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CONSULTANCY REPORT ON
OBSTACLES TO INVESTMENT IN THE Y.A.R.
AND
THE PROPOSED DRAFT INVESTMENT LAW
FOR THE MINISTER OF ECONOMY
OF THE YEMEN ARAB REPUBLIC

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REPORT TO THE MINISTER OF ECONOMY OF THE YEMEN ARAB REPUBLIC

ON

OBSTACLES TO INVESTMENT IN THE YEMEN ARAB REPUBLIC

AND

THE PROPOSED DRAFT INVESTMENT LAW

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INTRODUCTION

TO

THE REPORT

TO

THE MINISTER OF ECONOMY

OF THE

YEMEN ARAB REPUBLIC

ON

OBSTACLES TO INVESTMENT IN THE Y.A.R.

AND

THE PROPOSED DRAFT INVESTMENT LAW

A. Mission and Scope of Work of the Consultants

On the instructions of the Minister of Economy of the Yemen Arab Republic, the Consultants have undertaken the following tasks:

(1) To identify and report back on the main obstacles to private investment in the Y.A.R. by Yemenis, Arabs and foreigners;

(2) To prepare, in collaboration with the responsible Ministry officials, a draft investment law aimed at promoting and encouraging investment in the Y.A.R. by reducing or eliminating as many of those obstacles as possible;

(3) To recommend a coordinated plan of action to deal with major obstacles requiring action outside of the law;

(4) To prepare a commentary on the Draft Investment Law;

(5) To recommend appropriate follow-on activities in support of the new investment law; and

(6) To submit both the Draft Investment Law and this report in both English and Arabic.

B. Background of the Consultants

John Bentley is a lawyer and holds a Juris Doctor (J.D.) degree from the School of Law of the University of

California at Berkeley and a Bachelor of Arts in Government from Harvard University. He served from 1978-1982 as a legal consultant to the Ministries of Economy, Investment and Finance of the Government of Egypt on laws and procedures affecting investment and on the Companies and Tax Law reforms of 1981. He has also served as a legal advisor to the Foreign Investment Board of Indonesia. He currently is the chief international legal consultant to a law firm in Cairo which specializes in investment law problems.

Dr. Ronald G. Wolfe is an Arabist and an expert on the Middle East. He holds a Bachelor's degree from Georgetown University and earned his Ph.D. at Indiana University. He has taught Arabic at Georgetown and Indiana and has lived and worked in Cairo for many years with the Ford Foundation, as Director of America-Mideast Education and Training Services and as a private businessman.

C. Methodology

(1) Before coming to the Y.A.R., Mr. Bentley spent several days in Cambridge, Massachusetts, reviewing the Harvard Law School collection of the investment laws of the world and consulting with Vice Dean David Smith of Harvard Law School and Dean Jeswald Salacuse of the Fletcher School of Law and Diplomacy at Tufts University, both experts on foreign investment.

(2) In Cairo, before coming to the Y.A.R., Dr. Wolfe translated the third Ministry Draft investment law.

(3) After meeting with the Minister upon their arrival in the Y.A.R. on August 19, the consultants spent approximately ten days interviewing Y.A.R. Government officials, businessmen, investors, bankers and lawyers.

(4) Meanwhile, the consultants reviewed the Y.A.R. laws affecting investment and studied numerous reports on the economy and legal system of the Y.A.R.

(5) The consultants reviewed the existing Investment Law 18/1975 and two draft investment laws prepared by Ministry officials, the final one being presented on August 22.

(6) The consultants then worked in collaboration with the General Department for Investments to prepare the Draft Investment Law analyzed in Section 5 of this Report.

D. Organization of the Report

This report is organized in seven sections:

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Section 1 is the Executive Summary of the Report;

Section 2 provides an overview of the obstacles to investment in the Y.A.R. and compares the overall investment climate with other countries;

Section 3 analyzes what appear to be the most serious obstacles to investment in the Y.A.R. today: Namely, price controls, exchange controls, import restrictions, limits on interest rates and the government deficit and its financing;

Section 4 outlines the policy changes urgently needed in addition to a new investment law to improve the Y.A.R.'s investment climate;

Section 5 analyzes the Draft Investment Law article by article or chapter by chapter, as relevant, and identifies the obstacles to investment sought to be overcome;

Section 6 considers other obstacles to investment which cannot be addressed by the investment law; and

Section 7 outlines the actions needed to support the investment law after it is promulgated.

SECTION 1

EXECUTIVE SUMMARY

OF THE REPORT TO

THE MINISTER OF ECONOMY

OF THE

YEMEN ARAB REPUBLIC

ON

THE OBSTACLES TO INVESTMENT IN THE Y.A.R.

AND

THE DRAFT INVESTMENT LAW

1.1 A Primary Objective of Investment Law is to Reduce the Obstacles to Investment in the Y.A.R.

One of the objectives of enacting a new investment law is to reduce or eliminate legal and non-legal obstacles to both national and foreign investment in the Y.A.R. Passing such a law would raise the Y.A.R.'s standing relative to other countries who are also competing for investment funds around the world -- not only for foreign funds, but those of Yemenis as well. One of our discoveries during our stay in the Y.A.R. is that many Yemenis holding U.S. Dollars and other foreign currencies are investing them abroad, not only in foreign bank deposits and securities but even in projects in Thailand and Malaysia. Creating the right climate for investment in the Y.A.R. would encourage many Yemenis to invest in their own country. This in turn would be a key factor in attracting Arab and foreign investment to the Y.A.R.

1.2 The Worldwide Competition for Investment

Many countries today are competing hard for foreign investment. Some, including France, Ireland and Turkey offer cash grants to investors. Others, like Tunisia have done away with bureaucratic red tape involved in approvals and help pay for infrastructure. Still others like Egypt and Iraq have recently amended their investment laws.

1.3 Advantages Offered Investors by the Y.A.R.

Although it faces significant competition for investment funds (both foreign and Yemeni), the Y.A.R. also offers substantial advantages to the prospective investor including an excellent location, the greatest amount of arable land in the Arabian Peninsula, good climate, exciting tourism possibilities, ample energy supplies, and a self-confident people.

1.4 The Y.A.R.'s Standing in the World-Wide Competition for Investment

Despite the Y.A.R.'s significant advantages, a September 1988 world-wide survey measuring the investment climate in 95 non-communist countries according to 14 key factors found that the Y.A.R. possesses one of the least desireable investment climates of all of the countries considered. In fact, it was rated fourth from the bottom, behind almost every Arab and African country surveyed, including the oil-rich countries, Tunisia, Morocco, Jordan, Algeria, Egypt, Chad, Sudan, and even Syria, Somalia and Libya. Moreover, according to the "Report on the Investment Climate in the Arab Countries for 1988" by the Arab Organization for Investment Guarantees, the Y.A.R. received virtually no investment from other Arab countries in 1988.

1.5 Overview of Obstacles to Investment in the Y.A.R.

While these are only two studies surveying investor concerns, our research indicates that there are over 30 significant legal and non-legal obstacles to private foreign and local investment in the Y.A.R., the most serious of which are as follows:

(1) The pervasive system of government controls over economic and financial life in the Y.A.R. -- namely, import licensing, channelling all foreign exchange transactions through the Central Bank, interest rate limitations and price controls -- all of which encourage smuggling and consumption and discourage productive investment as described in greater detail in Section 3 and to be dealt with by the actions set forth in Section 4 of this report and Articles 21 and 22 of the Draft Investment Law;

(2) The size of the Government's deficit and its financing through borrowing also discussed in greater detail in Section 3 with recommended remedial actions described in Section 4 of this report;

(3) Powerful disincentives to bank lending to investment projects described in Section 3 and the commentary on

Article 23 and dealt with by actions suggested in Section 4, Article 20 and 23 of the Draft Investment Law and Section 6;

(4) The concept prevalent in existing legislation and regulations that every investment project is prohibited unless it is specifically permitted and the resulting wasteful bureaucratic procedures and delays inherent in the existing system of licensing projects and then separately licensing every phase of their activities including their imports, exemptions, companies, foreign workers, expansions, upgradings, and production levels, dealt with by Chapter 7 of the Draft Investment Law on licensing;

(5) Lack of stability in enforcement of the existing investment law and investors' rights, dealt with by Articles 17, 18, 19 and 81 and Chapter 13 of the Draft Investment Law;

(6) Direct taxes on capital, including the proportionate stamp tax and zakat and the equivalent tax on foreigners, addressed by Article 33.A. of the Draft Investment Law;

(7) The proportionate stamp tax on the value of contracts, also dealt with by Article 33.A. of the Draft Investment Law;

(8) Vagueness and uncertainty created by giving the Minister and the licensing authorities too much discretion instead of providing a stable, clear and predictable set of rules for investors and officials alike, dealt with by Chapter 7 of the Draft Investment Law on licensing and by trying to remove vagueness, uncertainty and unnecessary discretion from the entire law;

(9) Lack of a single organization with whom investors can deal which has sufficient authority and power to issue all needed licenses to establish and operate an investment project and which will support and assist the investor in relations with other government organizations, dealt with by the creation of the Investment Promotion Authority under Chapter 6 of the Draft Investment Law;

(10) Unnecessarily difficult procedures to form and operate shareholding and limited liability companies and excessive restrictions on company decisions and operations, dealt with by Chapter 8 of the Draft Investment Law;

(11) Uncertainty as to which law prevails when another existing law conflicts with the Investment Law, dealt with by Article 99 of the Draft Investment Law and specific articles;

(12) Lack of a well-developed banking and savings system, discussed in Section 6.

The Draft Investment Law is designed to eliminate most of these obstacles for investors and significantly improve the investment climate in the Y.A.R. No investment law, by itself, could eliminate all existing major obstacles to investment in the Y.A.R.

1.6 Policy Changes Outside of the New Investment Law are Required to Overcome What are Unquestionably the Most Serious Obstacles to Investment in the Y.A.R., Namely, the Controls Now Existing on Imports, Foreign Exchange, Interest and Prices as well as the Government Deficit and Means of Financing It

The biggest incentive to investment in any country is always the overall climate for business and investment, and while all of these policies may well have been justified at the time they were instituted, in the current circumstances they serve to encourage inflation, consumption and smuggling and discourage -- even block -- productive investment. Section 3 of the Report examines the individual and cumulative impact of each of these obstacles to investment, and Section 4 considers briefly what could be done to reduce or eliminate them.

(a) Price Controls Encourage Consumption and Waste, Cause Shortages and Inflation and Directly Discourage Production and Investment

Price controls encourage consumption by keeping the price on the price-controlled item low and discourage production and investment by limiting the return a producer can make on his investment. While encouraging consumption, price controls often cause inflation in two ways: First, demand is increased by the low prices at the same time that production is discouraged thereby resulting in shortages. These shortages then result in highly inflated prices for the price-controlled goods in the black market.

The second way that price controls cause inflation is that since local producers refuse to produce the price-controlled goods in sufficient quantities, the Government sometimes takes on the burden of supplying

them at a loss -- that is, below the world market price. This adds to government expenditures and adds to the deficit which in turn leads to more inflation.

(b) Exchange Controls Encourage Imports and Consumption, But Discourage Exports, Production and Investment

Exchange controls, used to maintain an overvalued rate for the Yemeni Rial, render Yemeni exports that much more uncompetitive on international markets, because they are 20 percent more expensive, and encourages a demand for and consumption of imports, because they are automatically made 20 percent cheaper relative to Y.A.R. products by the overvalued rate for the Yemeni Rial. Note that this also means that imported production inputs -- i.e., raw materials and machines become cheaper relative to Y.A.R. inputs such as Yemeni labor and Y.A.R. produced materials.

(c) Import Licenses, High Customs Duties and Other Import Restrictions Encourage Smuggling and Consumption and Cause Inflation While Blocking Production and Thereby Discouraging Investment and Depriving the Government of Customs and Tax Revenues

Import restrictions encourage smuggling because huge profits can be made by smugglers as a result of high demand for imports created by inflation which spurs Yemenis into buying imported goods before their Yemeni Rials decline further in value and because alternative goods are not being produced locally because exchange controls and import licensing prevent the import of sufficient production materials. In turn, the Government loses revenue because customs duties are not collected on the smuggled goods (as they would have been if the goods had been legally imported) and profits taxes and salary taxes are not collected from smugglers (as they would have been from legitimate importers).

(d) Banking Controls on Deposits Cause Speculation Against the Yemeni Rial and Capital Flight and Discourage Productive Investment

Existing banking controls on deposits discourage Yemenis from saving and encourage speculation against the Yemeni Rial, as well as speculation in land and gold, high levels of consumption and capital flight by paying interest only on 75 percent of deposits, paying interest on Yemeni Rial deposits at below the rate of inflation, and restricting withdrawals of foreign currency without official approval. This drives

Yemenis to stay away from banks, to speculate against the Yemeni Rial by purchasing foreign currency, gold, land or consumer goods instead of saving and to keep foreign currency holdings out of the Y.A.R. banking system.

(e) Interest Rate Limits on Loans

The maximum limits imposed on loans mean that banks have no desire to make long-term loans to investment projects because their cost of funds -- especially given the high reserve requirements -- on deposits over nine months exceeds the interest rate they can earn on loans of the same duration or longer.

(f) The Government Deficit and Deficit Finance

The Government deficit, which is financed primarily by Central Bank borrowing from Y.A.R. commercial banks at a 2 percent spread over the cost of funds to the banks, increases liquidity within the domestic economy and produces inflation without increasing production, a strong deterrent to investment. Inflation also encourages consumption, because of the psychology of "Buy today, because it will only be more expensive tomorrow." It also encourages Yemenis to speculate against the Yemeni Rial by buying foreign currency, gold and land as fast possible to protect the value of their money.

(g) Summary

In summary, price controls, exchange controls, import licensing and restrictions, banking controls and the public deficit discourage production, savings and productive investment but encourage inflation, consumption, imports, smuggling, monopolies, low tax collections and corruption. Dismantling these controls as outlined in Section 4 below is essential for the Y.A.R. to create a proper climate for serious investment.

1.7 Policy Changes Needed to Vastly Improve the Y.A.R. Investment Climate

As is outlined in detail in Section 4 of this Report, simultaneously with enacting the Investment Law, the Government should move rapidly to take the following steps in the order indicated:

(a) Abolish price controls except on monopolies;

(b) Eliminate controls on foreign exchange rates;

(c) Permit importers to import freely using their own foreign exchange;

(d) Reduce customs duties on productive machinery, equipment, instruments and tools to zero or one percent;

(e) Change customs duties to ensure adequate but not excessive protection for Y.A.R. infant industries;

(f) Reduce customs duties on non-essential goods by enough to drive smugglers out of business;

(g) Reduce the government deficit by increasing revenue and cutting spending with international financial assistance if necessary;

By removing import restrictions as outlined in Section 4, the Government will greatly increase revenues by collecting more customs duties and profits taxes on legitimate importers which it is not now collecting from smugglers. Otherwise, the deficit must be reduced by cutting government spending as much as possible, seeking assistance from international financial institutions or through bilateral arrangements if necessary.

(h) Increase interest rates on Yemeni Rial bank deposits to substantially above the inflation rate;

(i) Slowly ease restrictions on international capital movements into and out of the Y.A.R.;

The above measures will be substantial incentives for Yemenis to deposit their Y.A.R. and foreign currency in Y.A.R. banks and savings institutions and once again attract worker remittances into the country's financial institutions, mobilizing them for productive investment in projects. By increasing the real interest rate on Y.A.R. currency deposits to substantially above the inflation rate, Yemenis will reduce their purchases of foreign currency and speculation against the Yemeni Rial. By allowing Yemenis the opportunity freely to transfer their foreign currency deposits out of Y.A.R. bank deposits, they will not be afraid to bring them in the first place.

1.8 Timing and Sequence of Policy Changes Extremely Important

The timing and ordering of the above actions is extremely important and should occur as outlined in detail in Section 4.11 generally as follows:

(a) First Liberalize Trade and Begin Reducing the Government Deficit

This would be done by taking the actions described in Sections 4.1 - 4.7 with respect to ending controls on prices, foreign exchange rates and imports and reducing customs duties to outsell the smugglers and increase government revenues from customs duties and profits taxes collected from legitimate importers;

(b) Next Liberalize Domestic Y.A.R. Financial Market

Only when the deficit is under control and trade has been liberalized as described in subsection (a) above should the domestic financial market be liberalized and domestic interest rates raised to positive real values as outlined in Section 4.8

(c) Finally, Slowly Remove Restrictions on International Capital Movements Into and Out of the Y.A.R.

Then, only after the domestic capital market has been liberalized should controls on international capital movements into and out of the Y.A.R. be removed slowly and carefully as described in Section 4.9.

1.9 Policy Change Advantages

The benefits of the foregoing program for the People and Government of the Y.A.R. are as follows:

(a) Imports will be discouraged and Y.A.R. production of import substitutes and exports will be encouraged by giving Y.A.R. products an immediate 20 percent price advantage in the domestic and international markets because of floating the Yemeni Rial;

(b) As a result, productive investment in the Y.A.R. will receive a powerful incentive;

(c) Moreover, Y.A.R. producers will be encouraged to replace imported inputs and foreign labor which would suddenly be 20 percent more expensive with Y.A.R. materials and Yemeni labor;

(d) As interest rates are increased and restrictions eased on Y.A.R. financial markets and international capital movements, net foreign capital inflows will be attracted into the country's banks thereby mobilizing capital for productive investment;

(e) In addition, capital flight will be discouraged when Yemenis realize that they can receive the same or better benefits by keeping their money here as by depositing it in London, New York or Bahrain;

(f) As imports are discouraged and smuggling reduced and Y.A.R. production increases in response to the encouragement of a better market position for the Y.A.R., the balance of payments will improve, thereby promoting even greater investor and creditor confidence and giving the country yet more resources to develop its human and physical infrastructure;

(g) The Government will obtain substantially increased revenues from collecting customs duties, profits taxes and salary taxes from legitimate importers and investment projects and from their wholesalers and retailers which are not now being collected from smugglers;

(h) The gainers from these policies will be those who stand to benefit from a better international market position for the Y.A.R., namely, manufacturers, farmers, the tourist industry, workers and the unemployed; and the government will benefit from increased revenues and respect among the people for having reduced smuggling and increased production and investment in the country.

1.10 <u>If Properly Managed the Recommended Policy Changes Will not Cause Inflation But Will Reduce Inflation</u>:

It has been suggested that by allowing the foreign exchange rate to float and to allow private importers the right to use their own foreign exchange, inflation will result. But inflation results from government deficit spending. As noted above, an essential part of the program is reducing the deficit through increased revenues and spending restraint. This is essential in order to maintain the incentive for the production in the Y.A.R. of exportable and tradeable goods.

Liberalizing the trade sector in a way that will reduce or eliminate smuggling in the manner outlined above will be a powerful force for reducing inflation by increasing Government revenues from customs duties and taxes on importers and by dropping the price of legitimate imports which will take the

place of more expensive smuggled goods. Moreover, much of the inflation already has been absorbed by the Government's wise policy of allowing the informal free market of currency exchange to continue.

Moreover, the fact is that the Y.A.R. already has inflation which is evident in the market place and caused by policies which encourage smuggling, consumption and land speculation instead of investment and production. Even if inflation does result, it will be inflation with growth and investment which is far better than inflation with little or no growth or investment which is what the Y.A.R. currently is facing. With a population of ten million people, half of whom are under the age of fifteen, and growing at 3 percent per year one could venture to say that inflation with growth in productive investment is better than no inflation and no growth.

1.11 General Timing: Now is the Most Opportune Time to Take Action

For the Y.A.R., now is the opportune time to begin these reforms with liberalization of the exchange rate and the trade sector and deficit reduction. This would be a powerful message to Yemeni, Arab and foreign investors world-wide that the Y.A.R. is serious about encouraging and promoting real investment in the country. By implementing these policy changes now, the Y.A.R. would be well-positioned for competition within the ACC. Moreover, the Y.A.R. already is in a strong position to begin because:

(a) There are substantial liquid assets in Yemeni hands which could be put to immediate use for investment;

(b) The Y.A.R. policies of exchange controls, import restrictions and price controls are relatively new and not entrenched;

(c) The Y.A.R. has relatively little foreign debt, compared to many other countries;

(d) The differential between the official rate and the informal market rate for the Yemeni Rial is not so overwhelming that the adjustment would be unacceptably painful;

(e) The Y.A.R. should be able to obtain assistance, if needed, to carry it through any adjustment period from bilateral or international sources if it were to carry out the proposed program;

(f) The Y.A.R. is now enjoying revenues from oil which give it a cushion against any short-term adverse social

effects which may occur and will enable it to carry on its vital functions of providing the Y.A.R. people with security, education and infrastructure.

1.12 Review and Analysis of the Draft Investment Law

Section 5 of this report reviews and analyzes the Draft Investment Law article by article or chapter by chapter, as relevant.

The driving concept behind the law is to substantially enhance the investment climate in the Y.A.R. by eliminating or reducing as many of the obstacles described in Sections 2 and 3 of this report as possible and by providing substantially increased facilities for investors and incentives for desired investments.

In that regard, the main features of the Draft Investment Law are as follows:

(a) Articles 21 and 22 remove foreign exchange burdens from the Government and give investment projects the right and responsibility to obtain their own foreign exchange for project purposes.

Article 21 on foreign currency bank accounts provides that project foreign currency accounts may be credited with foreign currency from foreign invested capital, foreign loans, proceeds from exports, proceeds from sales to the domestic market in foreign currency as well as from any person, private or public, holding foreign currency within the Republic or outside of it. At the same time, Article 22 makes clear that projects shall have both the right and the <u>responsibility</u> to obtain their own foreign exchange from any source, private or public and, equally important, that the Government will be under no obligation to provide foreign exchange to projects. This article thereby relieves the Government of an impossible burden: That of guaranteeing to meet the foreign currency needs and demands of private investment projects.

Under Article 21.D., projects can use their foreign currency accounts to make any and all foreign currency payments required to establish, implement and operate their projects including payment for fixed assets, imported production materials, working capital, loan repayments, royalties and other fees for foreign technology transfer and transfer of profits or repatriation of capital pursuant to Articles 24 and 26.

Modelled on similar provisions in the Egyptian investment law, these clearly are the most important provisions in the Draft Investment Law dealing with what is by far the most serious obstacle to investment in the Y.A.R.: namely, the current inability of foreign investors to obtain and use their own foreign exchange to import investment project requirements and technology. Without these facilities, there will be very little private investment in the Y.A.R., no matter how many other guarantees, rights and exemptions are given to investors. As Dean Salacuse of the Fletcher School of Law and Diplomacy has said, "Foreign exchange is the mother's milk of investment." Without providing free access to foreign exchange, a dynamic program of large-scale private investment will not be possible.

Providing these facilities on the other hand, will channel the foreign exchange now being invested by Yemenis in smuggled goods, land and foreign countries into productive investment in the Y.A.R. In addition, nothing is more important for attracting foreign investors than providing these rights and facilities.

(b) Article 28 gives an investment project the license to import all fixed assets and production materials needed to establish and operate the project. Since all project imports will be financed with the project's own foreign exchange using the foreign currency bank account authorized by Article 21, there will be no need to have the import license approved by the Central Bank. In other words, the project's original license will serve as its license to import project requirements. To survive, projects must be able to import their production needs freely. Currently, projects wait many months in some cases to obtain import licenses and then get them for only 30 to 40 percent, at most, of their needs. Once the government rids itself of the burden of supplying foreign exchange for investment project imports, investors will be able to plan accordingly to provide their own foreign exchange.

(c) Article 29 provides customs exemptions to projects on fixed assets and materials required for their establishment.

(d) Article 30 gives investment projects a reduction of customs duties on production materials to the extent necessary to compete with equivalent finished imports.

(e) Article 24 grants the right to transfer abroad profits attributable to foreign invested capital using the

project's Article 21 foreign currency bank account. Similarly, Articles 25, 26 and 27 provide for repatriation of foreign invested capital in various circumstances. Again, all such transfers must be funded by the project's own foreign currency, not by that of the Government. The right to transfer profits and repatriate capital are fundamental to attracting foreign investment and are reflected in most investment laws.

(f) A principal objective of the law is to attract foreign capital held by Yemenis into investment projects in the Y.A.R. The means of realizing this objective is to guarantee Yemenis the same rights as Arabs and foreigners with respect to the foreign capital invested by them -- that is, the right to transfer profits abroad in respect of their foreign invested capital under Article 24 and to repatriate foreign invested capital under Articles 25 and 26. Thus "Foreign Invested Capital" is defined by nature and source, not by the nationality of its contributor. Similarly, Articles 7 and 8 guarantee freedom of investment and equal treatment of investors with the idea that Yemeni investors should be treated as well as foreign and Arab investors to encourage them to invest their foreign capital in the country.

(g) Although Yemenis are invited to invest foreign capital owned by them, Arab and foreign investors are not permitted to invest Yemeni Rials to establish a project, <u>except</u> in the case of a debt-equity conversion. In this case, under Article 3.A.(29), a foreign investor can purchase a foreign currency debt obligation of the Y.A.R., exchange it for Yemeni Rials at the Central Bank at the face value of the obligation and invest the Rials so obtained in a project in the Y.A.R. Such an investment would still be considered "Foreign Invested Capital" for all purposes of the law, including profit transfers abroad and capital repatriation rights.

(h) Chapter 7 establishes a streamlined licensing system which eliminates much of the duplication present in the existing system by leaving most projects to be licensed administratively and having only highly sensitive projects reviewed and approved by a high-level government body. Moreover, the principle of the system will be to allow all projects to proceed unless they are prohibited or clearly fail to come within the State's Socio-Economic Development Plan. This approach will be possible because all projects will now be responsible to provide their own foreign exchange to

meet their requirements and the burden will no longer be on the Government.

(i) Article 16 guarantees projects freedom from controls on profits and salaries and prices except in the case of monopolies and price fixing and except under extraordinary circumstances in the case of a specified list of essential goods. In addition, Article 15 guarantees projects against economic discrimination and Article 14 gives investors the right and freedom to manage their projects in accordance with business conditions as they see them. These guarantees are essential to attract private investment into the country.

(j) Article 23 seeks to remove the disincentives to bank lending to investment projects by removing government imposed limits on interest rates on loans, providing creditors with a means of perfecting and enforcing mortgages and ensuring that interest and other obligations of a debtor continue to accrue until a judgement is awarded, rather than being suspended by the initiation of legal action.

(k) Articles 20, 21 and 23 ensure that projects will receive interest on the full amount of their deposits regardless of reserve requirements and that such rates can be freely negotiated with the bank and are not subject to imposed limits.

(l) Article 10 guarantees projects the right to own land and provides a recording system to ensure clear title to land.

(m) Chapters 3, and 4 establish performance-based tax and customs exemption incentives for projects which meet specified conditions and objectives. Such exemptions will be granted only upon proof of performance and not automatically with the license as follows:

(1) To qualify for the longer tax exemption periods specified in Chapter 3, specific requirements must be met regarding the nature, location and value of new fixed assets and paid-in capital of the project, as well as whether it is a shareholding company with 25 percent of its shares held by the public;

(2) After the tax exemption period is competed, Chapter 4 provides incentives in the form of exemptions and rights to encourage:

(A) Project expansion and upgrading,

(B) Exports;

(C) High value added to the national economy by saving or earning foreign exchange and using local materials; and

(D) Employment of Yemenis.

(n) All Projects, however, will receive certain basic tax exemptions specified in Article 33, namely:

(1) Exemption of capital from proportionate stamp duty and other direct taxes and imposts on capital;

(2) Exemption from proportionate stamp tax of all contracts relating to a project's establishment, operation, expansion or upgrading;

(3) Exemption from the tax on salaries of foreign workers of a project of actual amounts paid in respect of housing the employees, educating their children in the Y.A.R. and air and sea transportation in bringing the employees here and repatriating them;

(4) Exemption from real estate transfer tax of all purchases and sales of real estate for project purposes and from profits tax interest on loans to finance investment costs and for three years on technology transfer fees;

(5) Every project will receive a four-year exemption from profits and real estate taxes, starting from the date of the license rather than the date of commencing operations in order to encourage quick implementation of the project.

(o) Article 32 provides projects with less costly and fairer procedures to obtain work permits and visas for foreign experts, managers and employees.

(p) Chapter 6 establishes an independent Investment Promotion Authority with the power to license projects and the task of promoting and facilitating investment in the Y.A.R. Although this is the sole responsibility of the IPA, Article 5 makes it the duty of every Government Official to facilitate the implementation and operation of all projects.

(q) Chapter 8 facilitates the formation and operation of shareholding and limited shareholding companies for investment projects as a means to help mobilize capital.

(r) Chapter 9 provides a system of rules and procedures for the establishment and operation of free zones for export industries.

(s) Chapter 11 provides the grounds for license cancellation, withdrawal of rights and penalties for violations. But Article 19 guarantees projects that licenses will not be cancelled, property seized or projects nationalized without a court order based on clear and convincing evidence and a specific provision of law issued after a judicial hearing in which the project or the investor, as the case may be, has had an opportunity to participate.

(t) In addition, Chapter 12 provides projects and investors with a system of administrative appeals, Chapter 13 guarantees the right to, and provides a complete system for, binding arbitration or litigation, to settle disputes with the government, among investors themselves and between projects and third parties. This should be read in connection with Article 18 which also guarantees investors the right to sue and arbitrate in respect of disputes.

(u) Article 9 ensures that projects will be governed by rules relating to the private sector, even if a project has up to 75 percent government or public sector participation, and Article 12 assures projects that the public sector will not subsequently monopolize the sale of their products .

(v) Numerous provisions seek to ensure stability and predictability in the law:

(1) Discretion with respect to providing exemptions is restricted to highly sensitive projects under Articles 61-63 or highly significant projects which can be awarded special privileges by the Cabinet or the IPA Board of Directors. Otherwise, rights and exemptions are either provided automatically to all projects under Chapter 2 or must be awarded on the basis of performance under Chapters 3 and 4.

(2) Article 17 ensures that the law cannot be modified except by another law specifically referring to it

and that rights granted cannot be taken away ex post facto;

(3) Article 99 requires that all existing laws be modified or cancelled to the extend required to give full effect to this law;

(4) Finally, to provide flexibility, some matters relating to minimum qualifications for tax exemptions and other matters may be amended by the Cabinet or by the IPA Board, but only once every five or three years as provided in Article 81.

1.13 Other Obstacles to Investment

Section 6 reviews obstacles to investment not dealt with by the law or Section 4 of this Report as follows:

(a) Lack of a well-developed competitive banking system to mobilize savings and finance investment throughout the country;

(b) The need for developing physical infrastructure facilities to attract investment, such as industrial estates, free zones and new urban communities where preplanned factory sites are supplied with water, power, sewage and transportation facilities;

(c) Excessively high internal transportation costs;

(d) Relatively low literacy rate;

(e) Need for higher training in management and business;

(f) Need for professional lawyers, judges, accountants, auditors, and engineers trained in the needs of investment projects in their respective fields;

(g) Need to survey and map the entire country and develop a modern land recording system based on the Australian system;

(h) A slow and restrictive visa system which must be streamlined to attract investment.

1.14 Recommended Follow-On Activities

Section 7 of the Report details the follow-on activities need to support the New Investment Law upon its promulgation:

(a) Immediately upon promulgation, the Minister will distribute copies of the law to all government offices and the public pending publication in the Official Gazette .

(b) Within 90 days, the Minister must prepare and issue the executive regulations and the official forms, including the form of application to establish projects, licenses, certificates, etc. as well as model articles of incorporation and statutes for projects.

(c) As soon as possible, senior officials responsible for implementing the law should make observation visits to countries which have been successful in promoting investment.

(d) Training and orientation of officials of the IPA and other Government Organizations concerned with investment and investment project activities.

(e) Review and Revision of other laws procedures and practices affecting investment.

(f) Review of tax administration and procedures; and

(g) Establishment of an economic policy analysis unit placed at a high level within the Government.

SECTION 2

OVERVIEW OF OBSTACLES TO INVESTMENT IN THE Y.A.R.

2.1 A Primary Objective of Investment Law is to Reduce the Obstacles to Investment in the Y.A.R.

One of the objectives of enacting a new investment law is to reduce or eliminate legal and non-legal obstacles to both national and foreign investment in the Y.A.R. Passing such a law would raise the nation's standing relative to others who are also competing for investment funds around the world -- not only for foreign funds, but those of Yemenis as well. One of our discoveries during our stay in the Y.A.R. is that many Yemenis holding U.S. Dollars and other foreign currencies are investing them abroad, not only in foreign bank deposits and securities but even in projects in Thailand and Malaysia. Creating the right climate for investment in the Y.A.R. would encourage many Yemenis to invest in their own country. This in turn would be a key factor in attracting Arab and foreign investment to the Y.A.R.

Certainly this has been the experience of Egypt which radically revised its Investment Law in 1974 expecting to attract foreign investment. But the first result of the 1974 Egyptian Law was to stimulate Egyptians to invest in their own country. Foreign investors then followed. But even today, statistics show that 65 percent of all investment in Egypt under the investment 1974 law has been by Egyptians, in foreign currency as well as Egyptian currency.

2.2 The World-Wide Competition for Investment

Many countries today are competing hard for foreign investment. Ireland, for example, provides a tax-free cash grant of up to 50 percent of the value of certain high-priority investments. Similarly, France offers cash grants of more than 50 percent to high-technology companies which locate in certain areas which the government wants to develop. These grants are made without the government taking back any shares, or seats on the Board of Directors or any kind of control of the project.

Within the Middle East region, competition for foreign investment is also very strong. Turkey, for example, provides cash assistance to selected investment projects from a special fund, though on a lesser scale than France or Ireland. Under its recent (1987) law for industrial investment, Tunisia pays 50 to 100 percent of the costs of constructing the infrastructure necessary to implement projects in designated areas, as well as all of the employer's social security contribution for five years, renewable for another five years. Closer to the Y.A.R., Egypt, Iraq and Djibouti have all recently revised their laws to reduce obstacles and offer more incentives to encourage investors. Dubai's efforts and energy in promoting investment there are well-known, and Bahrain has developed itself as an international financial center.

2.3 Advantages Offered Investors by the Y.A.R.

Although it faces significant competition for investment funds (both foreign and Yemeni), the Y.A.R. also offers substantial advantages to the prospective investor:

(1) A highly strategic location at the juncture of the Red Sea, the Gulf of Aden and the Indian Ocean;

(2) A good business location near the markets of such oil-rich countries as Saudi Arabia, Oman, Qatar, the United Arab Emirates and Kuwait;

(3) A very temperate, pleasant climate relative to surrounding countries;

(4) The greatest amount of arable land in the Arabian Peninsula with sufficient rainfall to grow seasonal fruits and vegetables for export to markets within 1,000 miles;

(5) Perhaps the most exciting possibilities for tourism development in the Middle East today with beautiful scenery and architecture, fascinating culture, friendly and hospitable people, historic sites, and again, a very pleasant climate;

(6) A relatively good financial position with a small international debt and significant cash liquidity which could be put to use in productive investments almost immediately;

(7) Ample supplies of electricity for industry;

(8) Substantial reserves of natural gas which some day can also supply energy to industry;

(9) Significant oil resources;

(10) A reasonable profits tax rate; and

(11) A large and growing population of people whose basic honesty, self-confidence and dynamism is known throughout the world.

In this regard, it is important to note that the key to economic development is people, not natural riches. The most successful countries in the world today, economically, have almost no significant natural resources to speak of: Switzerland, a small country which has the highest per capita income of any country in the world; the city state of Singapore, which has the highest per capita income in Asia after Japan; Hong Kong; Taiwan and South Korea, which both also have large defense establishments; and, of course, Japan itself, which has gone from feudalism only a hundred years ago and total defeat at the end of World War II to the economic giant of today's world economy.

Without significant natural resources all of these countries depend on imports and, of course, exports. They have succeeded by giving top priority to educating their people; then building their infrastructure; and then to following policies designed to encourage investment, savings and pride of workmanship.

2.4 The Y.A.R.'s Standing in the World-Wide Competition for Investment

Despite the Y.A.R.'s significant advantages, a September 1988 world-wide survey measuring the investment climate in 95 non-communist countries according to 14 key factors found that the Y.A.R. was one of the least desireable countries for foreign investment. In fact it was fourth from the bottom, behind almost every Arab and African country surveyed, including the oil-rich countries, Tunisia, Morocco, Jordan, Algeria, Egypt, Chad, Sudan, and even Syria, Somalia and Libya. Only Surinam, Burma and Iraq ranked lower, and Iraq has since changed its investment law. The 14 factors and the rankings of the countries are listed in Appendix A to this report. Areas of concern to investors in this particular study where the Y.A.R. scored low were ease of access to foreign exchange, the approval process, dispute settlement, ease of obtaining work permits for foreign employees, profit repatriation restrictions, investment incentives, domestic economic performance, international economic performance, and labor conditions.

Moreover, according to the "Report on the Investment Climate in the Arab Countries for 1988" by the Arab Organization for Investment Guarantees, the Y.A.R. received no investment from other Arab countries in 1988, either from private sources or from joint Arab projects. This is contrasted with the three countries at the top of the list: Egypt, US $ 51 Million; Tunisia, US $ 41 Million; and Morocco, US $ 39 Million. A list of the main factors affecting the decisions of Arab investors in 1988 as compiled from the Arab Investment Guarantee Organization's Report is contained in Appendix B to this report.

2.5 Overview of Obstacles to Investment in the Y.A.R.

While these are only two studies surveying investor concerns, our research indicates that there are indeed a number of serious legal and non-legal obstacles to private foreign and local investment in the Y.A.R. as follows:

(1) The pervasive system of government controls over economic and financial life in the Y.A.R. -- namely, import licensing, channelling all foreign exchange transactions through the Central Bank, interest rate limitations and price controls -- all of which encourage smuggling and consumption and discourage productive investment as described in greater detail in Section 3 and to be dealt with by the actions set forth in Section 4 of this report and Articles 21 and 22 of the Draft Investment Law;

(2) The size of the Government's deficit and its financing through borrowing also discussed in greater detail in Section 3 with recommended remedial actions described in Section 4 of this report;

(3) The concept prevalent in existing legislation and regulations that every investment project is prohibited unless it is specifically permitted and the resulting wasteful bureaucratic procedures and delays inherent in the existing system of licensing projects and then separately licensing every phase of their activities including their imports, exemptions, companies, foreign workers, expansions, upgradings, and production levels, dealt with by Chapter 7 of the Draft Investment Law on licensing;

(4) Powerful disincentives to bank lending to investment projects described in Section 3 and the commentary on Article 23 and dealt with by actions suggested in Section 4, Article 20 and 23 of the Draft Investment Law and Section 6;

(5) The negative attitudes generally of government officials toward private sector business and investment, discussed and dealt with by Article 5 of the Draft Investment Law and in Section 6;

(6) Lack of an effective system of establishing clear title to land, dealt with by Article 10 of the Draft Investment Law;

(7) Lack of a clear and certain system for arbitrating disputes, dealt with by Chapter 13 of the Draft Investment Law;

(8) Lack of stability in enforcement of the law and investors' rights, dealt with by Articles 17, 18, 19 and 81 and Chapter 13 of the Draft Investment Law;

(9) Use of police by government officials and private parties to resolve civil and commercial disputes, dealt with by Article 19 of the Draft Investment Law;

(10) Lack of clear judicial authority to reverse ministerial or governmental decisions which are contrary to clear provisions of the law or which have no authority in the law, dealt with by Articles 18 and 19 and Chapter 13 of the Draft Investment Law;

(11) A customs drawback system to encourage exports which does not work, because the drawback is often never paid

and cannot be collected, dealt with by Article 41.B. and C. of the Draft Investment Law;

(12) A rigid system of restricting customs exemptions to the letter and not allowing for reasonable variations in prices, delivery dates, nature of the item etc., dealt with by Article 29.C. of the Draft Investment Law;

(13) Delays in obtaining customs exemptions and in customs clearing procedures which lead to added costs to investors for demurrage and storage charges which sometimes render the customs exemption almost worthless, dealt with by Articles 29.E. and 67 of the Draft Investment Law ;

(14) A customs tariff which sometimes imposes heavier duties on raw materials used by Y.A.R. producers than on the finished equivalent imported product, dealt with by Article 30 of the Draft Investment Law;

(15) Long, costly and repetitive procedures to obtain work permits for foreign experts, managers and other employees, addressed by Article 32.A. of the Draft Investment Law;

(16) Direct taxes on capital, including the proportionate stamp tax and zakat and the equivalent tax on foreigners, addressed by Article 33.A. of the Draft Investment Law;

(17) The proportionate stamp tax on the value of contracts, also dealt with by Article 33.A. of the Draft Investment Law;

(18) Lack of a clear system for taxing and enforcing royalties, fees and other payments for transfer of technology, dealt with by Articles 33 and 83.B. of the Draft Investment Law;

(19) A system of basing tax incentives on the license, rather than on actual performance, dealt with by Chapters 3 and 4 of the Draft Investment Law;

(20) Vagueness and uncertainty created by giving the Minister and the licensing authorities too much discretion instead of providing a stable, clear and predictable set of rules for investors and officials alike, dealt with by Chapter 7 of the Draft Investment Law on licensing and by trying to remove vagueness, uncertainty and unnecessary discretion from the entire law;

(21) Lack of a single organization with whom investors can deal which has sufficient authority and power to issue all needed licenses to establish and operate an investment project and which will support and assist the investor in relations with other government organizations, dealt with by the creation of the IPA under Chapter 6 of the Draft Investment Law;

(22) Unnecessarily difficult procedures to form and operate shareholding and limited liability companies and excessive restrictions on company decisions and operations, dealt with by Chapter 8 of the Draft Investment Law;

(23) A tendency on the part of government officials to interpret the law as they see it usually to the detriment of an investor and often contrary to clearly stated provisions of the very law they are "interpreting," dealt with by Articles 5 and 99 of the Draft Investment Law;

(24) Lack of rules governing free zones in the event that they are established, dealt with by Chapter 9 of the Draft Investment Law;

(25) Uncertainly as to which law prevails when another existing law conflicts with the Investment Law, dealt with by Article 99 of the Draft Investment Law and specific articles;

(26) Lack of sufficient physical infrastructure facilities, such as roads, deep-water port facilities, industrial estates, etc., discussed in Section 6;

(27) Low literacy rate and low skilled labor force, discussed in Section 6;

(28) Excessively high rates for transportation within the country, discussed in Section 6;

(29) Lack of a well-developed banking and savings system, discussed in Section 6;

(30) Lack of efficient Governmental systems and trained officials to deal with modern business enterprises, discussed in Section 6;

(31) A somewhat restrictive and slow visa system and requirements for exit visas discussed in Section 6.

As noted above, many of the above listed obstacles are more fully analyzed and explained in the article by article analysis of the Draft Investment Law which follows in Section 5 below.
The Draft Investment Law is designed to eliminate most of these obstacles for investors and significantly improve the investment climate in the Y.A.R. No investment law, by itself, could eliminate all existing major obstacles to investment in the Y.A.R. Other obstacles both legal and nonlegal must be addressed by other means, as discussed in Sections 3, 4, and 6 of this report.

