



## **Indicators of the performance of the industrial sector in Yemen in light of conflict and war**

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## **Executive summary**

The industrial sector is one of the most important pillars of economic growth in Yemen, as it is one of the most productive sectors capable of creating job opportunities and reducing unemployment. It also represents a mainstay for expanding the production base and increasing income in national economy. Before 2015, the industrial sector, both extractive and manufacturing, contributed about 31.2% of the GDP and employed about 14.5% of the total employment.

With the beginning of the year 2015 and Yemen's entry into the cycle of conflict and war, the industrial sector witnessed multiple changes, most notably achieving a continuous annual recession during that period that reached about -17%, and cumulative economic losses in the sector's output during the years 2015-2020 which were estimated at about 14.1 trillion riyals. The employment rate of workers in the industrial sector also declined, as a result of the sector's layoffs of a total of 260,000 jobs during the years 2015-2020, in addition to about 479,000 jobs that could have been created during the period. Thus, the 739,000 jobs were lost in the private industrial sector (manufacturing industries) during the years 2015-2020. On the other hand, with the change in the political and security conditions in Yemen during the past years, the contribution of both extractive and manufacturing industries to the formation of the current GDP has changed in favor of the manufacturing industries, which witnessed an increase in their relative importance in the composition of the current GDP. The contribution of industrial establishments to the formation of industrial output changed in favor of large enterprises at the expense of SMEs.

It is worth noting that the industrial sector in Yemen operates in a difficult and unstimulating business and economic environment. Its growth and development face many challenges and obstacles. These challenges only worsened in light of conflict and war causing great damage to the industrial sector. Direct damages were represented in the destruction of many industrial facilities with partial or total suspension of production and layoffs of employees. Indirect damages, however, included the instability of the industrial supply chain and unavailability of the necessary production elements, or in the form of increased production costs.

In order to reduce these challenges and increase the role of the industrial sector in economic growth and development, the document presents a set of recommendations and priorities necessary to achieve the indispensable political and economic stability for the work of the industrial sector.



## **Background**

The industrial sector is one of the most important pillars of economic growth in Yemen, and occupies a special importance in the priorities of economic and social development, as it is one of the most productive sectors capable of creating job opportunities. Its important and pivotal role in increasing exports and improving the external position of the Yemeni economy, in addition to its great role in generating front and rear economic entanglements contribute to the integration of the various economic sectors and work on the distribution of investment activities in various regions, cities and governorates, thus establishing a balanced economic development.

Before 2015, the industrial sector, both extractive and manufacturing, contributed to the bulk of the GDP formation. Data indicate that the industrial sector contributed about 31.2% of the GDP in 2013, of which 23% were from the extractive industries (Oil and Gas) and about 8.2% from the manufacturing industries<sup>1</sup>. The industrial sector is also one of the vital economic sectors that employ Yemeni labor, as it employs about 14.5% of the total workforce<sup>2</sup>.

The structure of the industrial sector is characterized by the predominance small establishments, which represent about 89% of the number of industrial establishments, compared to about 9% for medium-sized enterprises and only about 2% for large enterprises. However, large enterprises contributed to the bulk of the industrial sector output in 2014 with a percentage of 62.2%, followed by small enterprises by about 30.6%, then medium enterprises by about 7.2%. When it comes to employment, large enterprises employed about 36% of the total workers in the industrial sector in 2014, coming in second place after small enterprises, which employed about 44.5% of the total workers, while medium-sized enterprises employed 19.5% of the total workers in the sector<sup>3</sup>.

With the beginning of 2015 and Yemen's entry into the cycle of conflict and war, and the emergence of many economic, political and security challenges, the performance of the industrial sector witnessed multiple changes, both in terms of growth and contribution to the gross domestic product and in employment generation. All this required a lot of effort to overcome these challenges and enhance the sector's contribution to the process of economic growth and sustainable development.

