USAID
FROM THE AMERICAN PEOPLE

USAID Yemen Economic Growth Appraisal

Final Report
Asia and the Middle East Economic Growth Best Practices (AMEG) Project
Chemonics International, Inc.

Task Order No. AID-OAA-12-00008

December 16, 2012

This publication was produced for review by the United States Agency for International Development by Chemonics International Inc.

ASIA AND THE MIDDLE EAST ECONOMIC GROWTH BEST PRACTICES PROJECT

USAID YEMEN ECONOMIC GROWTH APPRAISAL FINAL REPORT

Task Order No. AID-OAA-12-00008

Implemented by:

Chemonics International Inc.

CONTENTS

Trip Overview 5

Findings and Opportunities 6

Annexes 23

ACRONYMS

AMEG	Asia and the Middle East Economic Growth Best Practices Project
CBY	Central Bank of Yemen
MENA	Middle East North Africa
MNO	Mobile Network Operator
NGO	Nongovernmental organization
Y-EFE	Yemen-Education for Employment
YMN	Yemen Microfinance Network

TRIP OVERVIEW

An appraisal of opportunities to support economic growth in Yemen was conducted from December 8 to 16, 2012 by William Baldridge, Team Leader, Economic Growth of the USAID Asia and Middle East Bureau and Melissa Scudo and Kenneth Dorph representing the USAID Asia and the Middle East Economic Growth Best Practices (AMEG) project, managed by Chemonics International. The team would like to thank the representatives of financial institutions, private sector enterprises and Government of Yemen authorities for providing information and discussing the current constraints affecting growth in the financial sector and the economy. The team would also like thank Robert Wilson, Mission Director of USAID/Yemen for his leadership and orientation during the appraisal and in particular Mayad Yafai, Economic Growth Specialist for support and assistance with logistics and interviews. The team also acknowledges Andrew Batchelor for background research on Yemen's economy and financial sector.

The economic appraisal was designed as an action-driven, swift assessment of the most immediate and urgent vulnerabilities of the Yemen private and financial sectors with the objective of identifying discrete, time-bound impactful interventions to stimulate economic growth and create jobs in Yemen. In advance of the field appraisal, the team conducted secondary research on the state of Yemen's economy, macroeconomic indicators and reports summarizing previous and existing relevant economic growth interventions. A list of these references is presented in Annex C and electronic copies provided to the Mission. In country, the team conducted interviews with USAID, USAID practitioners, non-governmental organizations, donors, financial institutions, business leaders, think-tanks, and relevant Government of Yemen counterparts.

The next section of this report details the team's findings and opportunities for specific, time-bound interventions to increase financial inclusion and create jobs through workforce development. For each proposed activity, we present background and context, a description of the activity, a justification for USAID/Yemen support, and an estimated budget and timeframe for implementation. We also propose the mechanism through which the activity may best be implemented. The annexes present a summary of enterprise development indicators, a list of organizations consulted, and references.

FINDINGS AND OPPORTUNITIES

PROPOSED FINANCIAL INCLUSION ACTIVITIES

A. ACTIVITY: FACILITATE FINANCING IN SELECT VALUE CHAINS

Background. Formal, registered SMEs are estimated to generate less than 10 percent of Yemen's GDP since small businesses are dwarfed by the dominant large family companies and government sector activity, including the oil sector. A majority of Yemenis are outside the formal economy, mainly in small family farms and associated activities. As a result, despite their relatively small contribution to official GDP, SMEs overwhelmingly dominate job creation, driving more than 95 percent of all employment. No plan to increase employment in Yemen will be successful without fostering the growth of small businesses.

The Yemeni financial system does not adequately allocate financial services to smaller businesses. Financial intermediation is generally quite low and tends to concentrate on the government and the larger companies:

- Fewer than 4 percent of Yemenis have bank accounts.
- Loans to the private sector comprise less than 25 percent of total bank assets and less than 20 percent of conventional (non-Islamic) bank assets. Most funds are placed in Central Bank of Yemen (CBY) deposits or as government credits.
- Domestic credit to the private sector has dropped to less than 5 percent of GDP. This contrasts with almost 60 percent for the Middle East North Africa (MENA) region.
- According to interviews with the financial sector, the great bulk of credit to the private sector is in the form of short-term loans and guarantees, mainly for trade finance, to Yemen's twenty to thirty largest family firms.
- Any financial access for the vast majority of Yemenis is either through moneychangers or the national postal service. Both are limited mainly to transactional services and do not include credit extension.

Financial intermediation with small businesses is virtually non-existent outside the recently established microfinance institutions. Fewer than 15 percent of SMEs are estimated to have any interaction with the formal financial sector.

The banking sector has largely avoided small businesses due to:

- The very high dispersion of businesses and the lack of access (70 percent of the population lives in rural areas, many without access to paved roads).

- The normally high risk of lending to the SME sector compounded by the lack of mitigating information, including the banks' weak risk assessment capacity and the lack of system-wide credit information.
- The aversion to "riba" that dampens the appeal of conventional bank lending for most small businesses.
- The very high interest rates, with spreads almost twice prevailing MENA rates. The Central Bank has maintained high interest for monetary and exchange management purposes.

Yemen has essentially no public capital markets with very little private equity activity.

Opportunity. Lack of access to finance has been identified as a key impediment to SME growth and therefore private sector employment. An effective mechanism to increase financial access is to encourage bank lending through the implementation of a loan guarantee through the Development Credit Authority (DCA). To best mobilize resources, it is recommended that efforts focus on facilitating access to finance within a series of SME value chains that, based on secondary research and input from interviews conducted by the appraisal team, are identified as particularly promising. These include: coffee, beekeeping and honey production, and horticulture products. Fishing has also been identified as a high return line of business and could be a sector for consideration but has been omitted for now.

To support the effective financing of the value chains we have identified four activities: (1) a financial assessment of each value chain; (2) an assessment of the borrower sectors; (3) the analysis of the selected partner banks; and (4) technical assistance to facilitate value chain financing. Each is described in greater detail below.

