Report No. 9172-YEM

Republic of Yemen
A Medium-Term Economic Framework

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Country Operations Division
Country Department III
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CURRENCY EQUIVALENTS
(As of September 1991)

US$1.00	=	Yemeni Rials (YRls) 12.00
YRl 1.00	=	US$0.0833
Yemeni Dinar (YD) 1	=	YRls 26.00

FISCAL YEAR

January 1 - December 31

PREFACE

A World Bank economic mission visited Yemen in May 1991. International Monetary Fund staff participated in the mission, which comprised Messrs. Sawai Boonma, Sanjay Dhar, Hideo Hashimoto, Adalbert Knobl, Colm McCarthy, Melhem Melhem and Khai Nguyen. Messrs. Ram Chopra, Director, EMENA Country Department III, and Isik Erim visited Yemen during that period and participated in wrap-up discussions with government officials.

The mission worked with a counterpart team of government officials under the guidance of the Minister of Planning and Development. Unification has created a new economy that is not simply a linear combination of the previous two components and has created many issues relating to unification and transition. Government officials and the mission, however, agreed that since no economic surveys had been made on the Republic of Yemen and macroeconomic imbalances had been further aggravated by the consequences of the recent crisis in the region, the work of the mission should be most useful if it focuses on the issues relating to restoring economic stability and laying a foundation for resumption of economic growth in the medium-term. The scope of this Medium-Term Economic Framework paper is therefore limited to meeting these objectives.

REPUBLIC OF YEMEN

A MEDIUM-TERM ECONOMIC FRAMEWORK

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SUMMARY AND CONCLUSIONS

1. Republic of Yemen (Yemen) was formed on May 22, 1990, unifying the Yemen Arab Republic (YAR) and the People's Democratic Republic of Yemen (PDRY). The unified country's 1989 per capita income is estimated at $640.[1] The economy of Yemen will be based largely on the market system, which was followed by YAR before unification. Unification has created greater potential for long-term development than if the two parts were to remain separate. The new country has modest oil and gas reserves, large fishery resources, unexploited tourism potential, a dynamic private sector, and a larger domestic market to achieve a higher degree of economies of scale. In the immediate future, however, prospects for achieving such potential are clouded by the seriousness of the present macroeconomic imbalances.

2. Prior to the unification, both YAR and PDRY faced similar economic problems. Growth was low; unemployment/underemployment was on the rise; budget and balance of payments deficits were large; bank credit was extensively used to finance the budget deficit; inflationary pressures were intense; domestic savings were negative; main sources of foreign exchange - workers' remittances and external aid - were on a sharp decline; external debt was heavy; and prospects for growth in the immediate future were not promising. The unified country has inherited all these problems and challenges, which have been further aggravated by transition difficulties and events in the region since August 1990. Transition has not only entailed additional expenses for the country already in dire need of reducing a high budget deficit, but also has caused delays in economic policy decisions required to address urgent issues. The problems are being exacerbated by administrative difficulties resulting from amalgamation of two government administrations. The recent events in the Gulf have sent the majority of Yemeni workers home, causing substantial losses in remittances and aggravating the domestic unemployment situation; they have also reduced regional assistance to Yemen.

3. An apparent deterioration in the economic situation since unification is shown by the following preliminary indicators: (1) GDP declined in real terms by about 3 percent in 1990. (2) imports, at current prices, dropped by almost 17 percent in 1990, due mainly to shortages of foreign exchange; such a decline has adversely affected consumption, investment and output. (3) Monetary expansion continued at a rate higher than 20 percent in the first eleven months of 1990, reflecting partly the need for large bank credit to finance the budget deficit. (4) Inflationary pressures

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1/ Due to the difficulties of combining the two systems of accounts, data for 1990 are being reassessed before GNP per capita can be estimated with a reasonable degree of certainty.

have further intensified, as the average consumer price index in Sana'a accelerated to 34 percent in 1990 and to nearly 50 percent during March 1990 to March 1991. (5) The gap between the official and the parallel market exchange rates has widened, with the parallel rate declining to about YRls 25/US$1 in mid 1991 compared to about YRls 18/US$1 at the end of 1990, while the official rate remained at YRls 12/US$1. (6) The Government's inability to service fully its foreign debt obligations has created large arrears, especially on debt to the USSR.

4. Despite the present difficulties, the unification does present the Government with an opportunity to prepare and set in motion an integrated development strategy to realize the country's enhanced long-term potential. To be ready before the launching in 1993 of the development plan, formulation of such a strategy should begin shortly. As to the elements of the new strategy, the Government is fully aware that its options are unfortunately limited by the present economic problems and modest oil and gas reserves. This conclusion is supported by macroeconomic projections showing that, unless substantive policy measures - particularly in the areas of public finances and foreign exchange regime - are implemented, the levels of macroeconomic imbalances would continue to be unsustainably high. The budget deficit would continue to be in the order of 13-15 percent of GDP. With the declining trend in aid flows, most of the deficit would need to be financed by central bank credit. At the same time, continued excess domestic demand would put pressures on the exchange rate, which would further depreciate quickly. Projections also indicate that inflation is likely to accelerate.

5. With rapid population growth in excess of three percent annually, Yemen needs to achieve relatively high economic growth rates to prevent per capita income and the standard of living from declining. Because its limited resource base dictates that it cannot be self-sufficient in most of its requirements, even at high costs, the high growth rates need to be accompanied by the ability to earn sufficient foreign exchange to pay for necessary imports. To achieve these objectives, the country's development strategy would prima facie need to be outward-looking, focussing on exports of labor-intensive products and services. For quite some time, rapid growth and large labor requirements in the regional oil exporting countries provided opportunities for employment of Yemenis abroad. Slow economic growth in the area in recent years, however, has shut off much of such opportunities. At the same time, stagnation at home has limited growth of labor requirements in domestic markets, creating rising unemployment problems. These will be further aggravated by large numbers of returnees from the Gulf and of school leavers, resulting from past rapid population growth.

6. One major source of growth and foreign exchange earnings in recent years has been oil extraction and exports. Although exploration has increased, no substantial new discoveries have been made to augment the proven recoverable reserves of some 600 million barrels. At the present and projected rates of extraction, such reserves will be largely depleted by the end of this decade. While additional discoveries are not ruled out, prudent development strategy would seem to call for finding alternative sources of growth and foreign exchange to replace oil. Even if additional oil is

discovered, it should not be extracted solely to meet the short-term financial needs. Part of the revenues should be saved and invested to optimize the long-term income flows, so that when reserves are exhausted, income does not drop drastically. For this purpose, the idea of setting up an oil reserve fund that was once considered by YAR should be revived. Oil will help provide time to develop other sources, but it can not help absorb much labor.

7. Although land and water shortages will continue to severely constrain agriculture, the sector's potential to grow and save/earn foreign exchange remains considerable - through more efficient uses of factors of production and product diversification. With under-exploited resources, fisheries has great potential to grow both to satisfy a much larger domestic market and for export.

8. The role of manufacturing needs to be enhanced. Most of what has been achieved has focussed on satisfying domestic markets. Recent economic development history, especially in the small, newly industrialized countries, indicates that with appropriate outward-looking policies, this sector can become a dynamic engine of growth, earn large amounts of foreign exchange, and absorb a great deal of relatively low-skilled labor force. Some elements to vitalize this sector are already being made, such as the investment promotion law.

9. In services, tourism and the Port of Aden stand out as potential growth and sources of foreign exchange. Tourism has been small so far, but with the right policy it should be able to grow, earn substantial foreign exchange, and absorb labor. With investment already made to lengthen the life of the Aden Refinery, to set up a free-trade zone around Aden, and to revitalize the Port of Aden, service industries should be able to contribute substantially. While workers' remittances have been very important until now, and potential employment for Yemenis in the Gulf remains good once the regional situation returns to normal, prudent planning would seem to call for reduced reliance on such a source.

10. A development strategy with the elements discussed above will come to fruition only with an appropriate policy environment. Under the present circumstances, the first order of business would be to reduce sharply the present macroeconomic imbalances and to restore macroeconomic stability. To address these problems, the Government has taken the following measures in 1991: (i) doubling gasoline prices and raising by 50 percent the price of diesel fuel; (ii) withholding three days of civil servants pay; (iii) restraining expansion of 1991 budget expenditures; (iv) relaxing restrictions on the parallel foreign exchange market and legalizing exchange dealers; (v) liberalizing import licensing; and (vi) eliminating most of price controls, especially in the former PDRY. The Government realizes that additional measures are required and has started working on various policy options. While many options are being considered, a combination of measures indicated below has been found in simulations to be sufficient to pave the way for restoration of stability in the next couple of years.

11. In <u>government expenditures</u>, the following measures would be the most effective: (i) adopting all the current proposals to reduce the 1991

budget expenditures by YRls 3 billion; (ii) maintaining at the 1991 budget level non-interest current and capital transfers and the non-wage portion of defense expenditures for 1992; (iii) allowing the expenditures for wages and for services in 1992 to rise at about half of the rate of inflation in 1991; and (iv) freezing recruitment for the civil service except for exceptionally specialized skills.

12. The leading measures to increase government revenues, as far as it is practical, include the following; (i) converting specific customs duties to ad valorem; for goods remaining under specific duties, adjusting the rates periodically so that the rates in relation to import values remain approximately constant; (ii) applying a market-guided conversion rate to imported goods for the purpose of calculating import duties, beginning immediately with YRls 25/US$1, the exchange rate prevailing in the parallel market, and adjusting it periodically; (iii) adjusting the rates of taxes on goods, services, zakat, and stamps so that revenue yields stay approximately constant in real terms; and (iv) adopting measures to keep the yields of non-tax revenues constant in real terms.

13. Exchange rate measures include (i) applying the market-guided rate as the conversion rate to imports of the four essential commodities, beginning at YRls 18/US$1 in 1991, gradually moving to a totally market-determined rate; (ii) adopting the market-guided rate for the official exchange rate; and (iii) allowing foreign exchange dealers to operate without administrative hindrance.

14. Unification of interest rates, which has begun with raising the rates applied in the southern governorate, would be completed in the near future; they would then be adjusted periodically with the view of pricing credit closer to its market value. In order to secure a sharp slow down in monetary expansion, government borrowing would be from the general public through the issuance of zero-coupon investment certificates, at the imputed rates of return sufficiently remunerative to attract buyers.

REPUBLIC OF YEMEN
A MEDIUM-TERM ECONOMIC FRAMEWORK

I. The Setting

Background

1.01 On May 22, 1990, the Yemen Arab Republic (YAR) and the People's Democratic Republic of Yemen (PDRY) were unified to form the Republic of Yemen (Yemen). The unification brought together two economies of different orientation. The economy of YAR was based largely on liberal market principles, with a dominant role played by the private sector; that of PDRY, on the other hand, was organized on the socialist lines, with the government and public sector organizations playing the leading role. YAR, a much larger economy in terms of population (about 9 million) and production base, had attained $670 per capita GNP in 1989, while PDRY, with 2.4 million population, had reached $530 GNP per head. The per capita GNP of the unified country is estimated at $640 for 1989 As an indicator of the level of development, this seemingly high per capita GNP, however, is tempered somewhat by other social indicators usually associated with a lower level of income: life expectancy of 50 years, primary school enrollment rate of 67 percent, adult literacy rate of 20 percent. These indicators reflect, to a great extent, Yemen's late start in modern development, and point to a rather difficult development task ahead for the country.

1.02 YAR achieved rapid growth during the 1970s and early 1980s, thanks to large inflows of remittances of Yemenis working abroad and of external loans and grants. Growth of GDP averaged 8.7 percent per year during 1974-81; the balance of payments was easily managed; and the external debt burden was light, with the debt service ratio remaining in the single digit range. Precipitated by a sharp drop in remittances and external assistance, the economy encountered difficulties in the late 1970s and early 1980s, and by 1982 the large budget and balance of payments deficits could not be sustained. By sharply reducing expenditures, substantially devaluing the currency, and controlling imports, the Government was able to bring the economy back to health four years later.

1.03 With earnings from oil exports starting in 1987, the tight budget policy was not maintained and the exchange rate, particularly vis-a-vis the Saudi currency in which most Yemeni migrant workers earned their incomes, was allowed to appreciate substantially in real terms (Table 1). As a result,

there was a relapse of serious macroeconomic imbalances in 1987. Large oil export earnings in 1988-89 helped reduce the budget and balance of payments current account deficits, in relation to GDP, during those two years, and create positive domestic savings in 1989. In absolute terms, however, the deficits remained large and were financed mainly by borrowing from the Central Bank and by short-term loans. Inflationary pressures remained intense, which were reflected in continued high rates of inflation. Short-term external borrowing rapidly added to the external debt obligations. Short-term debt approached $900 million in 1989, in addition to $2.5 billion of medium- and long-term debt. The scheduled debt service ratio had risen sharply from only 9 percent in 1985 to 23 percent in 1989. The heavy repayment burden necessitated repeated rescheduling of debt to the USSR, which helped reduce the actual debt service ratio to 12 percent in 1989. In summary, at unification, YAR was faced with still unsustainable budget and balance of payments deficits, high rates of inflation, a heavy debt service burden, and the need to urgently adjust policies to stabilize the economy.

Table 1: YAR - SELECTED INDICATORS, 1984-89

	1984	1985	1986	1987	1988	1989
Budget Deficit (% of GDP)	-21.7	-18.4	-15.2	-23.8	-16.8	-9.2
Financed by CB Borrowing (% of Tot.Bud.Def.)	74.2	72.4	58.0	64.0	61.7	62.4
Change in Money and Quasi-Money (%)	..	20.0	25.5	10.1	6.2	4.5
Consumer Price Index Increase (%)	12.6	27.4	29.4	21.7	16.4	20.0
Nominal Exchange Rate (YRls/$) 1/	5.35	7.27	9.42	10.21	9.76	9.76
Real Effective Exchange Rate (1980=100)	121.5	114.2	96.0	95.5	108.2	130.0
Real Exchange Rate vis-a-vis Saudi Rials (1980=100)	116.2	114.9	120.8	137.9	167.1	200.6
Current Account Balance (% of GDP)	-9.9	-9.9	-8.9	-15.6	-14.3	-7.5
Imports of GNFS (US $ Million)	1687	1348	10..	1565	1687	1621
Oil Exports (US $ Million) 2/	..	..	..	18	398	539
Workers' Remittances (US $ Million) 3/	1067	809	669	762	343	344
Grants (US $ Million)	143	103	241	160	91	108
LT Debt Service (US $ Million)	68	72	104	179	186	160
External Debt DOD (US $ Million)	1871	2032	2366	2636	3034	3324
Medium/Long-term	1602	1842	2109	2294	2464	2445
Short-term 4/	269	191	257	342	570	879
Domestic Savings (% of GDP)	-14.0	-12.9	8.5	-15.1	-0.6	5.9
National Savings (% of GDP)	8.0	5.1	6.6	1.6	3.3	8.5
Public	-10.1	-10.4	-4.9	-11.6	-4.2	1.8
Private	18.0	15.5	11.5	13.2	7.5	6.7
Investment (% of GDP)	17.4	14.4	13.3	14.6	13.8	12.2
Public	10.6	9.2	8.1	8.7	8.8	5.6
Private	6.8	5.2	5.2	5.9	5.0	6.6
GDP (YR million)	24756	30969	37505	43519	53766	66069

Sources: Central Planning Organization; and World Bank staff estimates.