One of the primary functions of an investment law is to serve as a message to the world on the policy of a country toward investment: For some countries, the primary message is that investment must be controlled and restricted. For other countries, the message is that investment must be encouraged. Based on our interviews with ministers and other government officials, we understand that the intended purpose of the Y.A.R.'s new investment law will be to reflect a policy to encourage investment. If we are correct in our understanding, then, as is discussed below in Sections 4 and 6, it will be necessary to effect some major law and policy changes in addition to enacting a new investment law, partly by returning to some of the policies that were previously followed in the early 1980's and partly by initiating new policies.

In Egypt, as is well known, enactment of the 1974 Investment Law 43 presaged an overall change in policy from a closed, centrally controlled (and stagnating) economy to a much more open, less controlled and dynamic one. Accordingly the 1974 Egyptian investment law sought to remove what were overwhelming legal obstacles to private investment in Egypt because of restrictions contained in virtually all of the laws affecting investment: The foreign exchange laws, the companies laws, the tax laws, the labor laws, etc. Thus, the 1974 Egyptian law is virtually a catalog of exceptions to all of those laws.

Thereafter, the Egyptian Government and legislature proceeded to generally reform the laws affecting investment and business in Egypt passing in succession a reformed Foreign Exchange Law 97 of 1976 giving every private citizen and company the right to hold his own foreign exchange and transfer it abroad freely, a reformed Companies Law 159, a reformed Income Tax Law 157 and a reformed Labor Law 137 all in 1981. As indicated by the obstacles listed above and as will appear from the discussion below in Sections 3, 4 and 6, much will have to be done in addition to enacting a new investment law to create in the Y.A.R. a suitable climate for investment.

SECTION 3

THE MOST SERIOUS OBSTACLES TO INVESTMENT IN THE Y.A.R.: THE PUBLIC DEFICIT AND GOVERNMENT CONTROLS ON PRICES, FOREIGN EXCHANGE, IMPORTS AND INTEREST RATES

Policy changes outside of the new investment law are required to overcome what are unquestionably the most serious obstacles to investment in the Y.A.R., namely, the controls now existing on imports, foreign exchange, interest and prices as well as the government deficit and means of financing it. The biggest incentive to investment in any country is always the overall climate for business and investment, and while all of these policies may well have been justified at the time they were instituted, in the current circumstances they serve to encourage inflation, consumption and smuggling and discourage -- even block -- productive investment. Let us now examine the individual and cumulative impact of each of these obstacles to investment and consider in Chapter 4 briefly what could be done to reduce or eliminate them:

3.1. Price Controls Encourage Consumption and Waste, Cause Shortages and Inflation and Directly Discourage Production and Investment

Price controls encourage consumption by keeping the price on the price-controlled item low and discourage production and investment by limiting the return a producer can make on his investment. While encouraging consumption, price controls often cause inflation in two ways. First, demand is increased by the low prices at the same time that production is discouraged thereby resulting in shortages. These shortages then result in highly inflated prices for the price-controlled goods in the black market.

This situation then feeds on itself, because persons having control over such goods, being attracted by high black market prices, themselves sell the goods into the black market. In Egypt, for example, this happens in two ways. First, people line up at the government store to buy, say, chickens. When they are available, ordinary people will buy as many as possible and sell most of them into the black market. Second, sometimes the officials in charge of these stores will themselves sell the chickens into the black market, so that they never even reach the government store customer.

The second way that price controls cause inflation is that since local producers refuse to produce the price-controlled goods in sufficient quantities, the Government sometimes takes on the burden of supplying them at a loss -- that is, below the world market price. This adds to government expenditures and adds to the deficit which in turn leads to more inflation (and in turn to more demands for price controls).

There are many examples from the Egyptian experience where price controls have consistently discouraged local production, encouraged massive consumption and, at the same time, resulted in shortages and high prices in black markets and contributed substantially to a huge government deficit. A few years ago, the Egyptian government imposed price controls on watermelons, a popular fruit in Egypt. Overnight, watermelons disappeared from the market completely, except for some sold at high prices in the black market. The next year, very few watermelons were produced but the government lifted the price controls with the result that, in the following year, so many watermelons were produced that the prices actually dropped of their own accord.

Similarly, a few years ago, green seedless grapes were very few and very expensive. With no price controls, green grape production has rocketed to the point where they are now plentiful and much cheaper. Bread prices, however, remain controlled at a very low level with government bakeries producing most of the bread at huge losses. Every year Egyptian newspapers comment on how wheat consumption per person in Egypt is the highest in the world by far and how, because bread is so cheap, huge quantities of it are fed to animals because it is so much cheaper than animal feed. Moreover, price controls are applied only to legitimate investors and producers, not to smugglers and black marketeers.

3.2. Exchange Controls Encourage Imports and Consumption, But Discourage Exports, Production and Investment

Exchange controls, used to maintain an overvalued rate for the Yemeni Rial, have numerous adverse effects on investment. In our short stay here, the official rate has remained at YR 9.77 to US $ 1, while in the informal market the rate has ranged between YR 11.33 and YR 11.80, a difference of between 16 and 21 percent. With this differential, few tourists or Yemenis holding U.S. Dollars have much incentive to exchange U.S. Dollars through the commercial banks, preferring the informal market for obvious reasons. This differential also renders Yemeni exports that much more uncompetitive on international markets,because they are 20 percent more expensive, and encourages a demand for and consumption of imports, because they are automatically made 20 percent cheaper by the overvalued rate for the Yemeni Rial. Note that this also means that imported production inputs -- i.e., raw

materials and machines become cheaper relative to Y.A.R. inputs such as Yemeni labor and Y.A.R. produced materials. Thus Y.A.R. producers are encouraged to import labor-saving machines instead of using Y.A.R. labor and use imported rather than Y.A.R. raw and intermediate materials.

3.3. Import Licenses, High Customs Duties and Other Import Restrictions Encourage Smuggling and Consumption and Cause Inflation While Blocking Production and Thereby Discouraging Investment and Depriving the Government of Customs and Tax Revenues

Import restrictions in the form of excessively high tariff rates, import licenses and outright bans have the following bad effects on the investment climate:

(a) Import restrictions reduce the overall quantity of goods available, thereby encouraging inflation and increased demand for the now scarcer imports;

(b) Import licenses establish monopolistic or oligopolistic and highly profitable positions for the few who are able to obtain import licenses;

(c) Import restrictions encourage smuggling because huge profits can be made by smugglers as a result of the following:

(1) The high demand for imports created by the overvalued exchange rate for the Yemeni Rial making imports 20 percent cheaper relative to Y.A.R. products;

(2) Because high prices for imports are created by excessively high tariffs;

(3) Because the alternative of obtaining highly sought after goods through legitimate channels is blocked by the import licensing system; and

(4) Alterative goods are not being produced locally because of exchange controls and import licensing which prevent the import of sufficient production materials.

(d) Import restrictions reduce government revenues thereby increasing the government's deficit which in turn increases the danger of inflation, because:

(1) The government does not collect customs duties on goods which are smuggled or are not imported in the first place;

(2) Profits taxes are not collected on either legitimate importers or on smugglers.

(e) Import restrictions encourage corruption because of the excessively high profits to be made by those who obtain import licenses and those who smuggle, which in turn makes it worthwhile to bribe officials as a cost of doing a very lucrative business;

(f) Import restrictions encourage consumption and trading and discourage productive investment because:

(1) Easier, very high profits are to be made in smuggling and importing for those who can get licenses, whereas taking the trouble to get an investment project going and keeping it up is much more expensive in time and money and much more problematic in view of the overall investment climate; and

(2) While traders can always get their goods from smugglers who in turn can bring in goods in manageable quantities, investors must go through the import licensing system in order to get their raw materials in because the large, bulky quantities needed could not be easily smuggled in even if that were desired: For example, smuggling in five tons of production materials is difficult, five television sets, much easier.

(3) Currently, because of the government's shortage of foreign currency, import licenses for investors are months behind investment project production schedules and do not permit sufficient materials to maintain much more than one third of full production.

Few situations could be much more disastrous for the investment climate than the prevailing situation described above. Thus, for existing investors, the overall result of the import licensing system is a discontinuous, uncertain supply of imported inputs, inefficient and reduced utilization of existing production capacity and layoffs of workers.

3.4 Banking Controls on Deposits Cause Speculation Against the Yemeni Rial and Capital Flight and Discourage Productive Investment

Existing banking controls on deposits discourage Yemenis from saving and encourage speculation against the Yemeni Rial, as well as speculation in land and gold, high levels of consumption and capital flight as follows:

(a) Because banks apparently are subject to high reserve requirements of 25 percent on deposits, interest is paid only on 75 percent of the amount deposited, whether foreign currency or Yemeni Rials, either because of banking regulations or because of officially sanctioned banking practice. Thus, for example, assuming an interest rate of 10 percent, a deposit of US $ 1,000 for one year earns only US $ 75 of interest instead of US $ 100 -- that is, the effective rate of interest on the US $ 1,000 deposit is only 7.5 percent instead of 10 percent. Since any Yemeni holding surplus U.S. Dollars or other freely convertible foreign currencies can easily get the full interest rate in Bahrain, Saudi Arabia, London, or New York, he has virtually no economic incentive to deposit his foreign currency funds in a bank in his own country.

(b) This is compounded by the fact that he cannot withdraw more than US $ 1,500 without the permission of the Central Bank. This in itself, of course, is a significant deterrent to depositing the money in the first place: Anybody who cannot get their money out of a bank (or country) without official approval will not put it in there in the first place: Why take the unnecessary risk that the approval will not be given especially when an easy alterative is to deposit his money in a bank in Bahrain, or London where one can always get it back and be paid interest at international rates on the full deposit.

(c) Interest rates on Y.A.R. currency deposits are set at a level which is below the inflation rate resulting in a negative real rate of interest on such deposits. For example, let us assume that the annual rate of inflation is, say, 20 percent, and the interest rate on Yemeni Rial deposits is 10 percent -- but, as noted above, it is effectively only 7.5 percent because of the 25 percent reserve requirements. With 20 percent inflation, the depositor's Yemeni Rials deposited in a savings account in September 1989 will buy 20 percent less in September 1988. So, instead of earning 7.5 percent on his deposit, he has actually lost 12.5 percent.

By way of example, if he deposits YR 1,000 in October 1989, he will receive back YR 1075 in October 1990. But, with 20 percent annual inflation, those 1075 Yemeni Rials in October 1990 will buy only what YR 860 would have bought in October 1989. Therefore, to protect the value of his YR 1,000, he is better off to do one of the following :

(1) Buy U.S. Dollars or Swiss Francs or some other free foreign currency and deposit them in a U.S. or Swiss Bank -- i.e., speculate against the Yemeni Rial; or

(2) Buy gold in Yemen or elsewhere; or

(3) Buy land; or

(4) Buy consumer goods, e.g., Japanese television sets or a Toyota. The Yemeni will see that he better spend his rials today, because Toyotas and TV sets will only be that much more expensive tomorrow.

All of the above banking policies discourage Yemenis from saving in either foreign currency or Yemeni Rials in Y.A.R. banks, reducing the amount of loanable funds available for financing investment. In addition, of course, investment projects themselves will not wish to deposit either Y.A.R. or foreign currency in banks where they will lose money.

3.5. Interest Rate Limits on Loans Deprive Banks of the Incentive To Make Investment Project Loans

The maximum limits imposed on loans mean that banks have no desire to make long-term loans to investment projects because their cost of funds -- especially given the high reserve requirements -- on deposits over nine months exceeds the interest rate they can earn on loans of the same duration or longer. A loan of three months duration yields interest to the bank which is only one percent greater than the cost of funds. But the banks have no interest in making a loan for even that short a period for one percent profit when they can always make an easy guaranteed profit by selling excess deposits to the Central Bank at 2 percent over their average cost of funds. Investment projects of any size at all usually need term loans of at least five years to help finance the investment costs of establishing the project.

3.6 The Government Deficit and Deficit Finance Causes Inflation, Discourages Investment and Promotes Speculation in Land, Gold and Foreign Currency

Currently, we understand that the Y.A.R. Government is running a deficit which is financed primarily by Central Bank borrowing from Y.A.R. commercial banks at a 2 percent spread over the cost of funds to the banks. This increases liquidity within the domestic economy and produces inflation without increasing production, a strong deterrent to investment. Inflation also encourages consumption, because of the psychology of "Buy today, because it will only be more expensive tomorrow." It also encourages Yemenis to speculate against the Yemeni Rial by buying foreign currency, gold and land as fast as possible to protect the value of their money. Although the deficit was reduced somewhat last year, efforts must be made to assist its continued decline. One way is to cut government spending. Another is to increase government revenues by some of the means suggested below in Section 4.7. Undoubtedly, both means will have to be used.

3.7. Controls on Prices, Foreign Exchange, Imports and Banking Have Not Worked

Moreover, it would appear that the above controls actually have worsened the very situation they were intended to improve. Was the purpose of channelling all foreign exchange transactions through the Central Bank to maintain the government's foreign exchange position? It would seem to be so. Yet, in fact, this position appears to have declined. Thus, the Central Bank's gross foreign assets dropped from US $ 558 Million in 1987 to US $ 285 Million in 1988. Worker remittances through official channels have declined from a high of over US $ 1 Billion in 1983 to US $ 340 Million in 1988.

While some of this decline no doubt can be attributed to declining numbers of Yemeni workers in the oil rich states, much of it springs from the fact that, given a 20 percent differential between the official and unofficial rates for the Yemeni Rial and the 25 percent lower effective interest rate paid by Yemeni banks on foreign deposits, Yemenis can make more from their foreign earnings by channelling them into smuggled goods, gold, the informal foreign exchange market, speculation and, indeed, investments overseas, including simple bank deposits.

Was the intent of import controls to restrict imports of luxury goods or to increase Government revenues from higher customs duties? In fact the Yemeni market is filled with imported luxury consumer goods from Japanese cars, refrigerators and television sets as well as French perfumes, Swiss watches, Swedish scissors and German pens. The problem is that most of these are smuggled goods on which no customs are paid. Accordingly, Government

revenues from customs have dropped in recent years. Is the purpose of price controls and interest rate limitations to reduce inflation? In fact the Y.A.R. has plenty of inflation because both local production and legitimate imports are discouraged, but the smuggled goods are not subject to price controls.

3.8 Summary

In summary, price controls, exchange controls, import licensing and restrictions, banking controls and the public deficit discourage production, savings and productive investment but encourage inflation, consumption, imports, smuggling, monopolies, low tax collections and corruption. Dismantling these controls as outlined in Section 4 below is essential for the Y.A.R. to create a proper climate for serious investment.

SECTION 4

POLICY CHANGES NEEDED TO VASTLY IMPROVE THE Y.A.R. INVESTMENT CLIMATE

Although noteworthy, the failures of the above-discussed policies to achieve their intended goals are beside the main point, which is that their cumulative impact has been to create what is undoubtedly the worst climate for investment in the Arab world, except for Mauritania, Djibouti and the People's Democratic Republic of Yemen. In the study cited in Section 2 above, even Sudan, Somalia, and Libya were awarded higher ratings for their investment climates than the Y.A.R., though not much higher. Together with enacting the Investment Law, therefore, these policies must be changed as soon as possible, before their effects become an irreversible deterrent to productive investment. Moreover, if they are left in place, Y.A.R. businesses and investment projects will be ill prepared for competition within the Arab Cooperation Council (ACC).

If these polices are changed now, in the right sequence,the Y.A.R. could become the most productive and prosperous of all of the ACC countries within a few years, because all of these other countries are also plagued in varying degrees with the same obstacles, although currently on a lesser scale than that of the Y.A.R., because of recent reforms in those countries. Now is the time for the Y.A.R. to leap ahead of those countries and lead the way. With all of its natural advantages, the Y.A.R. can create one of the most attractive investment climates in the Arab world by a few discrete, well-executed changes of policy as follows:

First, the Draft Investment Law as described article by article in Section 5 should be enacted without delay. Within the Draft Investment Law, investors and projects must be granted the right to obtain and use their own foreign exchange to freely import the machinery, equipment and materials needed to establish and operate their projects, as well as to transfer profits, repatriate capital and make payments for foreign loans and technology transfer. This is discussed in detail below in the comments on Articles 20, 21 and 22 of the Draft Investment Law.

Simultaneously with enacting the Investment Law, the Government should move rapidly to take the following steps in the order indicated:

4.1 Abolish Price Controls Except on Monopolies

Ending price controls will send a powerful message to the people of Yemen and investors everywhere that henceforth the policy of the Government is to encourage production and investment in the Y.A.R. and discourage consumption and trading. As a result, production of Y.A.R. products will increase in response to the removal of controls. At the same time consumption of formerly price-controlled items will be discouraged. To the extent that such items were imports, consumers will prefer Y.A.R. products, stimulating Y.A.R. production further. The Y.A.R. has already experienced the benefits of increased production in the agricultural sector where farmers are able to sell their products at free market prices instead of controlled prices. To the extent that price controls have been subsidized by the government, eliminating them will help reduce government spending and the government deficit. Price controls should be reserved only for cases of monopolies, monopolistic practices and price fixing or attempted price fixing by companies trying to control the market. In these cases, the Government is justified in imposing price controls to protect the consumer. Otherwise, the consumer's best protection is a market with plenty of competition. That will get the best quality and the best prices.

4.2 Eliminate Controls on Foreign Exchange Rates

At the same time, the official exchange rate should be floated to eliminate the differential between the official and informal rates and then consistently managed in such away that it does not rise in value relative to foreign currencies and world prices. This will have the following results:

(a) Y.A.R. products will immediately become 20 percent cheaper than imports and therefore more competitive in the domestic market, since imports will now be at least 20 percent more expensive;

(b) Y.A.R. exports also immediately will become 20 percent cheaper relative to the products of foreign countries and thus that much more competitive internationally;

(c) This in turn will encourage both foreign and Yemeni investment in Y.A.R. projects to produce the more competitive exports and import substitutes, which will now be relatively more attractive to Yemenis than investing in land and smuggled goods;

(d) At the same time, Y.A.R. producers will be encouraged to replace imported inputs, which are now 20 percent more expensive because of the lower Yemeni Rial exchange rate, with less expensive Y.A.R. inputs. That is, Y.A.R. labor will now become relatively cheaper to foreign labor and to foreign labor-saving machines. Likewise, Y.A.R. produced raw and intermediate materials will become relatively less expensive than foreign ones. This will have a dynamic, multiplier effect on Y.A.R. production, employment of Yemenis and the Y.A.R. economy generally. This in turn will increase government revenues from salary taxes, consumption taxes and, eventually, profits taxes on projects.

(e) By making imports more expensive, the Y.A.R.'s overall balance of payments position should improve, especially as Y.A.R. producers begin exporting and Y.A.R. consumers begin choosing less expensive Y.A.R. products over more expensive imports.

(f) The tourist industry should receive a substantial boost since a lower official exchange rate will make the Y.A.R. a less expensive and therefore more desireable tourist destination for foreign tourists. This in turn will encourage substantial investment in the tourist industry.

In short, by allowing the exchange rate to float and thereby depreciate relative to foreign currencies, the idea is to lower the prices of domestic products relative to world prices thereby increasing the profitability of producing exportable goods and import substitutes in the Y.A.R.

While this could also be done by a government-managed devaluation or so-called "managed float", once the decision is made and implemented, allowing a free floating exchange rate reduces the political pressures on the Government. This is because there are always special interest groups who wish to maintain an overvalued exchange rate because it benefits them -- such as, for example, smugglers, importers, traders and those who wish to consume

imported products -- who will bring pressure to bear on the Government every time a decision must be made to bring down the exchange rate to encourage productive investment. They want to overvalue the rate because it encourages the consumption of imports which makes them rich.

The best way to avoid constant political pressures is to make the decision once and let the Yemeni Rial float freely. This decision should be made easier by the fact that the rate is already floating in the informal market anyway. The rate would then be managed through fiscal and other policies with the objective of keeping it relatively low compared to foreign currencies to maintain the newly acquired competitive position of Y.A.R. products in the world markets.

4.3 Permit Importers to Import Freely Using Their Own Foreign Exchange

Permit all importers to import using their own foreign exchange from whatever source and remove from the Government and the Central Bank the burden of providing foreign exchange for non-government imports. As we understand it, this would be similar to the system which prevailed a few years ago.

4.4 Reduce Customs Duties on Productive Machinery, Equipment, Instruments and Tools to Zero or One Percent

At the same time, to the extent not already done, reduce customs duties, taxes and fees to zero or a nominal rate of 1 percent on all imported productive machinery, equipment, instruments and tools including computers, office equipment and educational tools. The Y.A.R. needs all of the production goods and tools that it can get, and it does not matter who imports them, because eventually they will be used by someone to produce something or to learn to produce something (which is just as important) because that is all that they can be used for. Egypt, for example, recently reduced its tariff on computers to almost nothing, because the Egyptian government realized that getting computers into the country was important, even if they were only used for personal purposes.

Then, if customs duties are reduced on productive machinery and equipment in this way, investors and the government will not have to waste time and effort fighting over customs exemptions for goods that clearly are productive machinery, equipment and tools and are good for the country no matter who uses them. Instead, the question of customs exemptions would only arise in cases of investment projects where luxury and investment goods are identical such as television sets, hair dryers or luxury furniture for deluxe class hotels.

4.5 Change Customs Duties to Ensure Adequate But Not Excessive Protection for Y.A.R. Infant Industries

Change as needed customs duties on imports to ensure that:

(a) Y.A.R. industries receive some protection for their products in the early years, provided that the protection is not so great that inefficient use of resources in encouraged, and provided that the protection is reduced over time -- say, ten years -- so that Y.A.R. industries are encouraged to become competitive internationally; and

(b) Duties on raw materials used by Y.A.R. industries do not exceed the duties imposed on an imported finished product substantially equivalent to the Y.A.R. produced products.

4.6 Reduce Customs Duties on Non-Essential Goods by Enough to Drive Smugglers Out of Business

Reduce Customs duties, taxes and fees on nonessential and luxury goods to the point where the c.i.f. price, plus the importer's cost of sales and profit margin -- say 50 percent to be safe -- will be at least one-third less than that of equivalent smuggled goods in the market or whatever margin is required to undersell smuggled goods in the market. Together with allowing importers to import freely using their own foreign exchange, this should achieve the following results:

(a) Substantially increase government revenues from customs duties and profits taxes on importers; and

(b) Drive the smugglers out of business by substantially undercutting their prices. This measure should be bolstered by increasing, to the extent possible, police and military measures against smuggling. By themselves, however, police measures never will be enough to stop smuggling as long as huge profits can be made, because the smugglers will always find a way, which most likely would be bribing government officials. Unfortunately, bribery is an almost inevitable result when there are huge profits to be made from illegal activities.

(c) The only effective way to stop smuggling is take the profit out of it and put profits from imports back into the hands of legitimate importers by taking the steps outlined above. That way the government wins twice,

first by substantially reducing smuggling hopefully to insignificance, and, second, by getting a share of the revenues from imports that it now does not receive in the form of customs duties and profits taxes on importers.

4.7 Reduce Government Deficit by Increasing Revenue and Cutting Spending With International Financial Assistance If Necessary

At the same time, every effort must be expended to contain domestic inflation by dramatically reducing the government deficit as follows:

(a) The government deficit can be reduced through increased revenues. As noted above, this will occur as a matter of course from increased collection of:

(1) Customs duties on legal imports as suggested in Paragraph 2 above;

(2) Revenues from a Government declared customs "amnesty", giving people a period of time, say six months, within which to pay customs duties on smuggled goods -- especially vehicles -- or face severe penalties. We understand that the Government has been successful with this approach in the past;

(3) Taxes on the profits of legitimate importers;

(4) Taxes and social insurance contributions from newly-hired workers of investment and tourist projects encouraged by the improved competitive position of the Y.A.R.;

(5) Consumption taxes on newly-produced non-essential goods;

(6) Eventually, taxes on the profits of new investment and tourist projects themselves; and

(7) Profits taxes on wholesalers and retailers of legitimate imports and new Y.A.R. products which should increase.

(b) In addition, the government may be able to raise taxes by increasing consumption taxes on less essential goods and products such as juices, bottled water, soft drinks, cigarettes, luxury goods, etc.

(c) Perhaps annual license fees for vehicles also could be increased, but not so much as to make smuggling and evasion profitable again. This could be combined with a massive police effort to check vehicle registration papers and licenses like the Egyptian police do. Unregistered vehicles would be confiscated until heavy fines were paid.

(d) The deficit should be reduced by cutting government spending as much as possible, or at least resisting demands and pressures for increasing spending on government wages and nonessential services and budget items. In part, to the extent that the Government has been subsidizing price-controlled items, government spending and the deficit will be reduced accordingly by abolishing price controls as suggested in Section 4.1 above.

(e) Seeking financing for essential government programs such as education and construction of infrastructure from bilateral and international donors. Were the Y.A.R. to undertake this recommended program, we are certain that it could successfully bargain with bilateral and international donor organizations to receive substantial help to make the needed policy changes with as little dislocation as possible. But regardless of the difficulties, these changes are essential to improve the Y.A.R. investment climate sufficiently to become competitive with other countries in the region.

4.8 Increase Interest Rates on Yemeni Rial Bank Deposits to Substantially Above the Inflation Rate

After the above-described trade liberalization and deficit reduction measures have taken hold and inflation has started dropping, action must be taken to liberalize the Y.A.R. currency financial market and thereby encourage Yemenis to deposit Y.A.R. currency into the banking system to provide private capital for investment and loans to investment projects. This would be done as follows:

(a) First, all depositors of Y.A.R. currency would be granted the right to withdraw any and all funds from current accounts at any time and guaranteed that no withdrawals would require government or central bank approval, but rather would be subject to the depositors agreement privately negotiated with the bank. Without this assurance, few Yemenis will ever deposit money into the Y.A.R. banking system. Few people anywhere ever put money into a bank if they have any fear

whatsoever that they will be able to get it back out again.

(b) Next, steps must be taken to raise interest rates to positive real rates above the world interest rate to attract Yemeni savings in both Y.A.R. currency as follows:

(1) First, measures must be taken to assure Y.A.R. currency depositors that they will receive interest on the full amount of their deposits and not just 75 percent;

(2) At the same time, interest rates should be raised to exceed the Y.A.R. inflation rate by the amount of the world interest rate. So long as interest rates are less than the rate of inflation, Yemenis will keep their savings out of banks and put it instead into gold and expensive consumer goods. This may well mean that interest rates initially could go up to as much as 30 or 40 percent or more. But that will be necessary to encourage the savings that will be required to finance investment in the Y.A.R.

This is what happened in South Korea in the late 1960's when that country undertook a similar program. In 1968 the interest rate on savings in South Korea was almost 30 percent. But the system worked, and Koreans started saving and investing. Every Korean became an investor with a savings deposit. Today, the country is prosperous and successful and the interest rates have come way down since then. The policy goal should be to make every Yemeni an investor with a Yemeni Rial savings account. But the level of inflation -- and therefore the level of interest rates -- should already have dropped if the Government has successfully done its work to reduce its deficit as described in Section 4.7 above.

4.9 Slowly Ease Restrictions on International Capital Movements Into and Out of the Y.A.R.

After the Y.A.R.'s financial market has been liberalized and domestic interest rates raised as described above, and there has been ample opportunity for substantial local savings to occur, then controls on international capital movements into and out of the Y.A.R. should be lifted slowly:

(a) First: by assuring Yemeni, Arab and foreign depositors in Yemeni banks that withdrawal of foreign currency deposits will not be subject to prior government or Central Bank approval as in the case of Y.A.R. currency deposits;

(b) Second, by ensuring that depositors will receive interest on the full amount of their foreign currency deposits instead of only 75 percent;

(c) Third, by ensuring that depositors will receive something more than the world interest rate on foreign currency deposits;

(d) Fourth, by ensuring that bank charges, fees and commissions do not exceed New York, London, or Bahrain rates for deposits, withdrawals, transfers, checks, and other banking services; and

(e) Fifth, by removing any remaining controls on foreign capital movements into and out of the Y.A.R. Obviously, if potential depositors have reason to fear that they will not be able to get their foreign currency out of a Yemeni bank, they will never deposit it there in the first place.

4.10 Results of Liberalizing Domestic and International Financial Markets and Capital Movements

The above measures will be substantial incentives for Yemenis to deposit their Y.A.R. and foreign currency in Y.A.R. banks and savings institutions and once again attract worker remittances into the country's financial institutions, mobilizing them for productive investment in projects. By increasing the real interest rate on Y.A.R. currency deposits to substantially above the inflation rate, Yemenis will reduce their purchases of foreign currency and speculation against the Yemeni Rial. By allowing Yemenis the opportunity freely to transfer their foreign currency deposits out of Y.A.R. bank deposits, they will not be afraid to bring them in the first place.

This is what happened in Egypt after the new foreign exchange law was passed in 1976. Once Egyptians realized that they could get their money out of Egypt freely, they transferred it in freely. The same thing happened in Chile in 1976 and South Korea in 1966. These deposits by Yemenis in banks in their own country will ultimately become a major source of financing future investment in the Y.A.R.

4.11 Timing and Sequence of Policy Changes Extremely Important

The timing and ordering of the above actions is extremely important and should occur as follows:

(a) First Liberalize Trade and Begin Reducing the Government Deficit

First, the following actions should all be taken simultaneously on the same day:

(1) Abolition of all price controls except on monopolies as described above in Section 4.1;

(2) Reduction of the value of the Yemeni Rial relative to foreign currencies by permitting the official exchange rate to float freely to coincide with the informal market exchange rate as described in Section 4.2 above;

(3) Lifting of import controls and licensing by permitting all private importers to use their own foreign exchange to import any and all products and ending the Government's obligation to provide foreign exchange for private imports as described in Section 4.3 above;

(4) Reduction to zero or one percent of customs duties and taxes on all imported productive machinery, equipment, instruments and tools as described in Section 4.4 above;

(5) Reduction of customs duties and taxes on all imported raw and intermediate production materials sufficiently to allow Y.A.R. products made with such materials to compete with substantially equivalent imports as discussed in Section 4.5 above;

(6) Reduction of customs duties, taxes and fees on all non-essential consumer goods and vehicles to a level which is more than sufficient to compete with smuggled goods as discussed in Section 4.6 above;

7) At the same time, the government deficit must be reduced and kept under tight control by holding spending in check and increasing revenues as discussed above in Section 4.7 above;

(b) Next Liberalize Domestic Y.A.R. Financial Market

Only when the deficit is under control and trade has been liberalized as described in subsection (a) above should the domestic financial market be liberalized and domestic interest rates raised to positive real values at least 10 percent above the actual inflation rate as outlined in Section 4.8 above;

(c) Finally, Slowly Remove Restrictions on International Capital Movements Into and Out of the Y.A.R.

Then, only after the domestic capital market has been liberalized should controls on international capital movements into and out of the Y.A.R. be removed slowly and carefully as described in Section 4.9 above.

(d) Reasons for Sequence and Timing: Avoid Reversing Incentives to Y.A.R. Producers and Reduce Danger of Inflation

During the first phase of taking the actions outlined in subsection (a) above, it is important to maintain whatever controls exist on capital movements into and out of the Y.A.R. -- i.e., restrictions on withdrawal of foreign currency by Yemeni citizens, interest rate limits on savings deposits and other controls on capital movements. This is because the impact of floating the Yemeni Rial and reduction in import restrictions will result in a real reduction of the value of the Yemeni Rial relative to foreign currencies. In turn, this will, as noted above, make imports relatively more expensive in the Y.A.R. than locally-produced products, creating a powerful incentive for productive investment in combination with the new investment law.

But it will take time for impact of the change to take hold and start to work. First, there will be production bottlenecks to be overcome as investors react to the new situation: that is, it will take time to build factories, train workers, develop transportation, storage and other facilities, as well as to obtain raw and intermediate product suppliers either in the Y.A.R. or abroad. In short, there is always a lag time between doing what must be done to encourage investment projects for Y.A.R. production and getting the projects fully implemented and operating.

If the controls on Y.A.R. financial markets and international capital movements are taken off too quickly, the result probably would be massive inflows

of foreign and Y.A.R. capital into the Y.A.R. which would result in a real rise in the value of the Yemeni Rial relative to foreign currencies despite the floating rate. This is because, once Yemenis realize that they are receiving a real value for their Yemeni Rials by leaving them in a Y.A.R. bank, and are guaranteed that their deposits will gain value rather than lose it because of inflation, they will tend to stop buying foreign currency and speculating against the Yemeni Rial.

In addition, due to the added cost of imports, the demand for imports will drop. Meanwhile, because Y.A.R. products and materials and labor are now cheaper relative to imports, the demand for them will increase. Less demand for imports means less demand for foreign currency. Increased demand for Y.A.R. products and exports means increased demand for the Yemeni Rial.

The danger then is that allowing the value of the Yemeni Rial to rise relative to foreign currencies will reverse the process by once again making imports cheaper relative to Y.A.R. products and inputs. This would then reverse the desireable incentives for Y.A.R. production and against import consumption originally created by trade liberalization.

This is what happened in Chile in 1976 which liberalized its capital market too soon after liberalizing its international trade sector. This resulted in massive capital inflows, which in turn caused a rise in the value of the Chilean peso relative to foreign currencies, thereby again making imports cheaper relative to local products and Chilean exports more expensive relative to those of other countries. This reduced the profitability of production in Chile and caused investors to move out of the production of goods and into land speculation and construction.

Accordingly, in the usual case, controls on local financial markets should be lifted only well after trade has been liberalized and the deficit brought under control -- say six months to a year. Later, a substantial period after that, the restrictions on international capital movements into and out of the country should be removed slowly.

It is tempting for many countries to liberalize the controls on international capital flows too quickly as a way of obtaining quick and easy foreign exchange flows. But the result can be inflation and a reversal of the positive signals originally sent to investors by

a liberalized trade sector by causing an increase in the value of the Yemeni Rial relative to foreign currencies which would again cause imports to become cheaper relative to Y.A.R. products and exports.

4.12 General Timing: Now is the Most Opportune Time to Take Action

For the Y.A.R., now is the opportune time to begin these reforms with liberalization of the exchange rate and the trade sector and deficit reduction. This would be a powerful message to Yemeni, Arab and foreign investors world-wide that the Y.A.R. is serious about encouraging and promoting real investment in the country. By implementing these policy changes now, the Y.A.R. would be well-positioned for competition within the ACC. Moreover, the Y.A.R. already is in a strong position to begin because:

(a) There is a large amount of liquidity in the country which could be put to immediate use for investment;

(b) The Y.A.R. policies of exchange controls, import restrictions and price controls are relatively new and hopefully are not entrenched;

(c) The Y.A.R. has relatively little foreign debt, compared to many other countries;

(d) The differential between the official rate and the informal market rate for the Yemeni Rial, while significant enough to inhibit investment and encourage speculation in land and foreign currency, is not so overwhelming that the adjustment would be unacceptably painful. Egypt made a similar adjustment in 1987 which resulted in a significant increase in the country's exports within a short period which involved a devaluation of 60 percent (from LE 1.35 per US $ 1 to LE 2.16). Moreover, because the Y.A.R. has wisely allowed the informal market to exist and continue, much of the adjustment has already been made in the market; and

(e) The Y.A.R. undoubtedly could obtain assistance to carry it through any adjustment period from bilateral or international sources if it were to carry out the proposed program.

(f) The Y.A.R. is now enjoying revenues from oil which give it a cushion against any short-term adverse social effects which may occur and will enable it to carry on its vital functions of providing the Y.A.R. people with security, education and infrastructure. Other nations

have unwisely used oil revenues to borrow and spend beyond their means and to put off the actions that would have created dynamic, self-sustaining growth in their economies such as Venezuela, Nigeria and Egypt.

It may be useful to consider some aspects of the Egyptian experience in the field of economic policy reform. Egypt has made many advances since 1974 with its investment law in that year, the foreign exchange law in 1976, some (but not sufficient) liberalization of imports and trade, and tax and companies law reforms in 1981. Yet, Egypt still has fallen short of taking the decisive measures that it should have taken (and still should take) to create a truly dynamic climate for investment. It failed to use its oil revenues in the best way to help it make these changes at a time when it had its best opportunity to do so in the early 1980's. Moreover, Egypt's reforms were not well planned, timed or coordinated, and when taken, the reforms were sometimes incomplete and insufficient.

Today, Egypt is making changes slowly and painfully and only when it has to. Also, instead of having a well-coordinated plan of action, the changes have been made one at a time in a disjointed way. The result is that the changes are then overtaken by events and defeated.

For example, in 1987, as noted above, Egypt brought the official rate for the Egyptian Pound very close to the market rate. The result was that within a few months Egyptian exports began increasing. There were even instances where Egyptian merchants were buying Egyptian products (such as batteries) from the retail market and shipping them to Saudi Arabia.

Egypt did not substantially reduce its government deficit, however, and as a result, it continues to experience inflation of 20 to 30 percent per year at least. Moreover, instead of allowing the Egyptian Pound to float free, the Government created a committee to determine the rate on a daily basis. But because the Egyptian government had failed to control inflation by reducing its own deficit, the free market rate for the Pound dropped. In response, the committee failed to keep the official rate even with the free market rate, because it was subjected to political pressures to keep the pound consistently overvalued.

For example, in the summer of 1989, the free market rate for the Pound for the U.S. Dollar had gone up to almost LE 3 to US $ 1, while the committee kept the official rate at LE 2.45. Although the free market rate dropped somewhat, and the committee brought the official rate down to LE 2.57, the result is that Egyptian exporters have lost much of the advantage they had two years ago, and each decision by the committee to change the official rate is made reluctantly and with pain. It would have been much easier to allow the Pound simply to float up and naturally maintain its

true market level, thereby increasing the demand for Egyptian products and the resulting incentives for investment and production even more. Instead, the Egyptian economy currently is in a state of stagnation after the dynamism of the late 1970's, early 1980's and two years ago.

Strategically, the Y.A.R. is much better positioned by far than Egypt was in 1974, to take the decisive, coordinated actions outlined above: First, as noted above, the government policies which currently restrict and discourage investment -- exchange controls, import restrictions, price controls, etc. -- are only a few years old; whereas in 1974, Egypt had maintained one of the most centrally-controlled economies outside of the communist block for almost twenty years.

Second, the Y.A.R. has a relatively small public sector, whereas, Egypt's public sector in 1974 was all-pervasive and even today dominates the economy. There are few factors more inhibiting to private investment than a large public sector.

Third, the Y.A.R.'s external debt and budget deficit are much more manageable than Egypt's. Like Egypt, the Y.A.R. is producing relatively modest, but significant, amounts of oil and has large reserves of natural gas. Hopefully, unlike Egypt, the Y.A.R. will now use its oil revenues wisely to help initiate the policies and laws needed to promote dynamic self-sustaining growth by encouraging investment, instead of perpetuating policies which are politically popular in the short run but which create a poor investment climate and invite economic stagnation as has happened in Egypt.

4.13 Necessary Follow-Up Actions: Hold Down Inflation and Keep the Value of the Yemeni Rial Low Relative to Foreign Currencies to Maintain the Advantageous Competitive Position of Y.A.R. Products

Once the above program is initiated, it is essential to hold down the prices of non-traded goods, services and labor by restraining inflation by taking the fiscal measures necessary to restrain inflation -- i.e., by reducing the government defit through increasing revenues or reducing spending. If inflation does occur, then it is essential to lower the value of the Yemeni Rial further so that it stays low relative to foreign currencies and world prices. In other words, once the Yemeni Rial has been floated and devaluation has occurred to encourage Y.A.R. production and investment, then the position of the Y.A.R. producer must be maintained by keeping inflation down or by continuing to devalue the Yemeni Rial relative to foreign currencies. South Korea, Taiwan and Singapore have steadfastly and successfully followed this policy for 20 years and Japan for over 40 years, resulting in spectacular export-led economic

growth. Turkey is endeavoring to follow a similar policy with excellent results in increasing exports.

Again, politically the easiest way to keep the value of the Yemeni Rial low relative to other foreign currencies is to allow the Yemeni Rial to float freely. This takes the political burden of periodically adjusting the rate off of the Government. Such adjustments are unpopular among groups favored by overvalued exchange rates such as smugglers, traders and importers. Pegging exchange rates does not work because adjustments required by pegging cannot be timely enough to avoid encouraging black markets and leading to overvaluation of the currency.

4.14 Important to Resist Demands for Protection by Y.A.R. Producers

In addition, once the foregoing regime is instituted, as part of the fight against inflation, all efforts must be expended to resist demands by Y.A.R. producers for protection from imports through monopolies, subsidies, import quotas, import bans and excessively high duties on competing products. Protection will result in higher prices to Y.A.R. consumers which will fuel inflation and lead to a deterioration in the country's competitive position. It would also give an impetus to uneconomic and inefficient use of Y.A.R. resources and smuggling, if, as a resuslt of such protection, the quality of Y.A.R. products are too low, or the prices are too high.

4.15 Private Sector Competition for Foreign Exchange

It has been suggested that by allowing importers to use their own foreign exchange, the private sector and the government would be in competition for available foreign exchange. But the Government already is competing for foreign exchange with the private sector, and the Government is losing, as always happens when the competition offers a better price. Prominent businessmen estimate that well over 80 percent of the foreign exchange owned by Yemenis is outside official channels. Unfortunately, it is not being channelled into investment in the Y.A.R. as would be the case if the above program were adopted but into smuggled goods, land speculation and investments in other countries, as noted above.

4.16 If Properly Managed the Recommended Policy Changes Will not Cause Inflation But Will Reduce Inflation

It has been suggested that by allowing the foreign exchange rate to float and to allow private importers the right to use their own foreign exchange, inflation will result. But inflation

results from government deficit spending. As noted above, an essential part of the program is reducing the deficit through increased revenues and spending restraint. This is essential in order to maintain the incentive for the production in the Y.A.R. of exportable and tradeable goods.

Liberalizing the trade sector in a way that will reduce or eliminate smuggling as outlined above will be a powerful force for reducing inflation by increasing Government revenues from customs duties and taxes on importers and by dropping the price of legitimate imports which will take the place of more expensive smuggled goods. Moreover, much of the inflation already has been absorbed by the Government's wise policy of allowing the informal free market of currency exchange to continue. Then, it is the Government's responsibility to control inflation by reducing its budget deficit.

Moreover, the fact is that the Y.A.R. already has inflation which is evident in the market place and caused by policies which encourage smuggling, consumption and land speculation instead of investment and production. Even if inflation does result, it will be inflation with growth, if the exchange rate is properly managed to keep Y.A.R. prices below world prices, which is far better than inflation with little or no growth which is what the Y.A.R. currently is facing. With a population of ten million people, half of whom are under the age of fifteen and growing at 3 percent per year, one could venture to say that inflation with growth in productive investment is better than no inflation and no growth.

