

Rescuing Yemen's Economy



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Introduction

A political crisis has wracked the interim capital of Aden as the internationally recognized government struggles to deal with the plummeting Yemeni rial. The currency now trades at over YR2,000 to the dollar, having lost over a third of its value since the year began. Riven by political infighting and lacking the vision or tools to arrest the slide, an acute economic collapse appears imminent if significant and sustained financial support does not arrive.

Both short- and long-term factors have put downward pressure on the currency. The roots of the problem are difficult to unpick from Yemen's troubled pre-war economy, the stressors and destruction of the conflict, and the broader economic downturn that has accompanied it over the past decade, which continues despite a decline in frontline fighting. Yemen has limited natural resources and productive capacity, and the war has removed vast numbers of workers from productive sectors of the economy. Their reintegration and retraining will take time, as will the replacement of capital and infrastructure destroyed in the conflict.

However, short-term drivers of devaluation and financial instability might be isolated and ameliorated. Economic stability depends on the payment of salaries to the massive public sector and the stabilization of the rial, neither of which the government can currently afford. The Ministry of Finance reported that government revenues fell by half in 2023 and were down 42 percent through the first six months of 2024.^[1] The continued suspension of oil and gas exports is the primary factor, but customs revenues have fallen 34.5 percent as imports shift to Houthi-controlled ports in Hudaydah.^[2] Fiscal support from the government's primary backer, Saudi Arabia, has bolstered revenues this year, offsetting some of the rising expenditures of salary payments and service provision. Past support has been provided by the United Arab Emirates, the broader international community, and organizations such as the International Monetary Fund (IMF) and World Bank. But the erratic provision of grant money has been insufficient to change the trajectory of the economy or the government's fraught fiscal position. External actors have been hesitant to provide the divided government with the means to halt the collapse of the rial or stabilize the economy.

This is a mistake. At present, the only readily available source of transformative revenue is external financial support. Starving the government of hard currency will not improve its capacity for reform. Rather, it risks an economic and political collapse, which will exacerbate the current humanitarian situation. Yemen remains one of the largest humanitarian crises in the world, a position driven and sustained by economic deterioration. The country imports nearly all of its food, and there is a direct line between rising prices and diminished buying power and the incidence of

[1] "Yemen Economic Monitor: Confronting Escalating Challenges, Fall 2024," The World Bank, October 31, 2024, "<https://documents1.worldbank.org/curated/en/099943010292431765/pdf/IDU1f65eefe71d79414f1618a511921980f32f1b.pdf>

[2] Ibid.

hunger and renewed prospect of famine.^[3] The recent falloff in humanitarian funding compounds these dangers: at the time of writing, the UN's Yemen Humanitarian Response Plan for 2024 remains less than 50 percent funded.^[4] In December 2023, the World Food Programme was forced to suspend food aid in Houthi-controlled areas^[5] due to funding shortfalls and disagreements with the authorities in Sana'a before announcing the limited resumption of assistance in July.^[6]

A full economic recovery may be dependent on a comprehensive negotiated settlement, but peace talks have stalled amidst the ongoing regional conflagration, and Yemenis can ill afford to wait. Neither can the internationally recognized government. Further economic deterioration could precipitate greater political fragmentation or even pave the way for the renewal of widespread military operations by opportunistic Houthi forces. The government will be in no position to negotiate a settlement if it fails to survive until the resumption of peace talks, and the humanitarian fallout from political unrest or the renewal of widespread fighting would be calamitous.

With few cards to play, the government and the affiliated Central Bank of Yemen in Aden (CBY-Aden) made efforts to wrest control of the financial system from the authorities in Sana'a, but were compelled to abandon their campaign amid fears it would lead to military escalation and further economic disruption. They now have even less room to maneuver. The EU is reportedly preparing a new package of sanctions, and the return of the Trump administration could see the Houthis re-designated as a Foreign Terrorist Organization (FTO). With the government weakened and the central bank paralyzed, neither may be capable of shielding the civilian population and broader economy from their effects.

Plans to keep the government solvent and the economy functioning must be prepared, and such measures need not wait for the signing of a peace agreement. Hesitation will only invite further economic and humanitarian deterioration and risk systemic collapse. Primary recommendations for external actors, detailed at the end of this brief, focus on:

- Financially supporting the internationally recognized government to stabilize the currency and its purchasing power and finance the import of essential goods. Such support could also be structured to build the government's capacity to collect revenues and reform inefficiencies in expenditures, particularly the provision of electricity.
- Mitigating the impact of sanctions on civilians. Any new sanctions on the Houthis must take into account the government and CBY-Aden's diminished control of the financial and banking sectors and limited capacity to prevent broader economic fallout.