1. *A financial assessment of each value chain.*
   In order to uncover opportunities for financing, each value chain must be analyzed for financing potential. Each segment must be reviewed to identify any potential investment in an improved technology or process that would add enough value to justify the investment's cost, including the cost of financing.

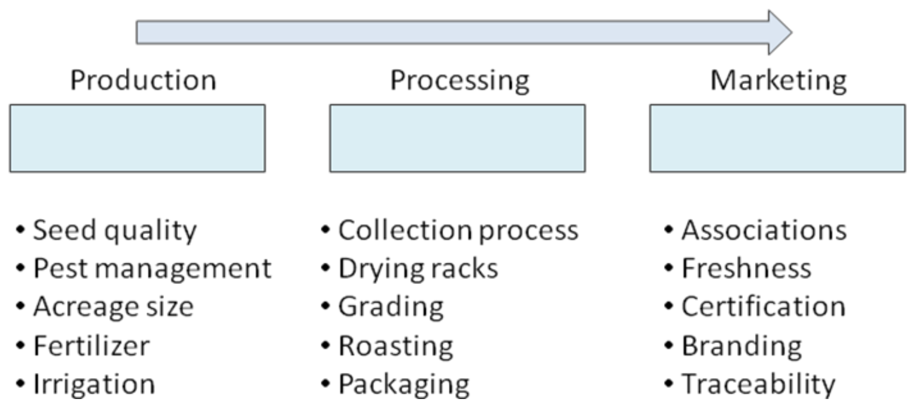
   For each of the three targeted value chains, an analysis would uncover opportunities for financial investment as well as other technical support. To do this, components of the value chain would be reviewed for potential strengthening and enhancement, with estimates on positive business results. Each potential enhancement would be considered independently for its financial feasibility. In cases where several investments together would have synergistic impacts, i.e. higher results than when taken alone, this would also be considered.

   Each potential financial investment would be viewed in terms of:

   - Expected investment cost and payback period.
   - Expected business impact and resulting financial impact.
   - Likely optimal agent to seek financing (e.g. farmer versus association).
   - Associated risks and possible mitigants.

For example in the coffee value chain, several possible enhancements have been identified, some of which may lead towards profitable financial investment.

Example: Coffee Value Chain



At each stage of the value chain weaknesses exist that could be addressed by upgrading technical or human processes. Some of these upgrades lend themselves to financing, e.g. for the purchase of technologies or tools that improve productivity or lower costs.
In the example of coffee, several possible upgrades to discrete links in the value chain present themselves, each with questions as to their financial viability. The following are *examples* of potential investments and the issues they raise:

- *Seed quality.* A continuous enhancement in input that requires permanent higher expense and so would need working capital financing, which is not readily available for most small farmers in Yemen. However as part of a program with technical support or with partial financing by a coffee growers' association, such financing might be possible.
- *Irrigation.* Water is a critical expense for Yemeni coffee growers, not because water is charged but rather because of the rising cost of diesel fuel to pump water from increasingly receding aquifers. Several distinct methods have been identified to lower the cost of water consumption, including solar pumps and drip irrigation. Solar pumps, which would be feasible of depths up to 200 meters, would lower or eliminate diesel consumption while drip irrigation would lower water use. Model farms upon which the two enhancements have been tested, along with greenhouses, have shown enough cost savings to pay back investments within two or three years. In all cases the size of the investment would be a consideration for small farmers.
- *Grading.* The implementation of quality grading systems and the associated machines for sorting and grading would considerably raise the final value of Yemeni coffee beans, especially for export. The investment would take not only purchase of specific sorting and grading machines but also improvements in the overall quality and reliability of the national quality grading process. The enhancement of this step could tie purchase of machinery with technical support to upgrade the overall grading system. Purchasing machinery alone without a corresponding improvement in the national quality grading system would be much less effective as an investment.
- *Associations.* The weakness of coffee grower associations is a major impediment to the efficiency of the coffee value chain. It would be difficult to finance improvements in the

functioning of associations with bank credits given their current structure. Such investment would at this stage more likely be part of a technical assistance program.

To the extent possible the analysis would document the likely total financing cost of any identified viable investment in the value chain. This would:

- Estimate the cost of various input investments (e.g. solar pumps or irrigation systems).
- Identify any independent support required to optimize the investment potential (e.g. training in use and maintenance of new machinery).
- Identify revenue enhancements or cost savings (e.g. higher yield or lower fuel expenses).
- Determine likely payback period and associated payments, including interest, given overall borrower cash flows and their marginal increase with the new investment.
- Identify any constraints, including collateral requirements or unusual risks.

Interest Rates

The high prevailing interest rates in Yemen are a major concern for the viability of any lending program, including the attractiveness of such a program to small borrowers. Although the Central Bank of Yemen has indicated a desire to lower interest rates, which have declined slightly in the past two years, rates are expected to remain high for the next few years. As such, the impact of the high rates on Yemeni Riyal lending must be considered in the financial and borrower analyses. Interest rates on foreign currency lending are considerably lower so any borrowing firms that are able to export some or all of their product would have a significant advantage in that they would have the foreign currency to repay lower cost foreign currency loans.

To gauge the viability of the aggregate investment in the financing of any one enhancement, some estimation of the total number of firms that would seek the investment must be made (e.g. the number of farms that would be able and willing to finance the purchase of solar pumps). See also the borrower sector assessment below.

2. *An assessment of the borrowing value chains/sectors.*
   In order to gauge the viability of a guarantee of bank credit, an analysis must determine the likelihood that the aggregate of the borrowers within the sector (1) would be attracted in sufficient numbers and (2) would have sufficient capacity for repayment to justify the execution of the credit guarantee. Such an analysis would:

- Determine the likely aggregate amount of borrowers and the likely total value of financed investments.
- Identify the current business framework including competitive intensity, market trends, and technical requirements.
- Evaluate the drivers of sector financial performance, including pricing determinants and cost structures, and the resulting associated risks.
- Evaluate how the sector currently finances its capital and working capital requirements.
- Assess the overall creditworthiness of the sector and, if identifiable, of that segment likely to seek credits.

