

Country Report of Yemen for the regional MDG project

1- Introduction

- Population is about 21 Million.
- Per Capita GDP is \$ 861 for 2006.
- The country is ranked 151 on the HDI index.
- Population growth rate is about 3.0%.
- Unemployment rate is about 16% in 2007.
- Inflation is about 13%.
- About 35% of the population lives below the national poverty line, with poverty more widespread and persistent in rural areas.
- There are large gender disparities, with significant gaps in women's access to economic, social and political opportunities.
- Yemen's first Millennium Development Goals Report in 2003 concluded that Yemen is currently off track with respect to meeting the MDGs, with the possible exception of universal primary education and under-five child mortality.

- **The country unified in 1990.**
- The country absorbed the costs of integrating two different civil service structures and economic systems.
- After 1990, Yemenis living and working in GCC countries up to one million Yemenis returned to Yemen.
- Despite all the disruptions associated with unification and the civil war of 1994 and external shocks, data show positive growth averaging 5.5% over the period 1990 to 1999.
- The trend of economic growth rate shows a decline in the second half of the 1990s to about 5%.
- This declining trend continues into the period since 2000, with the growth rate over the period 2000 to 2005, averaging 4.5%.
- **The structure of the economy underwent fundamental changes over the period from 1990 to 2006, with the share of key sectors in current prices changing substantially over the period.**

Table (1) *Changing Structure of Yemen's Economy*

	1991	1994	1997	2000	2003	2006
Agriculture	23.1	25	16.2	13.8	12.9	10.3
Oil and Gas	8.5	5.3	27.9	35.5	30.2	35.1
Manufacturing	18	15.1	7.7	5.7	6.5	7.8
Services	45.5	51.4	41.3	41.2	44.4	41.7
GDP	176132	336514	884192	1558370	2160608	3755122

2- Main reforms, macroeconomic policy, economic performance and vulnerabilities

Economic reforms and policy during the period 1990-2006

1. The initial period Yemen as a unified country was marked by an increase in financial imbalance.
2. The Government responded by introducing direct restrictions on imports, investments and movements of the exchange and interest rates.
3. In 1995, the Government embarked on market based reforms, focused on price stabilization and trade liberalization, fiscal adjustments and reform of the exchange rate regime.
4. The response of the economy to these stabilization efforts was a marked decline in the growth rate to an average of 5% over the period 1995-1999.
5. The liberal regime continued into the period since 2000, with gradual reduction of subsidies on major items, with petroleum

products remaining the main item subject to controlled pricing by 2006.

6. The Government has been implementing a Poverty Reduction Strategy Paper since 2003 with the objective of increasing allocation to basic social services and fostering broad based growth.
7. However, PRSP progress reports shows lack of success in achieving the stated objectives of the PRSP, with stagnant allocation of resources to basic social services, in terms of share of allocations to education and health in total public expenditures.

3- Evolution of the economy during the period 1990-2006

8. The structural composition of the economy has been influenced by the variations in the contribution of oil to national income in current prices around an upward trend.
9. The contribution of agriculture and industry to GDP has been more than halved, while services continues to be the dominant sector and makes the same percentage contribution to GDP in 2004 as it was making in 1990.
10. The opportunity offered by oil income has not been used to transform the structure of the economy, with manufacturing as a potential dynamic sector showing a substantial reduction in its contribution to GDP in current prices and only providing 5% of employment in the country.
11. Thus, what one observes is essentially a shift in the nature of the service sector, which has moved from being focussed on supporting agriculture in the period up to 1990 to being an

avenue for injecting oil income into the economy, through an expansion of foreign trade related service activities.

12. Private industry has failed to take advantage of the opportunities offered by greater availability of foreign exchange due to an unfavourable investment climate, largely related to weak governance and absence of a culture of rule of law.
13. Oil income has allowed the Government to adopt a relaxed attitude towards raising domestic resources. It also appears to have had a negative impact on the growth of both the agricultural and industrial sectors, by facilitating imports of foodstuffs and consumer goods.

4- Economic growth

- The economic growth of Yemen with an average growth rate showing a consistent downward trend, from an average of about 6.0% in the first 5 years, to 5% in the second half of 1990s and 4.5% in the period since 2000.
- A 0.5% decline in the growth rate of population from an average 3.5% over the period up to 1994 to 3% for the period to 2004, has partially compensated for this decline, but the per capita rise in GDP has been in the 1% range in the recent past, which is insufficient to make a major reduction in poverty in the country.

