YEMEN

Increased DFA intervention in the private sector in DFA-controlled areas

ACAPS ANALYSIS HUB YEMEN
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OVERVIEW

The 2019 National Vision for State Building outlines the restructuring of institutional governance and legal frameworks, including key economic sectors, as a central strategic objective of the de-facto authority (DFA) in the north of Yemen (also known as the Houthis) (SPC 26/03/2019; SCSS 14/04/2023). Their policies, however, appear aimed at disrupting the procedural and managerial status quo to enable the DFA full control over key economic sectors and resources, including the private sector. Substantial changes in private sector activities and working environments had already begun in 2019, but since the official expiry of the truce with the Internationally Recognized Government of Yemen (IRG) in October 2022, the DFA has intensified efforts to control, tax, and intervene in the private business sector in most of the Yemeni economic market under its control.

The DFA's multifaceted approach to regulating imports and distribution directly influences private sector stakeholders – including importers, distributors, and truck drivers. DFA strategies affect cost considerations, transport routes, and access to incentives, potentially reshaping trade dynamics and distribution networks within the region.

The continued struggle to control the financial system is critical to influencing the trajectory of the conflict and peace process in Yemen. The conflict's financial dynamics involve conflicting directives from the Central Bank of Yemen (CBY) branches in Sana'a and Aden, disrupting foreign exchange and funding for food imports and fostering economic instability. DFA control over foreign exchange supply influences private-sector dependence on its policies.

The DFA-led restructuring of the private sector via the takeover of the Sana'a-based Chamber of Commerce and Industry (SCCI) aims to influence ownership in key sectors and promote economic ties with specific countries. This dominance limits diverse viewpoints and independent input from the private sector, aligning interests with the DFA elite.

The DFA's consolidation of political and economic authority is a strategic move to gain a distinct advantage in the peace process. Growing DFA control is intricately tied to its attempt to diminish the political and economic influence of the IRG. Internally, the DFA navigates a delicate balance between the influence of conservative Islamists and the need to secure economic control and bolster income. Notably, this involves granting strategic control over the SCCI to key business elites, solidifying the DFA's economic dominance. Concurrently, measures such as price controls demonstrate the DFA's efforts to appease the population, underscoring its commitment to managing societal pressures and maintaining stability.

KEY MESSAGES

- The DFA is actively promoting and incentivising imports via the Red Sea ports under its control by offering benefits such as covering demurrage costs and providing advantageous customs rates. The DFA is also simultaneously implementing measures to discourage imports via IRG-controlled seaports and land border crossings by imposing added taxes and customs fees on goods entering DFA areas via these routes.
- The regulatory interventions of CBY-Sana'a, including the imposition of higher capital requirements, reduce liquidity and disrupt operations, hindering private sector growth. The money exchange sector, which expanded amid the banking sector's decline during the conflict, has started facing increased scrutiny around the delivery of remittances and withdrawing orders from clients' accounts.
- The ideologically driven prohibition on interest-based finance and trade reshapes the banking sector, posing challenges for banks, depositors, and businesses and potentially favouring informal networks while complicating reunification efforts.
- The enforcement of the DFA Ministry of Industry and Trade (MOIT) of strict food price controls in its areas of control creates a mismatch between official prices and market realities, pressuring vendors and risking insolvency for many businesses. The implementation of price caps deepens economic fragmentation between IRG- and DFA-controlled areas, affecting market dynamics.
- The armed DFA takeover of the SCCI and appointment of new leadership signal a shift in private sector dynamics. To complete its full control over the governance and regulation of the private sector, the DFA granted the President of the Superior Political Council the authority to amend tax laws without parliamentary approval. This power shift seeks to expedite national plans and protect the Ministry of Finance (MOF) from legal action by the private sector.

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About this report

Aim: This analysis provides an overview of the DFA's interventions in the private sector in 2022–2023, with a focus on import trade, the finance sector, and private sector governance. It highlights the political economy dynamics behind the DFA's various interventions, emphasising implications for the private sector and any identifiable linkages with the peace process (e.g. how some policies might conflict with IRG policies).

Methodology: This report is based on a review of secondary data on key contextual developments related to DFA-implemented policies between 2022–2023. Four key informant interviews with contextual experts complement this review.

