



Co-funded by the European Union



Economic Dimensions of the Conflict in Yemen: Final Report

Achim Wennmann and Fiona Davies

19 October 2020

DISCLAIMER

This report was produced with the financial and technical support of the European Union, UNDP and OCHA. Its contents are the sole responsibility of the authors and do not necessarily reflect the views of the European Union, OCHA and the UNDP.

Table of Contents

About this report.....	4
1. Economic dimensions of the crisis	5
2. Humanitarian dimensions	6
3. Economic interests of key constituencies.....	7
4. Economic issues in the peace process	9
5. Central banking	10
6. Operational considerations	11
Concluding reflections.....	12

About this report

This report is co-authored by Achim Wennmann and Fiona Davies¹. It synthesises responses from 20 interviews with interlocutors representing different constituencies within Yemen and the international community. The conversations took place in the context of the joint work that United Nations Development Programme (UNDP), the United Nations Office for the Coordination of Humanitarian Affairs (OCHA) and the European Union (EU) are undertaking in the area of the economic dimensions of the conflict in Yemen. The purpose is to analyse the economic drivers of the Yemeni conflict and potential opportunities for peace by researching the economic factors and interests that influence the conflict dynamics. It aims to provide a valuable input in the process of establishing a common understanding amongst all those supporting Yemen in this very sensitive and vital sector, and to support the United Nations Special Envoy for Yemen (UNSE) with the economic aspects of the political process.

The interviews conducted for this report took place between 14-20 April 2020 and 24 June and 1 July 2020. All conversation partners have requested to remain anonymous and the authors thank all of them for their insight. A reference group comprising focal points from UNDP, OCHA and the EU provided guidance and received briefings on the work throughout the process. Preliminary findings were presented to the *Cluster Meeting on the Economy of the Consultations with Track 2 Partners and Exchanges with the International Community* co-convened by the Office of the Special Envoy of the Secretary-General for Yemen (OSESGY) and the EU on 23 April 2020, to the Yemen Economic Working Group on 18 June 2020, to the UN Resident and Humanitarian Co-ordinator on 21 July 2020 and to the OSESGY on 23 July 2020.

The report is structured along the six areas of investigation that guided the interview process:

1. Economic dimensions of the crisis
2. Humanitarian dimensions
3. Economic interests of key constituencies
4. Economic issues in the peace process
5. Central banking
6. Operational considerations

The report concludes with overarching reflections emerging from the interview process.

¹ **Dr. Achim Wennmann** is Senior Researcher at the Centre on Conflict, Development and Peacebuilding (CCDP) of the Graduate Institute of International and Development Studies in Geneva, Switzerland. He acted as EU Advisor for the purposes of this study. **Fiona Davies** is Research Associate with the Overseas Development Institute (ODI). This synthesis does not necessarily represent the views of the UNDP, OCHA, the EU, ODI, or the Graduate Institute.

1. Economic dimensions of the crisis

The conversations reveal broad consensus that the economic dimension is a critical aspect of the conflict in Yemen. Not only do incompatibilities over control of resources represent a major reason for the armed conflict (including grievances associated with wealth sharing and marginalisation), they have also accentuated political conflict over the control of institutions at the national and governorate level. A particular driver of military dynamics relates to the control of key economic assets, including oil and gas extraction and production sites, ports, roads and other critical infrastructure.

The conversations highlight the severe effect of Yemen's conflict on the economy. Key impacts of the conflict include the destruction of critical infrastructure and production capacity, monopolistic control of a small number of gate-keepers to key economic sectors, the existence of multiple layers of internal and international barriers to trade, the fracture of central banking institutions, and increasing economic autonomy especially of oil producing governorates. Various conflict actors instrumentalise the economy to consolidate their own position.

There is also consensus that the impacts of COVID-19 on Yemen's economy are severe. Many Yemeni and international actors have prioritized COVID-19 response since March 2020. Interviews in April 2020 suggested widely shared expectation of downward trends in Yemen's key economic lifelines of remittances and oil as a result of COVID-19, as well as problems with imports due to disrupted international supply chains. Nonetheless, some interlocutors emphasised that many local actors perceive COVID-19 as just another crisis. Yemeni society, according to these views, was following the patterns of many societies around the world in underestimating the public health, economic and political consequences of COVID-19.