1/ Conversion rates for 1985-1987.
2/ Government share only.
3/ Includes labor income.
4/ Includes IMF credits.

1.04 PDRY achieved relatively lower growth, but made considerable progress in providing the population with basic needs - food supply, health services, and education. Substantial investment was made to expand infrastructure and production capacity. In the mid-1980s, however, PDRY was faced with a very difficult economic situation, due to a sharp fall in workers' remittances (Table 2). The Government responded by cutting imports, raising taxes, and freezing wages and salaries in the public sector, resulting in a sharp decline in output. From 1985 to 1988, despite a relatively high level of investment, real domestic output declined by about 3 percent per year. Real GNP fell even sharper because of the drop in workers' remittances, with the total contraction estimated at close to 20 percent during 1985-88. Small growth was indicated for 1989.

1.05 During this period, aggregate demand policies continued to be highly expansionary. The budget deficit rose from 37 percent of GDP in 1985 to 45 percent in 1989. The deficit was financed by external borrowing and by bank credit, further expanding money supply despite the fall in GDP. The situation, however, was not reflected in the increases in prices, which were administratively suppressed. Mirroring the budget, the balance of payments current account deficit rose sharply from 23 percent of GDP to 41 percent during the same period. The deficit was financed by external loans and by drawdowns of reserves. As a result, external debt increased from $1.4 billion in 1985 to $2.2 billion in 1989, and the reserves declined from $45 million to $34 million (1988). The accrued debt service burden substantially rose from 15 percent of foreign exchange earnings in 1985 to 56 percent in 1989.

1.06 The unification brings together two sets of resources that could probably be better developed jointly rather than separately. The northern part has proven oil and gas deposits, with a favorable outlook for more discoveries; good tourism prospects; and a dynamic market system. The southern part has large fishery resources; the port of Aden; modest proven oil reserves, with also good prospects for more discoveries. In addition, the former border area that is believed to have the greatest potential for further oil and gas discoveries can now be explored more expeditiously. With a larger market, unification also offers potential gains from economies of scale in various industries. But before the potential can be realized, the country is going through a difficult transition period that has been aggravated by the effects of recent events in the Middle East. Furthermore, with both constituent parts facing difficult economic situations, unification clearly brings together two sets of macroeconomic imbalances that, as will be discussed below, need urgent adjustments.

Table 2: PDRY - SELECTED INDICATORS, 1984-89

	1984	1985	1986	1987	1988	1989
Budget Deficit (% of GDP)	-32.2	-37.3	-41.4	-30.9	-43.7	-45.3
Financed by CB Borrowing (% of Tot.Bud.Def.)	53.9	60.0	58.3	37.3	43.6	34.8
Change in Money and Quasi-Money (%)	..	8.0	4.4	7.6	6.0	4.7
Consumer Price Index Increase (%)	1.2	5.1	0.9	2.5	0.3	1.6
Nominal Exchange Rate ($/YD)	2.899	2.899	2.899	2.899	2.899	2.899
Real Effective Exchange Rate (1980=100)	..	..	..	..	..	.
Real Exchange Rate vis-a-vis Saudi Rials (1980=100)	..	..	..	..	..	..
Current Account Balance (% of GDP)	-25.0	-22.9	-21.1	16.5	-38.3	-40.5
Imports of GNFS (US $ Million)	874.1	774.6	568.8	609.5	855.8	812.4
Oil Exports (US $ Million) 1/	3.3	9.7	3.5	34.2	48.5	53.1
Workers' Remittances (US $ Million) 2/	501.0	426.0	293.3	303.7	254.2	161.0
Grants (US $ Million)	29.6	32.0	30.7	50.7	35.0	43.4
LT Debt Service (US $ Million)	62.4	84.5	105.4	129.5	157.9	210.5
External Debt DOD (US $ Million)	..	..	..	..	..	..
Medium/Long-term 3/	1251.0	1417.8	1582.9	1804.7	1838.4	2176.7
Short-term	..	..	..	..	..	..
Domestic Savings (% of GDP)	-30.6	-28.2	-21.4	-15.8	-22.7	-12.3
National Savings (% of GDP)	15.7	11.6	9.3	14.0	3.5	4.9
Public	-3.4	-7.5	-13.5	-2.2	-3.4	-1.6
Private	19.1	19.1	22.8	16.2	6.9	6.4
Investment (% of GDP)	40.7	34.5	30.3	30.5	41.8	45.4
Public	33.6	28.7	27.9	28.7	40.2	43.8
Private	7.1	5.8	2.4	1.8	1.6	1.6
GDP (YD million)	389.7	382.3	339.2	376.4	395.6	412.0

Sources: Central Statistical Organization; and World Bank staff estimates.

1/ Petroleum products; from IMF RED 5/17/90, Table 10 BOP.
2/ Includes labor income.
3/ DOD excludes liabilities to the IMF and AHF.

Political, Administrative and Institutional Unification

1.07 The country has been under a provisional government since unification. Sana'a has been designated the national capital and Aden, the business and commercial capital. A nation-wide referendum was conducted in May 1991 to approve the newly drafted Constitution. A general election for Parliament is scheduled for early 1992, after which a permanent government will be formed.

1.08 The Government's task over the past year of amalgamating the two former public administrations has been largely complete. To some extent, the task has been made more difficult by the differences in the two former systems. For example, PDRY had a large number of civil servants - double that of YAR - despite having a population of a little over 20 percent of the

latter. There is a need to rationalize the public administration and public sector institutions. The issue of over-staffing, and its budget implications, will continue to be a major concern of the Government in the future.

1.09 From the perspective of the former YAR, the role of the state will not significantly change. While the Government will attempt to guide economic development along a strategy it considers most appropriate to achieve development objectives, it will limit the Government's role to creating a suitable environment for fostering growth of the private sector, relying on the market to allocate resources. This approach, of course, represents a radical change from the perspective of the former PDRY, which was run for a number of decades under the command economic principles. In April 1991, an investment promotion law was promulgated (Republican Decree-Law No. 22 of 1991). One of its main objectives is to attract private sector investment, both from domestic and from foreign sources.

1.10 Despite the expressed desire for the Government not to directly participate in economic activities, there remain important issues relating to state enterprises inherited from the former PDRY. The Government's expressed intentions are either to divest itself of these enterprises or to allow them complete autonomy. Little divestment has been made so far. The Government has indicated that the process of granting these enterprises autonomy has started. It is still too early to assess the prospects of these enterprises if, under the new setting, they receive no protection from the Government against competition. The Government could be obligated to come to their rescue, should some of them find themselves unprepared for complete autonomy and are unable to compete in the market. It is conceivable that, being the owner of the enterprises, the Government remains the ultimate guarantor of their liabilities, which could have a substantial impact on the budget.

II. Present Economic Position

Production and Distribution Structure

2.01 Before unification, the economic structure of the northern part of Yemen was undergoing significant changes as oil extraction became more substantial, reaching close to 180,000 b/d in 1989. Agriculture, however, remained the most dominant sector, accounting for about 24 percent of GDP during 1987-89, followed by manufacturing (12.8 percent) and government services (12.6 percent).[1] In the southern part, government services were by far the most important sector, accounting for almost one-third of output during 1987-89, followed by agriculture (14.4 percent). Industry, construction, trade and transport accounted for similar shares (about 10 percent each). In the combined setting, government services would be the most

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1/YAR national account data do not include the share of the foreign oil companies in the oil sector. Adjustment has been made to include that part for the present calculation.

important sector, accounting for over 21 percent of GDP in 1990, followed by agriculture with almost 20 percent (Table 3).

2.02 Domestic production in both parts of the country has been totally consumed. Domestic savings have been negative, with the exception of 1989 in the former YAR, which had positive savings for the first time in many years due to a sharp increase in oil exports. At the same time, investment in the south, mainly by the public sector, has been exceptionally high, averaging over 39 percent of GDP during 1987-89. As mentioned above, growth in recent years has been largely negative. The fact that this high investment did not generate growth was a cause for concern. In the north, investment had been modest in the past few years, averaging less than 14 percent of GDP (1987-89). Investment in both parts of the country has been financed from resources generated outside the country, either in the form of factor income (workers' remittances) or grants and loans. The unified national accounts of 1990 indicate that consumption exceeded output by some 4 percent and the resource balances were in the negative by almost 18 percent of GDP. Lack of domestic savings would be a major constraint for future development of the country.

2.03 Until the advent of oil, exports made up a very small share in GDP of the north, averaging less than 4 percent during 1984-86; with oil, the share went up to 19 percent in 1989. In the south, the share had been in the range of 6-10 percent. In 1990, exports of goods and non-factor services accounted for just over 12 percent of GDP, while imports represented 30 percent. These low shares of exports in GDP partly reflected the limited resource base of Yemen, as well as past inward-looking development strategies in both parts of the country. With relatively low exports, but very high imports, the resource imbalance has been exceptionally high, as much as one-third of GDP in the north and over 70 percent of GDP in the south in recent years. Clearly an economy depending that much on imports would need a strategy with the focus of earning foreign exchange to pay for them.

Public Finances

2.04 Both parts of the country experienced prolonged budget deficits. In 1989, the combined deficit was 16.5 percent of GDP (Table 4). Although restraints on some expenditure items and availability of oil revenues had brought down the deficit in the North to under 10 percent of GDP in 1989 (Table 1 and para. 1.03), the cumulative effects of continued large deficits and their financing, largely by borrowing from the Central Bank, have led to inflation, overvalued exchange rate, and balance of payments current account deficits.

2.05 Until recently, the leading source of revenues in the North was customs duties. In 1988 and 1989, however, oil profits plus income taxes laid on oil companies, having generated almost one-third of total revenues for the two years, replaced customs duties. On the expenditure side, two major items stand out, i.e., expenditures for wages and for defense. The former has been gradually taking a larger share of the budget, from less than 23 percent of total expenditures in 1984 to about 29 percent in 1989. The current portion of defense expenditure had declined somewhat in terms of the share of total

Table 3: Major Components of National Accounts
(As percent of GDP at current price)

	YAR			PDRY			YEMEN
	1987	1988	1989	1987	1988	1989	1990
Agriculture	27.4	23.0	20.3	13.7	14.5	15.0	19.6
Manufacturing	13.6	12.5	12.3	--	--	--	10.8
Mining and quarrying	1.9	9.9	10.1	--	--	--	4.6
Trade	11.9	11.5	13.6	11.8	10.5	9.7	13.6
Transport and communication	11.9	11.0	12.7	10.4	10.5	9.2	11.7
Government services	13.0	13.0	11.9	26.4	27.1	27.4	21.4
Exports, GNFS	5.3	17.3	19.0	9.5	10.1	10.4	12.4
Imports, GNFS	38.1	30.8	23.9	55.8	74.6	68.0	30.0
Resource balances	-32.8	-13.5	-4.6	-46.3	-64.5	-57.6	-17.6
Total consumption	115.1	100.6	94.1	115.8	122.7	112.3	104.0
Gross fixed investment	13.8	13.1	11.6	30.5	41.8	45.4	13.6
Gross domestic savings	-15.1	-0.6	5.9	-15.8	-22.7	-12.3	-4.0
Gross national savings	1.6	3.3	8.5	14.0	3.5	4.9	6.1

Sources: Central Statistics Organization;
World Bank Staff Estimates.

expenditures, from over 24 percent in 1984 to less than 21 percent in 1989. The other part, capital and capital transfers, on the other hand, had gone up from 3.5 percent to almost 10 percent of total during this period. A smaller item that had gone up is expenditures for materials and services, from 4.4 percent share to 5.8 percent during 1984-89. At unification, the North was in urgent need of further reducing the deficit by cutting expenditures and/or increasing tax revenues. Options under consideration were freezing of wages and salaries, defense spending, expenditures for materials and services, and some other items; and raising of excise taxes on qat, soft drinks, mineral water, and petroleum products.

2.06 In the southern part, the deficit level was even higher at 40 percent of GDP (1987-89 average). The largest source of revenues came from transfers from public enterprises, followed by taxes on goods and services. Transfers from public sector enterprises accounted for about 35 percent of total revenues in 1984, increasing to over 48 percent in 1987 and declining to about 44 percent in 1989. Large profits made by the Aden refinery, as a result of lower imported crude prices but high prices of products sold domestically, explains part of this substantial contribution. Customs duties accounted for about 26 percent of total in 1984, declining to less than 16 percent in 1989, due mainly to lower imports because of foreign exchange shortages. Current expenditures took between 54 and 62 percent of total expenditures during 1984-89, the largest item being wages and salaries taking between 29 and 35 percent of total. Being a centrally-planned economy, the south spent a considerably larger share for capital expenditures, which accounted for 37-46 percent of total in 1984-89. The large budget deficits were financed partly by external grants and partly by bank credit, creating a highly liquid situation in the economy whereby the GDP/money ratio declined to 0.6 in 1989. Due to price controls and a general lack of goods to buy, the increased liquidity in the economy did not show up in the price index.

Budgetary Results for 1990 and Outlook for 1991

2.07 From the limited information available,[2] the budget deficit appears to have increased by some 18 percent in nominal terms in 1990, despite substantially higher oil revenues reflecting higher prices (Table 4). Expenditures rose by 35 percent reflecting a 57 percent rise in current spending which was partially offset by a small decline in capital spending. With inflation estimated at about 34 percent, this implied a large increase in real current spending. The increase in current expenditures was largely owing to a sharp rise in wages and a substantial increase in interest payments. The increase in wages reflected mainly an average increase of 35 percent to workers in the former PDRY to bring the pay in line with that of the former YAR employees. The rise in interest payments was due largely to a

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2/ As unification took place in the middle of 1990, there were two separate budgets in 1990. Data provided to the mission on fiscal developments in 1990 were limited to the financing of the deficit. The only actual data provided on the revenue and expenditure sides were for oil receipts. Some preliminary estimates for capital expenditure were also given.