4.17 Summary of Policy Change Advantages

In summary, the benefits of the foregoing program are as follows:

(a) Imports will be discouraged and Y.A.R. production of import substitutes and exports will be encouraged by giving Y.A.R. products an immediate 20 percent price advantage in the domestic and international markets, by allowing the exchange rate for the Yemeni Rial to devalue by floating;

(b) As a result, productive investment in the Y.A.R. will receive a powerful incentive;

(c) Moreover, Y.A.R. producers will be encouraged to replace imported inputs and foreign labor which would suddenly be 20 percent more expensive with Y.A.R. materials and Yemeni labor;

(d) As interest rates are increased and restrictions eased on Y.A.R. financial markets and international capital movements, net foreign capital inflows will be

attracted into the country's banks thereby mobilizing capital for productive investment;

(e) In addition, capital flight will be discouraged, when Yemehis realize that they can receive the same or better benefits by keeping their money here as by depositing it in London, New York or Bahrain;

(f) As imports are discouraged, and as smuggling is reduced and as Y.A.R. production increases in response to the encouragement of a better market position for the Y.A.R., the balance of payments will improve, thereby promoting even greater investor and creditor confidence giving the country yet more resources to develop its human and physical infrastructure;

(g) The Government will obtain substantially increased revenues from collecting customs duties, profits taxes and salary taxes from legitimate importers and investment projects and from their wholesalers and retailers which are not now being collected from smugglers;

(h) The gainers from these policies will be those who stand to benefit from a better international market position for the Y.A.R., namely, manufacturers, farmers, the tourist industry, workers and the unemployed and the government will benefit from increased revenues and respect among the people for having reduced smuggling and increased production and investment in the country.

SECTION 5

Review and Analysis of the Draft Investment Law

Following is a commentary on the Draft Investment Law, article by article, and chapter by chapter, explaining the obstacles to investment that each is designed to reduce or eliminate or other purposes which the article may serve. Many of the articles originated in one or both of two earlier drafts provided to us by the Ministry of Economy. Some articles have been adapted from successful provisions of other investment laws from around the world. Many have been drafted with a view to eliminating obstacles to investment in the Y.A.R. identified in earlier sections of this report. In this commentary, the text of the articles and chapters is generally left out, and what follows the article heading is the text of the commentary.

Chapter 1

Preliminary Provisions

Article 1 - Title

The title introduces the principal concept behind the Draft Investment Law, which is to encourage and promote investment in the Y.A.R.

Article 2 - Purposes

It is important for investors and government officials to know at the outset what the purposes of the law are and for the Government and the Legislature to be agreed upon them. As we understand them, those purposes are to encourage, promote and facilitate Yemeni, Arab and foreign investment in the Y.A.R. within the framework of the State's Socio-Economic Development Plan <u>and</u> to provide a stable, clear and predictable legal and institutional framework for investment. It should be kept in mind that every single article of the Draft Investment Law reflects the philosophy contained in this statement of purposes.

Article 3 - Definitions and Construction

There are a number of definitions which represent key concepts in the law as follows:

A. <u>Definitions</u>

(4) "IPA" or "Authority" means the Investment Promotion Authority (IPA) established under Chapter 6 of this Law.

Chapter 6 of the law establishes "The Investment Promotion Authority" or "IPA", which will be a key institution which will have authority to license the establishment of all projects under the law, and to provide them with all other licenses needed to establish, operate and expand investment projects including import licenses and licenses to establish the companies need to carry projects into effect. The IPA also will provide investors and projects with assistance in dealing with other Government Organizations and with finding land, partners, suppliers, etc.

Additionally, the IPA will have the responsibility for certifying the rights of investors and projects to

various exemptions under the law. The IPA is discussed in detail in the commentary on Chapter 6 below.

(27) "Foreign Invested Capital" and (28) "Yemeni Invested Capital"

These definitions are extremely important for the success of the law. "Yemeni Invested Capital" means currency of the Y.A.R. and other locally sourced capital invested in a project by a citizen of the Y.A.R. "Foreign Invested Capital" is foreign capital invested in an Investment Project in the Y.A.R. in any of several defined forms including freely convertible foreign currency. Unlike Yemeni Invested Capital, however, Foreign Invested Capital is defined by its source, not by the nationality of the owner.

Thus, as is specifically provided in Article 8.D.(2), Yemenis may invest foreign funds in a Y.A.R. investment project, but foreigners and Arabs may not invest the Republic's currency. The idea is to attract foreign currency held by Yemenis either within the country or abroad into investment projects in the Y.A.R. To do that, it is necessary to define "Foreign Invested Capital" by its source rather than the nationality of the contributor. This means that Foreign Invested Capital contributed by Yemenis will have the same standing as that contributed by Arabs and foreigners with respect to transferring profits and capital abroad under Articles 24 and 26 of the law.

These are important rights which Yemenis must have in order to attract their foreign currency holdings into investment in the Y.A.R. No investor, regardless of whether he is Yemeni, Arab or foreign, will put money into a country if he does not think that he can get it back out. Currently, it appears from our research that Yemenis are holding large amounts of foreign currency both within the country and outside of it. Right now this money is being invested in smuggled goods, land speculation and foreign investments. The above provisions are essential to the effort to channel those foreign funds held by Yemenis into productive investment in their own country.

Clause 27(b) of Article 3 provides one exception to the rule that foreigners may not invest Yemeni Rials in a Y.A.R. investment project, namely, in the case of conversion of the Y.A.R.'s foreign debt (if any) to equity.

Thus, for example, assuming that the Y.A.R. had a foreign debt in U.S. Dollars, an Arab or foreign investor could purchase a portion of that debt, say, US $ 1 Million. Normally, in such cases the investor would purchase that debt at a discounted price of, for example, US $ 700,000. But, the investor could then receive the face amount of the obligation from the Central Bank in Yemeni Rials, in this case YR 10 Million. The investor could then under Clause 27(B) of Article 3 invest the YR 10 million in a project in the Y.A.R. and such investment would be counted as Foreign Invested Capital for all purposes of the investment law of US $ 1 million.

The concept of debt-to-equity conversions was pioneered by South American countries with large foreign debt burdens and was recently also adopted by Egypt in its new Investment Law.

(29) "Foreign or Arab Participation"

By contrast to "Foreign Invested Capital", definition (29) does define "Foreign or Arab Participation" in terms of nationality to mean the proportion of total capital of a Project owned and contributed to by non-Yemeni Foreign or Arab Investors. Similarly, in Definition (30), "Yemeni Participation" means the proportion of total capital of a Project owned and contributed to by Yemeni Investors. For a number of statistical and legal purposes, it is important to know the nationality of the participants in a project.

Other definitions will be discussed in the context of specific articles where needed. Paragraph B of Article 3 on Construction is self-explanatory.

Article 4 - Scope of Application

This article simply lets investors know from the beginning what projects are covered by the Law, namely all projects in all fields except those which must be established under other laws as is specifically set forth in a Schedule 1 to the law and those which are completely prohibited as listed in Schedule 2. Similarly, Paragraph C of the article, informs investors what projects require public sector participation in Schedule 3 to the Law. Paragraph D(1) explains that all projects are open for Arab or foreign participation except those reserved to Yemenis as are specifically set forth in Schedule 4 to the Law. It is important to inform investors from the beginning whether the project they have in mind will be subject to the law or not so that time is not wasted for either the investors or the Government.

Paragraph D(2) of Article 4, which forbids Arab and Foreign investors from investing Yemeni Rials except in the case of a debt-equity conversion, has already been discussed above in connection with the concept of "Foreign Invested Capital."

Article 5 - Duty of Government Officials to Facilitate Investment and Maintain Confidentiality

A. Duty of Government Officials to Facilitate Investment

Paragraph A of this article addresses a major obstacle to investment in the Y.A.R. That is the negative attitudes of Government officials which have been reported toward investors and investment projects. These attitudes show themselves in what often amounts to harsh treatment by such officials or in slow service in terms of approving licenses or clearing customs. These attitudes were a recurrent theme in our discussions with investors who said repeatedly that the biggest problem with the existing Investment Law 18/1975 was its implementation and that many Government Officials simply ignored clear provisions of the law when it suited them.

Although the organization charged with implementing the Law will be the IPA investors and projects inevitably will find themselves dealing with many Government Organizations and officials, including the Customs Authority, the Tax Authority, immigration officials, policemen, and officials from the Ministries of Economy, Municipalities, and Labor, not to mention the authorities responsible for the sector in which the project is working. Because of the importance of investment to the national economy, it must be a primary duty of every government official to facilitate investment and not just the job of the IPA.

In many countries which have such an organization to promote investment, other government agencies work against it. This happens especially when there is a change of policy from despising private investment to welcoming and trying to encourage it. Indeed, once the investment law is passed, to ensure its success, every government official should read it and participate in conferences to learn the importance of facilitating rather than harassing or delaying investment projects.

Accordingly, after the new law is passed it will be important to educate Government officials on why investment is vitally important for the Y.A.R. They should be taught that investment will create jobs, more and better quality goods in the market for them and their families as well as

all of the people and new sources of revenue for the Government through increased collections of salary taxes, consumption taxes and future profits taxes and customs duties.

B. Duty of Officials to Maintain a Project's Business Secrets

Similarly, in the course of their duties, government officials inevitably will discover legitimate company secrets relating to production know-how, secret formulas for making products, lists of customers and suppliers, plans for new products, plans for new financing, etc. Paragraph B makes it their duty to maintain confidentiality unless otherwise authorized. In other words, such information may be revealed only in the line of duty. Obviously, the business secrets which deserve to be protected do not include those relating to violations of law or breach of a project's legal obligations.

Article 6 - General Outline of Guarantees, Rights, Exemptions and Obligations for Licensed Projects

Ending Chapter 1 on Preliminary Provisions, Article 6 provides a brief overview of the scheme of rights and exemptions available to licensed projects under the law. Chapter 2 sets out the rights and benefits which all licensed projects shall receive. Chapters 3 and 4 set out additional rights and exemptions which are available only to those projects which earn them by meeting specified conditions and requirements. Finally, Chapter 5 sets out very special rights and exemptions which can be awarded only by the Cabinet, in some cases, or the Board of the IPA, in other cases, to projects found to be of "special social and economic significance."

Chapter 2

State Guarantees, Rights and Exemptions Provided in Respect of All Licensed Projects

As noted above, Chapter 2 sets out the guarantees, rights and exemptions available to all projects. This is a vital chapter because it addresses many of key obstacles to private investment in the Y.A.R. today.

Article 7 - Freedom of Investment; and

Article 8 - Equal Treatment of Investors

These two articles, guaranteeing freedom of investment and equal treatment to Yemenis, Arabs, and foreigners alike, are fully in keeping with the spirit of an open investment climate. It is as important that Yemenis have freedom to invest and equal treatment as it is Arabs and foreigners. The freedom of investment provisions are carried over from Law 18 of 1975 and the second Ministry Draft Investment Law delivered to us. The equal treatment article was contained in both Ministry drafts and will be very reassuring to investors.

Article 9 - Private Sector Status of Projects

Emanating from the first Ministry draft, this article provides assurance to investors that even with up to 75 percent public sector participation, a project will be considered a private sector project free of the rules encumbering public sector projects. This is similar to Article 7 of the new Egyptian law except that there projects under the Egyptian investment law will be considered as private sector projects regardless of the percentage of public sector participation.

Article 10 - Right to Own Land

A. Right of Investment Projects to Own and Lease Land

Taken from the Ministry's first Draft Investment Law, Paragraph A of this article provides important reassurances to Arab and foreign investors that they and their projects will be able to own or rent land for project purposes.

B. Problem of Establishing Clear Title to Land

Paragraph B of Article 10 addresses one of the most important problems facing investors today: Namely, the problem of obtaining clear and certain title to land. We learned that all too often after purchasing land from someone who appears to be the owner, an investor or any individual will suddenly discover that someone else claims ownership of the land. Even if the claim is not well founded, fighting it will mean costs and delay for the investor and his project.

C. Ultimate Solution is to Map and Record Land Ownership for the Entire Country

Ultimately, the solution to the problem of establishing clear title to land is to survey and map the entire country

to establish the ownership interests in each plat of land. This would be followed by establishment of a land recording system which would conclusively establish the ownership interests with respect to each piece of land in the Y.A.R. Hopefully, such a system could be computer-based using the Australian system of land recording and cross referenced by owners, lessees, easement owners, mortgagees and others with interests in the land. Certainly, this would be an important investment for the Government to make for many reasons including investment promotion and encouragement.

D. A Recording System to Help Investors Establish Clear Title to Land

Pending development of such a system, however, the investment law creates a recording system for investors using the Register of Projects to be established by the Investment Promotion Agency pursuant to Article 68. This will be a public register to which any person, private or public, will have access and will contain key information about each project. It will also be used under Article 10 to establish a Project's right to the land which they lease or buy against third-party claimants. This is a short-term solution to a very important problem affecting investment in the Y.A.R.

Article 11 - Project Right to Open Shops for Products

Taken from the Ministry's first draft, this article provides an important facility for Arab and foreign-owned or controlled projects to open shops for the purpose of selling project products which will be very reassuring to them. Many investors like to be able to control the marketing of their products, and they cannot do it in many other countries.

Article 12 - No Public Sector Monopoly

A. Investors Must Be Warned of Public Sector Monopolies If Any Exist

Adapted from the Investment Promotion Law of Thailand, this Article, guarantees investors against any public sector monopoly on sales of their products. If there are any exceptions, such as distribution of flour, for example they should not be allowed unless they are specifically listed and described in a schedule to the law. Article 12 should be read together with Article 4.C. which requires that investors be warned in Schedule 3 about projects requiring public sector participation.

B. Reasons for Foreign Investor Concern About Public Sector Competition and Activities

There are few areas of greater concern to private foreign investors than the specter of public sector competition, monopoly or dominance of the economy. There are several reasons for this concern by foreign private sector investors about the public sector. One is that public sector firms often receive preferential treatment from the government over private firms in the form of subsidized inputs, usually on the ground that such public sector firms are carrying a social burden of providing employment and cheap goods to the population. The other is that public sector firms often are inefficient and lose money which are made up by taxes paid by the private sector. Thus, the private investor pays twice.

In this regard, the Y.A.R. is fortunate in not having an overwhelming public sector which dominates the economy. We would urge that the Y.A.R. continue to restrict the public sector to existing state enterprises and to its more vital functions of providing security, building infrastructure, enforcing the laws and educating its people. Indeed, to the extent possible, we would urge the Y.A.R. to follow the world-wide trend and divest itself of business enterprises except those providing public services. The Government has enough responsibilities without having to worry about the risks of the marketplace.

Article 13 - Government Preference for Project Products Over Imports

Paragraph A of this article, taken from the Ministry's first draft, promises preference in government procurement to local products of equal quality including a ten percent price advantage. In Paragraph B, the Government would undertake not to import into the Republic products which would compete with those of licensed projects except to the extent that production does not meet demand.

Article 14 - Right to Manage Projects

Although it seems obvious, it is important that investors have assurance that they will be able to manage their projects as they see fit according to business and economic conditions and not according to government orders. Thus, projects must be able to determine production levels in accordance with the demands of the market and not be prevented from increasing production or, if necessary, decreasing production in accordance with elementary economic laws of supply and demand. This right will be a key in

the Y.A.R.'s drive to build its competitive position to attract investment in preparation for the advent of the ACC.

Article 15 - No Economic Discrimination

Derived from the Ministry's first draft, this is an important guarantee to investors that they will not be discriminated against in any way with respect to other private or state projects in the same activity. This applies on the high level of equality before the law and on the practical level that Government supplied inputs, such as energy or communications facilities, will be provided to all private and public sector projects at the same prices.

Article 16 - Freedom from Controls on Prices, Profits and Salaries

A. Freedom From Price Controls Guaranteed to Investment Projects Except for Monopolies and Price Fixing

Freedom from controls on prices, profits and salaries is one of the most important guarantees provided in the Draft Investment Law. As written, it is very similar to an article in the Ministry's first draft with two important differences:

(1) It provides an additional important exception to such freedom, namely, monopolies and projects engaging in price fixing or other monopolistic and anti-competitive practices (That is, projects which are themselves trying to control and fix prices). In such cases, the government has a perfectly legitimate right to control prices to see that they are in line with market prices, or, where there are no market prices, with a reasonable profit.

(2) Instead of leaving as vague and uncertain the question of what basic products the Cabinet could impose price controls on, the law should spell them out in a defined limited list, so that all investors know. It is not fair to investors to leave a matter like price controls vague and unclear and leave them uncertain as to whether or not their product might be found to be a "basic product" on which price controls can be imposed.

Accordingly, the list must be clear and defined in the law without listing some catchall category, such as "any other product found to be a basic product by the Cabinet or some other Government body." Because price controls are now in effect in the Y.A.R., it is very

important to guarantee investment projects future freedom from price control. If price controls are to be continued on some items, then it is essential that investors be clearly warned in advance exactly what those items are.

B. The Best Solution by Far is to Abolish All Price Controls, Except for Monopolies, to Discourage Consumption and Encourage Production

Price controls directly discourage private investment and are one of the most serious of the obstacles to private investment in the Y.A.R. Frankly, we believe that it is even a mistake to leave in the possibility of price controls for "basic products" like wheat, bread and cooking oil.

C. Price Controls Cause Shortages, Black Markets and Inflation

As is discussed in detail in Section 3.1 above, price controls invariably fail to achieve their purpose of guaranteeing basic necessities for ordinary people at reasonable prices. Instead, they usually create shortages in the price-controlled item because production in the country of similar or competing alternatives is directly discouraged. The shortage in turn usually results in black markets for the price-controlled item where it is sold for inflationary prices which far exceed what ordinary market prices would be.

D. The Egyptian Example

(1) Price Controls in Egypt Have Discouraged Production and Resulted in Shortages and Black Markets

In Egypt, price controls certainly have encouraged consumption of price-controlled items and discouraged local production. Often, this has led to a shortage of price-controlled goods and black markets where the goods are then sold for three or four times what the free market price would have been because that is the only way the goods can be obtained. For example, a few years ago the government imposed price controls on watermelons, a very popular fruit in Egypt. Overnight watermelons disappeared from the market. The next year almost none were grown. The government then decontrolled the prices, and the following year the markets were so full of watermelons that the prices came down of their own accord.

(2) Price Controls in Egypt Also Have Resulted in Massive Over Consumption and Waste

The other result of Egyptian price controls has been massive wastage. Thus, in Egypt bread prices are kept very low. The result is, as the newspapers report every year, that Egyptians consume more bread than any people on earth. Bread is so cheap that it is cheaper than animal feed, so people feed huge amounts of bread to their animals.

Article 17 - Stability of Laws

This article addresses one of the main concerns of investors anywhere. Stability and predictability of laws and rules is absolutely crucial to attracting investment. It is particularly important in the Y.A.R. because of actual examples of officials ignoring clear provisions of the law. Thus, Article 16 of Investment Law 18 of 1975 clearly provides for a 25 percent exemption for customs duties on raw materials and components. Yet, this right has been taken away by administrative action <u>not</u> by legislative amendment.

In another case we were told about, a customs official decided that machinery imported by a project under Law 18 was not entitled to a customs exemption because it was going to be used to produce goods under a foreign trademark. Nothing can kill the prospect of foreign investment faster than official attitudes like that. But overall, there is a strong impression among investors that no matter what investment law is passed, government officials will simply ignore it if it suits them. Moreover, there is a problem of conflicting laws. To avoid these problems, clear assurances are provided that no right provided under the law will be taken away retroactively and that no law will amend the Investment Law without a clear statement of intent to do so.

Article 18 - Right to Sue and Arbitrate in Respect of Disputes

This provision assures investors that they will have access to the courts or recourse to arbitration and that the Government itself is subject to suit including all Ministers, Ministries, Government Organizations and Officials. This subject is addressed in much greater detail in Chapter 13 on dispute settlement.

Article 19 - Guarantees Against Taking Property Without Judicial Due Process

A. Basic Guarantee Against Taking Property Without Judicial Due Process Essential to Encourage Investment

This article is based on important guarantees to investors against confiscating or nationalizing projects or assets provided under the Investment Law 18 and earlier Ministry Drafts and is an essential provision of all laws designed to encourage private investment.

B. Project Licenses Cannot Be Cancelled Without a Court Order Which May Be Granted on an Expedited Basis

Article 19.A(3) provides that a project license cannot be cancelled without a court order. For an investor, a license cancellation after he has made his investment is tantamount to confiscation or nationalization. There is a well-known case in a nearby country of an investor whose license was cancelled after he had invested over US $ 5 million. Even though he had done nothing wrong and even though the investment law of the country in question also provided guarantees against confiscation and nationalization, the investor still has not received compensation or even a court hearing in the country.

The Government at some point may well have good grounds for cancelling a license. If so, let the Government bring its case to court or to arbitration and let the court or the arbitrators decide if cancellation of the license is justified. Paragraph B(2) of Article 19 gives the Government the right to obtain a hearing on an expedited basis.

C. Court Orders to Seize Investment Project Property or Cancel Project Licenses Must Be Based on Clear and Convincing Evidence Justifying the Action Under a Specific Provision of Law and a Judicial Hearing After Fair Notice

In addition, Article 19.B. of the proposed draft specifies that the court order for any of the actions listed in Article 19.A. must be based upon clear and convincing evidence justifying the action under a specific provision of law and may be issued only after a hearing of which the investor has had fair notice and an opportunity to participate. Then, either party can appeal the court's decision on an urgent basis. This protects the Government as well as the Investor. Even if the current law requires the same procedures, notice and hearing, it is important to provide for them in the Investment Law as assurances to investors.

D. Expedited Procedures Allowed for Urgent Cases

The Government receives additional protection by having special expedited court procedures for cancelling licenses or if urgent action is required to seize assets. Again, however, there must be clear and convincing evidence justifying the action presented in a judicial hearing after notice to the investor.

E. Compensation at Market Value for Loss of Property by Projects or Investors

Finally, the proposed draft provides for compensation at the market value for property which is taken per the Ministry's second draft. In addition, it provides that compensation shall be prompt, adequate, effective and fair, adopting language similar to that of many bilateral investment treaties. Compensation for the loss of foreign invested capital may be freely transferred abroad the same as capital repatriation under Article 26.

Article 20 - Yemeni Rial Bank Accounts; and

Article 21 - Foreign Currency Bank Accounts; and

Article 22 - No Government Obligation to Provide Foreign Currency

A. Facilities Provided by These Articles are Essential to Promote Private Investment in the Y.A.R.

These articles begin what is perhaps the most important series of provisions in the law -- namely, those providing banking, foreign currency and import rights and facilities to investment projects. Without these facilities, there will be very little private investment in the Y.A.R., no matter how many other guarantees, rights and exemptions are given to investors. These provisions deal with what are by far the most serious obstacles to investment in the Y.A.R., namely, foreign exchange controls, import licenses, restrictive banking practices and restricted banking facilities, which are discussed in detail in Sections 3 and 4 above. The facilities provided by Articles 20, 21 and 22 solve the foreign exchange problem for investors, but not for the country as a whole.

B. Interest on the Full Amount of Investment Deposits Not Subject to Government Limitation

Articles 20 and 21 provide that all licensed projects are authorized to open local and foreign currency accounts, that banks may not refuse to open a project account, and that interest will be paid on the full amount of the projects' deposits regardless of reserve requirements. They also provide that interest on project deposits will not be subject to government limitation. The counterpart to this provision is that interest on loans shall not be subject to any limit other than that negotiated by the bank and the project as is provided in Article 23.B. on banking facilities discussed below.

C. Articles 21 and 22 Remove the Foreign Exchange Burden From the Government and Give Investment Projects the Right And Responsibility to Obtain Their Own Foreign Exchange for Project Purposes

Article 21 on foreign currency bank accounts provides that project foreign currency accounts may be credited with foreign currency from foreign invested capital, foreign loans, proceeds from exports, proceeds from sales to the domestic market in foreign currency as well as from any person, private or public, holding foreign currency within the Republic or outside of it. At the same time, Article 22 makes clear that projects shall have both the right and the responsibility to obtain their own foreign exchange from any source, private or public and, equally important, that the Government will be under no obligation to provide foreign exchange to projects. This article thereby relieves the Government of an impossible burden: That of guaranteeing to meet the foreign currency needs and demands of private investment projects.

D. Permitted Foreign Exchange Transfers

Under Article 21.D., projects can use their foreign currency accounts for any and all foreign currency payments required to establish, implement and operate their projects including payment for fixed assets, imported production materials, working capital, loan repayments, royalties and other fees for foreign technology transfer and transfer of profits or repatriation of capital pursuant to Articles 24 and 26.

E. The System of Requiring Investment Projects to Obtain Their Own Foreign Exchange and Removing the Obligation From the Government Has Worked Extremely Well in Egypt

These articles closely follow very successful similar provisions in Egypt's former Investment Law 43 of 1974,

except that the provisions of the proposed draft Y.A.R. investment law are stronger and clearer. Without these provisions, private investment would not have been possible in Egypt under Law 43 on the scale which it has occurred. Before Law 43 was passed, Egypt had very tight exchange controls. Two years after the investment law was enacted, Egypt passed a new foreign exchange law in 1976 which gave all Egyptians the right to their own foreign currency bank accounts and the right to obtain their own foreign exchange. This created the so-called "own exchange" free market for foreign exchange in Egypt which has met the foreign currency needs of all investment projects established there. The new Egyptian law contains similar provisions giving projects the right and the responsibility of obtaining their own foreign exchange and specifically taking the burden off of the government.

F. <u>The System of Requiring the Government to Provide Foreign Exchange for Private Investment Projects Cannot Work</u>

Clearly, the Central Bank and the Government of the Y.A.R. need also to rid themselves of a burden which they cannot now meet and should not be expected to meet. Currently, investors are able to obtain import permits and foreign exchange for less than 40 percent of their production needs, and some, even less. We understand that a number of projects have had to close down. The government simply does not have sufficient foreign exchange to meet the needs of current investment projects much less meet the demands of the kind of dynamic economy which the country is going to need to create jobs for its rapidly growing population and invite investment that will truly save foreign exchange through producing import substitutes or exports.

As noted above, the ideal solution is to follow the plan suggested in Section 4 above for removing these controls for the entire economy. At the very least, it would be wise in this case to follow Egypt's example and release these controls for investors. Right now the foreign exchange privately held by Yemenis both in the Y.A.R. and abroad is either going into smuggled goods or investments outside the country as is pointed out above. The facilities for investors under Articles 21 and 22 of the Draft Investment Law would enable a significant portion of these funds to be channelled into productive investment instead. Indeed, this will be the only effective way to mobilize the foreign exchange in the hands of private Yemeni citizens for investment in the country.

Article 23 - Preferential Financing and Facilities

A. Article Aims at Removing Disincentives for Y.A.R. Banks to Loan to Investment Projects

This Article deals with another very serious, almost crippling constraint on investment in the Y.A.R., namely the severe disincentives to commercial and project lending by the banks despite an excess of liquidity. These disincentives are so strong that banks understandably have virtually no desire to make long-term project loans. Without a banking system capable and willing to provide Yemeni Rial financing facilities to investment projects, few investors are going to be motivated to invest in the Y.A.R. The purpose of Article 23 is to remove as many of these disincentives as possible as explained below.

B. Article 23.C. Removes Government Imposed Limits on Interest Rates on Loans to Investment Projects

Because of interest rate ceilings on loans and high reserve requirements, banks lose money or break even on loans of over 90 days. The maximum rate of interest on loans is 15 percent with no add-ons or commissions permitted. But the cost of funds for a 90-day deposit is 14 percent, only 1 percent less, and for a 270-day deposit, 16.5 percent, a negative spread of 1.5 percent. With those spreads between costs and revenue, no Y.A.R. bank wants to provide, say, a five-year loan to finance establishment of a project, especially when it can sell excess bank deposits to the Central Bank any time at a 2 percent margin over the cost of its funds. The only solution to this problem is to give banks an incentive to loan to investment projects by removing the interest rate limitation on such loans leaving the interest rate to be negotiated between the parties. This is provided for in Paragraph C. of Article 23.

C. Article 23.E. Gives Banks an Easy and Certain Way of Perfecting Mortgages on Project Assets by Recording a Statement of Mortgage in The Investment Project Register

We also understand that it is difficult to perfect mortgages on property, creating another powerful disincentive to project lending. Accordingly, Paragraph E of Article 23 provides for a simple way for a creditor to perfect a mortgage on any asset of an investment project simply by submitting a mortgage statement signed by the project representative for recording in the Investment Project Register, which is to be established under Article 68 (and used under Article 10 to help a project establish its land title).

Since the Project Register will be open to the public, any other creditor can then look at the Register to see if some or all of a project's assets have already been mortgaged. Recording the information in the Project Register will be conclusive proof in court of the creditor's right to the mortgage as against the project or any third party. Where an asset is mortgaged to two creditors, the first creditor to file the statement will have priority. The mortgage can be released by submitting a mortgage release statement signed by the creditor for recording in the Project register.

D. Article 23.E. Provides an Expedited Procedure for Banks to Enforce Mortgages

Paragraph E of Article 23 then provides a clear and expedited procedure for creditors to enforce a registered mortgage. By providing a clear and simple system for creditors to perfect and enforce mortgages on project assets, banks should have much stronger incentives to loan to projects, especially if they can negotiate an interest rate which will allow them to make a reasonable profit over the cost of their funds as is provided in Paragraph B of Article 23.

E. Article 23.G. Allows Interest to Accrue Pending Legal Action to Collect Debt From Defaulting Project Borrower

We understand that another disincentive to bank lending is an ambiguity in the Commercial Code which makes it unclear whether interest stops accruing when the creditor takes legal action to collect a debt which is due. If interest does stop accruing, or if there is even uncertainty about it, this would be a strong incentive for a borrower to default. This in turn, of course, would make banks reluctant to lend without extremely strong security. Accordingly, Paragraph G clearly states that no legal action by a creditor of a project will stop interest or other obligations of project from continuing to accrue until a final judgment is rendered and enforced.

F. With Disincentives to Lending Removed, Banks No Longer Will Need to Demand Excessively High Collateral for Loans

As a result of the above-described disincentives, banks are extremely reluctant to lend and as a result follow very restrictive banking practices, one of which is to demand 150 percent collateral to secure their loans. Given the uncertainty in perfecting mortgages and with respect to accrued interest pending the outcome of litigation, this insistence is perhaps understandable. But with the protection and incentives for banks to loan to projects

built into the proposed draft, such a demand would no longer be necessary. Accordingly, Paragraph D of Article 23 restricts collateral on loans to projects to 100 percent and requires banks to accept project loans which can be 100 percent secured.

G. Projects Entitled to Obtain Foreign Loans Directly

A fifth constraint on project loan finance is the requirement that all foreign currency loans be channelled through the Central Bank at considerable cost to the borrower. Paragraph C would permit investment projects to make such loans directly. This is part of the overall purpose of the proposed draft to eliminate as many unnecessary investment costs as possible to make establishing projects in the Y.A.R. as inexpensive as possible relative to world costs. It must not be forgotten that Yemen is in competition with the rest of the world, and certainly the rest of the Arab world for investment, again of both Yemenis and foreigners. If an investor can establish a project at less cost elsewhere, he is likely to do so.

Article 24 - Right to Transfer Profits of Foreign Invested Capital

This article embodies the right to transfer profits which is absolutely fundamental to attracting foreign investment and is a feature of virtually all laws and systems designed to attract foreign capital. Indeed, it is a central feature of Law 18 and all earlier Ministry drafts. The difference here is that the transfer will be funded through the project's foreign currency account and that the government will not be obligated to provide the foreign exchange for such transfers. The project or the investor must obtain his own foreign exchange to fund the transfer. Paragraph B of Article 24 sets out the procedures for the transfer which are self-explanatory.

It is important to note that to the extent that Yemenis themselves invest freely convertible foreign currency in a Y.A.R. project, they also will have the right to transfer profits abroad under the principle of equality of treatment. A principal purpose of this law is to encourage Yemenis who are holding foreign currency to invest it in the country instead of in smuggled goods, land and foreign bank deposits. To do that effectively, Yemenis must have the same rights as foreigners and Arabs with respect to their own foreign invested capital which they put into an investment project in the country.

Article 25 - Transfer and Repatriation of Foreign Investment Funds Before Implementation of a Project; and

Article 26 - Repatriation of Foreign Invested Capital After Implementation of a Project; and

Article 27 - Investors Sale of Interest in Project

These three articles provide for the transfer abroad, or repatriation, of foreign invested capital in three cases:

(1) Where a project is not implemented for one reason or another either before or after an investment company has been formed;

(2) Following the dissolution and liquidation of the project after at least two years; and

(3) Upon the sale by the investor of his interest in the project.

Like the right to transfer profits arising from foreign invested capital, the right to repatriate foreign invested capital in the above listed instances is fundamental to attracting its investment in the first place and, accordingly, is a feature of most investment laws. Like transfers of profits under Article 24 discussed above, capital repatriation transfers under the proposed draft would be funded by the project's own foreign currency and not the Government's. Again, Yemenis would have the same rights with respect to transferring abroad their foreign invested capital as foreigners and Arabs. Obviously, to entice Yemenis, Arabs and foreigners to bring their money into the country, they need the assurance that they can get it back out again if something goes wrong or they change their minds, or they wish to sell out.

Article 28 - License to Import

This article licenses approved projects to import fixed assets and production materials needed for the projects' establishment, implementation, operation, expansion or upgrading, subject to inspection to ensure that imported goods are used for authorized project purposes. Since all project imports will be financed with the project's own foreign exchange using the foreign currency bank account authorized by Article 21, there will be no need to have the import license approved by the Central Bank. In other words, the project's original license (or amended license as the case may be) will serve as its license to import project requirements. To survive, projects must be able to import their production needs freely. Currently, projects wait many months in some cases to obtain import licenses, and they get them for only

30 to 40 percent, at most, of their needs. Once the government rids itself of the burden of supplying foreign exchange for investment project imports, investors will be able to plan accordingly to provide their own foreign exchange.

Article 29 - Customs Exemption for New Fixed Assets and Project Implementation Materials

A. The Purpose of the Customs Exemption is to Make Y.A.R. More Competitive as an Investment Target

It is common for investment laws to offer exemption for customs duties for the fixed assets and materials needed to establish, expand or upgrade a project. In addition, the household goods and effects of foreign managers and experts of projects are exempted. Given the fact that many countries are competing for foreign investment, this is an important mechanism for reducing the costs of establishing a project without much cost to the country.

Indeed, as discussed in Section 4.4 above, an excellent policy is to exempt all production machinery, equipment, instruments and tools from customs duties no matter who imports them. A country needs machines and tools for its development no matter who uses them. Then, customs and other government officials would not have to worry about exemptions for some importers but not others.

But for purposes of the investment law, this exemption is essential to make the Y.A.R. more competitive internationally as an investment destination by reducing the costs of investment as much as possible. Again, the concept is that once a project is licensed, it has the exemption and there will be no need to go back again to an exemption committee as is now the case.

B. Article 29.C. Permits Exemption Within Allowable Variations in the Price, Schedule and Model of the Exempted Goods

Moreover, Paragraph C of Article 29 provides allowances for variations with respect to the imported assets and materials to avoid the endless aggravation, delays and costs suffered by investors when products arrive on a different date, or have risen in value within a certain limit or are a different model from the one originally envisioned. Where variations are substantial, then a new license will be required, but easily obtained so long as there is no abuse.

C. Article 29.E. Requires Top Priority for Customs Clearance of Investment Project Goods

In addition, because of the importance of investment to the national economy and development, Paragraph E of Article 29 requires that the customs authorities give investment projects top priority in customs clearance. By comparison, it should be noted that South Korea maintains a special unit of customs officials trained to facilitate imports by investment projects.

D. Limit on Exemption for Spare Parts

Paragraph F of Article 29 limits the exemption on spare parts to 20 percent of the total value of new fixed assets being imported.

Article 30 - Customs Duty Reduction on Project Production Materials

Apparently, there are some circumstances where customs duties on total raw materials required to make a product in the Y.A.R., exceed the duties on a competing imported product. Article 30 provides, first, that duties on raw materials shall not exceed 90 percent of the duties on an imported competing product. Second, it provides that where an investment project can prove that such excess exists, it will be granted a reduction in duties by the amount of the excess. To the extent, however, that the excess disappears by reason of amendments in the tariff schedule, or changes in the project's raw material mix or for any other reasons, the reduction will be reduced or terminated. This provision will help local products compete effectively in the local market with equivalent imports.

Article 31 - Limitations on Project Import License and Customs Exemption

A. Project Imports May Be Used Only for Project Purposes

Article 29.A. makes it clear that exempted items must be used only for project purposes, and that violators are subject to losing their licenses under Article 85 or to punishment under Article 86.

B. Limits on Disposition of Imported Project Goods

The article also provides for the disposition of imported fixed assets and liability for the customs duties thereon, requires that accurate records be kept and provides for inspections to enforce these rules.

Article 32 - Employees of Projects

A. Unnecessary Costs and Delays Now Encountered in Obtaining Work Permits and Visas for Foreign Employees of Projects are an Obstacle to Investment in the Y.A.R. and Resulting Higher Costs Harm the Country's Competitive Position in Attracting Investment

Paragraph A of this article sets out rules relating to work permits and residence visas for authorized non-Yemeni employees of licensed projects. They are somewhat detailed in order to correct obstacles, delays and costs currently being encountered and incurred by investors.

(1) Costs of Advertising Position

First, apparently, in order to hire a foreigner an investor must advertise a position locally, which is reasonable enough. But we understand that the Labor Authorities require that the investor advertise on television in addition to newspapers, a very costly undertaking.

(2) Long, Costly and Repetitive Procedures to Obtain Initial Work Permit

Moreover, the existing application process is long, costly and fraught with aggravation. In this regard, we understand that the current situation is that investors apply for work permits before the worker arrives in country. This process can take from three months to one year, partly because each application must be reviewed by State Security. Then, once the worker arrives, the investor must turn over the worker's passport to the Ministry of Labor to have the work permit stamped in the passport. At this point, apparently, the whole procedure of referring the matter to state security is repeated and, again, it takes several months before the passport is returned with the work permit stamped in it.

(3) Investors Unfairly Fined for Delay by Officials

More disturbing, we understand that investors are then fined YR 40 for every day that the passport was kept by the Authorities because, technically, the worker has been working without a work permit. This seems unfair in addition to being costly, because the permit was previously approved and because it was not the investor's fault that the work permit was not stamped

in the passport on the day that the worker arrived in the country.

(4) Work Permit Renewal Procedures Also Costly, Repetitive and Unfair

Thereafter, the work permit must be renewed every year, and the Labor Office Authorities will not accept a renewal application before the date the permit expires. Then, although the worker was previously approved, processing the renewal also takes three to eight months during which the investor once again is fined YR 40 for every day between the date of expiration of the work permit and day the work permit is actually renewed. Moreover, apparently, no more renewals of a worker's permit are granted after four years, even if the investor is unable to hire a Yemeni to replace the foreigner and must hire another foreigner to replace the one that has left. This means added costs of transportation and training without getting the benefit of employing Yemenis.

(5) Work Permit Procedures Add to Costs and Aggravation of Investing in the Y.A.R.

These are unnecessary (and, in some cases, unjust) added costs of investing in the Y.A.R. and also cause unneeded aggravation between Government authorities and investors.

B. Article 32.A. Seeks to Eliminate Unnecessary Costs and Delays of Existing System

Accordingly, Paragraph A of Article 32 attempts to alleviate these problems by providing for:

(1) Newspaper Advertising for Positions

A one-time advertisement of a position in a newspaper of general circulation in the Project's area, eliminating the requirement of advertising on television. Perhaps the Government could establish its own service of announcing available jobs on television itself. Again, the idea is to reduce the costs of investing in the Y.A.R.

(2) Three-Year Work Permits Renewable Indefinitely on Recommendation by the IPA

Three-year work permits which can be renewed upon the recommendation of the IPA, when a Yemeni replacement is not available, so that the investor does not have to

undergo the costs and aggravation of annual renewal or of bringing in new foreign workers to replace those required to leave after four years.

(3) Expedited Procedures

An expedited process for issuing work permits and stamping passports, since there appears to be no good reason for taking months to process them (if the individual is a security risk, then that should be immediately apparent from the State Security's records).

(4) No Fines for Period Following Submission of Application

Eliminating fines from the date that passports or renewal applications are submitted to the Authorities since from that time the responsibility should be on them, not on the investment project. Naturally, fines would accrue for late submission of documents, but there is no justification for fines when the investor has submitted passports and applications on time.

C. Employees Generally and Project Right to Hire and Fire Subject to Employment Contract

(1) Provisions Will Reassure Investors

Paragraph B of Article 32 provides that with respect to employees generally, investors are free to hire and fire subject to employment contracts negotiated with the workers and specifically provides that investment projects will not be subject to government imposed pay raises or levels.

(2) Laws Restricting the Right to Fire Workers Discourage Job Creation and Hiring in the First Place

While we understand that this has not been a problem in the Y.A.R., investors will be reassured by these provisions. Many countries have laws which forbid or make very difficult firing workers, as in Europe and Egypt for example. The result is that investors are then reluctant to hire employees for fear that they will never be able to lay them off even when the project is in danger of losing money. As a result unemployment is much higher in Europe than, say, in the United States where hiring and firing and laying off is governed by contract rather than law. This is a another example where government controls have exactly the opposite impact of their intent: By making firing of workers difficult out of concern for workers' job

security, these controls make investors afraid to hire workers in the first place, thereby reducing job creation and increasing unemployment. Article 32.B. will provide better security for workers in the long run because investors will not be afraid to hire them.

4) Singapore's Experience: Provisions Guaranteeing Investors the Right to Hire and Fire Freely Subject to Employment Contracts Has Created Jobs and a High Standard of Living

In 1968, Singapore after a long and bitter political battle repealed a law enacted five years earlier which made firing workers difficult. The new law made hiring and firing a matter of contract negotiations between the investors and the workers. The day that the law was passed, Singapore police went onto the streets and into factories in force to put down riots among workers. The Singapore government stuck by the law, however, despite fierce opposition and the law has remained in effect ever since.

Today, Singapore has the lowest unemployment in the world and the highest standard of living in Asia, just behind Japan, and well ahead of most of the countries of southern Europe. In Singapore, investors readily hire workers when they need them because they know that they can lay them off if business turns bad. In West Germany and many parts of Europe, companies will not hire workers even when they need them because of the fear that if business goes down they will never be able to lay the workers off. The result is that Europe still has very high unemployment compared to Singapore and the United States.

Article 33 - Basic Tax Exemptions Available to all Projects

As the title makes clear, this article provides basic tax exemptions for all projects as follows:

A. Four-Year Profits and Real Estate Tax Exemption

First, every project will receive a four-year exemption from profits and real estate taxes, starting from the date of the ense rather than the date of commencing operations in er to encourage quick implementation of the project. s exemption is discussed in more detail in the commentary Chapters 3, 4 and 5 below.

B. Five-Year Loss Carry-Forward

For losses incurred after the exemption period is over, Projects will be able to carry losses forward for profits tax purposes for a period of five years. This is a standard provision in most profits tax laws, but we did not find it explicitly stated in the law on taxing commercial and industrial profits. It is important to limit the loss carry-forward period as well as allow it. Most tax laws seem to fix five years as a fair period.

C. Exemption of Capital From Proportionate Stamp Duty and Other Direct Taxes and Imposts on Capital

(1) Exemption From Proportionate Stamp Tax

Article 33.A.(3) provides for permanent exemption of the project's capital from the proportionate stamp tax and all other taxes on capital including the capital tax on foreigners. This is one of the most important tax exemptions in the Draft Investment Law by far. First, the taxes on capital are a direct tax on investment itself, the very act that the law is trying to encourage. Anything which unnecessarily increases the costs of capital -- i.e., the cost of establishing a project -- reduces the Y.A.R.'s competitive position for investment world-wide and should be eliminated.