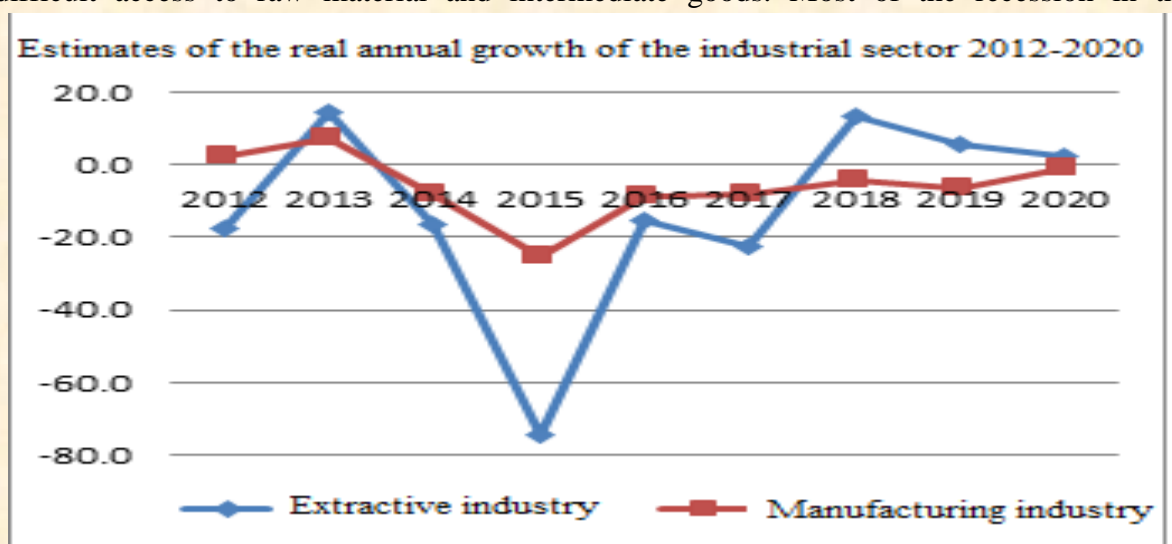
### **1. The performance of the industrial sector during the war.**

With the end of 2014, the political crisis began to escalate and turned into a state of civil war in a number of Yemeni governorates, and reached a state of total war in March 2015 after the regional intervention, and the subsequent measures of control and siege on Yemeni land, sea and air ports. Subsequently the Yemeni economy in general, and the industrial sector in particular, entered a state of stagflation. The absence of the government from the economic scene and the complete suspension of oil extraction in 2015 and 2016, and diminished activity since 2017, have contributed to a significant decline in public revenues, resulting in a complete halt to public investment and development programs. In addition, large part of the local capitals were invested abroad searching for investment opportunities in safe areas,

The performance of the industrial sector during the period 2015-2020 can be described as follow:

## 1.1. Constant annual recession

The exceptional circumstances that Yemen has experienced since 2011 and its aftermath have contributed to the emergence of many political, economic and security changes that have had a significant negative impact on the overall economic performance and industrial performance in particular during the years 2015-2020 . The available estimates<sup>4</sup> indicate that the industrial sector, in terms of extractive and manufacturing industries, witnessed a continuous recession. The main reason for the suspension of the activities were the lack of sufficient energy (electricity, oil derivatives) necessary for the production process and difficult access to raw material and intermediate goods. Most of the recession in the



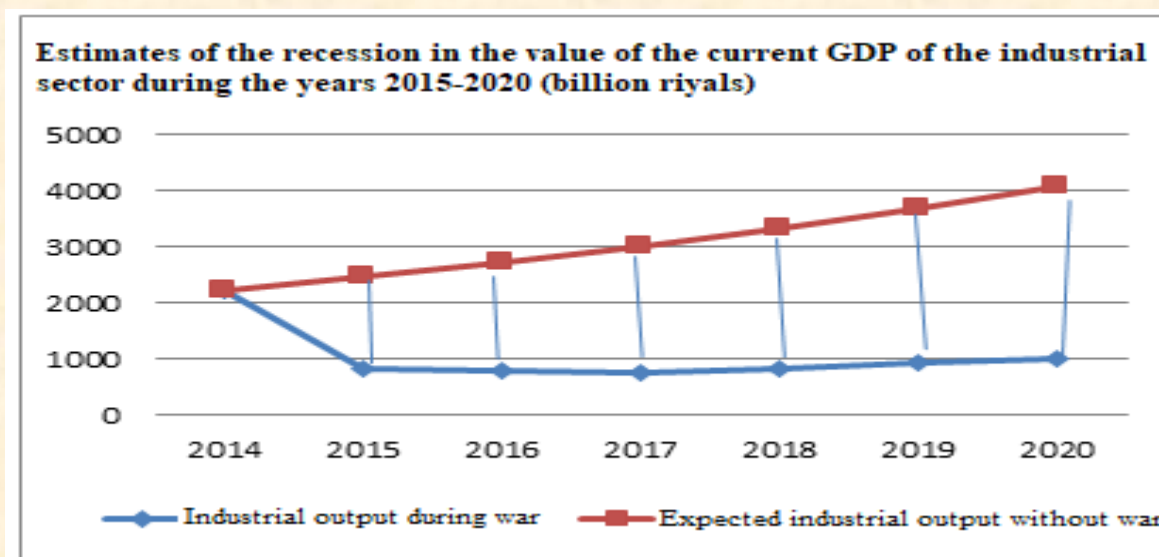
industrial sector's output was a direct consequence of the collapse of the extractive industries, which recorded an average annual decline during the years 2015-2020 of about -15.2%, while the annual rate of decline in the manufacturing industries during that period was about -9%.

