Two Birds With One Stone: Using Aid Transfers to Support Stable Commodity Prices in Yemen

By: Alex Harper and the Sana’a Center Economic Unit

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Cover photo: A shipment of wheat flour from the World Food Programme being offloaded at Hudaydah port on June 25, 2019 // Sana’a Center photo by Abduljabbar Zeyad.

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Executive Summary

During the conflict in Yemen, the government-run Central Bank of Yemen in Aden (CBY-Aden), and other government-aligned economic stakeholders have argued for a policy that would rationalize humanitarian and broader aid transfers to support the provision of foreign exchange (FX) to critical commodity importers. This could benefit the economy at large and specifically support the stabilization of food prices, a major driver of food insecurity. Such proposals have aimed to solve challenges resulting from the competing economic and monetary policies adopted by the parties to the conflict. However, the CBY-Aden is currently unable to effectively regulate Yemen's financial institutions to utilize aid funds for import financing and currency stabilization. Aid actors have also been reluctant to engage with past such proposals from the CBY-Aden for fear of politicizing aid implementation.

But institutional hesitation could miss an opportunity to address one of the primary drivers of humanitarian need in Yemen – a lack of purchasing power – by providing stable access to foreign exchange for critical commodity imports. While engaging directly with government institutions is not realistic, aid actors could be more transparent about when and how much they deposit in Yemeni financial institutions. This would be an essential first step in building confidence and momentum toward linking these deposits – through what would ideally be a neutral, transparent, and non-political reporting mechanism – to Yemeni importers, reducing capital flight and the cost of accessing foreign exchange, and ultimately supporting the import of essential commodities. This could in turn stabilize the market, help insulate it from conflict-driven shocks, and reduce prices.

The creation of a transparent system whereby aid funds could help stabilize the economy is a low-cost, high-reward endeavor that could be impactful regardless of the trajectory of the conflict and its troubled peace talks. It would also address any misperceptions around the amount of hard currency that reaches Yemeni financial institutions from abroad, which is significantly less than the overall amount spent by aid actors. Once these misperceptions are addressed, there is room for real and impactful engagement on the issue, and improved transparency not only around aid transfers to Yemen, but for the Yemeni financial market more broadly.
Introduction

One of the ramifications of the war in Yemen has been a major shock to the country’s balance of payments. Prior to the conflict, Yemen’s primary sources of hard currency (FX) were hydrocarbon exports and remittances. The suspension of oil exports at the onset of the conflict and the broader impacts of the war on the productive economy decreased the amount of FX available in the country. The split of the Central Bank of Yemen (CBY) into two branches associated with the rival parties to the conflict – the CBY-Aden under the control of the internationally recognized government and the CBY-Sana’a under Houthi authorities – has led to competing economic and monetary policies. These developments have negatively impacted the value of the Yemeni rial (YR) and led to significant price inflation, two primary drivers of humanitarian need.

Within this context, Yemeni importers have struggled to access the FX needed to import essential commodities. Attempts have been made to address this issue in the past, notably through a US$2 billion deposit made by Saudi Arabia with the CBY-Aden in 2018, and again in February 2023. The CBY-Aden began weekly FX auctions in November 2021, offering hard currency to Yemeni banks at a discounted rate to be channeled to essential commodity importers. However, the government’s FX reserves remain dangerously low, and its ability to maintain regular auctions moving forward is in question. Hydrocarbon exports came to a complete halt following Houthi drone attacks on southern Yemeni ports at the end of 2022, denying the government a critical source of hard currency. Limitations have been imposed on which banks are able to subscribe to the currency auctions amid competition with the Houthi-controlled CBY-Sana’a over regulation of the banking sector. As a result, Yemeni importers still struggle to access FX. In government-held areas, the rial has depreciated to lows not witnessed since late 2021.

As a result of the economic collapse caused by the conflict, Yemen has become heavily dependent on foreign humanitarian aid and remittances as its primary sources of FX. The aid industry comprises a substantial portion of the national economy and has vast macro and microeconomic impacts. However, there has been limited analysis of the economic impact of aid on the broader economy, including the degree to which aid funds contribute to currency stabilization, and whether they might be used more efficiently to this end. For instance, in 2021 a total of US$3.32 billion in foreign aid was pledged to Yemen. However, the amount reaching Yemeni financial institutions, while significant, was far lower. According to interviews conducted for this policy brief, approximately US$1 billion was transferred to Yemeni financial institutions by UN agencies during this period. Of this US$1 billion, a smaller fraction still was exchanged into Yemeni rials.