What should be taxed are the results of operations of a project -- that is, its income and products, but not its capital -- its establishment -- when that is the very thing which the Y.A.R. is trying to encourage. Right now the United States is considering changing its tax laws because the costs of capital in the United States are roughly twice the costs in Japan and higher that the U.K. and West Germany. The Y.A.R. can take this step first and eliminate the proportionate stamp tax on capital and the capital tax on foreigners.

(2) Zakat

As presently administered, zakat represents a tax on capital in that newly-formed companies, which have not had a chance to purchase assets are taxed on the invested funds held by them. This is especially difficult for limited shareholding companies which, under the law, must have one hundred percent of its capital paid in upon formation, which is then subject to zakat of two and a half percent. This represents a considerable cost, especially where the amount of investment costs required to establish a project are very large, say, in the millions. With this kind of

cost on the investment of paid-in equity capital, investors will make every effort to avoid paying in capital either by delaying the payment or, much worse, borrowing to finance investment costs instead of investing, a phenomenon which now occurs in the United States with disturbing regularity because of the high cost of capital in the U.S.

Not being experts in the Shari'a, we cannot pretend to be able to formulate a definitive solution to the problem of zakat. We strongly recommend that a team of distinguished Islamic lawyers and judges be assembled to determine how zakat can be imposed without being a direct charge on invested capital. We can only offer the following suggestions:

(a) The Draft Investment Law contains the following formulation:

> "With respect to Projects and Investment Companies, zakat shall be the individual responsibility of each of the Yemeni Investors with respect to the shares owned by them."

This at least would reduce the burden directly on the Project's capital and shift the responsibility to the Yemeni investors themselves. We understand that the approach of many other Islamic countries is to put the obligation on individuals rather than on companies. Again, whether this solution comports with the Shari'a is not something we are equipped to answer.

(b) An alternative formulation might be as follows:

> "Permanent exemption of the Project's capital from the proportionate stamp tax, and all other taxes on capital, including the capital tax on foreigners and zakat, provided however, that zakat shall instead be levied on that portion of a Project's net income attributable to Yemeni participation."

We understand that this is the approach in Saudi Arabia. The advantage is that it taxes the results of capital investment -- that is, the net income -- rather than the capital itself, a progressive solution.

(c) The Draft Investment Law itself contains some relief from the impact of zakat:

(1) Chapter 8, generally, and Article 70 in particular make formation of shareholding companies -- both publicly held and privately held -- much easier procedurally and removes many disincentives to their organization. Such companies have a much more flexible approach to paying in capital than limited shareholding companies in that only one-fifth of the capital must be paid in on formation.

(2) At the same time, Article 70.B.(11) makes paying capital for limited shareholding companies more flexible by allowing 25 percent to be paid in upon formation, rather than one hundred percent, with twenty-five percent being paid in every year after that until the capital is fully paid up.

The object of both of these provisions is to allow investors to pay capital in as it is required rather than all at once upon formation, even when it is not needed at that time, and thereby subjecting it to the zakat obligation. But these are only partial solutions, and it would be much better to find a way to impose zakat other than directly on invested capital which has not yet been expended on fixed assets.

C. Exemption From Proportionate Stamp Tax of All Contracts Relating to a Project's Establishment, Operation, Expansion or Upgrading Under Article 33.A.(4)

Along with the exemption from proportionate stamp tax on the value of capital discussed above, this is the most important tax exemption in the Draft Investment Law. The problem here is that the tax is imposed directly on the value of contracts. Because the value of contracts related to the establishment and operation of a large investment project can be huge -- say, loans and mortgages in the millions of Rials -- the tax will be very large even though the percentage may be small.

Accordingly, the tax has the adverse impact of discouraging investors from formalizing their contracts at a time when the investment law wants to encourage sound business practices and stability and predictability of legal relationships, an essential element in promoting economic growth. Again, what should be taxed are the results of business contracts and business operations -- i.e., net income, gross sales, or individual sales of products -- not

the contracts and operations themselves which produce those desireable results.

B. Exemption From the Tax on Salaries of Foreign Workers of a Project of Actual Amounts Paid in Respect of Housing the Employees, Educating Their Children in the Y.A.R. and Air and Sea Transportation in Bringing the Employees Here and Repatriating Them Under Article 33.A.(5)

While such allowances may or may not be subject to salaries tax in the Y.A.R., it is important to clarify the matter for investors. Although the salaries tax is imposed on the employee, in fact it is the investment project which bears the burden because it must negotiate net take home compensation with its employees. The cost of housing managers and experts and educating their children either in foreign schools in the Y.A.R. (such as the American School in Sana'a) or in boarding schools back in the employee's home country is very expensive, not to mention the cost of transporting an employee and his family to the Y.A.R.

If these elements are included as taxable income in the salaries of employees, the cost of bringing them to Yemen would be enormous. For that reason, the investment laws of many countries exempt these allowances from the salary tax specifically, and we recommend that the Y.A.R. do the same. Under no circumstances, however, should the foreign employee's salary itself be exempt from taxes, and the Draft Investment Law so provides. Again, the purpose is reduce the cost of investment in the Y.A.R. relative to other countries in the world and the region.

D. Exemption From Real Estate Transfer Tax of All Purchases and Sales of Real Estate for Project Purposes and From Profits Tax Interest on Loans to Finance Investment Costs and for Three Years on Technology Transfer Fees

(1) Exemption

Finally, Clauses 6, 7 and 8 of Article 33.A. exempt:

(a) From the real estate transfer tax all purchases and sales of real estate by projects for purposes of establishment or expansion (not for purposes of trading); and

(b) From profits taxes all interest paid by projects on loans to finance investment costs (but not operations); and

(c) From profits taxes for a period of three years following commencement of operations all payments

in respect of royalties and other fees for foreign transfer of technology.

(2) Reasons for Exemption

Although in several cases these are taxes paid by someone other than the Project or the investors -- i.e., banks, real estate transferor, and foreign transferor of technology -- there are strong reasons for these exemptions, namely:

(a) To encourage Y.A.R. banks to loan to projects for the purpose of financing their establishment. This is especially important in view of the many disincentives banks currently have for loaning to projects as noted above in Section 3.5 and in the commentary on Article 23 above;

(b) Similarly, to encourage landowners to sell or lease real estate to Projects, instead of to land speculators and thereby put land to the most productive use possible;

(c) Also to encourage the transfer of technology to the Y.A.R., one of the essential purposes of the law in the first place as we understand it. It should be noted that Article 83 of the Draft Investment Law provides for taxing technology fees following the end of the exemption period at specific rates, subject to any treaties the Y.A.R. may have or may conclude in the future with other countries for the prevention of double taxation. This subject is elaborated further in the discussion on Article 83 below.

(d) Finally, to reduce overall the costs of establishing investment projects in the Y.A.R. and improving the country's competitive position relative to other countries for attracting Arab, foreign and Yemeni investment.

Chapter 3

Extended Tax Exemption Periods Available Only to Projects Actually Meeting Specified Conditions; and

Chapter 4

Continuing Tax Exemptions Available to Projects Meeting Specified Conditions Following the Basic Exemption Period; and

Chapter 5

Rights and Exemptions Granted by Cabinet or IPA Decree To Projects of Special Economic and Social Significance

While all projects would receive the rights, exemptions and facilities specified in Chapter 2 of the Draft Investment Law, the special privileges and exemptions set out in Chapters 3, 4 and 5 would be received only by those projects which actually meet the criteria of projects which the Government specifically wants to encourage. The special privileges and exemptions provided by Chapters 3 and 4 would be available to any project meeting the conditions prescribed for each such right or exemption. Such incentives are referred to by experts in the field as "performance-based" or "performance-linked." This means that the project receives the right or exemption only it if actually performs or meets the conditions established by the law.

This differs from system under the current investment law and under Chapter 2 of the draft proposed law where the privileges, rights and exemptions are part of the license; that is, whoever receives the license is, on the face of it, entitled to the right, exemption or other incentive. Under the performance-based incentive system, every project has the chance to be established, but only those which actually perform the conditions receive special exemptions.

Chapters 3 and 4 of the Draft Investment Law thus provide for a number of performance-based incentives to encourage specific investments mostly in the form of tax exemptions. The system works as follows:

A. <u>Article 33.A.(1)</u> - <u>Four-Year Profits and Real Estate Tax Exemption for All Projects</u>

First, as already noted above, under Article 33.A. of Chapter 2, every project, regardless of size or other characteristics, receives an automatic exemption from

profits and real estate taxes for four (4) years from the date of the license. Although every project would receive this privilege, this really is a performance-based incentive also: By starting the exemption period from the date of the license of establishment, investors will have a powerful incentive to implement their projects and start production or operations quickly to get maximum benefit from the exemption. Those which get started quickly will get more benefit. Those which are slow to start up will receive less and possibly not benefit, since a tax holiday is not much use if you do not make taxable profits. This will also be a strong incentive for projects already to be well organized and ready to go at the time the application is first submitted.

B. Chapter 3 - Extended Tax Exemption Periods Available Only to Projects Actually Meeting Specified Conditions

After that, longer tax exemption periods are available under Chapter 3 to those projects which meet certain criteria as follows:

(1) Size of Investment

Under Article 37 of the Draft Investment Law, projects commencing production with new fixed assets (other than passenger cars, land and existing buildings) valued at YR 30 Million or more and paid-in capital of at least 30 percent of total investment costs receive a tax holiday of six years from the date of commencing production or operations, the first three years a 100 percent exemption, the second three years a 50 percent exemption.

Thereafter, for each additional YR 20 Million of new fixed asset value, the exemption period is increased two years up to a maximum of twenty years. Again, half the period would be a 100 percent exemption, the other half, 50 percent.

(2) Type of Investment

First, to provide extra encouragement to agriculture and education projects, Article 37.A.(2)(b) provides that only half of the above amount of new fixed assets are required to obtain the six-year tax holiday and subsequent additions for increased investment. Second, Article 37.A.(1) provides for a ten-year tax holiday for traditional craft industries certified as such by the Responsible Authority and for specific, highly desireable Projects listed on Schedule 6 to the Draft

Investment Law which can be changed only once every three years.

(3) Location

In addition to whatever other tax holiday a project would be entitled to, it would receive an additional two years if it is located in an area targeted for development which is outside the main population centers. Thus, the law envisages two development zones, A and B, which are defined by Schedule 5 to the law, which can be amended only once every five years to ensure stability. For example, a manufacturing project starting production with paid-in capital of 30 percent of total investment costs and YR 30 Million of new fixed assets in Zone A would receive a tax holiday of six years, whereas the same project located in Zone B will receive an eight-year tax holiday.

(4) Form of Company

On top of any other tax holiday, a shareholding company, 25 percent of the issued shares of which are held by the public, would receive an additional two-year tax holiday. Thus, if the project described in paragraph (3) were implemented by such a company in Zone B, the total tax holiday period would be ten years, instead of eight years, and eight instead of six in Zone A.

C. Chapter 4 Continuing Tax Exemptions for Projects Meeting Specified Conditions Following the Basic Exemption Period

While Chapter 3 of the Draft Investment Law provides for extended tax exemption periods to encourage specific kinds of investment, Chapter 4 provides for continuing incentives to encourage certain desireable activities and behavior as follows:

(1) Project Expansion and Upgrading

(a) Expansion During Exemption Period Under Paragraphs B and E of Article 37

Under Article 37 of the Draft Investment Law, project expansion and upgrading does not in itself qualify for a tax exemption period, although, if undertaken during the original exemption period, the expansion will extend the exemption period for two years under Paragraphs B and E of Article 37 if the investment is large enough. Thus, if a Project qualifies for a six-year holiday because

it has new fixed assets worth YR 30 Million in Zone A, and expands three years later with new fixed assets valued at an additional YR 20 Million, the period will be extended by two years for the entire project pursuant to Article 37.B.

(b) No New Exemption Period Following the End of the Tax Holiday

Following the end of the tax holiday, however, there would be no new exemption period for project expansions in and of themselves. The main incentive for expansion will be the market itself and the success of the project.

(c) Exemption for Reinvested Profits Used to Finance New Fixed Assets for Expansion

Article 39.A., however, encourages project expansion by providing that profits reinvested to increase paid-in capital and obtain new fixed assets would be tax exempt in the year invested or the following year at the investor's choice.

(d) Three-Year Depreciation for Purchase of New Machinery and Equipment

In addition, Article 39.B. provides that new machines and equipment purchased by a project can be depreciated at an accelerated rate of three years instead of ten years, 50 per cent in the year of purchase or the following year at the option of the project, 30 percent the year after that and 20 percent in the third year. Permitting this kind of accelerated depreciation of a new machine for tax purposes is a device which many countries -- including the United States -- use to encourage projects to upgrade and modernize their plant and equipment to become more efficient and more competitive with producers in other countries. Once a project is established, there is no reason to provide complete tax exemption periods for each expansion. But it is very important to encourage established projects to keep plant and equipment up-to-date and modern to at least stay even with world competition.

(2) Encouragement of Exports

To encourage exports, Article 41 of the Draft Investment Law provides:

(a) Exports will be exempt from any taxes on exports as well as consumption taxes on Y.A.R. produced inputs; and

(b) In addition, foreign currency revenues from exports will be exempt from profits taxes up to 50 percent of the total tax due;

(c) Finally, exporters will be entitled to a rebate of the customs paid on imported inputs. If the rebate is not paid right away, the exporter can credit the amount of the rebate on customs owing for new imports or sell his right to the rebate to any other project. This system should be much easier to enforce than the existing duty "drawback" system where exporters have a difficult time being repaid previously paid customs duties on imported inputs for exported products.

Here, if the Customs Authorities do not or cannot pay back customs duties previously paid by the exporter because of cash flow problems or other problem, they will be required to credit the amount against current or future import duties for whichever project presents the customs rebate certificate issued by the IPA. Similarly, the customs rebate-credit system will be much easier for the government to enforce than exempting the imported inputs of exporters from the beginning and trying to police the exemption.

(3) Tax Exemption to Encourage Value Added to the Economy

Under Article 42, Projects which can show that they have added value to the national economy in terms of foreign exchange earnings or savings pursuant to an analysis to be performed by the Investment Authority Administration would be entitled to an exemption of up to 50 percent depending on the percentage of value added. This exemption will encourage use of local materials and inputs.

(4) Employment of Yemenis

To encourage projects to employ Yemenis, Article 44 permits project to exempt an amount equal to 10 percent of total wages paid to Yemenis in the preceding year as evidenced by salary tax and social insurance records up to 50 percent of the total taxes due.

(5) Cumulation of exemptions

Article 44 allows projects which qualify for more than one profits tax exemption under the preceding Articles 41-43 to cumulate them, provided that the total exemptions do not exceed 50 percent of the total taxes due in any year. Thus, if a project were entitled to a 20 percent exemption from profits tax for export revenues under Article 41.A., and a 20 percent exemption for having added value to the national economy under Article 42 and another 20 percent for employing Yemenis under Article 43, the project would be exempted for a total of 50 percent of profits taxes due even though all of the exemptions together amounted to 60 percent. This limitation does not apply to reinvested profits for expansion purposes provided by Article 40.

D. Procedures to Obtain Exemptions

To obtain the performance-based tax exemptions under Articles 37 and 40-43, the project must prove that it has qualified for the exemption either to the Responsible Tax or Customs Authorities or to the IPA. For example, to obtain a six-year tax exemption under Article 37, a project would notify the Investment Authority within a reasonable period of commencing production, and produce evidence and documents to show that it had at least YR 30 Million worth of new fixed assets and a paid-in capital equal to at least 30 percent of its total investment costs. The Authority could then inspect the project site or examine books and records. After satisfying itself that the exemption was warranted, within a reasonable time of the project's request, it would issue a tax exemption certificate to the project which would be conclusive proof of the project's right to the exemption. Similarly, where an exporter can show that it is entitled to a customs rebate on imported production inputs, the Investment Authority would issue a customs rebate certificate which would be as good as a cash payment in respect of future customs duty obligations of the Project.

E. Summary of Performance-based Investment Incentive System

In summary, rather than giving a project a tax holiday in advance based on its plans and promises to export, or employ Yemenis or save foreign exchange, the project would be required to show that it had earned the exemption. By focusing on actual performance, instead of promises, the Authorities responsible for investment will waste less time and resources and be able to concentrate on the goal of promoting and encouraging investment. They will be able to conserve resources to analyze only special projects and give

additional exemptions only to projects which actually perform the desired conditions.

F. Chapter 5 - Rights and Exemptions Granted by Cabinet or IPA Decree to Projects of Special Economic and Social Significance

Finally, Chapter 5 provides for a category of projects of "special social significance" as defined by Article 46 to which the Cabinet can award extra incentives, rights and exemptions on a case-by-case basis such as longer tax exemption periods, government-assisted or guaranteed financing or state lands at favorable rates. The Cabinet in turn could define such projects in advance and delegate its licensing authority to the Investment Authority under Article 66.D.

Chapter 6

The Investment Promotion Authority (IPA)

A. Nature and Purpose of the Investment Promotion Authority

Taken almost completely from Chapter 2 of the Ministry's first Draft Investment Law and Chapter 4 of the second Draft Investment Law, Chapter 6 and Articles 48-57 of the Draft Investment Law provide for the establishment and organization of an Investment Promotion Authority (referred to in this report as the "IPA"). A legal entity having independent and administrative nature under the supervision of the Ministry of Economy, the IPA would be the principal agency responsible for carrying out the Investment Law.

B. Many Other Countries Have Similar Organizations to Promote Investment

Many countries have similar organizations and endeavor to create a single agency which prospective investors and licensed investment projects can go to with proposals and requests for assistance. Thus, Egypt has its General Authority for Investment; Singapore, an Economic Development Board; Tunisia, an Industrial Promotion Agency; Ghana, an Investments Centre; etc. Establishing such an agency whose sole concern is investment promotion is an important signal to potential investors that a country is serious about promoting investment.

C. Powers and Functions of the IPA

Under the Draft Investment Law, the IPA would have the following powers and functions:

(1) Issue all licenses to projects;

(2) Grant project import licenses;

(3) Establish project companies;

(4) Obtain work permits for foreign employees of projects;

(5) Issue project certificates for tax exemptions or customs rebates;

(6) Obtain other needed permits for projects;

(7) Process project applications;

(8) Evaluation and recommendation of projects requiring special review and approval under Articles 61-62;

(9) Assist projects with other government organizations;

(10) Establish and allocate state lands for free zones, industrial estates and tourist complexes;

(11) All other necessary tasks to implement licensed projects;

(12) Study laws affecting investment and make recommendations to the Cabinet;

(13) Study investment issues and make recommendations;

(14) Study investment opportunities in the Y.A.R.;

(15) Prepare and print lists of projects;

(16) Publish data and information relating to investment conditions in the Y.A.R.; and

(17) Other duties relating to investment promotion assigned by the Minister and the Cabinet.

The IPA would have all powers necessary to accomplish its purposes including the capacity to sue and be sued, to contract generally and acquire and dispose of property specifically, as well as the power to requisition land in return for fair compensation to the owner for purposes of

establishing free zones, industrial estates, tourist villages and complexes, etc.

D. IPA Board of Directors

The IPA would have a Board of Directors constituted according to Article 50 of the Law and formed by a decree of the President of the Republic who would also name the Chairman. This would give the IPA the prestige required to carry out its vital function of promoting and facilitating private investment in the Y.A.R. The Board would be the chief policy-making organ of the IPA.

E. IPA Executive Administration

Implementing the Board's policies and carrying on the day-to-day business of the IPA would be an executive administration headed by a Director General who would also serve as the Deputy Chairman of the Board. Egypt follows a similar pattern of organization for its General Authority for Investment.

F. Board Not Concerned With Routine Individual Projects

As a policy-making body, the Board would not be concerned with reviewing each investment project and deciding whether to approve it or not. Rather, under Chapter 7 on licensing procedures, this would be handled as a routine matter by the Executive Administration, except for the highly sensitive projects described in Article 61 and those requesting special benefits as projects of "special social and economic significance" under Chapter 5. Moreover, once one of these projects was approved by the IPA Board or the Cabinet as the case may be, all subsequent licenses and certificates of exemption would be issued by the Executive Administration without having to go back to the Board. Of course, the Board and its Chairman would be charged with overseeing the work of the Executive Administration, and the Director General would be responsible to keep the IPA Board fully informed on investment statistics and activities of the Executive Administration.

G. Assist Investment Projects With Other Government Organizations

One of the most important functions of the IPA will be to assist licensed investment projects with other Government Organizations which affect them. To facilitate these arrangements, such organizations will have offices located at the IPA which offices will be staffed by officials with full authority from their Ministries and Organizations to issue all permits and approvals required to establish,

implement and operate investment projects. Thus, the Ministry of Labor will have officials stationed at the IPA headquarters with authority to issue work permits to foreign employees of Investment Projects without going back to the Ministry for further approvals. Similarly, Immigration officials at the IPA would be empowered to issue residence visas to Arab and foreign investors and foreign managers, experts and employees of investment projects. To assist in security clearance problems, a representative of state security would be stationed at the IPA with authority to clear such permits and visas from the security standpoint on an expedited basis.

Likewise, Customs and Tax Authority officials would be stationed at the IPA with full authority to resolve investment project problems in their respective areas of competence. In this regard, it should be noted that South Korea has a special Customs unit which is trained and authorized to handle customs clearance of investment projects on an expedited basis. Such a unit could also be formed by the Y.A.R. Customs Authority. Also, officials representing the Companies Department and other relevant departments of the Ministry of Economy would also be stationed at the IPA with full authority to review and approve Investment Companies along with officials of the Ministry of Municipalities and housing.

H. <u>Establishment of the IPA Shows That the Y.A.R. is Serious About Promoting Private Investment in the Y.A.R.</u>

Establishing an all encompassing agency such as the IPA to implement the Investment Law would send a powerful message to potential Arab, foreign and Yemeni Investors that the Y.A.R. is serious about attracting and assisting investment projects in the country. Pending the formation and establishment of the IPA, Article 97, in Chapter 14 on Transitional Provisions, provides that the Ministry of Economy and the General Department of Investment will exercise the functions and powers of the IPA and that following such establishment, the General Department for Investments will be transferred to the IPA.

Chapter 7

Licensing and Registration Procedures for Projects

A. The Existing Licensing System for Projects is a Major Obstacle to Investment in the Y.A.R.

One of the most serious obstacles to investment in the Y.A.R. (and other countries as well) is the system of requiring government approval and licenses for every investment project and every expansion or change in the project thereafter. Approved projects under the Investment Law then receive certain privileges. But, the license for the project is only the beginning. Thereafter, investors must obtain separate licenses to form a company under the companies law 106/1976, as well as an import license to bring in each shipment of imported fixed assets and production materials which license must be validated by the Central Bank.

Moreover, even though a licensed project is theoretically entitled to a customs exemption for imported fixed assets needed to establish the project, a separate application must be made to obtain the customs exemption for each shipment of fixed assets which requires separate approval by the Exemptions Committee established under Article 20 of Investment Law 18/1975. Apparently, this latter procedure consumes so much time because it is difficult to get the Exemptions Committee together for a meeting, that investors often pay considerable fees for demurrage while they are waiting.

B. The Licensing System Imposes Heavy Costs in Time and Money on Investors and the Government Alike

Embodied in both Industry Law 20/1975 and Investment Law 18/1975, this system of separate applications and licenses imposes heavy costs in time and money for the investor in following up on his investment application. At the same time, the system also imposes heavy costs on the Government which must commit scarce human resources to the task of processing each application and analyzing feasibility studies and other data for each proposed project establishment or expansion. Analyzing investment proposals and feasibility studies requires expertise and experience rarely found among government employees, including Europe, America and Japan. Because they lack the experience and or expertise, government employees often delay decisions simply because they may fear making a mistake. Worse, anywhere in the world, license systems create many opportunities for favoritism, corruption and other abuses. In some other

countries investors have been shocked to find that officials have let out secret and sensitive information contained in an expensive feasibility study.

C. The Existing Licensing System Creates Monopolies or Privileged Positions for Those Who Already Have Licenses

Another unfortunate consequence of the licensing system is that those who receive approvals early find themselves in a monopoly or semi-monopoly position. They then become a highly-motivated pressure group which may try to prevent subsequent applicants in the same field from receiving licenses so that they can continue to monopolize or dominate the market and make easy profits. Even without such pressure groups, a long and costly approval process tends to create monopolies, semi-monopolies and highly profitable privileged positions for those who already have licenses.

D. A Possible Solution Would Be to Eliminate the Licensing System Entirely

The best solution would be simply to eliminate the approval process for most investment projects. The government review and approval process should be reserved only for a few categories of projects which are especially sensitive, such as those with unusually high foreign ownership percentages or high foreign inputs and outputs, or high debt-equity ratios or high priority projects of such special social and economic significance which can justify even greater privileges and exemptions which can be granted by the Cabinet or the IPA Board under Chapter 5 of the Draft Investment Law. This task should be made easier by the system of performance-based incentives set forth in Chapters 3 and 4 of the Draft Investment Law as outlined above, because such special rights and exemptions will not be granted automatically with each license, but instead will go only to those projects which prove that they qualify. The task should also be made easier by taking the burden of providing the foreign exchange needed by projects for their establishment and operation off of the Government and putting it on to the projects themselves. This will eliminate the need to have each import license approved by the Central Bank because every project license will no longer require an allocation of the Government's scarce foreign exchange holdings.

E. Many Countries Allow Investment Without a Licensing System

The Y.A.R. would not be the first country to adopt such a system. In the U.S. and Europe, it is very easy to form a company and establish or expand an investment project without obtaining prior approval. To form a company in the

United States, an investor simply prepares a set of articles of incorporation with certain required provisions and files them with the Corporations Commissioner. Once the articles are filed, the company is formed. The receiving officials looks only to see whether the required provisions are there, leaving the investor free to otherwise structure the company as he chooses to, then let it be easy to invest.

But this system is followed not only in the highly developed industrial countries. Tunisia recently adopted a similar system. Article 2 of the 1987 Tunisian Code of Industrial Investment provides as follows:

> "Article 2
>
> Investments in manufacturing industries can be carried out freely and are not subject to prior authorization. However, they are subject to a declaration made to the Industrial Promotion Agency. This declaration must contain, in particular, information on the nature of the project, where it will be located, jobs to be created, a list of the material to be acquired, foreign participation and the investment and financing schemes."

Thus, Tunisia has instituted a simple registration system for most projects, leaving only those desiring very special benefits to be reviewed and approved by the government.

F. The Solution of the Draft Investment Law is to Establish a Simpler, More Streamlined Licensing System

While highly desireable, a simple registration system would not be practical in the Y.A.R. at this time because so many licenses are still required in order to do business. Instead, Chapter 7 of the Draft Investment Law sets out a more streamlined licensing system as follows:

(1) The Draft Investment Law Eliminates the Requirement for a Feasibility Study and Substitutes a Detailed Standard Form Application

Pursuant to Article 59, investors will submit a standard form application which will require information covering the important facts about the Project which the Government and the public need to know:

(a) Description of the proposed business operations;

(b) Legal form;

(c) Investment costs of fixed and intangible assets;

(d) Yemeni and foreign invested capital;

(e) Foreign and local loan financing;

(f) Names, nationalities and proposed ownership interest of each of the investors;

(g) Names of references who can provide information about each of the investors.

In short the application will give the Government everything it needs to know about the proposed project from the standpoint of analyzing its impact on the national economy and the national income. There is then no need for the investor to supply a separate feasibility study. Most of the smaller projects do not need them, and the application itself will be designed in such a way that it will serve as a guide for the smaller investors to plan their projects. The larger projects will have feasibility studies any way.

Government officials should not have to waste time bothering with reviewing different feasibility studies with different formats. Many of the feasibility studies currently being submitted are either woefully inadequate or are outdated by the time the project is actually established. Indeed, the Government need not worry about the feasibility of each project. Because it is their money at stake, the investors themselves will do everything they can to ensure the success of the project.

The Government's main concern should and will be the effect of the project on the national economy: i.e., will the project benefit the national economy more than it costs it. This kind of analysis only needs to be performed on certain projects having high foreign costs, not every single project.

(2) <u>The Draft Investment Law will Reduce the Level of Authority to Issue Licenses</u>

(a) <u>Only Sensitive Projects Will Be Reviewed and Approved by the High Level IPA Board</u>

Instead of each project being reviewed and licensed by a high level government board or body, only highly sensitive projects above a certain size would be handled in this way. In the Draft Investment Law, these are set out in Article 61 as

projects exceeding YR 30 Million in investment costs for new fixed assets which could prove costly to the national economy in terms of foreign currency outflows, for example. These include projects having less than 30 percent Yemeni participation, or a high proportion of foreign currency payments relative to Yemeni Rial payments, or a high debt equity ratio, or whose products will be offered at substantially higher prices than equivalent imports, or those which require unusually large amounts of water.

Similarly, projects requesting or requiring unusual benefits such as government-guaranteed financing or State Lands below market prices or the license to establish a privately-owned and operated free zone are among those requiring scrutiny and approval at a high level. Other projects of a similar highly sensitive nature can be included in a schedule to the law which can be amended every two years.

(b) All Other Projects Will Be Licensed by the Executive Administration

But the essence of the proposed law is to leave most project licensing to be handled at the administrative level under Articles 59 and 60. The philosophy behind the law is that if a project is not specifically prohibited by the law or the State Plan, then it is permitted.

(3) Licensing Procedures Under Articles 59 and 60

(a) Determine If Project is Within the Scope of the Law Under Article 4

First, the IPA's Executive Administration would examine a project application to determine whether, pursuant to Article 4 of the Draft Investment Law, the project is specifically prohibited according to a schedule of prohibited projects attached to the law, or is required to be formed under another law (such as a bank for example) or is reserved to the public sector (such as an armaments factory, for example) or, if there is foreign participation, whether the project is in a field reserved totally to Yemeni citizens listed on another schedule to the law. If the project is found to be prohibited according to other foregoing tests, then, it will be rejected forthwith and a full statement of reasons given to

the investor. Of course, since investors will already know what projects are formed under other laws as listed in Schedule 1 to the Draft Investment Law, or prohibited according to Schedule 2, no one is ever likely to apply for such projects in the first place.

(b) Determine Whether Project Falls Into Article 61 Category Requiring Special Review and Approval

Next, the IPA Executive Administration will determine whether the project is one of those listed in Article 61 as requiring special review and approval by the Board of Directors. If it is, review and analysis will proceed up to the IPA Board level under Articles 62 and 63 as described above in subsection 2. If not, processing will continue under Article 60.

(c) Notice of Project to Responsible Authority for Sector to Determine Whether Project Fails to Conform to the State Plan

Under Article 60, a written notice will be sent to the Government Authority responsible for the sector in which the project proposes to work describing the project, its proposed location and its production capacity and inquiring whether the proposed project in any way fails to conform to the State's Socio-Economic Development Plan for the Sector.

(d) Response of Responsible Authority

The Responsible Authority then has fifteen days within which to respond in writing stating clearly any and all respects in which the project fails to conform to the State Plan.

(e) Certification That Project Conforms to the State Plan

If the Responsible Authority states that it has no objection to the project or does not provide detailed reasons why the project does not conform to the State Plan or fails to respond at all, the project will be deemed certified as conforming to the State Plan.

(f) Formation of Investment Company

The investors are then notified within five days whereupon they proceed to form their company to implement the project pursuant to Chapter 8 of the Draft Investment Law and Companies Law 106/1976.

(g) Issuance of License to Investment Company

Upon formation, the company will receive the license for the project from the IPA Executive Administration.

(h) Procedures Where the Project is not Certified as Conforming to the State Plan

If on the other hand, the Responsible Authority clearly states and describes reasons why the project is at variance with the State Plan, the investors will be supplied promptly with a copy of the reasons. If the project is then changed to meet all of the objections, the project will be approved forthwith and the investors invited to form their company. Otherwise, it would be rejected.

(4) Projects of High Social and Economic Significance

If the project falls into a category under Article 61 of being highly sensitive or of such social and economic significance that it needs and deserves special privileges, then the IPA Executive Administration would subject it to close national income analysis to determine whether the costs of the project to the country outweigh its benefits or vice versa and make a recommendation to the Board of Directors accordingly. Where special privileges have been requested which under the Draft Investment Law can only be approved by the Cabinet, these projects also would first have to be approved by the IPA Board. But most of the projects would be handled in the simple administrative manner described above.

(5) Project Changes

Articles 59 and 64 read together set out the scheme for handling changes, expansions or upgradings of projects. Articles 59.A.(2) and Article 64.A. require that all changes in the information contained in the original project application during the entire life of the project must be promptly reported to the IPA in an application amendment. Minor changes will be recorded

but will not affect the processing of an application. Major changes as defined by Article 64.B. made prior to the licensing of a project will cause the application to be treated as a new application and processed according to the procedures outlined above under Articles 59, 60 or 63 as the case may be.

Where a major change is made after the project is licensed, the Project will undergo only the procedures determined to be necessary by the IPA in light of the changes with a view to expediting procedures as much as possible. For example if the IPA Executive Administration determines that the changes are not such that it is necessary to revert to the Responsible Authority, then it will issue an amended license straight away. If, on the other hand, the IPA Executive Administration determines that the project is changed to the extent that the Responsible Authority should be consulted, then it will follow the procedures outlined in Article 60 for doing so.

Similarly, changes in projects will not have to go to the IPA Board unless they are of such magnitude as to bring the changed project within the scope of Article 61.

(6) Project Expansions and Upgradings

Under Article 65, expansions and upgradings of projects can be handled in one of two ways:

(a) In the Original Application

Where the investor foresees or plans a project expansion from the beginning, he can provided for it in the original application. In this case, the expansion will be approved in the original license; or

(b) Like a Change Under Article 64

If not foreseen or planned from the beginning, the expansion or upgrading will be treated like a change in the project under Article 64.

(7) Subsequent Licenses for Approved Projects

Article 66 makes clear that once a project is approved by the appropriate authority, all subsequent licenses will be issued by the IPA Executive Administration, unless the special conditions of Article 61 are triggered.

(8) Form and Legal Effect of Licenses

(a) Objective: Eliminating Wasteful Procedures

Article 67 on the form and legal effect of licenses eliminates the need for licensed projects to go back to special committees or higher authorities to obtain the customs and other rights and exemptions to which they are already entitled by virtue of the license they have already received.

(b) Form of License

Article 67.A. requires that the form of the license will set forth all of the rights and exemptions to which the project is entitled by virtue of Chapter 2 as well as any special rights or exemptions awarded by the Cabinet or the IPA Board under Chapter 5.

(c) Certificates of Exemption

As noted above, the IPA Executive Administration will issue certificates to projects which prove that they have performed the conditions necessary to qualify for additional rights and exemptions.

(d) Legal Effect of Licenses and Certificates

Article 67.B. then provides that the project's license or certificate will entitle projects to all of the rights and exemptions specified therein immediately upon presentation to the Responsible Authority concerned without any further licenses or authorizations by any other government authority being required. This will eliminate the need for duplicate procedures to obtain exemptions and rights for projects which have already received licenses unlike the current situation where a licensed project must go back to a special exemption committee for its customs exemption.

Articles 38.C. and 45.D., as well as Article 67.B., make clear that other Government Authorities must grant the exemptions specified in licenses and certificates issued by the IPA without question. This approach is essential if costly bureaucratic delays which now characterize the approval process are to be eliminated. These delays must be eliminated if the Y.A.R. is to

compete successfully for Arab, Foreign and Yemeni investment.

(9) The Proposed Procedures Will Make the Y.A.R. a Strong Competitor for Investment in the Middle East

If the proposed procedures are adopted, the Y.A.R. will have by far the most streamlined and efficient system of investment approvals in the Middle East and will substantially improve its competitive position.

(10) Overall Philosophy of the Licensing System: Let Investment Be Free and Easy, Not Restrained and Difficult

In short, if Yemenis, Arabs or foreigners want to make an investment in the Y.A.R., any investment in any field, let it be easy to do under guidelines and rules clearly stated in the law. The policy should be to encourage all investment, not just in a few favored areas but across the board. The Y.A.R. needs investment to create jobs, to soak up its excess liquidity in the most beneficial and least inflationary way and to start creating wealth. It is difficult enough to make an investment project work and be profitable and many projects will not succeed. But, without the opportunity to try and without some failures, there will be many fewer successes. Like seeds, not every investment comes to bear fruit. Many seeds have to be sown to grow a single orange tree or to have a successful crop of corn. Investment projects are the same way.

Chapter 8

Investment Companies

A. Importance of Shareholding and Limited Shareholding Companies

Shareholding companies and limited shareholding companies are the most efficient vehicles for implementing investment projects and for mobilizing capital generally. Shareholding companies are especially useful because their shares can be transferred easily and for successful projects capital can be raised by offering shares for public subscription. Accordingly, these companies should be made easy to form and operate with only as much government intervention as necessary to ensure that the public is protected. Chapter 8

provides a means for forming companies under the Investment Law and grants them a number of necessary exemptions from the Companies Law. Again, one of the overall purposes is to encourage the formation of these companies as, for example, Egypt has done with its companies law reform of 1981.

B. Certain Projects Required to Form Shareholding and Limited Shareholding Companies

Article 69 of the Draft Investment Law requires that projects of a certain size with more than two investors and projects with more that 49 percent foreign participation must form either a shareholding company or a limited shareholding company.

C. Model Articles and Statutes for Investment Companies

Article 70 provides for the IPA to promulgate model articles of association for investment companies. This is similar to what Egypt has done in that the Egyptian Investment Authority has done the same thing. Such articles should have certain mandatory provisions, but otherwise the investors should be able to structure control and management of the company as they see fit.

D. Modifications of Companies Law 106/1976

Article 70.B. provides for certain essential modifications of the Companies Law 106 as follows:

(1) Only Two Founders or Shareholders Required

Clause 1 lowers the minimum number of shareholders and/or founders to two for both shareholding and limited shareholding companies. This is in line with a world-wide trend. Egypt did the same thing in 1974 when it exempted investment projects from the requirement of having seven shareholders. In many countries, such companies can be formed by one person.

It is especially important to reduce the number of shareholders for the investment law because the shareholding company is the most flexible form of company for joint ventures involving foreign or Arab partners and Yemenis. Also, it should be remembered that very few shareholding companies start out by offering shares for public subscription. They usually begin as privately held shareholding companies and only offer shares for public subscription after they have become successful and need to raise capital to expand by offering their shares to the public.

Moreover, very few members of the public ever want to subscribe to a brand new venture. They wait to see whether it succeeds or not. Therefore, to improve the chances of mobilizing capital, it should be made easy to form such companies by reducing the number of shareholders and founders to the minimum.

(2) Publicly-Held Shareholding Companies to Be Formed by a Decision of the IPA Chairman; Privately-Held Shareholding Companies and Limited Shareholding Companies, by a Decision of the IPA Executive Director

Clauses 2 and 3 of Article 70.B. eliminate the requirement for investment shareholding companies offering their shares for public subscription to be formed by a decree of the President, and other companies to be formed by a decree of the Minister. These are holdover requirements from the days when all corporations or companies were formed by a charter from the King, such as the old British East India Company for example. It is not necessary for the President to be concerned with the formation of companies or to take responsibility for them.

Again, reducing the level of authority to form companies is part of a world-wide trend. In 1981, Egypt eliminated the requirement that companies be formed by a decree of either the president or a minister and allows companies to be formed by a review committee after review by their companies department. Accordingly, public shareholding companies under the Draft Investment Law would be formed by a decision of the IPA chairman and private shareholding and limited shareholding companies by a decision of the IPA director after review by the Companies Registration Department and the IPA Executive Administration. The same, of course applies to amendments of company statutes.

(3) Time Shortened for Decisions to Form Companies and Amend Statutes

Clauses 4 and 5 reduce the time for official decisions to form companies to 30 days, a more than reasonable period since the formation of companies is a routine matter. As noted above, in the U.S. and Europe companies are formed in a day simply by filing required articles and statutes with the Companies Law authorities. Companies also will be legally instituted from the date of the decision also in keeping with world-wide trends in this field. Clause 6 reduces the time for approving amendments to statutes to 15 days.

(4) New Minimum Capital Requirements

Clauses 7, 10 and 11 provide new minimum capital requirements for investment companies taking the form of public shareholding, private shareholding and limited shareholding companies respectively to reflect current values -- YR 10 Million for public shareholding companies, YR 500,000 for private shareholding companies and YR 250,000 for limited shareholding companies.

(5) Authorized But Unissued Capital Permitted for Shareholding Companies

Clause 8 provides a very important new advantage to shareholding companies, allowing them to provide in their statutes for an authorized capital of up to three times the amount of issued capital (shares) and permitting issued capital to be increased up to the level of the authorized capital by a vote of the board of directors instead of requiring the statutes to be amended each time the capital is increased by a vote of the extraordinary general meeting of shareholders. This clause also reflects a world-wide trend and is also found in the 1981 Companies Law reform enacted by Egypt. The objective is to make increasing capital easy and not difficult.

(6) Investment Companies Can Be Capitalized in Foreign Currency or Yemeni Rials

Clause 12 allows companies to be capitalized entirely in foreign currency or Yemeni Rials or both as the statutes may provide. Egypt also allows companies to be capitalized in foreign currency. Also established are rules for recording the currency of capital contributions in the company's books.

(7) Maximum Value of Share Increased to YR 100,000

Clause 13 raises the maximum face value of shares to YR 100,000. It is difficult and expensive for companies to have to have low value shares especially in joint venture situations where there are a small number of partners. Companies need flexibility in this area.

(8) Shares May Be Issued at a Premium

Clause 14 allows shares to be issued at a premium over the face value so long as this fact is recorded. Again, companies should be able to raise capital

easily, and if their shares turn out to command a better price than the face value, they should be able to benefit from that good fortune.

(9) Priority Rights of Existing Shareholders to Shares Transferred by Any Means

Clause 15 makes clear that existing shareholders can provide in the statutes that they can exercise a priority right to shares of a partner transferred by any means including gift, inheritance and seizure by creditors. Though joint ventures often take the form of a shareholding or limited shareholding company, they are still partnerships among people or companies who trust each other, but might not get along with another person to whom the shares are transferred, even if the transferee is a relative of the partner. This provision will be very reassuring to foreign investors. It expands a provision which is already in the law, Article 102 of Law 106, to cover all possibilities. Naturally, transfers cannot be stopped, but they can be made subject to a priority right.

(10) Directors Need Not Be Shareholders

Clause 16 eliminates the requirement that members of the board of directors be shareholders. Again, this is part of a world-wide trend. One of the advantages of shareholding companies and limited shareholding companies is that the management can be separate from the ownership of the shares. Of course, the management remains under the control of the shareholders since all board members must be elected by the shareholders. If the shareholders want to elect someone to the Board who is not a shareholder, then they should be allowed to do so.

Companies in the U.S. and Europe do not require that directors be shareholders, and foreign investors find it extremely burdensome to make each director a shareholder. This is especially true since foreign investors are usually companies themselves and must appoint natural persons to the board who cannot be shareholders without the burdensome and unnecessary routine of providing them with so-called "guarantee" shares.

(11) Shareholders Must Be Represented on the Board in Proportion to Their Shares

Clause 17 ensures that shareholders will be represented on the board in proportion to their shares. This

ensures that a shareholder owning only 51 percent of the shares will not be able to elect all members of the board.

