

THE ECONOMIC REPORT 2010



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THE
**ECONOMIC
REPORT**

2010

Abbreviations

BOD	Board of Directors
CBY	Central Bank of Yemen
CD	Certificate/s of Deposit
DPPR	Economic and Social Development Plan for Poverty Reduction
CSO	Central Statistics Organization
FYP	Five Years Plan
GCC	Gulf Cooperation Council
GDP	Gross Domestic Product
MDG	Millennium Development Goals
NGO	Non-Government Organization
SSN	Social Safety Net
UNDP	United Nations Development Program
WB	World Bank
TN	Treasury Note/s
WTO	World Trade Organization
YBC	Yemeni Businessmen Club

Foreword

We start the First Economic Report issued by the Yemeni Businessmen's Club, with all praises and thanks to God Al-Mighty, and gratitude to all those contributed to the production of this report, including academic researchers, members of the YBC Economic Report Committee, members of YBC Board of Directors. Acknowledgement is hereby warranted for all the efforts of all the latter in the production of this report.

It is deemed to be an extension of the economic articles which YBC issued in 2009. There were 2,000 copies of these articles distributed and widely acclaimed, which encouraged us to proceed accordingly. This report aims to produce a scientific and objective analysis that encompasses the YBC view of the economic and investment environment, which reflects an unbiased view of the business and finance climate, in terms of presentation of the issues involved and the appropriate solutions. We made sure to also present an English version for non-Arabic speaking readers.

This effort exerted by a few of those who clearly care about the national economy and are interested in its well being. This interest goes beyond the effort herein exerted, but rather seeks to have all the good capacities that pursue for the enhancement of Yemen to its deserved place in the global map. Special care was in place to ensure that the work is of a high, fruitful and meaningful quality. We also consider this report as a step forward and a contribution to be added to the balance of the contributions of businessmen from the private sector to push the wheel of development besides the efforts of the government in this respect.

We hope that we have contributed to identifying the risks and challenges that Yemen faces. We also worked towards defining the advantageous opportunities and approaches through which we can work towards achieving the required appropriate reforms for moving from the current to the desired situation, by means of mobilizing the efforts and resources towards sound achievements.

We hope to have been fortunate in dealing with the pertinent issues in business, which will constitute a basis of the matters to be dealt with in future annual reports. I also sincerely anticipate and look forward to receive any comments or suggestions for improving the quality of our future reports.

In pursuit of God's satisfaction,

Ahmed Bazara

Chairman of Board of Directors
Yemeni Businessmen Club (YBC)

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Executive Summary

In our annual report, we have attempted to go over the most significant Yemeni economic challenges. We have also presented recommendations for the solutions that should contribute to facing up and overcoming these challenges within the context of a national agenda for comprehensive reforms. We shed some light on the problems that are most associated with the difficulties and concerns of the private sector. We also tried to highlight, as much as possible, the most significant future economic orientations and to show the importance of the private sector involvement as a primary partner in drawing up the future vision of the country.

We have also, through this report, worked to present a semi-detailed vision on the foreign trade aspect, the investment environment in Yemen, and similarly, the monetary and banking industry in the country. We have tried to evaluate all these economic factors, supported by the proposed suggestions and solution, while giving the duty free and industrial zones special attention in this report. The latter are expected to contribute greatly to achieving the general objectives of aspired economic and social development.

In brief

All the information of the report states that Yemen is passing through a critical stage, which requires a real partnership internally with the private sector in the first place and externally with other countries, especially the Gulf states. The achievement of comprehensive national reforms on the basis of successful partnerships is a vital step forward to overcome all the challenges, which would eventually lead to improving the standards of living of the Yemeni people, mitigating poverty and unemployment rates, and fostering economic growth.

YBC, by means of the First Annual Economic Report, aspires that the proposed measures and recommendations would be taken into consideration, when drawing up the comprehensive vision for national reforms. This initiative is an ongoing responsibility to ensure the longevity of the contribution of the YBC in the discussion of the business environment in Yemen.

Challenges and Future Expectations of the Yemeni Economy

Development in Yemen faces numerous challenges, which are primarily the challenges brought on by the depletion of oil, population growth, scarce water resources. These are beside the poor infrastructure, low human development and in light of the increasing security and political challenges confronting Yemen currently. It could be said that Yemen's current situation is beset by several multifarious crisis. The recent events and facts have shown that the various phenomena characterizing the crisis in Yemen have exceeded Yemen's limitations, capabilities and means. It has come to the point of not just requiring the mobilization of all available national capacities and means, but rather by means of providing external sufficient financial resources, to enable Yemen to realize the comprehensive development objectives. That should be achieved through an effective regional partnership framework with GCC member states.

If Yemen indeed desires to achieve the country's comprehensive development aims, and within the context of an effective regional partnership, then it must first of all, undertake comprehensive national reforms. They are the real entry door to confronting the economic and other challenges. These reforms will ensure the efficient use of resources and thus increase the potentials for alleviation of poverty, reduction of unemployment, and raising the rates of economic growth. In other substantive words, Yemen's problems do not primarily lie in the scarcity of resources, but rather in the management of these resources as one of the challenges that could be solved by carrying out a set of national comprehensive reforms. On the other hand, the existence of suitable investment environment depends on improving all the socio – political and economic conditions of the country. Such conditions have significant impacts on the investment climate, which in turn constitutes the main factor and essential precondition for achieving comprehensive socio – economic development.

The priorities of government should include the containment of corruption and mitigating poverty, which would improve the economic and social conditions of Yemen.

The government should also provide public and basic services for all citizens and safeguard their rights. The neighbor states and all states care about Yemen, should strongly and effectively interfere to support the development of Yemen, according to a vision that works towards unifying the domestic efforts, besides providing adequate financial support to set Yemen on a course of positive domestic and foreign dimensions.

The government institutions are suffering from the lack of effectiveness that has resulted in widespread corruption and poverty and thus are exposing serious challenges.

The primary requirement for accomplishing all the foregoing is having the will accompanied by the ability to realize the desired change. There is a set of challenges which we will explore in detail, as follows:

I. Depletion of Oil

Notwithstanding the economic reforms being implemented since 1995 we notice that the Yemeni economy witnessed a slowdown in the last recent years. Official statistics suggest that the average growth rate of the GDP during the period 2004 – 2008, and in light of the rising world oil prices, which jumped from around US \$ 30 to around US \$ 110 per barrel on average in 2008. Then the contribution of the oil sector to GDP rose to more than 31% of total GDP during the period from 2002 – 2009 and its share of exports rose to 92% and oil revenues constituted more than 70% of public revenues during the same period. This kept the budget deficit within reasonably safe limits, while achieving surpluses in some of the years of the period. However, the situation began to change in 2009, with the deficit of the Government budget reaching 9.1% of GDP, this being because of the reduction in world oil prices, following the global financial crisis, which began in the last quarter of 2008. As a result, oil prices then reached US \$ 40 per barrel, beside the continuing increase in the reduction of oil production over recent years. The production is declining now to around 280 thousand barrels a day after having gone up to 430 thousand barrels per day in 2004; with the total quantity of annual output of crude oil declining from 147,5 million barrels in 2004 to 107.5 million barrels in 2008. Projections indicate that the production of crude oil will continue to decline during the forthcoming period, which will result in the reduction of oil revenues. This is due to the expected continuing decline of the Government's share of crude oil production from 71.3 million barrels in 2008 to 30 million barrels in 2015, Yemen then is expected to become a net oil importer.

Most of the official and international reports indicate that the proven oil reserves in Yemen will deplete by 2018, and in light of not finding any significant oil finds during the period, then the economic conditions are threatened with more deteriorations, especially if the foreign assistance to Yemen stay at their current levels without any increase.

Nevertheless, the production of liquefied natural gas started in the last quarter of 2009, contribute to reducing the decline of the role of the oil sector in the economy and its impact on public revenues. The natural gas reserves of Yemen are estimated to be about 10.15 trillion cubic feet available for export for twenty years. Returns from the latter are expected to range from US \$ 700 million to US \$ 1 billion annually on average throughout the period. In light of the retraction of investment flows to Yemen, this shows the extent of weakness of the Yemeni economy and its limited production base, which would cause the continuing decline of economic growth and make the financial situation worrisome. The fiscal deficiencies from which the government budget suffers, as a result of the decline in oil revenues, could come to a level where the situation becomes disastrous. This situation calls for the government and donors to draw up a program of financial salvation for the next five years, wherein the government budget deficit is expected to reach 20% of GDP within three years. Government reports supplied to the donors in the London Conference and the Riyadh Conference held in 2010 suggest that Yemen will need US \$ 2.6 billion annually starting from 2010. These reports also showed that the financing gap for the Fourth Economic and Social Development Plan for Poverty Reduction (DPPR – IV)¹ (2011 – 2015) comes to US \$ 39 billion, which is more than 75% of the funding required for all the projects of DPPR IV.

1 Sometimes referred to as Fourth Five Years Plan.

II. Increase in Current Expenditures and the Accumulated Budget Deficit

Current expenditures took up more than 80% of all public expenditures during the last three years, this being at the expense of development expenditures. Salaries and wages, subsidies for oil product derivatives, public debt service took up 75% of current expenditures on average for the period 2004 – 2008. This led to an exasperation of the deficit of the public budget, which has exceeded reasonably safe limits. The fiscal deficit is expected to reach 12 – 15% (of GDP) during the period 2011 – 2013. This threatens to cause significant deficiencies in the macro - economic equilibrium locally and externally, and threatens Yemen's future development in total. This requires speeding up the completion of the comprehensive institutional reforms, including economic and financial reforms, in order to face up to the forthcoming considerable economic challenges, and requires seeking sufficient foreign support to come out from the bottleneck in the short run and to achieve economic development in the medium and long term accordingly.

The achievement of relative stability in the currency exchange rate of the Yemeni Riyal, the favorable accumulation of foreign reserves and similarly the improvement of the current account balance and the positive surplus in some of the years in the Balance of Payments all primarily are attributed to the growth of oil proceeds in the past period, especially from 2004 – 2008. In light of the expected retraction of oil proceeds during the forthcoming years, with the projected reduction of oil revenues, with the expected worrisome deterioration of the exchange rate of the Yemeni Riyal, and similarly with the expected retraction of the economic balances, the monetary reserves have deteriorated from US \$ 8.2 billion at year end 2008 to about US \$ 6 billion mid – year 2010. This would only be sufficient to cover imports for a period of at least 7 months, instead of 11 months as was the case in 2000. In the event that the rate of reduction of the foreign reserves continue, Yemen will not be expected to have sufficient foreign reserves just to cover its food imports alone during the next two years. Unless Yemen finds an alternative way. Perhaps the regional external support is a short term recourse, especially as Yemen becomes a net importer of oil and oil derivative products by 2015, unless new oil discoveries are found which may change these projections.

III. Rise of Poverty and Unemployment

Although the official number indicates a reduction in the percentage of the numbers of poor people living under the poverty line to 34.8% in 2005, which is a lesser percentage than previous indicators which exceeded 40% of the population. However, the fact is according to what one of the foreign reports stated, and as noted by the World Bank reports on the effects of the world financial crisis on the poverty levels, that the rate of poverty rose 7% between 2005 – 2008, and that about half the population of Yemen are living below the poverty line. It should be noted that the Human Development Report for the Arab countries for 2008 issued in Beirut in 2009 indicates that percentage of people living in general poverty in Yemen comes to 59.9% of the total population, based on US \$ 1 per day per individual. With respect to unemployment rates these are also continuously rising, especially among youth and that the official figures, which point to unemployment rates of about 17%, and the unemployment among youth is 52% cannot be relied upon. Many of the objective reports indicate that the overall unemployment is between 35% - 40% of the labor force, that the unemployment rate among youth probably exceeds 60% and that most of the unemployed are people with

educational qualifications, especially graduates of secondary schools, technical institutes and universities. The latter comprise about 25% of the total unemployed. Based on the foregoing, this situation provides an army of the unemployed, who could be hit with despair and a feeling of depression, which could lead some of them to paths of uncertain consequences, whether at the individual and family level or for the society as a whole.