5- Main factors driving economic growth

- The economic growth in the country has been largely driven by the growth of the oil industry in terms of providing an ever greater financial contribution to the public treasury.

- The productive sectors of agriculture and manufacturing have seen their combined share of GDP in current prices decline from 43% in 1990 to 17.6% by 2005.
- At the same time the combined share of oil and services has increased from 52% in 1990 to over 77% in 2005, with construction retaining the same 5% share in GDP.
- The poor performance of the agricultural sector has meant that the country is now over 80% dependent on imports.
- The share of GDP allocated to total investment shows an upward trend during the period, from a trend rate of 18% in the early 1990s to around 20% in the period since 2000.
- This fairly modest upward trend in the overall investment rate, however, is the result of two contradictory trends with respect to public and private investment. Public sector investment shows a substantial upward trend, rising from an average level below 5% of GDP in the early 1990s to above 10% in the period since 2000, while private investment declines from an average of 13% of GDP in the early 1990s to around 9% in the period since 2000.
- When one juxtaposes this rising trend of overall investment, driven largely by a substantial increase in public investment, against a picture of declining growth over the period, questions arise as to the efficiency of public investment.

6- Has growth been pro-poor?

- The results of the 2005-2006 Household Budget Survey demonstrates a substantial reduction in urban poverty compared to the earlier HBS of 1998, with rural poverty remaining high.

- This result is consistent with a pattern of growth driven by the oil and service sectors that mostly create incomes in urban areas.
- The growth has not been pro-poor in the sense that it has not been accompanied by creation of quality jobs, with a rising level of unemployment and underemployment.
- The changes in the external environment, particularly the large scale return of Yemeni expatriate workers from neighbouring countries following the first Gulf War, has further aggravated poverty in the country.

7- Main economic imbalance and their financing

- The first years of Yemen as a unified country were marked by high costs associated with unification.
- It met through deficit financing on a major scale that led to ever rising rates of inflation.
- A stabilization programme was adopted by the beginning of 1995.
- Since then the mismatch between needs and resources has been met through constraining public expenditure to within resources available to the country, thus compressing social expenditures and not allowing a rapid rate of progress towards achieving the MDGs.

8- Vulnerabilities and economic constraints

Are public finances healthy?

- The structure of public sector accounts shows that for the first 5 years of Yemen as a unified country over 50% of the budget was spent on wages and salaries.
- However, as it became clear that this state of public finances was not sustainable public sector real wages were allowed to deteriorate substantially from 1996 onwards, thus leading to a more balanced structure of public finances, with wages and salaries accounting for under 30% of expenditures in the period since 1997.
- This has allowed greater attention to public investments, which rose from around 10% of total expenditures in the period 1990-1995 to averaging over 20% of expenditures in the period since 1997.
- This has, however, negatively affected the ability of the civil service to attract, motivate and retain qualified staff, leading to deteriorating quality of public services provided.
- Attention to operations and maintenance of public facilities has remained inadequate throughout the period averaging in the 10% range over the entire period 1990-2006.
- Subsidies, while initially only accounting for under 10% of expenditures have acquired increasing importance in the period since 1997, averaging over 25% as the government has felt obliged to provide a broad safety net to the public at large, essentially to facilitate access to affordable transport and electricity.
- Reforms introduced since 1996 in terms of curbing deficit financing have managed to keep interest payments in check, with their share

of total expenditures remaining below 7% in the period since 1997, as against levels exceeding 10% registered in the period 1990-1995.

14. Domestic borrowing remains within reasonable levels and external debt was cut substantially through debt reduction measures agreed with major lenders in the early 2000s.

15. The total stock of external debt is currently around 30% of GDP with the Government able to service it without difficulty.

16. As an element of its inflation control policy, the Central Bank of Yemen has been maintaining the value of the local currency fairly stable with respect to the US dollar. only allowing an annual depreciation of between 3-5% in the period since 2002.

- The tax effort of the Government has been fairly limited, with the share of taxes, both direct and indirect in total government revenues falling from the 40-50% range in the period 1990-1995 to just over 18% by 2006.

