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Privatization in the Middle East: An Insight Into Yemen's Initiatives

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Abstract: This article deals with privatization in the Middle East in general and in particular offers some insights into the country of Yemen's initiatives. It details the background, the reasons for privatization and the various challenges Yemen is facing in this era of privatization. As part of a comprehensive economic reform, the Government of Yemen initiated a privatization program in early 1995. Problems of economic development, public sector's poor performance, problem of government financing and promotion of private sector development were the major reasons in the adoption of privatization in Yemen. This article concludes with the various challenges and concerns that Yemen faces currently and in the future.

Key words: Privatization % Middle-East % Yemen

INTRODUCTION

So far, there have not been much work written on privatization in the Middle East and more so with regard to any particular country in the Middle East region even though such world-wide practices were available since 1980s. Many countries around the world moved to privatization in order to solve the economic problems which documented poor performance and failure of stated-owned enterprises. Privatization is a worldwide phenomenon with the many advantages propagated. According to Cowan [1] the concept of privatization has been used long time ago by Adam Smith when he talked about the great companies at that time like British South Africa company and Dutch East Indies Company but the term of privatization is new and defined as "the transfer of a function, activity, or organization from the public to the private sector". Savas [2] sees privatization as the change on the activity or on the ownership of assets which lead to decrease the government role and increment the private role. However," privatization should not be treated as dogma, but rather it should be based on reasonable motives and objectives clearly understood by all parties concerned. This is because privatization is seldom motivated by a single concern. This assertion reaffirms the need to explore thoroughly the motives behind the decisions to privatize. These motives contribute greatly to the selection of state-owned enterprises that were to be privatized, the methods to be adopted, the objectives pursued and the expected results [3].

As we have seen across many countries, the reasons for pursuing a privatization policy are related to the policy's potential benefits and most often the policy is part of a macroeconomic reform package with other components to stimulate the nation's economy. The stimuli may be in terms of investment, improved products and services, foreign market access, or increased capital. Some sources state that privatization is the "strong" policy called for because other measures, such as attempts to improve SOEs, do not go far enough; privatization is what is needed, for example, to get rid of excess labor and increase economic competition [4]. Lending and/or international agency pressure or persuasion is another compelling reason cited by authors for governments to pursue privatization, as following their recommendations may lead to fresh loans or an increase in donor funding [5]. The size of government, the bureaucratic activities of the government and the lack of efficiency also rendered such reasons for privatization which had caused tax revolt in many states in the USA even though by moving to privatization the needs of people had been delivered through less cost [6]. Many reasons had been mentioned in Development Research and Policy Analysis Division [7] that restricted SOEs and instead encouraged governments to opt for privatization which include:

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First, enterprises under privatized regime will lead to an increase in the social welfare. Second, the financial problem that State-Owned Enterprises (SOEs) faced. Third, the concern of global crises that emerged especially after the 1980s. Fourth, the pressure of International Monetary Fund and World Bank on the governments to opt for privatization, in addition to technological improvements and political changes in socialist countries. Lastly, the ideological performance of privatization presumed to enhance the efficiency of SOEs. Although, there are many reasons of adopting the privatization in many countries there are consensus around the efficiency of privatization to solve the economic problems that majority of developing countries faced. As a country in the Middle East region, Yemen adopted the privatization program in mid-1995 and still striving towards improving privatization program with cooperation of International Agencies. In the next section, we will review the privatization in the Middle East and North Africa countries and in particular evidence in Yemen.

Privatization in the Middle-east and North Africa Countries: Privatization of SOEs in the Middle East and North Africa (MENA) countries has been slow relative to other regions, especially Latin America, East Asia and South-east Asia. MENA countries embarked on privatization programs to improve investment in the private sector. The issue was and continues to be that implementation of these reforms is inconsistent and slow because of the varying interests involved and the fear of further job losses. Although privatization programs in many of the region's major economies have been in place since the early 1990s, progress in implementation has been slow. Globally, between 1990 and 1998, MENA's share of privatization transactions in developing countries was less than 3%. The region has also lagged in offering new projects for the private provision of infrastructure (PPI). Through the end of 1998, MENA accounted for only 4% of all PPI projects worldwide [8].

In the 1990s the majority of privatization initiatives took place in only Egypt, Morocco and Kuwait. Many other MENA countries later followed suit, but the potential of privatizations in MENA is very large, relative to what MENA states have accomplished to date. Within specific countries a major issue affecting the success and failure of these initiatives is convincing investors of the governments' intentions with respect to the methods of privatization, the types of enterprises for sale and the conditions of sales [8]. MENA states have a strong advantage over other developing regions in creating successful privatization programs because of considerable assets of Arab nationals who could be attracted to bring assets closer to home by investing in Arab states. The value of assets of Arab nationals outside of the region is very high and for some countries the total savings of nationals held abroad are higher than their GDP. MENA states are tapping into private capital from Gulf Cooperation Council (GCC) nationals, which could be an additional source of private investment considering the recent spike in oil prices. In addition, non-Arab investment and FDI inflows will likely play a larger role. Reforms continue to be sporadic and lack focus, thus for MENA states to compete in the global economy there must be more focus, consistency and acceleration of reform [9]. Moreover, privatization should focus on MENA countries selling state owned money losing ventures and attracting private investment through deregulation and decreasing institutional and political barriers [10].