IV. Population Challenges

Population challenge is exemplified by the increase of population growth by a rate of 3.1% per annum, the age structure of the population, whereby the under 15 years old age group comes to about 10.5 million and the age group from 15 – 29 years old is around 7.3 million people. This means that about 18 million people are below the age of 30 years old, constituting about 75% of the total population, which is about 24.3 million people, based on the population projections of the WB, and the UNDP of April 2009. This indicates that the Yemeni society is a young society with a pyramidal base, a situation that requires a large increase in health and educational services, and more job opportunities. The population base of the economically active is growing, by rates that exceed the employing capacity of the national economy. This would lead to increasing the number of unemployed in the forthcoming years, raise the dependency rate considerably higher. This is in light of the continued poor state of the existing infrastructure services, and the limited financial resources. At the basic education level, we find that 46% of school age Yemeni children. The rapid growth in the number of targeted children who must enroll in schools will lead to an increase in the percentage of children who are not enrolled in schools. So the population, educational, health, unemployment and poverty problems requires the implementation of integrated national population strategies for all sectors; otherwise, the scope of the problems will continue to increase.

V. Water Scarcity

The primary challenge is the rising demand for water in light of the expected depletion of underground water during the next thirty years, based on the current water extraction rates. The other challenge is the limited financial resources available with the society to face up to the problem and for the provision of water from other alternative sources such as by desalination of sea water and transporting water from distant basins in Hadhramaut Governorate. Both methods are costly and are not solutions for the mountainous areas or for the purposes of irrigation. In the meantime the contributions of the agriculture sector to GDP is reducing to 14% over the last ten years instead of the 20% contribution in the previous ten years thereto. The contributions of water to GDP in agriculture are estimated to be about 35%, which means that the contribution of the water used in agriculture to total GDP is not over 6% as official figures indicate. However growing qat takes up about two – thirds of the cultivated land area for the other cash crops and about 40% of agriculture GDP and provides jobs for more than 15% of the total work force, which makes qat growing a vital sector of the rural economy. On the other hand, the cultivation of qat constitutes increasing pressure on underground water and most of the other crops accordingly.

The scarcity of water, the fluctuating rainfall frequency, drought and desertification factors adversely affect agriculture and rural life in general, besides the exacerbation of the food security crisis. This adds to increasing the domestic migration rates, especially to the major

cities, which adds more to the poverty cycle and to the social fragmentation and the deterioration of livelihood. Besides this, there is the deterioration of health conditions, the exacerbation of deprivation and destitution within the society. Yemen's only escape from all these social and economic challenges is no other way except to mobilize all efforts and resources, as well as the anticipated foreign support in order to face up to the existing and increasing challenges. This is in order to be able to confront the current and increasing challenges, through development programs that work towards overcoming these challenges and achievement of the MDG, even if later than the set MDG date of 2015.

VI. Infrastructure and Millennium Development Goals

Yemen suffers from a weak infrastructure and unsuccessful attainment of the MDGs. The government has set forth its financing needs from donors, in order to attain the MDG, at US \$39 billion, within the context of a five – year program, in which total public expenditures amount to US \$ 48.4 billion. This situation shows that the ability of Yemen to achieve MDGs is primarily linked to the extent that the donors will respond to providing the required financial resources. On the other hand, it is also tied to the extent of the ability of the Yemenis to overcome the political, security and institutional challenges that stand in the way of the inflow of foreign resources, which add to complicating the domestic situations, and adversely affect the investment and business environment in the country.

VII. Existence of Good Governance

The lack of good governance leads to widespread corruption and weakening of institutions, besides the weakness of infrastructure. This situation is the major reason for the retraction of investments and slow economic growth. The modest foreign investment rates are attributed to the lack of the appropriate organs which support economic growth, and to remove the constraints that hinder private investment. The recent reforms undertaken were limited and were unable to attract private foreign investments. Investors are cautious apprehensive of the prevailing climate, as corruption increases the cost of investment projects and lowers their productivity. This compels many companies and corporations to make payments to avoid complications and the various administrative procedures. Good governance, in contrast, increases investments and their productivity, and accordingly raise the rates of economic growth. This would be under an improved ability of government organs in securing the appropriate investment environment and providing better quality and less costly services to investment projects. An example of this is electricity supply service, the recurring outages of which increase production costs of investment projects by 4% of total costs. Good governance similarly provides the rest of the infrastructure services, and provide the human capacities and skills, the lack of which constitute an investment constraint. Countries that suffer from mismanagement, due to lack of good governance are less capable of providing public commodities and services. Besides, the quality of such services is usually poor and they are generally costly. This adversely affects economic growth. On the other hand, good governance regimes are more susceptible to accountability. They also have open economies, flexible markets; they add confidence levels and reduce doubts; and such regimes ensure that rights are guaranteed and risk levels are minimized.

The quality of governance has a critical impact on economic growth and investment rates. Local

and foreign investors are facing many constraints in the market represented by complicated procedures, lack of transparency in contracts and tenders and the existence of intermediaries and partners for “protection”. Added to that the land problems, poor financing capacities of the banking system and the many obstacles that stand in the way of finding and establishing new enterprises. However, when the economic and investment policies are ineffective and perhaps even constraining, this sets a limit to the ambitions of companies and businessmen, and compel them to make critical decisions to turn to other directions and towards other countries wherein they will find better climates for their investment projects.

Yemen and the Gulf

Yemen is the southern gateway to the Arabian Peninsula, and shares a common religion, language and history with the rest of the states in the Peninsula. The security interests of the Arabian/Persian Gulf states are of the highest importance currently with respect to the relations of those states with Yemen. With respect to Yemen, the top concern of its relations with the states of the Gulf are the economic interests. The position of Yemen is vitally strategic for world trade, for oil producers and for oil consumers, since it overlooks the Bab Al-Mandab Straits, through which pass three million barrels of oil per day and 12 thousand commercial ships per annum. Besides, the southern position of Yemen along the Arabian Sea, which is a possible solution to avoid the threat of the closure of the Strait of Hormuz, in light of the possibilities of war breaking out between Iran and the major powers because of the nuclear issue and their respective strategies in the area. This could be by means of an agreement to lay a pipeline from the Eastern areas of Saudi Arabia and other oil extraction areas in the Gulf states to the Yemeni coasts along the Arabian Sea.

What Yemen wants from the Gulf states is to boost the economy, whether in terms of aid to Yemen or in other terms, especially the absorption of Yemeni labor in the labor markets of the Gulf. Yemen also desires for the inflow of private Gulf investments to Yemen, not to mention attention to increasing commercial trade between Yemen and the Gulf states, which is in favor of the Gulf states, although it is not significantly important economically for the latter.

As Yemen faces several significant challenges, the most prominent of which includes the economic challenge, looks continuously towards its neighbors in the Gulf, in order to improve its deteriorating economic conditions. Gulf state assistance to Yemen, led by official Saudi assistance is one of the most important sources for financing development projects in Yemen over the last four decades. The Yemeni expatriate remittances in Saudi Arabia and the rest of the Arabian/Persian Gulf contributed considerably in raising the standard of living of Yemeni citizens. It is still so, during the same period, especially from 1975 – 1990. This makes Yemenis reliant on the Gulf states to assist in reducing the severity of the economic crisis, at the official level by increasing the size of the official assistance to Yemen, and at the level of the people, by means of opening up the labor markets in the Gulf states for Yemeni labor. The number of such labor force can reach up to two million workers, which can be taken up by the Gulf labor markets over a few years. This would be if their entry was facilitated and offering them special advantages than those granted to other expatriate laborers, by means of waiving the need for a guarantor, reducing the visa fees, and not allotting them second/subordinate ranking. They should be allotted the right to employment, if they have competitive technical requirements. The latter would require implementing broad joint training programs

between Yemen and these states for the purpose of raising the qualifications of Yemeni laborers, who are facing severe competition from highly skilled Asian laborers technically. The latter also accept lower wages compared to Yemeni workers in general. In this respect, the absorption of considerable Gulf investments in Yemen, could be a better solution for the Yemeni laborers, not to mention that these investments would be an important factor in accelerating the mode and increasing the volume of investment activity. It will lead to significantly increasing the rates of economic growth, even though these investments are confronted by several factors that curtail their inflow to Yemen, of which the most prominent is the weak infrastructure and the increasing security challenges.

Currently, the relations of Yemen with GCC member states has taken on more significance; therefore, it is likely that relations with GCC members will be based on the significance of geographical neighborliness, in order to build an effective fruitful partnership that will be of benefit to Yemen and the GCC members. By means of establishing more effective relations between Yemen and the GCC members, the security and stability of the region shall be the primary premonition of the region, besides the economic gains for Yemen which will make Yemen more stable. This is the expected course for building a strong and sustainable partnership between Yemen and the GCC countries.

National Comprehensive Reform System

All Yemenis, led by the country's decision makers, must work to draw up the future map that will lead to release of potential capacities and will allow for the realization of positive accumulations of achievements at all fronts. It will turn the current situations to constructive trends and favorable climates, out of which another new different and happy Yemen could evolve that is not in anyone's mind currently. This could only occur by means of a comprehensive national reform agenda that will enable Yemen to overcome the different challenges, with the realization of good governance at the top this national reform agenda, meant to provide the suitable climate for accelerating economic growth.

The National Reform Agenda required may be set out as follows:

I. In Area of Good Governance

1. The achievement of a good governance regime and carrying out comprehensive institutional reforms.
2. Achievement of Sound Management .
3. Provide Security and Stability.
4. Prevalence of Law and Accountability and Transparency.

II. In the Area of Financial and Economic Reforms

1. Achievement of Transparency Standards in Different Stages of Budgeting .
2. Reform of Budgeting Management/Department.
3. Rationing Public Expenditures.
4. Control and Development of Public Resources of the Government.
5. Search for Revenue Alternatives for Achieving Fiscal Sustainability.
6. Increasing Development Expenditures to mitigate Poverty.
7. Control and Maintain Budget Deficit at a Safe limit.
8. Achievement of Tax Reforms by Means of:
 - Development of Tax Management and Achievement of the Concept of Selection/ Discretion with the Staff.
 - Raise the contribution/share of tax revenues to Public Revenues.
 - Spread the Tax Collection Base.
 - Exploit Potential Tax Capacity By Development of Partnership with the Private Sector.
 - Use Progressive Income Taxation More Often and Exempt Low Income Earners from Tax.

- Find an Efficient System of Calculating the Prices of Imported Goods and Merchandise.
- Increase Customs on Luxury Cars and Luxury Goods Used by High Income Earners.
- Increase Taxes Collected from Higher Earners and Property Taxes.
- Increase Tax collections from qat.

III. Trade and Banking

1. Increasing Competitiveness of National Economy and Development of Exports.
2. Creating a Compatible Structure for Participation of Private Sector.
3. Set Up an Export Financing Corporation.
4. Facilitate Business Performance.
5. Simplify and facilitate Business Start – Ups and Shorten Time for Completing Procedures.

IV. Banking

1. Reform Monetary Regime and Improve Efficiency of Banking System.
2. Reform Banking Sector and the Law for Development Plan Implementation.

V. Prevalence of Law

1. Achievement of Full Independence of Judicial Organs and Completion of Legal Framework of the Courts.
2. Development of the Institutional and Regulatory Structure.
3. Activate the Role of Judicial Inspection.
4. Reduce time needed to complete litigation.

V. In the Area of Public Administration and Civil Service

1. Modernization of Civil Service and Restructuring the Government Organs and Institutions Based on a Comprehensive Strategy That Fulfills the Tasks and Modern Inclinations of government.
2. Review of Organizational Structure and Job Descriptions.
3. Enhance Capacities of Government Training Institutions.
4. Improve the Efficiency of Human Staff in Government Organs and Increase the Minimum Wage to Make It Above the Poverty Line.
5. Attract Qualified Staff By Adopting Competitive Wages to Market Wages, Perhaps Leading to Provision of Suitable Quality Services to the Public and Achievement of Production Efficiency.
6. Set Forth the Overall Remedies of Surplus Manpower Based Upon a Comprehensive and Accurate Data Base on Civil Service Manpower.

VI. In the Area of Investment

1. Increase Investment in Infrastructure.
2. Focus on Development of Promising Sectors.
3. Achievement of Integration and Coordination Between General Government Budget and Economic and Social Development Plan for Poverty Reduction (Five Year Development Plans).
4. Review of Laws Associated with Improvement of Investment Environment.
5. Development of Partnership with Private Sector and Enabling the Latter to Lead the Development Process and Effectively Contribute to Drawing Up Economic Policies

VII. Mitigating Poverty and Unemployment

1. Give Priority to Labor Intensive Investment while Focusing on Rural Areas.
2. Broaden the Social Safety Net and Increase Amounts Paid to Poor Families.
3. Enlarge Financing of Small and Micro Enterprises and Simplify Access of Poor, Especially Poor Women to Such Financing.
4. Development of Human Capacities of the Poor.
5. Achievement of Food Security.