[3] "Conflict and economic crisis drive food insecurity and malnutrition in Yemen," UNICEF, May 25, 2023, <https://www.unicef.org/press-releases/conflict-and-economic-crisis-drive-food-insecurity-and-malnutrition-yemen>

[4] "Yemen 2024," Financial Tracking Services, UNOCHA, <https://fts.unocha.org/countries/248/summary/2024>

[5] "WFP pauses food distributions in northern areas of Yemen," The World Food Programme, December 5, 2023, <https://www.wfp.org/news/wfp-pauses-food-distributions-northern-areas-yemen>

[6] "WFP expected to gradually resume assistance distribution in SBA-controlled areas," Famine Early Warning Systems Network, July 9, 2024, <https://fews.net/middle-east-and-asia/yemen/key-message-update/july-2024>

- Facilitating the continued operation of the financial sector and limiting regulatory fragmentation across the zones of control. This includes restoring the authority of the central bank to stave off further disintegration and pursuing the eventual reunification of the currency.
- Exploring political options for the resumption of Yemen's only readily exploitable revenue stream: gas and oil exports.
- Supporting the UN Envoy's efforts to negotiate the payment of public sector salaries to civilian personnel. Various mechanisms for their provision in Houthi-controlled areas could be considered, such as tying such payments to the accession of other measures that would facilitate economic stabilization.

A History of Fragility

Yemen's enduring poverty and limited but exploitable oil and gas reserves ensure that the economic and political dimensions of the conflict will always be closely intertwined. The pre-war economy was highly reliant on hydrocarbon revenues, which the government used to subsidize fuel and electricity, import nearly all of its basic foodstuffs, and pay the salaries of a vast public sector. With high fixed expenditures and limited, and ultimately vulnerable, revenue streams, the economy was already fragile before the political turmoil of 2011-2014 and the subsequent outbreak of civil war.

The conflict has destroyed much of Yemen's economic capacity, both through outright destruction and disruption to the workforce, supply chains, cash flows, and trade routes. Oil and gas production was halted when fighting broke out and took years to resuscitate. Financial turmoil was compounded by the hasty division of the central bank, increased military spending and limited revenues, and the resulting decline in foreign currency reserves. The initial devaluation of the rial occurred early in the war, but downward pressure on the currency continued to mount. In 2016, the government-aligned Central Bank of Yemen in Aden (CBY-Aden) began printing bank notes to finance public spending as it ran out of cash to pay public sector salaries, particularly those of the mushrooming military and security sector. The government devalued the rial from YR214.25 to YR250 to the dollar; by 2017, it was unofficially trading at YR370^[7] before the peg was abandoned.^[8]

In 2020, Houthi authorities in Sana'a banned post-2016 banknotes, limiting their distribution to the government-held south and effectively bifurcating the currency. The dramatic expansion of the local money supply in government-held areas led to massive inflation. By spring 2022, "new rials" were worth only a fraction of the currency's former value, trading at YR1,260 to the dollar. The government had, however, made some progress in restoring oil and gas exports, and had limited expenditures by no longer paying public sector salaries in the populous Houthi-held north.

^[7] Peter Salisbury, "Bickering While Yemen Burns: Poverty, War, and Political Indifference," The Arab Gulf States Institute in Washington, June 22, 2017, https://agsiw.org/wp-content/uploads/2017/06/Salisbury_Yemen_ONLINE.pdf

^[8] Grace Easterly, "Currency in Crisis: The Yemeni Riyal and the Dangerous Effects of Depreciation," The Yemen Peace Project, July 27, 2018, https://www.yemenpeaceproject.org/blog-x/2018/7/27/currency-in-crisis-the-yemeni-rial-and-the-dangerous-effects-of-depreciation#_ftn7

Fighting reached a stalemate in the winter of 2021-2 following a failed Houthi offensive on Marib and its oil and gas fields, and a UN-sponsored truce in April 2022 offered a broader respite. Truce talks broached a number of economic issues, including the reopening of roads, the easing of import restrictions, and the payment of civil servant salaries.^[9] But the talks fell apart in October 2022 over eleventh-hour demands by Houthi negotiators for their military and security forces to be paid as well. Frontlines remained relatively stable, but the Houthis soon began attacking southern oil terminals and tankers with drones and missiles,^[10] effectively blockading hydrocarbon exports, the government's primary source of revenue and foreign currency.

The government has been almost entirely reliant on external aid ever since. In addition to a package from the Arab Monetary Fund,^[11] it has primarily been propped up by Saudi grants,^[12] which are disbursed in sporadic installments. The lack of a regular income has kept it financially weak, and it has struggled to provide basic services or reform revenue collection and expenditures, further undermining faith in the rial.

Beginning with the Houthi blockade of hydrocarbon exports, the conflict in Yemen has migrated to the economic sector and control of its institutions, which have been weaponized for political gain. Customs and tax revenues, domestic industry, and the financial sector have all become areas of increased contestation. Leveraging their military supremacy and Riyadh's transparent desire to leave the conflict, the Houthis have been able to carve out a greater share of revenue for themselves. Imports and customs fees have shifted to the Houthi-controlled ports of Hudaydah as the group has pressured shippers and imposed tariffs on overland trade.^[13] The Houthis have taken control of various economic sectors in order to extract revenue, including everything from telecommunications providers^[14] to tobacco production,^[15] and restricted the trade of goods from government-held areas. In early 2024, the economic war began to escalate in the financial and banking sectors.