However, recent privatization initiatives are working to incorporate the private sector in the economic reform process. The private sector can bring future growth by enhancing the region's competitiveness and by creating enough jobs in the future to sustain the increased labor force, something the public sector in MENA will not be able to do. The Gulf States, which depend mostly on oil exports, have some of the most vibrant private sectors in the region and could serve as a model for other Arab States to follow. For example the United Arab Emirates created substantial growth through non-oil sectors that accounted for 70 percent of GDP in 2000 and maintains the lowest unemployment rate in the region at about 2.3 percent [11]. The reasons that these models from Gulf States are not easily replicated in the other parts of Middle East are primarily due to the slow pace of policy reform, a business environment that discourages entrepreneurship, administrative and capital constraints, the difficulties in complying with regulations, weak enforcement of property rights and corruption. Moreover, public banks control the financial systems, which generally favor state-owned enterprises, larger industrial firms and offshore enterprises, making it difficult for new firms to secure startup capital [11].

MENA countries are working towards changing the investment conditions to encourage more FDI inflows. Some recent reforms include new or restructured investment legislation, incentives such as tax and custom duty breaks, relaxed restrictions on foreign ownership limitations, privatization and capital market reform [12]. Almost every Arab country passed some type of investment reform legislation in the 1990s. Saudi Arabia, Qatar and Kuwait passed legislation changing foreign ownership limitations. Qatar passed a new law in 2000 allowing 100 percent foreign investment ownership in selected sectors such as agriculture, industry, health, education and tourism, which is an increase from the previous cap of 49 percent. Allowing foreigners to own majority stock in more lucrative sectors will attract investment that may have stayed away from MENA countries due to these restrictions. Other countries such as Morocco, Jordan, Lebanon, Egypt, Bahrain and the United Arab Emirates offer strong incentives for FDI including free-trade zones with preferential treatment for foreign investors [12].

Most countries also relaxed restrictions on the operations of foreign firms. Morocco and Lebanon are the most open countries with no limits on foreign ownership, local content, domestic labor, or capital repatriation [12]. GCC countries have some domestic labor requirements and land ownership restrictions to GCC citizens only, but there are no local content and capital repatriation restrictions for foreigners. Tunisia and Egypt have some local content requirements to certain sectors and there are capital repatriation restrictions, however there are no major obstacles otherwise. This is in contrast to Syria where there are highly constraining repatriation restrictions but local content and labor requirements do not exist. Broad capital market reforms in the region progressed in recent years with Morocco privatizing its stock market, which is one of the most active in the Arab world. Other stock markets, which are not as active, can be found in Tunisia, Jordan, Lebanon, Egypt and GCC countries while Syria is planning to have its stock market operational in 2007. North Africa is moving ahead of the remainder of the Arab world with the implementation of provisions for new financial utensils such as venture capital and private equity funds. These reforms on regulation and capital market legislation play an integral role in the new institutions that need to be established in MENA states to create more competitive businesses and jobs, deepen financial markets and increase FDI inflows [12].

Privatization in Yemen: Yemen's unification in 1990 has shaped the country's subsequent development. The Yemen Arab Republic (North Yemen) was a lower middle-income country before 1990, functioning under a capitalist system. Compared with the People's Democratic Republic of Yemen (South Yemen), the North enjoyed a gross domestic product seven times larger, a population four times bigger and a per capita GDP nearly 50 percent greater. The smaller and poorer South Yemen, however, had its strength in better health, education and gender outcomes, because of 23 years of socialism preceding the unification. Some of the key problems facing united Yemen have their origin in the era before unification and in the terms of merger. The large civil service and difficulties in land titling are legacies of the socialist era of South Yemen. Difficulties in improving health or gender outcomes arise from the relatively conservative values in the northern part of Yemen. Since unification, Yemen has successfully overcome a civil war in 1994, coped with the return of around 800,000 Yemenis working in the Gulf countries and weathered several adverse economic shocks, including interrupted flows of remittances, volatile oil prices and suspension of most foreign aid. The negative spillover from the Iraq War also affected Yemen. Yemen continues to suffer from internal security issues. Traffic through Aden - the best natural port in the region - has barely recovered to the levels of 1988 [13].

Yemen continues to suffer from weak institutions and a high risk of internal conflict. Although the World Bank ranks Yemen barely above the categorization of low-income countries under stress, the U.K. Department for International Development, an important bilateral donor for Yemen, have labeled Yemen as a fragile state since January 2005. The index of failed states compiled by Foreign Policy magazine and the Fund for Peace ranks Yemen eighth in a global list of 60 countries rated for risk of state failure, ahead of Afghanistan. The categorization of Yemen as a fragile state underscores its difficulties in initiating and sustaining sound economic and social policies. This difficult operating environment calls for Yemen's development partners to take a more selective, nuanced approach to reforms. Yemen's prospects are mixed, as democratic institutions are slowly taking root but the main engines of economic growth are sputtering. Helped by a vibrant but somewhat muzzled press (third worst in the Middle East and North Africa), a nascent multiparty democratic tradition is taking root in Yemen. The holding of three multiparty parliamentary elections in 1993, 1997 and 2003 and the first direct presidential elections in 1999 are seen as substantial steps toward democracy. The passage of a law on local authority in 2000 is viewed as a major instrument of decentralization to elected councils at governorate and district levels.

Until 1984, foreign aid and worker remittances served as the main sources of Yemen's foreign exchange. After the discovery of oil in 1984, it quickly emerged as the major foreign exchange earner, accounting for 90 percent of merchandise exports. However, Yemen's oil is depleting fast: at the current rate of production rate, oil supplies will be exhausted in merely eight years. Water resources, too, are scant and being overexploited. Demographic dynamics exacerbate the scarcity of Yemen's limited and declining natural resources. High birth rates (six per woman) and population growth (3 percent per year) combine with rising labor force participation (especially among women in rural areas) to keep Yemen's labor force growing by 3.8 percent per year. Thus Yemen faces the stark reality that, if oil runs out and the looming water crisis cannot support, sustained growth in agriculture, an exodus of workers abroad could become inevitable, unless non-oil sectors grow rapidly. For nearly a decade after the 1990 unification, Yemen achieved a reasonable annual GDP growth rate (around 5.2 percent), securing a decent 2 percent per capita growth. The integration of North and South Yemen provided a bigger market; new oil wells came on stream in 1994, boosting oil production by 80 percent; and a successful macroeconomic stabilization and reform program in the second half of the 1990s controlled inflation, liberalized trade, reduced subsides, unified the exchange rate regime and reformed the financial sector. Economic growth peaked in the period 1995 to 1998 [14].