VIII. In the Area of Population

1. Change Population Growth to Human Development.
2. Focus on Labor Intensive Infrastructure Projects.
3. Achievement of Partnership Between the Government and the Private Sector and Local NGOs.
4. Expand on Small and Medium Term Loans to Include Large Groups of the Society.
5. Increase Loans Provided to Rural People and Facilitating Their Access to Them; Development of Rural Areas Alongside Development of Typical Productive Sectors, Not to Mention Creation of Job Opportunities.
6. Increase Support to Small Enterprises of Women and Youth.

IX. In Area of Improvement of Loan Absorption Capacity

The improvement of the institutional capacities of government organs concerned with the implementation of projects financed by foreign lending, will only occur if comprehensive institutional reforms are accomplished. These could provide the essential circumstances and conditions for the success of all the different government work and activities. Besides, the Government should work to consult with development partners, donors, private sector and civil society to ensure the implementation of the aspired development goals and increasing absorption capacity. This would be by means of:

1. Developing and diversifying the project implementation mechanisms.
2. Establishing a specialized fund or specialized funds for implementing projects financed by donors under their supervision.

3. Allocating fund according to specific agreed upon annual programs.
4. Setting up a mechanism for following donor financed programs, which would be a technical consultant for proposing recommendations and solutions, which would smooth down difficulties, that cause the delay in the implementation process.

X. In the Area of Water

There is no doubt that Yemen is deemed to be one of the 10 water poor countries of the world, because of the lack of financial resources for desalinating or transporting water. The problem becomes more complicated because of the limited ability of the society to find solutions to the water problem (Seminar of Scarce Water Resources and Limited Time). The size of the problem could be reduced by means of the following solutions:

1. Abandoning irrigated agriculture as much as possible and depend more on rainfed agriculture.
2. Increase dependence on private sector for providing water.
3. Resettle population, especially those living in the highlands and encourage their migration to the coastal areas and the main cities.
4. Expand on economic activities that are reliant on limited water.
5. Improve the economic returns from water use and increase the value added from crop cultivation.
6. Government should stop adopting wrong policies and work to achieving sound management of water resources.
7. Increase irrigation efficiency in Yemen and raising it from 40% to 90%, by means of using modern irrigation techniques.
8. Turning towards using assumed waters as secondary choice that will help in solving the water problem, by means of importing products from overseas, but this matter is contingent upon the economic capability.

XI. Yemeni Labor in Gulf Markets

1. Adopt flexible policies to absorb Yemeni labor and provide them with relative advantages to other workers.
2. Contribute towards improving and training the human capabilities in the Yemeni labor market to meet the needs of the Gulf labor market.
3. Exempt Yemeni laborers from the Guarantor requirements.
4. Give priority to Yemeni laborers in employment in service sectors and construction and building industries, and other sectors that do not require skilled laborers.

I. The Effect of Monetary Policy on the Business Environment

The elements of monetary stability which the Central Bank of Yemen aims to achieve are the general stability of prices, exchange rate and regulation of local liquidity in keeping with the requirements of actual economic activity.

Yemeni monetary policy passed through several transformations, through which the missions of the CBY evolved from having a simple role, which was to issue money and to regulate the banks. It should aim at development that goes beyond the aim of achieving monetary stability to contributing to support economic growth by means of financing the public budget deficit, influencing credit policies of banks by means of selective measures, directing credit towards specific sectors and setting ceilings on interest rates, which banks should not exceed. All these measures adversely affected the business environment and the optimum allocation of resources.

Since 1990, until the beginning of the implementation of the economic reform program, the CBY has not used recognized monetary policy mechanism, other than the legal reserve percentage requirement. Therefore monetary policy during that period was characterized by blundering, spontaneity, and ineffectiveness. The CBY lost its stimulating role in controlling and monitoring the monetary base and consequentially its ability to control money supply. This led to instability and the policies on exchange took on a frozen state and thus led to price distortions and the valuing system until the inflation rates reached record levels in 1994.

The actual implementation of the economic and financial reforms began in March 1995, of which Phase I included the monetary and fiscal reforms, in order to enhance the role and effectiveness of monetary policy.

The monetary reforms were in the form of freeing interest rates. This made the effective interest on deposits higher than the rate of inflation. Exchange rates were freed and the legal reserves were reduced on deposits. Similarly, treasury notes were issued in order to absorb liquidity surplus with the banks and individuals on one hand and to finance the public budget deficit by a non-inflationary mechanism on the other hand.

1. Monetary Policy During the Period (2001 – 2009)

Within the context of the economic and financial reforms, the CBY undertook several monetary reforms. It was intended to achieve monetary stability on one hand and to work towards preparing the banking structure, by means of improving the Yemeni banking system, from both an institutional and qualitative aspect on the other; in order to enable the system to carry out its role in serving the Yemeni economy. In order to achieve these objectives a set of banking legislations and laws were issued, of which the most significant are as follows:

- A) Requiring banks to increase their capital gradually, so that by 2009 they have reached YR 6 billion and to establish provisions for bad debts, in accordance Basel II.
- B) Issuance of law for the establishment of a deposit insurance corporation and for combating money laundering, and revision of Islamic Banking Law. This comes within the context of modernization of banking legislation.
- C) Issuance of Financial Leasing Law and the Electronic Banking and Automatic Teller Machines, in order to improve banking services.
- D) To benefit from the experience of foreign banks, the CBY should issue licenses for branches of foreign banks.

2. Money Supply

Money supply growth was characterized by volatility rising and falling during the period 2001 – 2009 with the rate of growth of 18.7% in 2001. The highest percentage growth occurred in 2006, where it reached 27.7% and in the last three years the percentage growth continued to fall until it reached 10.7%, which is the lowest percentage rate of growth of money supply since the beginning of implementation of the economic and financial reform program.

Table 1
Monetary Stability and Exchange Rate 2001 - 2009

	2001	2002	2003	2004	2005	2006	2007	2008	2009
Increase in Money Supply	18.7	18	20	13.9	13.7	27.7	16.8	13.7	10.7
Real Growth in GDP	5.9	5	5.8	4.6	5.2	4.6	4.7	4.5	4.7
Monetary Stability Coefficient	3.2	3.6	6.5	2.9	2.6	6	3.6	3	2.3
YR/US\$ Exchange Rate	168.7	175.5	183.5	184.8	191.4	197	198.9	199.8	202.9
Increase in Exchange Rate	-	4	4.6	7	3.6	2.9	9	5	1.6

Source: CBY, Banking Monetary Developments, May 2010, Annual Statistics Book -

The data on Table (1) indicates that the continuation of the state of monetary deficiency, with money supply growing by a rate that is far above Real GDP Growth, with the Monetary Stability Coefficient being 3.2 in 2001, whereas the same coefficient was about 2.3 in 2009, which was the lowest during the period. This resulted in the incompatibility of money supply to the requirements of the size of the transactions in the domestic market. Accordingly this results on increasing inflationary pressures that in the end lead to the reduction of the local currency, the Yemeni Riyal. Notwithstanding the chart, the lack of monetary stability adversely affects the business environment, thus creating doubts with the local and foreign investors, and the latter would accordingly be unable to confidently decide due to the caution about future expectations and lack of certainty. Eventually this leads to reduction in local and foreign investments.

3. Effectiveness of Performance of Monetary Policy Mechanisms

The Central Bank of Yemen uses a set of tools in managing and implementing CBY monetary policy. CBY monetary policy primarily aims to achieve monetary stabilization, which is the most important pillar for a conducive environment that will attract local and foreign investments, considering that this is the major engine for economic activity.

As Yemen proceeded with the implementation of an economic and financial reforms program since 1995, CBY used some of the typical recognized monetary policy tools, while some others were created anew by the Yemeni banking system, which is the open market mechanism, in which new financial instruments were used; i. e., Treasury Notes (TN) and Certificates of Deposits (CD).

Table 2
Some Monetary Policy Indicators and Mechanisms During the Period (2001 – 2009)

	2001	2002	2003	2004	2005	2006	2007	2008	2009
Legal Reserves on Deposits	10	10	10	10	10	10	10	10	7
Legal Reserves on Foreign Currency Deposits	10	10	20	20	30	20	20	20	20
Indicative Interest Rate (Deposits)	13	13	13	13	13	13	13	13	11
Lending Interest	15-21	15-21	15-21	15-21	15-21	15-21	15-21	15-21	15-21
Percentage of Commercial Bank Investments in TN and CBY Balances to Total Deposits	22.8	19.5	36	48.5	55.5	54.5	58	67	37

Source: CBY, Banking Monetary Developments, May 2010, Different Issues of Annual Statistics Book

A) Legal Reserves (Percentage)

The aim of using this tool is to grant the commercial banks more funds to provide more credit to the private sector. Although the percentage of reserve requirement was reduced on local currency deposits from 25% to 15% in 1996, then to 10% in 1997 until 2009, and on foreign currency deposits, the percentage of deposits for legal reserves was changed (between higher and lower) many times – see Table (2). However the goal of the CBY was not achieved due to two main reasons: (i) the Yemeni banking system is flushed with cash liquidity, which reaches in some years to 65% of deposit balances. Thus, no matter how much the CBY raises or lowers the legal reserves requirements, the effect that this will have is only a slight effect on the liquidity with banks. (ii) and this is a more important reason, is the reluctance of commercial banks to lend to the private sector, because of the problems that the banks encountered with bad loans, of which only a small portion could be repaid to the banks. This is due to the corruption in the courts and the long litigation procedures and thus the effectiveness of the reserve requirements tool on influencing money supply was quite limited.

B) Open Market Transactions

The aim of using this tool was for negotiating TN and other Government financial instruments, in order to absorb the surplus liquidity with the banks and confronting inflation on one hand. It was meant to finance the deficit of the Government public budget from a non inflationary source on the other, and to not to have to resort to issue newly printed money so as to create a stable environment, in which money supply grows in keeping with the growth of economic activity; and maintain the value of the national currency. This encouraged the commercial banks to invest in TNs, considering that TNs are a secure investment, and provide for a high level of liquidity, with the commercial banks investments in TNs, in addition to their balance with the CBY to approximately 44.5% of their total deposits on average during the period 2001 -2009. This is considered, by all standards, to be a high percentage of deposits. Supposedly, a significant percentage of bank deposits should be directed to loans and credit facilities for the private sector, so the latter can increase their investments, which are considered to be basic pillars upon which the development process rests. See Table (2).

Therefore the influence and effectiveness of this monetary tool is limited, with respect to such tool being an instrument of monetary policy. This is in view of the large amount of liquidity available outside the banking system, and thus the amount of liquidity held by banks is only affected to a limited extent. Accordingly this tool also had a limited effect on money supply. On the other hand the Government was crowding (competing) with the private sector for the resources of the banks, which are originally limited anyway.

C) Rediscount Rate

The effectiveness of this tool primarily rests on the existence of a market for financial securities, and similarly on the banks holding a considerable portion of commercial papers within the investment portfolios of banks.

In light of the absence of a financial securities market in Yemen, of the limited amounts held by banks in commercial bills, then the effect of this tool on controlling credit and money supply is very limited in light of the limited CBY credit to the commercial banks, especially as a significant portion of these banks are foreign owned. Thus when these banks need liquidity, they resort to their overseas head offices. The remaining portion of commercial banks is flushed with cash liquidity, as previously mentioned. Thus, this tool's impact on money supply is limited, and it is here that monetary policy has lost one of its effective tools.

D) Interest Rates

The Central Bank of Yemen took measures that were to set the interest rates for debit balances of deposits (Stimulating Interest Rates), while the lending interest rates for credit balances on loans was left to the commercial banks.

The CBY worked to move the interest rates up or down, as required by economic conditions, from the start of implementing the economic reform program until 2000. The influencing interest rates remained fixed from 2001 to 2009, without changing. The CBY was seeking to achieve stability in the exchange rate of the Yemeni Riyal and to attract savings, keeping the interest rates on local currency deposits positive, so that there will be no resorting to foreign currency speculation or saving in foreign currency.

However the reality was a different situation, as there was clear fumbling when setting the interest

rates, and their subsequent changes. This led to monetary disorder, which reflected the lack of ineffectiveness of interest rates in influencing inflationary and deflationary monetary situations, especially in light of the high percentage of currency that is negotiated outside the banking system to the total money supply and the high current account deposits relative as a percentage of total deposits. This means that a considerable portion of money supply are not influenced by interest rates, because they only influence long term deposits and loans and credits. This means that their influence on money supply is limited.