Yemen's economy has become politicised. At present, political, military and economic dimensions of the conflict are not distinct areas of operations but an integrated set of interests and objectives. This especially relates to the operation of war economies by different parties and associated military units that prioritise funding war efforts as well as personal enrichment of key individuals. It also severely affects monetary policy and the operation of the banking system. The business community is largely divided into partisan camps, with the exception of a few that try to remain equidistant to all parties. Yemen's technocrats have capacity to manage the economy but their work is hampered by divisions at senior political levels.

Despite the political discords and de-facto existence of two currencies and banking systems, many economic transactions take place across Yemen's internal divisions and international borders, albeit at significantly increased costs. There are existing relationships across the lines of division that enable exports, imports and remittances to reach end markets across conflict lines. Such relationships should not be divorced from Yemen's 'political marketplace' in which loyalty of one group to another is up for sale, especially in the context of Yemen's tribal politics.

International economic dimensions have contributed to escalating the conflict in Yemen and providing space for monopolistic behaviour and rent-seeking. Several interlocutors suggested that some UN member states are influencing policy within the United Nations to prevent more prominent awareness of the link between arms sales and the escalation of the Yemen conflict after 2015 and their related humanitarian consequences. Others interlocutors mention the embargo on Houthi-controlled areas and mechanisms of financial support to the Central Bank of Yemen. According to these interviewees, the embargo and financial mechanism are increasingly shaped by the economic motives of rent-seekers.

2. Humanitarian dimensions

Humanitarian aid is a key economic sector of Yemen's economy and therefore a part of the economic dimension of Yemen's conflict. Total aid accounts for about USD 4 billion per year and is therefore a critical economic sector and source of foreign exchange, together with remittances and oil revenues. Key donors of humanitarian aid are also parties associated to Yemen's conflict dynamics. Both international and local actors involved in Yemen's conflict have tried to influence the delivery of humanitarian aid to further their own interests in the conflict.

Humanitarian operations maintain key subsistence and health services for a great part of Yemen's population. Humanitarian actors focus primarily on food insecurity, responses to disease outbreaks and social safety nets for excluded and minority populations. Interlocutors emphasized that these operations maintained essential life supporting assistance for a great part of Yemen's populations, including 13-14 million people for food assistance and support for 2.5 million malnourished children. Humanitarian actors are also supporting key health service provisions, providing 18-20 million health consultations per year.

The operating environment in northern Yemen has become difficult. One conversation partner with decades of experience in complex humanitarian emergencies noted that Yemen is one of the most difficult places to work in the world. Such difficulties relate to the number of barriers to aid delivery at many levels. Many local political actors aim to control the delivery of food and essential services to the populations under their control and perceive international humanitarian actors as competition in their legitimization efforts. They also aim to control access to aid in order to maintain clientelistic political relationships or fund security operations. Some reportedly sell security services or access to vulnerable populations to humanitarian organizations to generate income. Because of such pressures, international humanitarian actors have toughened their risk management approach and proposed reducing their assistance by 50% (by halving daily food rations).

There was consensus amongst interviewees that there is considerable scope to improve the delivery of humanitarian aid, so that it supports economic development. Suggestions included (a) making greater use of the Yemeni private sector in distributing aid, as they are likely to be more efficient and have a wider distribution network; (b) tendering out basic commodity supply contracts in the local market where feasible, in order to stimulate domestic demand, increase inflows of foreign exchange and avoid crowding out local business people; and (c)

expanding cash for work initiatives in lieu of aid in kind, in order to stimulate domestic demand. Interviewees also suggested that more aid needs to be targeted towards supporting domestic production, for example fisheries and agriculture, and towards supporting local Small and Medium Enterprises (SMEs). It was noted that donors tend to be more interested in supporting social protection and community development at the expense of livelihood support, and that when livelihood support is provided (for example, by distributing solar panels), it is done in a way that crowds out local suppliers and distorts the local market.