(12) Exemptions From Companies Law 106 Provisions

Clause 18 exempts investment companies from certain provisions of Companies Law 106 as follows:

(a) Article 112, Paragraphs B and C

These provisions unnecessarily restrict a company's flexibility in issuing loan bonds by requiring that the capital be fully paid and that previous bond subscribers have paid their value in full. At a time when the country is trying to mobilize savings and capital for investment, companies need all the flexibility that they can get. If potential bondholders do not like the fact that the company's capital or prior bonds are not fully paid, they will not buy the bonds unless the company does whatever is required to remedy the matter or make the new bond offering attractive. A company can still be in excellent financial condition, even if its capital and prior bonds are not fully paid.

(b) Article 121, Paragraph B

This clause requires that members of the board be shareholders, an unnecessary and inconvenient requirement as discussed under number 10 above.

(c) Article 126, Paragraphs A and B

These paragraphs require that the majority of board members be of Yemeni nationality. Egypt also exempts its investment companies from nationality requirements for board members as do most other countries. If Arabs and foreigners are to be allowed to hold a majority interest in investment companies, then logically they must also be able to name whoever they wish to the board, regardless of nationality.

(d) Article 128

This article requires that if the government or the public sector owns any shares whatsoever in a company, they are entitled to permanent positions on the Board of Directors, a rule which is incompatible with the rule of Article 9 of the

Draft Investment Law that investment projects will be treated as being in the private sector even if the government or the public sector owns up to 75 percent of the project. For purposes of the Investment Law the government and the public sector must be treated like any other shareholder. They are entitled to occupy positions on the board in proportion to their participation in the company like other shareholders but no more. It does not make sense that if the government or the public sector owns one out of a thousand shares of a company that they become entitled to a permanent position on the board.

(e) Article 130, Paragraph C

This clause prevents an individual from being a director of more than two public shareholding companies, an unnecessary restriction. The shareholders should have the freedom to elect whomever they wish to the Board and they can decide whether they want someone who already is a member of several boards of directors. Many foreigners and Arabs are directors of more than one publicly-held shareholding company. Egypt also exempts investment companies from a similar provision of its companies law.

(f) Article 134

This article requires that all members of the board of directors except government representatives and corporations hold "guarantee shares" while they are on the board of directors, an extraordinarily burdensome requirement for investment companies as discussed under item 10 above.

(g) Article 137, Paragraphs C and D

These paragraphs restrict the remuneration of directors. This should be strictly a decision for the shareholders based on their assessment of the value of a director's contribution to the company. Note that the restriction of Paragraph B of Article 137 on the percentage of net profit to be allocated to the Board is retained, however.

(h) Article 141, Paragraph B

These provisions place unnecessary restrictions on the board of directors to enter into loan

agreements, sell or mortgage real estate owned by the company and absolve the company's debtors. The board of directors needs full powers to manage the company as they see fit limited only by restrictions contained in the company's statutes and directives by the general assembly of shareholders. The restrictions forbidding loans of greater than three years and mortgages are especially limiting when investment projects often require loans of five and ten years secured by mortgages of real estate and other assets. Egypt has removed these restrictions from all companies in its 1981 Companies Law.

(i) Article 194

This removes the requirement that amendment of statutes be approved by the Minister of Economy in light of the provisions of Clauses 2 and 3 of Article 70.B. of the Draft Investment Law shifting such decisions to the IPA Chairman or the IPA Director General after review by the Companies Registration Department and the IPA Executive Administration. See the discussion under number 2 above.

(j) Article 197

This article unnecessarily restricts the company from increasing capital until after the original capital is fully paid up. Most countries have eliminated this restriction, leaving the decision to potential buyers of the new shares as to whether this fact is important or not.

(k) Article 243

This article requires that limited shareholding companies have a fixed duration. Under the Draft Investment Law such companies have the possibility of unlimited duration thereby following world trends and taking advantage of one of the primary advantages of such companies. See the discussion under number 15 below.

(13) Powers of Chairman Reduced

Clauses 19 and 20 remove a number of powers from the Chairman of the Board as set forth in Article 142 of Law 106 and place them into the hands of the Board of Directors. Again, this is in keeping with a world-wide trend. The governing body of a shareholding company is

the board of directors who should have all of the power to manage the company, including the power to delegate their authority to anyone they choose and who may or may not be the chairman. In fact, the trend is that the Chairman is an honorary figure with power to call meetings and chair them but not much else. He is first among equals on the Board of Directors, but the management usually is delegated to a general manager or a managing director.

(14) Minutes of Board of Directors Meetings No Longer to Be Sent to the Minister of Economy

Clause 21 eliminates the requirement of sending minutes of board of directors meetings to the Ministry of Economy. This requirement exists almost no where in the world these days and represents an unwarranted interference by the government in the management of the company. While there are good reasons for sending minutes of shareholders meetings to the Ministry, eliminating the requirement for directors meetings will be a good signal to foreign and Arab investors.

(15) Unlimited Duration for Companies

Clause 22 allows shareholding and limited shareholding companies to be formed for an unlimited period of time in line with world trends. One of the advantages of a corporation as opposed to partnership companies is that they have an existence independent of their owners which can be unlimited in duration. There are some companies which are over two hundred years old and many, many which are over 100 years old. Removing the limitation on duration will be another reassuring signal to foreign investors.

(16) Directors of Limited Shareholding Companies May Be Organized as a Board

Clause 23 allows the statutes of limited shareholding companies to organize their directors -- where there are more than one -- like the board of directors of a shareholding company. This follows a similar provision in the 1981 Egyptian company law which has similar forms of companies. Of course, the company must notify the commercial register who is authorized to sign for it and what the restrictions on the managers are, if any.

(17) Minimum Vote for All Amendments Changed to Two Thirds

Clause 24 reduces the minimum percentage for any amendment to the statutes to two-thirds instead of requiring three-fourths for certain amendments. It is especially important for companies to be able to increase capital easily and a three-fourths majority is very difficult to achieve. Of course, the company's statutes can set a higher limit if the founders agree.

(18) Required Information on Company Stationery

Clause 25 requires companies to publicize certain key facts about their organization and capital on their stationery, a common requirement.

(19) Investment Companies Not Limited to 49 Percent Foreign or Arab Participation

Article 71 ensures that investment companies are not subject to the rule of the commercial law that foreign participation in enterprises cannot exceed 49 percent, an obvious conflict with the spirit of the investment law and a nagging ambiguity under Law 18.

Chapter 9

Free Zones

A. Free Zone Outside of the Country for Customs and Import Regulation Purposes

The Draft Investment Law adds this chapter to the Ministry's first draft to provide a framework for free zones in the event that the decision is made to establish them. The main concept of a free zone, of course, is that of an area which is within the borders of the country but outside of its customs territory. Accordingly, as is set forth in Articles 75 and 77, foreign goods and foreign currency can move between the free zone and international markets freely without being subject to customs duties and the usual import and exchange control rules.

Conversely, for purposes of the movement of goods between the free zone and the customs territory of the country, Article 76 treats the free zone as though it were a foreign country. Accordingly, goods shipped from the free zone into the country are treated as imports and subjected to customs duties on all foreign inputs, and goods shipped from the

country into the free zone as exports. Article 79 provides that for the purpose of determining the tax exemption for exports under Article 41.A. of the Draft Investment Law, however, only exports to foreign countries from both the free zone and the country will be counted, and that goods moving between them shall not.

B. Means of Establishing Free Zones

Article 72 provides for the means of establishing free zones by Cabinet decree along the lines of similar legislation in Egypt. An entire city may be made into a free zone only by a law, however.

C. Advanced Features of Draft Investment Law on Free Zones

The Draft Investment Law provides a considerable advance over the Egyptian law in the following respects:

(1) Free Zone Production for Exports Only, Not for the Y.A.R. Domestic Market

Paragraph B of Article 72 makes clear that the only purposes of the free zones are for the export of products and services and that free zone products will be sold into the country only under highly restricted circumstances. In this regard, Egypt's free zone industries have produced primarily for the Egyptian market. Producing for the domestic market in Y.A.R. free zones would not be allowed under the Draft Investment Law.

(2) Provision for Privately-Owned and Operated Free Zones

Article 72.A.(2) of the Draft Investment Law allows flexibility for having privately-managed free zones as well as publicly-managed free zones, reflecting a world-wide trend. The Egyptian law allows for setting up individual free zone projects within the country, a policy which has odd results. For example, there is a bank located in the middle of Cairo which is a "private free zone" all to itself. Whenever one stepz into the bank, he steps out of the customs territory of Egypt. The purpose of this is not clear. Yet there is no provision for having a large free zone with many projects which could be privately-owned and managed under suitable controls.

(3) Free Zone Goods Not Taxed

The Egyptian law places a tax on the movement of goods into and out of the free zone, which hits at the very

purpose of the free zone. The Draft Investment Law gives free zone projects the same rights and privileges of other investment projects, which means that they will eventually pay profits taxes. But, since free zone projects will be primarily export industries after their tax exemption period expires, they should pay only fifty percent income tax on revenues earned from exports to foreign countries under the provisions of Article 41.A.

(4) Finally, Management and Infrastructure Fees

Article 80 provides for payment of management fees by projects not to exceed 0.3 percent of annual gross sales, similar to projects in the free zones of Taiwan and an infrastructure fee to cover the costs of developing the free zone on a pro rata basis spread over 25 years, in addition to rent. Of course, care would have to used in establishing these charges to make sure that the Y.A.R. acquires and maintains a competitive edge in attracting industries to its free zone, especially in light of the nearby free zone in Aden and industrial estates in the United Arab Emirates.

(5) Power of IPA to Requisition Land for Free Zones on Payment of Fair Compensation to Property Owners

Note also that Article 49.E. gives the IPA power to obtain private land by requisition upon payment of fair compensation to the property owner for the purpose of establishing free zones, as well as industrial estates, tourist village and complexes and other investment facilities which would be within the customs territory of the country.

Chapter 10

General Provisions

This chapter covers various miscellaneous general provisions, namely amendment of schedules, project and investor obligations, technology transfer rules and notices and communications.

Article 81 - Amendment to Schedules, New Fixed Asset Values and Paid-In Capital Amounts

A. Amendment by Cabinet Decree Only Once Every Five Years of Schedules 5, 6, and 7 and of Fixed Asset Values and Paid-In Capital Amounts for Certain Tax Exemptions

Paragraph A of this Article permits amendment by Cabinet decree on recommendation of the IPA of Schedule 5 defining investment zones for purposes of Article 37.C. tax exemptions, Schedule 6 specifying with particularity high priority projects for which a ten-year tax holiday would be granted and the amounts for new fixed assets and paid-in capital established for the tax holidays in Articles 36, 37.A.(2) and 37.B. and 46.A.(4) and the categories of projects requiring IPA special review set forth in Article 61.A.

To ensure stability, it is necessary to makae such amendments only once every five years. The idea is to have both flexibility to adjust in the light of experience but to assure investors that there will be stability for a substantial period of time. In the long run, the less these schedules can be amended, the better, to avoid causing investors to delay investment decisions while they see how the schedules are going to be amended.

B. All Other Schedules May Be Amended by the IPA Board Only Once Every Three Years

Article 81.B. allows all other schedules to be amended by the IPA Board, but only once every three years, again to maintain stability.

C. Cabinet and IPA Board Amendments May Not Change the Law or Adversely Affect Vested Rights

Article 81.C. provides assurance to investors that schedules cannot be amended to take away existing rights or to change the intent of the law to encourage, promote and facilitate investment.

Article 82 - Obligations of Projects or Investors

A. Investor Obligations

This article spells out the obligations of investors to:

(1) Notify the IPA prior to commencing production;

(2) Maintain complete and accurate books and records;

(3) Keep separate accounts for merged projects;

(4) Provide the IPA with:

(a) Annual statements of the Article 21 foreign currency account;

(b) Annual balance sheet, profit and loss statement and report of activities; and

(c) Data and information reasonably requested within thirty days.

(5) Allowing IPA designated officials access to the project premises during normal working hours to carry out reasonable inspections for insuring that a project is meeting its obligations under the law.

B. Data Requests and Inspections Must Not Amount to Needless Harassment of Projects

The IPA should be mindful, however, that data requests and inspections should be made only for very important reasons. Supplying data to government agencies and undergoing inspections is time-consuming and expensive. If data requests or inspections amount to needless harassment, the Y.A.R.'s world competitive position for attracting investment could be seriously impaired.

Article 83 - Rules Relating to Technology Transfer

A. Technology Transfer Agreements Enforceable in the Y.A.R.

Paragraph A of this article provides assurance to foreign transferors of technology that their agreements with projects in the Y.A.R. will be enforceable, giving them access to both Y.A.R. courts and the arbitration procedures set forth in Chapter 13 of the Draft Investment Law.

B. Taxation of Technology Transfer Fees

Paragraph B provides for taxation of technology transfer fees following the end of the three-year tax holiday established in Article 33.A.(6). Because it is very difficult for tax authorities to establish what the profit on technology transfer fees are, it is best just to set them out very clearly so that everybody knows what the rules are and can plan accordingly. Predictability is very important in reassuring investors in an investment law. Uncertainty is one of the greatest disincentives to investment.

C. The Suggested Tax Rates Track Those Established in Treaties Between States for the Prevention of Double Taxation

The rationale for the suggested rates is that they closely track what often is found in treaties for the prevention of double taxation. They are set slightly lower, however, because at this stage the Y.A.R. wants to encourage technology transfer. At the same time, the Y.A.R. is entitled to obtain some tax revenues from them.

D. Trademark Royalties

Since trademark royalties are normally mostly profit, they are set at 20 percent. Trademarks nevertheless can be an important form of technology transfer because a lot of money and effort has gone into promoting the trademark and ensuring that its worth is maintained by keeping up high quality production standards. Accordingly, projects who are licensed to use trademarks are required and usually taught to maintain a certain standard of quality. Since quality standards are among the most important aspects of production, this can be one of the most important aspects of technology transfer.

E. Royalties for Patents and Know-How

The tax on patent and know-how royalties is set at 10 per cent, since they often have a lot of research and development expense behind them and, in any event, their use in the Y.A.R. is something to be encouraged.

F. Technical Assistance Fees

Technical assistance fees are for experts sent to the Y.A.R. to provide assistance on the spot or by telephone, telex or telefax and entail continuing expenses by the transferor and are one of the most desireable forms of technology transfer. The tax on such fees also is set at 10 percent because of the on-going expense in providing technical assistance and because it is another highly desireable form of technology transfer.

G. Management and Marketing Fees

Management and marketing fees are for on the spot services and also entail expenses in providing the services. Management and marketing "know-how" also is an important form of technology and should be welcomed. The tax rate is set at 15 percent in recognition of the costs of providing the service.

Article 84 - Notices and Communications

This article simply sets forth rules for how notices and communications should be sent and when they will be deemed received. The article encourages sending notices quickly by hand delivery or by electronic means such as telex and telefax, but cables are not among the permitted means of communication because it is difficult to know whether they have been received.

Chapter 11

License Cancellation, Withdrawal of Rights and Penalties

A. Grounds for Cancelling License or Withdrawing Rights

Taken largely from similar provisions in the Ministry's drafts, Article 85 sets out the grounds for cancelling a license or withdrawing rights as follows:

(1) Where a project fails to adhere to the conditions of the license; or

(2) Where the license or right was granted on the basis of false information; or

(3) Where a right or license is applied for other than authorized purposes; or

(4) Where a project knowingly or recklessly violated the law.

B. Court Order Required to Cancel License Under Article 19

Note, however, that a license may not be cancelled by administrative decision alone but only by a court order after a judicial hearing pursuant to Article 19 of the Draft Investment Law. This is an important guarantee for investors that an impartial judge will determine whether the grounds for cancellation exist. As noted under Article 19, for an investor who has invested in the country, cancellation of a license can mean the same thing as confiscation or nationalization. If the IPA has solid grounds for cancelling the license, then the court will order it cancelled if the IPA proves its case. Moreover, Article 19.B.(2) provides the IPA with the right to an expedited procedure for cancelling licenses.

C. Penalties

Article 86 sets out penalties for various violations of the law as follows:

(1) Knowingly or recklessly providing false information to obtain any license or right or exemption under the law is subject to fines of up to YR 500,000 and five years imprisonment plus returning the value of the right obtained.

(2) Any application of a right or license for any unauthorized purpose is subject to fines of up to YR 200,000 plus payment of twice the value of the right received.

(3) Wrongful disposition of imported assets is subject to the same fines as described in number 2 above plus paying twice the customs duties and fees due.

(4) Government officials who disclose secret information about projects without authorization are subject to a fine of up to YR 100,000 and imprisonment of up to two years.

(5) Government officials who engage in unwarranted obstruction or harassment of an investment project are subject to suspension from duty or reduction in rank and a fine of up to YR 50,000.

(6) Violation of all other provisions of the law are punishable by a fine of up to YR 100,000.

D. Treatment of Violations by Companies

Where an offense is committed by a company, Article 86.B. subjects the company itself to the applicable fines and officers of the company who perpetrated the offense or who knew of it and failed to report it to both the applicable fines and prison terms.

E. Prosecution of Investment Projects Requires Approval or Request of the IPA Chairman

Article 86.C. provides that all criminal complaints against investment projects must be requested or approved by the IPA Chairman in writing.

Chapter 12

Administrative Appeals and Remedies

Chapter 12 establishes a system of administrative appeals for investors and projects as follows;

A. Appeal Decisions by the IPA Executive Administration and Board

Taken from similar provisions in the Ministry's first draft, Article 87 allows investors to appeal decisions of the IPA Executive Administration to the IPA Board, whose decisions can then be appealed to the Minister and in turn to the Prime Minister as appropriate.

B. Complaints Against Government Organizations

Article 88, adapted from the Thai Investment Promotion Law, then provides that any investor or project which encounters difficulties or obstacles with another government agency may submit a complaint to the IPA. If the IPA is unable to resolve the matter, it can be appealed to the Minister and, again, in turn to the Prime Minister, who is then authorized to order any Government Organization or official to render any assistance the Prime Minister deems appropriate.

Under Article 88.C. such Government organizations or officials must comply with the Prime Minister's order within ten days or notify him in writing of all reasons in details why the order cannot be complied with. The Prime Minister can then take any appropriate action in light of the reasons given. Meanwhile, even without an investor complaint, the IPA can take action to report or eliminate obstacles to investment through the Minister and then the Prime Minister.

C. Appeal of Government Decisions to Court or Arbitration Panel Under Chapter 13

Finally, Article 89 makes clear that any Government decisions may be appealed to a Y.A.R. court or to an arbitration panel under Chapter 13 at any time without the need to complete the administrative appeal process set out in Chapter 12.

Chapter 13

Settlement of Disputes Concerning Projects

A. Overall Importance of Dispute Settlement Provisions to Reassure Investors

This is another extremely important chapter of the Draft Investment Law and expands on the provisions in the first Ministry draft calling for arbitration of investment disputes arising from the implementation of the law pursuant to the rules of the judicial jurisdiction. Few matters are more important to investors than security in knowing that any disputes they have with the government, with local partners and with suppliers, customers, employees and others will be tried fairly and objectively. Accordingly, investment laws of many countries contain commitments by the government to settle disputes with investors through one of several means of international arbitration. See for example the investment laws of Tunisia, Egypt, Singapore and Ghana.

B. Reasons for Governments to Commit to Settle Investment Disputes by Arbitration

A commitment by a Government to arbitrate disputes with investors sends a strong message of reassurance to investors that the government is serious about attracting investment into the country. There are three good reasons for this as follows:

(1) Guarantee of Neutrality

For one thing, a government commitment to arbitrate investment disputes provides assurance to investors that a dispute will be heard on neutral ground. In the case of the Y.A.R., for example, the problem is not that the country's courts might not be reliable or consistent or fair to foreign investors, but that Arab or foreign investors simply do not know the local courts. Because at this point very few foreign investors are familiar with the Y.A.R., it is important for the Government to agree to having investment disputes resolved by international arbitration.

(2) In Arbitration, Disputes Can Be Settled by Experts in the Subject Matter of the Dispute

Another good reason for such a commitment is that arbitration provides a means of having disputes settled by experts in the subject matter of the dispute. Investment and commercial disputes are often complex and difficult matters to understand and resolve and may

put a difficult burden on a court which is not used to considering them. Thus, arbitration offers an assurance of expertise as well as neutrality in settling disputes.

(3) Expedited Settlement of Disputes

Finally, many disputes are referred to arbitration in many countries because it is felt that they are resolved more quickly. In many places courts taken years to resolve disputes simply because they are overburdened with cases. Whereas courts in many countries used to resent dispute settlement by arbitration as an infringement on their jurisdiction, they now welcome it as a way to reduce their own case load.

C. For the Same Reasons, It is Helpful to Allow for the Settlement of Disputes Between Private Parties by Arbitration

So, for the three reasons of offering assurances of neutrality, expertise and speed in resolving disputes, it is wise for an investment law to commit the government to settling disputes with investors through arbitration. For the same reasons, it is also wise to allow investors to settle disputes among themselves and with other third parties through arbitration, provided that such parties agree to do so in writing. The government's agreement to do so, of course, is contained in the law to begin with. Of course, if investors or projects prefer to settle disputes through the courts, then the law must provide for that also.

D. Review of the Scheme of Dispute Settlement Under the Draft Proposed Law

(1) Generally Disputes May be Settled by Litigation in the Courts or by Binding Arbitration.

Article 90 of the Draft Investment Law provides that disputes can be settled either by litigation or by binding arbitration as set forth in the Chapter.

(2) Government Agreement to Settle Disputes With Arab or Foreign Investors by Litigation or Arbitration According to the Investor's Choice

In Article 91, the Government specifically agrees to settle disputes with foreign or Arab investors or any investment project by the means chosen by the investor or the project, as the case may be, either by litigation in the Y.A.R. courts or by arbitration

within the framework of any of the following means as listed in Article 91.B.:

(1) The Arab Organization for Investment Guarantee Agreement; or

(2) The Convention for the Settlement of Investment Disputes between States and the Nationals of Another State; or

(3) Any other international or bilateral agreement to which the Republic is a party; or

(4) The rules of procedure for commercial arbitration of the United Nations Commission on International Trade Law (UNCITRAL), at the nearest Regional Center for International Commercial Arbitration operating pursuant to such rules; or

(5) The rules and procedures set forth in Article 95 of this Law for binding arbitration in the Republic.

Note that the first four of these provide for international arbitration -- that is, arbitration in a neutral site, although of course the parties could agree to holding the arbitration in the Y.A.R. under, say, the UNCITRAL Rules or the Convention for the Settlement of Investment Disputes, instead of Cairo, for example, or Geneva. The fifth provides for arbitration within the Y.A.R. under the Rules set forth in Article 95 of the Draft Investment Law.

(3) <u>Rules for Arbitration of Disputes in the Y.A.R. Under the Investment Law</u>

Skipping ahead, Article 95 sets out a mechanism for arbitration within the Y.A.R. where no other means are agreed. The provisions of Article 95 have been drafted with a view to resolving some problems with Arbitration Law 33 of 1981, namely, that law requires the unanimous agreement of all three arbitrators to be binding on both parties and there is some uncertainty whether the Y.A.R. courts are obliged to enforce an arbitration award without reconsidering the entire case themselves in which case the arbitration proceedings would have been a wasted effort. Also, Arbitration Law 33 does not set out a detailed procedure covering the entire proceeding. Accordingly, Article 95 establishes the following machinery for binding arbitration of disputes involving investment projects where no other rules have been chosen:

(a) Three-Member Arbitration Panel

Article 95 provides for constituting a panel of three arbitrators with each party naming one and the two then agreeing on the third or, failing agreement, appointment by an "Appointing Authority" which would be either someone agreed to by the parties or the IPA director general;

(b) Proceedings Governed by UNCITRAL Rules

Once constituted in accordance with the time frame specified in the Article, the Panel will proceed according to the Rules for Commercial Arbitration of the United Nations Commission on International Trade Law (UNCITRAL) currently prevailing at the time of the dispute. These rules are perhaps the best and fairest rules overall in the world and have been adopted by many countries as their own rules, including many states of the United States of America.

(c) Final and Binding Awards by Majority Vote of the Arbitrators

Article 95.L. specifically provides that awards shall be by majority vote and shall be final and binding on both parties and enforceable as a final judgment.

(d) Disputing Parties Can Agree to Alter Any Procedure

Finally, Article 95.M. provides that, by agreement in writing, the parties can alter any of the procedures, or appointments or the proceedings at any time.

(e) Agreement to Arbitrate Required

Under Article 95.A., the only condition for using the arbitration procedures is an agreement in writing between the parties which may be made in advance or at any other time and may be part of any other written agreement or contract including Company formation documents. In the case of the Government, however, the Law itself is the agreement to arbitrate, and the foreign or Arab investor or the Project, as the case may be, could proceed directly to these provisions or directly to one of the other means of arbitration listed in Article 91.B.

(3) Government Agreement to Settle Disputes With Yemeni Investors by Litigation or Binding Arbitration Under Article 95 as Chosen by the Investor

In Article 92, the Government agrees to settle disputes with Yemeni investors by either of two means chosen by the investor, either litigation in the courts or binding arbitration according to Article 95, as discussed above. As in the case of foreign and Arab investors, the law itself would be considered the Government's agreement to arbitrate the dispute if the investor so chose.

(4) Arbitration of Disputes Between Investors in the Same Project or Between Projects and Third Parties

Article 93 provides that disputes between investors within the same project or between a project and any other party could be settled by arbitration pursuant to a written agreement by any means including the Article 95 rules or the rules and procedures of any existing institution providing machinery for commercial arbitration including, but not limited to, any Regional Center for Arbitration operating in accordance with the rules for commercial arbitration of the United Nations Commission on International Trade Law, the International Chamber of Commerce in Paris, the London Court of Arbitration or the American Arbitration Association. All of these organizations have well-established, excellent machinery and rules for proceeding and private parties should have the opportunity of choosing any of them which they wish. If private parties do not agree to arbitrate, then Article 92.B. guarantees them access to the courts of the Y.A.R.

(5) Assurance to Investors That Arbitration Awards and Judgments are Binding on All Parties Including the Government

Article 94 assures investors that final arbitration awards or court judgments, as the case may be, will be binding on all parties and will be complied with and obeyed by all disputing parties including the Government and all ministers, organizations and officials. This assurance that the government will abide by whatever means of dispute settlement is chosen is very important to promote investor confidence. This is especially important in the light of the Y.A.R.'s relatively low rating in this area according to the

study cited above. Even if it were not the case, however, the assurance would be an important one.

(6) Assurance to Investors That Y.A.R. Courts Will Enforce Arbitration Awards Without Retrying the Dispute

Article 94.B. then requires the Y.A.R. courts to enforce any arbitration award presented to it rendered in accordance with any of the other articles of Chapter 13 as though it were a final and nonappealable judgement rendered by a competent Y.A.R. court. Such enforcement must take place immediately and without delay and without considering the facts of the dispute or the arbitration procedures -- in other words, enforcement is to occur without rehearing the case. The only ground for not enforcing the award would be clear and convincing evidence that the award was based on fraud or corruption by the arbitrators, in which case the dispute would again be decided by binding arbitration according to the same procedures unless the parties agree otherwise. This assurance is important in light of the current uncertainty as to whether the courts will enforce arbitration awards in the Y.A.R. It is an important reassurance even if this were not a problem, because the courts of some other countries in the region have refused to enforce arbitration awards.

Chapter 14

Transitional Provisions

This chapter contains some extremely important provisions as follows:

Article 96 - Informal Publication of the Law

This article requires that immediately following promulgation of the law, even before its publication in the Official Gazette. The Minister will make copies of the Law and distribute them to all government offices and to the public upon request. This is important because we understand that the Official Gazette is many months behind in publishing laws. Pursuant to Article 1.B., the law would go into effect 90 days after its promulgation which could well be before its publication.

Because the effective implementation of the law depends upon compliance by all government organizations and officials and not just the IPA and the Ministry of Economy, it must be distributed, read and understood by all government officials as soon as

possible. Note again that this is required specifically by Article 5.A.(2)(b). Moreover, it is important for the public to have access to the law as soon as possible, so that the law can begin its primary function of encouraging and promoting investment in the Y.A.R.

Article 97 - Functions and Authority of the IPA Pending Establishment

This article provides that pending the establishment of the IPA, its functions, powers and authority shall be exercised by the Ministry of Economy; that of the IPA Chairman, by the Minister; that of the IPA Board, by the Law 18 Investment Exemption Committee; that of the IPA Executive Administration, by the General Department of Investment of the Ministry; and that of the IPA Director General, by the General Director of the Investment Department. This will allow the law to be enforced immediately upon its effective date by the above organizations and officials in the event that the IPA has not yet been established at that time. This article also provides that upon establishment of the IPA, the General Department of Investments will be transferred to the IPA.

Article 98 - Law 18/1975 Investment Projects

This article provides a procedures by which projects previously established under Law 18 can elect to be governed by the new law except for the Article 33.A. profits tax exemption granted to all newly licensed projects.

Article 99 -Cancellation and Modification of Laws

A. Investment Law 18/1975

Article 99.A. cancels Investment Law 18 of 1975 except to the extent that projects established thereunder do not choose to be governed by the new law and to the extent that the Investment Exemption Committee established by Article 20 of Law 18 acts as the IPA Board pending establishment of the IPA itself pursuant to Article 97.

B. Industry Law 20/1976

Article 99.B. provides that from the effective date of the new law all industrial projects will be licensed under the new law and that all provisions of Law 20 of 1976 which conflict in any way with the new law or any of its provisions will be cancelled or modified to the extent required to give full effect to the new law.

C. <u>All Other Laws Cancelled or Modified to the Extent Necessary to Give Full Effect to the New Investment Law</u>

Article 99.C. provides that there will be no conflicts with any existing laws, decrees, regulations, requirements, guidelines or orders by specifically stating that all conflicting provisions of any of them will be cancelled or modified to the extent required to give full effect to the new law. This rule applies to all laws and regulations including the following:

(1) Commercial Law 39 of 1976; and

(2) Companies Law 106 of 1976; and

(3) Foreign Ownership of Real Estate Law 114 of 1976; and

(4) Labor Law 5 of 1970; and

(5) Fisheries Law 20 of 1978; and

(6) Tourism Law 34 of 1981; and

(7) Import/Export Law 23 of 1975; and

(8) Commercial and Industrial Profits Tax Law 11 of 1972; and

(9) Employee Income Tax Law 20 of 1974; and

(10) Capital Transfer Tax on Foreigners Law 48 of 1976; and

(11) Real Estate Tax Law 21 of 1976; and

(12) Stamp Duty Law 6 of 1979; and

(13) Judicial Power Law 28 of 1979; and

(14) Commercial Court Law 40 of 1976; and

(15) Commercial and Civil Litigation Law 42 of 1981; and

(16) Arbitration Law 33 of 1981; and

(17) All banking and exchange control laws, decrees and regulations.

Not cancelled, however, is any law or regulation which provides more favorable rights or exemptions to investment projects than the new law.

Article 100 - Issuance of Executive Regulations

This article requires the Minister to issue the Executive Regulations needed to implement the law within 90 days of its promulgation but ensures that implementation of the law will not be delayed by requiring the Responsible Authorities to proceed with implementation to the extent possible even in the absence of the Executive Regulations in the event that they are delayed.

Article 101 -Responsibility for Implementation

The article state simply that the Prime Minister and the ministers are responsible for implementing the provisions of this Law.

SECTION 6

OTHER OBSTACLES TO INVESTMENT IN THE Y.A.R.

6.1 Introduction

As noted in Section 2 above, no investment law by itself can eliminate all existing major obstacles to investment in any country, including the Y.A.R. The principal obstacles to investment, indeed, are those identified in Section 3 of this Report, which must be dealt with by policy changes outlined in Section 4, in addition to the new Investment Law: namely, elimination of price controls, exchange controls, import restrictions, and controls on banking and reduction of the public deficit. The purpose of this section is to address other obstacles not fully addressed by the draft investment law or by Sections 3 and 4.

6.2 Lack of a Well-Developed Banking and Savings System

Critical problems of law and banking policy affecting the Y.A.R. investment climate have already been addressed above in Sections 3.4, 3.5, 4.8, 4.9, 4.10 and 4.11 and in the commentary in Chapter 5 on Articles 20, 21 and 23.

A thorough analysis of the banking system and its needs is far beyond the scope of this report. Certainly a thorough study in this area should be undertaken with the help of the banking and business community. This section simply summarizes some of the needs which we have observed relating to the Y.A.R. banking infrastructure as follows:

(a) Need for Competition

A healthy investment climate requires a system of multiple, competing and efficient banks and savings institutions which act to mobilize the country's savings and make loans to finance investment. Currently, the system is dominated by a single public sector bank. More and competing banks and other financial institutions will be required to meet the needs of a dynamic economy. Banks are now excluded from the Draft Investment Law. Thought should be given to providing the incentives needed to attract more banks into the system -- including foreign banks.

(b) Need to Expand the Banking Network and Financial Services Throughout the Country

To mobilize savings for investment and to finance projects of all sizes, an effective banking network needs to be established which extends into all rural, as well as urban, areas. Perhaps this could be along the lines of the postal savings and agricultural cooperative systems of Japan or Taiwan. One quick way to expand the financial services system might be to legalize private money changers and exchange houses. They seem to be operating anyway, but their activities should be kept limited. They could provide financial services to small businesses and farmers.

Another way to expand the system might be to give the specialized banks -- industrial, agricultural and housing -- more incentives to take deposits, expand and do commercially profitable lending. In addition, pension funds and insurance companies should be developed as lending and investment institutions.

(c) Training and Use of Modern Banking Techniques

Given the existing disincentives to commercial lending discussed in the other sections of this report, banks are not using modern techniques of financial and credit analysis and operations. Rather, as noted above, they rely on obtaining excessive guarantees and collateral before making loans. This will change upon passage of the new investment law and the policy changes described in Section 4. To start functioning like modern banks, training of loan officers and bank managers will be required. Training should be extended as well to pension fund and insurance company managers as well, as these can be important sources of investible funds.

6.3 Infrastructure Needs

The importance of physical infrastructure to the overall investment climate is obvious. Roads, water systems, power, sewage, deep water port facilities, airports are all critical to encouraging investment. Indeed, one of the most successful incentives to investors have been the so-called "industrial estates" or "new urban communities" where governments develop industrial sites for factories complete with roads, water, power, and sometimes even buildings. Finding a site for a factory can be one of the most difficult challenges for an investor. When the government has already taken care of that problem, the decision to invest is much easier.

There are many examples of success in this regard. Thus, Egypt has established several desert industrial cities under its New Urban Communities Law 59 of 1979 such as Tenth of Ramadan City and Sixth of October City, to name two of the most successful. Similarly, Dubai has established a well-known industrial estate, and the "export free zones" of Taiwan are famous.

The Draft Investment Law provides for the establishment of industrial estates, new communities and free zones. While the initial investment by the Government is substantial, it can recover many of its costs in rent, infrastructure and management fees. The return on such an investment could be well worth it, for given proper management, such zones and estates could even be profitable.

6.4 Excessively High Internal Transport Costs

It is our understanding that internal land transportation costs are extraordinarily high in the Y.A.R. One business man said that it costs him almost as much to ship a machine from Hodayda to Sana'a as it did to ship the same machine from Hamburg, Germany, to Hodayda. We also understand that a transport union has managed to keep these high charges in effect through monopoly power. For the Y.A.R. to be competitive in attracting investment, it is important to keep the costs of non-traded goods and services such as transportation as reasonably low as possible. One solution is to encourage competition. Fortunately, the Draft Investment Law would allow for transportation projects if the Responsible Authority approves. Competition should bring prices down, unless they are being controlled by a monopoly that is too powerful. We recommend that this matter be thoroughly investigated and prompt and effective action taken for the sake of improving the investment climate of the country.

6.5 Low Literacy Levels

We understand that the literacy rate in the Y.A.R. is relatively low, but that significant progress has been made since the revolution. This is heartening. Few goals could be more important for the ultimate improvement of the investment climate than achieving 100 percent literacy within a reasonable time period. As noted above, a country's greatest resource is its people, and the best investment a Government can make is educating them. This has been the approach of other countries which have been successful in attracting investment: South Korea, Taiwan, Singapore and, of course, Japan all have literacy rates of 100 percent, considerably higher than the United States of America. While illiterate people are not stupid and can learn without knowing how to read, reading makes technology transfer that much easier and faster. If a farmer cannot read the instructions for his new seed, or fertilizer or harvesting machine, learning takes longer.

6.6 Business Education

To take full advantage of a new investment climate, Yemenis will need management training. One way will undoubtedly occur through technology transfer from foreign investors. But, long range, establishing a management training facility or graduate business school is an important possibility to consider. Indeed, business education at the clerical and secretarial level appears to be an urgent need. In this respect, including education projects within the scope of application of the new investment law is a wise decision.

6.7 Land Survey, Mapping and Recording

As noted above in the commentary on Article 10, the lack of clear and certain means of ascertaining title to land is an serious impediment to investment. While the Draft Investment Law Article 10 deals with the matter for investors, the ultimate solution is to survey and map every plat of land in the entire country and establish a modern land recording system based on the Australian system, so that all ownership interests in any plat of land could easily be ascertained by any member of the public.

6.8 Slow and Restrictive Visa System

To encourage investors (and tourists who sometimes become investors after they visit a country) it is important to have a system for obtaining visas quickly and easily. Visas in Washington and Cairo can take several days without the intervention of high officials and sometimes apparently are

denied for no apparent reason. Visas should take no more than a day and should be mainly to record who is visiting the country. If security is a major concern, that fact alone is bad for the overall investment climate. The best form of security, of course, is prosperity for the country. In this regard, the Egyptians have done an admirable job in moving from a closed to an open country and still maintaining excellent security.

Exit visas should be completely phased out. They are nothing more than a bureaucratic irritant for long-term tourists and potential investors and waste both the Government's time and the visitor's time. The open door to investment means an open door to visitors generally. Work permits are entirely another matter and are addressed by the commentary to Article 32 above.

SECTION 7

FOLLOW-ON ACTIVITIES NEEDED TO SUPPORT THE NEW INVESTMENT LAW

7.1 Introduction

The purpose of this Section is to set out the activities which should follow promulgation of the new investment law.

7.2 Informal Publication of the Law

Immediately upon promulgation of the new investment law, pending publication in the Official Gazette, the Minister of Economy is required by Article 96 to distribute copies to all government offices. Hopefully, this will be accompanied by a Government-wide campaign to have every official to read it, especially those directly concerned with investment. In addition, the Minister is required to make copies available to the public.

7.3 The Executive Regulations

Article 100 of the Draft Investment Law requires the Minister of Economy to issue the Executive Regulations within 90 days of the promulgation of the law. This will be the most immediate and important substantive task to ensure swift and smooth implementation of the new investment law. The Regulations will set down detailed procedures for achieving the Law's objectives.

7.4 Design of Forms and Models

Together with the Executive Regulations the following forms and models should be designed and prepared:

(a) The application form to establish an investment project. This form will be extremely important and should be designed with the help of an expert on social cost-benefit analysis of investment projects.

(b) Project change forms;

(c) Certificates for exemptions, rebates, profit transfers and other rights;

(d) Applications for certificates;

(e) Licenses;

(f) Notices to other responsible Government Authorities, investors and third parties;

(g) Model arbitration demand form;

(h) Request to the IPA Executive Director to appoint an arbitrator under Article 95 of the Draft Investment Law;

(i) Model articles of incorporation and statutes for investment companies;

(j) Model statement of movement in foreign currency account;

(k) Model financial statements;

(l) Model business records;

(m) Etc.

7.5 Observation Visits

As soon as is practicable, senior officials responsible for implementing the new law from the IPA, as well as the Customs Authority, should make observation visits to countries which have been successful in attracting foreign investment, such as Taiwan, Singapore, Thailand, Malaysia, Tunisia, and Ireland.

7.6 Training and Orientation

Following promulgation of the law and the executive regulations, it will be necessary to hold seminars and conferences on the philosophy, concepts and procedures of the new law to train and orient the following important groups:

(a) IPA officials charged with implementing the new law;

(b) Officials of other organizations who also will have contact with investors:

(1) Customs Authority;

(2) Tax Authorities;

(3) Companies Registration Department;

(4) Ministry of Labor;

(5) State Security;

(6) Immigration;

(7) Ministry of Foreign Affairs;

(8) Judges of the Commercial Court;

(9) Tourism Corporation;

(10) Ministry of Agriculture;

(11) Ministry of Transportation;

(12) Ministry of Health;

(13) Central Planning Organization;

(14) Ministry of Education;

(15) Ministry of Justice;

(16) Other Responsible Authorities;

(c) Yemeni businessmen and bankers;

(d) Commercial Attaches of Foreign Embassies

A prime objective of this training will be to replace generally negative official attitudes toward investors and investment projects with generally positive ones.

7.7 Review and Revision of Other Laws and Procedures Affecting Investment

As soon as possible, the Government should commence a program to systematically review and revise all laws affecting investment.

The following appear to require the most urgent attention:

(a) All banking laws and regulations;

(b) Companies Law 106 of 1976;

(c) Preparation of a new capital markets and securities exchange law;

(d) Commercial Law 39 of 1976;

(e) Commercial and Industrial Profits Tax Law 11 of 1972;

(f) Stamp Duty Law 6 of 1979;

(g) All other tax laws;

(h) Labor Law 5 of 1970;

(i) Arbitration Law 33 of 1981; and

(j) Laws and regulations relating to issuance of visas.

7.8 Review and Analysis of Tax Collection Administration and Procedures

It is essential that the Government reap substantial benefit from new investments in the country through increased tax collections. Accordingly, if action has not already been taken, the tax collection administrative machinery and procedures should be reviewed to determine whether and how it can be improved. Tax collection officials should be thoroughly briefed and oriented on how to handle tax collections from investors, projects and foreign transferors of technology. In this regard, and in connection with reviewing the tax laws as well, it would be useful to call upon an institution such as the Harvard International Tax Center which specializes in developing countries' tax legislation and training tax officials.

7.9 Establishment of an Economic Policy Analysis Unit Within the Government to Monitor and Advise on the Timing and Coordination of the Policy Changes Set Out in Section 4 of This Report

If there is not already an economic policy analysis unit -- i.e., a so-called "think tank" -- placed at a high level in the Government, such a unit should be established as soon as possible and should develop contacts with economic experts around the world.

Policy analysis units also should be established within each ministry.

APPENDIX A

CRITERIA FOR FOREIGN DIRECT INVESTMENT CLIMATE

1. EXCHANGE CONTROLS. Ease of access to the foreign exchange needed to conduct business. Use of multiple exchange rates.

2. REPATRIATION RESTRICTIONS. Severity of restrictions on repatriating profits and capital, including limitations and taxes.

3. APPROVAL PROCESS. The amount of time and expense involved in obtaining required bureaucratic approvals. Honesty and competence of the bureaucracy.

4. DOMESTIC ECONOMIC PERFORMANCE. Relative performance of GDP growth, inflation, unemployment, investment, and budget balance.

5. INTERNATIONAL ECONOMIC PERFORMANCE. Relative performance of current account and foreign debt.

6. LABOR CONDITIONS. Availability of adequate labor, level of wages, and the flexibility allowed business in the use of labor.

7. EMPLOYMENT OF NATIONALS. The existence and enforcement of quotas mandating employment of host country nationals. Requirements for local participation in management. Residence requirements for foreign nationals intended to limit expatriate employment.

