Board Meeting of November 4, 1997
Statement by Enzo Del Bufalo

YEMEN: Country Assistance Strategy Progress Report

We would like to commend the Yemen authorities for the good performance of their economy during recent years. Inflation is now under control and the public deficit has been reduced to a manageable level. As a result, the country's external position has been stronger and the economic growth seems to be solid. Regarding the structural reforms, as it is stated in the CAS progress report, we also consider that the Yemen authorities have complied with the objectives set forth in the high-case scenario. For these reasons, we support a level of lending for FY98-99 which is commensurate with this case scenario.

Notwithstanding the progress achieved, many challenges still remain. The volume of resources earmarked for the social sector is still low, specially in the health sector (3.1% of GDP, among the lowest in the world). Additional efforts must be brought about in this area, taking into consideration that with the fiscal revenue level reaching now 37% of GDP there is margin for improvement. The Bank must monitor very closely the development in this sector.

Although there has been some improvement in the implementation performance, the ratio of unsatisfactory projects has used up to 17% of the total portfolio loan. We would like to know if this increase in the ratio could be partially due to a lack of ownership with Bank projects.

Finally, additional efforts must be attained to improve the environment that enables the private sector to flourish. We acknowledge the progress made in particular areas such as equal treatment for all investors to qualify for incentives. The elimination of barriers that prevent private sector involvement in infrastructure must be a priority together with the revitalization efforts to promote privatization.

Financial Sector Adjustment Credit

We support this credit and consider it very well timed in accordance to the situation of the financial sector described in the document. The reform in the sector is crucial for three reasons:

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First, it will increase confidence among savers and foster both domestic saving and remittances from emigrants abroad; second, it will provide a wider range of financial products to investors; and, third, it will increase the possibilities for the lower income levels of the population to have access to credit.

We consider that the project is well designed and deals with the main areas that must be faced in order to streamline the financial sector, banking regulations, supervision, capital adequacy, and provisioning requirement and tax treatment of provisions, institutional improvements and privatization.

We would also like to commend the staff for the candid description of Yemen’s financial sector status, but we would like to have further comments from management on the following three issues:

1. Is there an estimate of the total cost of stabilizing the present situation of the financial sector and, most of all, the impact that such stabilization process would have on the government budget?

2. Are there any calculations about the global cost of resolving the financial sector distress and the impact on the government budget?

3. Paragraph 62 mentions that introducing leasing financial lending will have added benefits because some forms of leasing appear to be consistent with the Sharia (Islamic law). We would like to know whether there is some incompatibility between the Sharia and the proper development of the financial sector in Yemen.

Finally, we would welcome more information about the restrictions currently being imposed on commercial bank lending to public enterprises. Are they going to be applied only to those firms that are not going to be sustainable in the long run, or be used as a general rule? In addition, we would like to know if there is room for other institutions different from commercial banks that could provide financing to PEs.

Thank you.