^[9] "Truce Extended, but Under Strain – The Yemen Review, August 2022," Sana'a Center for Strategic Studies, September 8, 2024, <https://sanaacenter.org/the-yemen-review/august-2022/18642>

^[10] "Yemen's Houthis attack al-Dhabba oil terminal, force ship to leave," Reuters, November 21, 2022, <https://www.reuters.com/world/middle-east/yemens-houthis-attack-al-dhabba-oil-terminal-force-ship-leave-2022-11-21/>

^[11] "Arab Monetary Fund signs \$1 bln agreement to support Yemeni government reforms - Saudi state media," Reuters, November 27, 2022, <https://www.reuters.com/world/middle-east/arab-monetary-fund-signs-1-bln-agreement-support-yemeni-government-reforms-saudi-2022-11-27/>

^[12] "Saudi Arabia to grant Yemen \$1.2 billion in economic aid," Associated Press, August 1, 2023, <https://apnews.com/article/yemen-economy-saudi-arabia-economic-aid-4329a38962c4b67da018eab44e7ae03>

^[13] Ned Whalley and the Sana'a Center Economic Unit, "Challenges to Public Revenues," December 19, 2023, <https://sanaacenter.org/publications/main-publications/21490>

^[14] "Final report of the Panel of Experts on Yemen established pursuant to Security Council resolution 2140 (2014)," United Nations Security Council, October 11, 2024, <https://documents.un.org/doc/undoc/gen/n24/259/53/pdf/n2425953.pdf>

^[15] Wadah al-Jalil, "Houthis seize Yemen's largest tobacco company [AR]," Asharq al-Awsat, October 9, 2024, https://aawsat.com/5069452-/العالم-العربي/5069452-?ocid=Nabd_App&page=1

The Central Banks Take Action

Finding its primary source of revenue and hard currency cut-off and external support inadequate, the government-affiliated Central Bank of Yemen in Aden (CBY-Aden) moved to take sole control of the country's financial and banking sectors. In February 2024, it announced the launch of the Unified Money Transfer Network (UNMONEY),^[16] intended to consolidate control over exchange outlets, money transfer networks, and banks, including those operating in Houthi-held Sana'a. The CBY-Aden hoped the new system would stamp out rampant currency speculation and manipulation and limit the illicit money flows that had plagued Yemeni remittance and transfer systems. Poorly regulated financial networks had made it difficult for the central bank to ensure that transactions were conducted in compliance with anti-money laundering and counter-terrorism financing (AML/CTF) measures, making the whole system vulnerable to US sanctions. This was increasingly problematic – in January, the US Treasury Department had re-classified the Houthis as a Specially Designated Global Terrorist (SDGT) group in response to its targeting of commercial shipping in the Red Sea.^[17] By unifying control, the CBY-Aden sought to curtail the growing reach of the authorities in Sana'a and stabilize the depreciating rial in areas under government control.

The Houthi-controlled Central Bank of Yemen in Sana'a (CBY-Sana'a) quickly retaliated, banning interaction with the network and threatening exchange companies and banks with punitive measures should they adopt it.^{[18], [19]} A key issue for authorities in Sana'a was the growing liquidity crisis in Houthi-controlled areas. The Houthis had banned all banknotes printed after 2016, but the older rial banknotes were physically deteriorating. To address the shortage of Yemeni rials and US dollars and hoping to reduce the potential impact of sanctions, the CBY-Sana'a decreed that international transfers be paid out in Saudi riyals instead.^[20] In turn, the CBY-Aden demanded all transfers flow exclusively through approved banks and money exchanges, with recipients receiving transfers in the currency sent.^[21]

March saw a brief respite as negotiations led by the Sana'a-based Yemeni Echargers Association facilitated a brief de-escalation. Each side revoked restrictions it had placed on money exchanges and banks for non-compliance. But underlying issues remained unresolved: the government's efforts to control money flows and support the currency were directly at odds with the Houthi consolidation of institutions

^[16] "Circular of the Central Bank of Yemen regarding money transfers through various exchange companies [AR]," Al-Khlassa Net, February 18, 2024, <https://www.khlaasa.net/1303652>

^[17] Anthony Blinken, "Terrorist Designation of The Houthis," US Department of State Press Release, January 17, 2024, <https://www.state.gov/terrorist-designation-of-the-houthis/>

^[18] "The Central Bank of Yemen in Sana'a suspends a number of remittance networks and exchange companies [AR]," March 4, 2024, Yemeneco, <https://yemeneco.org/archives/76876>

^[19] The network was also criticized by the Southern Money Changers Syndicate, representing major money exchanges affiliated with the Southern Transitional Council.

