Council countries. Also, Yemen was reinstated in the U.S.'s Millennium Challenge Corporation's threshold program. The Yemeni authorities recently committed to join the Extractive Industries Transparency Initiative.

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities.

Executive Board Assessment

The Executive Board welcomed Yemen's generally favorable recent economic performance, including the decline in the poverty rate, as well as the progress being made on a number of structural reforms. Nevertheless, Directors concurred that the authorities face considerable macroeconomic and structural policy challenges to promote strong economic growth, create ample employment opportunities, and reduce poverty, while ensuring fiscal and external sustainability. In this regard, Directors welcomed the authorities' strategy of basing policies on existing hydrocarbon reserves, while recognizing that the country's economic outlook could be significantly altered by the discovery of new oil and gas resources.

Directors, noting that inflationary pressures have not fully abated, were encouraged by the authorities' commitment to reducing inflation. They agreed that monetary policy should focus closely on price stability and welcomed the CBY recent efforts to keep the exchange rate of the rial vis-à-vis the U.S. dollar broadly stable, which should help limit imported inflation. Given the limitations of monetary policy in Yemen, Directors generally considered it to be appropriate for the CBY to continue to rely substantially on the exchange rate as a nominal anchor, in order to achieve lower inflation. While the exchange rate currently appears to be broadly in line with fundamentals, over time and in view of the expected decline in oil production, it will be important for the exchange rate to reflect evolving economic conditions.

Directors observed that the shallow financial intermediation, along with a relatively high level of dollarization, is limiting the effectiveness of monetary policy. They viewed that the removal of the minimum interest rate for rial deposits would allow the CBY to conduct a more active interest rate policy and enhance financial intermediation.

Directors noted that fiscal restraint, including public sector wage restraint, should provide an important complement to monetary policy in reducing inflationary pressures. They also underscored that frontloading fiscal adjustment will be needed, given the prospective decline in oil production and revenues.

Directors agreed that the gradual phasing out of domestic fuel subsidies will be central to fiscal adjustment, while recognizing that this will require political support. They noted that raising fuel prices should go hand-in-hand with strengthening the social safety net, in order to cushion the impact on the poor, including through persevering with ongoing efforts aimed at improving the Social Welfare Fund. Directors also were of the view that, if the authorities wished to cushion the impact of high wheat prices on the poor, it would be preferable to do so through the SWF. Strong efforts will also be needed to increase the government's non-oil revenues, reorient spending towards priority areas, and improve the quality and effectiveness of capital spending. Directors supported the progress being made towards strengthening the budgetary framework and improving fiscal transparency.

Directors underscored the importance of productivity-enhancing reforms to strengthen Yemen's competitiveness in non-oil exports. Further efforts are needed to improve the investment climate and the quality of labor, enhance governance and reduce red tape, including in tax and customs administration. Directors stressed that deepening financial markets will be essential for ensuring strong non-oil performance, and also recommended further strengthening of banking supervision. In this regard, they encouraged the authorities to request an Financial Sector Assessment Program update, which would help to assess potential risks in the financial system and to develop an agenda for financial sector reforms. Directors welcomed the revised Anti-Money Laundering law, and looked forward to its approval by parliament.

Directors looked forward to further efforts to improve the quality and timeliness of macroeconomic statistics, to better facilitate the formulation and monitoring of economic policies.

Republic of Yemen: Basic Economic and Financial Indicators, 2003-07

Quota = SDR 243.5 million
Population = 21.6 million (2006)
Per capita GDP: US$ 927 (2006)

	2003	2004	2005	Prel 2006	Proj 2007
		(Change in percent)			
National Income and Prices					
Real GDP	3.7	4.0	4.6	4.0	3.6
Real nonhydrocarbon GDP	4.8	5.4	5.3	5.7	5.2
Real hydrocarbon GDP	-2.1	-5.0	-0.8	-8.3	-10.1
Core consumer price index (end-of-period) [1/]	12.1	14.5	20.2	22.0	12.0
		(In millions of U.S. dollars)			
External sector					
Exports, f.o.b	3,924	4,676	6,413	7,285	6,377
of which: hydrocarbons	3,417	4,303	5,952	6,733	5,814
Imports, f.o.b	3,557	3,859	4,713	5,890	7,118
Current account, incl. official transfers (in percent of GDP)	1.5	1.6	3.8	3.2	-3.8
Overall balance (deficit-)	583	556	264	1,353	1,104
		(In percent of GDP)			
Fiscal variables					
Overall balance (cash basis) [2/]	-5.3	-1.7	-0.3	-0.2	-4.6
Nonhydrocarbon primary fiscal balance (cash) 2/	-25.7	-22.1	-24.4	-25.4	-24.9
Debt ratios					
Net public debt	52.2	45.5	37.1	31.4	32.0
External debt	45.0	38.5	30.8	27.3	25.8
		(12-month change in percent)			
Broad money	20.0	15.0	14.4	28.8	25.0
Credit to private sector	26.3	33.5	21.3	16.7	12.5
Benchmark deposit interest rate (percent per annum)	13.0	13.0	13.0	13.0	...
Central bank own gross foreign reserves [3/]					
In millions of U.S. dollar	4,449	5,068	5,338	6,798	7,975
In months of next year's imports of goods and services	15.2	15.0	11.0	10.8	12.6