The steady decline in internal conflicts in the second half of the 1990s and the improvement in four of the six dimensions of governance encouraged a surge in domestic private investment. There was little support, however, from foreign direct investment. Endowed with a small manufacturing base and rooted historically in a strong tradition of trading, Yemen's economy is dominated by the service sector, which responded well in the reform period, producing nearly half of GDP. Within the service sector, the trade, transport and hospitality sectors were the main forces behind the growth spurt. Integration of the North and South also increased the internal flow of goods and people. The fiscal deficit in this period was steadily shrinking under the stabilization program agreed with the International Monetary Fund and therefore much of the growth came from private sector investment [13].

Since 1999 GDP growth has slipped steadily. Revenue from the dramatic increases in oil prices since 2000 and the outbreak of antigovernment rebellion in parts of the country distracted the government from maintaining the momentum of the reforms. Over this period, quality of governance also deteriorated steadily. Several reform initiatives floundered: the privatization law of 1999 was never ratified, introduction of a general sales tax and the reduction in petroleum subsidies were repeatedly shelved, political commitment for legal and judicial reforms wavered and the implementation of civil service modernization and health sector reforms slowed. Since 2000, gains from strong oil prices contributed to terms of trade gains averaging 4 percent of GDP, reversing the trend of the previous decade. Internal conflicts increased after February 2000, preceding the infamous attack on USS Cole later that year and reversing the decline in violence over the preceding five years. Private investment slumped in 1999 and continued to fall steadily to reach a mere 10 percent of GDP, half the average during the period of reforms [14].

A major component of economic reform includes the government's withdrawal from the production and service sectors of the economy, including privatization of most public sector enterprises. The main challenge that the government of Yemen faced after a conflict and unification period was to speed up the economic growth, after it inherited the over-centralized public sector. In that sense, inefficiency, monopolies and overregulation appeared in public enterprises and restricted a lot of private sector activities. As part of comprehensive economic reforms, the Government of Yemen initiated a privatization program in early 1995 that aims to privatize about 70 percent (in employment terms) of its 212 public enterprises (SOEs) by the year 2000 and came to a standstill in April 2001 when Parliament refused to approve a World Bank credit to fund a larger, long-term privatization program. However, a few years later, the government funded the privatization program. In April 2004 Presidential directive decreed that land be granted to investors at no cost and that the investment projects enjoy profit tax exemption if the project capital is more than 10 million USD. A privatization program started in 1998 with sixteen enterprises in industry, tourism and trade, but came to a standstill in April 2001 when Parliament refused to approve a World Bank credit to fund a larger, long-term privatization program. This decision was later overturned. Between 2003 and 2004, where eight companies were privatized, seven of which was in public auction. The remaining company was transferred to the Yemeni Economic Corporation (YECO) also, according to the Technical Privatization Office (TPO), in 2005; the government privatized two enterprises and is working to privatized three more by the end of 2006. Recently, the Yemen government announced it would continue the process of privatization by privatizing fifteen factories in 2007, which are suffering from economic stagnation. Airport services, cements and medications are at the top of the privatization list. Airport services, cement factories and pharmaceutical companies remain at the top of the privatization priority list.

The successful implementation of macroeconomic reforms during the past two years has stabilized the economy and helped to restore business confidence.

In the continued pursuit of these reforms, privatization commands priority for rebalancing public/ private sector roles in the economy, improving economic efficiency and quality of services, containing budgetary deficits and contingent liabilities and accelerating private sector-led growth and investment. Credible privatization actions are seen by the Government as being essential for signaling to the world market and investors Yemen's commitment to economic reform and its attractiveness as a place to do business in the Middle East [14].

Reasons Behind Privatization Policy in Yemen

Problems of Economic Development: The economy of the new state unification inherited almost all the economic ailments of the two former states together with new ones. The increase in budget expenditures reflected the direct cost of unification. It represented the cost of a new public employment that was hired for political reasons. Besides, the costs of political promotion and military spending were additional reasons of unification. The indirect cost of unification was much higher. There was no accurate data on the cost. However, it is possible to make some stipulation about it. The Government claimed that the total costs of 1994 civil war were $12 billion. If we add to that figure the costs of human losses, the indirect total costs would be much higher. The other elements of indirect costs were the distorted new laws, regulation and institutions. During the unification process, the joint committees, which assigned responsibilities of unified constitution, laws and regulations, did not have much time and authority enough to come up with appropriate laws and regulations. During the Gulf War II, the national interest was ignored and required the Government to take pro-Saudi and Gulf States stance since these states hosted over two million Yemeni workers. In addition, these states provided Yemen with generous aids and development loans. Because of Yemen’s stand, Gulf States expelled over one million Yemeni workers and ceased aids and loans. Furthermore, the Saudi Government issued a new decree taking special treatment of Yemenis. The economic cost of this episode was very immense. The economy was so severely hit by these shocks that it was unable to recover again.