^[20] "Services of Banks and Financial Institutions Operating Foreign Remittance Services, Western Union, MoneyGram, and the Like [AR]" Central Bank of Yemen - Sana'a, March 13, 2024, https://yemeneco.org/wp-content/uploads/2024/03/_خدمات_البنوك_والمؤسسات_المالية_12_تعميم_رقم_خدمات_الخوالات_المشغلة_خدمات_الخوالات.pdf

^[21] Mohammed Nasser, "The Central Bank of Yemen strengthens its control over foreign transfers [AR]," Asharq Al-Awsat, May 28, 2024, <https://aawsat.com/العالم-العربي/الخليج-/5025163-المركزي-اليمتي-يعزز-سيطرته-على-التحويلات-الخارجية>

in Sana'a and efforts to address its lack of liquidity. It did not take long for the escalation to resume. On March 30, the Houthis announced they were minting new 100-rial coins, cementing the prevailing dual-exchange rate system and threatening a permanent monetary schism.^[22] As noted in a recent report by the UN Panel of Experts on Yemen, printing their own currency would allow the Houthis to generate and utilize further funding for military purposes, skirting existing sanctions.^[23] The CBY-Aden perceived the move as a clear threat to its legitimacy and international standing and denounced the coins as illegitimate. From this point, the stakes would only grow higher.

On April 2, the CBY-Aden responded, issuing a resolution stating that all Yemeni banks must relocate their headquarters to Aden within 60 days.^[24] The central bank had made a similar demand in August 2021 but never enforced it. However, the new resolution was seen as more serious. Already under pressure, the Houthi coinage stoked fears that the CBY-Aden would lose what power it had left. It now threatened to cut Sana'a-based banks off from the SWIFT network and international money transfer services like Western Union and MoneyGram if they did not move. It was unclear to what extent the demand was feasible. The relocation decree faced strong resistance from Sana'a-based banks, whose customer base was in the north. There was also pushback from recently established banks in Aden, which chafed at the prospect of competition from banks moving in. The move was swiftly condemned by the Sana'a-based Yemeni Banks Association (YBA), who derided it as political,^[25] but also by the chairman of the Aden-based Yemeni National Bank, who noted the inherent logistical hurdles.

Between May and July, the CBY-Aden intensified its rhetoric and efforts to assert control. On May 23, it moved to tighten regulations on remittances.^[26] These had become a key source of foreign currency; in 2023, they totaled approximately US\$6 billion.^[27] On May 30, it issued a resolution demanding all citizens exchange all pre-2016 rial banknotes within 60 days.^[28] This was never enforced, but was met with Sana'a's announcement of its own compensation mechanism. The CBY-Aden then moved to suspend exchange companies and impose regulations on other financial transfer networks. In June, it banned unlicensed e-wallet companies, challenging the Houthis' broad support for non-bank electronic payments. It also forbade the transport of foreign currency and pre-2016 rials into Houthi-controlled territory.

^[22] "Governor of the Central Bank of Yemen announces issuance of 100-rial coin [AR]," Yemen News Agency (saba), March 30, 2024, <https://www.saba.ye/ar/news3317264.htm>

^[23] "Final report of the Panel of Experts on Yemen established pursuant to Security Council resolution 2140 (2014)," United Nations Security Council, October 11, 2024, <https://documents.un.org/doc/undoc/gen/n24/259/53/pdf/n2425953.pdf>

^[24] "Decision of the Governor of the Central Bank regarding the transfer of the main headquarters of banks to Aden [AR]," Central Bank of Yemen, Head Office, Aden, April 2, 2024, <https://cby-ye.com/news/658>

^[25] Mohammad Rajih, "Yemen: Relocation of main banks shocks banking sector [AR]," The New Arab, April 23, 2024, <https://www.alaraby.co.uk/economy/اليمن-نقل-مقار-البنوك-الرئيسية-يصد-القطاع-المصرفي>

^[26] Mohammed Nasser, "The Central Bank of Yemen strengthens its control over foreign transfers [AR]," Asharq Al-Awsat, May 28, 2024, <https://aawsat.com/العالم-العربي/الخليج-5025163-المركزي-اليمني-يعزز-سيطرته-على-التحويلات-الخارجية>

^[27] "Yemen Economic Monitor: Navigating Increased Hardship and Growing Fragmentation, Spring 2024," The World Bank, October 31, 2024, <https://documents1.worldbank.org/curated/en/099926206242412700/pdf/IDU1dc601b321062b148fc1b59414e6cd5c70a66.pdf>

^[28] "Important Announcement [AR]," The Central Bank of Yemen, Head Office, Aden, May 30, 2024, <https://cby-ye.com/news/692>

The Houthi-controlled Yemen Exchangers Association retaliated by suspending dealings with CBY-Aden-controlled networks. In late May, the Houthi-controlled Financial Information Unit prohibited all banks under their control from sharing information with the CBY-Aden or the internationally recognized government. Any bank that breached the order was threatened with legal consequences, including charges of “communicating with the aggression [government]” – a severe offense in the current environment, in which the Houthis have increased arbitrary detentions and trumped-up accusations of treason. This effectively severed financial communication between the two parts of the country. The Houthis also ordered Sana'a-based banks to refrain from participating in the CBY-Aden's foreign currency auctions, Buna platform, and IBAN plans. On July 6, Houthi forces even stormed the Sana'a residence of the CBY-Aden's governor.^[29]

The crisis reached its apogee in July, when the CBY-Aden made clear that it would enforce the relocation order, revoking the licenses of six major Sana'a-based banks for failing to relocate.^[30] The plan was to solidify the interim capital as the country's financial hub and cement its oversight of the sector. The CBY-Aden wielded control over Yemen's integration with global banking systems, which gave it a significant advantage in regulating remittance flows and access to external funds, as well as leverage to compel compliance. Cutting off Sana'a-based banks from the SWIFT financial network and remittance companies like Western Union and MoneyGram represented the most serious challenge to the status quo.