Source: Yemeni authorities; and staff estimates and projections.
[1/] Core CPI is defined as the overall CPI less the CPI for qat.
[2/] Includes statistical discrepancy.
[3/] Gross reserves minus commercial bank and pension fund foreign exchange deposits held with the central bank.

ANNEX 4: COUNTRY AT A GLANCE (INCLUDES COUNTRY MAP)

Yemen, Rep. at a glance

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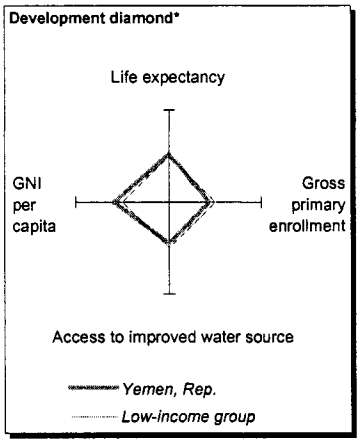
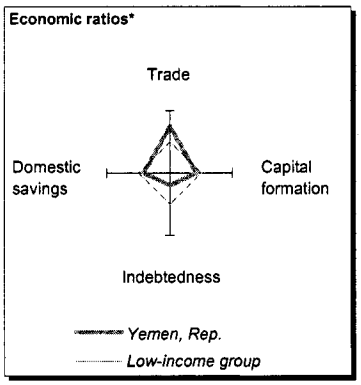
POVERTY and SOCIAL	Yemen	M. East & North Africa	Low-income
2006			
Population, mid-year *(millions)*	21.6	311	2,403
GNI per capita *(Atlas method, US$)*	760	2,481	650
GNI *(Atlas method, US$ billions)*	16.4	771	1,562
Average annual growth, 2000-06			
Population *(%)*	3.1	1.8	1.9
Labor force *(%)*	4.2	3.5	2.3
Most recent estimate (latest year available, 2000-06)			
Poverty *(% of population below national poverty line)*	..	..	..
Urban population *(% of total population)*	28	57	30
Life expectancy at birth *(years)*	62	70	59
Infant mortality *(per 1,000 live births)*	76	43	75
Child malnutrition *(% of children under 5)*	46	15	..
Access to an improved water source *(% of population)*	67	90	75
Literacy *(% of population age 15+)*	54	73	61
Gross primary enrollment *(% of school-age population)*	89	103	102
Male	101	106	108
Female	75	99	96



KEY ECONOMIC RATIOS and LONG-TERM TRENDS

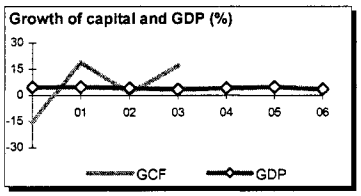
	1986	1996	2005	2006
GDP *(US$ billions)*	..	5.8	16.7	19.1
Gross capital formation/GDP	..	23.0	..	..
Exports of goods and services/GDP	..	42.3	..	..
Gross domestic savings/GDP	..	16.1	..	..
Gross national savings/GDP	..	25.1	28.3	..
Current account balance/GDP	..	1.8	4.2	..
Interest payments/GDP	..	0.4	0.3	..
Total debt/GDP	..	109.8	32.0	..
Total debt service/exports	..	2.4	2.6	..
Present value of debt/GDP	..	..	22.5	..
Present value of debt/exports	..	..	46.4	..

	1986-96	1996-06	2005	2006	2006-10
(average annual growth)					
GDP	5.7	4.3	4.6	3.3	..
GDP per capita	1.0	1.0	1.3	0.2	..
Exports of goods and services	34.5	6.3	..	..	..