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[4] It is important to note that the Financial Tracking Service does not provide any information on the modalities around how the funds are spent, and which financial institutions manage the funds. Therefore this tracking service does not provide the data and transparency levels being advocated for in this paper.
[5] Interview with senior aid official, July 2023. At the time and in response to a request by the UN Resident Coordinator’s office, UN agencies aggregated data on financial transfers to Yemen. This was part of a risk assessment conducted in response to a request by the CBY-Aden to funnel aid through its accounts in support of imports.
Since 2018, the CBY-Aden has attempted to establish a foreign exchange mechanism under its supervision through which the United Nations, international non-governmental organizations (INGOs), and international donors would transfer aid funds to Yemen. It has accused Houthi authorities in Sana’a of embezzling funds from foreign exchange transactions and financial aid transfers to support their war effort.[6] This has resulted in public and private calls for the UN and broader aid response to work with institutions such as the CBY-Aden, especially during periods of acute economic instability.[7] Calls for aid funds to be managed by the government-controlled central bank have also come from the Saudi-led coalition, in order to deny Houthi authorities in Sana’a access to these funds.[8] The issue was inherently political, linked with efforts to increase the leverage of the CBY-Aden and the government vis-à-vis Houthi authorities. It has also been interlinked with other issues, such as how aid actors exchange hard currency for Yemeni rials, and the risks faced by the aid sector when engaging with Yemen’s financial service providers to purchase unstable and diverging national currencies.[9]

The CBY-Aden has argued there would be economic benefits from its managing financial transfers from aid organizations, as they would be able to link these transfers to import financing requirements. This would improve access to hard currency by importers, therefore reducing currency volatility, and in turn, reducing price inflation for basic foodstuffs and other critical commodities. While recognizing that this issue has been politicized in the past, there is a logic to the CBY-Aden’s request. Due to the lack of regulatory oversight and the broader impact of the conflict, significant amounts of foreign exchange in Yemen continue to be spent on unnecessary luxuries and imported war materiel, or “lost” through ongoing capital flight, as evident in billions of dollars allegedly spent on foreign real-estate and the transference of business and manufacturing infrastructure abroad.[10] Within the current realities of Yemen’s financial landscape it is very difficult to effectively reduce or regulate capital flight, but funneling hard currency to importers of critical goods could go some way toward maintaining stability in fragile local currency markets. Access to aid deposits in foreign correspondent accounts may also reduce the costs importers face in accessing usable foreign currency in Yemen’s heavily de-risked domestic financial markets.[11]

Despite the challenges, initial consultations with a range of stakeholders indicate that there is room for action when aiming to link aid funds to import financing, notably increased transparency.[12]

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[7] Interview with a senior aid official, March 2023, and author’s previous experience working in the aid sector in Yemen.
[12] Reference to validation event with Yemeni and international stakeholders held on May 10, 2023, as well as interviews with aid officials, economists and experts.
Aid funds are “clean” and often held abroad in foreign correspondent accounts — this could not only assist traders struggling with accessing hard currency, but also provide more cost-efficient and transparent mechanisms to channel funds for the purpose of importing critical commodities. The resultant increase in transparency could also reduce misperceptions around the scale of aid financial transfers to Yemeni financial institutions and how these funds are allocated.
Methodology

This policy brief was based on six key informant interviews conducted with international aid officials, economists, and experts on Yemen between April and June 2023. The author also drew on his experience working in the international aid sector on Yemen from 2018 to 2021, collaboration with the Sana’a Center Economic Unit, and a thorough desk review of the existing literature.
The History

Yemen depends on imports for most of its fuel and food, and affordability continues to be the biggest driver of food insecurity. There have been multiple efforts by the internationally recognized government to argue for systematic regulation of financial aid flows and the linking of these to import financing needs. Some aid actors have stated that their financial transfers\[13\] have been in turn provided by banks to importers of critical commodities.\[14\] Houthi authorities have also argued that they linked FX provided by aid actors to the import financing of food and fuel. However, there is currently no systematic or transparent process to validate these claims.\[15\]

