

An Initiative to Develop Coordinated Monetary Policies in Yemen

Economic Reform Team
Studies and Economic Media Center

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The Yemeni Economic Reform Team (ERT) and its secretariat the Studies and Economic Media Center (SEMC) would like to thank the Center for International Private Enterprise (CIPE) for its support in developing this initiative.



Introduction:

The eight-year war in Yemen has caused major disruptions in all aspects of life, including the economy. Additionally, public and revenue collection institutions have been divided among the warring parties that politicized the economy. Consequently, the humanitarian and living conditions for millions of Yemeni citizens have been negatively affected. For example, disruptions in the public sector's payroll worsened the daily life for 31 percent of the country's workforce that rely on public salaries as the only source of income. The use of the economy as a political bargaining chip has contributed to one of the worst humanitarian catastrophes in the world.

This initiative is brought by the Yemeni private sector represented by the Economic Reform Team (ERT), supported by the Center of International Private Enterprise, to identify the current Yemeni economic challenges caused by the monetary crisis – and present practical proposals that contribute to solving it. In this initiative, the members of the Yemeni private sector and civil society clearly identify and highlight the bottlenecks and points of disagreement among the conflict parties, along with the recommended remedies.

Through this initiative, we invite all stakeholders to collaborate to address their disagreements in order to stabilize economic conditions and restore banking sector vitality to improve the living and humanitarian conditions for the Yemeni people across the country.



Yemen's Most Significant Economic Problems:

The current economic crisis is caused by four factors as follows:

A. The General Financial Conditions:

Yemen suffers from severe economic contraction, a drop in the Gross Domestic Product (GDP), and is running a budget deficit due to declining public revenues. Additionally, there is little communication and coordination between the Yemeni Central Bank (YCB) administration in Aden and the de facto administration in Sanaa, leading to competing and incoherent fiscal and monetary policies that further weaken Yemen's economy. Lack of efficient revenue collection mechanisms also contributed to the deficit and drop in the economic output. Public services worsened due to lack of investment, while public servants in Sana'a and other provinces were being paid irregularly. As a result and according to the YCB, the budget deficit amounted to 800 Billion Yemeni rials in 2020.

B. The Balance of Payments:

A deficit in the balance of payments continues, amounting to \$1.6 billion (USD) according to the YCB statistics for 2021, which led to a collapse in the local currency and an increase in inflation rates. This has been coupled with lack of foreign currency deposits and a decrease in the export of goods, which contributes to worsening Yemen's economic conditions. All this occurs within a duality of command and poor management of the external revenues.

Locally, people use different banknotes within the same conflict-ravaged country. Authorities in Sana'a and neighboring provinces have banned using the recently issued currency by Aden authorities regardless of the deep and fundamental liquidity crisis in Sana'a and its surroundings. As a result, two exchange rates emerged for foreign currencies as well as increasing the money transfer fees between both regions.



C. The Banking Sector:

The banking sector in Yemen faces severe difficulties caused by the two main parties to the conflict. The administrations in both Sana'a and Aden make financial policies independently. Sana'a and its neighboring governorates suffer from a scarcity of cash liquidity, which harms the economic and financial functions of Sana'a's administration and its effectiveness. On the other hand, the expansion of the parallel market in Aden complicates matters even more, causing money to leave Sana'a's, and Yemen's formal banking system altogether. For instance, up to 3.5 trillion rials are circulated outside the banking sector, representing 49 percent of the money supply, which occurs among the exchange companies and transfer networks. This situation has created significant opportunities for currency speculation and evasion of financial monitoring and auditing apparatuses in both regions.


D. Crisis of the Public Debt:

Yemen's public debt is 3.6 trillion rials according to the YCB's statistics in 2021. Yemen's banking sector allocated 50 percent of its assets to buying government bonds of public debt, making it the top buyer of government bonds out of all investors. From 2010 to 2014, it also bought 80 percent of the total treasury bills amounting to 1.501 trillion rials by 2014. This situation continued until the beginning of the liquidity crisis in the middle of 2016, when all those balances were frozen, along with their current accounts by the YCB. As a result, the banks were unable issue or withdraw the treasury bills it bought despite high demand from customers to withdraw their money. This problem has not been solved yet, which costs Yemen huge investment opportunities in these frozen assets.