The inefficiency of the Government and its institutions to deal with this crisis is attributed to poor coordination efforts. The immediate reaction of the coalition Government was to fix exchange rate and prices of basic goods and oil products, which caused a further deterioration. The economy had continued to deteriorate and was on the verge of collapse in early 1995. The serious attempt to increase economic growth by the Government had not started until 1995. At that time, the Government realized how serious the situation was, that it started to seriously consider potential solutions. Once again, political considerations played a significant role in choosing the direction and reform elements [14]. It was widely believed by the Government and IMF that the causes of the deterioration of the economy were the huge imbalances in aggregate accounts. Thus, the remedy, in view of the Government and IMF, was very obvious and simple, as it was achieving balances in these accounts. According to this diagnosis, any policy capable of reducing budget deficit and achieving economic stability also would get the economy back on the positive economic growth track [13].

Realizing the limited local resources and the need for international aids, the Government made contacts with both the International Monetary Fund and the World Bank for their assistance. The negotiations were fruitful and produced agreements relevant to the economic reform. The opposition parties had not been included in these negotiations. This reform program was a comprehensive and a detailed one. It consisted of stabilization and restructure policies. Stabilization policies included measures to reduce general expenditures, raise public revenue and restructure the budget. IMF put limits on budget deficit and its finances. The budget deficit must be reduced to no more than 3% GDP and must be covered through borrowing from the public rather than from the Central Bank of Yemen. To control general expenditures, the government had to cut wages and salaries and reduce direct and indirect transfers. In addition, the government had to increase revenue taxes through changing tax code and improving collection methods of the Tax Authority [14].

All economic indicators showed that Yemen’s economy was deteriorating during the period 1990-1995. The real GDP grew at a rate of 1.4% on average. The real oil GDP growth rate was 7% on average while the real non-oil GDP growth rate was closed to zero on average. Unlike the contribution of oil sector that was positive, the contribution of non-oil sectors was very low. Having a closer look at the non-oil sector, we will see that most sectors had negative and fluctuated growth rates. Only some service sectors witnessed some significant positive growth, however, these growth rates were not stable. Thus, the economy witnessed permanent deep chronic structural problems rather than transient shocks, causing bad effects on almost all economic indicators [13]. Domestic saving was negative as well as the national saving was very low whilst the investment remained stagnant and the private per capita consumption declined.

The government of Yemen with coordination efforts from both IMF and World Bank recognized that the privatization program as a substantial element of economic reform. Thus the program started in 1995 and the aim was to privatized 70% of the SOEs employments by the year 2000 but only small enterprises had been privatized and the large enterprises were still under the government control [14]. The program had moved slowly and by 2007 more than 100 enterprises were privatized.

Weak Performance of Public Sector: The administration of Yemen was severely impacted by a series of events since 1990; the unification of the North and the South required the merger of two very different systems creating a much larger civil service that at times duplicated functions; the return of around 800,000 Yemenis from the Gulf following the Gulf War required the Government to absorb a large number into the civil service for social reasons, further exacerbating the problem of over-staffing; and the economic turmoil throughout 1990-95 caused civil service wages to decline substantially in real terms. The overall result now is a very large, poorly-trained and poorly-paid public administration that lack adequate enforcement of civil service processes and procedures.

Simultaneously, the budget processes was not as effective as it should have been. Planning of expenditures and revenues was not always done with a proper framework. Emergency stabilization measures have brought the system under greater stress. Fiscal adjustments had to be done quickly, but in the absence of a smoothly operation budget system, the cuts were not always carefully targeted across different expenditure categories. Maintenance expenditures have suffered particularly, raising the issue of sustainability of many investments [14].

While there are no formal service delivery surveys, there are indications of poor service delivery. For example, concerns over discretionary application of laws and regulations, under-paid and unmotivated civil servants and a lack of protection for property rights and enforcement of contracts. Key development indicators also point to limited access to and quality of basic services. For example, enrollment rates, at both the primary and secondary level, are low. Adult illiteracy remains among the highest in the world. The low life expectancy and high infant mortality are indicators of deficiencies in basic health care provision. And, almost half of the population remains without access to safe water (Table 2). Hence, Yemen needs to enhance and expand coverage of services, in an environment of limited capacity and financial constraints. Meeting this challenge will require substantial upgrading in the system of public sector management so that scarce financial and human resources are most effectively deployed.

Table 3 shows an indicative assessment of citizen satisfaction also points to poor service delivery, where households were asked whether or not they used certain basic services in the past six months, the portion of these services provided by the government and satisfaction with the services. Private Service providers were proportionately more common for health care and garbage disposal, though the government still provided about three-quarters of these services. With the exception of telephone services (used by only about 10% of the households), satisfaction levels were dismal. While the court system and police services were used by only about 10% of those surveyed, 75% and 84%, respectively, of those individuals were dissatisfied. For both education and health care, less than half of the users were satisfied. Many of the common causes of dissatisfaction that were cited could be addressed through better management of limited resources, adequate funding for operations and maintenance, more careful attention to local needs in the planning process and service provided by appropriately motivated, accountable, honest civil servants [14].

Table 4 shows that while not all the services mentioned are best provided by the government (e.g., lower food costs, job opportunities), the top four responses (water, electricity, health care and education) could be enhanced by improved public sector management and/or more effective partnership with private sector service providers. Several other responses reveal a broad concern for a more effective safety net than currently exists. It is also important to note that the low quality of public services is particularly problematic for the poor since they lack the financial resources to use private providers of education, health care, or power generation [14].

Problems of Government Finance

Here We Evaluate Three Aspects: The first part reviews Yemen's budgetary institution; the second part considers the effectiveness of the public spending programs in creating conditions for sustainable growth and poverty reduction and finally, the public revenue and investment.