The CBY-Aden has requested that aid actors engage directly with them in the deposit and exchange of external hard currency transfers to rials, especially during periods when foreign currency reserves have been especially low, or when the rial is experiencing high volatility.\[16\] In other words, the “bank of banks” has proposed providing a direct banking service to aid operations to facilitate this exchange. One proposal from the Central Bank in Aden came in 2021, when above-market exchange rates were allegedly being provided to aid organizations by partner financial service providers. From 2020, following a ban by Houthi authorities notes printed by the Central Bank of Yemen in Aden,\[17\] the values of ‘old rials’ in Houthi-controlled areas and ‘new rials’ in government-controlled areas began to diverge. In December 2021, new rials traded at YR1,725 to US$1 in government-controlled areas, compared to around YR600 to US$1 for old rials in Houthi-controlled areas.\[18\] As the gap widened,\[19\] aid actors received less favorable exchange rates for programming taking place in government-controlled areas, with Sana’a-based banks providing exchange rates closer to the Houthi rate.\[20\]

The government’s economic authorities were cognizant of the potential benefit to commercial banks from the arbitrage opportunity. They were quick to remind the aid sector of the loss in value of aid transfers which took place in 2016 and 2017, during the initial period of conflict-driven depreciation experienced by the previously fixed currency exchange rate (through a managed float mechanism). During this period, Yemeni banks exchanging funds for international organizations reaped considerable profits at the expense of aid recipients.\[21\]

\[13\] In support of major cash programs, such as the UN-implemented and World Bank-funded Social Welfare Fund.
\[14\] Interviews conducted prior to this research with several senior aid officials in late 2019.
\[15\] Interview with an economic analyst focused on Yemen, May 2023.
\[16\] “Humanitarian Economics - Yemen,” Economic Committee (government-aligned), 2020 (report unavailable online).
\[20\] Interviews conducted prior to this research with aid sector and CBY-Aden officials, January-March 2020.
\[21\] “How currency arbitrage has reduced the funds available to address the humanitarian crisis,” The Sana’a Center for Strategic Studies, September 6, 2017, https://sanaacenter.org/publications/analysis/4740
According to interviews, the UN took these requests relatively seriously, and in 2021, made an effort to assess the exchange of aid deposits with the CBY-Aden. However, it was determined that the risks were too high, and the potential rewards too low, to justify significant engagement with the CBY-Aden. The considerations that factored into that decision are outlined below (see, 'Risks and Challenges'). Requests from government authorities to reconsider have continued, on an ad hoc basis, and the issue continues to have a high profile.

[22] Interviews conducted prior to this research with senior aid officials, January-May 2021.
Realities and Misperceptions of Aid Transfers to Yemen

The debate over utilizing aid transfers for supporting import financing has been hampered by misperceptions over the scale of financial transfers to Yemeni banks.[24] One interviewee stated that once these misperceptions are addressed, there is room for real and impactful engagement on the issue.

It is also important to note that any linkage of aid transfers to importers would not increase the amount of hard currency available on the market in Yemen, and therefore from a purely economic perspective wouldn’t strengthen the value of the Yemeni rial. However, as noted above, there is a strong economic argument that improving importers’ access to FX would reduce overheads and other costs associated with accessing hard currency in a constrained market and limit the “leakage” of hard currency spent on non-essential goods. A joint, transparent mechanism for regulating foreign aid funds to finance basic commodity imports could thereby indirectly mitigate the depreciation of the Yemeni rial. As foreign aid funds would be utilized to meet the FX demands of commercial importers, it would limit the potential for these funds to facilitate capital flight, and reduce pressure on the broader FX market.

What happens to aid money

A large percentage of foreign aid, and in particular humanitarian aid, is spent on: 1) the procurement of in-kind aid outside Yemen; and 2) hard currency expenses inside Yemen (salaries, procurement, etc).

While Overseas Development Assistance to Yemen has amounted to billions of dollars annually since 2015, the actual amount transferred to Yemeni financial institutions is much lower, and the amount converted into rials lower still.[25]

Most in-kind aid donations, such as wheat, are procured abroad and arrive in ships, especially USAID-funded, in-kind assistance.[26] Likewise, procurement from Yemeni businesses often involves transactions with their foreign correspondent banks abroad. Overall, while a significant amount, only a percentage of aid funds allocated to Yemen is available to traders and importers through the Yemeni banking system. With aid funding declining, the amount is expected to get even smaller.