- At the same time as the share of oil and gas revenue in public revenues rose from the 30% range in the early 1990s to over 70% in the period since 2000.

- One would expect there to be many opportunities for raising tax revenues, both by increasing the efficiency of direct taxation and introducing a value added tax regime with exemptions for items consumed by the poorer segments of population.

- The Government of Yemen has been receiving official development assistance from neighbouring Arab countries as well as OECD donors.

- But the level of assistance was negatively affected by political developments since the first Gulf War.

- The average level of assistance received by Yemen in the past 10 years has been between \$13-22 per capita.
- The low level of external assistance has definitely limited the ability of the Government to fund investments needed to meet the MDGs.
- The Consultative Group meeting held in London in November 2006 marked a turning point, with levels of assistance pledged reaching \$5 billion for a 4 year period.

9- Terms of trade shocks

As an oil exporter, Yemen faced a negative terms of trade shock with the drop in oil prices in the late 1990s, but has benefited from the rising trend of oil prices since 2003. In terms of prices of imports, the country has had to contend with the substantial rise in food prices in 2007, which is expected by most observers to continue into the future. The rising food prices poses a particularly difficult problem for Yemen, given the decline in domestic food production experienced ever since unification, with the country currently dependent on imports for over 80% of its basic food staples. Yemen is also dependent on remittances to the tune of \$1-2 billion per year, which has been vulnerable to political shocks, due to the concentration of Yemeni expatriates in GCC member countries.

10- Social Policy and MDG Achievement

Social Policy During the Period 1990-2006

- Yemen emerged as a unified country in May 1990, and had to integrate two different socio-economic systems,

17. The unification of the country imposed costs in terms of the public wage bill.
18. This extra financial burden, combined with the shock produced by the forced return of large number of Yemenis working in GCC member countries following the 1990 Gulf War and the cost of a brief but heavy civil war in 1994, at the same time as reducing the funds available for meeting the MDGs, increased the demand on basic social services due to the large influx of Yemenis returning home.
19. The Government initially tried to cope with the extra burden through maintaining and even expanding the level of public services through resorting to substantial deficit financing.
20. However, as the higher deficit inevitably led to inflationary pressures, the Government accepted IMF advice and implement a structural reform programme starting in 1995, that brought about a substantial reduction in the public deficit by 1997.
21. As a result of this contractionary policy the provision of public services suffered, with the pace of improvement in social indicators slowing down in the period since 1997, compared to the first 7 years of Yemen as a unified country.
22. As part of the structural reform programme price subsidies on various commodities were gradually reduced, with the share of subsidies in public expenditure declining to 14.6% by 2003, against a level of 29.3% in 1997.
23. However, since 2004, the rise in international oil prices and maintenance of administered prices for petroleum products has led to subsidies again becoming a major element of public expenditures, accounting for 25-30% of total public outlays over

the period 2004-2007, despite a substantial increase in domestic fuel prices in the second half of 2005.

11- Evolution and Structure of public spending (current and capital)

Has there been any connection between public spending and the MDGs?

24. In the period from 1990 to 1995, the Government put greater emphasis in its budget policy on maintaining public services at the cost of running up persistent budget deficits, as a result of which the unified country experienced a fairly rapid pace of improvement in MDG indicators.
25. However, following the adoption of a structural adjustment programme from 1995 stability was given greater importance at the cost of reducing the quality of public services.
26. Following agreements reached between Yemen and her creditors for debt relief under the HIPC initiative in the early 2000s, the Government adopted a Poverty Reduction Strategy Paper covering the period 2003 to 2005.
27. The PRSP called for a substantial real increase in spending on social sectors, with the ratio expected to reach 12.8% of GDP by 2004.
28. While spending on social sectors has an upward trend for the period since 1991, its share in GDP did not exceed 8.4% of GDP by 2006, substantially short of the PRS target.
29. The majority of this spending is on education (6.06% of GDP) and health (1.68%).