Power, water, telecommunication, and transport infrastructure represent four sectors that could serve as an entry point for coordination between international humanitarian and development actors. Rebuilding infrastructure and improving connections between and within regions makes trade and the delivery of aid easier and reduces transaction costs for traders and humanitarian actors. A focus on power, water and communications enable other economic activities. But more work is necessary to advance such collaboration in practice including through a Conflict-Sensitivity Platform that works on work at the nexus of humanitarian and development programming.

Key for sustainability will be to locate the needs for sectoral investment within the micro-dynamics of local politics. Conversation partners emphasized the role of tribal politics, which are transactional in nature. This makes it difficult to build longer-term partnerships, while reliance on tribal power relationships entrenches them and entails long terms risks, especially for constructing more inclusive local economies.

There is a perception of humanitarian actors as competitors to private sector actors. While there is an overall gratitude for the humanitarian support provided by the international community, some private actors view humanitarian and development actors as (inefficient) supply lines that bring key goods to Yemen's markets. They do not exploit potential synergies with the private sector, and interfere with and distort market dynamics in a way that stifles private sector activity. One interlocutor even noted that the private sector organisation he works for only focus on zones where there is no presence of international aid, because they know the presence of international actors spoils the secondary market for goods and they cannot compete against them. Interviewees also suggest that the Yemeni private sector has the capacity, know-how and relationships to supply Yemen with all necessary goods and services, and that returning to market-based mechanisms should be a priority.

3. Economic interests of key constituencies

Yemen faces a complex web of conflicts that involve many parties. Some interviewees draw distinctions between two parties, including Ansar Allah and associated groups, on the one hand, and the Government of Yemen supported by and international alliance involving Saudia Arabia, UAE, the USA, and the UK, on the other hand. Yet many conversation partners emphasize that the reduction of the conflict to two sides, and two associated economic spheres, is an oversimplification and does not represent realities on the ground. The UN Panel of Experts documented at least 12 micro conflicts in 2019 but interviewees point to a much greater number

of micro-conflicts at local levels. The economic interests of key constituencies therefore depends on the which specific segment of Yemen's web of conflictis involved.

Economic agendas are frequently related to conflict over revenues. Control over revenue generating assets and institutions managing the economy has been a driver of conflict dynamics (see above). On a territorial level, certain governorates now manage their revenues on a semi-autonomous basis, while movement of goods within active conflict zones is controlled and taxed by armed actors. In the case of the many localized conflicts, tribal politics and Yemen's political marketplace shape economic agendas, especially over the control of humanitarian assistance.

There are deeply entrenched economic interests in the status quo that concentrate in a small number of powerful individuals. These have positioned themselves to benefit from the economic blockade of Northern Yemen, the fracturing of central banking, the creation of two currencies, and the new patterns of territorial control. In sectoral terms, these interests concentrate in fuel and gas imports and exports, money exchange, and commodity imports. These individuals are preventing pathways to alleviation of the humanitarian situation and are spoiling progress towards peace and economic recovery. The pattern of rent seeking also seems to contribute to the skewing of the economic focus, towards importation and away from production, thus in turn exacerbating the humanitarian dependency of ordinary Yemenis. It also undermines the prospects for investment and expansion of non-petroleum productive sectors that are predominantly the domain of SMEs and have little political or economic influence, such as fisheries, agriculture and livestock.

No major economic transaction can be conducted without the implications of key gatekeepers, thus reflecting the character of a 'closed-access economy'. These individuals operate relatively unchecked and as a result can amass significant fortunes that are used to further entrench their power. In Northern Yemen, the efforts to control the economy are more systematised as part of a political vision to perpetuate Ansar Allah's de-facto governance in the areas they control. Smaller daily transaction by SMEs or traders are also affected by the entrenched economic interests as they have to interact with different parties or security actors at the local level on a daily basis leading to increased transportation costs (illegal check points), double taxation, and dual currency costs.