8. INVESTMENT INCENTIVES. Scope and magnitude of incentives in the form of tax holidays, free trade zones and subsidies.

9. TAX RATES. Level of corporate taxes and overall tax burden. Discrimination against foreign firms in tax policy.

10. DISPUTE SETTLEMENT. Reliability of local courts and administrative agencies in resolving disputes. Discrimination against foreigners and foreign businesses as opposed to local interests; preference of some foreign investors over others. Availability of international dispute settlement and binding arbitration machinery for cases involving foreign business.

11. PERFORMANCE REQUIREMENTS. Regulations concerning local content, offsetting part of imports with exports, countertrade, barter, or devoting a percentage of production

to exports. Regulations concerning the use and sharing of technology.

12. CONTROLS ON OWNERSHIP. Percentage of ownership allowed. Number of sectors in which ownership is permitted. Requirements for joint ventures and regulations specifying that foreign assets be sold to local interests after a specified period of time.

13. SECURITY OF OPERATIONS. Threats from political turmoil, labor strife and crime

14. REGIME STABILITY. The degree of uncertainty over the composition of and change in the current government.

COUNTRY RANKINGS ON INVESTMENT CLIMATE

ACCORDING TO THE FOREGOING FACTORS

(5 IS THE MOST FAVORABLE SCORE AND 1 IS THE LEAST FAVORABLE)

RANK	COUNTRY	AVERAGE SCORE
1	SINGAPORE	4.7
2	HONG KONG	4.6
3	TAIWAN	4.4
4	SPAIN	4.3
5	BOTSWANA	4.1
5	IRELAND	4.1
5	MAURITIUS	4.1
5	SWAZILAND	4.1
5	THAILAND	4.1
10	KUWAIT	4.0
11	BARBADOS	3.9
11	CYPRUS	3.9
11	SAUDI ARABIA	3.9
11	TUNISIA	3.9
15	MALTA	3.8
15	SOUTH KOREA	3.8
17	MALAYSIA	3.7
17	PORTUGAL	3.7
19	CAMEROON	3.6
19	CHILE	3.6
19	COLOMBIA	3.6

RANK	COUNTRY	AVERAGE SCORE
19	IVORY COAST	3.6
19	LESOTHO	3.6
19	PARAGUAY	3.6
19	PHILIPPINES	3.6
19	SRI LANKA	3.6
19	TOGO	3.6
28	GABON	3.5
28	MOROCCO	3.5
28	PANAMA	3.5
28	SOUTH AFRICA	3.5
28	CONGO	3.4
32	COSTA RICA	3.4
32	FIJI	3.4
32	GHANA	3.4
32	GUINEA	3.4
32	HONDURAS	3.4
32	ISRAEL	3.4
32	JORDAN	3.4
32	JAMAICA	3.4
32	PAKISTAN	3.4
32	TURKEY	3.4
32	URUGUAY	3.4
44	ALGERIA	3.3
45	EGYPT	3.2
45	INDONESIA	3.2
45	SENEGAL	3.2
48	BERMUDA	3.1
48	DOMINICAN REPUBLIC	3.1
48	GUYANA	3.1
48	MEXICO	3.1
52	BANGLADESH	3.0
52	BOLIVIA	3.0
52	BURUNDI	3.0
52	CHAD	3.0
52	MADAGASCAR	3.0
52	MALAWI	3.0
52	VENEZUELA	3.0
59	BENIN	2.9
59	CENTRAL AFRICAN REP.	2.9
59	HAITI	2.9
59	INDIA	2.9
59	NIGER	2.9
59	ZAIRE	2.9
59	PAPUA NEW GUINEA	2.9
66	GREECE	2.8
66	KENYA	2.8
66	RWANDA	2.8
66	UGANDA	2.8
66	ZIMBABWE	2.8
71	CHINA	2.7

RANK	COUNTRY	AVERAGE SCORE
71	ECUADOR	2.7
71	EL SALVADOR	2.7
71	GAMBIA	2.7
71	SUDAN	2.7
76	ARGENTINA	2.6
76	BRAZIL	2.6
76	BURKINA FASO	2.6
76	GUATEMALA	2.6
76	MALI	2.6
76	NEPAL	2.6
82	ZAMBIA	2.5
83	LIBERIA	2.4
83	LIBYA	2.4
83	MOZAMBIQUE	2.4
83	NIGERIA	2.4
83	PERU	2.4
83	SYRIA	2.4
83	TANZANIA	2.4
90	SOMALIA	2.3
91	ETHIOPIA	2.2
91	NORTH YEMEN	2.2
91	SURINAM	2.2
94	IRAQ	2.1
95	BURMA	1.8

APPENDIX B

NEGATIVE FACTORS AFFECTING INVESTMENT FOR ARAB INVESTORS

CONTAINED IN:

THE REPORT ON THE INVESTMENT CLIMATE IN THE ARAB COUNTRIES 1988

BY

THE ARAB ORGANIZATION FOR INVESTMENT GUARANTEES

1. LACK OF ACCESS TO FOREIGN EXCHANGE
2. PRICE CONTROLS
3. RESTRICTIONS ON TRANSFER OF PROFITS AND CAPITAL
4. LACK OF LOCAL FINANCING RESOURCES AND CREDIT FACILITIES
5. UNSTABLE INVESTMENT LAW
6. BUREAUCRATIC DIFFICULTIES IN LICENSING
7. MULTIPLICITY OF GOVERNMENT ORGANIZATIONS OVERSEEING LICENSES FOR INVESTMENT PROJECTS' ACTIVITIES
8. DIFFICULTIES WITH GOVERNMENT AUTHORITIES IN IMPLEMENTING LICENSED PROJECTS
9. EXCESSIVE, CONFLICTING AND UNCLEAR LAWS
10. PUBLIC SECTOR CONTROL OF ECONOMY
11. WEAK PRIVATE SECTOR
12. COMPULSORY LOCAL PARTNER ARRANGEMENTS
13. NO LEGAL PROTECTION FOR FOREIGN INVESTED CAPITAL
14. RESTRICTION ON MOVEMENT OF PEOPLE
15. CLOSED ECONOMIC POLICY
16. UNCLEAR ECONOMIC POLICY
17. LABOR UNION DOMINANCE
18. HIGH PRODUCTION COSTS

19. FAILURE TO ADHERE TO AGREEMENTS WITH INVESTORS

20. UNCLEAR TAX EXEMPTION POLICIES

21. IMPOSITION OF LABOR ON PROJECTS

22. INABILITY TO FREELY OWN LAND AND PROPERTY FOR INVESTMENT PROJECTS

23. LACK OF TRAINED UPPER LEVEL CADRES

24. INABILITY TO OBTAIN HIGH DEGREE OF CONTROL OVER THE PROJECT

25. LACK OF ADEQUATE PROTECTION FOR LOCAL INDUSTRY

26. FAILURE TO RESPECT THE OWNERSHIP RIGHTS OF INVESTORS

27. EXCESSIVE GOVERNMENT CONTROLS

28. HIGH ENERGY COSTS

29. LACK OF POLITICAL STABILITY

30. INABILITY TO EARN A HIGH RETURN ON INVESTMENT

Chapter 1

Preliminary Provisions

Article 1 - Title

A. This Law is entitled the Investment Encouragement and Promotion Law No. ( ) of 198( ) AD.

B. This Law shall go into effect 90 days after its promulgation and shall be published in the Official Gazette.

Article 2 - Purposes

The purposes of this Law are:

A. To encourage, promote and facilitate investment of national, Arab and Foreign capital in the Yemen Arab Republic within the framework of the overall policy of the State and the objectives and priorities of the State's Socio-Economic Development Plan;

B. To organize and encourage investment, specifically in Projects in industry, agriculture, tourism, education, health, housing and construction, or any other economic sector which will lead to increased exports, domestic production, employment opportunities, and technological advancement, and which will add real value to the national economy;

C. To facilitate the establishment of Investment Projects and provide means to support them to ensure their prompt and effective implementation and operation so that they can participate in hastening the process of socio-economic development;

D. To render Yemen's economic environment more competitive for investment by providing guarantees, rights, facilities and exemptions to Investment Projects in a manner that encourages and promotes productive investment in the Republic; and

E. To establish a clear, stable and predictable legal and institutional framework for investment.

Article 3 - Definitions and Construction

A. Definitions

In applying the provisions of this Law, the words and phrases set forth below shall carry the meaning indicated, provided that the construction of the wording does not demand another meaning.

(1) "Republic" means the Yemen Arab Republic.

(2) "Government" means the Government of the Republic including all of its Ministries, Departments, Authorities, Agencies, Organizations and Officials.

(3) "Minister" means the Minister of Economy, Supply and Trade.

(4) "IPA" or "Authority" means the Investment Promotion Authority (IPA) established under Chapter 6 of this Law.

(5) "IPA Board" means the IPA Board of Directors.

(6) "IPA Chairman" means the Chairman of the IPA Board of Directors.

(7) "IPA Executive Administration" means the IPA's administrative office of managers and technicians working in IPA departments, sections and units under the IPA's organizational structure.

(8) "Government Organization" means any Government Ministry, Department, Authority or Organization.

(9) "Responsible Authority" means the government Organization or Official responsible for the sector in which a Project is working or is intended to be established, or depending on the context, for any matter relating to the Project or to the Project's rights, obligations or liabilities.

(10) "Executive Regulations" means the regulations to be issued by the Minister which include the detailed procedural provisions, instructions and rules required to implement this Law.

(11) "Investment Project" or "Project" means every activity of investment the primary purpose of which is to produce goods or provide services in the sectors described in Article 2.B. As used herein, depending upon the context, the term also includes the Investors

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in the Project and the Investment Company formed to implement it.

(12) "Agricultural Project" means a Project engaged in primary food production, that is, the production of crops and livestock.

(13) "Expansion" means increasing the productive capacity of a Project by the means described in Article 65.A.(1).

(14) "Upgrading" means replacement of worn out or obsolescent Project machinery and equipment, as described in full in Article 65.A.(2).

(15) "License" means the official authorization by the IPA for a Project's establishment, expansion or upgrading pursuant to Chapter 7 and includes License Amendments, amended Licenses, Import Licenses and all other Licenses and certificates issued by the IPA to enable a Project to obtain the Rights and Exemptions provided by this Law.

(16) "Licensed Project" means a Project licensed by the IPA to operate pursuant to Chapter 7 of this Law.

(17) "Investor" means every natural or corporate person, be he Yemeni, Arab or Foreign, who invests in a Project, or who holds or acquires any proprietary interest in a Project, or who wishes to establish a Project under this Law.

(18) "Investment Company" means the company formed by Investors to carry out a Licensed Project pursuant to Articles 60.E. and 63.H. and Chapter 8.

(19) "Right" means any right, guarantee, facility, privilege or exemption granted or provided to Licensed Projects by this Law.

(20) "Yemeni" means or pertains to a natural person who is a citizen of the Republic or a legal entity established under the laws of the Republic, the majority of the capital of which is owned by Yemeni citizens.

(21) "Arab" means or pertains to a natural person who is a citizen of an Arab country or a legal entity established under the laws of an Arab country.

(22) "Foreign" means of or pertaining to a "Foreigner," which in turn means a natural person who is a citizen of a Foreign country or a legal entity established under the laws of a Foreign country.

(23) "Fixed Assets" means all fixed assets needed for the establishment, expansion or upgrading of a Project including land, buildings, machinery, equipment, appliances, instruments, means of transport, tools, spare parts, laboratory installations, refrigeration equipment, air conditioning and ventilation equipment, safety equipment, buses designed specifically for tourism, fishing boats, furniture, and furnishings for schools, training institutes, hotels, restaurants, hospitals and clinics, regardless of whether they are imported or produced or purchased locally.

(24) "New Fixed Assets" means new Fixed Assets as defined in Clause 23 excluding land and existing buildings but including new buildings, prefabricated buildings and building materials.

(25) "Foreign Currency" means freely convertible Foreign currency.

(26) "Investment Cost" means the total costs of the elements comprising the fixed capital and the working capital needed to establish and operate or expand or upgrade a Project.

(27) "Foreign Invested Capital" means Foreign capital invested in a Project in any of the following forms:

(a) Foreign Currency and Foreign Currency denominated transferrable securities for the purposes of establishing a Project or purchasing or subscribing to shares in a Project;

(b) The Republic's currency invested in a Project which has been obtained pursuant to a debt-to-equity conversion whereby the Investor has purchased a Foreign Currency obligation or debt of the Republic and exchanged such obligation at its face value for the Republic's currency ;

(c) New Fixed assets imported from abroad as an in-kind contribution to the capital of a Project;

(d) Foreign intangible rights such as patents, trademarks and other intellectual property stipulated for use in the Project and registered in the Republic, or with a recognized international organization or which are protected under an international or bilateral agreement to which the Republic is a party;

(e) Profits and gains realized from Foreign Invested Capital in the Republic and transferred to the paid-in capital of the Project or invested in another Project.

(28) "Yemeni Invested Capital" means:

(a) The Republic's currency invested by a Yemeni citizen or by a Yemeni legal entity the majority of which is owned by Yemenis;

(b) Local intangible rights and assets such as patents, trademarks and other intellectual property registered in the Republic;

(c) Profits realized from the investment of Yemeni Invested Capital and transferred to the paid-in capital of the Project.

(29) "Foreign or Arab Participation" means the proportion of total capital of a Project owned and contributed to by non-Yemeni Foreign or Arab Investors.

(30) "Yemeni Participation" means the proportion of total capital of a Project owned and contributed to by Yemeni Investors.

(31) "Application" means the Application to Establish an Investment Project required by Article 59.A.

(32) "Bank" means any commercial, specialized or other bank authorized to operate in the Republic.

(33) "Service Fees" means fees imposed in exchange for services or a benefit actually received such as harbor or storage fees and the like.

(34) "Customs Duties, Taxes and Fees" means all duties, taxes, charges and fees of any kind imposed on exports or imports, including without limitation, export or import duties, defense tax, statistical tax and earthquake reconstruction tax, and any other duty, tax, fee or charge whatsoever imposed on or in respect of exports or imports other than Service Fees in exchange for an actual benefit or service.

(35) "Customs Territory" means the territory of the Republic, excluding free zones established pursuant to Chapter 9, where imports or exports are subject to Customs Duties, Taxes and Fees according to prevailing law and regulations.

(36) "Days" means days on which Government Organizations are working and excludes Fridays and official holidays.

(37) "Major Change" in a Project has the meaning set forth in Article 64.B.

(38) " Project" means Investment Project as defined in Clause (11) above.

(39) "Project Representative" means the representative of a Licensed cr proposed Project designated as such in the Project Application or by written notice to the IPA.

(40) "Products" means anything produced by a Project and includes goods, services, and housing and other buildings or installations.

(41) "Production Materials" means all materials required for a Project to operate or produce in the ordinary course of business including, without limitation, all raw and intermediate materials, spare parts, maintenance materials, tools and supplies.

(42) "Tax Exemption Period" means the period for which a Licensed Project is exempt from profits and real estate taxes as described in Article 33.A.

(43) "Technology Transfer" means:

(a) The licensing, assignment, sale and use of patents, know-how, trademarks, copyrights or other intellectual property rights;

(b) The supply of technical know-how, assistance or knowledge;

(c) Technical design, engineering or other technical services of any kind or form;

(d) Management, marketing or other services.

B. Construction

Unless otherwise specified or required by the context:

(1) The singular shall comprise the plural, and nouns comprise verbs, and vice versa; and

(2) References to "Article" and "Chapter" mean articles and chapters of this Law. "Paragraph" refers to a paragraph in the same article and "Clause" to a clause in the same paragraph.

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(3) Titles and Headings of Chapters, Articles, Paragraphs and Clauses are for reference only and shall have no legal effect.

Article 4 - Scope of Application

A. Projects Covered

Except for the excluded Projects described in Paragraph B, the provisions of this Law shall be applied to all Investment Projects comprised under the definition of Project as specified in Article 3.A.(11) of this Law, regardless of whether the Project is in the public, private or mixed sector, and regardless of whether the invested capital is Yemeni, Arab, Foreign or a combination thereof; and any Investment Project in manufacturing, agriculture, tourism, education, transportation, housing and health, and any other field may be established, expanded, upgraded or changed provided that it has been licensed by the IPA pursuant to Chapter 7 of this Law.

B. Excluded Projects

(1) Projects Requiring Establishment Under Other Laws

Any Project listed and described in Schedule 1 of this Law must be established under the Law indicated and may not be established under this Law.

(2) Prohibited Projects

Any Project listed and described in Schedule 2 of this Law is prohibited and may not be established under this Law.

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C. Projects Requiring Public Sector Participation

Any Projects listed and described in Schedule 3 of this Law may be established under this Law only with participation by the Public Sector in the ownership of the Project. Otherwise, any Investment Project which is entirely privately-owned and operated may be established pursuant to the relevant provisions of this Law.

D. Foreign and Arab Participation

(1) Any Investment Project having Foreign or Arab participation may be established pursuant to the relevant provisions of this Law, except for the Projects listed and described in Schedule 4 of this Law which are reserved for one hundred (100) percent ownership by Yemenis.

(2) Except in the case of a debt to equity conversion as described in Article 3.A.(2)(b), Foreigners and Arabs may not invest the Republic's currency in a Project. Yemenis, however, may invest Foreign Funds in a Project.

Article 5 - Duty of Government Officials to Facilitate Investment and Maintain Confidentiality

A. Duty to Facilitate Investment

(1) Because of the vital importance to the national economy of encouraging investment in productive Projects, it is a primary duty of each and every Minister, Ministry, Government Organization, Official and Employee to eliminate obstacles to investment under this Law and to facilitate the implementation and operation of all Licensed Investment Projects.

(2) To this end, all Responsible Government officials:

(a) Must carry out their duties in a manner which does not delay, obstruct or harass Projects and gives them priority in importing and exporting goods, obtaining needed Government permits, facilities and services, and in implementing and conducting operations; and

(b) Are hereby instructed accordingly to read this Law and be familiar with it.

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(3) Any unwarranted obstruction or harassment of a Project may result in a fine and disciplinary action pursuant to Article 86.A.(5).

B. Duty to Maintain Confidentiality

(1) Personnel affiliated with IPA and the Responsible Authorities authorized to review Project operations are required to maintain the secrecy of the data, information and documents to which they have had access by virtue of their work and to use it only for the purpose of enforcing this Law. The Executive Regulations shall indicate the nature of information to be considered secret for purposes of this Article.

(2) Any employee violating the provisions of Clause (1) shall be subject to punishment pursuant to Article 86.A.(4), in addition to disciplinary action.

Article 6 - General Outline of Guarantees, Rights, Exemptions and Obligations for Licensed Projects

A. Guarantees, Rights and Exemptions for All Licensed Projects

All Investment Projects licensed under this Law and their Investors shall be entitled to the guarantees, Rights and exemptions and subject to the obligations listed and described in Chapter 2 of this Law.

B. Performance-Based Exemptions

Only Licensed Projects which actually meet the specific criteria of any of the Rights listed and described in Chapters 3 and 4 hereof will be entitled to such Rights.

C. Rights and Exemptions Requiring Special Approval

Projects shall be entitled to Rights and exemptions listed and described in Chapter 5 of this Law only as approved by the IPA Board or the Cabinet.

D. Obligations

All Licensed Projects shall be subject to the obligations set forth in this Law and specifically in Article 82.

Chapter 2

State Guarantees, Rights and Exemptions Provided to All Licensed Projects and Investors

All Licensed Projects shall be entitled to the guarantees, Rights and exemptions provided in this Chapter.

Article 7 - Freedom of Investment

The State guarantees Yemeni, Arab and Foreign natural and legal persons freedom of investment in Investment Projects pursuant to this Law.

Article 8 - Equal Treatment of Investors

Arab and Foreign Invested Capital and Investors shall be treated equally with Yemeni Invested Capital and Investors with no distinction regarding the Rights, obligations, rules and procedures imposed under this Law, regardless of whether the Foreign or Arab investment is made independently, or in participation with each other or in participation with Yemenis.

Article 9 - Private Sector Status of Projects

Projects established under this Law, including those in which the State or its public institutions participate in a percentage not exceeding seventy-five (75) percent of the authorized capital, shall be considered private sector Projects, and the laws and regulations related to the public or mixed sectors or their employees shall not apply to them, notwithstanding any other laws, decrees, regulations, guidelines, orders or practices to the contrary.

Article 10 - Right to Own Land

A. Right to Own or Rent Land or Buildings for Project Purposes

Projects, Investment Companies, and Arab and Foreign Investors have the right to purchase or rent lands or buildings owned by the private sector or the State to be utilized only for the purposes for which the Project is licensed under this Law, and shall not take any action concerning such lands for other than Project purposes without the prior approval of IPA.

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B. Registration of Property Rights with the IPA

(1) Upon purchasing or leasing an interest in real property, the Project or the Investors shall submit an authenticated copy of documents evidencing their title to such real property interest to the IPA, who shall then promptly register the same in the Special Register of Projects established under Article 68.

(2) Such registration shall be conclusive evidence of the Project's or the Investor's right to such real property interest against all parties, provided that the real property interest was obtained in good faith from a person who would have reasonably appeared to have the right or authority to convey the interest to an ordinarily prudent businessman.

(3) Accordingly, the Project or the Investor shall not be deprived of such real property interest except by a court order and payment of compensation equal to the fair market value of the interest.

Article 11 - Project Right to Open Shops for Products

Regardless of the percentage of non-Yemeni participation in their capital or management, industrial and agricultural Projects may open commercial shops on their own, or in cooperation with other Projects, to sell such Products on condition that the commercial activity of such shops be restricted to such Products.

Article 12 - No Public Sector Monopoly

Neither the Government nor the Public Sector shall monopolize or attempt to monopolize the sale of the same or substantially equivalent products as those produced or assembled by a Licensed Project.

Article 13 - Government Preference for Project Products Over Imports

A. Preference in government and public institution procurement shall be given to local agricultural and industrial Products of Projects over imports, including a ten (10) percent price advantage.

B. The Government shall not permit any Government Ministries or Organizations or Public Sector Companies to import into the Republic products which are substantially equivalent to Products of any Licensed Project, except where not produced

in sufficient quantity to meet the needs of such Government Ministries or Organizations or Public Sector Companies.

Article 14 - Right to Manage Projects

Investors shall have the right to manage their Projects in accordance with their own judgement of business and economic conditions.

Article 15 - No Economic Discrimination

Financial or other types of burdens or obligations shall not be imposed which violate the principle of equality between them and public and private sector Projects working in the same activity and established either under, or outside the scope of, this Law.

Article 16 - Freedom from Controls on Prices, Profits and Salaries

All Products of Licensed Projects shall be exempt from all forms of price control and limitation on profits and/or salaries to Project employees, provided that:

A. The Project is not a monopoly and does not engage in monopolistic practices; and/or

B. The Project does not fix prices or attempt to fix prices by agreement with other producers or sellers of equivalent products, housing or services; or

C. The Cabinet may impose price controls permitting no more than a reasonable profit over costs of producing the following basic Products only in times of severe shortage:

(1) Wheat, flour, bread and other essential grains;

(2) Meat and poultry products;

(3) Milk;

(4) Cooking oil; and

(5) All forms of fuel and petroleum products.

Article 17 - Stability of Laws

A. Neither this Law nor any provision thereof shall be cancelled or amended or modified in any way except by a subsequent law which specifically refers to this law and to the specific provision or provisions intended to be so cancelled, amended or modified.

B. In any event, Rights and Exemptions already granted to Licensed Projects under this Law shall not be nullified, withheld, withdrawn or infringed upon by any other subsequent or existing law, decree, regulation, guideline, order or practice.

Article 18 - Right to Sue and Arbitrate in Respect of Disputes

As detailed in Chapter 13, all Projects and Investors are guaranteed:

A. The right of access to the courts of the Republic to sue the Government, or any private or public individuals or entities in respect of claims or disputes; and

B. The right to settle disputes with the Government or any other party by binding arbitration.

Article 19 - Guarantees Against Taking Property Without Judicial Due Process

A. Prohibited Actions

Except by an order issued by a duly authorized court pursuant to procedures and conditions set forth in Paragraph B, and against fair compensation as provided in Paragraph C:

(1) No Project shall be nationalized, closed or seized, or their business stopped, by any police or Government Organizations or Officials:

(2) No property, assets, bank accounts or funds of a Project or Investor shall be seized, impounded, frozen, confiscated or sequestrated; and

(3) No Project License issued hereunder may be cancelled, nor any right or exemption provided by this Law be taken away.

B. Required Procedure

(1) Such court order may be issued only after presentation in a judicial hearing of clear and convincing evidence justifying such action under a specific provision of law in which the Project or the Investors, as applicable, shall have had fair notice and an opportunity to participate.

(2) Within no more than five (5) days of application by the IPA to cancel a Project's License pursuant to Article 85, the court shall schedule such hearing within not more than forty-five (45) days, provided that written notice of the hearing and all grounds for cancelling the License is delivered to the Project by hand or by court bailiff not less than thirty (30) days prior to the hearing. No Government Organization or Official other than the IPA shall be competent to initiate action to cancel a Project License.

(3) Within one (1) day of a justifiable application by the competent Responsible Authority for a hearing on an urgent basis with respect to any of the other actions listed in Paragraph A, the court shall schedule such hearing within no more than ten (10) days provided that written notice of the hearing and all grounds for the requested action shall be delivered to the Project by hand or by court bailiff not less than five (5) days prior to the hearing.

(4) The court's decision in the first hearing in any such case may be appealed immediately by either party to a higher court on an urgent basis, which appeal shall be heard within five (.) days and decided within five (5) days after that.

C. Compensation

For any of the actions described in Paragraph A, the Project or the Investors, as applicable, shall be promptly, adequately, effectively and fairly compensated for any loss or damage based on the market value of the property concerned and in the same currency as that invested. Compensation for loss of Foreign Invested Capital may be freely transferred abroad.

Article 20 - Local Currency Bank Accounts

A. Opening and Closing Bank Accounts

All Licensed Projects shall be authorized to open local currency accounts in any Bank upon presentation to the Bank of the Project License. Banks shall not refuse to open any Project's account or accept any Project's deposit. Any such accounts may be closed and the entire credit balance withdrawn at any time by the Project.

B. Interest on Project Deposits and Loans

Interest on bank deposits of Projects and loans to Projects shall not be subject to limitation, and interest at the highest declared commercial rate determined by the Bank shall be paid on the full amount of the credit balance of a Licensed Project's account regardless of reserve requirements, notwithstanding any contrary law, decree, regulation or banking practice. To the extent necessary to render the foregoing provisions effective, Project accounts and deposits shall not be subject to reserve requirements.

Article 21 - Foreign Currency Bank Accounts

A. Obligation and Right to Open Accounts

An Investment Project having Foreign Invested Capital or Foreign Currency costs shall be required, and shall have the right, to open Foreign Currency accounts with a Bank operating in the Republic, through which the transactions described in Paragraphs C and D are authorized to take place. To open a Foreign Currency account the Project License must be presented to the Bank with no other license, authorization or approval by any other Government Organization or Official being required. Banks shall not refuse to open any Project's Foreign Currency account or accept any Project's Foreign Currency deposit.

B. Obligation to Submit Annual Statement of Account to IPA

The Project shall submit to IPA at the end of each financial year, a statement duly endorsed by a certified public accountant, indicating all movements in such account, together with such bank statements and other documents and information as the IPA may reasonably request to ascertain that the utilization has been in keeping with the purposes of this Law.

C. Authorized Credits

The Project's Foreign Currency bank account may be credited at any time with the following:

(1) The Project's Foreign Invested Capital deposited in Foreign Currency;

(2) Proceeds of Foreign Currency loans obtained by the Project to finance Investment Costs and operations of the Project;

(3) Proceeds from the visible and invisible exports of the Project and sales in Foreign Currency to the domestic market;

(4) Foreign Currency proceeds from dissolution, liquidation, sale or other disposal of the Project pursuant to Article 26;

(5) Foreign Currency purchased through other Foreign Currency accounts at banks in the Republic or abroad from their owners;

(6) Foreign Currency obtained from banks, Projects, companies or private persons in cash or checks drawn on any Foreign or Yemeni bank; and

(7) Any interest paid in respect of the credit balance in the account.

D. Authorized Transfers

The following payments and transfers abroad from the Project's Foreign Currency account may be freely made at any time for the following purposes:

(1) Payments for the Project's New Fixed Assets and Production Materials imported from abroad;

(2) Payments in the Republic for Investment Costs;

(3) Payments to meet the Project's current working capital needs;

(4) Payments of installments of principal and interest due in respect of Foreign Currency loans;

(5) Transfers of Profits of the Project abroad pursuant to Article 24;

(6) Repatriation of Foreign Invested Capital pursuant to Article 26;

(7) Payments of royalties, fees and charges in respect of Technology Transfer agreements;

(8) Other expenses necessary for the Project;

(9) Transfers to other Licensed Projects; and

(10) Payments abroad to the account of a Foreign employee at his request of up to seventy (70) percent of his salary and compensation.

E. Interest on Full Amounts

The Project's Foreign Currency accounts shall be entitled to interest on the full amount of the credit balance of the account as determined by commonly accepted international banking practice, regardless of reserve requirements and notwithstanding any contrary law, decree, regulation or banking practice. To the extent necessary to render the foregoing provisions effective, Project accounts and deposits shall not be subject to reserve requirements.

F. Withdrawals

A Project shall have the right to withdraw any amount from its Foreign Currency bank account up to the entire credit balance at any time.

G. Closing Accounts

A Project may close its Foreign Currency accounts at any time provided that the IPA is notified of such action and provided again that movements in all such accounts are reported in the annual statement required by Paragraph A.

Article 22 - No Government Obligation to Provide Foreign Currency

The Government shall not have any obligation whatsoever to provide the Foreign Currency necessary for the authorized establishment, operations, expansion or upgrading of any Investment Project. Rather, to fund authorized Foreign Currency transactions of the Project and fund the Foreign Currency account, a Licensed Investment Project shall be required, and is hereby authorized, to obtain its own Foreign Currency at any time from the sources listed and described in Article 21.C., notwithstanding any provisions to the contrary of any other law,

decree, regulation, order or practice governing transactions in Foreign Currency.

Article 23 - Preferential Financing and Facilities

A. Preference to be Given to Projects

Subject to Paragraph B, in granting loans and credit facilities, Banks and specialized development finance institutions shall give preference to Licensed Projects, provided that they meet the conditions under which such banks and institutions operate, in accordance with the finance policies they have in effect.

B. No Limit on Loan Interest

Interest on loans to Projects shall not be subject to any limitation and shall be negotiated freely between the Bank and the Project in accordance with internationally accepted commercial banking practice.

C. Project Rights to Direct Loans

Projects shall have the right to obtain loans in Foreign Currency and the Republic's currency directly from the Bank without channelling such loans through any Government Organization or other institution notwithstanding any law, decree, regulation, guideline, order or practice to the contrary.

D. Collateral Requirements

Collateral requirements for loans to Projects shall not exceed one hundred (100) percent of the total loan amounts due. No Bank shall refuse any loan to any Project which can be one hundred secured by collateral.

E. Creditors Rights to Perfect Mortgages and Liens by Filing with the IPA ~~and the Commercial Register~~

(1) Any Creditor of a Project shall have the right to perfect a mortgage on any asset or group of assets of a Project to secure its loan by submitting to the IPA an original and one copy of a mortgage statement describing the loan terms and each mortgaged asset. Such statement shall be signed by the authorized officers of the creditors and the Project. The receiving IPA official shall immediately record the date and the time of submission on the original and the copy and return the copy to the person submitting it.

(2) Within one day of receiving the said mortgage statement, the IPA shall register the mortgage in the Special Register of Projects provided for in Article 68.

(3) The Statement registered with the IPA shall be conclusive proof of the creditor's right to the mortgage against all third parties.

(4) Where an asset is mortgaged more than once, the mortgages shall have priority in the order of their submission to the IPA.

(5) The mortgage may cover any tangible or intangible asset of the Project including, without limitation, land, buildings, all other Fixed Assets, inventories of Production Materials or Products, accounts receivable, or other debts due to the Project, but not including the Project's rights under Technology Transfer agreements or lease agreements for Fixed Assets which preserve the owners' rights against the lender. A mortgage may also cover all assets of the Investment Project as a going business including its trade name and good will, in addition to the assets described above.

(6) The mortgage shall be released by submitting to the IPA a Statement of Release of Mortgage signed by the creditors or a court order releasing the mortgage. The IPA shall register relevant details of the mortgage release in the manner specified in Clauses (1) and (2).

(7) The IPA shall submit the pertinent information regarding mortgages and their release to the relevant officials for registration in the Commercial Register as well.

F. Creditor Rights to Enforce Mortgages

Upon default by a Project of obligations covered by a valid and existing mortgage registered with the IPA as set forth above, the creditor shall have the right to enforce the mortgage by an expedited process before the commercial court as follows:

(1) Upon application, the IPA shall immediately issue a Certificate of Mortgage to the creditor, which shall be conclusive proof of his right to the mortgage.

(2) Within five (5) days of the date of such Certificate, the creditor shall apply to the Commercial Court to enforce the mortgage.

(3) Within no more than five (5) days of receiving such application, the court shall order a hearing on such application within not more than sixty (60) days provided that the Project is notified within ten (10) days of such order by hand delivery or court bailiff. The court shall Render a final decision and judgement within no more than thirty (30) days of the first hearing on the mortgage foreclosure.

(4) Upon a justifiable showing by the creditor that the mortgaged assets are in danger of being lost and prima facie evidence that the creditor is entitled to foreclose on the mortgage, on the same day, the court shall order the mortgaged assets to be seized pending the hearing and a final court decision. Such seizure may be appealed by the Project to the same court which appeal shall be heard and decided within no more than five days, or sooner if the matter is urgent, upon notice to the other party.

G. Project Creditor Rights Generally

No legal action by a creditor regarding a valid obligation of a Project as described in this Article or otherwise, including a lawsuit, a bankruptcy action or initiation of binding arbitration proceedings, as applicable, shall stop interest accruing in respect of such obligation, or other obligations of a Project from continuing, until a final judgement or arbitration award is rendered and enforced.

Article 24 - Right to Transfer Profits of Foreign Invested Capital

A. Principle

The right to transfer abroad the net profits resulting from Foreign Invested Capital is guaranteed within the credit balance of the Project's Foreign Currency bank account in accordance with the procedures set forth in Paragraph B, provided that all taxes and obligations due and owing have been paid and provided further that the Project shall fund the transfer using its own Foreign exchange and the Government shall not be obligated to provide any Foreign Currency required pursuant to Article 22.

B. Procedures

(1) No prior authorization for the transfer is required provided that there has first been submitted to the IPA:

(a) All reports and documents for the financial year concerned pursuant to Article 83.D.;

(b) A certificate issued by a chartered accountant attesting that the Project has submitted its tax declaration and discharged all taxes as well as other obligations due to the State; and

(c) A Statement showing the distribution of profits to all Investors in the Project.

(2) Immediately upon submission of the documents required above, the IPA shall issue a Profit Transfer Certificate to the Project.

(3) The Project's Bank shall immediately execute the transfer:

(a) Upon submission of the IPA certificate set forth in Clause (2); and

(b) To the extent that the transfer is covered by the credit balance in the Project's Foreign Currency account.

Article 25 - Transfer and Repatriation of Foreign Investment Funds Before Implementation of a Project

A. Funds Brought in Before Company Formation

Any person wishing to transfer his funds in Foreign Currency from abroad to the Republic for the purpose of investment may do so via one of the Banks in the Republic. In the event that he decides against investing such funds before implementation, he has the right to re-transfer such funds abroad, together with any interest accrued thereon, in the same currency in which they entered, or in any other convertible currency, within no more than one month from his application to do so.

B. After Company Formation

Similarly, in the event that an Investment Company which has received Foreign Invested Capital does not implement a Project, it may return such Foreign Invested Capital,

together with any interest accrued thereon, to the Investors to the extent permitted by the credit balance in its Foreign Currency account, provided that all Investment Company obligations have been paid, after notifying the IPA.

Article 26 - Repatriation of Foreign Invested Capital After Implementation of a Project

Investors shall have the right to repatriate proceeds of Foreign Invested Capital resulting from the liquidation, sale or other disposal of a Project after at least two years have passed since the Project commenced operations, even if such proceeds exceed the amount originally invested, in accordance with the following:

A. Funds

Repatriation of Foreign Invested Capital funds within the credit balance of the Project's Foreign Currency account, provided that all taxes and obligations due and owing by the Project have been paid as evidenced by the Project's final liquidation or other papers and tax declaration.

B. In-Kind Capital

Foreign Invested Capital brought in kind may be re-exported in kind.

C. Procedures

Procedures for the repatriation of capital shall be the same as those for transfer of net profits, except that all documents evidencing liquidation or sale shall also be submitted to the IPA whereupon a Certificate of Repatriation of Foreign Invested Capital shall be issued.

Article 27 - Investors Sale of Interest in Project

A. Rights of Sale

After notifying the IPA in writing, any Investor may dispose of all of or part of his share or shares in a Project in return for the Republic's currency or for Foreign Currency. In the latter case the Investor shall have the right to transfer such Foreign Currency abroad, even if the amount of sale proceeds exceeds the amount originally invested.

B. Rights of Purchase

In the event of such sale, the purchaser shall replace the Investor in benefitting from the provisions of this Law, provided that a purchaser of shares represented by an original investment of the Republic's currency shall not benefit from the right to transfer profits under Article 24 or repatriate capital under Article 26.

Article 28 - License to Import

Notwithstanding any other law, decree, regulation, guideline order or practice, Investment Projects are hereby licensed to import directly by themselves, but subject to IPA inspection, all New Fixed Assets and Production Materials as are specified in the Project License as being required for the Project's implementation, establishment, expansion, upgrading or operations. Such importation shall be permitted without delay upon presentation of the Project License to the Responsible Customs or other Official without requiring any additional license, permit, paper or authorization from any Government Organization or Official.

Article 29 - Customs Exemption for New Fixed Assets and Project Implementation Materials

A. Exemption

The following goods as described in the Project License, shall be exempted from all Customs Import Duties, Taxes and Fees, except for Service Fees:

(1) New Fixed Assets imported to establish, expand or upgrade Investment Projects, including minibuses and other vehicles for transporting tourists or Project employees and other means of transport for Project purposes, but excluding passenger cars and jeeps; and

(2) The household goods and effects of expatriate managers and experts of Projects.

B. Presentation of Project License to Customs Authority Sufficient to Obtain Exemption

Presentation of the Project License shall be sufficient to obtain the exemption at the customs point, and no other license, permit, paper or authorization of any kind by any Government Organization or Official shall be required to obtain the exemption notwithstanding any other law, decree,

regulation, guideline, order, requirement or practice to the contrary.

C. Variations

The full exemption shall not be denied or limited where:

(1) The value measured by the Foreign Currency C.I.F. price of any exempted imports exceeds the value stated in the Project License by an amount up to fifty (50) percent of such value;

(2) The arrival date or dates of the goods varies by less than six months from the schedule set forth in the License; or

(3) There are minor variations in the model or type of good described in the License.

D. New License for Variations in Value and Timing

Upon presentation of evidence showing significant increases in prices of exempted imports or that different New Fixed Assets are needed or of substantial shipping delays, the IPA shall promptly issue new Project Import Licenses.

E. Expedited Customs Clearance for Investment Projects

Customs Officials shall give Investment Projects top priority because of their importance to the National Economy and shall clear their New Fixed Assets and Production Materials, as well as the household goods and personal effects of Project experts and managers, without delay.

F. Limitation on Exemption

The value of spare parts and maintenance supplies imported for Projects under Paragraph A must not exceed 20 percent of the total value of New Fixed Assets imported and declared exempt.

Article 30 - Customs Duty Reduction on Project Production Materials

A. Customs Duty Limitation on Finished Imports Competing with Project Products

Total Customs Import Duties, Taxes and Fees, other than Service Fees, imposed on Production Materials imported by a Licensed Project to produce a Product shall not exceed 90 percent of such Customs Import Duties, Taxes and Fees

imposed on a finished product which is equivalent to that produced by the Project. Where it can be shown that such excess exists, then the Project shall be granted a reduction in total import duties and taxes by the amount of the excess.

B. Procedures

(1) An application shall be submitted to the IPA showing clearly that the excess exists together with any relevant evidentiary documents.

(2) Upon review and determination that such excess exists, and within ten (10) days of receiving the application, the IPA Executive Administration shall issue a Certificate of Customs Duty Reduction stating the amount of the reduction and the production materials eligible therefor.

(3) Upon presentation of such certificate at the customs point, the reduction shall be granted immediately by the Responsible Customs Officials. No other license, permit, paper or authorization by any Government Organization or Official shall be required to obtain the reduction, notwithstanding any other law, decree, regulation, guideline, order, requirement or practice.

C. Reduction or Termination of Exemption

Should the excess be reduced or disappear by changes in the tariff schedule or otherwise, the reduction automatically shall be reduced to the same extent or terminated, as applicable.

Article 31 - Limitations on Project Import License and Customs Exemption

A. Goods to be Used Only for Project Purposes

The Import License and Customs exemptions set forth in Articles 28, 29 and 30 are only for the import of New Fixed Assets and Production materials required for authorized Project purposes. Any other use shall be subject to action under Article 85.A.(3) and punishment in accordance with Article 86.A.(2) and Article 86.A.(3).

B. Disposition of Exempted and Imported Goods

(1) Fixed Assets

Unless sold to another Project, Fixed Assets exempted from Customs Import Duties, Taxes and Fees pursuant to Article 29 shall not be disposed of locally by a Project before five (5) years without either:

(a) Paying all of the Customs Import Duties, Taxes and Fees previously exempted; or

(b) Authorization by the IPA which authorization shall not be unreasonably withheld upon a showing of legitimate need by the Project.

The IPA may condition its authorization on payment of part of such Customs Import Duties, Taxes and Fees as shall seem reasonable under the circumstances. Failure to comply with the foregoing shall be punishable pursuant to Article 86.A.(3).

(2) Production Materials

Projects may import hereunder only materials required for their authorized operations. In the event of a legitimate business need to dispose of imported materials, a Project may do so after informing the IPA.

C. Records Required

Projects shall maintain accurate records with respect to the location, use and disposition of all imported goods.

D. Inspection

(1) Projects and their records shall be subject to inspection at any time in respect of goods imported and exempted in accordance with this Law.

(2) When production facilities have been assembled using exempted imported New Fixed Assets, the IPA shall be notified prior to the commencement of production or operations. Upon such notification, the IPA may conduct a full inspection of the facilities.

Article 32 - Employees of Projects

A. Non-Yemeni Employees

(1) Projects are encouraged to employ and train as many Yemenis as possible. To the extent required, however, any Project may employ non-Yemenis as set forth in its License. Such non-Yemeni employees shall be entitled to three-year work permits and residence visas which shall be renewed upon recommendation by the IPA.