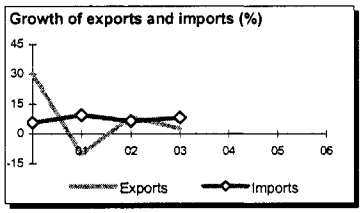


STRUCTURE of the ECONOMY

	1986	1996	2005	2006
(% of GDP)				
Agriculture	..	16.9	..	..
Industry	..	41.5	..	..
Manufacturing	..	10.8	..	..
Services	..	41.6	..	..
Household final consumption expenditure	..	70.8	..	..
General gov't final consumption expenditure	..	13.1	..	..
Imports of goods and services	..	49.2	..	..



	1986-96	1996-06	2005	2006
(average annual growth)				
Agriculture	4.5	4.2	..	..
Industry	7.7	4.8	..	..
Manufacturing	5.2	9.0	..	..
Services	5.2	4.4	..	..
Household final consumption expenditure	2.6	2.1	..	..
General gov't final consumption expenditure	0.1	8.6	..	..
Gross capital formation	15.0	2.5	..	..
Imports of goods and services	21.1	2.3	..	..



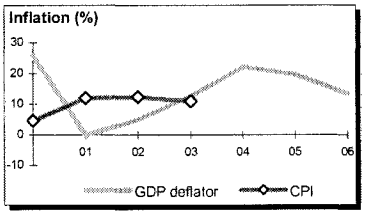
Note: 2006 data are preliminary estimates.

This table was produced from the Development Economics LDB database.

* The diamonds show four key indicators in the country (in bold) compared with its income-group average. If data are missing, the diamond will be incomplete.

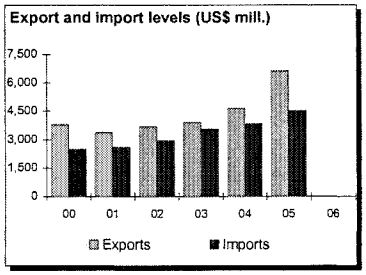
PRICES and GOVERNMENT FINANCE

	1986	1996	2005	2006
Domestic prices				
(% change)				
Consumer prices	..	30.7	..	..
Implicit GDP deflator	..	35.9	19.7	13.3
Government finance				
(% of GDP, includes current grants)				
Current revenue	..	28.8	34.5	..
Current budget balance	..	4.8	6.2	..
Overall surplus/deficit	..	-0.9	-2.2	..



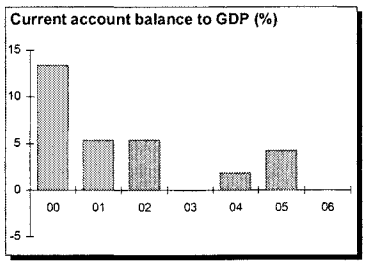
TRADE

	1986	1996	2005	2006
(US$ millions)				
Total exports (fob)	..	2,263	6,624	..
Crude oil (government share)	..	958	..	..
Crude oil (company share)	..	1,018	..	..
Manufactures	..	24	6,333	..
Total imports (cif)	..	2,294	4,538	..
Food	..	974	..	..
Fuel and energy	..	192	..	..
Capital goods	..	433	1,560	..
Export price index *(2000=100)*	..	76	177	..
Import price index *(2000=100)*	..	115	113	..
Terms of trade *(2000=100)*	..	66	157	..



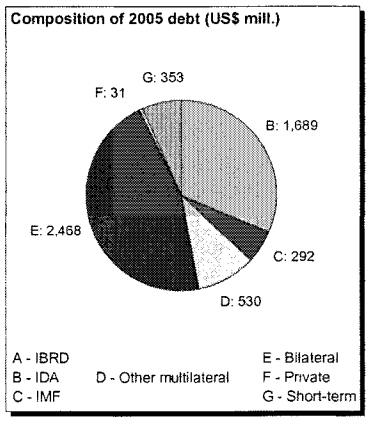
BALANCE of PAYMENTS

	1986	1996	2005	2006
(US$ millions)				
Exports of goods and services	..	2,448	6,908	..
Imports of goods and services	..	2,849	5,694	..
Resource balance	..	-400	1,214	..
Net income	..	-634	-1,676	..
Net current transfers	..	1,141	1,171	..
Current account balance	..	106	709	..
Financing items (net)	..	-400	-169	..
Changes in net reserves	..	294	-539	..
Memo:				
Reserves including gold *(US$ millions)*	..	1,036	6,198	..
Conversion rate *(DEC, local/US$)*	..	128.2	191.5	197.1



EXTERNAL DEBT and RESOURCE FLOWS

	1986	1996	2005	2006
(US$ millions)				
Total debt outstanding and disbursed	3,882	6,362	5,363	..
IBRD	0	0	0	0
IDA	407	893	1,689	1,894
Total debt service	173	87	211	..
IBRD	0	0	0	0
IDA	5	15	42	45
Composition of net resource flows				
Official grants	146	109	151	..
Official creditors	162	106	131	..
Private creditors	129	0	24	..
Foreign direct investment (net inflows)	6	-60	-266	..
Portfolio equity (net inflows)	0	0	0	..
World Bank program				
Commitments	47	207	40	0
Disbursements	47	95	129	160
Principal repayments	1	9	27	31
Net flows	45	86	102	130
Interest payments	4	6	15	15
Net transfers	42	80	87	115



Note: This table was produced from the Development Economics LDB database.