Once money is transferred into Yemen, it is then spent in two ways. Following a CBY decree in 2016, aid organizations are permitted to use dollars for operational expenses.[27] This process increased significantly in 2018 when the rial began to experience volatility - pushing traders and businesses working with the aid sector to demand payments in foreign currency, often in cash, in order to hedge against the risk posed by sharp periods of depreciation. Aid sector salary payments are also often paid in hard currency to both national and international staff.[28]

[26] Some procurement for in kind assistance does take place in Yemen.
[28] Interviews conducted prior to this research with aid actors throughout 2020.
Risks and Challenges

Further politicization of aid assistance

Any engagement with economic authorities in Yemen runs the risk of having aid mobilized in support of political agendas, especially given the extent to which "economic warfare" has characterized political dynamics in recent years. This, in combination with the aid sector’s general lack of trust in Yemen’s public institutions, in both Sana’a and Aden, acts as a strong disincentive for engagement. Senior aid officials viewed proposals by Yemeni economic authorities (such as the request by CBY-Aden in 2021) as self-motivated and incognizant of the risks inherent in such processes, such as the further politicization and instrumentalization of assistance, potentially pulling the humanitarian sector further into the economic war between government and Houthi authorities.

Interview subjects also questioned the role of the UN in providing a stable source of financing for critical commodity importers, and whether this, in particular, runs the risk of politicizing humanitarian assistance. Engaging directly with the CBY-Aden was seen as potentially decreasing the efficiency of assistance, particularly in Houthi-controlled areas, where a majority of the population resides. The timing has also been questioned, with one interviewee stating that a post-conflict environment might be a better time to consider such an approach.[29]

One interviewee noted that previous CBY-Aden proposals have lacked detail, leaving open a long list of technical questions related to how any system would be managed.[30] How would aid implementers be assured that access to funds would be timely and consistent? How would the impact of such a program be tracked over time? How effective have previous and current import financing schemes been in practice? And perhaps most importantly, is this the best utilization of the aid sector’s time and resources?[31]

There is some concern that revealing the true value of aid transferred to Yemeni banks, significantly smaller than the overall size of pledges, might inflame public sentiment against an aid response already under regular attack for being wasteful.[32] It was also noted by one interviewee that the structure of the UN system is complex, and doesn’t lend itself well to these kinds of data collection processes, which require a significant investment of time and buy-in.[33] Another interviewee was more explicit, stating that it is unlikely that certain UN agencies would welcome this kind of attention and transparency, for fear of calls for greater accountability.[34]

[29] Interview with one senior aid sector official, May 16, 2023; and interview with a second senior aid sector official, July 2, 2023.
[34] Interview with senior aid sector official, May 16, 2023.
Yemeni economic institutions and a lack of transparency

A crucial part of any approach to linking aid funds to import financing is understanding the role played by Yemeni economic institutions in both Houthi- and government-controlled areas in managing the provision of FX reserves to traders. In Sana’a, this role is largely played by the Payments Committee, an economic institution set up by Houthi authorities in 2018 to help manage access to foreign exchange reserves for importers.[35] There is opacity around the functioning of this institution and how it allocates reserves. Given the predominant operational focus of aid actors, and the banks that service them, in Houthi-controlled areas, the Payment Committee plays a key role in deciding which traders access these resources, although it has stated that they are prioritized toward critical commodity imports.[36] One interviewee stated that Houthi economic authorities are particularly adverse to increased transparency in the financial sector and institutions under their control.[37]

The CBY-Aden currently operates with less opacity and implements a currency auction system to support banks, and through them importers, in need of hard currency.[38] However, while the amounts and commodities are published, the names of purchasing banks and traders, and information on where the hard currency originates, are not. The auctions have consistently been undersubscribed by banks, which purchased over 60 percent of what was offered only twice from January to May 2023.[39] This is at least partially the result of unfavorable rates, exchange market dynamics, and Houthi authorities banning banks from participating.[40]

The current context presents challenges to platforming any policy recommendations across competing and often opposed stakeholders. Past efforts to engage aid actors and the international community to link aid transfers to import financing were problematic, and a degree of skepticism, if not outright opposition, within the aid sector is to be expected. Done wrong, such linkages could further entangle the humanitarian response in political dynamics. Stakeholders in the aid sector have rightly pointed out that linking aid transfers to specific parties, such as the CBY-Aden, could invite a response from authorities in Sana’a, which could directly affect humanitarian programming and negatively impact the lives of millions of Yemenis dependent on assistance.