It is worth noting that the year 2015 recorded the largest recession in the output of the industrial sector by about -60% (-74.2% on the side of the extractive industries and -25.2% on the side of the manufacturing industries).

After 2015, industrial establishments started to adopt multiple adaptation strategies to continue to work and overcome the challenges they faced. The results of a survey<sup>5</sup> conducted by the Small and Micro Enterprise Promotion Service, indicated that 41% of economic establishments, including 64% of large-sized enterprises, used adaptation strategies to continue their work. It consisted in adding new products/services that met the needs of the community and suited the situation the country. Some establishments also followed the strategy of reducing the volume of business, or moving to other regions inside or outside Yemen; thus the annual recession rate in the output of the industrial sector, in terms of extractive and manufacturing sectors, has fallen to less than 1% in the year 2020.

## 1.2. Accumulated economic losses.

The size of the cumulative recession in the value of the current GDP of the industrial sector in 2020 was estimated at 52% from its size in 2012, and the cumulative economic losses in the sector's output during the years 2015-2020 were estimated at about 14.1 trillion riyals, equivalent to 35 billion dollars<sup>6</sup> according to the average exchange rate in the parallel market, of which \$30.5 billion is the losses of the public sector, represented in the revenues of the



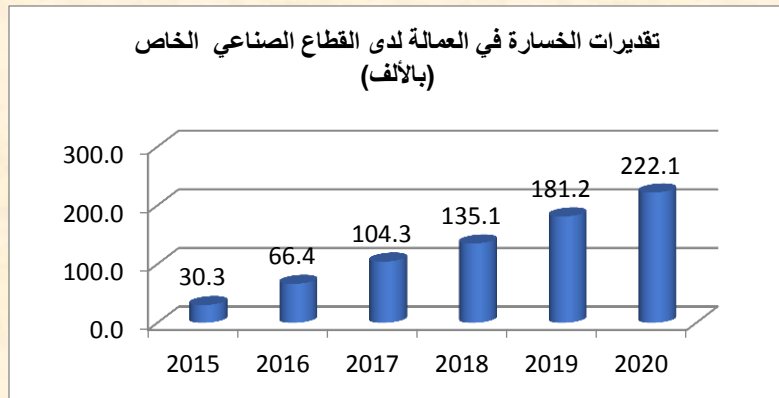
extractive industries (oil and gas) and about \$4.5 billion are the losses of the private industrial sector. Thus, the rate of operation and production in the industrial sector, both extractive and manufacturing, during the period 2015-2020 was about 27% only of the possible operational capacity of the sector under the conditions prevailing before the war.

## 1.3. Decreased employment rates in the sector.

The decline in the gross domestic product (GDP) value of the industrial sector during the period 2015-2020 was coupled with a decline in the employment in the sector; it is estimated that the number of workers in the private industrial sector decreased from about 240,000 workers in 2013 to less than 190,000 workers in 2015 before returning to about 217,000 workers in 2020<sup>7</sup>, meaning that the industrial sector laid off a total of 260 thousand job opportunities during the years 2015-2020, along with about 479,000 job opportunities that could have been created during the period if the conditions were normal and without war, and thus the total loss of job opportunities in the private industrial sector (manufacturing industries) amounted to 739,000 job opportunities during that period<sup>8</sup>, which contributed to an increase in the unemployment rate in the overall economy (taking into account the decline in the employment rate in the rest of the economic sectors) to reach about 32% of the total workforce in the economy in the year 2020, compared to about 13.5% in 2014<sup>9</sup>, knowing that unemployment rates among youth and women remain higher than the general rate since young men and women are the most laid-off category of workers during the war, in addition to the fact that many new entrants (youth) to the labor market do not get suitable job opportunities, and thus remain among the unemployed.