(2) Accordingly, upon presentation of its License to the Responsible Authority together with the relevant required documents, a Project shall be entitled to obtain work permits and visas for all authorized non-Yemeni employees for a period of three years upon payment of all required fees in advance, as follows:

(a) The Responsible Authority shall issue such Work Permits without delay and within no more than thirty (30) days from receipt of the application, notwithstanding any existing law, decree, regulation, guideline, order or practice to the contrary; and

(b) Projects are exempt from any requirement to advertise for national employees beyond once in a newspaper serving the general area where the Project will be located; and

(c) Within no more than five (5) days of receiving the passport of an authorized non-Yemeni employee of a Project who has entered the Republic, the Responsible Authorities shall stamp such passport with the relevant visa and work permit, or renewal of same as the case may be. Moreover, no fines or fees shall be charged to the Project or such employee for not having a work permit or visa for any period following such 5-day period where the visa and the work permit have previously been approved, nor for renewal of same where application has been made prior to expiration of the existing work permit or visa.

(3) Non-Yemeni employees working in administrative and technical positions in any Project may transfer 70 percent of their net salaries and all of their end of service compensation abroad to the extent permitted by the credit balance of the Project's Foreign Currency account.

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B. Employees Generally

Notwithstanding any law, decree, regulation, guideline, order or practice to the contrary, Projects are free to hire and terminate and lay off employees, as is deemed necessary by the Project's management or owners, but subject to the employment contract. Amounts paid to employees shall be entirely a matter for negotiation and agreement between the Project and the Employee, and Projects shall be exempt from any and all laws, decrees, regulations, and Government orders imposing pay levels, increases or decreases.

Article 33 - Basic Tax Exemptions Available ~~to~~ in respect of all Projects

A.' Exemptions

Without prejudice to more favorable exemptions provided ~~to qualified Projects~~ by other provisions of this Law or other laws, all Licensed Projects ~~shall be entitled to the following:~~

(1) Exemption for a period of four years from the date of issuance of the License ~~to establish the Project~~ from:

(a) All taxes on net profits of the Project's authorized activities; and

(b) Real estate tax on land, buildings, and installations rented, owned or used by the Project for its authorized purposes.

(2) Following the end of any tax exemption period, a Project may thereafter carry forward and deduct losses from operations in any year for a period of five (5) years. This provision shall not apply to any losses incurred during the tax exemption period.

(3) Permanent exemption of the Project's capital from the proportionate stamp tax, and all other taxes on capital, including the capital tax on Foreigners. With respect to Projects and Investment Companies, zakat shall be the individual responsibility of each of the Yemeni Investors with respect to the shares owned by them.

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for all [illegible]

(4) Permanent exemption from proportionate stamp tax of:

(a) All Company incorporation contracts and all amendments thereto;

(b) All contracts relating to:

(1) The implementation of a Project's establishment, expansion or upgrading;

(2) A Project's ongoing operations;

(3) Disposal of all or part of a Project's fixed assets;

(4) The sale of shares in a Project by an Investor;

(5) Liquidation, merger, purchase or sale of all or part of a Project;

[translation] Hire raw material

(6) Lease, purchase or sales of land and buildings, fixed assets, machinery, raw materials or products;

(7) Technology transfer, patents, know-how, management, technical assistance and transportation of goods.

(5) Exemption from the tax on salaries and wages of the following allowances and amounts actually paid in respect of a Project's non-Yemeni employees:

(a) Housing; and

(b) Education; and

(c) Air or sea transportation to and from Yemen.

Salaries and wages of such non-Yemeni employees are otherwise subject to such tax.

[illegible] transfer Foreign [illegible]

(6) Exemption from profits tax for a period of three (3) years following the commencement of operations or production of all fees charges and Royalties paid by Projects in respect of Foreign Technology Transfer as defined in Article 3. Thereafter, taxes thereon shall be withheld by the Project and paid as provided in Article 83.

for Banks

(7) Exemption from profits tax of interest paid by Projects on Foreign Currency loans used to finance Investment Costs. [illegible]

(8) Exemption from real estate transfer tax of all purchase and sales of real estate by Project for purposes of establishment or expansion.

B. Procedures

The foregoing exemptions shall be provided by the Responsible Tax Authorities forthwith upon presentation of the Project's License.

Chapter 3

Extended Tax Exemption Periods Available Only to Projects Actually Meeting Specified Conditions

Article 34 - General Nature of Exemption

A. Only Projects which meet the conditions required pursuant to this Chapter shall be entitled to any of the extended tax exemption periods indicated in Article 37 from profits and real estate taxes.

B. The tax exemption shall be 100 percent of taxes due for the first half of the indicated exemption period and fifty (50) percent for the second half.

C. The length of the exemption period shall depend upon the Project's location, minimum paid-in capital, and the other minimum qualifications indicated in Articles 35, 36 and 37. Such exemption period shall begin with the date the Project commences production or operations, as applicable, rather than the date of the license to establish the Project, and shall replace the exemption period specified in Article 33.A.

Article 35 - Investment Zones

A. Zone Location

For the purpose of establishing one of the criteria for the tax exemptions provided under this Chapter, the Republic shall be divided into Zone A and Zone B as set forth in Schedule 5.

B. Amendment of Zones by Cabinet

After five years the Cabinet may amend the Investment Zones by decree and every five years after that based on the needs and demands of development within the Republic pursuant to Article 81.A.(1).

Article 36 - General Conditions for Extended Profits and Real Estate Tax Exemption Period

A. New Fixed Assets

The value of New Fixed Assets required in Article 37 shall exclude the costs and value of passenger cars and jeeps.

B. Paid-In Capital

Paid-in capital shall be not less than thirty (30) percent of total Investment Costs.

C. Buildings

Buildings for hotels and housing shall be built to conform to the architectural style prevailing in the area.

D. Procedures and Obligations

Projects shall comply with the Procedures set forth in Article 38.

Article 37 - Specific Exemption Periods and Requirements

Subject to the conditions specified in Articles 34, 35 and 36:

A. Basic Exemption and Requirements

The basic tax exemption period shall be:

(1) Ten (10) years:

(a) For all traditional craft industries certified by the Responsible Authority as such; and

(b) For the specific Projects described with particularity in Schedule 6 of this Law.

(2) Six (6) years:

(a) For any Investment Project, other than agricultural and education sector Projects,

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commencing production or operations in Zone A with New Fixed Assets valued at not less than YR Ten Million, or the equivalent of USD One Million, whichever is greater; or

(b) For any agricultural or education sector Projects in Zone A with New Fixed Assets of half the value specified in Clause (a).

Projects which qualify for more than one basic exemption period pursuant to Clauses 1 and 2 shall elect one only.

B. Increased Exemption for Greater Investment

Any of the exemption periods specified in Paragraph A shall be increased by two years for each YR Thirty Million of New Fixed Asset value or the equivalent of USD Three Million, whichever is greater, up to a maximum of twenty (20) years. Project Expansion of sufficient magnitude undertaken during the Initial Tax Exemption period shall qualify to extend the Total Tax Exemption Period for the entire Project under this Paragraph.

C. Increased Exemption For Investment in Zone B

The total exemption period for which a Project would otherwise be entitled in Zone A shall be extended by an additional two years for any Project commencing new production or operations in Zone B.

D. Increased Exemption For Publicly-Held Shareholding Companies

The total exemption period to which a Project would otherwise be entitled under this Article or Article 33.A shall be extended for an additional two years for any Project owned by a public stock company in which the percentage of publicly held stock is no less than 25% of its capital.

E. Project Expansion or Upgrading

Except as provided in Paragraph B, Project Expansion or Upgrading shall not qualify for the exemptions provided by this Article or Article 33.A., but may qualify for the rights and exemptions set forth in Article 40.

F. Increasing New Fixed Asset Value Requirements

Every five (5) years, the Cabinet, upon the recommendation of the IPA Board, may increase the New Fixed Asset value requirements set forth in this Article, pursuant to Article 81.A.(3).

Article 38 - Procedures to Obtain Tax Exemptions Under This Chapter

A. Evidence Supporting Claim for Exemption

Within ninety (90) days of commencing production or operations, evidence shall be submitted to the IPA in support of any claim for tax exemption under this Chapter.

B. IPA Inspection

The IPA may inspect the Project and its books, records and inventory at any time in respect of the exemption request.

C. Certificate of Exemption

Once it is proved to the IPA's reasonable satisfaction that all conditions for the requested tax exemption have been met, and within no more than sixty (60) days of receipt of all documents reasonably requested of the Project, whichever first occurs, the IPA shall issue a Certificate of Exemption to the Project specifying the terms of the exemption in accordance with this Chapter. The relevant Responsible Tax Authorities shall then grant the stated exemption immediately upon presentation of such IPA Certificate.

Chapter 4

Continuing Tax Exemptions Available to Projects Meeting Specified Conditions Following the Basic Exemption Period

Article 39 - General

Following the end of the total Tax Exemption Period provided for in Article 33.A. and Chapter 3, any Project meeting specified conditions may receive the tax exemptions provided for in this Chapter, pursuant to the procedures prescribed in Article 45, but subject, however, to the limitation specified in Article 44 that

the cumulative exemptions in respect of Profits tax under Articles 41.A.(3), 42 and 43 shall not exceed fifty (50) percent of the total tax due.

Article 40 - Tax Exemptions to Encourage Project Expansion and Upgrading

A. Exemption for Re-Invested Profits

Profits of any Licensed Project reinvested to increase the Project's paid-in capital and used to finance the purchase of productive new fixed assets or technology, in whole or in part shall be exempt from profits tax in that year.

B. Accelerated Depreciation for New Machinery

Any Licensed Project shall be entitled to deductions for accelerated depreciation of the cost of new machinery, equipment or instruments purchased for the upgrading or expansion of a Project over three (3) years as follows:

Fifty (50) percent in the year of purchase or the following year, as the Project may choose;

Thirty (30) percent in the succeeding year; and

Twenty (20) percent in the next succeeding year.

C. Exemption Under Article 37

A Project Expansion or Upgrading of sufficient magnitude and otherwise meeting the conditions specified, may elect a more favorable tax exemption under Article 37.

Article 41 - Tax Exemptions and Customs Rebate to Encourage Exports

Any Project which exports all or part of its production shall be entitled to the following:

A. Tax Exemption

Exemption From:

(1) All customs duties, taxes and fees imposed on exports of whatever kind or type, other than service fees; and

(2) ~~Production~~ Consumption tax on that portion of the production exported; and

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(3) Profits tax to the extent of fifty (50) percent of total tax due on all profits attributable to export revenues in freely convertible Foreign Currency transferred through any Authorized Bank into the Republic; and

B. Customs Rebate

A rebate for all Customs Import Duties, Taxes and Fees of any type whatsoever on imported Production Materials which are incorporated into that portion of production exported.

C. Customs Rebate Certificate

To the extent that the customs rebate authorized by Paragraph B is not paid immediately, a Project may use the amount thereof as a credit against all Customs Import Duties, Taxes and Fees imposed on any future imports by the Project. In such case, a Customs Rebate Credit Certificate issued by the IPA pursuant to Article 45 shall be treated by the Responsible Customs Official as though it were a cash payment for the Customs Import Duties, Taxes or Fees due. A Project may transfer its IPA Customs Rebate Certificate to another Project after notifying the IPA.

Article 42 - Tax Exemption to Encourage Value Added to the National Economy

Any Project producing Products for sale to the domestic market which can be shown to have added real value to the National Economy in any financial year according to an analysis by the IPA in accordance with Article 62.A. shall receive a tax exemption against taxes on net profits as follows:

Positive Real Value Added to the Economy	Tax Credit As % Of Taxes Due
Below 30%	0%
30% to 40%	10%
40% to 60%	20%
60% to 80%	30%
80% to 100%	40%
100% plus	50%

The Project may elect to apply the foregoing tax exemption either in the current year or in the next succeeding financial year in which the Project generates profits.

Article 43 - Tax Exemption to Encourage Employment of Yemenis

To encourage employment of Yemenis, Investment Projects shall receive an exemption from taxes on net profits in any year of an amount equal to ten percent of total salaries paid to Yemenis in the preceding year as evidenced by salary tax and social insurance records, provided however, that such tax exemption shall not exceed fifty (50) percent of total tax due.

Article 44 - Cumulation of Exemptions

Projects qualifying for more than one exemption from profits tax under Articles 41.A.(3), 42 and 43 may cumulate them; provided that, following the end of the Project's relevant tax exemption period as specified in Articles 33.A.(1) or 37 as the case may be, Projects shall pay a tax of not less than fifty (50) percent of total profits tax due even if the cumulated exemptions would otherwise result in less tax.

Article 45 - Procedures to Obtain Exemption

To obtain any tax and customs duty exemptions or credits provided for in Articles 40-43.

A. Presentation of Evidence to Responsible Authority
Projects may deal directly with the Responsible Tax or Customs Authority who shall grant the requested right, exemption or credit immediately upon presentation of sufficient evidence showing entitlement thereto under this Law.

B. Request for IPA Certificate of Exemption or Rebate

Alternatively, a request for a Certificate of Exemption or Rebate may be made to the IPA, in which case evidence may be submitted to the IPA in support of any claim for tax exemption under this Chapter.

C. IPA Inspection

The IPA may inspect the Project and its books, records and inventories at any time in respect of the exemption request.

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D. IPA Issuance of Certificate

Once it is proved to the IPA's reasonable satisfaction that all conditions for the requested tax exemption have been met, and within no more than sixty (60) days of receipt of all documents reasonably requested of the Project, whichever first occurs, the IPA shall issue a Certificate of Exemption, Rebate or Credit, as the case may be, specifying the terms thereof in accordance with this law. The Responsible Tax or Customs Authorities shall then grant the relevant exemption, rebate or credit immediately upon presentation of such IPA Certificate.

Chapter 5

Rights and Exemptions Granted by Cabinet or IPA Decree To Projects of Special Economic and Social Significance

Article 46 - Rights and Exemptions Granted Only by Cabinet Decree to Projects of Special Economic and Social Significance

A. Criteria

The Cabinet may set the conditions and criteria for considering an Investment Project to be of special economic and social significance and deserving of one or more of the rights and exemptions listed in Paragraph B in accordance with the general policy of the State, provided that in addition to such conditions and criteria, the Project must fulfill one or more of the following conditions:

(1) The Project must make a highly significant contribution to achieving food security in basic foodstuffs; or

(2) The Project must make an appropriate and highly significant contribution to the development and upgrading of rural or remote areas; or

(3) It must be a joint Arab Project, especially one established by Arab companies formed in the context of Arab organizations; or

(4) The actual value of New Fixed Assets must be no less than YR 500 million or the equivalent of USD 50 million, whichever is greater, and the paid-in capital must be no less than thirty (30) percent of the investment cost.

B. Rights and Exemptions

Upon recommendation from the IPA, following the special review and approval procedures set forth in Articles 61-63, the Cabinet may grant any Investment Project of special economic and social significance to the national economy as defined in Paragraph A, one or more of the following rights and exemptions.

(1) Increased Exemption from Profits and Real Estate Taxes

Full or partial exemption from profits taxes, real estate taxes or companies' taxes, or from all of these taxes together, for an additional period not to exceed ten (10) years, over and above the highest tax exemption period for which the Project would otherwise be qualified under Articles 33.A. or 37 of this Law;

(2) Preference in Obtaining State Lands

Preference in the acquisition of needed expanses of State lands allocated for the establishment of Projects and renting or selling them at favorable rates or at no cost, upon such terms and conditions as the Cabinet may decree;

(3) Favorable Financing Facilities

Facilities permitting the Project to obtain loans needed for financing on easy terms either through national finance institutions or international specialized institutions, and allow the transfer abroad of the net profits resulting from Foreign Invested Capital investments therein without restriction or condition;

(4) Temporary Protection from Exports

Provide the Project with adequate protection from Foreign competition, provided however, that:

(a) the adequacy of local production and competition be taken into account in terms of quantity, quality and benefit to the consumer; and that

(b) Such protection shall continue for a period not to exceed ten (10) years for any given Product or class of Products.

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Article 47 - Rights Which May be Granted by Special Action of the IPA to Projects

A. Sale or Lease of Land

The IPA may sell or lease land under its authority to Projects at prices and rents and upon such terms as it shall deem reasonable and appropriate under the circumstances.

B. Feasibility Study Costs

Following special review and approval of a Project's application pursuant to Articles 61-63, upon a decree by the IPA Board, the IPA may participate in all or part of the feasibility study costs of Projects deemed by the IPA Board to be of significance to the national economy.

C. Protection of Local Production

In order to protect local production, upon recommendation of IPA, following special review and approval of any concerned Project Application pursuant to Articles 61-63, the Minister may impose or increase customs duties on the importation of finished or primary goods substantially equivalent to national production, provided that:

(1) The adequacy of local production and competition be taken into account in terms of quantity, quality and benefit to the consumer; and

(2) No monopoly or oligopoly shall be created or monopolistic practices shall be permitted; and that

(3) Such protection shall continue for a period up to but not exceeding ten (10) years for any given Product or class of Products.

Chapter 6

The Investment Promotion Authority (IPA)

Article 48 - Establishment of the IPA

A. Independent Status

A public authority shall be established to be called the Investment Promotion Authority (IPA) having corporate status and an independent financial and administrative nature.

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B. Supervising Minister

The Minister of Economy, Supply and Trade shall supervise the IPA.

C. IPA Composition

The IPA shall have:

(1) A Board

A Board of Directors headed by a Chairman and formed by decree of the President of the Republic; and

(2) IPA Executive Administration and Director General

An Executive Administration headed by a Director General who shall also serve as Deputy Chairman of the IPA Board and preside over the IPA Board in the event of the Chairman's absence, who shall be appointed by a decree issued by the President of the Republic.

(3) Power to Sign

The IPA Chairman, the Director General and senior officials of the IPA Executive Administration delegated by the IPA Board shall have the right to sign in the name of the IPA.

D. IPA Headquarters

The headquarters of the IPA shall be in the city of Sana'a, and it may open branches and offices in other areas inside or outside the Republic as the exigencies of work require.

E. Other Government Organization Offices at IPA Headquarters

Offices representing the Ministry of Economy, Supply and Trade, the Ministry of Social Affairs and Labor, the Ministry of Municipalities and Housing, the Passport Authority, the Customs Authority, and the Tax Authority and other responsible authorities shall be established at the IPA headquarters within ninety (90) days of the IPA's establishment. Such offices shall be responsible for carrying out all procedures pertaining to Investment Project activities related to their Ministries, and pursuant to this Law. They shall be invested with all powers required to process expeditiously and issue all permits and approvals required from their Ministries or Government Organizations

or Authorities to establish, implement, operate, expand and upgrade Investment Projects.

Article 49 - IPA Jurisdiction

A. Overall Purpose

The sole responsibility of the IPA shall be to promote, encourage and facilitate Yemeni, Arab and Foreign capital investments pursuant to this Law and the objectives of the State's Socio-Economic Development Plan, with the active assistance and support of all other Government Organizations and Officials.

B. IPA Powers and Functions

The IPA may adopt the policies and measures which it deems necessary to accomplish the purpose for which it was established. In particular the IPA shall have power to:

(1) Issue Project Licenses

Issue all official Licenses and License Amendments to establish, expand and upgrade Investment Projects.

(2) Grant Project Import Licenses

Grant import Licenses to Licensed Projects for all machinery, equipment, appliances, instruments, tools, means of transport, raw and intermediate materials, building materials and installations, furnishings, spare parts, maintenance materials and supplies needed to establish, expand, upgrade and operate Investment Projects.

(3) Establish Project Companies

Grant permits for the establishment of companies formed for the purpose of investing in and implementing Investment Projects pursuant to the provisions of Chapter 8.

(4) Obtain Work Permits

Grant entry and residence visas and work permits to non-Yemeni owners and workers in Investment Projects.

(5) Issue Project Certificates

Issue Certificates to Licensed Projects which qualify for the rights established by this Law.

(6) Obtain Other Needed Permits for Projects

Obtain from the Responsible Authorities on behalf of Project Owners all other permits and approvals required to establish, expand, upgrade and operate Projects.

(7) Process Project Applications

Expeditiously process applications for establishing, expanding or upgrading Investment Projects, following up with other Responsible Authorities where required.

(8) Evaluation and Recommendation

Conduct any evaluation of proposed Projects required pursuant to Article 62 to determine their value to the national economy and present recommendations to the IPA Board of Directors for decision wherever required pursuant to this Law.

(9) Assist Projects with Other Organizations

Assist Projects in their relations with other Government Organizations and Officials and in reducing obstacles to the implementation, establishment and operation of Investment Projects.

(10) Establish and Allocate State Lands for Free Zones, Industrial Estates and Tourist Complexes

Pursuant to Cabinet guidelines:

(a) Establish and allocate State lands needed for Investment Projects, industrial estates, tourist villages, parks and resorts, new urban communities and complexes and free zones in various regions of the country;

(b) Provide them with the utilities and basic services required to establish Investment Projects therein; and

(c) Conclude contracts to lease or sell such lands to Investment Projects.

All Responsible Authorities are required to provide the IPA with all maps and information related to lands at their disposal for this

purpose, including the rules and conditions related to contracting for them.

(11) All Other Necessary Tasks

Undertake all other tasks required to implement Licensed Projects pursuant to this Law and to facilitate their commercial and economic success.

(12) Study Laws

Study the laws, decrees, systems and regulations related to encouraging and promoting Yemeni, Arab and Foreign capital investments in the Republic and make any necessary recommendations in this regard.

(13) Study Investment Issues

Conduct research concerning investment issues including impediments and blocks limiting the encouragement, organization or effective channelling of investment, and offer to the Responsible Authorities appropriate ideas and suggestions in this regard.

(14) Study Investment Opportunities

Conduct studies related to discovering available investment opportunities, the economic feasibility of Projects and the promotion thereof among Yemeni, Arab and Foreign businessmen.

(15) Prepare and Print Lists of Projects

Prepare and print lists of available profitable investment fields, opportunities and Projects that national, Arab and Foreign capital are invited to invest in under this Law.

(16) Publish Data

Gather and publish data and information relating to investment conditions with the aim of acquainting Investors with the investment climate in the Republic and working to facilitate acquisition of the studies, research, data and information they need to establish, expand or upgrade Projects upon request.

(17) Other Duties Assigned by Minister and Cabinet

Undertake other duties and tasks assigned to the IPA by the Minister or the Cabinet in matters related to investment or in Investment Project transactions.

C. Capacity to Sue or Be Sued

The IPA may sue and be sued in its own name.

D. Power to Contract and Dispose of Property

The IPA has the power to hold and dispose of any moveable or immoveable property, enter into contracts or any other transactions and open, close and operate bank accounts.

E. Power to Obtain Land

For the purpose of establishing free zones and industrial estates pursuant to Clause 12 of Paragraph B, the IPA shall have power to purchase, lease or otherwise obtain privately-owned land. For such purposes, the IPA shall also have the power of eminent domain to requisition privately-owned land, provided that compensation is made to the owners at the fair market value of the land.

F. All Powers Needed to Achieve Purposes

The IPA has all the other powers required to achieve the purpose for which it was established, including setting investment policy, defining investment priorities in the economic sectors and fields covered by this Law in the context of the State's socio-economic development plan, as well as concluding contracts required to carry out its tasks and achieve its purposes.

Article 50 - Composition and Jurisdiction of the IPA Board of Directors

A. Composition of the IPA Board

The IPA Board shall be constituted as follows:

(1) Chairman

(2) IPA Director General (Deputy Chairman)

(3) Deputy Chairman of the Central Planning Organization

(4) Deputy Minister of Agriculture

(5) Deputy Minister of Economy

(6) Deputy Chairman of the General Company for Tourism

(8) One (1) member to be appointed by the Federation of Chambers of Commerce for a three (3) year term; and

(9) Two (2) members to be appointed by the Chairman for three (3) year terms.

B. IPA Board Responsibilities

The IPA Board of Directors shall be considered the supreme authority in charge of IPA affairs, conducting its business and drafting the policies it shall follow. It may take the decisions it deems necessary to achieve the purpose for which it was established. In addition to its areas of competence and powers specified elsewhere in this Law, the IPA Board may perform the following specific activities:

(1) Establish and draft general policies and plans for conducting and developing IPA activity on a modern technical and managerial basis, including the rules, bases and criteria for Project evaluation in a manner in keeping with this Law and the various developments affecting the national economy and the demands of State public policy;

(2) Review applications to establish, expand or upgrade Investment Projects requiring special review and approval pursuant to Articles 61-63 and the Rights and exemptions being requested for them in light of the results of the evaluation submitted to the Board by the IPA Executive Administration and make appropriate decisions regarding them pursuant to the provisions and procedural rules contained in this Law, including guidance to the Minister and the Cabinet concerning granting the additional Rights contained in Article 46 of this Law;

(3) Review the periodic reports submitted by the Chairman of the Board on the progress of IPA activity, including information and statistics on the issuance of routine Licenses to establish, expand or upgrade Projects by the IPA Administration not requiring Board approval pursuant to Article 60.

(4) Review the IPA's financial status regularly and approve the IPA's annual budget proposal and its closing accounts;

(5) Approve the conclusion of loans and credit facilities on behalf of IPA pursuant to stipulated rules and procedures;

(6) Review issues presented by the Chairman of the Board or his Deputy falling under IPA jurisdiction so that appropriate policy decisions may be made regarding them; and

(7) Determine the fees for services provided by IPA.

C. Delegation of Powers and Responsibilities

The IPA Board may form one or more committees composed of Board members to be entrusted with some of its responsibilities. It may also entrust some of its responsibilities to the Chairman or the Director General or delegate one of its members or an IPA official to undertake a specific task.

Article 51 - IPA Board Meetings

A. Meeting Procedures

(1) The IPA Board shall meet regularly at least once monthly or as often as may be required at the invitation of the Chairman, or his Deputy in the event of his absence. The invitation shall be sent to Board members at least seven days in advance of the announced meeting date. In the event of an emergency, this time period shall not be binding. The IPA Board shall also meet at the request of the Chairman or a majority of Board members, should the need arise.

(2) Board meetings shall not be valid unless a majority of the members are present, provided that the Chairman or his Deputy is also present.

(3) Board decisions shall be made by majority vote of those present. In the event of a tied vote, the side taken by the Chairman shall prevail.

(4) Proceedings and decisions of the IPA Board shall be considered secret and may not be disseminated until the decrees regarding them have been issued.

(5) Minutes of meetings of the IPA Board shall be recorded in a special register and signed in accordance with a system to be determined by the IPA Board.

(6) Board decisions shall be reported to the Minister and the public promptly. Decisions of the IPA Board shall be issued under the signature of the Chairman of the IPA Board, or in his absence, by his Deputy, and the official in charge of the Secretariat.

B. Outside Participants

The IPA Board may invite to attend its sessions those individuals whose knowledge or experience it wishes to use to offer their opinions or advice, however they shall not be entitled to vote in the proceedings.

C. Conflict of Interest

If any member of the IPA Board has a personal interest in any Board decision to be taken on a subject under review, he must so declare and withdraw from the session while it is being discussed.

Article 52 - Responsibilities of the IPA Board Chairman

The IPA Board Chairman is responsible for implementing the public policy established to achieve the objectives of the IPA. He is specifically responsible for carrying out the following tasks:

A. Oversee IPA Management

Overseeing IPA management and monitoring and developing its system of work to ensure that objectives are met;

B. Appoint Officials

Appointing officials and employees within the limits established by IPA's internal regulations;

C. Form Committees

Forming committees to undertake specific tasks to help meet IPA objectives;

D. Represent Before Courts

Representing the IPA before the courts and in its contacts with others; and

E. Other Responsibilities

Exercising all other responsibilities assigned to him pursuant to this Law or by the IPA Board.

Article 53 - Responsibilities of the IPA Director General

A. Deputy Chairman

The IPA Director General shall be the Deputy Chairman of the Board, presiding over the IPA Board in the Chairman's absence.

B. Management of IPA Executive Administration

The IPA Director General shall be responsible for management or IPA Executive Administration and for defining its activities. He shall have the following responsibilities in particular:

(1) Overall supervision of IPA departments, sections and units and coordinating them;

(2) Conducting the financial, technical and managerial activities of the IPA administration and developing a system of work to meet its objectives;

(3) Contracting in the name of IPA within the limits established by IPA's internal regulations, except where contracting authority is specifically reserved to the Chairman by the Board;

(4) Implementing IPA Board decisions; and

(5) Exercising all powers delegated to him by the IPA Board.

Article 54 - The IPA Executive Administration

Under the supervision of the IPA Director General, the IPA Executive Administration shall implement the policies of the IPA Board and carry out the business, functions and responsibilities of the IPA and exercise its authority on a day-to-day basis, including processing all Applications and issuing all routine Project Licenses, License Amendments and Certificates, except those requiring special review and approval under Articles 61-63, which must be specifically reviewed and authorized by a decision of the IPA Board, and those under Article 46 which must be reviewed and approved by a decree of the Cabinet.

Article 55 - IPA Budget, Fund and Accounts

A. Budget

IPA shall have an independent annual budget prepared in accordance with rules applied to commercial establishments. It shall not be bound by the special provisions concerning the budgets of public institutions and authorities.

B. Public Funds

IPA funds shall be considered public funds and shall not be appropriated by prescription by others. They shall be disbursed pursuant to regulations issued by the IPA Board and approved by the Minister.

C. Accounts

IPA accounts shall be audited by a legal auditor appointed by the IPA Board and approved by the Minister.

Article 56 - IPA Resources

IPA resources shall be composed of the following:

A. Appropriations made by the State to the IPA General Budget;

B. Loans contracted for by IPA with a government or other bank or institutional guarantee pursuant to the relevant regulations in force;

C. Aid and assistance approved by the IPA Board; and

D. Revenue earned in exchange for services rendered or fees collected in the course of IPA activity in accordance with the conditions and limits set by the IPA Board and approved by the Minister.

Article 57 - Internal Guidelines

The IPA Board shall issue decrees and regulations organizing IPA departments, sections and units, defining their responsibilities, as well as budget, accounting, personnel and other decrees required to implement the provisions contained in this Law.

Chapter 7

Licensing and Registration Procedures for Projects

Article 58 - General

The establishment of all Investment Projects shall be licensed in accordance with the provisions specified in Article 60, except for Projects requiring special review and approval pursuant to Articles 61-63.

Article 59 - Establishment Licensing Procedures Applicable to All Projects

A. Submission of Application to Establish an Investment Project

(1) To establish any Investment Project under this Law, an Application for the Establishment of an Investment Project must be submitted to the IPA on the form to be designated for this purpose and shall contain basically the following information about the Project:

(a) The Project Representative's name, nationality and address;

(b) Description of the proposed business operations;

(c) Legal form;

(d) Investment Costs;

(e) Yemeni and Foreign Invested Capital;

(f) Foreign and local loan financing;

(g) Names, nationalities and proposed ownership interest of each of the Investors;

(h) Names of references who can provide information about each of the Investors; and

(i) Any other relevant information specified by the Executive Regulations.

(2) Any changes in the information contained in such Application must promptly be filed with the IPA during the life of the Project.

(3) Intentionally or recklessly submitting false or misleading information with respect to such Application, or failing to file changes thereto with intent to mislead shall be punished by fines and imprisonment pursuant to Article 86.A.(1) hereof.

B. IPA Review of Application for Omissions and Errors

(1) The receiving IPA official shall immediately examine the Application to see if there are any obvious omissions. If so, the IPA official shall promptly return the Application to the individual submitting it pointing out any such omissions. If the Application appears complete, the receiving official shall accept it and issue a dated receipt.

(2) Within no more than ten (10) days of receipt, the IPA shall examine the Application thoroughly to determine whether the proposed Project falls within the scope of the Law pursuant to Article 4.The IPA shall then notify the Project Representative in writing of all omissions and any apparent errors. If the omissions are serious enough to prevent the IPA from proceeding further with licensing procedures, the IPA shall suspend action pending a satisfactory response from the Investor. Upon receipt of all information required in the Application, or if omissions are minor, the IPA shall proceed forthwith to process all Projects pursuant to Article 60, except those classified as requiring special IPA review and approval which shall be processed pursuant to Articles 61-63.

Article 60 - Establishment of All Investment Projects Except Those Requiring Special Treatment

Any Investment Project in manufacturing, agriculture, tourism, education, transportation, housing, health and any other field, except for Projects classified as requiring special treatment under Article 61, may be licensed pursuant to the following procedures:

A. Notice to Responsible Authority

Within three (3) days of receiving a completed Application pursuant to Article 59, the IPA shall send a notice to the Responsible Authority describing the Project, its planned

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capacity and the proposed date of commencing operations and inquiring whether the Project in any way fails to conform to the State's Socio-Economic Development Plan for the sector concerned.

B. Response of Responsible Authority Required Within Fifteen Days

Within fifteen (15) days of the IPA notice, the Responsible Authority shall deliver to the IPA a written statement according to IPA's standard form as promulgated by the Executive Regulations which either:

(1) States that the Responsible Authority has no objection to the proposed Project as submitted; or

(2) Describes in complete detail all respects in which the proposed Project fails to conform to the objectives of the State's Socio-Economic Development Plan.

C. Notice to Investor of Objection by Responsible Authority

If within such fifteen (15) day period the IPA receives the Responsible Authority's detailed written statement of all respects in which the Project fails to conform to the State's Plan, the IPA shall send a copy of such statement within five (5) days of its receipt to the Project Representative. If the Investors fail to meet such stated objections within one-hundred eighty (180) days, the Project Application shall be deemed rejected and no further action shall be taken in respect thereto. If within such one-hundred eighty (180) day period, however, the Investors submit to the IPA an Amended Project Application which substantially meets all of the stated objections, then, the proposed Project shall be deemed certified by the Responsible Authority as being in conformity with the State's Plan, and the IPA shall so notify the Project Representative within no more than five (5) days that the Project is approved, and the procedures set forth in Paragraph E shall be followed. If the IPA Executive Administration has any doubt as to whether the application substantially meets the objections of the Responsible Authority, then the procedures set forth in paragraphs A and B shall be repeated.

D. Certification by Responsibility Authority and Notice to Investor

On the other hand, if within said fifteen-day period the IPA either:

(1) Receives from the Responsible Authority a statement of no objection to the proposed Project; or

(2) Receives from the Responsible Authority an objection which is not supported by a clear and sufficient statement of detailed reasons why the proposed Project fails to conform to the State Plan; or

(3) Receives no statement at all from the Responsible Authority;

then, the proposed Project shall be deemed certified by the Responsible Authority as being in conformity with the State's Plan, and the IPA shall so notify the Project Representative within no more than five (5) days.

E. Application to Form Investment Company

Within one hundred eighty (180) days of a notice or approval under Paragraphs C or D, as the case may be, the Investors shall submit an application and related documents shall be submitted to the IPA to form an Investment Company to carry out the Project pursuant to Chapter 8 hereof and the Companies Law. Only Projects to be carried out by a single individual shall not require formation of an Investment Company.

F. IPA Issuance of License

Within five (5) days of receiving notice of the formation of the Investment Company, the IPA Executive Director or his delegate shall issue a license for the Project to the Investment Company in the form to be prescribed by the Executive Regulations. License for Projects to be carried out by individuals shall be issued within five (5) days of certification pursuant to Paragraphs C or D of this Law.

G. Registration in Commercial Register

Upon receiving the license, the Investors shall register the Project in the Commercial Register.

H. No Other License Required

Upon registration in the Commercial Register, the Investment Project may be carried out freely with no further license or authorization being required.

Article 61 - Projects Requiring Special Review and Approval

The following Projects may be established only after review and approval by the IPA pursuant to the criteria and procedures set forth in Articles 62 and 63:

A. Certain Projects Exceeding YR Thirty Million

Any Project having a total Investment Cost for New Fixed Assets exceeding YR Thirty Million, or the equivalent of USD Three Million, whichever is greater:

(1) Which has less than thirty (30) percent Yemeni participation; or

(2) Where, after full production is reached, the total annual Foreign Currency payments exceed sixty (60) percent of the total annual payments; or

(3) Which is financed by total loans exceeding three (3) times the paid-in capital; or

(4) Which produces for the domestic market and where, after full production is reached, the unit ~~price~~ cost of the Products would exceed one hundred ten (110) percent of the C.I.F. unit price of same or substantially equivalent competing products landed at a seaport in the Republic before import duties; or

(5) Which requires unusually large amounts of water as specified in the Executive Regulations.

B. Request for Special Rights and Exemptions Under Chapter Five

Projects requesting any or all of the special Rights and exemptions set forth in Chapter 5 of this Law.

C. Establish Private Free Zones

Projects to establish free zones to be privately owned, operated or managed under Chapter 9 hereof.

D. Other Projects

Projects specified in Schedule 7 of this Law.

Article 62 - Criteria for Establishment of Projects Requiring Special IPA Review and Approval

Investment Projects having the characteristics described in Article 61 may be established in accordance with the licensing procedures set forth in Article 63 only after review and analysis by the IPA Executive Administration and a determination by the IPA Board that the proposed Project would meet needs specifically identified in the States Socio-Economic Development Plan and add substantial real value to the national income and economy as follows:

A. Net National Income Benefits and Costs

The IPA Executive Administration shall first analyze the Project to determine the extent to which benefits of the Project to the national economy exceed its costs pursuant to the criteria and procedures to be set forth in the Executive Regulations.

B. Additional Benefits and Costs to the National Economy

In addition, the IPA shall consider other respects in which the Project meets needs specifically identified in the State's Socio-Economic Development Plan in terms of the following factors:

(1) The creation of employment opportunities and training for Yemeni citizens;

(2) The utilization of local materials, supplies and services;

(3) The potential for stimulating the development, expansion and diversification of existing domestic industries and Projects;

(4) The transfer, development or upgrading of appropriate technology;

(5) The distribution of viable Projects within the country;

(6) Positive effects on national income distribution; and

(7) Any other benefits to the national economy brought to the IPA's attention; as well as

(8) Potential costs to the Nation in terms of:

(a) Damage to the environment or ecology of the area of a Project's location; and

(b) Any other costs brought to the IPA's attention.

Article 63 - Licensing Procedures for Establishment of Projects Requiring Special IPA Review and Approval

Investment Projects specified in Article 61 as requiring the special review and determination described in Article 62 may be established only after approval by the IPA Board in accordance with the following procedures:

A. Statement Showing How the Project Will Add Value to the National Economy or Be of Special Significance

In addition to the Application to Establish an Investment Project required by Article 59, a statement must be submitted to the IPA showing clearly and precisely the extent to which the Project will add real net value to the national income and economy by achieving a substantial real increase in national export earnings or in Foreign exchange savings on imports or otherwise according to the criteria set forth in Article 62.

B. Statement Showing Special Economic and Social Significance for Projects Seeking Special Chapter 5 Rights and Exemptions

In addition to the Application and the statement required by Paragraph A, Investors wishing to have a Project considered

for the Rights and exemptions provided for in Chapter 5 must also submit a statement which:

(1) Sets forth the special Rights and exemptions requested; and

(2) Shows clearly why the Project is of such Special Economic and Social Significance that it needs and deserves such special Rights and exemptions.

C. IPA Analysis and Recommendation

Within sixty (60) days of receiving the completed Application and Statements, the IPA Executive Administration shall:

(1) Determine whether and on what conditions, if any, the Responsible Authority has certified the Project as conforming to the State's Plan for the sector concerned pursuant to the procedures specified in Paragraphs B, C, and D of Article 60; and

(2) Determine the extent to which the proposed Project would add net real value to the national economy and income pursuant to the provisions and criteria of Article 62; and

(3) Determine, in the case of an Application requesting special Rights and Exemptions under Chapter 5, whether the Project is of such special social and economic significance that it needs and deserves such Rights and Privileges; and

(4) Recommend to the IPA Board, based on such determinations, whether to:

(a) Approve the Project as submitted; or

(b) Approve the Project conditionally subject to acceptance by the Investor of specified changes and conditions required to make the Project acceptable to the IPA, in terms of the criteria specified in Article 62, or to the Responsible Authority in order to comply with the State's Plan for the sector concerned; or

(c) Reject the proposal as submitted.

D. IPA Board Decision Within Sixty Days

Within sixty (60) days of receiving the Executive Administration's recommendation, the IPA Board shall render its decision.

E. Notification of Board Action

Within five (5) days of the IPA Board's action, the IPA Executive Administration shall notify the Project Representative of the IPA Board decision and any and all conditions for approval or reasons for rejection, as applicable.

F. Investor Acceptance of Conditions

In case of a conditional approval, the Investors shall have one hundred eighty (180) days within which to accept in writing all changes required by the IPA's notice.

(1) Upon such acceptance, the Project shall be deemed approved as changed and the Project Application amended accordingly. No further approval action by the IPA Board shall be required, and the Investors may complete the procedures according to this Article.

(2) On the other hand, the Investor's failure to respond to the IPA's notice within such 180-day period or upon non-acceptance of any of the changes required, the IPA shall treat the Project as rejected.

G. IPA Recommendation and Decision Notification

Upon approval of a Project of Economic and Social Significance seeking special Rights and exemptions which can be granted only by the Cabinet pursuant to Article 46, the IPA Board shall submit its recommendation to the Cabinet. Within five (5) days of the Cabinet's decision, the IPA shall notify the Project Representative of the Cabinet's decision.

H. Formation of Investment Company

Within one hundred eighty (180) days of a notice of approval of the Project by the IPA Board or the Cabinet, or of acceptance of required changes pursuant to Paragraph E, as the case may be, an application and related documents shall be submitted to the IPA to form an Investment Company to carry out the Project pursuant to Chapter 8 hereof and the Companies Law. All Projects licensed pursuant to this Article must form an Investment Company.

I. IPA Issuance of License

Within five (5) days of receiving notice of the formation of the company, the IPA Executive Director or his delegate shall issue a license for the Project to the Investment Company in the form to be prescribed by the Executive Regulations.

J. Registration in Commercial Register

Upon receiving the license, the Investors shall register the Project in the Commercial Register.

K. No Further License Required

Upon registration in the Commercial Register, the Investment Project may be carried out freely with no further license or authorization being required.

Article 64 - Licensing for Project Change - General

A. Application Amendment Required

Any change in information contained in an Application to Establish a Project previously submitted to the IPA shall be reported promptly to the IPA in an Application Amendment in the form to be prescribed by the Executive Regulations which shall describe all respects in which the Project has been changed. Intentional or reckless failure promptly to report major changes shall be punished by imprisonment and fines pursuant to Article 84.A.(6).

B. Definition of Major Change

"Major Changes" in an Investment Project include substantial changes in the nature, technology, capacity, location, fixed assets, production inputs, financial data, or financing of the Project or any other factors which could reasonably be expected to affect treatment of the Project under the Law.

C. Changes in a Project Prior to Licensing

Where one or more Major Changes are made to a Project which has not yet been licensed, the Application Amendment shall be treated as a new Application and processed accordingly. Minor changes shall be noted, but shall not affect the processing of the Application for Licensing Purposes.

D. Major Changes in a Project After Licensing

Major changes to a Project which already has been licensed shall undergo only the approval procedures necessary pursuant to Articles 60 or 63. Such procedures shall be determined by the IPA in light of the changes in the Application Amendment with a view to eliminating and expediting procedures as much as possible. Upon successful completion of such procedures, the IPA shall issue an amended License for the Project which shall reflect the changes.

E. Changes in Company Documents and Commercial Register

Where required:

(1) The relevant company formation documents shall be amended to reflect a Major Change in accordance with the Companies Law and Chapter 8 of this Law; and/or

(2) Major Changes shall be registered in the Commercial Register.

F. Major Changes After Licensing and Before Implementation

Where a major change is made to a Licensed Project before it is implemented, the Investors shall stay implementation pending:

(1) Granting of the amended license by the IPA pursuant to Paragraph D; and

(2) Amending company formation documents and registration in the Commercial Register to reflect the Major Change where required pursuant to Paragraph E.