The borrower sector analysis may also reveal financing channels other than banks, such as supplier credits. In Yemen, for example, importers of irrigation equipment offer supplier credits to retail agents, in terms of up to a year, but do not offer credit to final buyers of irrigation equipment given their low volumes. If a program could be developed to organize equipment purchases through a consortium, such as growers' associations, it is possible that equipment sellers would be interested in a credit guarantee to offer financing terms to final buyers.

The conclusions drawn from the borrower sector analysis when combined with the observations from the financial assessment of the value chain will together establish the overall rationale for the broader financing program. The characteristics that are revealed will also help determine the size and structure of the credit guarantee.

3. *An analysis of selected partner banks.*
Once the overall feasibility of the targeted financing is established, the partner banks would be analyzed. The first level analysis would be an overall assessment of the potential lending banks, soliciting their interest and assessing their broad eligibility. Once potential partner banks are identified they would undergo a detailed analysis of their capacity and their creditworthiness. This analysis would include:

- Review of the bank's key governance structures, including its legal incorporation, board functioning, audit and control structures, and risk management.
- Financial health and solvency assessment, including review of past dues and provisioning levels.
- Review of the bank's credit risk management processes.
- Review of available CBY reports including CAMEL assessments.
- Review of independent evaluations of the bank's credit quality, such as of rating agencies, if they exist.
- Review of the bank's strategy and business plan, including for the SME market.

One bank, Tadhamon International Islamic Bank ("Tadhamon") has expressed interest in seeking a loan guarantee to support microfinance of identified value chains. Tadhamon is Yemen's largest bank and has recently set up a separate microfinance unit to encourage investment in the sector. Tadhamon's management has received the initial application questions, which they are in the process of completing.

At least two other banks that focus on microfinance, Al-Amal Bank and Alkuraimi Bank, are perceived as potential candidates for a loan guarantee. Both have substantial experience with small borrowers and each has expressed interest in expanding agricultural lending especially if the attendant risks could be mitigated. The management of each has specifically expressed interest in the loan guarantee program.

4. *Consulting and technical assistance to facilitate financing of the targeted value chains.*
The partner bank analysis will highlight opportunities to strengthen the capacity of the financial institutions to expand lending activity. We recommend that this technical assistance be structured as an up to 50 percent cost-share with the partner financial institution.

Examples of technical assistance to facilitate financing in the targeted value chains might include:

- Engaging an agronomist or sector expert to strengthen bank officer understanding of targeted sectors and thus their capacity to develop new products for the sector, market products to the sector, assess credit risk and administer loans
- Engaging banking consultants to assist bank officers in market research, product development and marketing
- Any technical assistance that would demonstrably improve the financial viability of borrowing firms or that would enhance the impact of any financed technology would be especially attractive and would be higher priority for donor support.

Rationale. The successful initiation of a credit guarantee, especially if paired with critical technical assistance, would encourage the expansion of the financial institutions into the agricultural SME sector. The guarantee would lower the overall risk to the banks of sector entry and, by focusing on high value investments, could lead to major changes in the value chain's structure and efficiency.

Immediate next steps are to approach the USAID DCA office to (1) initiate partner bank analyses with interested financial institutions in Yemen; and (2) organize the financial analysis of the value chains and the borrower sector analysis to validate overall program viability. Once viability is established, DCA can confirm the targeted banks' eligibility and then soon thereafter seek approval from the DCA credit review board. Ongoing technical assistance to strengthen the capacity of selected financial institutions to increase lending to targeted sectors can be facilitated through the AMEG project.

B. ACTIVITY: CAPACITY BUILDING TO FINANCIAL INSTITUTIONS TO SUPPORT AGRICULTURAL LENDING

Background. The Yemen Microfinance Network (YMN) is a member-based microfinance non-governmental organization (NGO) that was founded by the UNDP and the Social Fund for Development in 2009. YMN organizes resources among its members and within civil society to improve the scale, sustainability, transparency, and effectiveness of its member institutions with the goal of increasing the reach of financial services to the poor. To do this, YMN engages in training and capacity building, lobbying, exchanging information, and networking. YMN also works to secure resources for technical assistance to member organizations and to the microfinance sector overall.

YMN is particularly interested in using its resources to expand microfinance services beyond the urban areas where they are currently concentrated into rural areas where the vast majority of Yemenis live and where economic disenfranchisement is highest. YMN has specifically targeted agricultural finance as a needed focus area in order to achieve rural penetration.

Opportunities. Support for the YMN targeted at agricultural finance would complement the loan guarantee and value chain approach. USAID would support training in agricultural microfinance for YMN member organizations and at the same time would support training permanent trainers within YMN to make such training a permanent feature of the Yemeni economy.

USAID could engage a consultant to:

- Tailor agricultural finance training materials to the Yemeni context;
- Conduct train-the-trainers programs with YMN to refine the program and develop in-house training capacity;
- Organize and conduct two training programs with Yemeni institutions engaged in microfinance and with focus on those that have specifically targeted the agricultural sector, including the selected partner banks; and
- Develop and bequeath a guidebook on agricultural finance appropriate to the Yemeni context.

Rationale. Supporting training in agricultural microfinance would strengthen the credit-granting capacity of participating institutions. This would encourage expansion of lending into the sector while also increasing the capacity of those firms who seek a credit guarantee, expanding access and also lowering the risk of claims. If successful, such a program would create a permanent function of SME agricultural lending within the Yemeni financial system.

The training program should be timed to support the credit extensions envisioned under the loan guarantee program. The entire project, including development of the materials, conducting targeted training, training the trainers, and compiling a guidebook should not take more than six months.