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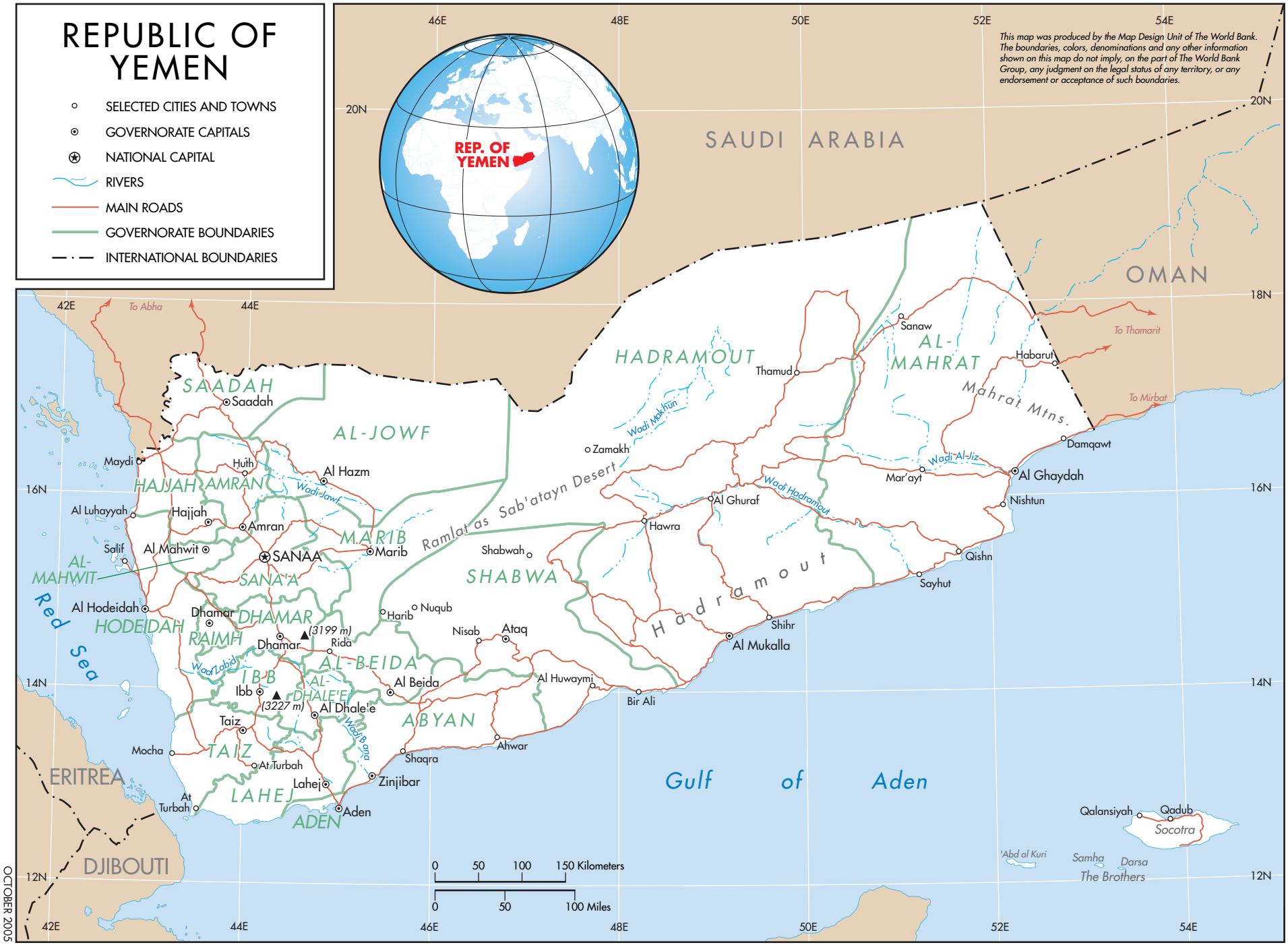
MAP SECTION



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