Limitations: While the policy interventions analysed in this report were implemented between 2022–2023, in some instances, their impact and drivers remain challenging to assess. This challenge relates to the lack of both the quantitative data necessary to make viable estimates and qualitative information on the real motivations behind some of the changes introduced. Given the current dynamics in the region, specifically around DFA attacks on vessels in the Red Sea, shipping cost trends and the functionality of DFA ports are changing.

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INTRODUCTION

The DFA has taken a multifaceted approach to restructuring the private sector, mostly through regulating imports, exerting control over the financial sector, and capturing the private sector's regulatory bodies. This report analyses how these interventions have disrupted trade dynamics, complicated the economic landscape, and affected the peace process.

Two influential factors determine the timing and scale of the DFA's private sector policy decisions: pressure from the Houthis' religious wing and the need to sustain economic growth. Regarding interventions driven by the DFA's religious wing, actions take a more radical approach, such as banning usury transactions, implementing price caps, and boycotting trade with certain countries. For interventions related to economic growth, however, such as rent generation and controlling private sector reactions, the DFA takes slow, gradual steps in response to evolving country dynamics. If faced with resistance from targeted stakeholders or bodies, the DFA may resort to stronger policy positions, such as amending tax laws and making changes to the SCCI leadership.

This report focuses on the three main areas of concentrated DFA intervention: the regulation of imports and distribution, control over the financial sector, and market control and private sector governance. Each subsection introduces the policy implemented and actions taken, followed by impacts on the private sector and peace process.

REGULATING IMPORTS AND DISTRIBUTION

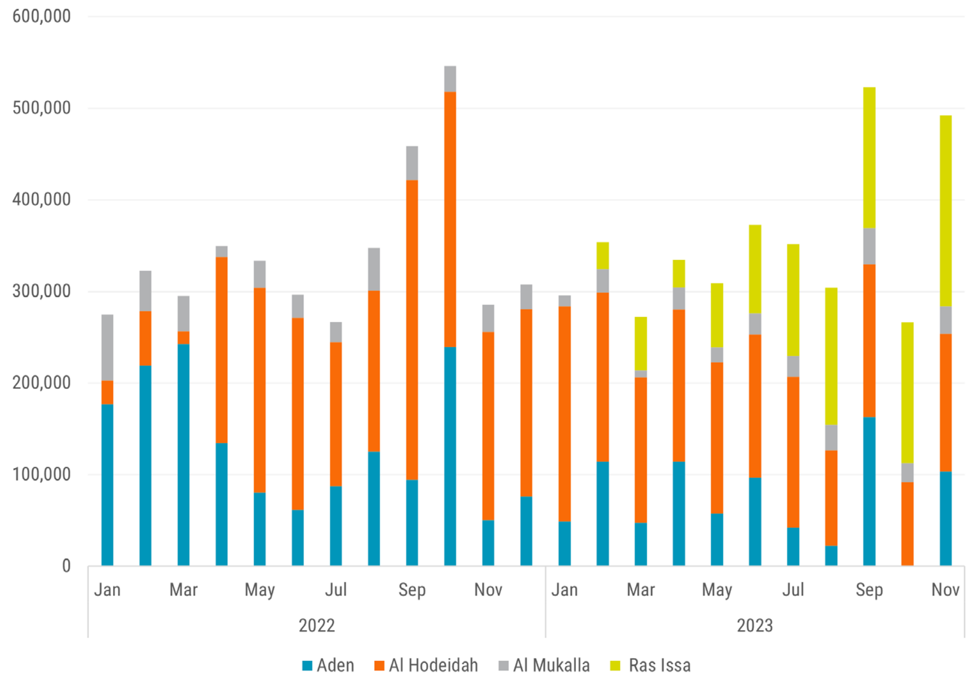
This section discusses the four key areas by which the DFA has extended its control over imports and distribution networks: (1) incentivising import trade through the Red Sea ports; (2) substantially increasing LPG imports through the Red Sea ports; (3) disincentivising import trade through IRG-controlled seaports and land border crossings; and (4) revising transport routes, resulting in added costs for traders.

Incentivising imports via the Al Hodeidah and Saleef ports and Ras Issa oil terminal

The DFA is pursuing attempts to increase import levels alongside measures to disincentivise traders from importing goods via IRG-controlled seaports and land border crossings. Specifically, the DFA has taken several steps designed to (1) incentivise and subsequently increase import activity via the Al Hodeidah and Saleef ports and Ras Issa oil terminal, which are under its control, and (2) reshape internal distribution practices.