C. ACTIVITY: FACILITATE PILOTS OF INNOVATIVE ALTERNATIVE ENERGY TECHNOLOGIES

Background. Yemen could benefit substantially from the introduction and integration of alternative technology solutions into its economy, including into the identified value chains. The attraction of green technologies especially has risen given the confluence of several factors:

- The rising cost of fossil fuels, especially diesel, as indigenous oil sources decline;
- The ample availability of solar energy (Yemen enjoys more than 300 sunny days per year);
- The rising global consciousness around carbon expenditure and the growing willingness to invest in alternatives; and
- The increasing scarcity of water in Yemen as fossil aquifers are overdrawn and as inefficient water usage methods become increasingly costly.

Interviews with Yemeni business leaders and decision-makers revealed a low level of awareness of the potential of alternative technologies on the Yemeni economy. The government, business community, and broader population all have relatively little knowledge of specific technologies or of their potential impact.

At present there is no broad awareness either of the specific technologies or of their broad potential impact on the economy if such technologies are widely and strategically introduced.

Opportunity. Yemen has the opportunity to define a national plan to support environmental approaches including the systematic introduction of green and alternative technologies to address rising challenges, above all water scarcity. USAID could support the creation and execution of such a plan by hiring an expert in national environmental strategy to work with Yemeni decision-makers and technical experts. The plan would focus specifically on agriculture, with an emphasis on the identified value chain, and might also include or link with broader national strategies.

Such a plan could include several components:

- An analysis of national water use patterns in agriculture to reveal opportunities for technological and process improvements that would have greatest impact on raising water consumption efficiency.
- An analysis of energy use in agriculture, including for water pumping but also for other purposes, to identify possible efficiency improvements.
- Identification of environmental development zones to apply environmental approaches and technologies on a broader scale. This might include for example an activity as focused as a zone aligned with a heritage coffee growing region that introduces environmentally appropriate approaches such as organic farming, or as broad as a regional environmental development plan to optimally channel development on the environmentally sensitive island of Socotra.
- Development of scopes of work for pilot projects, including model green farms that demonstrate how to deploy a full complement of alternative technologies profitably and efficiently.
- Design of a public awareness campaign to engage interested stakeholders in the public and private sectors and in the broader community.

As a first step, it is recommended that a study be commissioned to assess commercially viable opportunities to integrate alternative energy technologies and recommend pilot activities to test the integrated use of these technologies to utilize as a demonstration. The study would:

- Engage Yemeni thought leaders, government decision-makers, and the private sector to define the broad goals of such a study;
- Involve stakeholders, from both the public and the private sector, to design and review the study.
- Develop two to three demonstration pilots to test hypotheses resulting from the study, These might, for example, be model farms that employ selected technologies comprehensively.
- Design a follow-up strategy, including a public awareness campaign for dissemination of lessons learned.

Two to three demonstration pilots could be launched to test hypotheses resulting from the study and measure their effects.

Rationale. As funds are invested in alternate technologies, it is important that these not be isolated ventures with no impacts beyond their immediate range but rather that they link with broader trends and that they are components of broad and sustainable regional or national strategies.

D. ACTIVITY: SUPPORT DRAFTING OF MOBILE MONEY LAW AND DEVELOPMENT OF FINANCIALLY VIABLE MOBILE MONEY PRODUCTS

Background. Nearly 70 percent of the population in Yemen lives in rural areas in more than 130,000 localities throughout the country, and lack basic infrastructure and services. On the other hand, there are more than 8 million mobile phone customers, but less than 1 million bank accounts. With the above factors in mind, it is not difficult to imagine a very different access to finance profile in Yemen if mobile phone users were provided with mobile and branchless financial services. This would represent a quantum leap for Yemen's institutions, microfinance programs and their clients, in both rural and urban areas.

Opportunity. Support drafting of mobile money law and support the capacity of Central Bank to supervise and enforce the law. Support drafting implementing regulations for the recently adopted electronic transactions law (2006), officially the "Payment Systems and Electronic Financial and Banking Transactions Law." Support the development of mobile money and mobile phone banking services to advance financial inclusion. Outcomes of the effort would include:

1) An improved policy environment enabling the introduction of financial services including money transfer, salary, payment, loan and savings services via branchless banking and mobile phone devices and the clarification of the roles of financial institutions and telecommunications/mobile network operators in the process. These efforts are expected to result in the expansion of mobile money product and service offerings from microfinance institutions, banks, and the Yemen Post for the benefit of small and microfinance institutions and their customers.

2) Increased capacity of the Central Bank to supervise and enforce implementing regulations governing the use of electronic systems and branchless banking services, including mobile money.

3) Increased access to mobile money transfer and financial services to individuals in rural areas.

Rationale. USAID/Yemen has committed to support strengthening microfinance institutions, increasing household incomes of the rural poor, and improving the business environment through policy reform and training.

E. ACTIVITY: FACILITATE IDENTIFICATION OF FINANCIALLY VIABLE MOBILE MONEY PRODUCTS THROUGH YEMEN POST

Background. The Government of Yemen's Post and Postal Savings Corporation is a wholly government-owned provider of banking service to most of the Yemen's citizens, and is thought to be transparent and free of corruption. With 320 branches that provide financial services, it serves far more of the nation's rural population than the rest of the banking system combined. This massive 'agent' network provides the opportunity to leverage and amplify any gains achieved by USAID and CGAP's efforts on mobile banking by providing a large, existing and operational ‘agent network’ to provide ‘cash-in’ and ‘cash-out’ services to make mobile banking effective.

Opportunity. Provide Government to Government (G2G) cash transfer to support Yemen Post in introducing or partnering with other financial institutions to provide access to financial services in rural areas. Establishing this G2G relationship would strengthen Yemen Post regulations, technical and administrative capabilities, and enable the Post and Postal Savings Corporation to engage international expertise to increase the capacity of its field staff to deliver financial services to Yemen’s rural and low-income clients.

Rationale. USAID/Yemen has committed to support strengthening microfinance institutions and increasing rural livelihoods.