Table 4 Republic of Yemen: Fiscal Accounts, 1987-1991

	Actuals 1987	Actuals 1988	Prelim. Est. 1/ 1989	Budget 1990	Prelim. Est. 1990	Budget 1991
	(In millions of Yemeni rials)					
Nongrant revenues	12,198	17,188	20,700	25,814	29,939	35,218
Taxes	7,323	9,727	12,273	14,907	16,440	19,055
Indirect	5,761	6,666	7,834	8,962	8,962	10,124
Taxes on international trade	2,839	3,403	4,046	4,276	4,276	5,250
Taxes on goods and services	1,824	2,091	2,684	3,262	3,262	3,361
Zakat and stamp taxes	1,097	1,171	1,103	1,424	1,424	1,512
Direct	1,562	3,061	4,439	5,945	7,478	8,931
Taxes on oil companies income	—	1,406	2,410	2,202	3,735 2/	4,283
Other direct taxes	1,562	1,655	2,029	3,743	3,743	4,648
Nontax revenues	4,875	7,461	8,427	10,907	13,499	16,163
Oil profits	725	2,921	3,365	4,673	7,265	9,770
Other nontax revenues	4,150	4,540	5,062	6,234	6,234	6,393
Current expenditures 3/	14,714	19,143	21,685	33,990	33,990	40,884
Interest payments 4/	492	657	802	3,222	3,222	6,590
Noninterest current expenditures	14,222	18,486	20,883	30,768	30,768	34,294
Nondefense current expenditures	9,491	11,120	12,452	15,651	15,651	19,181
Wage and salaries	6,765	7,911	9,121	12,633	12,633	15,401
Materials and services	2,726	3,209	3,331	3,018	3,018	3,780
Defense expenditure	3,400	6,071	6,958	11,819	11,819	12,423
Noninterest current transfers	1,163	1,086	1,223	3,298	3,298	2,690
Unclassified	168	209	251	—	—	—
Capital expenditures and transfers 5/	8,550	10,058	10,417	10,119	10,389	12,314
Development expenditures	7,720	9,184	9,409	9,567	8,837	10,571
Portions funded by budget	2,514	3,106	3,545	8,567 6/	2,957	4,691
Portions funded by external loans 7/	5,206	6,078	5,864	...	5,880	5,880 8/
Capital transfers	830	874	1,008	1,552	1,552	1,743
Extrabudgetary expenditure	2,778	1,696	1,459		799	
Overall balance	-13,843	-13,709	-12,862	-18,295	-15,238	-17,980 8/
Financing	13,843	13,709	12,862	...	15,238	...
Grants	1,644	999	1,470 7/	904	1,245 7/	88
External finance (net) 7/	4,320	5,137	5,061	...	4,980	...
Project and commodity loans	5,206	6,078	5,864	...	5,880	...
Cash loans	90	352	170	...	420	...
Less: repayments 9/	-977	-1,293	-973	...	-1,320	...
Borrowing from banks (net)	7,880	7,572	6,331	...	9,015	...
Central Bank	7,938	7,575	6,331	...	9,015 10/	...
Commercial banks	-58	-3	—	...	—	...
	(In percent)					
Memorandum items:						
Total revenue:						
Ratio to total GDP	22.3	26.5	26.8	...	29.5	23.4
Non-oil revenue:						
Ratio to total GDP	21.0	19.8	19.4	...	18.6	14.0
Total expenditure:						
Ratio to total GDP	47.6	47.6	43.5	...	44.5	35.3
Overall balance with oil revenue:						
Ratio to total GDP	-25.3	-21.4	-16.5	...	-15.0	-11.9
Overall balance with oil revenue:						
Ratio to non-oil GDP	-25.5	-23.2	-18.2	...	-16.1	-14.0
Overall balance without oil revenue:						
Ratio to total GDP	-26.6	-28.1	-24.0	...	-25.8	-21.3
Overall balance without oil revenue:						
Ratio to non-oil GDP	-26.9	-30.4	-26.3	...	-27.8	-24.9

Sources: Ministry of Finance, Central Bank of Yemen, and staff estimates.

1/ Preliminary data from Y.A.R. and P.D.R. of Yemen were consolidated by the staff.
2/ Includes YRls 1 billion of fees for new concessions.
3/ As adjusted by the staff to include all of defense expenditures as current expenditure. In the official budget presentation, defense capital spending is included with "budget development expenditure," while defense capital transfers are included with other capital transfers.
4/ Actual payments. Some arrears might have occured.
5/ Differ from official budget presentation by excluding defense capital spending and defense capital transfers and the inclusion of externally financed capital outlays.
6/ Includes externally financed capital outlays in the former PDR of Yemen.
7/ From balance of payments.
8/ Differs from the authorities' budget presentation in that it includes an estimate of expenditures funded by external loans (amount similar to 1990).
9/ Actual payments. Arrears in 1990 and 1991 are substantial. Exact figures are not available at this time.
10/ Differs from monetary survey as it excludes net position of social security and pension funds.

depreciation of the rial, an increase in debt outstanding, and an increase in interest paid on government debt in the former PDRY. In relation to GDP, the deficit declined from 16.5 percent in 1989 to 15 percent in 1990. (Excluding oil revenues, however, the deficit rose as a proportion of non-oil GDP from 26 percent in 1989 to 28 percent in 1990.) Expenditure remained at about 44 percent of GDP while revenue rose to 29 percent of GDP compared with 27 percent in 1989. Most of the deficit was financed by credit from the Central Bank.

2.08 The budget for 1991 fully integrates both parts of the country; it projects a deficit of YRls 18 billion[3] compared with YRls 15.2 billion in 1990. In relation to GDP, the deficit is budgeted to decline from 15 percent in 1990 to some 12 percent in 1991. The improvement in the budget is mainly due to a decline in real spending in line with the Government intention of curtailing the deficit.

2.09 The projected improvement, however, may not materialize. First, oil revenues are likely to be lower than budgeted because oil prices used in the budget ($21/b average) are not likely to be achieved. Second, customs tariff revenues could be lower than budgeted due to falling imports. As a result, the Government again may have to resort to substantial borrowing from the Central Bank as foreign grants were expected to be minimal (less than YRls 90 million, compared to YRls 1.5 billion in 1989 and YRls 1.2 billion in 1990). There is also another potential drain on the budget, now that the public sector enterprises have to compete with the private sector; little information is currently available on these enterprises. The effective devaluation of the dinar by some 23 percent at unification has a potential impact on the budget to the extent that the portion of their liabilities that are dominated in foreign currencies have increased, requiring higher debt service payments. The Government has recognized these potential adverse developments and plans to take some action to address them, including a cut in expenditures of YRls 3 billion (1.5 percent of GDP) and additional revenue measures to make up for the shortfall in oil receipts.

Monetary and Financial Sector

2.10 In both parts of the country, monetary developments in the recent past have been dominated by the expansionary impact of central bank financing of the large budget deficits and the efforts to minimize the impact of such financing on domestic liquidity. In the North, the 1989 GDP/money (including quasi-money) ratio was 1.8; the same ratio in the South was 0.6. At the rate of exchange of YRls 26/YD1, fixed at unification, the GDP/money ratio for the unified economy was 1.3. The unified economy is therefore relatively more liquid than that of the former YAR but less liquid than that of the former PDRY. Because most prices that were once controlled in the South are now free to move, this high liquid situation will have a considerable influence on

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3/Includes externally financed development expenditures, estimated at YRls 5.9 billion (same as in 1990), which the Government does not include in the budget.

price movement. In the North, the principal anti-inflationary tools were raising of reserve requirements, adjusting of interest rates, and imposing direct credit ceilings. In the South, the main instrument were a reduction in credit to the public enterprises and the private sector. At unification, commercial banks in both parts of the country were in an excess reserve position with the central bank, partly reflecting high liquidity in the economy and a general lack of opportunities for sound lending. Due to a lack of lending opportunities, commercial banks were not willing to accept long-term, interest bearing, deposits. The Government intends to focus mainly on reducing the budget deficit, thus reducing the need for central bank financing, as a means to address this high liquidity situation.

2.11 In 1990, monetary growth accelerated to more than 20 percent in the first eleven months of the year (Table 5). The sharp rise in the broad money reflected the continued large recourse to central bank financing by the Government, but also a substantial increase in foreign assets (net) and a major rise in credit to non-government sector.[4] The increase in foreign assets (net) was due mainly to the foreign assets brought back by returning workers and to the depreciation of the rial in the official market. The increase in credit to the non-government sector reflected the liberalization of the economy and a substantial amount of borrowing for foreign exchange speculation. This growth in liquidity thus facilitated a sharp depreciation of the parallel exchange rate which, coupled with price liberalization, led to a drastic rise in inflation - close to 50 percent during March 1990-March 1991.

2.12 At the time of unification, the two parts of the country had two different interest rate structures. The interest rate structure in the North was last changed in February 1990 to reflect the rising inflation. However, with the consumer price index rising at a much higher rate, the real interest rates - with the maximum lending rate of 17 percent, the ceiling enforced by the Central Bank - were strongly negative. Even at real negative interest rates, the (effective) demand for credit was lower than supply, reflecting various rigidities in the economy, the demand for collateral far in excess in value of the loan, and the difficulty to collect repayment arrears. In the South, the interest rate structure with the maximum lending rate of 8 percent, was last changed in January 1978. Since (administered) inflation has been lower, real interest rates were positive.
The unification of rates, adopting the rate structure existing in the North, is ongoing. With the maximum rate remaining unchanged, however, the real interest rates remain negative.

Trade and Balance of Payments

2.13 With prolonged budget deficits significantly contributing to a persistent excess demand situation, the current account of the balance of payments in both parts of the country consistently had large gaps. In the North, until the advent of oil in 1987, merchandise exports were very small

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4/Foreign assets are valued at the official rate. If the parallel market exchange rate was used, the monetary growth would be substantially higher.

Table 5. Republic of Yemen: Monetary Survey, 1987-1990

	Dec. 1987	Dec. 1988	Dec. 1989	Nov. 1990
	(in millions of Yemeni rials)			
Money	37,492.2	38,965.5	43,954.4	50,967.1
Currency outside banks	27,955.6	29,086.7	30,327.3	36,814.7
Demand deposits	9,536.6	9,878.8	13,627.1	14,152.4
Quasi money	11,355.0	14,288.4	12,726.1	17,124.7
Broad money (M3)	48,847.2	53,253.9	56,680.5	68,091.8
Foreign assets (net)	4,897.4	1,682.7	665.7	3,900.1
Domestic credit	50,270.6	59,525.3	66,813.5	77,574.7
Government (net)	43,819.1	52,530.6	58,861.7	66,632.5
Nongovernment sector	6,451.5	6,994.7	7,951.8	10,942.2
(Public enterprises)	1,989.9	1,913.8	2,214.3	2,943.2
(Private sector)	4,461.6	5,080.9	5,737.5	7,999.0
Other items (net)	-6,320.8	-7,954.1	-10,798.7	-13,383.0
	(Changes in percent of broad money at beginning of period)			
Broad money	9.4	9.0	6.4	20.1
Foreign assets (net)	1.1	-6.6	-1.9	5.7
Domestic credit	13.8	18.9	13.7	19.0
Government	17.3	17.8	11.9	13.7
Nongovernment	-3.4	1.1	1.8	5.3
Other items (net)	-5.5	-3.3	-5.3	-4.6

Source: Central Bank of Yemen.

compared to the import needs and to GDP. The largest non-oil exports were the group of coffee, tea, cocoa and spices, which earned less than $3 million in 1988, followed by fruits and vegetables ($1.7 million). Compared to the 1988 import bill of about $1.7 billion (goods and non-factor services), these exports were marginal. Limited resource endowment explains part of the low exports. But the main factors probably lay with development policies that were not conducive to export growth. Most investments were geared primarily toward the domestic market, and producers were heavily protected from competition from outside through import restrictions and exchange control. Imports were controlled by a system of import licensing. Having attained licenses, importers automatically received foreign exchange from the Central Bank. They could not go to private markets even if the Central Bank was short of foreign exchange. Commercial banks were allowed to act only as agents of the Central Bank in gathering and allocating foreign exchange. Money changers were outlawed, although they operated quite openly in the local markets (suks). Some imports were banned altogether. There was not a comprehensive policy to promote exports. Because the exchange rate changed only infrequently, not enough to reflect the differences in price changes between YAR and the trading partners, the overvaluation of the currency was a disincentive to exporters. A recent study clearly indicates the need to dismantle the import and foreign exchange controls to reduce the high level of effective protection.[5]

2.14 In the South, the story was much the same. The largest exports were from the oil refinery, which imported crude oil and exported refined products; such exports were about $49 million in 1988, followed by exports of fish and fish products of $13 million. The import bill (goods and non-factor services) for that same year was $856 million. As in other economies run on the socialist doctrine, most economic activities were under control of the state. Imports were controlled through the import programs of government monopolies and public enterprises. Investments and production were also controlled. Exports were not promoted. The exchange rate did not change since 1973. All activities were geared toward satisfying basic needs of the population. In such a system, it is difficult to calculate the level of effective protection received by local producers, but it was likely to be very high.

2.15 With such a small merchandise export base and persistent excess demand, both parts of Yemen had large trade deficits over the years. In the past, the gap was filled mostly by workers' remittances and foreign loans and grants. In the last couple of years (1988-89), oil exports earned almost $1 billion for the North. Despite a substantial increase in oil exports, the current account deficit was higher in 1989 than in 1987 (Table 6). This increase in the deficit reflected the sharp fall in workers' remittances and grants, and the increase in imports.

5/George Fane and Chris Jones, "The Manufacturing Sector of the Yemen Arab Republic: Effective Protection and Domestic Resource Costs", Final Report to the UNDP and World Bank, November 1989.

Table 6. Republic of Yemen: Balance of Payments, 1988-91

(In millions of U.S. dollars)

	1988	1989	Prelim. Est. 1/ 1990	Proj. 2/ 1991
Current account balance	-1,098.7	-1,009.3	-217	-709
Trade balance	-1,449.1	-1,181.4	-1,045	-991
Exports	519.4	693.4	626	728
Oil	397.9	538.9	515	528
Others	121.5	154.5	111	200
Imports	1,968.5	1,874.8	1,671	1,719
Net services	350.4	172,1	829	280
Receipts	1,083.8	1,000.3	1,404	872
Services	357.7	396.5	300	322
Private transfers	574.5	409.7	1,000	350
Official transfers (cash)	126.4	150.6	104	50
Official transfers (kind)	25.2	43.5	--	150
Payments	733.4	828.2	575	590
Services	701	789.9	552	580
Private transfers	31.5	38	23	10
Official transfers	0.9	0.3	—	...
Capital account (net)	762.3	841.8	101	-5
Total capital inflow	1,075.5	1,086.2	674	838
Long-term disbursement	670.9	618.2	525	602
Developments and commodity	614.2	600.8	489	602
Cash	56.7	17.4	36	...
Suppliers' credit	404.6	468	149	236
Portfolio	—	—	—	--
Other investment	—	—	--	—
Principal repayment	313.2	244.4	574	843
Long-term	136.7	99.7	259	563
Short-term	176.5	144.7	314	280
Errors and omissions 3/	-4.6	78.3	—	...
Balance of payments position	-341	-89.1	-116	-714
Exceptional financing (arrears)	—	—	354	428
Balance of payments position after exceptional financing	-341	-89.1	238	-286
Monetary movement 4/	341	89.1	-238	286
Central Bank	234.2	27.9	-16	...
Commercial banks	91.8	66.6	-264	...
Valuation adjustment	15	-5.4	42	...