Budgetary Institution: There are three crucial questions to look at in assessing whether or not budgetary institutions foster good expenditure outcomes. Do institutions safeguard overall fiscal disciple? Do they

Table 1: Macroeconomic Indicators in Yemen, 1991-2000

Year	GDP growth (%)	Non- oil GDP (%)	Oil Value added (%)	Inflation CPI (%)	Fiscal balance (% of GDP)
1991	2.0	3.2	-5.6	44.9	-3.5
1992	8.3	11.7	-15.4	50.6	-11.9
1993	4.1	4.0	4.2	54.8	-12.8
1994	2.2	-2.3	42.7	71.3	-14.7
1995	10.9	9.4	19.9	62.5	-5.2
1996	5.9	4.5	13.5	40.0	-0.9
1997	8.1	8.2	7.5	4.6	-1.5
1998	4.9	5.4	2.5	11.5	-7.9
1999	3.7	2.9	7.8	8.0	0.1
2000	5.1	4.7	7.2	8.5	7.9

Source: World Bank, [14]

Table 2: Indicators of Service Delivery

	Yemen		Comparators	
	1970	1996	1970	1996
Gross Primary Enrollment	41	53	55	72
Gross Secondary Enrollment	8	23	9	21
Adult Illiteracy	90	62	79	54
Access to Safe Water	5	52	na	42
Life Expectancy (*)	54	63		
Infant Mortality Rate (per 1000 live births) (*)	96	69		

Source: Country Assistance Review, Operations Evaluation Department, World Bank, Report No. 19030, 1999

Table 3: Access To and Satisfaction with Services

Service	Service used in last 6 mth (% of HH)	Service provided by gvt (% of services)	Satisfied with Services (%)	Main reason for dissatisfaction
Health services	80	72	43	High cost, lack of concern of health staff, no medicines
Schools	64	98	50	Poor quality, lack of desks/chairs, far away, disrepair, associated costs
Water	62	78	35	Frequent cuts, low pressure, price increases
Electricity	50	100	56	High prices, power cuts, poor service
Sewage	40	82	50	Lines in disrepair, no service
Garbage disposal	29	72	28	Containers far away, negligence, dishonest employees
Courts	12	100	16	Bribes required, no justice
Telephone	11	100	81	
Police	11	100	26	Dishonesty, delays in resolving conflicts

Source: World Bank, [14]

ensure that budgetary allocations reflect the strategic priorities of policy makers? And do they promote efficient, effective use of resources as agencies spend the allocation. This section looks at the budget formulation process, the budget execution process and budgetary control in light of these three characteristics.

In the past, in Yemen, budgets were prepared without broad agreement on a macroeconomic framework and financial aggregates. Budget circulars provided no indication of the financial limits within which the budget requests were to be made. And the forms which line ministries had to complete for investment projects were overly detailed. As a result, line ministries submitted high budget proposals (which they regarded as initial bargaining position) and incomplete forms (generally excluding even the most basic, critical data). As result, budget proposals were cut through a time-consuming, *ad hoc* process that did not necessarily reflect sectoral priorities. Furthermore, the budget process was not unified. The Ministry of Finance (MOF) prepared the current budget, with the Ministry of Civil Service and Administrative Reform taking the lead on the wage portion. The investment budget was prepared separately by the Ministry of Planning and Development (MOPD). In the past, the particularly poor coordination between the formulation of the investment and recurrent budget led to ineffective and inefficient resource allocations [14].

Table 4: Unavailable Services that Government Should Provide

Services, by grouping	Number of respondents
Water, regulate water service	148
Nearby health care, inexpensive or free health services, mother and child centers	102
Electricity service, improved electrical apparatus	100
Education, expansion of schools, free education, improved quality, school equipment and facilities, school for girls, transportation for students	84
Food assistance, lower food costs	84
Job opportunities	33
Sewers	31
Garbage collection, clean the streets	31
Provide homes, repair old houses, enlarge houses	23
Telephone services	21
Pave streets	21
Loans with easy conditions	16
Improve electricity service	11
Financial assistance, Clothing for the poor, Raise incomes, Provide cooking gas, Lower costs of services, Provide security, Provide fishing boats, Gardens for children, Provide merchandise on installment, Provide agricultural services, Provide social welfare, Provide land, Take care of the environment and pesticides, Improve social welfare, Laws to resolve disputes, Police station, Youth clubs, Make available a just person to resolve problems, Provide harbor for boats	10 or less Each

Source: World Bank, [14]

There has been a sustained effort over the past couple of years, supported by IMF technical assistance, to correct some of these problems. These efforts culminated in the introduction of a new budget preparation system for the year 2000 budget (initiated in the summer, 1999 and approved by Parliament in December, 1999). Noteworthy, the overall responsibility for the budget has been given to the MOF. A unified budget circular was issued that at least provided some guidelines on spending ceilings within a budget envelope set from a medium-term macroeconomic framework developed with the IMF. These guidelines, however, continued to be incremental in nature, therefore providing very limited flexibility for line ministries to make allocation decisions between budget chapters. Furthermore, in general, line ministries did not submit constrained budgets. The process of cutting back proposal was done, as in the past, during budget committee negotiations [14]. While the issue of inadequate coordination between the MOF and the MOPD has more or less been resolved, other institutional factors continue to hinder effective budget preparation. These factors include: (i) continued confusion, in practice, on the responsibilities of line ministries; (ii) low civil service salaries and inadequate managerial autonomy; (iii) no forward budget estimates; (iv) limited flexibility of line agencies; and (v) the absence of objective criteria on which to base allocation decisions.