F. ACTIVITY: FACILITATE WOMEN’S ACCESS TO LIVELIHOOD ACTIVITIES

Background. Yemen’s severe economic challenges result in food insecurity, exacerbated by a scarce water supply, leaving 32 percent of the country undernourished. Over 45 percent of the population lives under $2 per day and about 17 percent lives under $1.25. Yemen’s Social Welfare Fund (SWF) is tasked with addressing the survival needs of this portion of the Yemeni population. Pressures on the Yemeni public budget resulting from poor tax performance and severely declining hydrocarbon revenues suggest that ensuring resilience for this Yemeni population of ultra poor requires a sustainable private sector solution.

Opportunity. Building on a model developed by CGAP and SFD in three provinces in Yemen, identify severely impoverished households in Yemen, design a program to facilitate training to selected participants on income generating micro-enterprise activities, such as sewing, raising livestock, or small scale trading. As households’ income stabilizes, the model may encourage participants to open a savings account at the local post bank or other financial institution with an objective of encouraging participants to reach a specified savings goal by the end of a defined period. In designing the model, explore an approach of CGAP and SFD to integrate additional trainings to participants on topics such as financial literacy, confidence building, social integration and sanitation and personal hygiene.

It is recommended that USAID explore collaborating with CGAP, the Ford Foundation and Innovations for Poverty Action-IPA (or another organization with expertise in impact evaluation) in the design of the activity and in particular, the integration of an evaluation to determine the effectiveness of the model. The evaluation may be structured consistently with a similar series of evaluations supported by CGAP, the Ford Foundation and IPA in which a sample of poor households are identified and verified using a specified index. The households would then be randomly assigned to a treatment or comparison group. Beneficiaries in the treatment group would receive training on an income-generating activity and would be encouraged to open and actively maintain a savings account as described above. An end-line survey would examine the impact of the intervention on beneficiaries in the treatment group against a comparison group that did not receive the intervention.

Rationale. USAID/Yemen has committed to support increased inclusive economic growth, and specifically increased employment among food insecure

PROPOSED WORKFORCE DEVELOPMENT ACTIVITIES

G. ACTIVITY: FACILITATE DEMAND-DRIVEN VOCATIONAL TRAINING, JOB FAIRS, CAREER COUNSELING

Background. Since 2011, the economy has contracted by almost 11 percent, and the number of people living below the poverty line increased by an estimated 12 percentage points in two years. Youth were most affected by the crisis, with more than 75 percent of the population below the age of 25. Unemployment of Yemeni youth ages 18 to 24 is more than 50 percent. This factor has proven to be a trigger for volatility and violence. Fifty four percent of university graduates, and 44 percent of those with an intermediate level of education remain unemployed as the poverty rate has continues to increase.

To address these challenges and to support Yemen's government during the transition phase in minimizing the effects of the crises, USAID/Yemen implemented workforce development interventions which were centered on providing immediate income generation and short- and long-term employment for Yemeni's youth. Marginalized, at-risk, skilled and unskilled youth were targeted. Interventions included: 1) Entrepreneurship and self-employment programs, 2) Vocational Training & Employment Support, and 3) Labor Intensive Rehabilitation work.

1) In the Entrepreneurship and self-employment program, USAID partnered with a number of leading local NGOs and supported programs that built the capacities of youth to become micro or small entrepreneurs.

2) In the Vocational Training & Employment (TVET) support activity, USAID provided job-targeted skills training through two implementing partners so that youth participants might move directly to fill entry level job openings in business administrative and construction trades. Because one of the implementer partners, Yemen-Education for Employment (Y-EFE) rigorously selected training curricula to match up with jobs actually available in the areas where the trainees lived or wished to work, Y-EFE's trainings for both the 'white collar' and 'blue collar' skill sets resulted in 72 percent of the 1200 participants being placed in to paying employment in the area of training following completion of the training. The remaining unplaced trainees are working with the training provider, Y-EFE and some of those may still find employment. The methodology used featured skills training in demand-tested areas, accompanied by internship placements. Many of the internships featured long-term potential employment opportunities at the partnering companies. USAID has invested approximately $1 million dollars on this activity and over 1000 Yemeni youth have been placed into paying jobs. USAID invested a similar amount of funding through another job-training implementer to train approximately 1000 youth, but because the curricula were not matched up with jobs available, job placement results are not as positive.

3) In the Labor Intensive Rehabilitation (LIR) activity, USAID implemented quick impact activities providing short-term employment to Yemeni youth residing in urban centers. The work done involved disbursing daily wages to youth to remove rubble and waste in Sana'a, Aden, and Taiz. USAID's implementing project, Creative Livelihoods, partnered with the Social Fund for Development, and other local NGOs for this activity.

From 2010 to 2012 approximately 12,328 youth benefited from income generation opportunities; 2,000 entrepreneurs received microfinance services, 200 trained entrepreneurs started their own businesses, 2,280 received vocational training and internships, and 7,848 were engaged in labor intensive rehabilitation.

Opportunity. Going forward a threefold opportunity exists:

1) The first opportunity lies in diminishing job training efforts that are not explicitly tied to known, demonstrated job vacancies in communities where the trainees wish to reside; i.e., Mission can require that all job training be demand driven so that training curricula are driven by needs of employers in the area targeted by the training. Discontinuing funding *for non-demand driven* vocational training and instead providing resources to demand driven job training programs could substantially increase the number of trainees placed in jobs as a percentage of total trainees, thus increasing results and effectiveness. This demand driven approach is currently practiced by Y-EFE in Yemen.

2) The second opportunity is to provide funding for Y-EFE to support a cost-share program with the private sector in which the private sector funds approximately 33% of costs for placing youth in vocational technical training. The program's anticipated results are to place at least 70 to 75 percent of training participants in paying jobs. As part of this undertaking, USAID might also consider a broader demand assessment of job market needs in order to enable better targeting of job training efforts and provide a better understanding of the potential for job training and job placement in Yemen.