The Houthis were acutely aware of the potential consequences of their further isolation from the international financial system, already curtailed by US sanctions, and promptly threatened Saudi Arabia and the government with renewed military action. The result was an immediate and dramatic intervention from Riyadh. Under pressure from Saudi Arabia, the Presidential Leadership Council (PLC) abandoned the central bank's measures to consolidate control of the sector and enforce compliance.^[31] Facilitated by UN mediation, both sides made a public commitment to revoke the reciprocal financial and economic sanctions undertaken since February.^[32]

^[29] “Houthis Storm Central Bank Governor's Home in Sana'a After Economic Countermeasures,” Barran Press, July 6, 2024, <https://en.barran.press/news/topic/3318>

^[30] “Central Bank Governor Decision No. (30) of 2024 Concerning Licenses of Banks, [AR]” Central Bank of Yemen-Aden, July 8, 2024, <https://sahaafa.net/show188125903.html>

^[31] Ned Whalley and the Sana'a Center Economic Unit, “Saudis Give In to Houthi Pressure, Force CBY-Aden to Back Down,” Sana'a Center for Strategic Studies, July 23, 2024, <https://sanaacenter.org/publications/analysis/23062>

^[32] “Statement by the Office of the UN Special Envoy for Yemen,” Office of the Special Envoy of the Secretary-General for Yemen, July 23, 2024, <https://osesgy.unmissions.org/statement-office-un-special-envoy-yemen>

The Current Crisis

Following the Houthis' successful blackmail, authorities in Sana'a may seek to resume their efforts to control the banking system and money transfer networks and could resume printing currency. Critical functions once reserved for the internationally recognized CBY-Aden are slowly being usurped. This may be to the Houthis' short-term detriment – economic conditions in the north remain dire – but the measures have heightened the risk of a complete financial collapse in the government-held south, which would have severe humanitarian consequences.

The climbdown irrevocably undermined the CBY-Aden's leadership. Its monetary and fiscal sovereignty, capacity to enforce regulations, and relationship with the global financial system have all been thrown into question. The central bank had cautiously hoped that control over the financial sector would allow the government to negotiate on a more even footing with the Houthis, perhaps even extending to a deal on the resumption of oil and gas exports, which would have transformed its fiscal position. Instead, the central bank has been left weakened and adrift. As reserves run low, it has been regularly forced to suspend FX auctions intended to support the rial and the import of critical foodstuffs, and efforts to raise funds through various public debt instruments have failed to stabilize the situation.

There are reports of new EU sanctions on the horizon, and the incoming Trump administration may choose to reinstate the FTO designation that it placed on the Houthis in the final days of its last tenure. In 2021, this designation was quickly repealed by the incoming Biden administration over concerns that it would have a deleterious effect on the humanitarian situation.^[33] This time could be worse. With the CBY-Aden weakened and its control of the banking system jeopardized, it will be in no position to safeguard the civilian economy from fallout. All the while, the government lingers on the brink of insolvency, and economic deterioration and the fall of the new rial continue unabated.

The situation appears to be spiraling out of control. The CBY-Aden's attempt to introduce a unified money transfer network was intended, in part, to stem speculation on the rial. With the project aborted, there are reports that currency speculation is now rife,^[34] with Yemeni banks and individuals manipulating the new rial's volatility and decline for personal, and in some cases political, benefit. Aspersion have also been cast further afield, with some pointing the finger at money exchanges in Oman or Sana'a looking to benefit from the rial's collapse. The government has responded by cracking down on unlicensed money exchange shops, but the value of new rials continues to slide and is now below YR2,000 to the dollar. Houthi military action in the Red Sea continues to drive up shipping costs, putting further pressure on prices. CBY-Aden Governor Ahmed Ghaleb al-Maabqi recently

^[33] Antony Blinken, "Revocation of the Terrorist Designations of Ansarallah," US Department of State Press Release, February 12, 2021, <https://www.state.gov/revocation-of-the-terrorist-designations-of-ansarallah/>

^[34] Saeed al-Batati, "Yemen's government shuts down unlicensed exchange firms to stop rial devaluation," Arab News, November 4, 2024, <https://www.arabnews.com/node/2578032/middle-east>

met with representatives of the IMF and World Bank in Washington,^[35] where he reportedly told them the government had lost some US\$6 billion in revenues over the last 30 months. Most public sector salaries in government-held areas have now gone unpaid for two months.