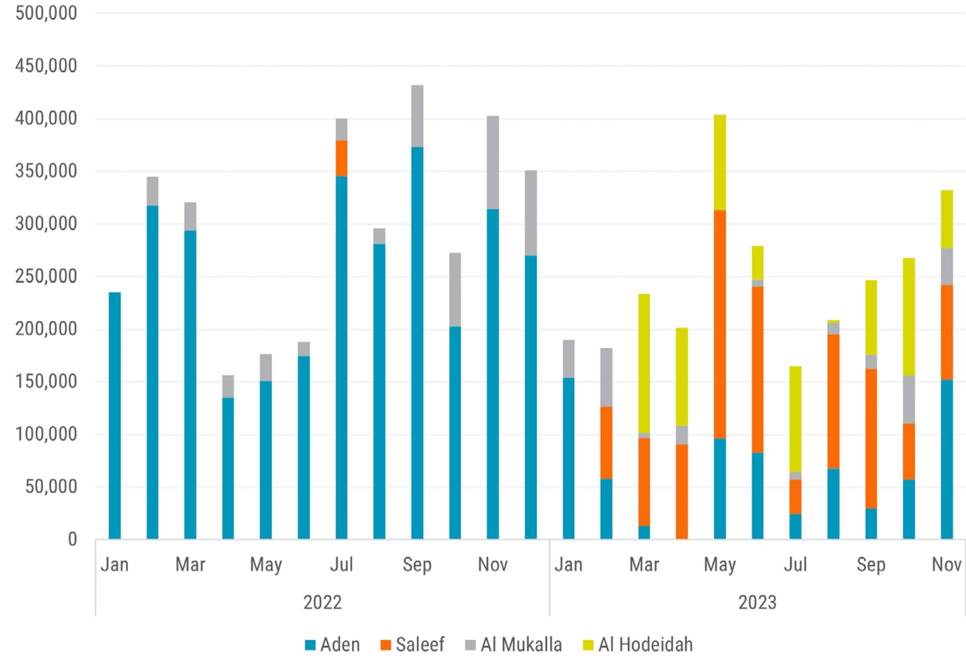
Since April 2022, DFA-controlled ports have sustained high fuel import levels, primarily driven by the Saudi-led coalition (SLC) decision to allow fuel imports via Al Hodeidah as part of the April 2022 truce agreement and allowing Ras Issa to re-open for imports from February 2023. Since January 2023, there has also been a remarkable increase in the volume and frequency of construction materials and other commercial goods carried in containers and imported via the Al Hodeidah and Saleef ports. UNVIM facilitated this increased import of construction materials and other goods. According to the head of the DFA-run Yemen Red Sea Ports Corporation, UNVIM began allowing more types of goods to enter via DFA-run ports in March 2023 and extended their operating hours to enable more clearances (MOT Yemen YouTube 04/03/2023).

Figure 1. Fuel imports (in MT) from January 2022 to November 2023



Source: YETI (accessed 20/12/2023)

Figure 2. Construction materials imported (in MT) from January 2022 to November 2023



Source: YETI (accessed 20/12/2023)

The DFA has also been offering incentives to importers as part of promoting trade through the Al Hodeidah and Saleef ports and Ras Issa oil terminal (Yemeni Parliament 03/12/2023; ACAPS 13/04/2023).

- The DFA covers the demurrage costs accumulated by importers while they wait to berth and discharge at Al Hodeidah, Ras Issa, or Saleef. Although the DFA has covered these costs since 2019, it has begun extending the offer to more importers.
- The DFA is offering importers advantageous customs rates and payment terms, such as the opportunity to pay 50% of customs bills through a combination of cash and cheques if importers are unable to pay the total in cash (Hodeidah_Media X 25/01/2023).

The latter incentive was implemented in February 2023 in response to the IRG's January 2023 decision to raise the customs exchange rate for non-essential food items from YER 500 to YER 750 per USD 1 (Reuters 26/07/2021). The DFA's stated YER 250 per USD 1 customs rate is applied only to cash payments, while an exchange rate closer to the IRG market exchange rate (YER 1,250 per USD 1) is applied to cheque payments. This is not a real incentive, as paying up to 50% of customs bills by cheque makes the total amount exceed the cost of paying in cash only. These fees, when using either cash or a mixture of cash and cheque, are also higher than the customs rate in IRG-controlled ports when converted to USD.