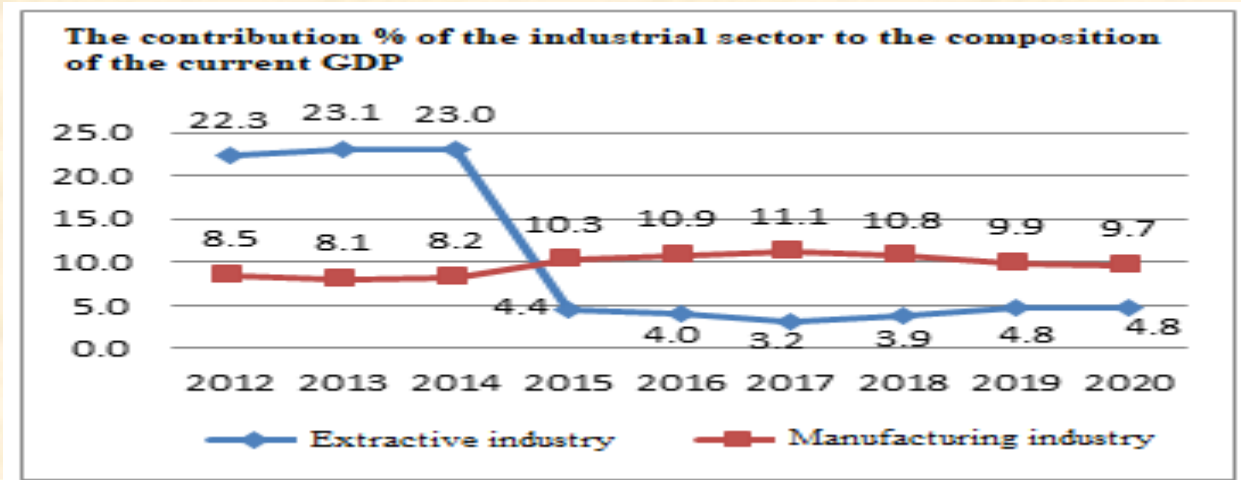


It is worth noting that the decline in employment rates in the economy and the decline in the value of real GDP contributed to the decline in the average per capita income, and thus more population slipped below the poverty line and the severity of the humanitarian crisis increased, as the rate of poverty in society increased significantly during the period 2014-2020, as the proportion of the population below the national poverty line reached 76.9% in 2016, then 77.9% in 2017, and is expected to reach 80% of the population in 2020<sup>10</sup>.



#### 1.4. Change in the structure of the sector

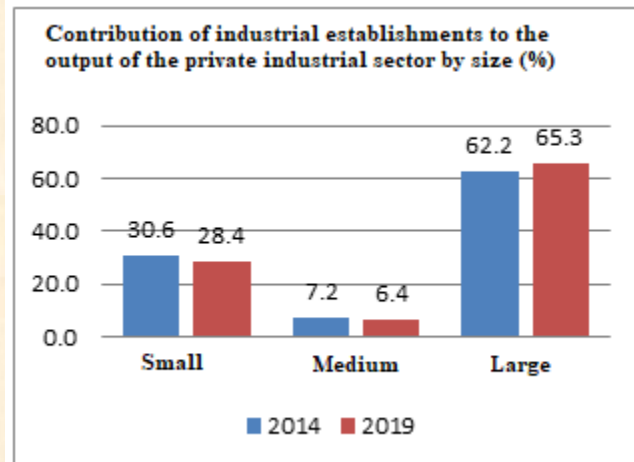
Before 2015, the extractive industries (oil and gas) represented the largest component in the structure of the current GDP, with a contribution rate of about 23% of the GDP, and the revenues of oil and gas exports amounted to about 90% of Yemen's total exports and about 50 % of the state's public revenues, while the contribution of manufacturing industries to the GDP structure was limited to 8.2% in 2014. With the change in the political and security conditions in Yemen and entering into a state of all-out war since the beginning of 2015, most of the oil and gas companies operating in Yemen have suspended their work. As a result, the contribution of the