[36] Ibid.

[37] Interview with senior aid sector official, June 2, 2023.


[39] Interview with economic analyst, April 2023.

[40] In mid-January, the Houthi-run CBY-Sana’a issued a decree banning Yemeni banks and commercial traders headquartered in Sana’a from participating in the auctions or utilizing Letters of Credit under the CBY-Aden’s scheme, thus limiting amount of hard currency that the CBY-Aden could sell for financing basic commodity imports. Since then, banks could only participate in the CBY-Aden’s FX auctions to finance imports into government-controlled regions, which are less densely populated. During the period of January to May 2023, Yemeni banks only purchased 42 percent of FX on offer during auctions. Prior to the ban, Sana’a-based commercial traders and Yemeni banks purchased almost 60 percent of foreign currency auctions offered by the CBY-Aden, according to Sana’a Center Economic Unit estimates.
The case for a neutral, transparent process for linking financial flows from aid actors to imports

Aid actors should be aware that avoiding engagement with any proposal for increased transparency around financial transfers, on the basis of risk misunderstands the fragility in their relationship with the Yemeni financial service providers upon which they depend to implement assistance. Yemeni banks and broader financial institutions operate within a complex cross-national web of relationships and infrastructure that doesn’t match easily with the zones of control. Domestic political and private sector actors have their own agency and could choose to exert leverage in ways not currently anticipated. Within this context, good faith and proactive action are needed to avert purely reactive responses to changes in context.

The current lack of clarity around political negotiations acts as a disincentive for international actors to seek policy engagement. This has been cited by senior aid officials as a reason not to pursue a transparent process for linking aid transfers with importers of critical commodities. But now is exactly the time that such proactive engagement should take place. Increasing transparency and working toward the creation of a system whereby aid funds could help stabilize the economy is a low-cost, high-reward exercise that could be impactful in both optimistic and pessimistic scenarios for Yemen’s peace talks going forward. In addition, it would more efficiently anchor the provision of assistance into broader humanitarian-development-peace nexus objectives.

Should progress on a peace deal be achieved, small confidence-building measures could be instrumental toward laying the foundations for larger, more ambitious plans to build consensus towards de-escalating the economic war in Yemen, or mitigating its impact on ordinary Yemenis. Alternatively, should there be a lack of any progress in current peace negotiations, economic instability and currency volatility will increase, reiterating the need for an effective and transparent mechanism for linking aid transfers to importers of critical commodities.
Recommendations

To UN agencies and international non-governmental organizations active in the Yemen aid response:

- Aggregate internal financial data to build a robust map of how much is transferred to Yemeni banks and over what time periods, in order to create the foundations of a system whereby international financial transfers are more robustly linked to the financing needs of Yemeni critical commodity importers.

To Yemeni economic authorities:

- Where possible, publish data around aid transfers to Yemeni financial institutions.
  - The CBY-Aden should utilize its oversight of SWIFT networks to help identify transfers from aid organizations to Yemeni banks. It should provide greater transparency on how hard currency sold in its regular currency auctions is sourced, and pressure purchasing institutions to identify when this is supporting the import of critical commodities, such as food and fuel. It must avoid further politicizing the issue.
  - The CBY-Sana’a and other economic authorities in Sana’a should positively engage with efforts to improve transparency around linking aid transfers to critical commodity importers and publish data related to this.

To Yemeni banks and commercial actors:

- Publish information on who purchases the hard currency transferred from aid organizations, and commit to a consensus-based mechanism that prioritizes using transfers to support the purchase of critical commodities, such as food and fuel.

To Yemeni civil society, international actors, and private sector stakeholders (both importers and financial institutions):

- Collaborate to explore the development of a neutral, third-party mechanism for the aggregation of financial data on humanitarian transfers, which financial institutions receive them, and how they can be directed toward supporting essential commodity importers.
**Alex Harper** is an aid sector-focused analyst and researcher and has spent the last 6 years working for international aid organizations across the MENA region, namely on Lebanon and Yemen. He has significant experience working on Yemen's economy in this capacity and previously worked with the Sana’a Center between 2016-2018.

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