Not all actors with entrenched interests in the status quo have the power to spoil the peace process and economic recovery. For instance, while the businesspersons controlling the fuel and wheat sectors are well-connected, they were not considered by interviewees to have the political influence to be spoilers. Nonetheless, they will be content to benefit from the status quo as long as it pertains. In Houthi controlled territory, some connected businesspersons are making money out of certain sectors (e.g. money exchange), but their interests may not drive the Houthi's approach to all economic issues – instead, the main driver for the Houthis appears predominantly to be to gain greater access to revenues, in order to be able to consolidate their political position.

International donor funds are subject to the rules of the 'closed-access economy'. Humanitarian and development assistance is part of the economy and has few means to limit its

exposure to co-optation by conflict actors. Whatever the intention of the donors, parts of their funds are absorbed by conflict parties and gatekeepers, allegedly with the knowledge of leading international officials working within UN and other international agencies. Several interviewees alleged that a significant amount of the donor support from Saudi Arabia is absorbed by leading figures within its diplomatic and intelligence services that themselves have developed entrenched interests in the status quo. Some private sector actors perceive the linkage between international donors and gatekeepers as collusion, which has contributed to a critical view on the UN and international donors.

There are constituencies within the trading and banking community that still believe in the value of a neutral economy that can help bring the country together. While some business constituencies are aligned along party interests, other actors have continuously emphasized the importance of the economy and the Central Bank remaining 'neutral' – i.e. not to become part of the conflict. They have repeatedly made the case to the international community and the UNSE over the past three years for addressing the economic dimensions of the conflict within the peace process. However, interviewees reported that multiple attempts at engagement in international capitals and through written submissions to international organizations have gained no traction. They feel they had no power to prevent the weaponization of the economy. Some interlocutors believe that as a result of the inaction on the economic dimensions by the international community and the UNSE, actors with entrenched interests into the conflict have been able to increase their power viz-a-viz those constituencies with an interest in an open economy.

4. Economic issues in the peace process

The characteristics of the economies controlled by different conflict actors vary considerably, and their economic interests in the peace process are influenced accordingly. The internationally recognized Government of Yemen (GoY) is presiding over an economy funded by natural resources and support from Gulf States. This economy is characterized as being built on 'unearned income' and being shaped by an economic interest in paying salaries in order to maintain the GoY's political legitimacy. Much of the 'earned' income that the GoY previously had access to (e.g. income from Aden port) is being actively contested by the Southern Transitional Council. These factors might explain the focus of GoY on salaries and government revenue in its position in peace discussion led by the UNSE. Ansar Allah on the other hand is presiding over an economy funded by taxes on local economic activity and humanitarian assistance. These sources of income are dwindling in the face of COVID19-related economic crises and declining humanitarian assistance, and therefore its revenue base is vulnerable. In consequence, measures to resuscitate economic activity are vital for Ansar Allah because they rely more on resource mobilization within the territory under their control, in a way that is not the case for GoY, because it controls ever less territory and is more dependent on support by its international patrons. These factors might explain why Ansar Allah focuses on lifting the blockade and opening the ports in its position in peace discussions led by UNSE. Separately, Marib and Hadramawt have become relatively autonomous economic spaces, interviewees suggest. Marib draws resources from control over oil and gas production, while Hadramawt is supported by

substantial diaspora remittances. These two provinces have high stakes in keeping their relative economic autonomy.

At the level of monetary policy and the financial sector, Yemen is already operating under a quasi-two-country system. Interviewees felt that the economy could and should be used as a lever to exit conflict. However, in order to make peace profitable and sustainable, in their view, structural changes are needed to the management of monetary policy and public finance, as well as the distribution of resources between the centre and the regions (see also part 5 below)

Four interventions were identified as having the greatest immediate impact in stimulating private sector activity, neutralising the war economy and relieving the humanitarian situation. These four interventions are:

- Opening up the port of Hudaydah and Sana'a airport, to solve the brunt of the supply problem of key goods, especially in Northern Yemen, while also helping lower prices and dismantling a key element of the war economy.
- Re-establishing a neutral and unified Central Bank of Yemen and a single currency, to provide a more stable macroeconomic situation to enable imports and exports, reduce the cost of doing business across the country, stabilize consumer prices and help rehabilitate the financial sector.
- Opening roads and enabling unimpeded mobility internally, to facilitate trade, lower cost of consumer goods and increase the security of traders and their products.
- Predictable payment of salaries for public servants, to stabilize household incomes and boost local demand – although to meet this objective, it was noted as essential that salaries are not funded through money creation.