A medium-term macroeconomic framework is now being used, but it is one developed primarily with the IMF. There is no in-house capability with which to establish overall and sectoral envelopes within which expenditures programs are to be prepared. For the past couple of years, such units have been established (on paper) in both the MOPD and MOF, but neither have the staff or skills. To focus public expenditures on priorities, sector strategies are now being prepared in key line ministries. Public expenditures are to be aligned with sectoral objectives on the basis of these strategies. Forms for development projects have also been simplified and effort are underway to maintain a reliable database on investment projects, including information on resources needed for completion and the extent of physical completion. In the past, lack of this information has made budget preparation difficult. However, to date, institutional confusion over the responsibilities of line ministries and the MOPD has impeded the development of such a database.

Several characteristics of the budget impede efficient use of budgetary resources. Some of these issues that need to be addressed during the budget formulations process include: There are “projects” in the budget that actually finance the upkeep of existing facilities. Such projects should be transferred to the current budget.

C The investment budget typically includes a large number of projects that are only partially funded. For example, rather than financing the construction of one school, resources are provided to finance the partial construction of five schools. As a result, a large portion of the budget is spent without usable assets being created. Closer attention needs to be paid to including only priority projects in the budget and funding them adequately.

- There is inadequate funding of operations and maintenance. The problem is particularly severe in the education, health and agriculture sectors. Adequate provisions for Operations & Maintenance (O&M) need to be made and closer attention needs to be paid to the trade of between initiating new projects and increasing allocations to O&M.

Defense spending is up (over 20% increase amounting to some US$ 90 million; to put this in perspective, this increase is equivalent to the total amount budgeted for the Ministry of Public Health in 1999). The wage bill has increased dramatically (35% of the budget, in large part because of the costs of implementing the new teacher and healthcare worker laws) and the public investment budget is, in real terms, about 20-25% higher than last year. It is unlikely that the government can efficiently undertake this level of public investment as they haven't demonstrated this capacity at the lower investment levels. The budget, as presented to Parliament, shows a deficit of about 3.5%. This is at the outer range of what can be financed from non- inflationary sources. While the budget was prepared on the basis of oil prices at $17/barrel (and expected prices based on future markets points to a more likely case of around $19), other assumptions are unlikely and may push the realized deficit higher [14].

The existing procedures for the release of funds to spending agencies and the control over expenditures from the budget are time-consuming, difficult to administer and not very effective. As a result, monitoring of budget execution is not timely and there is insufficient information available for effective cash management. Furthermore, the systems for reallocating appropriations inhibit the managerial function of making bona fide shifts in expenditure to attain specified objectives. Ad hoc procedures for supplementary appropriations do not permit proper priority planning.

At the agency level, each spending unit has 3 separate accounts at the Central Bank, each for recurrent expenditures, development expenditures and revenue. The MOF keeps track of budget execution through these Central Bank accounts. However, these accounts cannot provide detail on budget execution below the chapter level. Each month, MOF makes an allocation for spending on each account, based on Central Bank data on cash flows. The main macro- fiscal control is that cumulative expenditures on each chapter do not exceed MOF allocations. Each agency is supposed to submit a monthly statement of revenues and expenditures to the MOF. Usually, agencies are delayed by late returns from branches in the governorates. There are no comprehensive commitments accounting, though large commitment may be recorded in statistic records. Reforms are planned to correct some of these information deficiencies and to transfer functions from the Central Bank to the MOF. In principle, the General Director of Finance (a MOF employee) controls budget execution in each spending unit. All payments must pass through him. However, with dual reporting responsibilities, under-qualified staff and limited motivation of the poorly paid staff, there is ample opportunity for circumventing the system of control.

Preliminary numbers on the realization of the 1999 budget and the content of the 2000 budget indicate that in 1999 the Government's prioritization program was not observed in some sectors. For example, in both health and education, the 2000 budget includes many of the high priority projects that were expected to be completed in 1999. In addition, in agriculture the government planned to shift a number of "projects" that actually financed upkeep of existing facilities to the recurrent budget. However, these projects continue to appear in the 2000 proposed program [14].

Yemen's budget control system is lacking in the required fundamentals which include:

- Clear laws and guidelines on financial administration and penalties for non-compliance;
- Clear organization and procedures defining who does what and how;
- Competent and motivated public officers and good supervision; and
- Ex-post and independence audit of financial transactions and investigation and reporting of irregularities.

According to Finance Law Number 8 of 1990, (article 56), the Ministry of Finance is responsible for overall financial control, internal control and inspection and preparation of the final accounts of the Government. While MOF is assigned these responsibilities, it does not always have effective tools with which to fulfill its mandate, nor does the Finance Law provide for sanctions when violations are uncovered. The Central Organization for Control and Auditing (COCA) is designated as the supreme audit institution in Yemen under COCA Act No

39 of 1992. It is responsible for: (i) control over public funds; (ii) performance audits; and (iii) development of the accountancy and auditing profession in Yemen. To meet these objectives, it is authorized to conduct financial, compliance and performance audits. In principle, it performs an annual financial audit on every ministry and authority, in each governorate, as well as all bodies who receive government subsidies. In practice, it does not have the required technical competency nor can it cover all agencies every year. Furthermore, follow up on audits is weak.

In addition there are about 30 agencies in which internal audit units have been set up. There is some confusion about internal audit as a ministry may have two internal audit units, one performing a pre-audit on financial transactions and reporting to the chief accountant (this reporting indirectly to MOF and COCA) and also an Internal Audit and Inspection Unit, heading by a General Director, performing financial and technical audit of compliance with laws and regulations, appointed by the Minister.

Expenditure: There are four main reasons why Yemen's public expenditure program does not reflect the detailed prioritization needed to make the best use of limited resources. Addressing these problems would increase the impact of public expenditures on growth as well as on alleviating poverty.

- The data on projects are inadequate to carry out a prioritization of the investment program. Details on the total cost or money required to complete ongoing projects are not available; nor is there information on the extent of physical completion.
- The investment program consists of a very large number of small projects.