New customs payment terms in practice

Below is an example of two different scenarios for traders importing non-essential food items through the Red Sea ports. Scenario 1 is for traders paying in cash only for a USD 1 million shipment, and Scenario 2 is for traders paying in a combination of cash and cheque. The 5% customs rate is applied to the shipment total. This example shows that customs costs are higher for importers when the incentives package is applied (50% discount and 50% non-cash payment) as a result of the exchange rate used (nearer to the IRG market exchange rate) to settle the cheque payment amount.

Scenario 1: cash only

DFA customs fees in cash: USD 1,000,000 × 5% × YER 250/1 USD = YER 12,500,000

Scenario 2: cash and cheque

USD 1,000,000 × 5% = USD 50,000

50% discount = USD 25,000

Customs fee due = USD 25,000

50% cash = USD 12,500 × YER 250/1 USD = YER 3,125,000

50% cheque = USD 12,500 × YER 1,250/1 USD = YER 15,625,000

The total custom fees with incentives = YER 3,125,000 + YER 15,625,000 = YER 18,750,000

Comparison between IRG and DFA customs rates

Below is an example using the 5% customs rate applied to a shipment worth USD 1 million using the exchange rate of YER 750 per USD 1 to compare customs fees at DFA and IRG ports. The final fees are then converted to USD using an exchange rate of YER 1,600 for new IRG banknotes and YER 530 for old DFA banknotes.

IRG customs fees in YER: USD 1,000,000 × 5% × YER 750/1 USD = YER 37,500,000

IRG customs fees in USD: YER 37,500,000/YER 1,600/1 USD = USD 23,438

DFA customs fees in USD (cash only): YER 12,500,000/YER 530/1 USD = USD 23,585

DFA customs fees in USD (cash and cheques): YER 18,750,000/YER 530/1 USD = USD 35,377

The DFA is also leveraging traders' desire to access DFA markets as directly as possible, making shorter land routes available from the Al Hodeidah and Saleef ports and Ras Issa oil terminal to DFA territories, where the majority of the population resides, providing greater trade and financial activity than in IRG-controlled areas.

The increase in fuel imports through the DFA-controlled port of Al Hodeidah and Ras Issa oil terminal has allowed the DFA to avoid abiding by the IRG's regulatory framework, including conditions outlined in Decree No. 75 (2018) and Decree No. 49 (2019) requiring government import fees to be paid to and processed by CBY-Aden (WB 01/12/2019).

Implications for the private sector

The DFA is capitalising on the IRG's January 2023 decision to raise the customs exchange rate from YER 500 to YER 750 per USD 1, which has motivated private sector importers and other major freight and logistics companies to reroute their construction materials from Aden to Al Hodeidah, Ras Issa, and Saleef. The customs exchange rate was increased at the same time that SLC import restrictions on the Red Sea ports were relaxed. In January 2024, the war risk insurance cost for a shipment to the Red Sea ports was 35% higher than for IRG ports. The war risk insurance premium rate for a shipment to the Red Sea ports was 0.62% compared to 0.4% for IRG ports (ACAPS 19/01/2024). Despite higher insurance costs for importing via the Red Sea ports, as compared to the Gulf of Aden, the overall costs for traders looking to import, distribute, and sell goods in DFA territories are still lower when importing via the Red Sea, particularly considering that the DFA shoulders the demurrage costs. Traders also benefit from the significant reduction in land delivery distances and costs after entering Yemen via Al Hodeidah governorate. An estimate of transportation costs based on distance and fuel price in Al Hodeidah and Aden shows that the fuel cost to transport a 28.3MT truck from Al Hodeidah to Sana'a is USD 153 versus USD 868 from Aden to Sana'a (see Annex 1 for details). These figures do not yet include the double taxation rates, as described in section 1.3 below.