These views were contrasted with what was considered by interlocutors to be the relatively narrower focus of the UNSE, concentrated on pooling revenues for the payment of salaries. Some respondents underlined that this is the key economic interest of GoY as public sector salary payments are essential to their perceived legitimacy in Yemen. Payment of salaries is also one of several economic interests of the Houthi authorities, but measures to stimulate private sector activity are also important to them, as they rely on taxes as a major source of revenue (see above). For the private sector, payment of public sector salaries is perceived as being relatively less important than measures that can help remove the barriers and distortions to economic activity, thus creating the potential for increased enterprise and reduced humanitarian dependency.

5. Central banking

Interviewees illustrated the depth and breadth of the problems created by the fragmentation of the Central Bank since 2016, with two rival Central Banks operating in Aden and Sana'a. Yemen's monetary policy is no longer unified; the Government of Yemen has borrowed extensively from the Central Bank in Aden to finance its domestic expenditures. In order to protect the Northern economy from the resulting inflationary pressures, the Central Bank in Sana'a has rejected the use of bank notes printed after 2016 in Houthi-controlled territories. This

has enabled inflation in the North to be more contained than in the South; the exchange rate of the pre-2016 Rial in the North is approximately twenty per cent stronger than the exchange rate of the post-2016 Rial in the South. However, the de-facto existence of a dual currency system was reported to be creating considerable transaction costs to private sector entities trying to operate across both territories. One interviewee noted that Northern farmers selling produce to the South feel as if they are ‘exporting to another country’, given the need to navigate the differences in exchange rate/currency value.

The Houthi’s decision to ban the use of post-2016 Rial in the North has created a physical shortage of bank notes across the territory, with the existing stock becoming extremely degraded. Banks are reported to have suspended the withdrawal of customer deposits due to the scarcity of notes, and are charging a 70% premium when customers wish to purchase foreign exchange using the funds on their account instead of with cash. It was not clear if this premium applies only to the purchase of foreign exchange in cash or also the conversion of Rial deposits into foreign exchange deposits.

There is increasing evidence of the weaponization of the Central Bank function. In June 2020, commercial banks headquartered in Northern Yemen were largely unable to access the Letter of Credit scheme managed by the Central Bank in Aden, due to the requirement that they physically deposit cash in Aden. Likewise, efforts by Banks headquartered in Northern Yemen to apply to the Central Bank in Aden for mobile money licenses, in order to alleviate the pressure caused by cash shortages, have reportedly been unsuccessful due to the requirement that the servers be held in Aden. Northern banks can apparently no longer access their deposits held with the Central Bank in Aden, which they had previously used to settle customs duty payments in Aden, and now have to use other funds to make the payments. Northern banks are also reportedly fined and threatened with closure if they do not provide customer details to the Central Bank in Aden, yet the Central Bank in Sana’a has prevented them from doing so.

The reality is that Yemen’s economy is increasingly operating under two different monetary and financial systems, with two separate currencies. This creates multiple costly distortions for economic actors, and is placing extreme stress on the banking system. Unless steps are taken to unify the Central Bank, restore its neutrality and to ensure the separation of monetary and fiscal policy, the prospects for economic recovery in Yemen are limited, as are any enabling roles by the private sector.

6. Operational considerations

An exclusive reliance on technical interventions to revive Yemen’s economy will be insufficient in the face of deeply entrenched interests in the status quo. There is sufficient insider knowledge available about who these individuals behind entrenched interests are, yet this knowledge appears not to shape peace and economic recovery efforts. Some interviewees maintain that decisions to dismantle the distorted economic system need to be taken by Saudi Arabia – and more specifically the Crown Prince of Saudi Arabia. According to these views, this is where the political leverage needs to be focused in order to unlock economic potential within

Yemen's economy, especially with respect to lifting the economic blockade of the Northern Yemen.