   Requesting significant contributions to training expenses from employers that benefit from the training represents an opportunity to increase effectiveness. For example, if USAID/Yemen were to secure 33 percent matching cash contribution to the job training programs from employers that shape the training curriculum and receive trained employees, USAID could achieve an outcome of one third more trainees placed into paying jobs. [Note: The World Bank is supporting a job placement program with private sector with a 50:50 cost share, and integrating an impact evaluation.]

   Securing a direct grantor/grantee relationship with a training provider, such as Y-EFE, could both help ensure direct and effective communication between the Mission and the implementing partner. Currently Y-EFE is a sub-grantee under a different award. This approach increases administrative overhead and inserts a layer of management between USAID and the project it funds. If it is possible to provide the grant directly to the local Yemeni EFE affiliate, the grant would help support USAID Forward priorities.

3) The third opportunity is to provide targeted technical assistance and other support to a private training institute or the Yemen Businessmen's Club to implement a series of five job fairs in Yemen targeting the placement of at least 1000 job-seekers. The technical assistance and demonstration event job fair will seek to instantiate a practice of private sector led and funded job fairs to place qualified Yemenis in jobs in Yemen and abroad.

Rationale. USAID has committed to support Republic of Yemen Government's efforts under the Transitional Program for Stabilization and Development (TPSD) to create employment especially among the youth.

OTHER PROPOSED ACTIVITIES

H. ACTIVITY: FACILITATE PUBLIC-PRIVATE SECTOR DIALOGUE TO SUPPORT IMPROVED BUSINESS CLIMATE AND ECONOMIC POLICY ADVISORY ASSISTANCE TO INFORM NATIONAL DIALOGUE PROCESS

Background: Public Private Dialogue to Support Improved Business Climate. Yemen's business enabling exerts strong headwinds against the economic growth needed to recover from the recent crisis and grow at a rate sufficient to accommodate the 250,000 new entrants to the Yemeni workforce each year that compete for the approximately 50,000 new jobs that are added to the Yemeni economy annually. Examples of sub-optimal policies and practices in Yemen that constrain economic growth that might be productively resolved are as follows:

- The cost of securing electricity, expressed as a percent of per capita income, is worse than any country in the Middle East Region, and far above global norms.
- The ease of getting credit in Yemen is not only the second worst in the Middle East Region (exceeded only by Iraq), but among the worst globally.
- Yemen ranks second worst in the region, exceeded only by Iran, in protecting investors' rights.
- Yemen ranks poorly by regional and global standards in trading across borders and resolving insolvencies.

Background: Economic Policy Advisory Assistance to Inform to National Dialogue Process. The Gulf Cooperation Council (GCC) agreement calls for developing a National Dialogue process. The October 2012 Friends of Yemen meetings in Riyadh, Saudi Arabia identified the need to include discussion of economic policy as part of the National Dialogue process.

Opportunity: Public Private Dialogue to Support Improved Business Climate. Facilitate a strengthened relationship between the central government and the private sector. Using international expertise and local business and policy leaders, facilitate private sector advocacy with government. Examples could include fostering informed, targeted dialogue with Yemeni business persons associations or chambers of commerce with appropriate government counterparts on issues which currently impede business growth in Yemen, such as:

- Rationalizing electrical tariff rates, billing and collection policies for traditional power generation and distribution and similarly establishing a supportive tariff rate environment for distributed power generators so that they may sell their power onto the national power grid, or into a micro-local power grid on a price basis that is hospitable to technologies that produce power from alternative sources.

- Establishing a moveable property collateral registry, a modern credit reference bureau, and complete the ratification of the current leasing law
- Clarifying and standardizing whether or not disclosure of conflict of interest in a given transaction by a board member needs to be notified before the transaction is completed, immediate after the transaction is completed, or not at all.
- Forming consensus between the private sector and government on economic decentralization regarding decision making for business operations, the creation of special economic zones, or best testing standards and equipment for horticultural products transiting in to Saudi Arabia.

Opportunity: Economic Policy Advisory Assistance to Inform to National Dialogue Process. In Riyadh, senior Yemeni officials succeeded in introducing economic policy to the National Dialogue process. USAID/Yemen has the opportunity to help inform that policy dialogue process by providing short-term economic policy advisory support to senior Yemeni officials responsible for leading this economic policy component of the National Dialogue process.

Rationale: Public Private Dialogue to Support Improved Business Climate. USAID/Yemen is committed to supporting the government of Yemen’s efforts under the Transitional Program for Stabilization and Development (TPSD) to promote sustainable agriculture and in urban areas, increase livelihoods and household income by expanding youth employment, strengthen the national microfinance sector, and improve the business environment through support for policy reform and training.

Rationale: Economic Policy Advisory Assistance to Inform to National Dialogue Process. USAID/Yemen is committed to support the National Dialogue Process.