In sum, it could be said: the problem lies in the ineffective way the CBY manages monetary policy by means of the various tools of that policy, and the clear lack of influence thereof on money supply, according to the economic data which are required for any phase of the different stages. Therefore, the monetary policy lost its clear influence, which was adversely reflected on the business environment and on local and foreign investment, because monetary stabilization provides a suitable and secure environment for investment.

4. Exchange Rate

The exchange rate of the Yemeni Riyal against the US Dollar witnessed significantly regular changes during the period 2001 – 2009, with exchange rate rising to US \$ 1 = YR 168.7 in 2001 until it reached YR 202.9 in 2009. The annual increase of the exchange rate during the period was about 2.1% per annum. See Table (1). It is worth noting that during that period, the high oil proceeds of foreign currency helped to stabilize the relative exchange rate, especially between 2006 – 2008. This enabled the CBY to intervene in the currency exchange market, and supply the market with its foreign currency needs, in the event of pressure on the demand for foreign currency. Therefore the monetary policy was characterized by its significant flexibility, especially with respect to absorbing the changes of the exchange rate in keeping with economic developments.

On the other hand, the exchange rate lost this stability during 2009, until Mid-August 2010, with the exchange rate reaching US \$ 1 = YR 240. This increase was accompanied by a considerable increase in the inflation rate, and thus the CBY was unable to maintain monetary stability as a result of sometimes following an unsound policy, as well as the combination of a set of factors, the most important of which are:

1. Poor control of exchange rate by CBY.
2. Reduced proceeds of foreign currency to Yemen, as a result of reduced oil production and also reduced international oil prices from the prices that preceded the financial crisis. In addition, Yemeni expatriate remittances from overseas also declined, and also the scanty foreign loans and assistance grants.
3. Rise of consumer demand due to the rise in seasonal demand, which also partially had an influence on the exchange rate.
4. Decline in interest rates for Yemeni Riyals to the point where the inflation rate was higher than the interest rate, and therefore the real interest rates were negative, which led to individuals buying foreign currency, so as to maintain the value of their savings, or they bought gold and durable goods and savings, which are known as the means of «hedging against inflation», which in the end led to the appearance of the «dollaring» phenomenon in the Yemeni economy again.

Therefore, this unstable situation adversely affects the investment environment and investment climate, because a stable economy helps to attract local and foreign investments.

II. The Effects of the Performance of the Banking System on the Business Environment in Yemen

The banking system acquires considerable significance in any society in view of the core function of the system in providing the savings instruments for individuals, distributes the available balances for lending and investment in the different economic enterprises.

The significance of the development and efficiency of the banking system lies in its positive effects on stimulating economic growth, by means of the ability of the system to select projects, monitor their performance and specialize in choosing the most feasible thereof, in order to use savings efficiently, and thus raise the quality of investment and accordingly increase capital accumulation.

The Yemeni banking system acquires significance, especially in light of the lack of other receptacles for savings to be funneled to, which are provided by capital markets. The banking system comprises sixteen commercial banks, of which four are Islamic banks, as well as one specialized bank, which is the Housing Bank.

1. The Situation of the Yemeni Banking System

There are a set of indicators and implications that could be helpful when evaluating the efficiency of the banking system in any society. These reflect the efficiency of the banking system or the latter's weakness in terms of performing its major role, which is to act as financial intermediary. The effectiveness of a banking system in carrying out this role depends on the extent of competition between the banks, the level of focus, the growth of the sector and the level of efficiency of the activities of financial intermediaries.

When considering the situation of the Yemeni banking system, we find that the level of concentration is very high, when measuring the concentration on the assets criteria. Three banks (Al-Tadhamon Islamic Bank, Cooperative and Agricultural Credit Bank, the Arab Bank Limited) held about 46% of the total assets of the Yemeni banking system in 2009. This concentration suggests the considerably low degree of competition between the Yemeni banks. This has an influence on the efficiency of their performance, and is adversely reflected on their ability to attract deposits, and on their lending and financing operations.

On the sizes of the Yemeni banks, they are significantly small, with the total assets of the Yemeni banks together amounting to about US \$ 8.3 billion in 2009, or at best the equivalence of the assets of one of the small or medium sized commercial banks in Europe or America. This of course considerably has an adverse effect on their financing performance.

Similarly, each bank is almost operating in isolation from the other banks, in view of the absence of an interbank market or any joint lending transactions worth noting. These banks only serve a limited group of the population.

In addition, the evidence suggest that Yemeni banks are not interested in providing loans or mobilize deposits. The Industrial Enterprises Survey results, which number 481 establishment, show that 53% of these enterprises do not have a bank account in any commercial bank, but rather rely on their own resources to finance their projects. Accordingly, the Yemeni banking system primarily concentrates its credit facilities to a limited number of establishments, which is evidence that confirms the poor efficiency of the role of Yemeni banks as financial intermediaries.

2. The Performance of the Banking System and Its Effect on the Private Sector

In view of the different weakness factors, which the Yemeni banking system suffers from, and its fragmentation in small entities, the poor role of finance intermediaries, high costs, the effects of which are adversely reflected in the performance of the banks of their primary function as financial intermediaries, which consists of two aspects (attracting savings and employing these savings).

In the resources side (attracting savings), despite the considerably high cash liquidity of the Yemeni banking system, however the effect is still limited, since most of the bank branches are concentrated in the capital city and the major cities. Therefore, there is a big potential to increase the mobilization of savings. This is a result of the low efficiency of banks in the first aspect of the role as financial intermediary.

Then comes the side of the use of resources (provide loans, credit and investments), which is the important side of the role as financial intermediaries.

There is a basic and continuous problem with the Yemeni banks, which is their lack of desire in providing loans and credit facilities to the private sector, this adversely affecting the performance of this sector, considering that it is the first engine for driving growth and development.

Table (3)
Indicators of the Total Deposits and Loans of Commercial Banks and the Investments of Islamic Banks for the Period (2001 – 2009)

YR Billion	2001	2002	2003	2004	2005	2006	2007	2008	2009
Total Commercial Bank Deposits	258.34	310.274	360.032	424.562	455.4	610.842	773.792	899.288	969.811
Loans by Commercial Banks to Private Sector	56.06	47.782	51.519	62.411	129.509	160.042	209.425	241.895	228.463
Percentage of Loans Given to Private Sector to Total Deposits	21.7	15.4	14.3	14.7	28.4	26.2	27	27	23.5
Total Deposits with Islamic Banks	50.606	74.511	109.949	149.988	184.574	242.991	279.571	336.753	400.159
Percentage of Investments to Deposits	46	52	49.5	52.9	50.6	42.4	53.8	47.1	45.7
Percentage of Deposits of Islamic Banks to Total Deposits of Banking System	16.2	20.3	24.3	26.3	28.9	28.5	26.5	27.3	29.7

Source: CBY, Monetary Banking Developments, Different Years, Consolidated Balance Sheet Developments of Banks, Different Years

The lack of desire of the banks to provide loans is apparent by means of the policies on the use of resources, which are followed by these banks, with the investments of commercial banks in TNs, in addition to the cash balances with CBY – other than the CBY reserve requirements, as a percentage of their total deposits come to about 45% on average during the period 2001 – 2009. The loans and credits given to the private sector, as a percentage of the total deposits of those banks came to about 22% on average during the same period. See Table (3).

However, a large portion of the remaining amounts of the total deposits of the banks are placed with banks overseas. This is proof that there is a significant deficiency in their financing structure, which involves misallocation and misappropriation of resources.

The major part of the reason for this deficiency is attributed to the very cautious credit policies, which are followed by these banks, especially the branches of foreign commercial banks, as they turn towards safe riskless investments (TNs, CDs), and a large share of the cash funds are deposited with the CBY. Therefore, these have become the major funder of the Government public budget, and abandoned its primary function of providing loans and credits to the private sector, the adverse effect of which was reflected on the movement of domestic investments.

Monetary policy, by all of its tools, similarly worked to compete with investors for the sources of finance in the economy, which are limited to start with. These matters were reflected in the retraction in the movement of investments of the private sector within the economy. This in turn will have negative results on the economic growth rates, especially since the private sector now has an increasing role and became an essential partner in the economic development process.

On the other hand, the Islamic banks constitute about 20% of the total number of units in the Yemeni banking system. However, the percentage of their investments to the total number of loans, credits and investments of the banking system come to about 39% during the period (2001 – 2009), although the percentage of their deposits to the aggregate deposits of the banking system on average was about 25% during the same mentioned period/ This demonstrates that the Islamic banks are more efficient and more prone to invest their deposits, and are better contributors to financing the projects of the private sector. Therefore, they contribute to the stability of the business environment and are an attracting factor to investment.

3. A Future Vision for Improving the Efficiency and Effectiveness of Monetary Policy and the Yemeni Banking System

- A. Monetary authorities should work to limit Money Supply, in keeping with the growth rates of GDP. This requires that the growth of issuance of new money should be through well studies rates.
- B. Review current banking legislation and issue legislation, which would introduce new models for banking such as joint funding, opening Islamic banking windows in the regular commercial banks,
- C. Ration the issuance of TNs in keeping with the surplus liquidity with the banking system, so as to reduce the surplus; work towards introducing new financial securities, in order to activate the tools of unemployed money. In this area, one can make use of issuance of the various forms of Islamic Investment Securities/Drafts, as an appropriate and efficient alternative to interest bearing securities.

- D. Remedy the bad loans problem by activating the specialized courts in this area and enforce the rulings of the Courts accordingly.
- E. Enhance competition between the banks in order to enhance their growth and make them more widespread.
- F. Develop the interbank lending market by creating a new mechanism for the CBY to regulate these transactions efficiently, under competitive conditions, so as to help the banks to manage their liquidity efficiently, also to help the CBY to improve the efficiency and effectiveness of monetary policy, as well sharing information between banks will serve their common interests, which would lead to an increase of transparency and clarity.
- G. In order to enhance the competence of the banking system, and to have the system play a more effective role in mobilizing and allocating financial resources in favor of the private sector, the CBY should compel the commercial banks to set specialized departments for evaluation of projects that are in need of financing. The evaluation of securities offered by projects has been based on a personal evaluation only, and not reliant on objective basis in many of the banks.
- H. In order to enhance the efficiency of the banking system, the CBY should set up strict measures of Boards of Directors members, as many of them are obtaining large credit facilities from the relative banks, especially overdraft facilities. As such, they are using the funds of depositors for their own personal benefit, while at the same time they restrict the facilities provided to other possible successful projects. The evaluation will be subject to personal issues rather than an objective assessment of the projects. This leads to constraining the investment environment and accordingly constrain development within the society.
- I. Improve banking services, by means of encouraging the banks to provide new banking services, and improve the efficiency of the employees of the banking system through training courses, so they gain the necessary skills and capabilities to be able to carry out the new transactions.
- J. Encourage the merger of smaller banks into larger units to enhance their competitive abilities, especially in light of the liberation of the services industries, including the financial and banking services.
- K. Change the current structure of interest rates, with the possibility of offering preferred interest rates for certain projects, based on specific criteria to be agreed upon with the banks, such as the projects with high export potentials, which employ more workers, in small and medium industries, which produce import substitution products.
- L. The CBY should improve the qualifications of its employees, or obtain better qualified staff from outside the bank, train these staff locally or overseas in order to be able to help the bank implement and follow up on the monetary and credit policies and to achieve an effective banking control function.

- M. Speed up the creation of a financial market in order to mobilize national savings, and also to finance the sectors that have a shortage of cash liquidity. The market will also work to attract funds from overseas, in particular the savings of the Yemeni emigrants. Thus the CBY will be able to use the financial securities effectively in the market.
- N. With the existence of a money market, similarly banks and insurance companies will be able to set up investment funds. These funds should work to link national savings with the financial securities market and enable small investors to invest in financial securities, etc easily and with little hardships, and thus they will considerably solve the financing problem, which local businessmen and investors are facing.
- O. The CBY should work towards providing an incentive system for commercial banks, which provide loans and credit facilities to projects and companies that operate in successful commercial activities, which absorb large numbers of workers, and also to owners of small and micro enterprises, by means of reducing the legal reserves on bank deposits to banks that respond with these incentives, whether they are commercial banks or Islamic banks.
- P. With a view towards motivating banks to give loans to the private sector, the CBY should set up a joint fund for which the required funds are collected by means of transferring a certain percentage of the legal reserves of bank deposits. The primary function of this fund is to compensate the banks in the event that unsuccessful projects are unable to repay their loans. They should be taking strict control measures for providing loans, in terms of collecting all the complete information on the enterprises that are applying for the loans and their operations; setting up standardized criteria for sound accounting and auditing, that all enterprises should apply, so as to spread an air of confidence with the banks on the financial position of their clients.
- Q. In order to achieve monetary stabilization, the CBY should use a deflationary monetary policy, with the aim of reducing inflation rates, enhance the stability of the exchange rate. This should be paralleled with raising the internist rates of the monetary tools of the CBY (rediscount rates, open market operations). This would be with the aim of creating a flexible and suitable interest pricing structure that is consistent with the domestic economic conditions and the developments with world interest rates; i. e., the effects on interest rates should not be direct, and this would lead to response of the banks with the policy that the CBY takes, so they will raise interest rates when the CBY raises them and lower them as long as the CBY wants them to be lower.
- R. In order to enhance monetary and economic stabilization and since the budget deficit is financed by TNs, which is not inflationary, the average growth of money supply is in agreement with the growth rate of the economy. Economic activities is monitored by the CBY on a quarterly basis, so if the economic growth rate achieved is more than was expected, the CBY can change the growth of money supply, in response to that rate. Thus the CBY can control the rate of inflation, and therefore there will be relative stability of prices. In this case, the investment environment will be suitable and stable to a considerable extent and will be a factor for attracting domestic and foreign investments.