Sources: Central Bank of Yemen and staff estimates.

1/ Staff estimates.
2/ Projections provided by the authorities.
3/ Includes private capital movement (net).
4/ Negative = increase in assets.

2.16 In 1990, the current account deficit declined sharply to $217 million from an average of over $1 billion in 1988-89 mainly due to a more than doubling of workers' remittances and a decline in imports. The one-time increase in workers' remittances reflected the repatriation of savings by workers returning from the Gulf, but also reflected the inclusion (for the first time) of an estimate of unrecorded transfers in this item. The compression of imports was largely due to the cessation of oil imports in the last five months of the year because of the situation in the region, and a decline in external project financing

2.17 On February 19, 1990, the official rate of the Yemeni (YRl) was depreciated by 19 percent from YRls 9.76 = US$1 to YRls 12.01 = US$1, and on May 22, at the time of the unification of the two Yemens, the Yemeni dinar (YD) was depreciated by a similar percentage and a fixed exchange rate of YRls 26 = YD 1 was set between the two currencies. Restrictions on access to the parallel exchange market were relaxed in mid-1990, and all private foreign exchange earnings are now channeled through the parallel market. Moreover, all import financing with the exception of that for wheat, flour, rice, and LPG, which are mostly imported by the Government, was shifted to the parallel exchange market.[6] Exchange dealers have been allowed to operate legally. Imports of the aforementioned four commodities (about 15 percent of total imports in 1990) continued to be financed at the official rate from the proceeds of petroleum sales which were also valued at the official rate. Beginning in early 1991, however, a special fee has been levied on these commodities, making the effective exchange rate move to YRls16/US$1.

2.18 The outlook for 1991 is not very encouraging. The Government projects total cash remittances, both recorded and unrecorded, to decline from US$1,000 million in 1990 to just US$350 million in 1991. Oil output is projected to increase from 189,000 b/d to 200,000 b/d, yielding revenues (Government's share) of US$528 million in 1991, compared to US$515 million in 1990.[7] Even with the optimistic expectations over grants and external project financing, imports are expected to decline in real terms in 1991. The fall in imports, and the consequent decline in investment and output, however, is

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6/ The Yemeni rial stood at YRls 25=US$1 in the parallel market in mid-May 1991 compared with YRls 14 in mid-1990 and YRls 17 at end-1990. Using the parallel market exchange rate, the Real Effective Exchange Rate index (base year 1980) of Yemen stood at 80.

7/This oil export receipt number differs significantly from the calculation based on data provided by the Ministry of Petroleum and Mineral Resources. The data from the Ministry indicates that oil export earnings in 1990 should be about $827 million. The mission was not able to reconcile this significant difference. For 1991, export earnings may not reach $528 million as projected because a good part of oil will need to be refined at the Aden Refinery for domestic use. On the basis of oil imports in 1990, the oil export receipt may only be about $400 million.

likely to be much larger than projected as grants and external financing expectations (US$802 million) are unlikely to materialize. Government officials acknowledged that their expectations were on the optimistic side and agreed that imports would be further cut if projected grants and external financing did not materialize.

External Debt

2.19 With a very small export base, Yemen has depended significantly on external borrowing. Until recently, borrowing had been on concessional terms, from both bilateral and multilateral sources. With projected availability of oil income, the former YAR, however, resorted to short-term borrowing in the last couple of years, leading to a substantial increase in short-term debt, which stood at about $900 million at the end of 1989. Medium- and long-term debt at the end of 1989 was about $2.5 billion (36 percent of GDP). Although most borrowings were on soft terms, grace periods of many loans had expired and the repayment burden had sharply increased - the debt service ratio, if all obligations were to be fully paid, is estimated have risen up to 23 percent in 1989 compared to 5 percent in 1984; due to rescheduling the actual ratio was lower. Scheduled interest payments rose to 6 percent of exports from 3 percent during the same period. Based on scheduled repayment obligations, the net transfers would have become negative in 1989.

2.20 The South had no short-term debt. But with a much smaller economy, the medium- and long-term debt of $2.2 billion or about 207 percent of GDP was a heavier burden than that of the North. The debt service ratio substantially went up from less than 10 percent in 1984 to over 53 percent in 1989; interest payments alone went up from 3 percent of foreign exchange earnings to about 18 percent during this period. Projected disbursements and repayments of debt in the pipeline show that there would still be some positive net transfers in the next few years.

2.21 The combined economy is heavily burdened with the existing debt obligations. Total debt outstanding at the end of 1990 stood at $6.1 billion or about 75 percent of GDP. Medium- and long-term debt amounted to $5.2 billion. Total scheduled medium- and long-term debt service for 1990 was over $400 million or some 20 percent of total foreign exchange earnings. Due to foreign exchange shortage, however, not all debt was serviced; only about $147 million was paid. Interest payments in 1990 were about $35 million or less than 2 percent of total foreign exchange earnings. The arrears are mainly for the debt owed to the USSR and other former socialist countries. The Government has indicated that arrears to other creditors have all been settled in early 1991 but those to the former socialist group would continue to accumulate; it is hoping to negotiate with these creditors for a reduction of debt, mainly through the use of the market exchange rates.[8]

8/At the official exchange rate (US$1.76/Rubl1), debt to the USSR stood at $2.9 billion at the end of 1990. However, if this debt is valued at the market rate of R27.6/US$1, it amounts to less than $60 million.

Employment, Wages and Prices

2.22 Yemen is facing a serious unemployment/underemployment situation. As a result of past rapid population growth, the number of school leavers seeking employment continues to be large. In the 1970s and early 1980s, opportunities for employment in the regional oil exporting countries served as a large outlet, keeping unemployment at home at a low level. With stagnating opportunities in these countries and returning migrants, unemployment and underemployment were estimated to have increased to around 400,000 or some 15 percent of the labor force. Returnees arriving from the Gulf in late 1990 have raised the rate of unemployment to some 25 percent. To some extent the non-formal sector has absorbed some of the unemployed. However, unless the economy can grow at a relatively high rate, especially in the labor-intensive sectors, unemployment and underemployment will continue to be a major problem.

2.23 Labor surplus centers only on the non-skilled or semi-skilled groups, while at the same time there are shortages in the skilled categories, which have been filled to some extent by expatriates. Unification has created economies of scale in government services. But it has also shut off employment opportunities for new entrants. At the same time some dislocation can be expected as the highly protected state-owned industries in the South are open to competition from private industries. These factors may aggravate the unemployment/underemployment situation.

2.24 Information on wages, especially in the private sector, is limited. At unification, public sector wages differed substantially - the average pay in the South was much less than that of the North. Pay rates have been equalized. The two, of course, cannot be truly compared because of lower (controlled) prices and subsidies in the South. The last general salary adjustments for YAR were made in May 1988. The 1991 budget does not contain any provision for wage rate adjustments. With limited information on wages and less than fully reliable price indexes (below), it is not possible to calculate a meaningful movement of the real wage rates over time.

2.25 Inflation has accelerated in the past few years. Indicators of price movements, however, should be viewed with caution. In the North, information is confined to certain cities, with limited coverage and outdated weighting distribution. The Sana'a consumer price index indicates that inflation has been quite high, averaging over 19 percent during 1987-89, accelerating to 34 percent in 1990 and 47 percent from March 1990 to March 1991. In the South, since prices were mostly controlled and general shortage of goods existed, the price index did not reflect the inflationary pressures that, without controls, could rise at a much quicker rate. In 1986-88, the consumer price index rose at around 1.2 percent per year. Since the removal of controls, prices have increased sharply. For example, during March 1990 - March 1991, the consumer price index in Aden rose by more than 150 percent.

2.26 At present, except for a few commodities, prices are set by the market. Prices of the main petroleum products, which are produced and distributed by state enterprises, are set by the Government. These include products such as gasoline, diesel, fuel oil, and LPG. The Government's expressed policy is not to provide subsidies for the consumption of these

domestically produced commodities. Because their prices do not frequently change, however, an element of implicit subsidy/tax may occur at a given time due to fluctuations in the international prices of oil. The prices of those products also contain an element of cross subsidy on the rationale that LPG, for example, particularly benefit the relatively poor. In principle, the Government will not subsidize any consumption out of state budget. For wheat, wheat flour, and rice, which are imported at a preferential exchange rate, the prices are controlled through fixed trade margins.

III. Macroeconomic Outlook

3.01 This chapter assesses the prospects of the economy on the basis of the present policy stance. Because Yemen is highly dependent on imports for most requirements, its macroeconomic outlook depends a great deal on its ability to pay for imports. Until the advent of oil exports in 1987, Yemen depended principally on workers' remittances, grants and external borrowing for its foreign exchange needs. Oil has reduced the importance of these traditional sources of foreign exchange. Workers' remittances have been further reduced by the recent regional events. The reduction of remittances significantly has lowered the country's ability to pay for imports while the needs, particularly for necessities such as food, have increased as the returnees from the Gulf have added to the population by some nine percent. Increased foreign exchange allocation for necessities leads to a decline in the ability to pay for other goods - machinery, spare parts, intermediate inputs, etc.

Oil Extraction and Exports.

3.02 Oil exports overtook workers' remittances as the most important source of foreign exchange since 1988 and accounted for 90 percent of merchandise exports in 1990. The fields in Marib have recoverable reserves of over 600 million barrels. By end 1990, about 199 million barrels were extracted, leaving in the reservoirs some 400 plus million barrels. Planned extraction rates for 1991 are to average about 208,000 b/d. At this average rate of extraction and without substantial new discoveries, the known recoverable reserves in Marib will be largely depleted in about six years. Projected extraction rates, however, will decline (Table 7) stretching the lives of the fields into the next century. In the Shabwa area, oil was discovered in 1987. Modest amounts were extracted in 1989-90. Due to difficulties arising from the changing of the oil contractors, extraction has stopped in 1991. Negotiations with new contractors are near completion. The field should be back to production shortly with the extraction rate in the range of 25,000 - 35,000 b/d beginning in 1992.

Table 7: Projected Oil Extraction
(In '000 b/d)

	1991	1992	1993	1994	1995
Without additional investment					
Alif/Azal	150	119	75	48	30
Asa Al Kamil and others	58	45	35	30	30
Shabwa Block 4	-	25	30	35	35
Total	208	189	140	113	95
With planned additional investment					
Alif/Azal and others	208	195	182	169	156
Shabwa Block 4	-	25	30	35	35
Total	208	220	212	204	191

3.03 At present, proposals are being made to increase recoveries in the Marib fields; these proposals amount to $820 million for 1991-95. It is expected that this additional investment will lead to enhanced recovery and increased extraction from the existing fields. As a result, the decline in output will be much less than what had been once expected.

3.04 Exploration activities in various parts of the country have intensified after unification. Additional discoveries have been made recently, but the size of reserves has not been ascertained. Based on limited data available, the reserves may be quite substantial and could support an extraction rate of some 300,000 b/d. It would take some time, however, to develop the fields. This level of extraction, therefore, is not expected to materialize until after 1995.

3.05 It may be noted that even without additional substantial reserves, oil will continue to play an important role in the next development plan, due to be launched in 1993. The known limited reserves, if used prudently, would last long enough for the country to lay a foundation for future development. The depletion date can be further postponed if gas can be developed quickly to substitute for oil, e.g., in power generation. Should additional large reserves be confirmed, oil will of course be the leading impetus for growth well into the next century.

Other exports.

3.06 Out of non-oil exports of about $100 million in 1989, about two-thirds are from four commodities which are agriculture- and fishing-based.

	$Mn
Coffee, tea, cocoa, spices	21.7
Fruits and vegetables	20.5
Fish	13.1
Raw hides and skins	11.5
Sub-total	66.8
Others	33.8
Total	100.6

3.07 The country has some potential to increase exports, provided that appropriate policies are adopted to replace past, basically inward-looking, development strategy. Since unification, changes have been made on the exchange rate whereby most trade has been allowed at the parallel exchange rate. This represents a marked improvement over the fixed exchange regime, with generally overvalued exchange rates, pursued previously in both YAR and PDRY. The country, however, has not yet drawn up an export promotion strategy, which should be an integral part of the next development plan. In terms of potential to earn foreign exchange, the following sectors appear promising.

Agriculture

3.08 As indicated above, agriculture will continue to be the most important productive sector in the economy despite well known constraints of limited arable land and shortages of water. Total cultivated land is only 1.4 million hectares, or less than 3 percent of the total land mass. Out of these cultivated areas, about 20 percent is irrigated; the rest depends on the unpredictable rainfall which regularly alternates between long spells of drought and heavy deluges causing damaging floods. A larger area of pasture exists; most of which, however, is scrub land, supporting sheep, goats, camels, and cattle. Although the pasture remains the most important factor for animal husbandry industry, an increasing number of the animals is being raised on cultivated and commercial fodder - creating competition with food crops for the same resources.

3.09 Due to rising incomes and changing demand patterns, the traditional crops such as cotton, coffee and coarse grains have been replaced by cash crops such as fruits and vegetables, fodder and qat. Although data on qat are not collected, it is generally believed that a large portion of resources in terms of land and water has gone into its production. Some may also be exported.[9] In the past, both parts of the country were heavily promoting agriculture to produce for home consumption by banning some imports, price supports, etc. Traditional exports such as cotton and coffee have suffered by such a policy and by the competition from qat.

3.10 An assessment of export prospects in this sector is complicated by the fact that the two parts of the country had been run on very different principles. In the North, agriculture is in the hands of the private sector. Although the Government provided a lot of supports, it did not get directly involved except in a couple of state farms; no direct subsidies were provided, and the market determined farm gate prices. In the South, the Government directly participated, through state farms, cooperatives, support prices, price controls and subsidies; private farmers owned a smaller share of land.

9/The position of qat as an export crop remains a problem. Even if the Government were to recognize it as a cash crop and a legitimate part of national income, it could not openly promote the cultivation for export because other countries do not allow it to be imported legally.

The South had taken some liberalization measures before unification. This process continues in the new setting as state farms and state enterprises have become autonomous, running on the market principles, and as the Government has begun to distribute land to private holders/cultivators.