ANNEX A

INDICATORS TABLE

Yemen Enterprise Development Indicators		
Enterprise Performance		
1	Growth of exports (annual % change, 2005-2011)	-1.81
	• annual % change 2010	15.84
2	Labor productivity per person employed	NA
Enterprise Landscape		
3	Number of SMEs per 1,000 inhabitants (average, 2000 to 2005)	16.2
4	Diversification of export industries (% concentration in top three, 2011)	58.7
5	Informality (% of firms that started operation without being formally registered)	81.7
Enterprise Sophistication		
6	Percentage of firms with internationally recognized quality certifications (2010)	4.4
Proactive Strategy		
7	Control of international distribution (7 high, 1 low; 2012)	3.14
8	Production process sophistication (7 high, 1 low; 2012)	2.43
9	Extent of marketing (7 high, 1 low; 2012)	2.65
10	Degree of customer orientation (7 high, 1 low; 2012)	6.15
11	Value chain breadth (7 high, 1 low; 2012)	2.66
Access to Finance		
12	Access to loans (7 high, 1 low; 2012)	1.51
13	Financing through local equity market (7 high, 1 low; 2012)	1.65
14	Access to venture capital (7 high, 1 low; 2012)	2.26
Workforce and Skills Development		
Training of Workforce		
15	Extent of staff training (7 high, 1 low; 2012)	3.24
16	Percentage of firms offering formal training (where available)	NA
17	Local availability of research and training services (7 high, 1 low; 2012)	2.54
18	Brain drain (7 high, 1 low; 2012)	2.19
Legal and Regulatory Environment		
19	Regulatory quality (percentile rank, 2011)	23.2
Competitive Environment		
20	Nature of competitive advantage (7 high, 1 low; 2012)	2.77
21	Buyer sophistication (7 high, 1 low; 2012)	2.38
22	Cluster development (7 high, 1 low; 2012)	2.16
23	Intensity of local competition (7 high, 1 low; 2012)	4.70
Knowledge and Technology		
24	Internet users per 100 pop. (2012)	14.91
25	Mobile telephone subscribers per 100 pop. (2012)	47.04
26	Capacity for innovation (7 high, 1 low; 2012)	1.90
27	Adoption of technology (7 high, 1 low; 2012)	3.65

Explanation of MEASURE Indicators

List of Acronyms

GCR	Global Competitiveness Report
IFC	International Finance Corporation
ILO	International Labor Organization
KILM	Key Indicators of the Labor Market
WB	World Bank
WDI	World Development Indicators
WEF	World Economic Forum
WTO	World Trade Organization

Enterprise Performance

1. *Growth of exports* (WTO, Trade Statistics Database) measures the rate of growth of exports. It includes both 1-year and 7-year growth. Consideration should be given as well to size of the export base; it is frequently more difficult to grow rapidly from a higher base.
2. *Labor productivity* (ILO, KILM 18) for the aggregate economy, the GDP per person employed. A higher number reflects higher productivity.

Enterprise Landscape

3. *Firm size* (WDI 5.1 (2007 latest), # of SMEs per 1,000 people). Consider versus Jordan's 26.4 over the same time period. Note: This data series was discontinued after 2007. Micro, small, and medium-size enterprises are business, that may be defined by the number of employees. There is no international standard definition of firm size; however, many institutions that collect information use the following size categories: micro enterprises have 0–9 employees, small enterprises have 10–49 employees, and medium-size enterprises have 50–249 employees.
4. *Diversification of export industries* (Composition of total exports made up by Top 3, UN Commission on Trade) measures the degree to which exports are concentrated in a single product (or, conversely, how well they are distributed among many products). This is a percentage; the higher the percentage, the lower the degree of diversification.
5. *Informality* (WB/IFC Enterprise Survey, 2010) measure the percentage of firms that started operation without being formally registered. It is a proxy for the prevalence of informality in the economy.

Enterprise Sophistication

6. *Production certifications* (WB/IFC Enterprise Survey, 2010). Extent to which firms invest in obtaining recognized certificates of production and accounting practices. Obtaining international quality certifications can open doors to technology and innovation and they also provide a sign of high quality that may open markets.

- *Proactive strategy* (GCR indicators including control of international distribution, 11.06; production process sophistication, 11.07; extent of marketing, 11.08; and degree of customer orientation, 6.15).[1]

7. *Control of international distribution* measures the degree to which international distribution is controlled by domestic firms versus international firms. This is ranked on a scale of 1-7, where a score of 7 indicates control by national firms and a score of 1 indicates complete control by international firms.

[1] It is important to keep in mind throughout the diagnostic that the GCR primarily measures *perceptions* of local business leaders of their operating environment rather than relying on an objective measure.

8. *Production process sophistication* measures the degree to which the production process makes use of process technology versus the degree to which it depends on labor. This is ranked on a scale of 1-7, where a score of 7 suggests a high degree of process technology while a score of 1 suggests a high degree of labor intensity.
9. *Extent of marketing* measures the degree to which marketing is sophisticated or primitive. Scored from 1-7, where a score of 7 is highly sophisticated and a score of 1 very primitive.
10. *Degree of customer orientation* measures the degree to which firms are highly responsive to their customers. Scored from 1-7, where a score of 7 is highly responsive and a score of 1 non-responsive.
11. *Value chain breadth* (GCR 11.05) measures the degree to which a country's exporting companies are primarily involved in individual steps in the value chain (e.g. resource extraction or production) versus the degree to which they perform higher level functions such as product design, marketing, sales, logistics, and after-sale services. This is a scale of 1-7, where 7 represents high value add activities and 1 low value-add activities.

Access to Finance

12. *Access to loans* (GCR 8.04) measures how easy it is to obtain a bank loan with only a good business plan and no collateral. Scored from 1-7, where 7 is very easy and 1 impossible.
13. *Financing through local equity market* (GCR 8.03) reflects the ease of raising money by issuing shares on the local stock market. Scored 1-7, where 7 is very easy and 1 impossible.
14. *Access to venture capital* (GCR 8.05) measures the ease with which entrepreneurs with innovative but risky projects can generally find venture capital. Again on a scale of 1-7, where 7 is very easy and 1 impossible.

Workforce and Skills Development

15. *Training of workforce* (*extent of staff training*, GCR 5.08, and percentage of firms offering formal training, Enterprise Survey, WB) measures the approach of companies to human resources as evaluated by the degree to which they invest in training and employee development.
    a. Extent of Staff Training is scored from 1-7 in the GCR, where 7 indicates substantial investment in staff training and 1 suggests no staff training.
    b. Percentage of firms offering formal training is presented as a percentage of total firms interviewed.
16. *Local availability of research and training services* (GCR 5.07), which measures the degree to which specialized research and training services are available. Scored from 1-7, where 7 represents extensively available and 1 is non-existent.
17. *Brain drain* (GCR 7.07), which measures the extent to which the most talented people leave to pursue opportunities in other countries rather than staying in their own. Again scored from 1-7, where 7 represents a low degree of brain drain and 1 represents a very high degree.