I. Investment Situation in Yemen

The private investment situation in Yemen indicates that it is the modest in terms of size, especially as the different economic plans have sought to achieve considerable increases in total investments in the economy. In view of the increasing economic importance of the private sector, it is therefore expected that the sector's investment to rise in light of the economic reform policy adopted by the government in the Mid Nineties of the last century. The Economic Reforms Program focuses on increasing foreign capital inflow, and any accompanying modern technologies and stimulating local investments, considering that the latter is as an essential pillar to drive the wheel of economic growth.

The basic objectives of the economic reforms included the provision of a suitable investment climate, in view of the positive role of the latter in improving incomes and reducing unemployment. The future of economic growth rested on achieving this climate. However evidence suggest a noticeable retraction of the importance of private investments relative to total real investments, in view of the modest growth rates of such investments during the period 2003 – 2009, which is demonstrated in Table (4) below.

Table (4)
Developments of Private Investments in Yemen (2003 – 2009) (YR millions)

	2003	2004	2005	2006	2007	2008	2009
Real GDP	2,067,701	2,163,551	2,274,736	2,380,299	2,491,775	2,604,037	2,726,529
Private Investments	209,200	226,400	241,100	216,600	249,200	255,200	250,800
Private Investments/GDP (%)	10	11	11	10	10	10	9
Total Investments	405,300	439,200	420,800	390,400	428,600	440,100	422,600
Private Investments/Total Investments (%)	47	52	57	56	58	58	59
Average Growth Rate of Private Investment	-	8	7	(10)	15	2	(2)

Source: Central Statistics Organization, Annual Statistics Book, 2009 –
Ministry of Finance, Government Financial Statistics, 2009

From the above table, we can note an increase in private investment from YR 209.2 billion in 2003 reaching YR 250.8 billion in 2009.

However the annual growth rate of private investments fluctuated during the period, coming to an average of only 3%. This indicates a retraction of the relative significance of private investments as a percentage of GDP from 10.5% in 2003 to 9.2% in 2009.

Aside from this, the relative importance of private investment to total investment increased from 46.7% in 2003 until it reached 59.3% in 2009. However, it still did not reach the aim sought by the Third Five Year Development Plan (2006 – 2010) - DPPR III, which anticipated an increase of private investments to that goes up to 62% and the increase thereof relative to GDP to about 16.5%.

1. Registered and Implemented Private Investment Projects during the Period (2001 – 2009)

All countries, without exception, seek to attract direct foreign investment and accompanying modern technologies and technical and marketing expertise. Yemen is a country also seeking to attract direct foreign investment, by means of providing an appropriate investment environment and also through tourism promotion.

The number of licensed investment projects registered with the General Investment Authority during the period 2001 - 2009 was about 3,176 projects at a total investment cost of about YR 20,020,032 million. These investments provided about 106,767 job opportunities.

The projects executed by economic sector during the same period numbered 1,987 projects, which provided 74,851 job opportunities, and were at a total investment cost of YR 1,436,585 million as shown in Table (5) below.

Table (5)
Executed Investment Projects By Economic Sector During the Period (2001 - 2009)

Annum	Industrial Sector	Agricultural Sector	Fisheries Sector	Service Sector	Tourism Sector	Total	Job opportunities	Investment Capital (YR Millions)
2001	116	77	9	35	34	271	6,203	70,594
2002	123	49	10	50	36	268	10,082	2,306,094
2003	115	25	1	28	25	194	6,164	917,117
2004	107	16	1	42	27	193	11,554	926,969
2005	117	8	3	35	29	196	8,046	1,188,843
2006	115	20	4	40	36	215	6,435	1,341,047
2007	154	28	6	49	39	276	11,036	2,305,185
2008	106	22	2	61	38	2,299	9,518	2,518,768
2009	61	19	1	41	23	145	5,813	2,155,886
Total	1014	264	37	381	287	1,987	74,851	14,365,849
Percentage	51	13.30	1.9	19.2	14.4	100		

Source: General Investment Authority, the Level of Implementation of Investment Projects, Sana'a, 2010
The data of Table (5) shows the breakdown of investment executed by economic sectors during the

period (2001 – 2009). The industrial projects had the biggest percentage of these projects numbering 1,014 projects, comprising about 51% of all the projects during the period. This is attributed to the majority of the investments directed to that sector – except for the oil and gas sectors – are directed to food manufacturing, as a result of their high profitability and the short period needed for project capital recovery. The service sector projects follow with 381 projects and a share of 19.2%. Then comes tourism projects with 287 projects and a percentage of 14.4%. Agricultural projects are next to last in rank with 264 projects and a percentage of 13.3% and last ranking is the fisheries sector with about 37 projects and a percentage of 1.9%.

Source: Although the Investment Law stipulates that benefits and incentives for investors are the same for all sectors, however there is a considerable difference in allocation of projects among these sectors as noted. Also, notwithstanding the length of the coastline of the Republic of Yemen, which is rich in resources, fisheries projects did not attract the attention of investors. This is due to the lack of sound planning in investment promotion, which is supposed to direct greater attention to fisheries in Yemen.

2. Direct Foreign Investment

Notwithstanding the Government instructions seeking to encourage direct foreign investment, by means of amending the Investment Law of 1997, which would include a set of incentives, transform the role of GIA from merely an agency that issues approvals for setting up investment projects to a role that is more predominantly facilitator and promoter of investments. The foreign and local investors, however accorded a limited response. This indicates the existence of many and various constraints that stand in the way of having a suitable environment for encouraging the attraction of investments, whether they be local or foreign investments.

Table (6)
Developments in Direct Foreign Investments in Period (2001 – 2009) Amounts in YR Millions

	2001	2002	2003	2004	2005	2006	2007	2008	2009
Total Arab Investments	50,002	287,152	26,498	16,134	698,814	85,795	184,514	1,199,604	1,304,444
Percentage of Total Investments	0	0	0	0	49	29	7	31	42
Total Foreign Investments	6489.6	110.4	12055	82.5	248.4	1372.4	45949.7	4251.5	509.5
Percentage of Total Investments	7.10%	4.00%	11.30%	0.60%	2.00%	5.00%	16.60%	1.10%	2.00%
Total Direct Foreign Investments	114,898	288,256	38,553	16	701,298	871,674	644,011	1,238,555	1,309,538
Percentage of Total Investments	12.60%	11.40%	36.20%	12.20%	49.30%	29.50%	23.30%	31.8	41.70%
Total Direct Domestic Investments	795,688	2,242,136	679,596	1,164,267	721,992	207,930	2,128,963	2,655,805	1,836,354
Percentage of Total Investments	87.4	88.6	63.8	87.8	50.7	70.5	76.7	68.2	58.3

Source: General Investment Authority, the Level of Implementation of Investment Projects, Sana'a, 2010

Table (6) shows the modest size, as well as the fluctuation of investments, whether domestic or foreign over the period (2001 – 2009). In 2001 the total investments did not exceed YR 91 billion, but in the following year it reached YR 253 billion; in 2003, it declined by 150% from the previous year. During the rest of the period, however, there was fluctuation, rises and falls in the amounts of total investments until it reached about YR 314 billion.

The same table shows the rather modest amounts of direct foreign investments compared to the amounts of domestic investment, with the percentage of foreign investments (Arab and non-Arab) during the period (2001 – 2009) on average being only about 27.5% of all investments, whereas domestic investments amounted to 72.5% of total investments during the same period.

What is noticeable is that foreign investment (non-Arab) was on average about 4.1% only, which means that foreign investments in Yemen are very modest and marginal. This is naturally attributed to the economic, social and political situations, which reflected themselves on the investment climate, and the business environment, which is confronted by a set of real constraints, to which the government could not find solutions. These are real obstacles, which are a bottleneck that stand in the way of investors. They include, for example, but not limited to, deficiency of infrastructure – roads, transportation, electricity, communications, water and sewerage, ..., etc. taxes and customs that are in favor of fully manufactured commodities and products, and similarly for production inputs, which are locally produced.

II. Problems and Constraints of the Investment Environment in Yemen

In the Report on Business Environment, Yemen occupied a relatively advanced position, compared to the situation in 2008, taking the 98 rank in the general ranking instead of the 123rd rank. This progress in ranking came as a result of carrying out reforms in simplifying procedures for start up operations.

This, however, does not mean that there is improvement in the business environment, which would lead to attract more foreign and local investments, especially as Yemen is still far behind in the more significant indicators that considerably and effectively affect the business environment. This is attributed to a number of economic, social and political problems and constraints, with the following being perhaps the most obvious:

- A) Low income levels in public employment, which helps to bring about considerable corruption in the Government administrative apparatus, especially in the entities that are associated with the business environment.
- B) Some laws are intertwining and cross interfere with each other, which created some kind of conflict in the mandates of the different agencies.
- C) Lack of desire by the banking system to provide financing required for large investment projects, especially with respect to medium-term and long-term financing.
- D) Weakness and extended procedures of the Courts, which reduces the incentives for providing more loans by the commercial banks.

- E) Adoption of the concept of bargaining between tax collectors and taxpayers at the expense of due taxes, which wastes a lot of the time required to settle taxes. This is an additional cost element borne business owners.
- F) Continuation of and adoption of conflicting macroeconomic deflationary policies, which contributed to the limiting the effectiveness of liberalization measures and competitiveness of the national economy.
- G) Poor investment environmental and lack of suitable climate to attract domestic and foreign investments, which is exemplified by the lack of adequate studies and information on the investment opportunities, which investors would like to see available. Similarly, poor promotion and marketing of investment opportunities, advantages available to investors, as well as the poor quality of infrastructure services in the different investment locations, and in industrial zones also.
- H) Private Sector activities experience considerable constraints which stand as hindrances to achieving added value. This is due to the size of most of the projects/enterprises being either small or very large. Medium size establishments are, however, in modest numbers. Thus, large establishments are able to enter markets easily, and to solve the problems they might encounter, in terms of providing transport, distribution, training, and power services. In contrast, the small and micro enterprises, which are prevented from entering markets by the administrative constraints, or cause such entry to be very costly. This leads to higher production costs and accordingly less profits.
- I) Higher transaction costs for smaller and micro enterprises, in view of the weakness of the competence of the mechanism for implementing and lawfully enforcing contracts, as well as the difficulty of settling commercial disputes, which creates an environment in which lack of legal assurance prevails.
- J) Corruption is the major obstacle in the business environment in Yemen. It is deemed to be the biggest constraint standing in the way of profitable expansion of enterprises, as well as the other institutional and administrative hindrances related to taxes, commercial disputes, lack of assurance with respect to macroeconomic policies.
- K) Small enterprises face problems related with infrastructure, such as electricity supply, and also face the problem of easily acquiring land to set up any business. This compels business owners to pay large amounts of unofficial money as bribes to be able to set up their enterprises.
- L) Macroeconomic indicators are less stable in Yemen, such as the instability of inflation rates, lack of consistency in public revenues of the government, which are a result of fluctuations in oil prices, and fluctuations in the exchange rate. These indicators show lack of economic stability, which in turn reflected on the private sector by making them cautious, and cause them to delay their long term capital investments, and to turn to engage in short-term low-risk activities at the expense of more productive investments in the event of the existence of economic stability.
- M) Foreign investors look at the Yemeni taxation system as a very complex scheme, and as being characterized by corruption. This is due to the frequency of visits by tax authority

employees and sometimes officials to the offices of business establishments to collect the same due tax. The investor is left with the choice of recurrent payments of the same tax or paying a bribe to the tax collector. This is among the major constraints that confront the faces of foreign and domestic investors.