3.11 It may be noted that, with the lack of water, it would be difficult for agriculture to become the main engine of growth in the future, and the country cannot expect to be self-sufficient in many agricultural products. The sector, however, has potential to substantially grow, by more efficient uses of resources through modernization.

Fisheries

3.12 Most of fisheries resources are along the 1,400 km. coastline and 22,000 sq.km. continental shelf on the Gulf of Aden and the Arabian Sea; resources along the Red Sea are limited. Fish stocks are large and capable of supporting a much larger annual catch than the current level of some 65,000-90,000 tons. With a domestic market expanding from 2.4 million to over 11 million consumers, however, the increased domestic demand, while providing a boost for output growth, could very well lead to lower exports. In the past, many constraints have prevented the sector from realizing its potential. A lack of suitable technology, inadequate infrastructure, outmoded fishing methods/tools, poor pricing policy, inadequate institutional set-up and operations are key constraints which are being addressed in on-going IDA-financed projects.

Manufacturing

3.13 Except for the oil refinery at Aden, the manufacturing sector focuses on supplying domestic markets, with food processing, construction materials and light consumer goods dominating.[10] Except for selected food processing and construction materials - activities based on local raw materials - the sector generally imports inputs, performs mostly simple manufacturing, provides little value-added, and depends on a system of protection for survival. Until unification, the government in the southern part of the country directly participated in the sector through public sector enterprises and through other direct controls. Most of these enterprises have recently been granted autonomy. In the northern part, except for very few large enterprises, including the 10,000 b/d oil refinery at Marib, the private sector is dominant.

3.14 Due to shortages of imported raw materials resulting from the foreign exchange constraint, the sector has been operating at far below capacity in recent years. And in the immediate future, lack of foreign

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10/A recent examination of the constraints to expanding industrial production is contained in World Bank, Republic of Yemen: Institutional and Policy Framework for Industrial Development. October 31, 1990. (Report No. 9008-ROY).

exchange will continue to be a major constraining factor. To some extent, a lack of local raw materials will be a major hindrance for the development of manufacturing in the longer-run. A more serious constraint, however, is the lack of skills and industrial organization to transform imported raw materials into exportable products. With a projected rapid increase in the labor force in the coming years, it would seem that this sector has a potential to grow if it were to concentrate on labor-intensive export-oriented industries.

Tourism

3.15 Tourism in Yemen has played a small role, earning some $40-50 million per year in recent years. It can conceivably be developed along two lines, although they are not necessarily mutually exclusive. First, establish facilities and provide services for tourists who normally spend time at resorts. There are areas that offer sites for holiday villages, especially for those seeking warm climate during the winter months in the northern hemisphere. Some basic infrastructure already exists, such as the airports at Hodiedah and Aden, around which developments can be placed. Second, with a rich regional history dating back to antiquity and an exotic setting, development can be targeted at educational tourists. Some facilities already exist for this line of development, including hotels and good paved roads.

3.16 Constraints to development of tourism, however, remain challenging. Even with some basic infrastructure already in place, there remains a need for substantial additional investment for water, sewerage, etc. and for the facilities proper. The present financial constraints would make such investment difficult. To a great extent, the country as a tourist destination is relatively unknown and competition for tourists is intense. The Government has expressed the wish for greater participation of private sector capital, both domestic and foreign, and is ready to provide promotional incentives. The investment law referred to above applies also to investment in tourism.

Other Services

3.17 The main potential in this sector lies with the revival of the Port of Aden. Due to the change in shipping patterns, the importance of Aden as a bunkering port has declined. The port, however, continues to generate substantial sums of foreign exchange for the country. During 1987-89, revenues generated by the port averaged about YD11 million or $32 million. This is as much as total merchandise exports of PDRY, excluding exports from the refinery. Currently, the Port is in the process of being rehabilitated. The aim is to compete with other ports in the region and to attract additional bunkering activities. A plan is also afoot to make the areas around the Port a free trade zone.

Workers' remittances.

3.18 In the northern part, recorded workers' remittances (including labor income) substantially declined in recent years, from $1.1 billion in 1984 to $340 million in 1989. The decline, however, could not be explained by

the numbers of workers abroad, which until the Gulf crisis, were estimated to have decreased only slightly, and by the wage rates in the employing countries. The most important contributing factor was the sharp real appreciation of the Yemeni riyal vis-a-vis the Saudi currency, in which most Yemenis earned their incomes. This gives credence to the contention that with the appreciating rial, workers found it more advantageous to remit incomes through the unofficial channels and in the form of goods. As a result, total remittances - in cash and in kind - could be much larger than the amounts recorded in official statistics. Estimates on the basis of numbers of workers, wage rates, and exchange rate developments, indicate that the 1989 remittances could have been close to $1 billion.

3.19 For the southern part, workers' remittances were also the most important source of foreign exchange but was surpassed in the last couple of years by foreign aid. A similar decline of remittances was experienced in recent years, from $500 million in 1984 to $160 in 1989. Because the price index in that part was based on official fixed prices, with little inflation resulting, the change in the indicator for real effective exchange rate could not explain the decline in remittances. Because there was a general shortage of goods in the southern part and a lack of private investment opportunities, workers had an additional incentive to remit earnings in goods; they could also have reduced remittances to the minimum required to maintain the families.

3.20 The prospects of remittances have been complicated by the present uncertainty in the region. It is expected that with the settlement of the conflict, demand for Yemeni workers would again go up, though not to the same extent as before. Whether the workers will remit their wages, keep most abroad, or remit mostly through unofficial channels, depends a great deal on an appropriate exchange rate policy and on an improved business environment.

Foreign investment.

3.21 Foreign direct investment has never played a significant role in Yemen, except for oil development in the past few years. Before unification, both parts of the country were in the process of attracting foreign capital; the South had enacted a new investment law, while the North was in the final stage of doing the same. The Government has recently issued a new Investment Law that it hopes will attract foreign capital through a more comprehensive set of guidelines and a much more liberal attitude. Disposal of state enterprises and property could also attract some foreign capital. Until recently, interest had been expressed by Yemenis settled abroad and by regional investors to invest in Yemen. The Gulf crisis, however, has significantly reduced prospects of inflows for the time being.

External Assistance.

3.22 Yemen received considerable grants, averaging $190 million per year during 1986-89. Due partly to economic difficulties faced by the donor countries, grants have been declining from $272 million in 1986 to $151

million in 1989. Prospects for the future are uncertain because of the recent events in the Middle-East and economic and political restructuring going on in much of the traditional donors in the former socialist world. Government projections indicate only $50 million of cash grants for 1991.

3.23 As regards concessional loans, before unification the northern part expected to receive only small net transfers because of the ending of grace periods of many of the loans contracted in the past. In fact if it were to repay all scheduled debt service, the net transfers would be negative. The southern part had a much better picture in terms of the projected net transfers based on the committed loans. When combined, the net transfers would be positive but continue the declining trend from $358 million in 1988 to $104 million in 1990 unless substantial new commitments are received in the near future. (New commitments were only $134 million in 1990, compared to the peak of $1.2 billion in 1988.) Major donors have indicated that assistance for Yemen's development efforts will continue. Some, however, still await the Government's economic policy direction. Adoption of appropriate changes in policies could, therefore, lead to substantial new commitments, including quick-disbursing operations, from these donors.

Needs for Further Policy Changes

3.24 Based on factors described above, the economic outlook, while promising in the long term, appears unfavorable in the short term. The Government is fully aware of the situation and that the policies adopted so far are unlikely to be sufficient to address the problem. This Government's mainly qualitative assessment is supported by macroeconomic projections up to 1992, using a macroeconomic model of Yemen.[11] (This model will also be used to simulate a set of policy measures that will lead to restoration of economic stability as detailed in Chapter IV). Salient assumptions and conclusions of these projections are as follows:

Assumptions.

3.25 Assumptions on the country's ability to earn foreign exchange and pay for imports are in line with the assessment of each sector discussed above. Some of the leading assumptions are the following. (i) Regarding oil, it is assumed that proposals for additional investment by oil companies will be approved and will result in some increase in output. As a result, oil extraction rates will not decline as projected in the first part of Table 7 under the assumption of no additional investment. It is assumed that the decline in the next few years will be much more gradual, as indicated in the second part of the same Table 7. The prices of oil exports are assumed to be in the range of $18.5/b and $23.8/b, as currently projected by the World Bank.

11/Detailed discussions of the model structure and its various characteristics are contained in Annex II, A Macro-Economic Model for Yemen, of the draft paper Republic of Yemen: A Medium-Term Policy Framework, sent to the Minister of Planning and Development on February 21, 1991.

3.26 (ii) Workers' remittances are assumed to be significantly affected by the Gulf crisis. A gradual recovery of remittances after 1990-91 is assumed, the actual amount depending greatly on the real effective exchange rates between the Yemeni currencies and the Saudi rial, as it was the case in YAR before unification. The exchange rate is assumed to be maintained at the present RY12/US$1.

3.27 (iii) In government finance, besides the recent changes such as the doubling of gasoline prices, no other policy changes are assumed regarding revenue generation and expenditure restraints. It is assumed that non-oil revenues will go up at the same rate as nominal GDP. On the expenditure side, the unification and the Gulf crisis would significantly add to the expenditures - for transition expenses, for returnees assistance, and for security. These expenditures will more than absorb what would be generated by increased gasoline prices. Other major expenditures are not assumed to rise beyond growth in GDP.

Conclusions

3.28 The projections are summarized in Table 8. The following salient points can be inferred from the projections: First, the budget deficit would continue to be large, YRls 18.8 billion in 1991 increasing to YRls 27.6 billion in 1992. In relation to GDP the declining trend would be reversed, from 13.3 percent in 1991 to 14 percent in 1992. Second, with limited availability of external financing from grants and loans, a large part of the deficit would need to be financed by central bank credit. Third, the limited availability of foreign exchange and the continued excess demand would result in rapid depreciation of the free market exchange rate, reaching YRls 55/US$1 by 1992. Fourth, the monetary expansion and depreciation of the exchange rate would continue to fuel inflationary pressures. The inflation rate would accelerate to average around 46 percent in 1991-92.

3.29 These trends are indicative of the non-sustainability of the present policy stance. For this reason, the Government has set up a high level committee charged with formulating policy measures needed to reverse these trends.

Table 8: Selected Indicators - No Policy Changes

	Estimated	Projected	
	1990	1991	1992
Budget deficit (YRls billion)	15.2	18.8	27.6
As % of GDP	15.0	13.3	14.0
Financed by bank credit (%)	59.2	84.4	91.3
Banking system claims on gov't (% rise)	15.9	22.9	30.7
Official exchange rate (YRls/US$1)	12	12	12
Parallel market rate (YRls/US$1)	15	34	55
Sana'a CPI increase (%)	34	46	45

IV. A Medium-Term Policy Framework

4.01 As indicated above, unification has created for Yemen greater development potential than if the two parts of the country were to remain separate. Obviously this long-run potential can only be realized under an appropriate policy environment. In the present circumstances, it would seem that the country needs a two-pronged strategy to achieve its development potential. (i) Although the development strategy will not be spelled out until the launching of the development plan in 1993, it is not too early to start delineating some major elements of the new long-term development strategy for the unified country. (ii) Because the country is currently facing serious macroeconomic imbalances and high inflation, a program for economic stabilization should be implemented.

Elements of a Development Strategy: Preliminary Identification of Sources of Growth and Constraints

4.02 With rapid population growth and a limited natural resource base, Yemen would need to (i) achieve a relatively high economic growth rate to prevent real per capita income from falling, and (ii) generate sufficient foreign exchange to pay for what it cannot produce at home. It is of paramount importance, therefore, that the next development plan provide an adequate framework for growth and foreign exchange earnings, especially under the prudent assumption that no substantial additional oil reserves will be found. The following paragraphs put forward some preliminary ideas as to what *prima facie* seem promising; further in-depth analyses should be focussed in these areas in order to come up with specific policy recommendations.

4.03 Although government statistics have all indicated the dire financial difficulties that have befallen the economy, casual observations indicate a somewhat contradictory picture - at least until the recent Middle East crisis. In the North especially, brisk private economic activities were observed to be taking place. These activities cannot be quantified partly because the Government does not recognize them. For example, the production of *qat* is not recorded in the national income account statistics, although it is recognized that *qat* commands a substantial portion of incomes of households, is traded openly and taxed by the Government. *Qat* brings handsome incomes to growers and is a basis for substantial economic activities. Recorded remittances, which now stands at less than one-third of the peak level of the early 1980s, are widely believed to be significantly underestimated. Large unrecorded inflows, some are in the form of goods, are believed to take place and play a crucial role in the thriving private activities. At the same time, substantial transit trade between Africa and Arabia is believed to go through Yemen, providing a source of income that is not recorded. The Government has expressed the intention to let the private sector participate fully in its development efforts, including abolishing pervasive controls that were once imposed in the South. One primary objective to keep in mind when designing strategy for the next plan, therefore, is to provide an environment that will minimize the premium for the parallel market and to allow the private sector to openly engage in normal activities. With

the private sector's open participation, the government has a better chance of effecting the desired economic policies.

4.04 With a limited resource base, Yemen cannot hope to become self sufficient, even at relatively high costs, in most products. Recent development history, particularly of the newly industrialized economies (NIEs) of East Asia, indicates that to achieve rapid growth and raise the standard of living in such setting, the development strategy needs to be outward-looking. Exports are the principal vehicle for growth and trade is the most efficient tool to acquire the needed goods that cannot be produced at home.

4.05 As discussed earlier, Yemen has a young population. The labor force, especially of low-skilled category, is expected to increase rapidly. The situation will be further aggravated as more women are willing to work outside traditional occupations, and by the large influx of returnees from abroad. To absorb these workers, the new development strategy would need to focus on labor-intensive activities. Again experiences of East Asia NIEs indicate that rapid growth in the labor force can successfully be absorbed with appropriate policies. The above factors would seem to indicate, therefore, that the new development strategy for Yemen needs to be private-sector oriented, outward-looking, focussing on labor-intensive export industries. The role of the Government would be focussed on providing a policy environment conducive to fostering private sector activities and export growth, orienting its investment to physical infrastucture and the development of human resources through increased emphasis on health, education and technical training.

4.06 Despite facing serious cultural difficulties, the government has reexamined its population policies and the implications of rapid population growth on the country's limited resource base. However, even if an effective program to slow down population growth were adopted in the near future, the efforts needed to provide the young population with basic education, health care, skill training, and productive employment will be taxing on the country's already stretched financial and technical resources. An effective population policy and a nation-wide program to slow down the birth rate should be adopted in the next development plan, if not sooner. In this regard, it is important to include the role of women in development and population policies; with increased sound knowledge through both formal and non-formal education, they will play a critical role in the success/failure of not only population but also health, nutrition, and other social policies.