The CBY-Aden had pressured remittance networks to tighten their relations with Yemeni banks and money exchange outlets operating under Houthi control, but the central bank's forced retreat has severely damaged its relationship with international outfits like MoneyGram and Western Union, undermining its authority as the regulator of these cash flows. The CBY-Aden had hoped to use the regulation of remittances and international transfers to better access hard currency. Without it, there will be further downward pressure on the rial.

Houthi pressure on Yemeni banks to withdraw from critical international financial platforms like SWIFT Scope, Buna, IBAN Checker, and Refinitiv could further disrupt remittances and trade and isolate Yemen from the global financial system, interrupting the flow of aid. In early August, the Houthis allowed Yemeni banks operating under their control to reconnect the SWIFT Scope, which is still monitored by the CBY-Aden. Yemen is already under increased monitoring,^[36] but the Houthis' rising international profile risks the country being labeled a high-risk jurisdiction by the Financial Action Task Force (FATF), which could lead to the termination of relationships with correspondent banks and further economic marginalization.

With limited resources and control, the government is also at the mercy of local interests. The wealthy, oil-rich governorate of Hadramawt, which has largely been spared from the conflict, has long pushed for greater autonomy and, in particular, a greater share of its hydrocarbon revenues. Local agitation led by the Hadramawt Tribal Alliance has escalated as government services falter. Governor Mabkhout bin Madi has now agreed with the central government to lower the local price of diesel, a subsidy it can ill afford.^[37] Subsidization, particularly of electricity, is enormously expensive and, coupled with a general inability to collect rents, has pushed government finances closer to the brink.

Political infighting has only made the situation worse. Animosity between Prime Minister Ahmed Awad bin Mubarak and the PLC, particularly its head, Rashad al-Alimi, is reportedly delaying action on economic reforms. The PLC's economic advisory council reportedly put forward plans some three months ago. Bin Mubarak has belatedly announced a reform plan that would entail restructuring a number of government institutions,^[38] but details remain sketchy, and it is unclear if he has the political support or resources to press ahead with the proposed reforms.

^[35] "Yemen's delegation discusses with IMF emergency support programs," Yemen News Agency (Saba), October 24, 2024, <https://www.sabanew.net/story/en/119134>

^[36] "Jurisdictions under Increased Monitoring - 25 October 2024," Financial Action Task Force, October 25, 2024, <https://www.fatf-gafi.org/en/publications/High-risk-and-other-monitored-jurisdictions/increased-monitoring-october-2024.html>

^[37] "Hadramout Governor issues decision to reduce diesel price [AR]," Aden Independent Channel (AIC), October 26, 2024, <https://www.aicaden.net/14742>

^[38] "Wage reform and employment policy.. The government launches a comprehensive restructuring of state institutions [AR]," Belqees, November 18, 2024, <https://belqees.net/locals/اصلاح-الاجور-وسياسة-التوظيف-الحكومة-تطلق-هيكلية-شاملة-للمؤسسات-الدولة>

The political paralysis in Aden is not new, but the government's apparent inability to tackle the financial crisis does not bode well for its resolution. The fundamental instability of the government, with constant rumors about its reformulation and restructuring, may have incentivized its members to value short-term political point-scoring over long-term policy. The PLC's authority and legitimacy, such as they are, depend on its ability to provide services, pay public sector salaries, and ensure that those salaries have purchasing power. It is currently failing on all three counts. If the rial continues to fall, a broader economic collapse is highly likely, which would deepen political dysfunction and precipitate further fragmentation.

Moving Forward

The current situation is dire – the government is struggling to pay its bills, the CBY-Aden is running low on foreign currency reserves, and domestic institutions lay shattered and toothless. The continued decline of the rial has eroded purchasing power and threatens economic collapse and humanitarian disaster. Yemen suffers from widespread food insecurity, malnutrition, and recurrent outbreaks of cholera.^[39] Famine is never far away. If the situation deteriorates further, the scale of the resulting humanitarian fallout could be devastating. Political turmoil in the south could undermine what security exists, impeding humanitarian access, driving security competition, and allowing local armed groups to become entrenched, including non-state actors such as Al-Qaeda. The Houthis could seize such an opportunity to resume large-scale military operations in Marib or Hudaydah.

Yemen is in the throes of crisis, but at present, there are still two sides, each with some level of central administration, and frontline fighting remains limited. The resumption of widespread conflict or a more complete state failure would be far more difficult and complex to rectify, and such an outcome should be feared. But there is still an opportunity to act. It is up to Yemen's allies and the international community to arrest its current economic trajectory, restore faith in the financial capacity of the state, and provide the requisite balance of power for a functioning dialogue on economic de-escalation. Saudi Arabia, the UAE, and the international community must provide systematic and sustained financial support for the internationally recognized government at a scale that fosters the strengthening of institutional capacities. As it stands, the various political groups that make up the PLC and government are widely perceived to lack agency independent of Saudi Arabia or the UAE, which has undermined their domestic legitimacy. Such alignments are also at play at the governorate level. The weak and fragmented PLC and its failure to provide basic services or pay timely salaries have pushed some local authorities at the governorate level to pursue unilateral decision-making, which only further weakens the central government. The failures of service provision are even more damning when it is outdone by the Houthi authorities in Sana'a, a difference not lost on many Yemenis. Allowing the government to be outcompeted in governance is a strategic failure that cements support or tacit acceptance of the regime in Sana'a.