extractive industries to the composition of the current GDP declined from 23% in 2014 to 4.8% in 2020, and in return the contribution of manufacturing industries in the composition of the gross domestic product increased from 8.2% in 2014 to about 11.1% in 2017, before declining to about 9.7% in 2020; the increase in the contribution of manufacturing industries in the composition of the gross domestic product came as a result of the decline in the share of the oil

sector on the one hand, and on the other hand, due to the general rise in inflation levels during the period and the increase in the value of the current output of the various economic sectors.

On the other hand, the past years witnessed limited changes in the contribution of industrial establishments to the formation of industrial output in favor of large enterprises at the expense of medium and small enterprises, as the relative importance of the contribution of large enterprises in the formation of industrial output increased from 62.2% in 2014 to 65.3% in 2019, while the contribution of medium enterprises declined from 7.2% to 6.4% during that period, as well as for small enterprises, whose contribution decreased during that period from 30.6% to 28.4%<sup>11</sup>. The increase in the contribution of large enterprises to the sector's output compared to small and medium enterprises is due to their great ability to adapt and their possession of adaptation strategies to continue to work and face challenges as they are more affected by the course and results of conflict and war, in addition to having high financial, technical and administrative capabilities that enable them to adapt to new situations and keep pace with developments in the business environment compared to small and medium enterprises, which are characterized by capital scarcity and limited administrative and technical capabilities.



## 2. Challenges and obstacles facing the industrial sector

Many economic and development studies and reports have shown that the industrial sector in Yemen in particular, and the private sector in general, operates in a difficult and depressed business environment, and faces many challenges and obstacles that hinder its growth and development; the pace of those challenges and difficulties has increased in light of the conflict and war that has afflicted the industrial sector causing great damage, either directly - represented in the destruction of many industrial facilities, the partial or complete suspension of production and the layoff of workers - or indirectly, represented in the instability of the industrial supply chain and the unavailability of the necessary production elements or in the form of increased production costs.

The most important of these obstacles are summarized below:

### 2.1. Political stability and security

The absence of an effective central government, the multiplicity of ruling authorities in Yemen, the growing calls for regional and regional secession, and the resulting decline in the actual control of official state agencies, have contributed to the spread of violence and chaos, and the high rates of corruption and crime, and consequently the increased risks related to the production and investment environment. According to Yemen Business Climate Survey Report 2020



produced by the Small & Micro Enterprise Promotion Service the most important challenges related to this situation can be highlighted through:

- Absence of political stability, which represents a major obstacle for about 40% of private facilities<sup>12</sup>, and results in insecurity, the spread of carrying weapons and attacks on private institutions and factories.
- The high costs of insurance and shipping to Yemeni ports as a failed state with unstable security, and this is reflected in the high production costs, as the percentage of increase in insurance fees for shipments coming to Yemen ranged between 500-1000 US dollars per container<sup>13</sup>.
- The weak purchasing power of citizens due to the interruption of government salaries for a large proportion of employees, and the limited job opportunities, thus affecting the volume and quantity of sales produced by industrial establishments.

## 2.2. Transportation challenges

Land transport in Yemen represents the main connection between production areas and consumption areas, and between import and export ports and production and consumption areas, and contributes significantly to the flow of supply chains between governorates and different regions. During the past years, the network of internal trade routes and the movement of travelers witnessed a significant change due to the deliberate closure by the parties to the conflict of the main roads between the various governorates and cities and diversion of movement towards inappropriate and relatively long and high-cost secondary roads; this contributed to a surge in the transport cost reaching 165% by the end of 2020<sup>14</sup> compared to pre conflict level. The most important challenges related to roads and transportation can be summarized as follow:

- Increasing interruptions on the roads, whether by various militias or criminal gangs, and the security and economic risks that this poses to the commercial and industrial movement.
- Illegal levies by security checkpoints on different roads, particularly the roads linking ports to production and consumption areas, and their impact on increasing production costs; industrialists' estimates indicate that there are between 37-40 checkpoints on the road from Aden to Sana'a, all of which contribute to delaying the arrival of shipments and the imposition of royalties and various fees sometimes amounting to more than 3 million riyals<sup>15</sup>.
- Closure of main roads between governorates and the difficulty of transporting various goods and services through alternative routes that have high costs and risks, in addition to closing major ports and airports close to production and marketing areas.