Legal and Regulatory Environment

18. *Regulatory quality* (WB Worldwide Governance Indicators), which measures the ability of the government to formulate and implement sound policies and regulations that permit and promote private sector development. This is measured on a scale of -2.5 to 2.5 (with 2.5 being outstanding governance and -2.5 being as poor as possible). However, for simplification's sake, this is presented as a more easily understandable percentile rank.

Competitive Environment

19. *Nature of competitive advantage* (GCR 11.04), a proxy for Factor Conditions, which measures whether a country's competitive advantage in international markets is due primarily to low-cost or local natural resources or whether it is based primarily on unique products or processes. Scored

from 1-7, where 7 represents competitive advantage based purely on unique products or processes, and 1 represents competitive advantage based primarily on low costs.

20. *Buyer sophistication* (GCR 6.15), a proxy for Demand Conditions, which measures the degree to which buyers in a given country make their purchasing decision based solely on the lowest price versus basing their decision on a sophisticated analysis of performance attributes. Scored from 1-7, where 7 represents more sophisticated customers and 1 represents less sophisticated customers.[2]
21. *Cluster development* (GCR 11.03), a proxy for the existence and strength of Related and Supporting Industries, which measures the degree to which strong and deep clusters are widespread throughout the economy. Scored from 1-7, where 7 suggests strong cluster presence (and therefore strong related and supporting industries) and 1 represents limited cluster formation, and therefore weak related and supporting industries.
22. *Intensity of local competition* (GCR 6.01), a proxy for Industry Strategy, Structure, and Rivalry, which measures the extent to which competition in local markets is limited in most industries, with only rare cases of price-cutting, versus the extent to which competition is intense in most industries as market leadership changes over time. Scored from 1-7, where 7 indicated highly intense competition and 1 indicates an absence of competition.

Knowledge and Technology

23. *Internet users* (GCR 9.02), which measures the number of Internet users per 100 people. This measure uses hard data and produces a rank only (relative to other countries).
24. *Mobile telephone subscribers* (GCR 2.08), which measures the number of mobile telephone subscribers per 100 people.
25. *Capacity for innovation* (GCR 12.01), which measures the extent to which companies obtain technology exclusively from licensing or imitating foreign companies or whether they obtain them by conducting formal research and pioneering their own new products and processes. Scored from 1-7, where 7 indicates that most innovation is internal, whereas 1 indicates that technology originates strictly from outside the firm.
26. *Adoption of technology* (f*irm-level technology absorption*, GCR 9.02). This measures the degree to which companies in a country are able to absorb new technology. Scale of 1-7, where 7 suggests that companies are very able to adopt new technology, while 1 indicates that they are virtually incapable of doing so.

[2] Porter postulates that both size and sophistication of demand are relevant. However, he places far more emphasis on sophistication than on size, pointing to myriad examples of sophisticated local markets that promoted upgrading and therefore facilitated access to wider regional and international markets. As such, this diagnostic has placed emphasis on the sophistication of demand over its size.

ANNEX B

INTERVIEWS

Al-Amal Bank

Alhadha Trade and Agencies Est.

Al Khair Foundation for Social Development

Alkuraimi Bank

Central Bank of Yemen

Economic Opportunities Fund

Griffin International Ltd.

Jumaan Trading and Investing Co.

International Bank of Yemen

Ministry of Industry and Trade, Republic of Yemen

Ministry of Technical and Vocational Education

MTN

Natco Holding Co.

Sabeha Brothers Enterprises Co Ltd.

Small and Microenterprise Promotion Service

Silatech

Social Fund for Development

Tadhamon Bank

Technical Supplies Center

U.S. Department of the Treasury

USAID Yemen

USAID Yemen Community Livelihoods Project

USAID Yemen Responsive Governance Project

Yemeni Businessmen Club

Yemen Businesswomen Council

Yemen Education for Employment

Yemen Microfinance Network

Yemen Post

ANNEX C

REFERENCES

Consultative Group to Assist the Poorest, Financial Access 2010: The State of Financial Inclusion Through the Crisis

Economist Intelligence Unit, Outlook for 2012-16, Yemen – Country Report

Economist Intelligence Unit, Outlook for 2012-16, Yemen - External Sectors

Economist Intelligence Unit, Outlook for 2012-16, Yemen - Highlights

Economist Intelligence Unit, Outlook for 2012-16, Yemen – Fiscal Policy

Economist Intelligence Unit, Outlook for 2012-16, Yemen – Forecast Summary

Economist Intelligence Unit, Outlook for 2012-16, Yemen – Monetary Policy

Freedom House: Freedom of the World, 2012

Government of Yemen Small and Micro Enterprise Development Unit (SMED) Presentation, 2011-2012

Government of Yemen Small and Micro Enterprise Development Unit (SMED): Coffee Productivity Study, 2010

Social Fund for Development Yemen: Small and Micro Enterprises Development in Yemen and Future Prospects, 2011

Government of Yemen Small and Micro Enterprise Promotion Service (SMEPS), Draft Report: Analysis of 5 Value Chains (Fish, Honey, Coffee, Wheat, Qat), July 2009

United States Agency for International Development: Ensuring Demand-Driven Youth Training Programs – How to Conduct an Effective Labor Market Assessment

United States Agency for International Development: Mobile Financial Services Risk Matrix, 2010

World Bank: Enterprise Rapid Assessment, 2011

World Bank: World Governance Indicators, 2012

World Bank/International Finance Corporation: Enterprise Survey Yemen Country Profile, 2010

World Bank/International Finance Corporation: Assessment of MSE Financial Needs, 2007

World Economic Forum, Global Competitiveness Report, 2012

World Economic Forum, Global Gender Gap, 2012

U.S. Agency for International Development
1300 Pennsylvania Avenue, NW
Washington, D.C. 20523
Tel: 202.712.0000
Fax: 202.216.3524
www.usaid.gov