Article 65 - Project Expansion or Upgrading

A. Definitions

For the purpose of applying this Law:

(1) "Expansion" means increasing the productive capacity of an established Project by the addition of New Fixed Assets or technology either to produce a greater quantity of existing Products, or to improve their quality or to produce new Products; and

(2) "Upgrading" means replacement of worn out or obsolescent Project Fixed Assets, in whole or in part, by those which are new or more advanced, or by upgrading existing Fixed Assets through the addition of new motors or instruments or parts thereof for the purpose of increasing production efficiency or improving the quality of Products and services.

B. Procedure

Any Licensed Investment Project may be expanded or upgraded as follows:

(1) By a Provision in the Original Application:

(a) Any planned expansion or upgrading may be provided for in the Application to Establish an Investment Project originally filed with the IPA.

(b) As such, the expansion or upgrading automatically will be covered by the original license issued by the IPA.

(c) Accordingly, Investors or the Project, as the case may be, only need notify the IPA at the time that the expansion or upgrading takes place.

(2) By Submitting an Application Amendment:

(a) Any previously unforeseen expansion or upgrading constituting a Major Change in an Investment Project as defined in Article 64.B. should be the subject of an Application Amendment submitted to the IPA.

(b) The expansion or upgrading shall then be approved in an amended license which must be granted by the IPA in accordance with Article 64.D.

(c) If an expansion requires an amendment to the Investment Company's formation documents or the Investment Company's commercial registration, this must be also be done as required by Article 64.E.

C. Guarantees, Rights and Exemptions for Project Expansion and Upgrading

As in the case of any Investment Project:

(1) Any Licensed expansion or upgrading is eligible for the guarantees, Rights and exemptions provided in Chapter 2 for all Projects generally.

(2) Only those expansions or upgradings which specifically qualify will receive the Rights and exemptions provided in Chapters 3 and 4.

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(3) The special Rights and exemptions set forth in Chapter 5 are reserved for those expansions and upgradings which specifically qualify and are subjected to the special procedures for review and approval set forth in Article 61-63.

Article 66 - Issuance of Licenses and Certificates and Delegation of Licensing Authority

A. Projects Requiring Cabinet Approval

All Licenses for the establishment or expansion of Projects specified in Article 46 shall be issued by the IPA Executive Administration upon a decision by the Cabinet and shall be signed by the IPA Chairman or the IPA Director General or their delegates.

B. Projects Requiring Special Review and Approval

All Licenses for the establishment or expansion of Projects specified in Article 61 shall be issued upon a decision by the IPA Board and signed by the Chairman or the IPA Director General or their delegates.

C. Other Licenses and Certificates

All other Project Licenses, License Amendments, Project Import Licenses, Certificates of Exemption and other IPA approvals or Licenses required by Licensed Projects hereunder shall be issued by the IPA Executive Administration in the ordinary course of its business and signed by the IPA Director General or his delegate.

D. Delegation of Licensing Authority

The Cabinet's Licensing authority may be delegated to the IPA Board, and that of the IPA Board to the IPA Chairman to the IPA Director General, and that of the IPA Director General to any senior official of the Executive Administration. Any such delegation shall be in writing and signed by a duly authorized official.

Article 68 - Project Registration

A. Project Register

A special register of Investment Projects subject to the provisions of this Law shall be established at IPA. The data contained in the Register shall be immediately available to any member of the public who requests it. The Executive Regulations will specify the initial basic data and information it shall contain, including the following:

(1) Project name and legal form.

(2) Description of the Project site, and the state of the Project's title to the land and buildings.

(3) Basic aims of the Project.

(4) Productive capacity of the Project.

(5) Value of the Project's fixed assets.

(6) Investment Cost of the Project.

(7) Project capital in the currency of the Republic and the currency of investment, both paid-in and authorized.

(8) Names, addresses and nationalities of Investors and their paid-in contributions to the Project Capital.

B. Procedures

The Executive Regulations shall also specify the detailed procedures and fees for making, altering and deleting entries to the Register and making extracts of information to be given to members of the public.

C. Changes

Changes to the information originally submitted shall be promptly recorded in the Register.

D. Valuation of Capital

Valuation of capital in the currency of the Republic for purposes of determining Foreign, Arab and Yemeni participation shall be determined by the Investors.

E. Creditor Filings

As provided in Article 23.E., Creditors may file mortgage statements or final judgements against a Project to provide notice to all third parties.

F. Project Land Title Information

As provided in Article 10.B., the Project shall submit evidence of its title to its land and buildings and the IPA shall record the pertinent information in the Register.

Chapter 8

Investment Companies

Article 69 - Investment Company Form for Projects

Investment Companies shall take any of the legal forms authorized under the Company Law, provided that the following Projects shall be established in the form of either a shareholding company or a limited shareholding company:

A. Any Project having more than two Investors with paid-in capital of YR Five Million or more, or the equivalent of USD 500,000 or more, whichever is greater; and

B. Any Project with more than forty-nine (49) percent Foreign or Arab participation.

Article 70 - Company Law Modification With Respect to Investment Companies

The Companies Law shall govern Investment Companies in all respects except that the relevant provisions of Companies Law 106/1976 shall be modified or cancelled as follows:

A. IPA Model Contracts for Investment Companies

The IPA may recommend model contracts for any or all forms of Investment Companies to be promulgated by decree of the Minister. Such models shall indicate which provisions are mandatory. Except for such mandatory provisions, Investors shall be free to structure Investment Companies as they wish, unless contrary to a specific and clear provision in the Companies Law of 106 of 1976 as modified by this Law.

B. Modification of Rules Applicable to Limited Shareholding and Shareholding Companies

Regarding Investment Companies in the form of shareholding and limited shareholding companies, the following shall apply:

(1) The minimum number of shareholders or promoters shall be two (2) for a Shareholding Company and for a Limited Shareholding Company, and the applications for such companies shall be signed by not less than two (2) persons.

(2) Shareholding Companies offering their shares for public subscription shall be formed and statutes amended upon a decision of the IPA Chairman, or his delegate, after review by the Companies Registration Department and the IPA Executive Administration.

(3) Limited Shareholding Companies and Shareholding Companies not offering shares for public subscription may be formed and statutes amended by a decision of the IPA Director General, or his delegate, after review by the Companies Registration Department and the IPA Executive Administration.

(4) The decision licensing an Investment Company shall be issued within not more than thirty (30) days following the receipt of the application.

(5) Investment Companies shall be considered legally instituted from the date of said decisions.

(6) Amendments to an Investment Company's statutes or articles of association shall be decided upon within not more than fifteen (15) days of submission of the minutes of the extraordinary general meeting of shareholders amending the statutes. Should this period expire without a decision, the same shall be considered an acceptance for publication in the Official Gazette, if required, and for recording in the Commercial Register and in the Investment Projects Register. Such amendments shall be effective from the date of the decision or the expiration of the fifteen (15) day period, whichever first occurs.

(7) For a shareholding Investment Company offering its shares for public subscription, the minimum capital shall be YR Ten Million, or the equivalent of USD One Million, whichever is greater.

(8) The articles of a shareholding company may provide for:

(a) Authorized but unissued share capital of up to three (3) times the amount of the issued capital;

(b) Increasing the issued capital by issuing new shares up to the level of the authorized capital by vote of the Board of Directors, provided that the total authorized capital may be increased only by the extraordinary general meeting of shareholders;

(c) The issuance of different classes of shares and bonds with different Rights and preferences, provided that the rights and obligations pertaining to each such class are clearly specified in the statutes of the Company.

(9) All Shareholding Investment Companies which did not offer shares for public subscription upon their initial formation may do so provided that they shall follow similar procedures to those set forth Companies Law 106 of 1976, Articles 71-79 and Article 86, as applicable, and other relevant articles, as modified by this Law;

(10) For a shareholding Investment Company not offering its shares for public subscription, the minimum issued capital shall be YR 500,000 or the equivalent of USD 50,000, whichever is greater.

(11) For a Limited Shareholding Investment Company, the minimum issued capital shall be YR 250,000, or the equivalent of USD 25,000, whichever is greater, of which at least twenty-five (25) percent shall be paid in upon formation, and twenty-five (25) percent every year after that.

(12) An Investment Company may be capitalized entirely in Foreign Currency, or in local currency or both, according to the original contributions to the capital, as the Investors may decide. The Company's statutes or articles of association and the Company's books and records shall clearly set forth the value of each Investor's contribution to the Company's capital in the currency of investment. The Company may issue shares, allotments, loan bonds or debentures in Foreign or local currency.

(13) The maximum face value of shares or allotments shall be YR 100,000, or the equivalent of USD 10,000, whichever is greater.

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(14) Shares or allotments may be issued at a premium if duly recorded as such.

(15) The statutes or articles of association of a shareholding company not offering its shares for public subscription or a limited shareholding company may provide controlling measures on the circulation of nominal shares giving existing shareholders or partners a priority right to purchase or obtain any shares transferred by another partner or shareholder by sale, assignment, gift, bequest, inheritance, seizure by creditors in respect of a debt, or by any other means; on condition, however, that such measures do not prohibit circulation.

(16) Members of the Board of Directors of shareholding companies and managers of limited shareholding companies need not be Shareholders or partners.

(17) Shareholders shall be represented on the Board of Directors according to the proportion of their shares of the total shares of the Company.

(18) Investment Companies shall be exempted from the following provisions of Companies Law 106/1976: Article 112, Paragraphs B and C; Article 121, Paragraph B; Article 126, Paragraphs A and B; Article 128; Article 130, Paragraph C; Article 134; Article 137, Paragraphs C and D; Article 141, Paragraph B; Article 194; Article 197; and Article 243.

(19) The Board of Directors has full power to manage the Company and may delegate any of its powers and responsibilities to the Chairman of the Board, or another director, or the General Manager, or any other person as it may decide, including but not limited to, the following:

(a) Daily administration of the Company;

(b) Signing on behalf of the Company;

(c) Implementation of Board decisions;

(d) Appointing an accounts controller, at the request of the Shareholders Assembly;

(e) Supervision of bookkeeping; and

(f) Any other task or responsibility as the Board may determine, except those reserved to the Chairman listed in Clause (21).

(20) The duties of the Chairman of the Board of Directors of a shareholding company shall be:

(a) To call Board of Directors and Shareholders meetings;

(b) To represent the Company before the courts; and

(c) Those as determined by the Board of Directors.

(21) Except as required by Article 124 of Companies Law 106 of 1976, it shall not be required to send minutes of Board of Directors meetings and decisions to the Ministry of Economy.

(22) Both a shareholding company and a limited shareholding company shall be formed for an unlimited period, unless otherwise stated in their statutes.

(23) The statutes of a limited shareholding company may organize the managers like a board of directors of a shareholding company, and according to the rules pertaining thereto as modified by this Law. Such Board may in turn limit the authority to sign for the company to specified managers or other persons, provided however, that any such restrictions shall be recorded in the Commercial Register.

(24) All decisions of the extraordinary general meeting of shareholders of a shareholding company and a limited shareholding company to amend the Statutes, increase or decrease the capital, prolong the company's duration, merge or joint venture with another company, or dissolve the company are to be issued by approval of a majority of two thirds of the shares or allotments, as the case may be, represented in the meeting unless the statutes provide for a higher majority. A resolution by the extraordinary general meeting of shareholders passed by the required majority shall be the only action required by the shareholders to amend the statutes of either a shareholding company or a limited shareholding company. Unless otherwise specified in the statutes, the managers of the company shall have full power to take all procedures and sign all documents necessary to make the amendment effective in accordance with Companies Law 106 of 1976 as modified by this Law.

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(25) All Investment Companies shall record on their stationery and all communications to the public the following information:

(a) Name;

(b) Legal form;

(c) Headquarters address;

(d) Commercial Register Number;

(e) Authorized capital;

(f) Issued capital;

(g) Paid-in capital; and

(h) Date of expiration, if any.

Article 71 - Extent of Arab or Foreign Participation in Licensed Projects

Subject to Articles 4.C. and 61, the percentage of participation in Licensed Investment Companies by Yemenis, Arabs or Foreigners respectively shall not be limited, any provisions in the Commercial Law or any other laws to the contrary notwithstanding.

Chapter 9

Free Zones

Article 72 - Establishment, Purposes and Management of Free Zones

A. Establishment of Free Zones

(1) The Cabinet may, upon the proposal of the IPA's Board, decide to establish public free zones for such Projects as may be licensed under this Law; or

(2) The IPA's Board may establish private free zones as Projects under this Law, after the special review and approval procedures set forth in Articles 61-63.

(3) The establishment of a free zone covering an entire city shall be by a law.

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(4) The decree establishing a free zone shall indicate its location and boundaries.

B. Purposes of Free Zones to Increase Exports

The purposes of Free Zones established hereunder shall be to promote industrial investment and increase the export of products and services of the Republic. Accordingly, Products of Free Zone Projects shall not be sold within the Customs territory of the Republic unless:

(1) The import of the Products is required by domestic Investment Projects within the Republic's Customs Territory; and

(2) Such Products cannot be manufactured in the Customs Territory of the Republic, or to the standards and specifications required by such Investment Projects; and

(3) All Customs Import Duties, Taxes and Fees shall be paid in respect of such goods.

C. Eligible Free Zone Projects

Projects shall be eligible to be licensed in the Free Zone if they are engaged in the following activities:

(1) The manufacture, processing or assembling of export products;

(2) International shipping industries;

(3) Banking, insurance and reinsurance business servicing the international markets;

(4) Industries serving offshore oil exploration; and

(5) Transport, storage, loading, unloading, packing, repair and service activities essential to the production or sales operation of export industries and to the benefit of personnel working in the zone.

D. Legal Status and Management of Free Zones

Each Free Zone, public or private, shall be a separate legal entity and shall be managed as follows:

(1) Public Free Zones

Management of a public free zone shall be conducted by a board of directors, the formation and the appointment

of the chairman of which shall be by a resolution of the IPA Board. The board of directors of a public free zone shall have competence to implement the provisions of this law and its Executive Regulations, as well as the regulations and resolutions issued by the IPA Board.

(2) Private Free Zones

Management of a private free zone shall be within the framework of a shareholding company formed pursuant to this Law.

Article 73 - Regulations Governing Free Zones

The IPA Board shall be the authority responsible for the affairs of all free zones. It shall be concerned with laying down the policy to be pursued within the framework of the State general policy and the aims and priorities of the State Plan for Socio-Economic Development. It may adopt such resolutions as it deems necessary to attain the object of establishing such zones and in particular:

A. Regulations

Laying down regulations for governing all activities within the free zones.

B. License Conditions

Laying down the conditions for the granting of licenses and occupancy of lands and premises in the free zones, the rules governing the ingress and egress of goods and registration thereof, including country of origin requirements, the charges for occupying the places in which they are stored, verification of documents and audits; and the systems related to control and security of such zones and collecting dues owing the IPA, and Customs Duties, Taxes and Fees when due.

Article 74 - Licensing Free Zone Projects

A. The board of directors of a public or private free zone shall be competent to approve the system for establishing Projects in the free zone within guidelines established by the IPA Board. The license authorizing a Project to pursue activity may be issued by a decision of the zone's general manager.

B. The license shall be in the form specified by IPA regulations.

C. A Licensed Free Zone Project shall not enjoy the Rights and exemptions provided for in this Law beyond the purposes specified in the License.

Article 75 - Free Zone Exemptions and Movement of Goods

A. Exemption From Usual Import and Export Regulations and Customs Duties

Subject to the provisions of laws and regulations banning the circulation of certain dangerous or illegal goods or materials, all goods may be freely exported or imported from abroad by free zone Projects for their use, and shall not be subject to the laws, rules and customs procedures applicable to exports and imports. Further, such goods shall not be subject to Customs Import or Export Duties, Taxes and Fees, but shall be subject to Service Fees.

B. New Fixed Assets and Production Materials of Free Zone Projects

Like other goods, as set forth in Paragraph A, all New Fixed Assets and Production Materials required for establishing, operating, expanding or upgrading Licensed Projects inside free zones shall be exempted from Customs Import Duties, Taxes and Fees and all other taxes, duties, charges and fees, with the exception of Service Fees.

C. Movement and Security of Goods Within Free Zones

IPA Regulations shall specify the procedures for the movement and security of all goods in, from and within a free zone from the start of unloading until disposition or export.

D. Shortages and Losses

Projects operating in the free zones shall be wholly responsible for any loss, shortage or change in the weight, number, kinds or quality of goods in storage. The Project may be exempted from responsibility if such loss, shortage or change is due to the nature of the goods themselves or is a result of force majeure. Within the limits and pursuant to the rules adopted by the IPA Board, the zone's administration may collect Customs Import Duties, Taxes and Fees and levy fines in respect of losses or shortages not approved by the

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zone's administration. The provisions of this Paragraph shall not apply to losses resulting from industrial operations.

Article 76 - Customs Rules Applicable to the Movement of Goods Between Free Zones and the Republic

A. Customs Duties on Imports into Domestic Market

Customs Duties, Taxes and Fees shall be paid on goods imported from the free zone into the local market as if they were imported from abroad.

B. Calculation of Customs on Products With Both Local and Foreign Content

As for products imported from free zone Projects that include both local and Foreign components, the amount subject to Customs Import Duties, Taxes and Fees thereon shall be only the value of the Foreign components calculated as of the date of their import into the free zone, exclusive of operating costs in such zone.

C. Country of Origin

The free zone shall be deemed the country of origin with respect to the calculation of freight for the Products manufactured therein.

D. Imports from Free Zones Subject to Usual Rules

The movement of goods between the free zones and the Republic's Customs Territory shall be in accordance with the general rules governing imports and exports, provided that Projects within the Republic's Customs Territory shall not be entitled to the Rights and exemptions provided by Article 41 with respect to revenues from exports to a free zone.

E. Temporary Movement of Goods

Pursuant to IPA Regulations, the Free Zone manager or the IPA Executive Administration may permit the temporary entry of local and Foreign goods, materials, parts and raw materials, from inside the country into the free zone for repair or for performing industrial operations thereon, and returning the same into the country, or vice versa, all in the manner prescribed in the IPA Regulations and without their being subject to the import rules in effect. The

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customs tax shall be collected only on the value added in the free zone in respect of the repair or operation performed there.

F. Waste and Scrap

By way of exception from the usual import rules and procedures, Free Zone managers may permit withdrawal into the Republic's Customs Territory of leftovers, ordinary containers and empty receptacles after paying all Customs Import Duties, Taxes and Fees due thereon.

G. Duty Free Materials

All materials imported into a free zone free of Customs Import Duties, Taxes and Fees in accordance with Article 76 shall not be imported into the Republic's Customs Territory unless:

(1) They fall in one of the following conditions so that they can not be disposed of within the free zone;

(a) When the export enterprise declares its dissolution; or

(b) When the imported materials are subject to seizure pursuant to a court judgement to repay debts; or

(c) When the export enterprise is ordered to be removed from the free zone by the Responsible Authority or the Free Zone Management; and

(2) Such materials are of the class permissible for importation; and

(3) The importation is approved by the IPA Director General upon verification of the foregoing by the Free Zone Manager.

Article 77 - Currency Transactions Within Free Zones

Transactions carried out in free zones, and between such zones and other countries shall not be subject to the provisions of any law, decree, regulation, guideline, order or practice governing exchange control in the Republic.

Article 78 - Movement of Persons and Currency

Entry of individuals into free zones or their residence therein, as well as bringing local currency out of or into such zones, shall be in conformity with the terms and conditions set forth in IPA Regulations.

Article 79 - State Guarantees, Rights and Exemptions Provided to All Free Zone Projects

Projects established in public or private free zones, as well as privately-operated free zones which are themselves licensed as Projects, shall be entitled to all of the guarantees, Rights and exemptions provided to other Licensed Projects set forth in Chapter 2 of this Law in addition to the exemptions set forth in this Chapter, as well as the Rights and exemptions set forth in Chapters 3, 4, and 5 to the extent that stipulated conditions are met; provided however, that only earnings from exports to other countries shall qualify for the exemption of export earnings from profits tax provided by Article 41.A.(3) and not exports to the Republic.

Article 80 - Obligations of Free Zone Projects

A. Payment of Fees

In all cases, Projects shall be bound to pay fees which may be determined by the IPA Board for the following:

(1) Services;

(2) Management fees not to exceed 0.3% (Point Three percent) of the annual gross sales revenues of the Project;

(3) Rent for leased land;

(4) An infrastructure fee representing the Project's prorated share of expenses for development of any public utilities, installations and facilities for the Project's site in the form of an annual payment over twenty-five (25) years.

B. General

(1) In all other respects, the obligations of Free Zone Projects shall be governed by this Law and IPA Regulations issued pursuant hereto.

(2) Matters relating to Free Zone Projects which are not covered by a provision of this Law or by an IPA regulation shall be governed by the relevant laws of the Republic.

Chapter 10

General Provisions

Article 81 - Amendment to Schedules, New Fixed Asset Values and Paid-In Capital Amounts

A. Amendment by Cabinet Decree

The following shall remain in effect for five years and thereafter may be amended by a decree of the Cabinet upon the recommendation of the IPA Board not more than once every five years.

(1) Schedule 5 concerning Investment Zones;

(2) Schedule 6 concerning Projects eligible for a ten (10) tax holiday.

(3) The amounts for New Fixed Asset values and paid-in capital set forth in Articles 36, 37.A.(2), 37.B., 46.A.(4), and 61.A.

B. Amendment by Board Decree

All other Schedules shall remain in effect for three (3) years and thereafter may be amended by a decree of the IPA Board no more than once every three (3) years.

C. No Adverse Retroactive Effect on Existing Licensed Projects

No such amendments may be made in a way which:

(1) Derogates from any guarantee, Right or exemption provided by this Law; or

(2) Takes away retroactively any Rights enjoyed by Investment Projects licensed and existing at the time of such amendment; or

(3) Conflicts with the main aim of this Law to encourage, promote and facilitate investment and Investment Projects in the Republic.

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Article 82 - Obligations of Projects or Investors

In addition to those stipulated in the previous Articles of this Law, the following obligations are encumbent upon Owners of Projects or Investors, as applicable:

Notification to the IPA prior to commencing production or operations.

B. Maintenance of complete and accurate books, records of account, and inventories, including, but not limited to, a special register of fixed assets containing all the details pertaining thereto, in accordance with law and recognized accounting and business systems.

C. Whenever Projects are expanded or merged, clear and separate accounts must be maintained in respect of the Projects which still enjoy the Rights and exemptions granted them by this Law for the entire remaining period, so that the Rights and exemptions will be applied only to those Projects entitled to benefit from them and not to Projects which are not so entitled.

D. Providing the IPA with the Project's annual Foreign Currency account statement as required by Article 21.B., annual balance sheets, profit and loss statement and report of activities during the previous financial year, as well as data and information related to the Project reasonably requested within a maximum of 30 days from receipt of the request.

E. Allowing any official delegated in writing by the IPA to enter the Project during normal working hours to review Project records, books, its fixed assets, inventories of production materials and production operations and provide any clarification reasonably requested to determine that the Project is meeting its obligations under this Law.

Article 83 - Rules Relating to Technology Transfer

A. Technology Transfer Agreements Enforceable

Subject to this Law, Transfer of Technology Agreements shall be enforceable in the courts of the Republic by Foreign Licensors and other parties to such agreements. Foreign parties to such agreements also have the Right to settle disputes by binding arbitration pursuant to Chapter 13.

B. Taxes on Transfer of Technology Fees

(1) After expiration of the tax exemption period for Transfer of Technology fees provided by Article 33.A.(6), Projects shall withhold and pay to the Responsible Tax Authorities income taxes in respect of such fees at the following rates:

(a)	Trademark License Royalties	20 percent
(b)	Patent and Know-How License Royalties	10 percent
(c)	Technical Assistance Fees	10 percent
(d)	Management Fees and Other Fees for Services Performed In the Republic	15 percent

(2) The rates specified in Clause (1) shall prevail unless otherwise provided in an applicable treaty to which the Republic is a party with the Home Country of the Foreign Licensor or Transferor of Technology.

(3) Provisions in Technology Transfer Agreements providing for payment of fees and royalties net of tax shall be invalid.

Article 84 - Notices and Communications

A. All notices and communications hereunder must be in writing and delivered by any of the means set forth in Paragraph B.

B. A communication shall be deemed to have been received by the addressee:

(1) On the day of delivery by hand against receipt;

(2) On the next day following transmission by telex or telephone facsimile machine (telefax);

(3) Following dispatch by registered mail:

(a) Fifteen (15) days between addressees within the Republic;

(b) Twenty (20) days by air mail between the Republic and any Arab or African country; and

(c) Thirty (30) days by air mail between the Republic and any other country.

Chapter 11

License Cancellation, Withdrawal of Rights and Penalties

Article 85 - License Cancellation and Withdrawal of Rights and Exemptions

A. Upon approval of the Minister, IPA may initiate court action to cancel a Project license or withdraw the Rights and exemptions granted to a Project in whole or in part pursuant to Article 19, after warning and notifying the Project Owner, in the following cases:

(1) Where the Project or the Investor, as applicable, has failed to adhere to any of the terms and conditions contained in the License; or

(2) Where the license or Rights were granted based on false information; or

(3) Where a Project applies any Right under this Law for purposes other than the authorized purposes of the Project; or

(4) Where a Project has knowingly or recklessly committed a serious violation of any provision of this Law.

B. An Investor or Project whose license has been cancelled or whose Rights have been withdrawn may submit a new application for licensing or to regain such Rights after one year.

Article 86 - Penalties

A. (1) Without prejudice to any more severe penalty provided for in another law, any Investor, Project Representative, manager or other person who knowingly or recklessly provides false or forged information to the IPA or the Responsible Authority concerning a Project with intent to obtain any license, Right, or exemption under this Law shall be punished by imprisonment for a period not to exceed five (5) years and a fine not less than YR 50,000, or the equivalent of USD 5000, whichever is greater, and not to exceed YR 500,000, or the equivalent of USD 50,000, whichever is greater, or either of these two punishments and shall be obliged to return the value of any license, Right, or exemption wrongly received.

(2) Any disposition locally of imported Fixed Assets for non-Project purposes before five years, except to another Project, without IPA authorization or without paying all Customs Import Duties, Taxes and Fees as required by Article 31 shall be subject to a fine not less than YR 50,000, or the equivalent of USD 5000, whichever is greater, and not to exceed YR 200,000, or the equivalent of USD 20,000, whichever is greater, in addition to the payment of twice the customs fees and duties and other incurred importation fees on the imported assets.

(3) Any person who knowingly or recklessly applies any Right or exemption under this Law for any purpose other than an authorized purpose of a Licensed Project shall be subject to the same fines as are set forth in Clause (2) in addition to payment of twice the value of the benefit received.

(4) Any Government Official who in the course of his duties obtains possession of, or control over, any document or information and who without authorization communicates all or part of such document or information to any other person to whom he is not authorized to communicate the same, in violation of Article 5.B, shall be subject to a fine not exceeding YR 100,000 or imprisonment for a term not exceeding two years or to both.

(5) Any Government Official who engages in unwarranted obstruction or harassment of an Investment Project shall be subject to a disciplinary action, including suspension from duty or reduction in rank or to a fine not exceeding YR 50,000 or all three actions.

(6) Violations of any other provisions of this Law which are specifically made punishable by their forms shall be subject to a fine not less than YR 25,000 and not to exceed YR 100,000.

B. Where one of the offenses set forth above is committed by any company:

(1) The Company shall be subject to the applicable fines; and

(2) The following directors and officers of the Company shall be subject to both such fines and the applicable imprisonment:

(a) Those who perpetrated the offense; or

(b) Those who had knowledge of the offense and failed to prevent its commission or report it to Responsible Authorities following its commission.

C. Criminal complaints and public lawsuits shall not be filed regarding violations referred to in Paragraph A without a request or approval in writing from the Chairman of the IPA Board. The IPA Board or its delegate may engage in conciliation efforts regarding such pending public lawsuits, provided the minimum penalty stipulated is paid in case of a proven violation.

Chapter 12

Administrative Appeals and Remedies

Article 87 - Administrative Appeals of Decisions Issued by IPA Officials or the IPA Board

Investors or Projects may appeal decisions issued under this Law, first to the IPA Board, then to the Minister and finally to the Prime Minister, as appropriate, regarding any matter affecting their interests or rights.

Article 88 - Administrative Appeal Regarding Government Officials, or Agencies, or State Enterprises

A. Investor Complaints and Appeals

In the event an Investor or Project encounters any problems or obstacles in the course of carrying out his activity, a complaint may be submitted to the IPA, and the IPA shall make every effort to resolve the matter. Should the IPA be unable to do so, the IPA Chairman shall refer the matter to the Minister. Should the Minister be unable to resolve the matter, he may in turn refer it to the Prime Minister who is hereby authorized to issue an order for the rendering of any assistance which he may deem appropriate or to order the Responsible Government Ministries, Authorities, Officials or State enterprises to provide assistance without delay.

B. Unilateral Government Action to Remove Obstacles

In the event that procedures or practices for the collection of taxes, customs duties or fees or for the conduct of other government business are found to be an obstacle to an Investment Project in particular, or to Investment Projects generally, whether or not a grievance has been submitted to

the IPA under Paragraph A, upon recommendation of the Minister, the Prime Minister shall order the related government officials, agencies, organizations, or state enterprises to take remedial action.

C. Response Required of Government Organizations and Officials

Any Government Ministries, Authorities, Officials, Agencies, Organizations, or State enterprises to whom an order of the Prime Minister has been issued under Paragraphs A and B shall:

(1) Expeditiously render the assistance demanded or otherwise comply with such order; or

(2) Within ten (10) days from the date on which the order was received notify the Prime Minister in writing in detail of all reasons why the order cannot be complied with.

D. Final Administrative Action By the Prime Minister

Where any order issued under Paragraphs A or B has not been complied with in the manner required by Paragraph C(1), upon receiving the notification of reasons for noncompliance under Paragraph C, or if no such notice has been received, the Prime Minister shall take any appropriate action which shall be final and compliance shall be required of the Responsible Government Authorities, Officials, or State enterprises without delay.

Article 89 - Appeal to Courts or Binding Arbitration

Decisions of the IPA Executive Administration, the IPA Board, the Minister, or the Prime Minister affecting an Investment Project may be appealed or referred at any time to the concerned court, or to an arbitration panel pursuant to Chapter 13, without the need to complete the administrative appeal process provided for in this Chapter. In this regard, the decision of such court or arbitration panel, as the case may be, shall be final.

Chapter 13

Settlement of Disputes Concerning Projects

Article 90 - General

Disputes concerning Investment Projects under this Law shall be resolved by litigation in the courts or by binding arbitration as provided in this Chapter.

Article 91 - Disputes Between the Government and Foreign or Arab Investors or Any Majority Foreign or Arab-Owned Projects

The Government hereby consents and agrees that any dispute with any Foreign or Arab Investors or any Project fifty-one (51) percent owned by such Investors arising from the implementation of any provisions of this Law shall be settled by one of the following means chosen by the Investor or the Project as the case may be:

A. Litigation before the local judiciary pursuant to the rules of Judicial Jurisdiction and Procedure; or

B. Binding arbitration within the framework of any of the following means chosen by the Project or the Investor:

(1) The Arab Organization for Investment Guarantee Agreement; or

(2) The Convention for the Settlement of Investment Disputes between States and the Nationals of Another State; or

(3) Any other international or bilateral agreement to which the Republic is a party; or

(4) The rules of procedure for commercial arbitration of the United Nations Commission on International Trade Law (UNCITRAL), at the nearest Regional Center for International Commercial Arbitration operating pursuant to such rules; or

(5) The rules and procedures set forth in Article 95 of this Law for binding arbitration in the Republic.

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Article 92 - Disputes Between the Government and Yemeni Investors or Majority Yemeni-Owned Projects

The Government hereby consents and agrees that any dispute with any Yemeni Investors or any Yemeni majority-owned Project arising from the implementation of any provisions of this Law shall be settled by one of the following means chosen by of the Investors or the Project as the case may be:

A. Litigation before the local judiciary pursuant to the rules of Judicial Jurisdiction and Procedure; or

B. Binding arbitration in the Republic in accordance with the procedures set forth in Article 95.

Article 93 - Disputes Between Private Investors Within the Same Project and Between Projects and Other Parties

A. Agreement to Arbitrate

Disputes between a Project and any other person or party, as well as disputes between or among any Investors in the same Project, shall be settled by binding arbitration if the parties so agree in accordance with any rules or procedures agreed to, including:

(1) The rules and procedures set forth in Article 95 hereof; or

(2) The rules and procedures of any existing institution providing machinery for commercial arbitration including, but not limited to, any Regional Center for Arbitration operating in accordance with the rules for commercial arbitration of the United Nations Commission on International Trade Law, the International Chamber of Commerce in Paris, the London Court of Arbitration or the American Arbitration Association.

The agreement to arbitrate may be made in advance or at any time and must be in writing. Such agreement may be part of any written contract or agreement and may be included in the Investment Company formation documents.

B. Litigation

In the absence of any such written agreement to arbitrate, such disputes may be settled by litigation before the local judiciary pursuant to the rules of Judicial Jurisdiction and Procedure.

Article 94 - Effect and Enforcement of Judgements and Arbitration Awards

A. Final Arbitration Awards or Final non-appealable court judgements issued pursuant to Articles 91, 92, 93 and 94 hereof shall be binding upon all parties and shall be immediately complied with and obeyed by all disputing parties affected including the Government and all of its Government Ministers, Organizations and Officials and state enterprises, as well as Investors, Projects and third parties, as applicable.

B. Notwithstanding the provisions of any other law, decree, regulation, order or practice:

(1) The courts of the Republic shall enforce any arbitration award presented to it rendered in accordance with any of the provisions of Articles 91, 92, 93 and 94 hereof as though it were a final and nonappealable judgement rendered by a competent Court.

(2) Accordingly, the courts shall enforce such awards without delay upon presentation of such arbitration award without considering any of the facts of the underlying dispute or questioning the arbitration procedures.

(3) The courts may withhold enforcement only upon receiving clear, convincing and unchallengeable evidence that the judgement was based upon fraud or corruption by the arbitrators. In such case, the dispute shall be decided again by binding arbitration according to the same procedures unless both parties otherwise specifically agree in writing.

Article 95 - Procedures and Rules for Settling Disputes Involving Investment Projects by Binding Arbitration in the Republic

Except where otherwise specifically agreed in writing by the parties, or as otherwise provided by provisions of Articles 91, 92 and 93 hereof, the following procedures and rules shall govern proceedings in the Republic for the settlement of disputes involving Investment Projects by binding arbitration:

A. There must be a written agreement between the parties to arbitrate which may be made in advance or at any other time and may be part of any other written agreement or contract, including Company formation documents.

B. An Arbitration Panel shall be constituted, comprising a member on behalf of each disputing party and a third member acting as chairman to be jointly named by the said two members.

C. The Arbitration shall be initiated by sending to the other party a statement in writing demanding arbitration setting forth the first party's complaint or claim, and appointing an arbitrator to the Panel.

D. Within no more than thirty (30) days the second party shall respond in writing appointing its arbitrator to the Panel.

E. Upon failure to nominate an arbitrator within such 30-day period, the second party forfeits entirely the right to do so. Thereupon, the first party may, after notifying the second Party, apply to the Appointing Authority which shall nominate the second arbitrator and notify the parties within no more than thirty (30) days thereof.

F. For purposes of this Article, the "Appointing Authority" shall be either:

(1) A person, organization or body agreed to by the disputing parties in writing; or

(2) In the event of no such agreement, the IPA Director General or his delegate.

G. Should the Appointing Authority fail to nominate the second arbitrator within such 30-day period, the first arbitrator shall appoint the second arbitrator as soon as possible, notifying the parties in writing of the nomination.

H. Failing agreement on the nomination of the third member to act as chairman of the arbitration panel within thirty (30) days of the appointment of the second arbitrator, the arbitration panel chairman shall be chosen by the Appointing Authority, at the request of either party. Such chairman shall be neutral and unbiased as between the parties and have a reputation for fairness and objectivity.

I. The Appointing Authority shall notify the parties in writing of the appointed third member, after which the parties shall have five (5) days within which to appeal the appointment with notice to the other party, which appeal shall be heard and decided by the Appointing Authority within no more than thirty (30) days of the appeal. The decision of the Appointing Authority either to appoint a new chairman or retain the original appointment shall be final and non-appealable unless the two other arbitrators agree on a third

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arbitrator to replace the appointee of the Appointing Authority prior to the first meeting of the Panel.

J. Unless the parties otherwise agree, the Arbitration Panel shall meet within no more than thirty (30) days of the appointment of the chairman, who shall designate the time and place of the meeting and make all arrangements necessary therefor.

K. Except as specifically provided in this Article or as determined by majority vote of the arbitrators, or as specifically agreed in writing by the parties, the proceedings shall be conducted in accordance with the rules of procedure for commercial arbitration prevailing at the time of the dispute of the United Nations Commission on International Trade Law, which are hereby adopted for that purpose.

L. The Panel shall see to it that the dispute is expeditiously resolved. Awards shall be rendered by majority vote, shall be in writing, shall be signed by at least a majority of the arbitrators, and shall be final and binding on both parties and enforceable as any other final judgement. The Arbitration Panel shall decide on the costs of Arbitration and shall determine who shall bear such costs.

M. Any of the foregoing provisions, procedures or appointments may be altered, or the arbitration proceedings terminated or suspended, at any time by an agreement in writing by all parties or arbitrators.

Chapter 14

Transitional Provisions

Article 96 - Informal Publication of the Law

Immediately following promulgation of this Law and pending its publication in the Official Gazette pursuant to Article 1.B., the Minister shall make copies of the Law and distribute them to all government offices. Copies shall also be made available to Investors and the public upon request.

Article 97 - Functions and Authority of the IPA Pending Establishment

In the event the IPA has not been established by the date this Law goes into effect pursuant to Article 1.B., the functions and authority of the IPA shall be exercised by the Ministry of Economy, Supply and Trade and the General Department for Investments pending the IPA's establishment. More specifically, all functions and authority under this law of:

A. The IPA Chairman shall be exercised by the Minister of Economy; and

B. The IPA Board of Directors shall be exercised by the Investment Exemption Committee established under Law 18 of 1975; and

C. The IPA Executive Administration shall be exercised by the General Department for Investment at the Ministry of Economy; and

D. The IPA Director General shall be exercised by the General Director of the General Department for Investment of the Ministry of Economy. Upon establishment of the IPA, such General Department of Investment and its staff shall be transferred to the IPA.

Article 98 - Law 18/1975 Investment Projects

All Project licensed pursuant to Investment Incentive Law 18 of 1975, or to the Arrangement and Encouragement of Industry Law 20 of 1976, shall continue to benefit from all Rights and exemptions granted it under that law; provided that, by application to the IPA, any such Project may elect to be governed by this Law. Within thirty (30) days of receipt of the completed Application, the IPA Executive Administration shall issue such Project a new License under this Law without the need to obtain the prior certification of the Responsible Authority under Article 60, unless the Project requests special Rights pursuant to Chapter 5. Thereupon such Project shall be subject to all obligations hereunder and entitled to all rights granted by this Law, except the tax exemption granted by Article 33.A.

Article 99 - Cancellation and Modification of Laws

A. Law 18/1975

Subject only to Articles 97.B. and 98, the Investment Incentive and Regulation Law 18 of 1975 is hereby cancelled.

B. Law 20/1976

The Regulation and Encouragement of Industry Law 20 of 1976 is hereby modified to the extent that henceforth all industrial Projects shall be licensed under this Law. Accordingly, subject only to Article 98, all provisions of Law 20 of 1976 which conflict in any way with this Law or any of its provisions are hereby cancelled or modified to the extent required to give full effect to this law.

C. Other Laws

All provisions of the following laws as well as all other laws, decrees, regulations, requirements, guidelines or orders which conflict with this Law shall be modified or cancelled to the extent required to give full effect to this Law, provided, however, that no provision of any Law shall be cancelled which offers more favorable Rights or exemptions to Investment Projects:

(1) Commercial Law 39 of 1976; and

(2) Companies Law 106 of 1976; and

(3) Foreign Ownership of Real Estate Law 114 of 1976; and

(4) Labor Law 5 of 1970; and

(5) Fisheries Law 20 of 1978; and

(6) Tourism Law 34 of 1981; and

(7) Import/Export Law 23 of 1975; and

(8) Commercial and Industrial Profits Tax Law 11 of 1972; and

(9) Employee Income Tax Law 20 of 1974; and

(10) Capital Transfer Tax on Foreigners Law 48 of 1976; and

(11) Real Estate Tax Law 21 of 1976; and

(12) Stamp Duty Law 6 of 1979; and

(13) Judicial Power Law 28 of 1979; and

(14) Commercial Court Law 40 of 1976; and

(15) Commercial and Civil Litigation Law 42 of 1981; and

(16) Arbitration Law 33 of 1981; and

(17) All banking and exchange control laws, decrees and regulations.

Article 100 - Issuance of Executive Regulations

The Minister shall issue the Executive Regulations required to implement this Law within ninety (90) days of its promulgation. Any failure to do so, however, shall not delay the effective date of this Law, and the Responsible Authorities shall implement it upon its effective date to the extent possible in the absence of such Executive Regulations.

Article 101 - Responsibility for Implementation

The Prime Minister and the ministers are responsible for implementing the provisions of this Law.

B. Law 20/1976

The Regulation and Encouragement of Industry Law 20 of 1976 is hereby modified to the extent that henceforth all industrial Projects shall be licensed under this Law. Accordingly, subject only to Article 98, all provisions of Law 20 of 1976 which conflict in any way with this Law or any of its provisions are hereby cancelled or modified to the extent required to give full effect to this law.

C. Other Laws

All provisions of the following laws as well as all other laws, decrees, regulations, requirements, guidelines or orders which conflict with this Law shall be modified or cancelled to the extent required to give full effect to this Law, provided, however, that no provision of any Law shall be cancelled which offers more favorable Rights or exemptions to Investment Projects:

(1) Commercial Law 39 of 1976; and

(2) Companies Law 106 of 1976; and

(3) Foreign Ownership of Real Estate Law 114 of 1976; and

(4) Labor Law 5 of 1970; and

(5) Fisheries Law 20 of 1978; and

(6) Tourism Law 34 of 1981; and

(7) Import/Export Law 23 of 1975; and

(8) Commercial and Industrial Profits Tax Law 11 of 1972; and

(9) Employee Income Tax Law 20 of 1974; and

(10) Capital Transfer Tax on Foreigners Law 48 of 1976; and

(11) Real Estate Tax Law 21 of 1976; and

(12) Stamp Duty Law 6 of 1979; and

(13) Judicial Power Law 28 of 1979; and

(14) Commercial Court Law 40 of 1976; and

(15) Commercial and Civil Litigation Law 42 of 1981; and

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(16) Arbitration Law 33 of 1981; and

(17) All banking and exchange control laws, decrees and regulations.

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The Minister shall issue the Executive Regulations required to implement this Law within ninety (90) days of its promulgation. Any failure to do so, however, shall not delay the effective date of this Law, and the Responsible Authorities shall implement it upon its effective date to the extent possible in the absence of such Executive Regulations.

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