Shifting the discussion on economic de-escalation and recovery to the political level opens a new set of questions. Who has the power to lift the blockade? It is really only Saudi Arabia or is it possible to envision that other political constellations can be instrumental in a decision to lift the embargo? Which stakeholders are critical to the prospects of reunifying the Central Bank and assuring its functionality and independence? Where do decisions to open up internal roads get taken? How do we go about assessing the depth of entrenchment of specific constituencies in the 'closed-access economy'? Who has entrenched interests in the status quo and the political power to 'spoil a peace'? While the answers to these questions are outside of the scope of this report, the questions suggest that if peace discussions are to have a substantive economic dimension, then a broader range of stakeholders need to be engaged than is currently the case.

Agreeing to a narrow peace deal in the context of highly entrenched economic interest risks limiting future development and peace prospects for Yemen. The risk is that the 'closed-access' economy characteristics will be perpetuated in a transitional period including perpetuation of monopolistic control of access to key sectors and the multiplication of control points across multiple economic zones. This seems unlikely to yield a sustainable peace, as the fight for control over resources will continue. Yemeni and international actors with an interest to expand economic opportunities in Yemen have a strong case to elevate the strategic importance of the broader economic dimensions in the UN-led peace process.

Private actors operate within the realities of a divided Yemen. From their perspective, two currencies make two countries with significant transaction inefficiencies and money lost. Yet the reality of a unified Yemen under a centralized administration and single economy appears increasingly distant. Seeking to attain such outcomes without significant adjustment and reform to the way in which resources are managed and distributed could generate additional instability or conflict recurrence, especially in the face of resistance of key stakeholders with a stake in the status quo.

Concluding reflections

Interviews held with Yemeni actors were more critical of the UN, international donors, and powerful gatekeepers, reflecting that the Yemeni people are really worn out by the war with little trust in anyone. While there is gratitude for life-saving aid there is also a desire to strengthen local economic activity and the functionality of local markets and to reduce aid dependence. Many Yemeni actors noted that the international actors do not listen enough to local voices and that this is a great source of frustration.

There is considerable insight into what it would take to deescalate the conflict in the economic domain. The key elements noted in Section 4 might be described in short as 'lift the economic blockade', "reestablish a single market with a unified central bank, joint currency, and unobstructed trade and mobility within Yemen", and "pay public salaries for key governance

functions to work and to foster consumption”. Economic de-escalation along these three points would result in an immediate improvement of the humanitarian situation as international actors and Yemeni private sector actors could more easily (and at lower cost) operate within Yemen. Such economic de-escalation would also offer a prospect of reducing dependency on imported humanitarian assistance in the medium term, as a more functional single market would support local private sector supply mechanisms and value chains. But translating these elements of de-escalation into practice will have to navigate the interests in the existing pattern of control of the economy, and will require a new political alliance for Yemen’s economic recovery.

The option of decentralized governance and explicit arrangements for resource-sharing might be ‘rational’ to some international actors, and was also envisaged by the 2014 National Dialogue, yet it might face the prospect of little wider political support in a region that is shaped by centralized political systems. Without sufficient agreement on the shape of the future political system, Yemen might face continued fracture into disparate economic zones whose gate-keepers negotiate the terms of access to their respective economy space – creating de-facto governance entities – while the formal trappings of statehood are subject to contestation. The result might be a Yemen trapped in a ‘no war, no peace’ scenario that serves the interests of a limited set of stakeholders within and outside Yemen, and that perpetuate an international humanitarian presence for the years to come.

The ‘no war, no peace’ scenario is not inevitable. By prioritizing the economic dimensions of the conflict in Yemen, local and international constituencies could initiate a process to unlock Yemen’s economy. The perspectives gathered in this report suggest that there is both the understanding and know-how available to design appropriate responses for de-escalating the economic dimensions of the conflict and for building the necessary partnerships for economic recovery. The interviews suggest that these sources of understanding and know-how primarily reside amongst stakeholders within Yemen; but also that international actors do not always have the right connections to them to leverage Yemen’s economy for peace.