30. At 0.1% of GDP, Social protection spending is very limited. Spending on the social sectors also takes place through the Social Fund for Development (SFD).
31. The SFD executed 1,309 projects in 2003-04, at a total cost of \$123.3 million or about .5% of GDP per year.
32. A rising proportion of the budget goes to subsidize oil derivatives and electricity, mostly diesel.
33. These subsidies rose from 3.1% of GDP in 2002 to 6.3% in 2004, and peaked at close to 10% of GDP in 2006, substantially exceeding the allocation to education.
34. In 2005, the Government started reducing these subsidies on a gradual basis in order to free up resources for poverty reduction, though the rise in international oil prices since January 2006 eroded most of the gains made, with the per liter subsidy actually registering a higher value in 2007 than prevailed prior to price adjustments in 2005.

Table (2) shows that despite fairly substantial increases in allocations to health and education in nominal terms, their share of GDP only increased from a combined total of about 5.5% of GDP in 1991 to 7.8% by 2006, with their share in total government expenditure showing a marginal increase from 18.7% in 1991 to only 19.8% by 2006.

Table (2)
Key components of public expenditure

	1991	1994	1997	2000	2003	2006
Defense	23.3	39	18.2	16.8	18.2	14.1
Health	3.7	4.1	3.3	4.1	4	4.3
As share of GDP	1.1	1.2	1.2	1.4	1.4	1.7
Education	15	21.6	15.2	18	17	15.5
As share of GDP	4.4	6.1	5.3	5.9	6.1	6.1
Subsidies	6.4	10.1	29.3	28.7	14.6	26.8

Table (3)
Percentage contributions of taxes and oil income to budget revenues

	1991	1994	1997	2000	2003	2006
Direct Tax	10.5	18.9	7.5	7.4	10.1	9.1
Indirect Tax	30.1	33.4	19.2	11.5	12.7	9.3
Oil and Gas	30.8	15.1	64.8	63.9	61	74.8

(4) *Key components of public expenditure*

	1991	1994	1997	2000	2003	2006
Defence	23.3	39	18.2	16.8	18.2	14.1
Health	3.7	4.1	3.3	4.1	4	4.3
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Do social policy reforms seem to produce pro-poor outcomes?

35. Yemen has undertaken a certain number of reforms that have gradually liberalized the economy and increased the opportunity for participation of the private sector in provision of basic social services.
36. Private investment has not responded positively to the more liberal economic regime, thus not creating the expected improvement in terms of private sector jobs, in order to reduce unemployment.
37. The more liberal trading regime led to increases in the prices of basic commodities consumed by the poor.

- The increased provision of health care services by the private sector and stagnant allocation of public resources to the sector has made it more difficult for the poor to access health care services.
38. Analysis carried out based on data from the 2005-2006 household budget survey shows that the substantial amounts spent on fuel subsidies have only partially benefited the poor, with around 80% of the benefits accruing to the non-poor.
39. The high cost of health care discourages the poor from seeking care.

12- Evolution of the MDGs over the period 1990-2006

40. Yemen's first Millennium Development Goals Report in 2003, produced by the Government with support from UNDP, concluded that Yemen is currently off track with respect to meeting the MDGs, with the possible exception of universal primary education and under-five child mortality.
41. On the malnutrition front, due to a combination of stagnating per capita income levels and worsening nutritional patterns (e.g. rising consumption of junk food and qat) the situation has even got worse over time, with the proportion of under five children who are underweight rising from 30% in 1992 to 46% by 1997/8 and remaining at that level through 2003.
42. The 2005-2006 HBS showed that 35% of the Yemeni population lives under the national income poverty line, with substantial differences between rural and urban poverty, with respective rates of 42 and 22%.

43. The other dimension of poverty in Yemen is the disparities among different governorates with poverty incidence highest in Amran governorate (64%), and lowest in Al Mahrah (9%).
 44. Evidence from comparable household budget surveys in 1998 and 2005-6 suggest that there has been significant decrease in income poverty since 1998 with the proportion of the population below the poverty line falling to 35% from 40%.
 45. The proportion below food poverty line shows an even more steep decline, with the rate falling to 12.5% in 2006 from over 20% in 1998.
 46. The reduction has been remarkable in urban areas, with the poverty rate falling by over 1/3, while rural poverty remains stubbornly high at above 40%.
 47. Trends over the last few years in primary education point to an increase in gross enrolment rates in basic education from 58% in 1997/8 to 66.5% in 2003/04, with adult literacy reaching 50% by 2006.
 48. Despite substantial progress in girls' education, GER for girls only reached 51.5% in 2003.
 49. These average rates of school enrolment in the country hide serious geographic disparities. Boys and urban children enjoy greater education opportunities and higher enrolment rates.
- While the gender gap in primary enrolment decreased from 37.18 in 90/91 to 24.79 in 2002, the female enrolment rate in the first year of basic education was only 75% of the male enrolment rate in 2002.