Potential Sources of Growth and Foreign Exchange

4.07 As discussed under production and distribution structure above, despite recent emergence of oil, government services and agriculture remain the most dominant in the output structure. Obviously, the government services cannot be a lasting source of growth for the future. Despite serious constraints imposed by shortages of arable land and water, agriculture still

holds potential for further expansion.[12] Its largest potential may lie in fruits and vegetables, both for efficient import substitution and for exports. With large resources that are not yet fully exploited and a much larger domestic market, fisheries should be able to expand substantially to satisfy home consumption as well as for exports.[13]

4.08 Oil has provided a major stimulus for growth both in terms of output and foreign exchange earnings in the last few years. Although its long-term contribution needs to be further assessed, in the medium-term it will continue to be the most important source of foreign exchange. At the current and projected rates of extraction, the known reserves will be virtually depleted by the end of the 1990s. Since oil is a non-renewable resource, consideration needs to be given to save part of oil revenues in the form of income-generating reserves so that when oil is depleted, income will not sharply drop. The idea of setting up an oil reserve fund is not new in Yemen. Prior to unification, the YAR Government decided to set up such a fund. The onset of financial difficulties, however, necessitated a postponement of its operations. Alternatively, extraction rates may be kept at a low level, thus stretching out the oil era well into the next century. With large untapped reserves, gas offers great potential for contribution, not necessarily in earning foreign exchange but for domestic use so that more oil can be exported.

4.09 So far the role of manufacturing has been limited. Experiences of NIEs indicate that, under an appropriate policy environment, this sector offers considerable potential for growth by absorbing new workers, both in efficient import substitution and in export of relatively labor-intensive products. Before unification, both parts of Yemen launched investment promotion programs aimed largely at promoting investment in this sector. It would seem appropriate for such promotion to intensify under the recently promulgated Investment Law.

4.10 In the service sectors, potential lies with tourism and the Port of Aden. Despite having considerable potential for development, tourism has not been promoted. There are legitimate social and cultural reasons for the Government's reluctance. In order to minimize the degree of cultural impact that tourism could bring, the initial development could start with expansion of group tours that have been ongoing for some time, and with enclave villages. With already existing airports, infrastructure costs could be minimized for tourism villages along the Red Sea. Besides providing a good source of foreign exchange, tourism could help absorb a large share of new graduates who are expected to join the labor force in large numbers as the young population matures.

12/Discussions on the role of agriculture are contained in Staff Appraisal Report, Agriculture Sector Management Support Project, August 14, 1991 (Report No. 8432-YEM).

13/Discussions on this sector can be found in Staff Appraisal Report, Fourth Fisheries Development Project, May 20, 1991 (Report No. 8429-YEM).

4.11 Although it may be difficult to restore the Port of Aden to its former position, the low level of operations that the port has declined to would seem to indicate that an increased role of the port can be made. The government has already made some investment to revitalize it. A free-trade zone is also being considered for the areas around the Port, whose prospects would be considerably enhanced by activities in the free-trade zone.

4.12 Another source of foreign exchange has been workers' remittances. The present situation in the Gulf has significantly clouded the prospects of workers' remittances, at least for the immediate future. In the past, recorded remittances were highly affected by the change in real effective exchange rates between the Yemeni currencies and the Saudi riyal. If the Government is successful in preventing the real effective exchange rate from appreciating, workers' remittances should continue to be an important source of foreign exchange.

Stabilization Policies for 1991-92 and a Medium-term Framework

4.13 Under the present circumstances, the prerequisite to realizing future growth potential is restoration of macroeconomic balances and stability. Various options are open to the Government. With additional expenses being incurred during the transition and to assist returnees, the Government may be tempted to further resort to bank credit and short-term external borrowing. Such a policy will clearly exacerbate the inflationary pressures that are already intensified by an overly liquid situation in the economy. Because the external debt situation is already precarious, adding to the short-term debt would make the situation more difficult.

4.14 Generally, economies facing serious macroeconomic imbalances similar to those of Yemen focus on reducing the budget and balance of payments deficits through such measures as expenditure cuts, tax increases, exchange rate adjustments, import restraints, etc. The Government has been discussing the measures in these areas in the past few months, has adopted some measures and is in the process of implementing additional ones. While many options are open, one set of measures has been found to achieve the goal, based on simulations using the macroeconomic model of Yemen.

4.15 In, government expenditures the following measures would be the most effective: (i) adopting all the current proposals to reduce the 1991 budget expenditures by YRls 3 billion; (ii) maintaining at the 1991 budget level non-interest current and capital transfers and the non-wage portion of defense expenditures for 1992; (iii) allowing the expenditures for wages and for services in 1992 to rise at about half of the rate of inflation in 1991; and (iv) freezing recruitment for the civil service except for exceptionally specialized skills.

4.16 These expenditure measures should be complemented by revenue measures which include the following as far as it is practical: (i) Convert specific customs duties to ad valorem; for goods remaining under specific duties, adjust the rates periodically so that the rates in relation to import values remain approximately constant. (ii) Apply a market-guided conversion

rate to imported goods for the purpose of calculating import duties, beginning immediately with YRls 25/US$1, the prevailing rate in the parallel market (vis-a-vis the official rate of YRls 12/US$1 being used at present), and adjust this rate periodically. As the foreign exchange for most imports is already obtained at the parallel rate, valuing imports at this rate will restore the tariff rates, which are effectively declining in relation to the values of imports, to their intended level. It should be noted that the parallel rate is likely to be more realistic than the official rate because the former is obtained in the market and applies to about 80 percent of trade. (iii) Adjust the rates of taxes on goods, services, zakat, and stamps so that revenue yields stay approximately constant in real terms. And (iv) adopt measures to keep the yields of non-tax revenues constant in real terms.

4.17 Exchange rate measures include (i) adopting the market-guided rate as the conversion rate to imports of the four essential commodities, beginning at YRls 18/US$1 in 1991, gradually moving to a totally market-determined rate; (ii) adopting the market-guided rate for the official exchange rate; and (iii) allowing foreign exchange dealers to operate without administrative hindrance.

4.18 Interest rates which are being unified by raising the rates applied in the Southern Governorate to those of the North, ought to be adjusted with the view of pricing credit closer to its market value. In order to secure a sharp slow down in monetary expansion, government borrowing ought to be from the general public through the issuance of zero-coupon investment certificates, at the imputed rates of return sufficiently remunerative to attract buyers.

4.19 Adopting these measures should reverse the trends of the past few years. As indicated in Table 9, the budget deficit would decline both in absolute terms and in relation to GDP starting in 1991. Inflation would peak in 1991 and sharply decline in 1992.

4.20 These trends toward stability can be further enforced in the medium-term by continuation of restraining fiscal and monetary policies as well as by the market-guided exchange rate and interest rate policy. The projections in Table 9 assume that three major expenditure items, namely, wages, materials and services, and defense will be allowed to grow about 25 percent less than the growth in nominal GDP in 1993, and at the same rate of nominal GDP thereafter. Other current expenditures, excluding for interest and for investment (most of which is foreign-financed), will also grow no more than nominal GDP in 1993-95.

4.21 The seriousness of the difficulties facing Yemen and the urgency of adopting an adjustment program would seem to indicate that the country would go through a difficult period for the next 2-3 years before the turn around. Again it should be emphasized that these projections are carried out purely for illustrative purposes. Simulations carried out within the framework of the model used here could be a valuable tool for assessing implications of various options under consideration by the Government.

Table 9: Selected Indicators - With Policy Adjustments

	1991	1992	1993	1994	1995
Budget deficit (YRls billion)	13.3	8.1	8.5	5.0	3.4
As % of GDP	9.9	4.9	4.5	2.4	1.5
Financed by bank credit (%)	77.9	10.3	-	-	-
Velocity of money	1.75	2.05	2.26	2.44	2.64
Balance of payments deficit ($MN)	703.5	352.3	303.2	274.3	263.7
Official exchange rate (YRls/US$)	12	30	45	50	55
Parallel market rate (YRls/US$)	32	40	45	50	55
Sana'a CPI increase (%)	38	15.3	11.5	7.3	5.4

Statistical Annex

Table

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TABLE 1.1 : POPULATION

(thousands)

	1985	1986	1987	1988	1989	1990
Total	9,811	10,135	10,475	10,830	11,200	11,588
North	7,661	7,919	8,190	8,474	8,771	9,083
South	2,150	2,216	2,285	2,356	2,429	2,505

Source : World Bank (PHRWN).

TABLE 1.2 : POPULATION IN MAJOR CITIES in 1986

(thousands)

	Population (000)	Share (%)
Sana'a	427	49.8
Taiz	178	20.8
Hodeidah	155	18.1
Ibb	49	5.7
Dhamar	48	5.6
Total 5 Cities	857	100.0
Total Pop in 5 Cities in the North	857	67.8
Total Pop in Major Cities in the South	407	32.2
Total Population in Major Cities in Yemen	1264	100.0

Source : Ministry of Planning and Development and Central Statistical Organization

TABLE 1.3 : LABOR FORCE BY ECONOMIC SECTOR, SEX, AND RURAL/URBAN AREA, 1990

	Total		Male		Female		Female Workers as %
	Number	%	Number	%	Number	%	of Total Labor Force
Agriculture	1615320	62.0	958692	50.2	656628	94.4	40.7
Mining & Quarrying	7323	0.3	7259	0.4	64	0.0	0.9
Manufacturing	105482	4.0	89291	4.7	16191	2.3	15.3
Electricity & Gas & Water	17663	0.7	17110	0.9	553	0.1	3.1
Construction	144941	5.6	144129	7.5	812	0.1	0.6
Wholesale & Retail Trade	184915	7.1	178110	9.3	6805	1.0	3.7
Transport & Communication	104459	4.0	103790	5.4	669	0.1	0.6
Finance & Business	10198	0.4	9193	0.5	1005	0.1	9.9
Social & Personal Services	414621	15.9	401560	21.0	13061	1.9	3.2
Total	2604922	100.0	1909134	100.0	695788	100.0	26.7

	Total		Rural		Urban		Urban Workers as %
	Number	%	Number	%	Number	%	of Total Labor Force
Agriculture	1615320	62.0	1585275	74.2	30045	6.4	1.9
Mining & Quarrying	7323	0.3	6186	0.3	1137	0.2	15.5
Manufacturing	105482	4.0	60557	2.8	44925	9.6	42.6
Electricity & Gas & Water	17663	0.7	6385	0.3	11278	2.4	63.9
Construction	144941	5.6	102807	4.8	42134	9.0	29.1
Wholesale & Retail Trade	184915	7.1	98819	4.6	86096	18.4	46.6
Transport & Communication	104459	4.0	64984	3.0	39475	8.4	37.8
Finance & Business	10198	0.4	1517	0.1	8681	1.9	85.1
Social & Personal Services	414621	15.9	210236	9.8	204385	43.7	49.3
Total	2604922	100.0	2136766	100.0	468156	100.0	18.0

Sources : Ministry of Planning & Development and Central Statistics Organization.

TABLE 2.1 : NATIONAL ACCOUNTS

(millions of current YR)

	1985	1986	1987	1988	1989	1990
GDP at market prices	39905	46436	53572	62080	74068	98124
GDP at factor cost	35389	41219	48923	56528	67371	91002
Agriculture	9161	12337	13235	13882	15081	19191
Industry	7553	8296	10228	13799	16315	19862
Mining and quarrying	241	382	580	2941	3676	4502
Manufacturing	4352	5034	6440	7239	8713	10565
Services, etc.	18675	20586	25460	28847	35975	51949
Imports of GS	17158	15112	21079	24414	24514	29485
Exports of GS	2526	2263	3429	8053	10148	12186
Resource balance	-14632	-12849	-17650	-16361	-14366	-17299
Total Expenditures	55401	59453	71353	78829	88842	115422
Total consumption, etc	47486	52004	62178	67076	77178	102043
General government	9209	9554	12039	15382	16159	24216
Private, etc	38277	42450	50139	51694	61019	77827
Gross domestic investment	7915	7449	9175	11753	11664	13379
GDFI	7972	7623	9030	11342	11511	13322
Nonfinancial Pub. Sector	..	..	..	..	..	..
General Government	..	..	..	..	..	..
Central Govt.	..	..	..	..	..	..
State and Local Govt.	..	..	..	..	..	..
Nonfinancial Pub. Enterp.	..	..	..	..	..	..
Private Sector	..	..	..	..	..	..
Changes in Stocks	-57	-174	145	411	153	57
Statistical discrepancy	-864	-168	-131	-388	-408	1
Gross domestic saving	-7581	-5568	-8606	-4996	-3110	-3919
Net factor income	9481	8049	9893	4635	3368	8457
Net current transfers	944	2115	1915	1314	1606	1417
Gross national saving	2844	4596	3202	953	1864	5955
Net Indirect Taxes	4516	5217	4649	5552	6697	7122
Indirect Taxes	..	..	..	..	..	..
Subsidies	..	..	..	..	..	..
Gross national product	49386	54485	63465	66715	77436	106581
IFS conversion factor	7.3633	9.6392	10.3417	9.7717	9.7600	..
IEC conversion factor	..	..	..	..	..	..
GDP at mp (cur. mil. US$)	6225	6267	5959	6400	7581	8305
Av Exch Rate (Rials/US$)	6.4100	7.4100	8.9900	9.7000	9.7700	11.8150

Note : a/ Data for 1985-89 result from adding national income account data of Yemen Arab Republic and the People's Democratic Republic of Yemen, at the official exchange rate. The two were unified in 1990 and the 1990 data represent a new series that may not be strictly comparable to data of earlier years.

Source : Ministry of Planning & Development and Central Statistics Organization.