- N) Disputes over land are among the most complicated problems faced by investors from the private sector. This is in view of the considerable ineffectiveness and lack of clarity of the system for registration and proving the ownership of land, in addition to the slow and longevity of litigation procedures, and thus the solution to such disputes is deemed to be costly and time consuming in order to resolve land ownership claims cases. This is a considerable major constraint that is confronted in the business environment and faced by the private sector in Yemen.
- O) Private sector enterprises face complex regulatory and administrative procedures, when setting up large enterprises or expanding existing business. These complications can lead to withdrawal of investor halfway through the procedures or to forfeiting the renewal of annual licenses. This is in addition to the multiplicity of the agencies involved and the conflict of mandates thereof. The license issuing agency is not responsible for facilitating investments. This in turn stands as a constraint facing investments in the business environment of Yemen.
- P) Private sector enterprises face problems arising out of the poor infrastructure, such as electricity supply and transportation. There are still many areas that are not connected to the national electricity grid, and there are recurrent outages. In addition airports and sea ports are not completed, which affects the ability of manufacturers to export their products, not to mention the prevailing monopolists in the private sector to the transport vehicles through the transport syndicates system, and thus set up constraints confronting private sector enterprises entering the market.
- Q) Investors suffer from the lack of security in some areas, with the kidnapping of foreigners and the imposition of protection money by people of influence constituting a considerable constraint that limits the inflow of foreign direct investments to Yemen.
- R) There are also constraints that are attributed to the investors themselves, such as the lack of innovation of new investment projects in Yemen. Often the idea of projects would be associated with a commercial business already being undertaken by the project founder, and most of the existing projects are repetitions of typical models, as well as the neglect of preliminary study stages and the feasibility studies of projects, which are considered essential requirements for undertaking investment projects.

III. Future Vision for the Provision of A Suitable Environment for the Private Sector

1. The Yemeni government must exert a greater and ongoing effort to achieve economic stabilization, to involve the private sector in reviewing and regulating economic policy and government programs. It should be involved to present recommendations to be considered by relevant concerned entities in government, so as to enable the private sector (domestic and foreign investors) to plan for their future, in terms of the quantities of output for their enterprises and the levels of investments when prices have become stable.
2. Involve the private sector in presenting a vision, with respect to the legal problems and administrative constraints that stand in the way of investor in the private sector and to come out with results that work towards reforming the investment environment in Yemen.
3. In order to confront the issues of bribery and corruption in the taxation scheme, the government must carry out reforms and set up accountability procedures for the employees who are supervising private sector businesses, have their roles and responsibilities set out accurately. Mechanisms for accountability should be set in the event that they are violating of their responsibilities, in turn their salaries should increase so as to reduce their inclination to resort to bribery and corruption.
4. To speed up litigation processes and simplify litigation measures, the government, in collaboration with the private sector and donors, should set up a specialized commercial court that is affiliated with any court, with the judges chosen very carefully. This court should have jurisdiction to deal with the issues involving certain limits of financial amounts, provided that the fee schedule of this court should be higher than the general section of the higher court. Tthe decisions of this court shall be final and not subject to appeals, so that this court shall only deal with important and urgent cases.
5. To develop private sector activity, with respect to start ups, the government should designate all procedures related to obtaining information and issuing licenses and permits for starting or expanding an ongoing business in Yemen to GIA. This will help in attracting more investments.
6. In order to solve the problem of transport costs, and to obtain services at competitive prices, the government should set up a specialized authority for overland transport. It will be responsible for licensing transport vehicles, drawing up transport tariffs and fully regulate the transport sector.
7. The fisheries sector is a promising sector which is expected to yield good results, since it is one of the strategic alternatives to depleting resources, in view of the length of the Yemeni coastline, extending for 2,700 km and the diversity of the fish catch. The government should therefore encourage this sector, and draw up strategic plans for the sector, with respect to promotion, and how to exploit its resources through foreign investment or joint projects, which will encourage Yemeni investors to invest in storage, filling and packaging, marketing of fish and in boat services.

8. The government should speed up the establishment of industrial zones, since they are considered as a means to attract investments in the private sector, whether local or foreign, and to avoid the widespread conflicts over land, provide public services, at competitive costs. These zones may also be managed by the private sector, but only after the government has provided the required infrastructure for such zones.
9. The development of the required infrastructure for investment needs resources, which could be in excess of the available resources of the Government. Therefore, there is a possibility for an investment opportunity for the private sector, on a BOT basis. This type of system helps to attract investments in view of its simplicity and is used on broad basis in infrastructure projects, such as roads, bridges, tunnels, ports, airports, electricity and water supply stations.
10. The government should work towards strengthening the relations with Gulf Cooperation Council member states, in order to facilitate commercial trade, and to attract more investments.
11. The government should work strenuously in order to improve and modernize the investment climate in Yemen, by means of improving and strengthening infrastructure services. It should be extending road networks in the rural areas, improving operational performance of the electricity sector and to work towards finding and developing alternative sources of energy such as natural gas, solar and wind energy.
12. The government should work towards developing urban services to enhance the ability to compete in large cities such as Sana'a, Aden, Hodeida, ..., etc and enhance the partnership opportunities between the government and the private sector by means of exploring partnership opportunities, especially in electricity and port management.
13. Attention to technical and vocational education and training and prequalifying workers to work for industrial companies and other enterprises that require trained skilled and professional workers.
14. Enhance the potentials for economic growth, because it will eventually lead to economic stabilization, which in turn will lead to inflow of investments, whether local or foreign. In this respect focus should be on two very important and renewable resources, and maybe the suitable and optimal alternatives to depleting resources. These are the tourism and fisheries sectors, as well as the development of seaports, and duty free zones. This will help to enhance economic growth, if these resources are exploited properly.
15. The judicial system in Yemen is characterized by the underdeveloped courts, the long periods of litigation and the lack of enforcement of issued judicial rulings. Therefore, the situation here calls for the reform of the judicial regime, in terms of modernizing the courts and the judicial institutions. Similarly, the sound selection of judges based on general requirements with equal opportunity for outstanding candidates from specialized colleges. On top of that they should be trained and equipped with judicial and linguistic skills, and should go gradually through the appropriate grade levels until they reach the judicial bench. The current judges should also go through training courses that will improve their skills provided their salaries shall increase and they should undergo periodic evaluations in order to determine their judicial skill levels.

16. Develop the investment institutions, in order to introduce the investment opportunities available in the different economic sectors, and to be able to get the GIA to promote the latter and to undertake media campaigns, to set up exhibitions overseas, which would present a realistic situation of the investment environment in Yemen. This should be with the allocation of land and special zones for investment and these should be secured from illegal takeover by some of the influential dignitaries. This would be a factor of attraction of local and foreign investments.
17. Provide a data base on the Yemeni economy, which would be needed by investors, regardless of their nationality. The information should be documented and updated regularly, and such information should include a certain summary of the laws associated with the business activities of investors, such the Tax Law, Customs Law and Labor Law.
18. Enhance political and economic stability, since both are considered among the most important factor affecting business environments and the attraction of foreign and domestic investments. The response of local and foreign investors for all the elements that stimulate investment is weak, as long as the political and economic environment is unstable, therefore the situation calls for reforming financial, monetary and other policies, with a view towards achieving monetary and economic stabilization in order to stabilize prices and exchange rates for the national currency.

Foreign Trade, Export Performance of Non-Oil Commodities

(The Real Situation, Constraints and Recommended Solutions Introduction)

Foreign Trade plays an essential and pivotal role in boosting economic activities, and accordingly contributes to bringing about positive changes in development generally, and improving economic growth indicators in particular.

There is also a close relationship between increasing exports and increasing the economic development ratios; a rise in exports could never occur without the occurrence of both domestic and foreign investments. This means increasing economic activity, and thus achieving sustainable positive economic growth indicators.

Yemen gained a considerable reputation during ancient times, and occupied an outstanding place in world trade. The geographical location of Yemen overlooking both the Arabian Sea and the Red Sea, made Yemen an important link in the shipping routes which connected the different countries of the world, whether in both the continents of Asia and Africa or Europe.

Yemen also became famous in the past for exporting locally produced commodities, such as coffee, incense and other commodities, giving Yemen an international reputation.

I. Yemen Foreign Trade and the Performance of Commodity Exports

Foreign trade for Yemen currently is an important part of economic activity, as foreign trade takes up about 15% of GDP of Yemen. Yemen follows a trade policy that rests on trade liberalization. This is done in pursuit of compliance with World Trade Organization (WTO) membership requirements, even though such a policy does lead to deficiencies in the Balance of Payments.

Examination and analysis of the Balance of Payments of Yemen shows that about 90% or more of the value of exports is taken up by oil exports, whereas the value of remaining exports (including reexports) takes up about 10% or less. There is also a weakness in the base of non-oil exports. These constitute of a limited number of products, led by coffee and fish, which comprise the majority of non-oil exports. Nevertheless, the added value of fish exports are low when compared to those of other fish exporting countries. Exports of manufactured products are still similarly limited, compared to other states within the least income countries, with similar conditions to those of Yemen. The following shows the Yemen's Terms of Trade (Balance of Trade) for the period (2000 – 2009).

Table (7)
Yemen's Terms of Trade (2000 – 2009) YR Millions

Year	Imports	Exports	Reexports	Trade Balance
2000	375.8	351.6	45.7	283.8
2001	415.9	316.9	47.4	153.1
2002	523.0	521.6	45.2	72.9
2003	674.1	540.7	25.4	10.8
2004	736.5	659.5	21.8	17.1
2005	1029.9	731.8	33.9	44.7
2006	1196.8	1040.7	45.3	119.4
2007	1693.9	1270.9	41.9	437.5-
2008	2087.9	1438.3	80.8	-568.7
2009	1861.7	1225.8	44.3	-591.5

Source: Annual Statistics Books for 2009, Table (1)

As can be noticed, the Terms of Trade (TOT) was in Yemen's favor (surplus) for the years 2000 until 2006, however TOT was negative by a considerable deficit for the years, 2007, 2008 and 2009, as a result of the fall of oil prices. This demonstrates the deficiency of relying on one primary commodity to top all exports, which comprises 86% (as an average for the years 2006 – 2009) of the foreign currency proceeds of Yemen. Tables 2 and 3 show the Yemen's imports and exports broken down by the nature of the commodity.

Table (8)
**Percentages of the Quantities and Values of Imports
by Nature of Substance/Commodity for Period (2006 – 2009)**

Year Type of Commodity	2006		2007		2008		2009	
	%Quantity	% Value	%Quantity	% Value	%Quantity	% Value	%Quantity	% Value
Raw Materials	26.26	11.47	23.63	11.9	21.91	12.68	26.8	12.4
Semi - Manufactured	37.42	28.38	39.1	25.95	31.6	20.94	29.5	24.8
Manufactured	36.32	60.15	37.36	62.15	47.3	66.38	43.7	62.8
Total	100	100	100	100	100	100	100	100

Source: Annual Statistics Books for Years 2006, 2007, 2008, 2009

Table (9)
Percentages of the Quantities and Values of Exports
by Nature of Substance/Commodity for Period (2006 – 2009)

Year Type of Commodity	2006		2007		2008		2009	
	%Quantity	% Value	%Quantity	% Value	%Quantity	% Value	%Quantity	% Value
Raw Materials	90.23	89.51	86.0	84.63	83.79	84.9	88.1	87.3
Semi - Manufactured	1.9	1.76	2.13	3.09	2.57	2.33	1.9	1.5
Manufactured	7.87	8.73	11.87	12.29	13,65	12.77	10	11.2
Total	100	100	100	100	100	100	100	100

Source: Annual Statistics Books for Years 2006, 2007, 2008, 2009

We can see from the two previous tables that the Yemeni raw material exports comprised about 87% of the quantities and values of exports, where as manufactured goods led the quantities and values of imports.

It is worth mentioning that Yemen ranks very low in the world economy. This is clear from the size of the economy and its trade with the outside world.

There is a clear relationship between the foreign trade of Yemen and the basic characteristics of the economy. The international and regional impact on Yemen's trading relations with the outside world, From the foreign trade data, the geographical concentration of Yemen's foreign trade with the twenty leading importers of Yemeni exports. These took up more than 98% of Yemen's exports. Asian countries are at the top of these countries, with China leading the list of 20 countries by shares amounting to 21.52% 33.8%, for 2007 and 2008 respectively, then Thailand and India follows with 20.2% and 25.11% for the former and 16.6% and 8.34 for the latter respectively. In total, the Asian countries took up about 69.76% and 75.76% of Yemen's total exports for both 2007 and 2008 respectively.