^[39] "Yemen - Humanitarian Situation Report No. 2," UNICEF, September 8, 2024, <https://www.unicef.org/media/161521/file/Yemen-Humanitarian-SitRep-No.02-30-June-2024.pdf>

The international community must continue to work towards a comprehensive economic roadmap, which includes strengthening the CBY-Aden's ability to effectively regulate and control financial systems and allowing it to negotiate with Sana'a on a more equal footing. Shuttle diplomacy by the UN Special Envoy has sought to work toward the reunification of the currency and, ultimately, the central bank. Any durable peace agreement must include provisions for the unification of the domestic banking system, the reintegration of Yemen into the global financial system, the establishment of a credible monetary policy framework, and the submission of all parties to a neutral and unified financial system to support economic recovery and aid provision.

But such measures are currently absent. The Houthis hold the whip in hand in Yemen, and the authorities in Sana'a are continuing to leverage their military supremacy to monopolize and institutionalize their control of the economy and levers of the state. The current imbalance promises a bleak economic future characterized by further instability, poverty, and suffering. Saudi Arabia will reportedly soon release the final tranche of a US\$1 billion grant announced last year, according to a senior government official. The program's conclusion provides an opportunity to reconsider and recast the shape of systemic support. The economic situation has become a potent vector of instability in Yemen. Left ignored, it could fester, then explode.

Recommendations

To the International Community

- **Provide Immediate Financial Relief**

The international community has shown limited appetite for providing sufficient financial support to the internationally recognized government. Humanitarian needs in Yemen remain high due to the persistent economic degradation of the country. The situation risks continued deterioration if substantial financial support is not forthcoming to stabilize the currency and the government's fiscal position. An immediate package should be put together.

- **Mediate an Economic Truce**

Broader rehabilitation of the economy is dependent on mutual de-escalation. The international community should continue to support the efforts of the UN Special Envoy to broker an economic ceasefire. All parties must commit to halting economic warfare and respecting the neutrality of the banking sector so that it can continue to provide essential services, such as access to remittances and facilitating the disbursement of humanitarian funding. The UN and the international community must explore all available levers of pressure and incentivization to secure commitment from stakeholders.

A negotiated economic deal could strike a balance, ensuring neither central bank branch dominates the other. However, to facilitate trade, cross-border investment, and the delivery of humanitarian aid, Yemeni banks must be compelled to share all their operational data with the CBY-Aden to ensure compliance with AML/CTF regulations.

- **Create a Comprehensive Economic Roadmap**

To revitalize Yemen's economy and redress the persistent humanitarian situation, the UN Special Envoy must continue to develop a comprehensive economic roadmap in collaboration with key international stakeholders. This should extend beyond the immediate banking crisis and address critical issues such as public sector salaries and revenue management and distribution, including the resumption of hydrocarbon exports.

- **Prioritize Public Sector Salaries:** Houthi-controlled regions have been devastated by the lack of regular salary payments since 2016, and salaries are now two months late in the south. The UN and its partners must continue to advocate for their restoration. Any plan must prioritize partial payments to civil servants and retirees in Houthi-controlled regions, excluding military and security personnel. A combination of existing funds and external support could be utilized to cover initial disbursements. A comprehensive, unified payroll database should be developed, incorporating robust verification and cross-checking processes and transparent payments linked to national identification numbers and/or biometric verification. In addition, a sustainable revenue-sharing mechanism to finance salaries must be found. The search should explore options such as customs revenues, oil and gas revenues, and external support.

- **Reunify the Currency:** Further talks should address the currency division, including potential measures for ameliorating the dual exchange rate system, along with localized inflation and lack of liquidity. Measures such as printing new banknotes or allowing both currencies in certain regions should be considered. The UN and international community should seek to facilitate robust financial assistance and technical expertise to support payroll restoration and currency unification.
- **Ensure Equitable Revenue Distribution:** Any revenue distribution mechanism must consider the fair allocation of funds to Houthi- and government-controlled territories, with a particular emphasis on historically marginalized governorates. Failure to address existing and historical grievances could undermine peace efforts and create new sources of conflict.
- **Maintain Humanitarian and Development Aid Flows:** Donors must continue financing Yemen's humanitarian needs during the conflict and seek to ameliorate current funding shortfalls. Where possible, they should prepare for a shift to development aid to enable the building of sustainable economic assets, accumulation of capital, and income-generating opportunities.
- **Ready International Support:** The international community must be prepared to provide further substantial financial and technical support once a genuine economic de-escalation and political roadmap is ready to be implemented in Yemen. This is crucial to prevent the complete collapse of the Yemeni economy and facilitate the reintegration of its fragmented monetary and financial systems.