## 2.3. Market and competition challenges

They are represented in a set of challenges and obstacles that increase the production and marketing costs of the local product compared to similar imported goods, and those challenges intensify with smuggled goods and products, knowing that the severity of these challenges increased during the years of conflict and war, and the most prominent of these challenges are<sup>16</sup>:

- Double taxation and customs, in particular the value-added tax, which is paid at 5% at the port of Aden, and paid again at the affiliated customs ports of the Sana'a government;
- Demanding cash payment of 100% of taxes and customs due to the cash and banking crisis
- Imposing unjustified fines and detaining goods at customs ports, especially raw materials, in addition to canceling customs exemptions for investors stipulated in the Investment Law, which increases the financial costs of primary and intermediate materials and final goods, and according to the Business Environment Survey in Yemen 2019, 72% of the total private economic establishments operating in Yemen confirmed increases in their operating expenses due to conflict and war conditions and related factors during the years 2017-2019.

#### **2-4. Weak government institutions and infrastructure**

It is one of the most important challenges and chronic obstacles suffered by the various economic sectors for long periods, with many negative effects on the economic and investment environment. Over the past years, the conditions of conflict and war have contributed to the intensification and exacerbation of these challenges, and consequently their significant impact on the performance of the private industrial sector. Those challenges are:

- The institutional division of government authorities between Sana'a and Aden, especially for sovereign institutions such as the Central Bank, bureaucracy, delay in the sector's transactions, lengthening of litigation procedures and government transactions. In this regard, the data of the Business Environment Survey in Yemen 2019 indicate that 78% of the private establishments believe that the central and local government institutions are weak and ineffective, and represent an obstacle for their work.
- Changing government regulations and procedures regulating the relationship with the private sector and imposing unilateral changes to the private sector, even in violation of the laws in force.
- The spread of corruption in all its forms and manifestations, with its effect on increasing production costs.
- The limited infrastructure necessary for the industrial sector to operate, particularly the energy sources needed for the operation process (electricity, oil derivatives), the absence of industrial and commercial areas, and the limited means of transportation and other infrastructure.
- Stopping government investments, which were one of the sources of aggregate demand in the economy.

#### **2.5. Finance and monetary policy challenges**

**Some of the main issues related to the financial and monetary challenges are summarized here below:**

- The continuous deterioration in the value of the local currency, which reached record levels during the war years, as the exchange rate (an annual average) of the Yemeni riyal in the parallel market declined from about 215 riyals / dollar in March 2015 to about 287.4 riyals / dollar in 2016, and then to 535. 4 in 2018, and about 663 riyals / dollar at the national level in 2020, with an annual decline rate that ranged between -7.3% and -50% during the years 2015-2020<sup>17</sup>, in addition to the multiplicity of exchange rates between the different governorates.
- Financial institutions are struggling and access to credit for business has become almost impossible. More than 60% of private enterprises do not have access to source of financing other than their own resources); the percentage of private enterprises that received financing from the local banking sector in Yemen in 2020 reached 4%, compared to about 23 % of establishments at the Arab level<sup>18</sup>.
- Duplication and conflict between standards and directives issued by the monetary authorities in Sana'a and Aden, especially the pressures exerted on local bank administrations regarding the presence of their main centers and work mechanisms, and renewing licenses and paying taxes, in addition to creating new financial and service companies and networks<sup>19</sup>. This caused great confusion in the financial sector and made it difficult to deal with government agencies as supervisory bodies, and consequently the severity of the financial and monetary challenges in the economy increased.

### **3. Looking to the future and enhancing the role of the industrial sector**

Economic results in the previous years reflect the extent of the economic and financial losses suffered by the industrial sector in Yemen as a result of political conflicts and wars.