TABLE 2.2 : PRODUCTION OF MAJOR CROPS

	(thousand metric tons)				(% change p.a.)		
	1987	1988	1989	1990	1988	1989	1990
Sorghum and millet	508.8	594.1	574.4	491.3	16.8	-3.3	-14.5
Maize	54.0	57.5	68.5	65.6	6.5	19.1	-4.2
Wheat	112.0	142.0	162.6	155.0	26.8	14.5	-4.7
Barley	40.6	48.6	58.6	55.0	19.7	20.6	-6.1
Total Cereals	715.4	842.2	864.1	766.9	17.7	2.6	-11.2
Dry legumes	39.5	46.2	73.6	75.8	17.0	59.3	3.0
Sesame	5.0	6.0	8.1	9.4	20.0	35.0	16.0
Potatoes	119.2	127.6	141.0	160.0	7.0	10.5	13.5
Vegetables	433.1	511.0	441.5	375.8	18.0	-13.6	-14.9
Fruits	294.9	347.0	313.1	313.1	17.7	-9.8	0.0
Grapes	129.2	133.4	134.7	142.9	3.3	1.0	6.1
Dates	34.7	33.0	25.0	20.7	-4.9	-24.2	-17.2
Coffee	3.1	6.5	7.8	7.4	109.7	20.0	-5.1
Total Fruits & Vegetables	1058.7	1210.7	1144.8	1105.1	14.4	-5.4	-3.5
Tobacco	5.3	6.4	4.4	6.8	20.8	-31.3	54.5
Cotton	6.6	7.8	13.0	7.8	18.2	66.7	-40.0
Alfalfa (Fodder)	na	na	120.2	119.0	na	na	-1.0
Total Non-Food Agriculture	na	na	137.6	133.6	na	na	-2.9
Meat	35.2	36.4	37.5	37.7	3.4	3.0	0.5
Poultry Meat	54.6	77.3	60.0	39.0	41.6	-22.4	-35.0
Milk	140.6	147.6	152.2	153.7	5.0	3.1	1.0
Eggs (million eggs)	293.0	318.0	338.0	335.0	8.5	6.3	-0.9
Total Meat & Milk & Eggs	523.4	579.3	587.7	565.4	10.7	1.5	-3.8
Surface Water Fish	55.7	57.8	58.1	na	3.8	0.5	na
Deep Water Fish	52.3	41.7	43.1	na	-20.3	3.4	na
Other Aquatic Catch	4.2	3.5	5.1	na	-16.7	45.7	na
Total Fish	112.2	103.0	106.3	na	-8.2	3.2	na

Source : Ministry of Planning & Central Statistics Organization

TABLE 2.3 : TOTAL CROPPED AREA OF MAJOR CROPS

(thousand hectares)

	1987	1988	1989	1990	(% change p.a.) 1988	1989	1990
Sorghum and millet	687.5	696.8	681.0	643.0	1.4	-2.3	-5.6
Maize	43.4	45.2	51.6	51.5	4.1	14.2	-0.2
Wheat	74.1	82.1	94.4	98.0	10.8	15.0	3.8
Barley	47.0	44.9	53.0	52.0	-4.5	18.0	-1.9
Total Cereals	852.0	869.0	880.0	844.5	2.0	1.3	-4.0
Dry legumes	27.4	30.6	46.1	49.3	11.7	50.7	6.9
Sesame	15.7	15.6	22.0	18.6	-0.6	41.0	-15.5
Potatoes	9.6	10.0	11.5	13.6	4.2	15.0	18.3
Vegetables	na	na	na	na	na	na	na
Fruits	na	na	54.5	56.5	na	na	3.7
Grapes	14.7	15.0	15.3	17.1	2.0	2.0	11.8
Dates	16.0	16.2	16.5	15.3	1.2	1.9	-7.3
Coffee	18.0	14.5	27.2	24.8	-19.4	87.6	-8.8
Total Fruits & Vegetables	na	na	193.1	195.2	na	na	1.1
Tobacco	3.3	4.0	2.8	3.7	21.2	-30.0	32.1
Cotton	9.5	9.6	15.8	10.4	1.1	64.6	-34.2
Alfalfa (Fodder)	14.8	15.0	16.7	16.6	1.4	11.3	-0.6
Total Non-Food Agriculture	27.6	28.6	35.3	30.7	3.6	23.4	-13.0
Total Agriculture	na	na	1108.4	1070.4	na	na	-3.4

Source : Ministry of Planning & Central Statistics Organization

TABLE 2.4 : YIELD OF MAJOR CROPS

(metric tons per hectare)

	1987	1988	1989	1990
Cereals				
Sorghum and millet	0.74	0.85	0.84	0.76
Maize	1.24	1.27	1.33	1.27
Wheat	1.51	1.73	1.72	1.58
Barley	0.86	1.08	1.11	1.06
Fruits & Vegetables				
Dry legumes	1.44	1.51	1.60	[illegible]
Sesame	0.32	0.38	0.37	[illegible]
Potatoes	12.42	12.76	12.26	11.76
Vegetables	na	na	na	na
Fruits	na	na	5.74	5.54
Grapes	8.79	8.89	8.80	8.36
Dates	2.17	2.04	1.52	1.35
Coffee	0.17	0.45	0.29	0.30

Source : Ministry of Planning & Central Statistics Organization

TABLE 2.5 : INDUSTRIAL PRODUCTION BY SECTOR, 1987-89 a/

(thousands of Yemeni Rials)

	1987			1988			1989		
Sector	Total	South b/	North	Total	South b/	North	Total	South b/	North
Public Sector	3041640	994292	2047348	3256517	1021322	2235195	15166551	1122569	14043982
Co-operative Sector	65116	64652	464	62309	61706	603	69787	69742	45
Mixed Sector	939318	268791	670527	1034272	272425	761847	987171	265541	721630
Private Sector	5686655	90493	5596162	6561211	94700	6466511	7275181	92687	7182494
Total	9732728	1418227	8314501	10914309	1450153	9464156	23498690	1550539	21948151

	1987			1988			1989		
Industrial Branch	Total	South b/	North	Total	South b/	North	Total	South b/	North
Extraction Industry	97660	48812	48848	106281	63482	42799	11820781	79479	11741302
Food	5238503	471952	4766551	5795864	468187.2	5327677	6194634	532870	5661764
Textiles, Clothing, & Products	343777	132506	211271	417055	133416	283639	449061	161062	287999
Wood & Wood Products	65660	61508	4152	109169	62897	46272	111574	69537	42037
Paper, Printing, & Publications	275830	50825	225005	368450	69896	298554	446121	60177	385944
Chemicals & Oil Refining	2773957	495204	2278753	3005546	510214	2495332	3478360	498649	2979711
Building Materials	690003	34185	655818	840918	28943	811975	698357	31174	667183
Metallic Products	233408	123235	110173	259588	113118	146470	299802	117590	182212
Total	9718798	1418227	8300571	10902871	1450153	9452718	23498691	1550539	21948152

Notes : a/ The total production of industrial sectors may slightly differ from that of industrial branches.
b/ Values of production in Yemeni Dinars were converted into Yemeni Rials at the 26 YR/YD rate.

Source : Ministry of PLanning & Development

TABLE 2.6 : NUMBER OF INDUSTRIAL ESTABLISHMENTS BY SECTOR, 1987-89 a/

	1987			1988			1989		
Sector	Total	South	North	Total	South	North	Total	South	North
Public Sector	47	32	15	48	33	15	47	33	14
Co-operative Sector	9	8	1	9	8	1	9	8	1
Mixed Sector	12	10	2	13	11	2	13	11	2
Private Sector	120	21	99	132	23	109	137	23	114
Total	188	71	117	202	75	127	206	75	131

	1987			1988			1989		
Industrial Branch	Total	South	North	Total	South	North	Total	South	North
Extraction Industry	9	2	7	9	2	7	8	2	6
Food	55	17	38	58	19	39	61	19	42
Textiles, Clothing, & Products	26	19	7	28	20	8	29	20	9
Wood & Wood Products	5	4	1	6	4	2	6	4	2
Paper, Printing, & Publications	8	4	4	9	4	5	9	4	5
Chemicals & Oil Refining	38	12	26	42	12	30	47	12	35
Building Materials	21	3	18	20	3	17	19	3	16
Metallic Products	26	10	16	30	11	19	27	11	16
Total	188	71	117	202	75	127	206	75	131

Note : a/ Excluding small companies which had less than 10 employees.

Source : Ministry of PLanning & Development

TABLE 2.7 : AVERAGE NUMBER OF EMPLOYEES IN ORGANIZED INDUSTRIAL ESTABLISHEMENTS, 1987-89 a/

(excluding employees in the oil extraction industry)

	1987		1988		1989	
Sector	South	North	South	North	South	North
Public Sector	8245	3662	8034	3836	8277	4045
Co-operative Sector	442	11	935	12	915	7
Mixed Sector	1217	429	1279	499	1277	474
Private Sector	365	10445	389	10432	370	10841

	1987		1988		1989	
Industrial Branch	South	North	South	North	South	North
Extraction Industry	492	271	515	281	508	235
Food	1979	7415	2200	7253	2256	7761
Textiles, Clothing, & Products	1899	2111	1889	2274	1885	2259
Wood & Wood Products	787	24	812	259	798	246
Paper, Printing, & Publications	620	145	567	209	574	231
Chemicals & Oil Refining	3140	2189	3215	2217	3346	2484
Building Materials	280	1612	302	1540	291	1571
Metallic Products	1072	780	1137	746	1181	598

Note : a/ including small companies which had less than 10 employees.

Source : Ministry of Planning & Development

TABLE 3.1 BALANCE OF PAYMENTS a/

(millions of current US$)

	1988	1989	1990 p/	1991 g/
Exports of GS b/	877.1	1089.9	926.0	1050.0
Merchandise (FOB)	519.4	693.4	626.0	728.0
o/w Oil	397.9	538.9	515.0	528.0
Services	357.7	396.5	300.0	322.0
Imports of GS b/	2669.5	2664.7	2223.0	2298.8
Merchandise (CIF)	1968.5	1874.8	1671.0	1719.0
Services	701.0	789.9	552.0	579.8
Resource balance	-1792.4	-1574.8	-1297.0	-1248.8
Net factor income c/	..	..	..	..
Factor receipts	..	..	..	..
Factor payments	..	..	..	..
Total interest paid (DRS)	..	..	..	..
Interest due but not paid	..	..	..	..
Other Factor Payments & disc.	..	..	..	..
Net current transfers	543.0	371.7	977.0	340.0
Current Receipts	574.5	409.7	1000.0	350.0
Workers remittances	574.5	409.7	1000.0	350.0
Other curr. transfers	..	..	..	..
Current Payments	31.5	38.0	23.0	10.0
Curr.A/C Bal before Off. Transfer	-1249.4	-1203.1	-320.0	-908.8
Net All Off. Transfer	150.7	193.8	104.0	200.0
Curr.A/C Bal after Off. Transfer	-1098.7	-1009.3	-216.0	-708.8
LT Capital Inflows	762.3	841.8	100.4	-5.0
Direct investment	..	..	..	..
Net LT Borrowing (DRS)	762.3	841.8	100.4	-5.0
Disbursements (incl SC)	1075.5	1086.2	674.0	838.0
Repayment (incl short-term)	313.2	244.4	573.6	843.0
Other LT Inflows (net)	0.0	0.0	0.0	0.0
Total Other items (Net)	..	..	..	..
Net short-term capital	..	..	..	..
Change in Int. Arrears (Net)	..	..	..	.
Other Net ST Capital	..	..	..	..
Capital flows n.e.i.	..	..	..	..
Errors and omissions	-4.6	78.3	0.0	0.0
Changes in net reserves	..	..	..	..
Net credit from IMF	..	..	..	..
Reserve changes n.e.i.	..	..	..	..
Gross Reserves exc Gold (IFS)	365.0	324.4	..	..
Gross Reserves inc Gold (IFS)	367.3	326.7	..	..

Notes : a/ Data for 1990 and thereafter represent a new series.
They are not stricly comparable to data for earlier years.
b/ Including factor income.
c/ Data are not available separately.
g/ Government projections.
p/ Preliminary estimates by the mission.

Source : Central Bank of Yemen and the mission.

TABLE 3.2 : EXTERNAL TRADE BY COMMODITIES

(millions of current YR)	1987	1988	1989
EXPORTS :			
Food and Live Animals	413	686	766
Beverages and Tobacco	74	89	95
Raw Materials	124	179	253
Minerals, Fuels, Lubricants	308	4323	6165
Animal & Vegetable Oils & Fats	0	2	2
Chemicals	2	10	38
Manufactured Goods	19	35	42
Machinery & Transport Equip.	6	9	2
Misc. Manufactured Articles	5	5	10
Unclassified	0	1	0
Total	950	5338	7372
IMPORTS :			
Food and Live Animals	4003	5702	5884
Beverages and Tobacco	269	363	290
Raw Materials	198	468	512
Minerals, Fuels, Lubricants	1133	2946	3043
Animal & Vegetable Oils & Fats	295	356	416
Chemicals	1076	1637	1181
Manufactured Goods	2806	3892	3188
Machinery & Transport Equip.	3083	3084	3516
Misc. Manufactured Articles	719	911	891
Unclassified	6	30	7
Total	13589	19390	18928

Note : a/ Values of external trade in Yemeni Dinars from the south were con - verted into Yemeni Rials at the 26 YR/YD rate.

Source : Ministry of Planning & Development and Central Statistics Organization.

TABLE 3.3 : EXTERNAL DEBT (as of end-1990)

(US$ millions at Current Prices)

	1985	1986	1987	1988	1989	1990
DISBURSEMENT						
Public & Publicly Guar. LT	278.6	351.4	389.6	637.5	504.2	265.8
1. Official Creditors	2,7.8	281.4	389.6	555.7	466.0	265.8
a. Multilateral	115.6	102.8	95.5	125.0	92.4	58.0
Concessional,	87.1	88.4	85.7	88.2	91.5	57.1
of which IDA	45.1	46.7	40.9	49.2	43.7	28.3
Nonconcessional,	28.5	14.4	9.8	36.8	0.9	1.0
of which IBRD	0.0	0.0	0.0	0.0	0.0	0.0
b. Bilateral	162.1	178.6	294.0	430.7	373.6	207.7
Concessional	138.4	140.2	293.3	430.7	373.6	207.7
Nonconcessional	23.7	38.4	0.7	-0.0	-0.0	0.0
2. Private Creditors	0.9	70.0	0.0	81.8	38.2	0.0
a. Suppliers' Credits	0.0	0.0	0.0	0.0	0.0	0.0
b. Commercial Banks	0.0	70.0	0.0	81.8	38.2	0.0
c. Other Private	0.9	0.0	0.0	0.0	0.0	0.0
Private Non-Guaranteed LT	0.0	0.0	0.0	0.0	0.0	0.0
Total LT Disbursements	278.6	351.4	389.6	637.5	504.2	265.8
IMF Purchases	0.0	0.0	0.0	0.0	0.0	0.0
Net Short-Term Capital	..	..	..	..	..	..
Total Disbursements	278.6	351.4	389.6	637.5	504.2	265.8
REPAYMENT (actual)						
Public & Publicly Guar. LT	68.3	76.8	145.6	161.2	126.7	111.9
1. Official Creditors	64.3	71.9	115.2	130.9	63.6	71.9
a. Multilateral	22.4	27.3	65.1	65.7	21.8	26.4
Concessional,	14.0	19.5	22.2	26.7	20.9	25.5
of which IDA	0.8	1.3	1.5	1.7	2.2	2.3
Nonconcessional,	8.4	7.8	42.8	39.0	0.9	1.0
of which IBRD	0.0	0.0	0.0	0.0	0.0	0.0
b. Bilateral	41.9	44.6	50.1	65.2	41.7	45.5
Concessional	37.8	43.0	47.7	62.8	40.9	45.5
Nonconcessional	4.1	1.6	2.4	2.4	0.8	-0.0
2. Private Creditors	4.0	4.9	30.5	30.3	63.1	40.0
a. Suppliers' Credits	1.5	1.9	2.3	2.2	1.0	0.0
b. Commercial Banks	0.0	0.0	24.7	24.7	60.7	40.0
c. Other Private	2.5	3.0	3.5	3.4	1.4	0.0
Private Non-Guranteed LT	0.0	0.0	0.0	0.0	0.0	0.0
Total LT Repayments	68.3	76.8	145.6	161.2	126.7	111.9
IMF Repurchases	6.8	19.9	21.0	8.3	4.2	1.2
Total LT Repay + IMF Repur.	75.1	96.7	166.6	169.6	130.9	113.1
Memorandum Item:						
Stock of Arrear (principal)	164.7	230.3	334.0	433.9	537.6	789.7
COMMITMENT						
IBRD commitments	0.0	0.0	0.0	0.0	0.0	0.0
of which fast Disbursing	0.0	0.0	0.0	0.0	0.0	0.0
IDA commitments	43.6	47.2	46.0	43.2	30.5	57.8
of which fast Disbursing	0.0	0.0	0.0	0.0	0.0	0.0

Source : IECDI.