To Saudi Arabia

- **Balance Economic Power:** Saudi Arabia must recognize that a sustainable economic truce in Yemen requires a balanced approach. The kingdom should refrain from granting further concessions to the Houthis outside the UN-led process, as it risks entrenching Houthi dominance over the economy.
- **Leverage Financial Influence to Promote Cooperation:** As the largest regional financial network, Saudi Arabia plays a critical role in facilitating cross-border remittances to Yemen. Given the substantial number of Yemeni workers in the Saudi labor market, its banks channel a significant portion of remittance flows into Yemen and provide Yemeni banks with valuable opportunities to connect to the global financial system through platforms like Buna. This is crucial for Yemeni banks facing de-risking challenges that hinder their ability to conduct international transactions. To support Yemen's economic recovery, Saudi Arabia must use this leverage to pressure the Houthis to cooperate with the CBY-Aden. By threatening to restrict remittance flows to Houthi-controlled areas, Saudi Arabia could create a powerful incentive for the Houthis to comply with international standards and respect the neutrality of the banking and money transfer system.

- **Provide Targeted Financial Support:** Riyadh should immediately increase its financial support for the internationally recognized government. To date, grant money has been announced and disbursed in irregularly timed tranches. This policy appears to reflect concern over the prior misappropriation of funds and a desire to keep the government acquiescent, but it is no replacement for a more coherent long-term policy. Irregular payments drive down confidence in the government's viability and contribute to inflation. A regular schedule could help stabilize the rial, improve food security by supporting import financing, allow for the regular payment of public sector salaries, and mitigate speculation. If sufficiently funded, the government's borrowing costs would decrease, and it would be better placed to raise further funds independently.
- **Promote Service Provision:** The government's massive subsidization of fuel and electricity and its byzantine process for delivery are in dire need of long-term reform. But the PLC's short-term legitimacy is tied to their current provision. Saudi Arabia is well-placed to facilitate energy needs, either through grants, fuel shipments, or the construction of power plants. Each of these has been tried, but the scale and implementation have been insufficient. Recurring power cuts, particularly in Aden, give the lie to any assertions of government competency. Apart from fueling public discontent and political unrest, the limited and unreliable supply hampers development.

To the Internationally Recognized Government

- **Trim Expenditures:** The government should also carefully consider where it might limit and reform expenditures. Subsidization programs, such as those for electricity, should be reformed, and payrolls interrogated to eliminate inactive employees.
- **Improve Revenue Collection:** The government currently recoups only a fraction of the revenues it is owed through taxation and utility bills, both of which are collected far more efficiently in the Houthi-held north. While improved collection may require greater capacity, the government should pursue all avenues to collect legally owed sources of revenue.
- **Combat Corruption and Increase Transparency:** The government should commit to fighting corruption and building sound governing frameworks for the effective and transparent provision of services, collection of revenues, and allocation of expenditures. This should include the passing and publishing timely budgets and detailing its earnings, expenditures, and debt obligations and those of state-owned companies.
- **Centralize Financial Networks:** The central bank branches in Sana'a and Aden have sought to establish separate, unified financial networks within their respective areas of control. This reflects a broader power struggle for control over the exchange and remittance sector. To mitigate tensions and facilitate a transition towards a unified financial system, international actors should help the banks to:

- **Reduce Escalation:** De-escalate tensions between the conflicting parties and promote a collaborative approach to financial matters.
- **Set up Temporary Dual Networks:** During a transitional phase, allow each party to operate a separate, unified financial network within their area.
- **Build an Intermediary Network:** Establish an intermediary network to handle remittances between the divided conflict areas, providing a bridge during the transitional period.
- **Work Toward Gradual Unification:** If progress is made in the peace process and the management of the Central Bank of Yemen is unified, work towards the gradual integration of the separate financial networks into a single, unified system.

To the Houthi Authorities

- **Engage Constructively:** The Houthis must engage in peace talks under the UN's sponsorship to facilitate an immediate economic truce. This truce should create a neutral environment for the private sector and banking system to operate freely and address the needs of all Yemenis, regardless of their political affiliations.
- **Commit to Confidence Building Measures:** As part of the economic truce, the Houthis should allow Yemeni banks operating under their control to share critical banking data with the CBY-Aden to enable the banking system to meet international standards and continue facilitating the import of essential commodities, including food. Additionally, the Houthis should refrain from issuing new rial banknotes or coins, as this could worsen inflation and undermine efforts to stabilize the economy.
- **Negotiate the Resumption of Oil Exports:** The oil and gas sector was the main source of income for Yemen prior to the conflict. The restoration of exports is essential to the economy, specifically to finance the payment of public sector salaries. Yemen cannot rely on foreign aid indefinitely - the current humanitarian response is already underfunded as donors struggle to respond to crises around the world. The Houthis should commit to allowing the resumption of hydrocarbon exports based on an equitable revenue-sharing mechanism.

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