It is important to focus on policies and priorities that limit the deterioration of conditions in the industrial sector and the rest of the national economy sectors and enhance opportunities for growth and development in the economy:

#### **3.1. Policies and priorities for achieving political and economic stability**

- Working to reach a **peace agreement** with the various parties to the conflict, albeit gradually, to end the state of conflict and war, put solutions to challenges and problems, and eliminate all armed manifestations. In this regard, **it is possible to start extending the current truce for a relatively long period so that the economy can breath and start recovering.**
- **Restarting the stalled oil and gas sectors** to reduce the oil crises that has been afflicting the economy in the recent years
- **Reviewing mechanisms and programs for inspecting ships outside Yemeni ports** and introducing new provisions including transferring these procedures to Yemeni ports in a way that contributes to improving the flow of goods and services and reducing additional costs borne by citizens. In this regard, the private sector can provide an



integrated vision and strive to implement it in cooperation with UN mechanisms and international partners.

- **Ending the division of state institutions**, especially those that play an important role in the economic aspect, such as the central bank, and working to improve financial and monetary policies and maintain the stability of the exchange rate of the local currency.
- The importance of the **ruling authorities paying the salaries of employees and retirees that have been interrupted for several years**, as these salaries are extremely important to the national economy as they foster internal demand

### **3.2. Communication policies and priorities**

- Working to spread economic awareness among government officials about the importance of the economic cycle, and to provide the private sector with an opportunity to work in a stimulating economic and investment environment and the extent of the damage to the industrial sector, the national economy and public revenues as a result of the various fiscal policies, including the dissemination of global economic experiences based on the leadership of the private sector. In this aspect, private sector organizations, led by the General Federation of Chambers of Commerce and Industry, can conduct a series of seminars and awareness workshops on the importance of completed economic cycles and the extent to which stimulus policies contribute to overall economic growth and increasing government revenues.
- Indicating the extent of the ability of the private sector and the industrial sector to break the siege measures imposed on the Yemeni economy through the production of alternative goods for imported products, and clarifying the most important requirements necessary to achieve this, and identifying the roles and main actors to achieve this.
- Continuing to demand the neutralization of the national economy from conflict and war and activating the initiatives presented by the private sector, especially those related to the neutralization of the Central Bank and the stability of monetary policies.
- Intensifying and activating the work of advocacy and support for the initiatives, visions and directions of the private sector, especially with regard to the aspect of opening main roads, ports and airports. In order to activate the aspects of advocacy and support, it is important to work on the governance of various business organizations and to separate the work of the executive departments from the boards of directors..

### **3-3. Infrastructure development policies and priorities**

- Adopting a **national strategy for the reconstruction of most important infrastructures destroyed by the war**, and encouraging donors to fund it
- Entering into **investment partnerships to build infrastructure**, particularly power plants under the partnership system, whether traditional or renewable, such as solar power plants, wind farms, or thermal energy

- Using the mechanisms of **Islamic sukuk issuance** as a practical approach to infrastructure financing, given the advantages this type of financing provides for governments or investors.
- **Establishing trust funds to undertake investment in infrastructure**, which can be financed through public subscription, whether by individuals, commercial companies or Yemeni expatriates abroad.

### **3.4. Policies to enhance the partnership between the government and the private sector**

- Enhancing the principle of **transparency in government agencies**, lifting quantitative, administrative and financial restrictions by government institutions, particularly investment, customs, and taxes imposed on importing production inputs or expanding production and other operations, and providing an appropriate legal and regulatory environment.
- **Issuing the Public-Private Partnership Law**, and forming the necessary institutional structures for its implementation and supervision.
- Continuing to **demand the presence of a seat for the private sector in the political negotiations between the parties and components of the conflict in Yemen**, which are carried out under the auspices of the United Nations and regional and global countries in order to highlight the economic aspects and the visions of the private sector in the outcomes of those negotiations.
- Participation of the private sector in formulating economic policies and government plans for reconstruction and development.

### **3.5. Policies and priorities for restructuring the industrial sector**

- Working on **transforming individual establishments into joint stock companies** that can compete and maintain continuity under different circumstances and changes.
- **Focusing on industries with local inputs** to activate other economic sectors, increase employment levels in the national economy, reduce unemployment rates and increase economic growth.
- Encouraging research, development and innovation for the goods, products and services required by the industrial sector and working with the private sector, educational and governmental institutions and donor organizations to establish a fund to support and encourage applied studies necessary to develop the industrial sector and increase and diversify its products, in addition to creating links between researchers and private economic establishments.
- **Improving the quality of industrial production** and raising competitiveness, enabling local goods to compete with imported ones, as well as gaining access to foreign markets and increasing industrial exports.

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