Planners are under great pressure to include low priority projects to serve regional interests, even if they have only a token allocation. This means that resources are spread thinly over many projects, which remain unfinished year after year. Thus, money is spent without creating usable assets.

- The composition of the sectoral investment program often does not reflect the sector strategy. Part of the problem may be the absence of a broad agreement on sectoral objectives. For instance, although the sector strategy in power and water stresses an increasing role for the private sector, most of the investment in these sectors continues to be financed by public funds. Similarly, in the education sector, expenditures do not reflect the emphasis government policy places on expanding primary education especially for girls and in under-served areas.
- Recurring resources for operations and maintenance (O&M) are rarely sufficient to operate existing facilities. This makes it even more difficult to provide the O&M budget for facilities coming on stream out of the ongoing investment program.

Often the planners and donors get around this by including projects in the investment program, which are in fact instruments to finance recurrent costs. Thus, the resources required to operate existing facilities are severely understated in the budget. The lack of O&M outlays is a major reason behind the poor delivery of health and primary education services which are crucial to alleviate poverty in the medium term. To create the conditions for sustainable growth and poverty reduction, the government needs an expenditure reform program that focuses on reducing nonessential current spending, maximizing benefits from investment spending and reorients outlays toward priority areas. Areas where current spending could be rationalized include: (i) remaining (minimal) subsidies; (ii) aggregate transfers to public enterprises and entities; and (iii) the large public sector wage bill. Instead, current expenditures could be reoriented toward priority areas of education, health, O&M for infrastructure and the social sectors, vocational training programs and the social safety net.

The relatively high levels of development expenditure in recent years have had little measurable impact on economic growth, reflecting weaknesses in selecting the most productive projects and in monitoring implementation. To ensure the quality of public investment, the government needs to strengthen its capacity to select projects with the highest economic return and to monitor implementation. In the meantime, development expenditure needs to be limited mainly to ongoing projects. Given the pressing physical infrastructure needs, development outlays will need to be maintained at a high level, with priority given to basic education and health, power, water and wastewater, transport (roads, ports and airports) and agricultural extension and research. Public investment in the power and water sectors needs to be supplemented by the opening of these sectors to private investment [15].

Table 5: GDP by Private/Public Sector 1995-2005

Non-Oil Sector Oil Sector Private Sector Public Sector (incl. Oil)	1995 Ratio to GDP (%)	2000 MN YR at 2000 prices	 Ratio to GDP (%)	Target 2005 MN YR at 2000 prices	 Ratio to GDP (%)	 Average Annual Growth Rate, (%), 2001-2005
Total GDP	86.5	914,343	66.3	1,346,500	74.3	8.0
	13.5	465,469	33.7	465,500	25.7	0.0
	66.2	605,131	43.9	973,132	53.7	10.0
	33.8	774,681	56.1	838,868	46.3	1.6
	100.0	1,379,812	100.0	1,812,000	100.0	5.6

Source: SFYP [15]

Revenue: At only 10% of GDP in 1998, Yemen has one of the lowest non-oil tax efforts in the region. In addition, the tax system contains a number of inefficiencies resulting from inappropriate definitions of the tax base, nuisance taxes which yield little revenue and arbitrary exemptions. Finally, like many other areas of the government, tax administration needs substantial improvement.

Since 1997, in the framework of the IMF's ESAF/EFF programs, the Government has embarked on a program to increase non-oil revenue and improve its efficiency. The Government has submitted to the parliament two new tax laws which thoroughly reform both direct (income) and indirect (production) taxes. Proposed changes to the income tax system include consolidating income from all sources, rationalizing tax brackets, broadening the tax base and eliminating ad- hoc exemptions. Indirect tax reforms include the introduction of an excise tax which approximates a general sales tax (GST). The measure will provide for an input tax credit mechanism to avoid cascading, zero rating of exports and drawbacks for import duties and indirect taxes. This system is, however, only a precursor to a more comprehensive GST which the government plans in the coming few years [16] in enhancing the private sector development.

Yemen's private sector is small and its relative importance to GDP continued to decline in the late 1990s. Despite difficulties in obtaining accurate data on its size and contribution to GDP, available estimates show that the share of private sector value-added in total GDP was about 66% of GDP in 1995, but continued to decline during the FFYP. Private sector value-added declined to 58% during 1996-1997, rising to 66% in 1998 (reflecting collapse in oil prices) before starting its decline again to 55% in 1999 and further to 44% in 2000. Private sector output as a ratio of non-oil GDP, increased from 77% in 1995 to 80% in 1997 and remained at about 78% during 1998-1999 before declining to 66% in 2000 (Table 5).

Private investment (mainly domestic) also witnessed sharp increase during 1995-1997 and a sharp decline in 1998-1999 before modest recovery in 2000. This can be seen also from the trend of new investment projects during 1992-2000. Private foreign investment projects remained at about YR 6 billion during 1995- 1999 and jumped to YR 22 billion in 2000 [16]. Increasing the size and scope of the non-oil private sector is Yemen's primary challenge in terms of job-creation. Excluding oil, gas and refining, the industrial sector contributed less than 10% of GDP in 2000. Within this, the non-oil manufacturing sector was less than 5% of GDP in 2000 (down from 12.6% of GDP in 1995). The private service sector comprised 44% of GDP in 2000, but almost two-thirds of the sector was concentrated in trade, tourism and transportation, traditionally not sources of high productivity or wages. Given the higher productivity and wages in manufacturing (and thus better living standards that could result from more productive manufacturing jobs), the troubling statistic is that manufacturing employed only 2.5% of Yemen's work force in 2000 [16].