However, for 2009, and based on the data on Table (9) of the Annual Statistics Book for 2009, the data appears to need revision by those who are responsible for preparing the Table, despite the Table's ranking of the top 20 importing countries from Yemen. It does not make sense that the top twenty importing countries of Yemeni exports take up 2,62% of Yemen's exports and the rest of the world takes up 97.38%, unless there is a mistake in these data. Therefore we will not point to them, or base any analysis on them accordingly. The Arab states (especially GCC countries) rank next with 11.63% and 14.23% respectively, with the United Arab Emirates leading the list of Arab countries by 6.09 and 7.89%.

However, with respect to reexports, which were about 3%, 5% and 3.5% of all exports for 2007, 2008 and 2009, the UAE took up 50.13%, 38.86%, and 33.7% of these exports, followed by the Kingdom of Saudi Arabia with percentages of 17.81%, 15.89% and 13.6%. Generally, the Arab States take up 70.9%, 63.51% and 59.75% of the list of reexports, with second rank going to Asian countries.

The same case applies to imports. The top 20 exporters to Yemen take up 82.27%, 84.73% and 83.11% of the value of imports to Yemen for the years 2007, 2008, and 2009.

Notwithstanding the low quantities of non-oil exports, they also include primary commodities (raw materials), manufactured and semi-manufactured products.

To clarify more on the role of non-oil exports, it is essential to learn what the quantities of these exports are, and what they represent in the economic structure of Yemen, whether in terms of their percentage of GDP or the Gross National Product, and their percentage of total exports.

Table (10) shows us these percentages, which demonstrate the low quantities of non-oil exports, and their insignificant contribution to the economic components cited.

Table (10)
2006 - 2009 Percentage of Non-oil Exports to GDP, National Gross Product (GNP) and the Total Export for the period 2006 - 2009

Year	Percentage of Non-Oil Exports to GDP	Percentage of Non-Oil Exports to GNP	Percentage of Non-Oil Exports to Total Exports
2006	2.64	2.81	8.3
2007	1.04	1.11	3.9
2008	3.62	3.42	12.11
2009	3.34	3.47	16.55

Percentages calculated on the basis of Annual Statistics Book for 2007, 2008 and 2009

We note from the table that the average percentage of the contribution of exports in the formation of GDP amounted to about 2.66% for the years 2006 – 2009, whereas this percentage amounted to 2.7% of GNP, and 10.2% of Total Exports. In view of the significance of exports to the formation of GNP, and the potential role they can play in stimulating economic activity, and thus the rates of GDP growth, and based on the analysis of the performance of Yemeni exports; which shows clearly the poor performance of non-oil exports, which do not correspond to the desires of Yemen, it is imperative to learn constraints that prevent the improvement of the level of such performance.

II. Constraints

There are several constraints that prevent the development and growth of Yemeni non-oil exports, with these constraints being either domestic or foreign, some of which are associated with the supply side and some others are related to the demand side, as well as the institutional constraints.

The leading and most significant constraint, which stands as an obstacle against the and continuation of the development and growth of non-oil export commodities in general,

perhaps lie in the hidden deficiencies in the structure of the Yemeni economy. The culture of export is lacking among the people who draw up the government policies. This caused the lack of clarity in vision and the absence of a national strategy to turn to exports.

The constraints hindering the growth of non-oil commodity exports maybe described as follows:

1. Poor and Deficient Framework Structure of the Yemeni Economy

By following the growth of GDP of the Yemeni economy, we can clearly trace the low rate of this growth, in general, and we can see the poor performance of the components that make up GDP (excluding the oil and gas sectors), and the differences in the performance thereof. This means the weakness of the productive base in the Yemeni economy and demonstrates that there is a latent structural deficiency, especially in both the agriculture and manufacturing sectors, which are considered to be among the most significant sectors that drive the wheel of economic development, the development of exports and similarly the absorption of labor.

2. Constraints Associated with the Supply Side

A. From within the Enterprise/Establishment

Poor competitive ability of most of the Yemeni enterprises, due to:

1. Poor quality of products.
2. High cost of production, which leads to high cost of local products.
3. Lack of sufficient expertise/experience of Yemeni producers/manufacturers that will enable them to enter foreign markets.
4. The small capital of the enterprise (undercapitalized).
5. Lack of information with the enterprises on the foreign markets or those to which products will be exported.
6. Lack of studies and similarly not undertaking studies on foreign markets

B. From Outside the Enterprise:

1. Insufficient or lack of official export plans.
2. Shortage or lack of support to enterprises to enable them to export their products.
3. Low or lack of participation in overseas exhibitions.
4. Poor infrastructure and structural framework for exports.
5. Poor investment climate and environment.
6. Multiplicity and complexity of government procedures.
7. Absence of finance establishments that are specialized in supporting and funding exports.
8. High cost of transport compared to countries that compete with Yemeni products, such as fish, like China, India and other states.
9. Weakness of current laws, which regulate economic activity such as the fishing laws.

3. Constraints Related to Demand Side

- A. Heavy competition from overseas for local products.
- B. Difficulty of finding suitable export inlets.
- C. Problems related to outside pricing.

4. Summary Analysis of these Constraints

A. Poor Product Quality

Due to Yemen following an import substitution manufacturing strategy, this has provided protection of local products from competition of foreign products for a long time. This situation led to laziness and reliance of several local manufacturers on such protection, and thus they did not work towards improving the quality of their products, in anticipation of any changes that could arise in government policies or in trade policies in general.

B. High Cost of Production, which leads to higher prices of local products

The protection policies similarly have also had an adverse effect on cost of production, as this protection could generate the inability of the producer/ investor to compete with external producers, in terms of reducing the cost of production, which could generate higher costs of commodities produced in Yemen, despite the low quality of the latter compared to foreign competing commodities.

C. Lack of sufficient experience of Yemeni producers, which would enable the latter to reach external markets.

D. Several enterprises lack information on outside markets, or export markets and lack of studies or studies were not undertaken on external markets.

In view of most Yemeni producers not having experience in dealing with external markets, as there is a lack of information on these markets, or studies on them.

E. Low Capitalization of Enterprises

Small and micro enterprises comprise more than 92% of the total Yemeni establishments. The establishments, which are classified as being large, although they are as such classified, however their capital is still small, when compared other similar establishments overseas, which does not enable them to be competitive.

F. Insufficient or lack of official plans for exports and lack of or inadequate appropriate economic policies.

G. Although the policies and procedures which the government took under the economic reform program, which aimed to liberalize external trade and free the latter from restrictions; and improve performance of exports. However these policies did not achieve the desired objective accordingly. There are still several technical constraints, such as the customs procedures, tax transactions, and other administrative dealings, which stand as obstacles confronting exporters and investors alike. In fact, their effects are doubled in the event that the exporter aims to provide raw materials for manufacturing export products. In such a case the latter is confronted with the measures twice, when importing raw materials and when exporting the product. The role of the Council for the Development of Export

Commodities is also absent.

It is worth noting that, despite the steps taken by the government in the course of liberalizing trade and freeing trade from all restrictions, this did not raise foreign investments, which are regarded as the major engine for driving exports, and contribute significantly to their success. This shows clearly the deficiency of these policies followed by the government, and that the strategic vision for development of exports is absent from economic policy makers.

- H. Shortage or lack of support directed to enterprises, to enable them to export their products, and lack of financial establishments specialized in supporting and funding exports.
- I. There are some establishments which export some of their output to external markets. However these establishments rely fully on their own autonomous capabilities, and are not fortunate to get any support from the Government. Similarly, there is a complete absence of the Government and the banking system in financing exports, to support or encourage the manufacturers that seek to export. There are no credit establishments that specialize in supporting and funding exports, and where there are some services offered as such, they are usually costly.
- J. Poor Infrastructure

Yemen lacks the adequate and suitable infrastructure for encouraging exports. We mean by this funding, qualified and trained manpower, sea ports, the required expertise for contacting external markets to carry out transaction deals and to learn of the conditions and developments of external markets to keep pace with such development and adapt to them.

Based on the foregoing, we must prepare solutions to these constraint, so as to contribute to motivate and improve the performance of exports of Yemeni products. We shall present herewith some of the recommended solutions, which could contribute (in our viewpoint) to the improvement of this performance.

III. Recommended Solutions

In order to encourage and motivate Yemeni investors to turn towards exports, efforts of the government and the private sector should be combined to provide a suitable investment environment. Suitable solutions must be set out to remove all the obstacles that reduce the ability of investors to progress and grow, and based on the foregoing we recommend the following:

1. The government must continue to adopt and implement structural reforms, which would lead to enhancing and supporting economic activity. It will help strengthening and deepen its competitive ability, and which would lead to raising the level of production and productivity, improving the quality of local products and reducing costs, in order for these products to find places in overseas markets, and to compete with foreign products that flood the Yemeni market.
2. Follow industrial policies with clear benchmarks and specific targets to encourage and

develop exports, and turn to overseas markets. Some mechanisms or tools could be used such as:

- A. Customs Tariffs
- B. Support.
- C. Exchange Rate
- D. Industrial Credit
- E. Interest Rates

We can also list some policy tools to encourage exports in the following table:

	Description
<ul style="list-style-type: none"> • Tax Exemption / Tax Refunds, Tax Exceptions 	<ul style="list-style-type: none"> • Reduce a certain percentage of imposed taxes on income of company/establishment that exports, with exemptions from indirect taxes on exported commodities; partial exemption on production inputs that are used to produce export commodities.
<ul style="list-style-type: none"> • Export loans and security/guarantees 	<ul style="list-style-type: none"> • Finance pre-shipping expenses of exported commodities. • Issue letters of credit. • Reduce interest rates on industrial loans, or loans which are taken for the purpose of investment in opportunities for export • Finance after shipping expenditures. • Reduced prices for basic services, such as electricity, water, communications and export activities. • Develop industrial zones for export manufacturers.
<ul style="list-style-type: none"> • Other Assistance • Investment in Infrastructure • Custom Procedures 	<ul style="list-style-type: none"> • Facilitate customs procedures and deal only with one entity. • Facilitate the procedures for determining country of origin. • Exclude exported commodities for normal customs procedures.
<ul style="list-style-type: none"> • Institutional Support 	<ul style="list-style-type: none"> • Establish organs with broad mandates to take all measures related exports.

3. Activate partnership between government and private sector, based on controls, by which the roles of the government and private sector, the nature of this relationship, characterized by transparency in all dealings, with a view to enhancing the role of the private sector and which works to rejuvenate this role generally and so as to enhance its role in exports.
4. Cooperation between the government and the private sector to promote Yemeni goods through setting up external exhibitions to market high quality competitive products.
5. Contribute to finding outlets for marketing Yemeni products, provide data base and conduct studies on potential external markets.
6. Adopt international specifications by the Yemeni Authority for Standards and Measurement and compel productive enterprises to adhere to them.
7. Establishment of a real partnership between the Government and the private sector to set up export preparation zones, with a view towards motivating economic growth, by means of attracting Yemeni capital and foreign direct investments. These zones should duty free zones, special economic zones, industrial development zones, customs warehouses, duty free ports and industrial duty free zones.
8. Draw up program to modernize industry (with the involvement of the Government and private sector) which will be concerned with the establishment and formation of several programs and policies, providing support and backing for industrial projects, and the industrial sector in general. These programs should be run by efficient and qualified personnel.
9. The work of the program should aim at developing the private sector, and enhancing its competitive abilities.
10. Direct attention to the medium and small enterprises which constitute the majority of the private sector.
11. Draw up appropriate policies for protecting local products from illegal competition in trade; issuance of law that protects these products from unfair drowning of markets and unfair competition of illegal products, provided that local manufacturers are motivated and developed to enhance their competitive advantages.
12. Set up a center for supporting and developing the industrial sector, to turn towards external markets. The center should be set up with joint capital of Government and the private sector, with open membership to all who wish to join. The center should be granted financial and administrative autonomy. The center should be managed by people with qualifications and experience and should provide the required information and studies on the industries that can compete and be marketed externally, and which can support the enterprises that are facing technical difficulties.