TABLE 3.4 : EXTERNAL DEBT (as of end-1990)

(US$ millions at Current Prices)

	1985	1986	1987	1988	1989	1990
INTEREST PAYMENTS (actual)						
Public & Publicly Guar. LT	26.1	51.6	62.3	62.6	53.1	35.0
1. Official Creditors	24.7	49.4	57.8	59.7	40.0	28.1
a. Multilateral	12.5	15.8	18.7	16.5	12.4	14.3
Concessional,	10.1	11.8	13.0	14.1	10.2	11.9
of which IDA	3.1	3.6	4.1	4.6	3.9	3.5
Nonconcessional,	2.4	3.9	5.7	2.3	2.2	2.4
of which IBRD	0.0	0.0	0.0	0.0	0.0	0.0
b. Bilateral	12.2	32.6	39.2	43.3	27.6	13.8
Concessional	10.6	28.5	29.6	29.9	27.2	13.8
Nonconcessional	1.6	4.1	9.6	13.4	0.4	0.0
2. Private Creditors	1.4	3.1	4.5	2.9	13.1	6.9
a. Suppliers' Credits	0.6	0.7	0.6	0.4	0.1	0.0
b. Commercial Banks	0.0	1.6	3.3	2.1	12.8	6.9
c. Other Private	0.8	0.6	0.6	0.2	0.1	0.0
Private Non-Guaranteed LT	0.0	0.0	0.0	0.0	0.0	0.0
Total LT Interest	26.1	51.6	62.3	62.6	53.1	35.0
IMF Service Charges	1.9	1.7	0.7	0.1	0.0	0.0
Interest Paid on ST Debt	28.2	22.6	30.8	47.0	50.2	28.0
Total Interest Paid	56.2	75.8	93.8	109.7	103.3	63.0
Memorandum Item:						
Stock of Arrear (interest)	20.0	31.5	47.7	63.5	115.7	205.6
DEBT OUTSTANDING & DISB.						
Public & Publicly Guar. LT	2980.0	3433.9	4023.0	4440.0	4700.2	5155.2
1. Official Creditors	2961.9	3348.5	3965.3	4331.9	4617.2	5111.7
a. Multilateral	695.0	793.8	885.8	917.3	970.7	1038.3
Concessional,	629.3	713.9	829.0	865.5	923.5	1002.0
of which IDA	348.1	406.6	473.4	509.8	546.5	602.4
Nonconcessional,	65.7	79.9	56.9	51.7	47.2	36.4
of which IBRD	0.0	0.0	0.0	0.0	0.0	0.0
b. Bilateral	2266.9	2554.7	3079.5	3414.6	3646.4	4073.4
Concessional	2175.9	2341.6	2754.6	3012.2	3335.8	3819.7
Nonconcessional	91.0	213.1	324.9	402.4	310.6	253.7
2. Private Creditors	18.1	85.4	57.7	108.1	83.1	43.5
a. Suppliers' Credits	7.9	7.2	6.2	3.3	2.3	2.6
b. Commercial Banks	0.0	70.0	45.3	102.5	80.0	40.0
c. Other Private	10.2	8.1	6.2	2.3	0.8	0.9
Private Non-Guaranteed LT	0.0	0.0	0.0	0.0	0.0	0.0
Total LT DOD	2980.0	3433.9	4023.0	4440.0	4700.2	5155.2
Use of IMF Credit	47.7	32.4	14.8	5.7	1.3	0.1
Short-Term Debt	301.0	374.2	458.4	688.0	909.0	957.0
Total External Debt	3328.7	3840.5	4496.2	5133.7	5610.5	6112.3
Principal Reduction Due to:						
1. Debt-Equity Swaps+Buybacks	..	..	..	..	..	..
2. Debt Exchanges	..	..	..	..	..	..
3. Debt Forgiveness	..	..	..	..	..	..
Memorandum Item:						
% Debt on Concessional Terms	84.3	79.6	79.7	75.5	75.9	78.9
% Debt at Variable Int. Rates	0.3	2.0	1.1	2.0	1.4	0.7
Preferred Creditor DS	..	..	..	..	..	..
Share of IBRD Portfolio	0.0	0.0	0.0	0.0	0.0	0.0

Source : IECDI.

TABLE 4.1 : MONEY and CREDIT

(millions of current YR)

	1985	1986	1987	1988	1989	Nov 1990
Annual Changes:						
Net Domestic Credit	6319	11046	6653	6040	6271	13996
To Government Budget	6440	8016	7709	8712	6331	7771
To Priv Sect & Pub Enter.	905	282	-1539	543	957	2990
Foreign Assets	-1027	2748	483	-3215	-1017	3234
Total Assets & Liabilities	6319	11046	6653	6040	6271	13996
Money and Quasi money	5699	10354	4216	4407	3427	11411
Net Other Liabilities	620	683	2437	1633	2845	2584
End-of-Year Stocks:						
Net Domestic Credit	37469	48515	55168	61208	67479	81475
To Government Budget	28094	36110	43819	52531	58862	66633
To Priv Sect & Pub Enter.	7708	7991	6452	6995	7952	10942
Foreign Assets	1667	4414	4897	1683	666	3900
Total Assets & Liabilities	37469	48515	55168	61208	67479	81475
Money and Quasi money	34268	44631	48847	53254	56681	68092
Net Other Liabilities	3201	3884	6321	7954	10799	13383
Memorandum Items:						
International Gross Reserves (mill US$)						
Change during the year	..	86	67	-272	-41	..
Stock at end of year(Dec 31)	486	572	639	367	327	417

Source : Central Bank of Yemen.

TABLE 5.4 : CONSUMER PRICE INDEX BY CITIES

(Annual percentage change)

	1986	1987	1988	1989	1990
Sana'a	33.5	21.8	16.4	20.1	..
Taiz	28.1	20.5	9.3	18.9	..
Hodeidah	27.5	17.6	11.4	17.5	..
Ibb	24.2	22.8	12.1	18.3	..
Dhamar	32.8	20.4	14.9	21.1	..
Aden	0.9	2.5	0.3	0.0	34.2

Source : Ministry of Planning & Development

TABLE 5.5 : WEIGHTED CONSUMER PRICE INDEX FOR URBAN AREA IN THE NORTH

(1985 = 100.0)

City	Population Share	1985	1986	1987	1988	1989	1990
Sana'a	49.8	49.8	66.5	81.0	94.3	113.3	..
Taiz	20.8	20.8	26.6	32.1	35.0	41.6	..
Hodeidah	18.1	18.1	23.1	27.1	30.2	35.5	..
Ibb	5.7	5.7	7.1	8.7	9.8	11.6	..
Dhamar	5.6	5.6	7.4	9.0	10.3	12.5	..
Urban Area	100.0	100.0	130.7	157.9	179.6	214.5	287.9
Growth rate		na	30.7	20.8	13.8	19.4	34.2

Source : Ministry of Planning & Development

TABLE 5.6 : WEIGHTED CPI FOR URBAN AREA

(1985 = 100.0)

	Population Share	1985	1986	1987	1988	1989	1990
NORTH (5 cities)	67.8	67.8	88.6	107.0	121.8	145.4	195.2
SOUTH (Aden)	32.2	32.2	32.5	33.3	33.4	33.4	44.8
ALL URBAN AREA	100.0	100.0	121.1	140.3	155.2	178.8	240.0
Growth Rate		na	21.1	15.9	10.6	15.2	34.2

Source : Ministry of Planning & Development

TABLE 5.3 : CONSUMER PRICE INDEX BY CITIES, 1985-90

Base year = 1969 (Aden), 1977/78 (others)

	1985	1986	1987	1988	1989	1990
Sana'a	220.8	294.8	359.0	418.0	502.0	..
Taiz	217.0	278.0	335.0	366.0	435.0	..
Hodeidah	222.0	283.0	333.0	371.0	436.0	..
Ibb	227.0	282.0	340.0	388.0	459.0	..
Dhamar	222.0	294.8	355.0	408.0	494.0	..
Aden	353.0	356.0	365.0	366.0	366.0	491.2

(Baseyear = 1985)

	1985	1986	1987	1988	1989	1990
Sana'a	100.0	133.5	162.6	189.3	227.4	..
Taiz	100.0	128.1	154.4	168.7	200.5	..
Hodeidah	100.0	127.5	150.0	167.1	196.4	..
Ibb	100.0	124.2	152.5	170.9	202.2	..
Dhamar	100.0	132.8	159.9	183.8	222.5	..
Aden	100.0	100.9	103.4	103.7	103.7	139.2

Source : Ministry of Planning & Development

TABLE 4.2 : CENTRAL GOVERNMENT BUDGET

(millions of current Yemeni Rials)

	1987	1988	1989 p	1990 p	1991 b
Direct Taxes	1562	3061	4439	7478	8931
Indirect Taxes	5761	6666	7834	8962	10124
Nontax Receipts	4875	7461	8427	13499	16163
Total Current Revenues	12198	17188	20700	29939	35218
Interest Payments	492	657	802	3222	6590
Non-Interest Current Expenditures	14222	18486	20883	30768	34294
Non-Defense Expenditures	9491	11120	12452	15651	19181
Defense Expenditures	3400	6071	6958	11819	12423
Non-Interest Current Transfer	1163	1086	1223	3298	2690
Unclassified	168	209	251	..	..
Total Current Expenditures	14714	19143	21685	33990	40884
Budgetary Savings	-2516	-1955	-985	-4051	-5666
Capital Revenues	..	..	..	..	..
Capital Transfers	830	874	1008	1552	1743
Budgetary Investment c/	7720	9184	9409	8837	9491
Total Capital Expenditures	8550	10058	10417	10389	11234
Extra budgetary Expenditure	2778	1696	1459	799	0
Overall Balance	-13844	-13709	-12861	-15239	-16900
Total Deficit Financing	13844	13708	12862	15238	..
External Capital Grants	1644	999	1470	1243	88
External Borrowing (net)	4320	5137	5061	4980	..
Monetary System Credit (net)	7880	7572	6331	9015	..
Other Domes. Borrowing (net)	0	0	0	0	..
Debt (at end of year)					
External Debt					
(in millions of LCUs)	..	..	..	..	..
(in millions of US$)	4496	5134	5611	6112	..
Domestic Debt					
To Central Bank	7938	7575	6331	9015	..
To Commercial Banks	-58	-3	0	0	..

Notes : a/ Central government.
p/ Preliminary estimates by the mission.
b/ Budget.
c/ Including portions funded by external loans as estimated by the mission.

Source : Ministry of Finance and the mission.

TABLE 5.1 : EXCHANGE RATES

(Yemeni Rials/US$)	1985	1986	1987	1988	1989	1990
Av Exch Rate	6.4100	7.4100	8.9900	9.7000	9.7700	11.8150
Ave Official Exch Rate (IFS)	7.3633	9.6392	10.3417	9.7717	9.7600	..
End of Year Off Rate (IFS)	8.1000	12.2500	9.9000	9.7600	9.7600	..

Source : Central Bank of Yemen and IMF.

TABLE 5.2 : CONSUMER PRICE INDEX IN MAJOR CITIES BY COMMODITIES & SERVICES, 1988-89

(1969=100 for Aden, 1977-78=100 for other cities)

	Dhamar		Ibb		Hodeidah		Taiz		Aden		Sana'a	
	1988	1989	1988	1989	1988	1989	1988	1989	1988	1989	1988	1989
Overall index	408	494	388	459	371	436	366	435	366	366	418	502
Food stuffs	357	433	319	378	315	372	310	371	401	401	346	415
Cereals	352	457	318	396	329	415	280	348	271	271	379	485
Legumes	501	606	544	632	450	530	554	655	363	363	556	666
Meat	238	287	214	251	253	300	220	265	257	257	230	230
Vegetables	341	395	239	265	201	223	196	233	289	298	352	405
Milk & Eggs & Cheese	628	770	563	672	368	429	470	556	237	237	525	638
Edible oil and fats	289	357	285	344	224	266	264	320	397	397	390	485
Fruits	295	370	402	490	459	547	490	596	252	276	517	650
Sugar	284	348	275	331	339	287	244	294	600	600	315	384
Soft drinks	283	393	263	404	240	320	180	231	270	270	248	350
Tobacco	465	557	376	432	390	456	400	472	818	818	340	400
Beverages	359	432	345	410	301	352	263	310	250	250	461	551
Canned & Dried Fruits	358	415	275	305	271	301	300	346	406	406	320	366
Clothing	865	1023	689	785	787	880	822	938	554	554	966	1123
Clothes	869	1035	663	760	776	870	783	903	564	564	923	1080
Shoes	854	985	818	911	908	989	988	1085	446	446	1153	1325
Housing	486	591	487	577	415	486	400	478	232	232	482	588
Furniture & utensils	383	470	595	1125	481	559	410	475	337	337	557	665
Durable goods	304	356	508	566	283	308	310	339	300	300	363	410
Rent and water	526	632	455	519	399	460	360	425	89	89	435	530
Fuel and lighting	475	592	489	608	506	628	564	706	421	421	643	800
Others	416	493	467	558	385	446	394	458	244	244	434	522
Transportation	436	479	316	348	370	400	333	366	197	197	314	348
Education and culture	158	166	293	313	331	357	364	393	227	227	345	386
Medical expenditures	905	1131	816	1020	608	760	683	854	397	397	898	1122
Household cleaning items	283	346	291	354	269	320	280	341	217	217	271	346
Personal items	470	575	504	594	375	436	436	515	317	317	393	479

Source: Ministry of Planning & Central Statistics Organization