The size of most private firms in Yemen is small and remuneration in these small firms is low-and growth both in size and compensation is also slow. This suggests the presence of substantial barriers to the growth of smaller firms. The Industrial Survey of 1999 showed that only 288 firms (less than 1% of manufacturing firms) had more than 10 employees. About 95% of firms had three or fewer employees and these numbers were virtually unchanged from 1996. Much of private manufacturing in Yemen is small-scale by one or two-person partnership firms, producing small amounts of the product, distributing/selling directly to customers, with little interaction with intermediaries. The resulting inability to achieve any economies of scale or scope and the lack of specialization of skills, means that while new entry into the sector is always possible, most existing firms are not growing larger and more efficient. And compensation in these mostly smaller firms was over 50% lower than in larger firms. Smallness is not a function of age, as the average age of firms is 14.2 years, based on a recent survey of 947 firms in 5 governorates. In addition to being small, the majority of firms has concentrated ownership (single proprietorship) and is engaged in simple, low value-added activities: shop keeping, hairdressing and plumbing, together with carpentry shops, car repair and welding workshops. Most firms are structured as limited partnerships and proprietorships with 12% of large companies being public shareholding firms, while 28% are government owned. Level of foreign ownership among firms is very low and most firms are directed towards production for the domestic market.

The structure of private sector activity in Yemen suggests the presence of significant barriers to growth in value added and specialization of firms. The large number of very small formal enterprises and very large firms (low numbers of medium sized companies) combined with a more significant tendency for large firms to report barriers to growth suggest that while entry into the formal sector may be relatively easy, profitable expansion may be limited by high levels of risk and uncertainty, administrative hurdles, infrastructure inadequacies, excessive competition and weak firm capacity. This is further underscored by the behavior of existing large firms, which are characterized by significant internalization of activities and services, namely electricity generation, transport, distribution and training as in the case of the largest firms. In other words, profitable market opportunities and services complementary with expanding production are either non-existent (missing) for SMEs or access is highly restricted and/or prohibitively costly. This effectively raises costs of production and in effect the minimum efficient size for profitable firms in the private sector. High transaction costs related to insufficient mechanisms for contract enforcement, resolution of commercial disputes creates an environment of general legal uncertainty furthering limiting growth potential [16].

Governance problems are perhaps the most evident and important barrier to the development of the private sector and an impediment to the growth of the size of firms. In general, Yemeni firms face a lack of profitable opportunities and weak capacity for expansion in product markets. Yet, larger and older firms tend to be more successful, owning their own land and engaging in export activities. One reason for that appears to be the ability of these firms to use their own extensive informal networks. In bypassing formal marketing institutions and creating integrated firm structures, they can bypass the governance and institutional failures in Yemen's business environment. However, these opportunities are restricted to a few groups in the country and thus the poor functioning of formal market-supporting institutions is a barrier to the successful growth of many new entrants into Yemeni business [14].

As shown in a survey of Yemeni firms in late 2001, poor governance manifests itself in a number of ways in Yemen: (i) corruption and inefficiency in the interaction of public officials and private businesses; (ii) ineffective or absent market-promoting institutions, such as those enforcing contracts (courts, tribunals etc.) or regulating information flows (e.g., about creditworthiness) and (iii) poor performance of the public sector in terms of delivering essential services. But this suggests that there is considerable scope to remove the constraints to growth for new small and medium sized firms, by creating formal institutional alternatives to the informal arrangements possessed by the few successful firms. The keys to opening up small and medium firm growth in Yemen seems to lie in developing ways to allow smaller and newer firms access to formal alternatives to the informal and exclusionary mechanisms used by the older and larger firms [14].

CONCLUSION

This article depicts the insights of privatization efforts particularly in Yemen where the source is mainly attributed to governance. Governance has been shown, in a wide variety of studies, to significantly influence development outcomes. Corruption, in particular, has a destructive effect on investment and economic growth rates. By contrast, greater enforcement of property rights, stronger rule of law and efficient government service delivery promotes investment and economic growth [16]. These links between governance measures and development hold not only for traditional economic indicators, but are also well recognized for other development outcomes, including infant mortality, literacy and equality of income growth. In Yemen, governance performance is weak and that would affect investment and growth. On control of corruption, Yemen ranks only in the 15th percentile and its rankings for rule of law and political stability/lack of violence indicators are significantly lower. Even relative to the 19 countries in the Middle East and North Africa region, Yemen's performance on governance indicators is poor. In political stability and lack of violence, only Iraq and Algeria rate lower than Yemen. Out of 19 countries, Yemen ranks 15th in government effectiveness, 14th in regulatory framework and 16th in both rule of law and corruption. Only in voice and accountability does Yemen perform relatively better, ranking 6th out of the 19 MENA countries [16].

Within the Yemeni private sector as well, governance concerns are identified as extremely significant. In the recent private sector survey in Yemen, 82% of firms identified corruption as a major obstacle to the profitable expansion of Yemeni firms. And more than half identified constraints in the administrative, regulatory and legal frameworks in which firms operate and current gaps in the physical infrastructure (electricity) upon which firms depend for production and distribution of goods and services [16]. Overall, the greatest concerns in the Yemeni business sector seems to be in two areas: institutional/administrative problems (corruption, taxes, smuggling/dumping, dispute settlement); and volatility/uncertainty (about macro and other policies and about crime and disorder). To a slightly lesser extent infrastructure and input issues (electricity, access to land) are also perceived to be problems. Relatively few firms, on the other hand, identified telecommunication problems or labor regulations as moderate to severe barriers to expansion. In this perspective, the reasons and pursuance of privatization in Yemen is faced with various continuous challenges that the government needs to address in ensuring a more success story.

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