Duty Free Zones and Industrial Zones

Introduction

Industry, unlike any other sector, is characterized by its high features in achieving the general objectives of economic development. Without industry economic, social and cultural underdevelopment of Yemen could not be overcome. The contribution of industry came to broaden the productivity base, to diversify the sources of income and to build a balanced economy by using local material and human resources. The link of industrial development with these considerations made industrial development a basic rule of the occurrence of real economic growth. Notwithstanding the noticeable development realized by the manufacturing sector in Yemen, it still, like the other economic sectors, faces complicated difficulties, with the severe deficiency of infrastructure being the most apparent.

In order to overcome this problem, with a view towards improving the capacities of this sector, the Government paid attention to the establishment of duty free and industrial zones. This is because of the major and vital role such zones play in increasing GDP and national income, creation of thousands of job opportunities, and the resulting increase in standards of living, encouragement of scientific research for progress and development.

I. Duty Free Zones

Definition and Concept

Duty free Zones are zones that are exempted from customs duties and export restrictions. They offer an environment that induce the attraction of investments, promotion of exports, transfer of technology to the world, provision of job opportunities and other activities, including commercial transit trade, shipping, storage and distribution. The concept of duty free zones, which is a development originating with duty free ports, has witnessed changes with the passage of time, and has taken different forms throughout the world.

In general, duty free zones are intended to mean an area that is surrounded by a wire fence, or wall, which have control points for entry and exit, in which certain concessions economic and financial are granted to encourage exports. In the meanwhile, it is defined as part of the region or the government, and the goods produced or presented in the zones as being outside the customs area and are not subject to customs duties or restrictions. There are two types of Zones:

1. Commercial duty free zones, in which merchandise is primarily stored, without being classified or processed prior to export.
2. Industrial duty free zones wherein goods are manufactured for export purposes.

Duty free zones are an old concept, which is the granting of facilities in ports and commercial centers, especially between East and West. Such places include: Gibraltar, Malta, Aden, and Hong Kong. These facilities have led to trade prospering and increase of manpower, as well as increasing the growth rates of national income, which led to increasing the attention of states and governments to the importance of these zones in the national economies. They prepared the legislation and enacted laws governing these zones and they also gave them more incentives and concessions making a focal point for attracting local and foreign investments, and in various economic activities.

In view of the importance and reputation of the City of Aden throughout the world and the elements of success as a duty free zone, the City of Aden was declared a Duty Free Port in 1991, which was to be carried out in stages. For this reason the Republican Decrees and laws regulating the work of this Zone were issued, so as to create an appropriate investment environment and help in the innovation and creation and the integration on Aden with the world economy and to safeguard the environment.

The arrangements taken by the Yemeni Government for the promotion of exports include the issuance of the Law of the Duty Free Zone No. 4 for 1994, and the Zone was allotted a piece of land in the City of Aden with an area of 170 km² to become the first Duty Liberalized Trade Zone in the country. The multi-purpose Al-Mualla Station Terminal was also set up, with funding from the Arab Fund for Social and Economic Development and under the supervision of the Yemen Port Authority. The Aden Container Terminal is considered as the foundation stone in the Commercial Free Zone in Aden, and it is expected that it will provide 10,000 to 20,000 job opportunities, in the event that the Stage II and III are completed and the Industrial Zone is established.

II. Industrial Zones

1. Definition and Concept

Undoubtedly, the establishment of industrial cities in the governorates, which have elements of success for industry and foreign trade, will contribute considerably in solving many of the problems and constraints which manufacturing is facing in Yemen. In light of this, Republican Decree No 79 for 2005 Concerning the Regulations for establishment, management and supervision of Industrial Zones. The aim of this was to contribute to industrial development and distribute industrial activity throughout the governorates of the republic. A Council of Ministers Decree was issued in 2006 for inaugurating the Industrial Zones, within the context of the Three Major Industrial Zones Project, in Aden, Hodeida and Hadhramaut Governorates.

The Government aims to set up 10 industrial zones in Aden, Hadhramaut, and Hodeida Governorate as an initial stage. The second stage the Government aims to set up seven industrial cities in the Capital Secretariat and the Governorates of Taiz, Lahj, Shabwa, Abyan, Al-Mahara and Sana'a. These zones will be prepared as industrial and export zones at the same time.

Similarly, the government work towards taking steps to enhance the partnership between Yemen and the GCC countries, with the aim of rejuvenating the industrial sector and attract local and foreign

investments. The work was initiated officially by the establishment of the economic and commercial zone in Al-Wadia'a inlet in Hadhramaut Governorate and in the Al-Tiwal inlet border inlet. Both are along the Yemeni – Saudi border, and the economic zone at Al-Maziouna in on the Yemeni – Omani border.

We could define qualified industrial zones as being any area that is approved and named by the government and local authorities as an area allotted for setting up industrial establishment or projects that provide services to the enterprises working in the sector.

The following are a list of the Industrial Zones:

- A) Aden Industrial Zone: Area, 196 hectares which can be extended to a larger area.
- B) Hadhramaut Industrial Zones; three zones have been identified with an area of 3,000 hectares (Al-Shihr, Khalaf, Al-Sulb).
- C) Al-Hodeida Industrial Zone, aside the international road, Hodeida – Jaizan Road, with an area of 315 km.
- D) Lahj Industrial Zone, with an area of 28 km².
- E) Abyan Industrial Zone:

There is an area of 20% of the industrial zones allotted to small enterprises.

2. Industrial Zones under Establishment

- A) Belhaf Industrial Export Zone, Shabwa, for mining and extracted ores, construction materials and decorative stones.
- B) Haradh Industrial Zone, borderline with Saudi Arabia.
- C) Mareb/ Al-Jouf Industrial Area, extractive industry for mining ores and building stones, building materials, marble, granite and decorative stones.
- D) Industrial and Services Zones: Capital Secretariat.

III. Objectives of Duty Free Areas and Industrial Areas

1. Duty Free Areas:

The objectives, which states set for establishing duty free areas and industrial cities were and still are economic and social, at the national economic level. The success or failure of the zones is based on the results of achieved objectives.

The detailed aims for these zones have evolved with accelerated developments of the world, and in general, are similar with the desired aims of establishing duty free zones, the most significant of which are as follows:

- A. Motivate the private sector to contribute to the achievement of economic and social development, by means of attracting local and foreign capital
- B. Introduction of modern technology and gain required technical skills for improving their production.
- C. Enhance the front and rear linkages of the productive commodities and service sectors in duty free zones, which would lead to stimulating these sectors, and thus motivate growth in the national

economy.

- D. Provide the duty free zones with a «window exhibit» of the abilities and products of the national firms and workers.
- E. Provide job opportunities for laborers and increase, improve, and develop their skills.
- F. Develop new duty free zones by setting up investment projects in them.
- G. Encourage the establishment of export industries and stimulate transit trade.
- H. Enhance the pioneering role of the private sector and activate it in the establishment of private and joint duty free zones, which use local primary materials in production inputs.
- I. Support the national economy with hard currency and support the balance of payments.
- J. Assist duty free zones to develop ports.
- K. Encourage exports and develop international trade.

2. Industrial Zones

These zones are the result of industrial policies that seek to diversify and broaden the opportunities in manufacturing sectors, while finding areas, in which it is possible to increase the rates of economic growth in a compatible environment. The geographic concentration of industrialists and service providers in the industrial zones could allow for gains in the productivity. It will enhance the competitive capabilities arising out of the savings from volume, and the flowing effects which will be realized as a result of shared knowledge and experience and transfer the latter from the innovators to the beneficiaries thereof.

These characteristics include easy access to business support services, improvement of transport networks which connect industrial zones with the trade passages and ports and lower costs associated with setting up services and basic environmental structures.

IV. Industrial Zone Policies

Generally, adopted industrial zone policies are those meant to enhance setting up industrial zones to achieve one objective or another of the following development objectives:

1. Enhance investment, especially direct foreign investment.
2. Enhance the front and rear linkages of the productive commodities and service sectors in duty free zones, which would lead to stimulating these sectors, and thus motivate growth in the national economy.
3. Enhance the pioneering role of the private sector and activate it in the establishment of private and joint duty free zones, which use local primary materials in production inputs.
4. Diversify the trading transaction through local industrialists or through reexports.
5. Decentralization of economic development to serve the rural and remote areas, with a view towards decreasing migration to the urban areas, or to move the environmental polluting industries to uninhabited areas.
6. Facilitate the establishment of industrial complexes, networking, and industrial technology transfer and within industries.
7. Encourage the spirit of initiative to set up projects, create job opportunities by presenting

special incentives and services in support of business, which are consistent with the needs of targeted industries, including small and medium sized industries.

Despite the passage of more than thirty years since Aden was declared a duty free zone, however the anticipated achievements desired therefrom have yet to be fully realized. The inflow of foreign and local investments are still quite limited. As for the industrial zones, although five years have elapsed since the issuance of promotional brochures on two industrial zones, which are Aden Industrial Zone and Hodeida Industrial Zone. No further progress achieved so far.

The major constraint hindering the success of duty free zones and industrial zones in Yemen are exemplified by the lack of finance for setting up the infrastructure and basic services required for these areas, so as to serve and work to attract local and foreign investors.

In order to overcome the difficulties that stand in the way of successfully establishing industrial zones, the following measures must be taken:

1. Confirm the value of industrial cities and zones, and get ministries concerned to benefit from them in their economic development plans.
2. The importance of drawing up clear strategies for industrial cities and zones, and the need to disseminate awareness and create confidence with business institutions to encourage them to use industrial cities.
3. Form a committee of experts under the supervision of the Ministry of Industry and Trade or an Authority for Industrial Cities and Zones to set forth the required concepts, policies, procedures and working rules. They should clarify the structures of these industrial cities and zones and the services they offer, in view of the intertwining nature of these concepts and their lack of accurate clarification.
4. The need to work towards drawing up strategies for providing services and infrastructure, for developing industrial cities and zones to firstly face the challenges of international competition in industry and secondly to support activities related to activities of economic development.
5. Those who are supervising industrial cities and zones should work to draw up marketing policies for industrial cities and to provide information on the available different services, to make them available to businessmen, and to clarify the most important benefits and cost of these services.
6. The need to pay attention to training and retraining programs for industrial workers; this is because many of the workers in the industrial sector have a weakness in absorbing the technology of electronic operation
7. Work towards simplifying the conditions for investment in duty free and industrial zones to avoid administrative bureaucratic routines, and give investors a full opportunity to manage their investments.
8. The need to take into consideration the environmental impact of establishing duty free zones and industrial zones.
9. Gather all mandates on investments with one entity or supreme authority for investments that enjoys broad powers, autonomy, and has qualified staff, The private sector should

- have adequate representation in this authority.
10. To work towards computerizing the procedures used in all the areas concerned (Customs and Taxation Authorities).
 11. Carry out comparative studies of Yemeni duty free zones and industrial zones and their counterparts in countries that have achieved success in the field to be used as basic references for researchers, students and interested parties.
 12. The policy makers and planners should set forth the strategic aims behind setting up duty free and industrial zones, to enable them to cope with the effects and effectiveness of these initiatives as required and to evaluate them continuously.
 13. The industrial development strategy should work towards build industrial zones and to set up the appropriate infrastructure in less developed areas, since they are the basic mechanisms for achieving the objectives of industrial policies. It should set forth the employment of citizens as one of the major aims thereof. Similarly they should work towards creating national chain links for the values which connect small and medium sized enterprises with the larger companies.
 14. The strategy should view industrial zones as a means of achieving several goals in the area of policies, including the development of small and medium sized projects, creation of opportunities for decentralized development.
 15. Set up industrial zones catering to serving the major economic sectors.
 16. Draw up an industrial map that eases the establishment of small and medium size industries.
 17. Associate policies related to industrial and duty free zones with the national initiatives seeking to find income and job opportunities from small and medium sized enterprises, which are operating in fisheries. This is attributed to the location of the duty free zone, and that several of the planned will be in coastal towns, and some of these zones will be dealing with large industries (which could dispose of heavy minerals in the sea water, which could affect the sustainability of the fisheries sector.

It is noteworthy to mention that experience of others are useful, especially of those who have been successful in similar endeavors. It would enable us to save time and effort, and would come back to us with benefits for the national economy in general, as there are several countries that preceded Yemen in establishing duty free zones, industrial zones and cities, whether in the Arab World or in other countries of the world.

The United Arab Emirates is one most successful and advanced countries in duty free zones. Industrial Zones have been resorted to most, if not all Arab countries, in order to provide suitable investment environments and climates.

To ensure the success of industrial cities and areas in Yemen, we should make use of successful experiences, the provision of adequate financing, good planning, and qualified and trained personnel to manage these zones, and to work in them, and there should be sincerity and transparency in every step and executive program.