- Both boys and girls intake rates in the past few years have increased in large measure due to the emphasis on improving primary school education.
- Boys are making greater gains from these new opportunities in access to education, while girls' primary intake rate continues to lag behind.
- The available data show that while both under five and infant mortality had a clear downward trend from 1990 to 1997, the rate of decline has slowed substantially since.
- Maternal mortality in Yemen in 1990 was generally believed to exceed 500 per 100,000 live births, even though the 1992 DHS survey does not provide a figure.
- The ratio had fallen to around 350 by the time the 1997 DHS was carried out, but has not shown much change since.
- Maternal mortality is the leading cause of deaths among women of reproductive age, accounting for 42% of all deaths. 77% of births took place at home, with less than 30% attended by a qualified person.
- The MDG Report shows a negative trend on account of Malaria, with the prevalence rate actually rising over the period from 1990 to 2000, to reach 35% of the population, while the MDG goal is to reduce it to 3% by 2015.
- A similar trend is also seen for TB cases.
- On the positive front, there has been some remarkable reduction in such contagious disease as measles and polio, though in the latter case, there has been a recent resurgence of the disease imported from Africa in 2005.

- Yemen is unlikely to meet the MDG target of reducing the proportion of people without access to safe drinking water.

Is the country on track to achieve the MDGs? Why?

- As indicated above Yemen is not yet on track to achieve the MDGs, with the possible exception of infant mortality.
- The main reason for the slow pace of improvement experienced has been insufficient allocation of resources to MDGs over an extended period and poor policy choices made in the use of the limited resources actually allocated to MDGs.
- The persistence of a high population growth rate that continues to exceed 3% and is not expected to decline radically in the near future further complicates the task of reaching the MDGs by requiring substantial increases in numbers provided with services, simply in order to maintain current coverage rates.
- For example with respect to the income poverty goal, the 3% increase in population absorbs around $\frac{3}{4}$ of the 4% annual increase in consumption levels registered in the period since 2000, thus only allowing for a 1% increase in per capita consumption levels, while attaining the income poverty goal requires a 4% increase in per capita consumption levels on an annual basis.

Based on current achievements, what policies should the country put in place to achieve the MDGs ?

- Analysis of the factors behind the slow pace of progress towards MDGs, indicates the need for adoption of a twin pronged approach made up of promoting a pro-poor growth process while at the same time curbing population growth, in order to both directly attain the

MDG income poverty goal and increase the likelihood of reaching the other MDGs.

- In addition to moving forward with actual implementation of increasing allocation of public resources to basic social services.
- Given wide regional diversities in levels of MDGs, it is critical that greater attention be paid to areas with greatest levels of relative deprivation in order to make sure national targets are met in an equitable manner.

Thank You

Conclusion

50. The nature of the growth process experienced in Yemen and social policies followed since reunification of the country in 1990 unfortunately has not generated much progress on various aspects of human welfare.
51. While there are opportunities for improving the contribution that economic growth and social policies make towards attainment of MDGs, the steep improvements needed with respect to most indicators for achieving the globally agreed MDG targets render the attainment of these goals unlikely under the most favourable conditions.
52. It might well be necessary to adopt country specific realistic targets that can actually serve as guides to action.

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Annexes

Annex 1: Changing Structure of Yemen's Economy

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Annex 2: Major features of public expenditures and investment, as a percentage of GDP

	1991	1994	1997	2000	2003	2006
Public Expenditures	29.19	28.44	35	33	35.63	39.09
Deficit	4.02	14.45	0.89	-6.4	4.12	-1.71
Public Investment	3.01	2.77	8.8	8.85	11.04	8.9
Private Investment	10.8	16.36	16.22	8.11	9.68	7.3
Total Investment	13.81	19.13	25.02	16.96	20.72	16.2

Annex 3: Percentage contributions of taxes and oil income to budget revenues

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Annex 4: Key components of public expenditure

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