Consequences of the YCB the Division on Economic and Humanitarian Conditions in Yemen


Continuous division of the YCB Administrations without a possible solution to this crisis will result in harmful implications at every level, be it economic or social. Thus, the humanitarian and livelihood crises will get worse, impacting all groups of Yemeni people. The consequence can be summarized in the following ways:

- The suspension of the payment of salaries will continue and public revenue spending will not benefit the economy. The banking administrations will continue to employ policies that increase inflation in order to cover the public deficit, which leads to the collapse of the local currency.
- An increased decline in foreign currency revenues and cash reserves due to the duality of external payment management practices that will negatively impact the trade balance, which is already running a deficit.
- Continuation of pressure on the banking sector through enforcing unfair policies on private banks that are already suffering from the YCB's division. The direct impact of these conditions will be on the private sector due to the duality in taxes and fees in addition to the high cost borne by commercial companies, not to mention the violations and extortion practices.
- There is an increasing burden on humanitarian interventions and difficulty in providing relief management due to the existence of two domestic exchange rates in Aden and Sana'a. On a humanitarian level, the crisis in Yemen is considered the worst humanitarian crisis the world has ever witnessed. UN agencies are expecting that the humanitarian situation will be even worse throughout the rest of 2022. It is expected that the number of individuals unable to meet their minimum food requirements will rise by 19 million. Following the latest publication of the Integrated



Food Security Phase Classification (IPC) in Yemen, UNICEF and the World Food Program warned of a severe hunger crisis in Yemen, which puts the country on the verge of an inevitable disaster.

- This deterioration of the economy and the continuation of the division of the Central Banking administrations will create catastrophic social and humanitarian crises. Currently, about four million displaced refugees live in camps and rural areas. Of the four million refugees, 1.5 million are children and thousands of them have dropped out of school. Overall 2.5 million children suffer from severe malnutrition.
- The vast majority of people who receive a government salary are unpaid or receive irregular salary payments, leading to decreased sources of income. Not only are public sector employees being underpaid or not paid at all, but inflation also lowers the purchasing power of the Yemeni people, lowering the actual value of the salary and income they are receiving. Salary payments in practice are now closer to being a federal stipend or aid, rather than a salary. In other words, a teacher whose salary was an average of eighty thousand rials, equivalent to \$372 USD, receives what is now equivalent to \$64 USD. This estimation is based on the exchange rate of one dollar equal to 1240 rials at the end of March 2022.
- The continuation of currency devaluation and the rise in the price of daily commodities is due to the rial depreciation compared to other foreign currencies as well. The Yemeni rial lost 166 percent of its value between December 2019, when the newly printed currency was forbidden, until December 2021. On the other hand, it lost 700 percent of its value since the outbreak of war in 2014 until December 2021 when the exchange rate was 1700 rials equal to one USD.
- The division of the YCB has an impact on banking sector's ability to work with external financial institutions and international financial networks. Local banks are unable to send wire transfers in US dollars via foreign banks. This severely impacts their cash cycles and has contributed to expanding the unregulated market, hidden from the banks. It has also



led to the rise of unauthorized and unregulated monetary networks and exchange companies. Another impact is the increased Yemeni currency speculation.

- The private sector companies suffer from increased transportation costs due to obstructions in delivering goods and commodities among the governorates that increases the final cost of goods to the consumer. There is a massive goods exchange in the areas that are controlled by both parties, where payments of goods are made in foreign currencies, adding to the liquidity crisis.
- Yemen's overall economic crisis is aggravated by the ongoing issues in increasing public debt, the cash reserves, and debt balances owed by the YCB to domestic banks. Depositors suffer from the liquidity crisis, and the loss of opportunities to invest money in economic activities and opportunities.



Proposals and Solutions


Due to the economic situation described above and the catastrophic consequences ensuing from the ongoing division of the YCB, it is inevitable that these problems and the humanitarian crisis will worsen if not addressed. There must be middle-ground solutions to stop the collapse of the economy and spare the vulnerable Yemeni communities further challenges and humanitarian crisis. The coordination of the monetary policies may be the key to solving Yemen's current economic crisis. For that purpose, we propose the following:

To start, we recommend that both YCB administrations form a joint committee composed of technical and financial professionals from each administration.

This will help them face one another to discuss all the above-mentioned challenges and build consensus on immediate solutions on a depoliticized basis to help stabilize and insulate Yemen's monetary policy away from the conflict. In doing so, they will discuss the differences in their monetary and financial policies to negotiate practical and effective solutions that are in the best interests of the country and society. Such solutions should proactively address the anticipated crises. The committee has the right to seek the necessary technical assistance from inside and outside Yemen.

After the formation of the committee, these are the general guidelines to work on:

- 1- Establish a joint working group to oversee the activities of the banking sector, create a unified database for the sector, and enforce the anti-money laundering and terrorist financing guides.
- 2- Neutralize the local banking activities, create a unified budget for the banking sector, and adopt monetary policies that improve the performance of the banking and economic sector in general.
- 3- End the duality in procedures and regulations in all their forms and allow the technical experts to present all points of disagreement for discussion and study and to propose necessary solutions.
- 4- After reaching technical agreements, the YCB should allow the circulation of all kinds of local currency across Yemen. This will contribute to limiting the effects of previous currency issuances and eliminate price distortions between different currencies to restore confidence in the local currency.
- 5- Determine the amount of cash needed based on the economic activity in the country in a way that does not affect inflation rates. The joint committee can coordinate with the banking sector and the YCB branches in the governorates in addition to rescinding all restrictions on funds movement and banking transactions.
- 6- Regulate the work of exchange companies and networks through joint supervision to prevent interference with banking business, such as opening accounts and commercial remittances, and creating a mechanism for trading liquidity. This contributes to stabilizing the currency value and exchange rate.
- 7- Develop a joint mechanism for external payments through banks and large exchange companies to reduce the balance of payments deficit by focusing on the inflows of foreign currency, especially that comes from



the humanitarian aid, income remittances, and oil derivatives, to enhance the cash reserves and strengthen the value of the local currency.

8- Utilize the international institutions' programs such as those of the World Bank and the International Monetary Fund. Gain their support for the goal of coordinating monetary policies and work with them to address the urgent priorities of the economy across Yemen.

9- Promote establishing efficient limited liability financial networks to control the movement and flow of liquidity, both internally and externally, in a way that enhances the efficiency of the adopted monetary policies, and the accompanying control systems.

10- Seek to unify the foreign currency sources according to a mechanism that consolidates banks and exchange companies in one entity, such as foreign currency auctions organized by central banks in other countries. Such a mechanism will stabilize supply and demand on foreign currency for importers and contribute to the availability and price stability of basic goods, which must be prioritized in this process.

11- Determine criteria and conditions for granting licenses to exchange companies and money transfer networks according to the effective regulations and laws and in the interest of the banking sector.

12- Exclude unqualified financial networks and exchange companies and encourage mergers among them to form new entities with efficiency and financial capabilities. A joint mechanism to monitor their performance should be developed to avoid exposing them to high risks that may cause serious problems for the banking and financial sector.

The joint committee's efforts will benefit Yemen's economy, and in turn, Yemen's population, from all the procedures and effective policies adopted by both administrations that aim to improve the banking sector and the national economy.

Recommended Action Plan:

Implementing the following action plan would contribute to trust between both sides (Aden and Sana'a) in working with each other in an apolitical manner, as well as help stabilize Yemen's economy. In addition to creating trust from both parties, the plan will directly improve the livelihood of thousands of Yemeni citizens that currently cannot afford food and other essential items due to Yemen's slumping economy. Altogether, the plan is a steppingstone to a comprehensive peace process, as it will help improve the humanitarian situation on the ground, and help garner trust between both administrations that can be parlayed into more advanced discussions and peace plans.

- Submit the initiative through the Office of the UN Envoy.
- Each administration nominates a representative(s) in the committee through the Office of the UN Envoy.
- In coordination with the office of the UN Envoy, the Joint Committee chooses an independent headquarters whether in Yemen or another country.
- Gain the support of the UN Special Envoy for Yemen to establish the committee through the technical means and diplomatic support of its good offices and liaise with the two administrations to enable its functioning.
- The committee is to hold its first meeting and develop a plan that includes timely tasks, including regularly scheduled meetings under the observation of the UN.
- The committee will continue to convene its meetings according the schedule, with mutually agreed upon ground rules.
- The committee has the right to seek the assistance of experts from the private sector, Yemeni Banking Association, Association of Exchangers, etc. as needed.

Since 1983 CIPE has been working with local partners to craft business-driven solutions to social-economic problems that affect millions of people. We at CIPE believe that democracy is at its strongest when the private sector is flourishing. Working with our local partners that include business associations, chambers of commerce, think tanks, universities and advocacy organizations, CIPE is helping create the enabling environment for business to thrive. This can only happen when the core institutions of democracy are strong and transparent. CIPE currently has more than 200 projects on the ground, including grants with local partners, in over 80 countries to help build those institutions.



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The Studies & Economic Media Center is one of the most important Yemeni civil society organizations working in economic affairs, raising awareness of economic issues, promoting transparency, good governance, citizen engagement in decision-making, and creating professional media.

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