Container traffic, which used to be heavily concentrated in the Aden Container Terminal, has been on the rise in Al Hodeidah since April 2023. As at October 2023, container imports at both ports were approximately equal. Al Hodeidah's unloading capacity, however, is more limited, as the lack of operational quay cranes requires ship cranes to handle containers. In this regard, the DFA is calling on international stakeholders (specifically the UN) to restore

Al Hodeidah's unloading capacity by replacing at least two of the damaged cranes to reduce waiting and unloading times.

Unless the IRG can improve the competitiveness of the Gulf of Aden and Arabian Sea ports, such shifts in the import of construction materials are likely to be further consolidated in the medium to long term, and an even higher proportion of containers will most likely enter Yemen via the Red Sea ports.

Implications of DFA attacks on the Red Sea shipping route

Continued DFA attacks along the Red Sea's crucial trade route are prompting major shipping firms to halt shipments. Between 26 November 2023 and 11 January 2024, the DFA carried out 26 such attacks (Al Jazeera 19/11/2023 and 11/01/2024). The resulting disruption, intensified in response to Israel's actions in Gaza, has diverted vessels around the Cape of Good Hope, adding thousands of miles to journeys and up to USD 1 million in extra fuel costs, potentially causing a renewed inflation shock globally. For Yemen, this could also result in a reversal of the current shift in cargo, with increased import activity returning to Aden and other IRG seaports and land border crossings (The Guardian 03/01/2024). As at January 2024, the cost of the minimum food basket in both DFA and IRG areas had remained relatively stable since November 2023 (FAO accessed 11/01/2024).

Implications for the peace process

Increased imports via the Red Sea ports and the consequent decrease in the volume of goods through IRG-controlled ports have led to a sharp decline, up to 70%, in IRG income from taxes and customs fees (Arab News 16/08/2023). This comes alongside reduced revenue from the halt in oil exports caused by the DFA attacks on IRG-controlled oil terminals and the DFA ban on sales in its governorates of control of LPG produced in IRG-controlled Ma'rib (see ACAPS' December 2023 report on LPG dynamics in Yemen). These interventions intend to apply maximum pressure on the IRG and secure a stronger negotiating position for the DFA, affecting the overall peace process. The lifting of all SLC restrictions on imports to the DFA-controlled Red Sea ports has granted the DFA financial advantages that could affect the perceived dividends of further peace negotiations. The DFA stands to gain substantial tax and customs revenues, allowing DFA-affiliated business elites to import without restrictions at the expense of unaffiliated private importers.

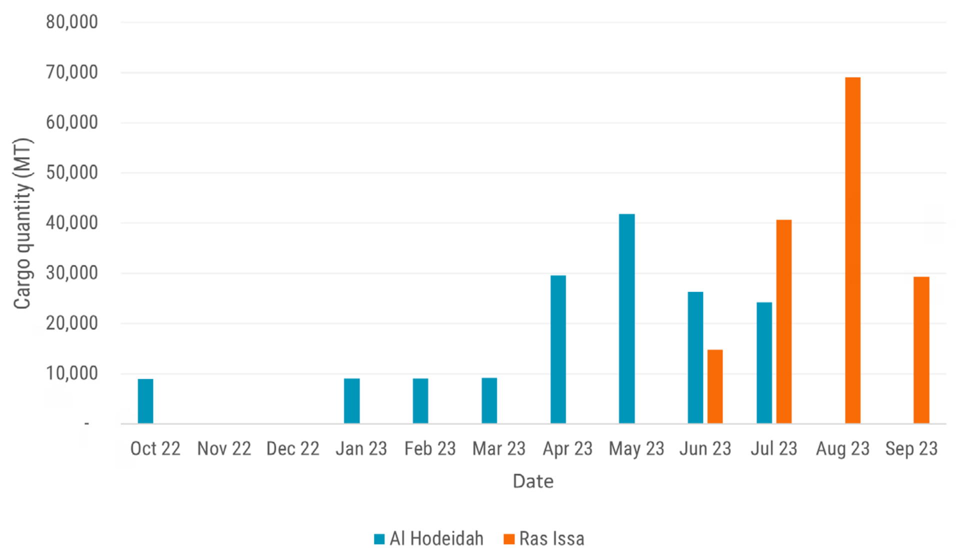
Since the truce in April 2022, the unrestricted flow of imports to Al Hodeidah port has increased the influx of external resources, which can be used to bolster military capabilities and activities. This unrestricted flow also strengthens the grip of affiliated business elites around the private sector economy, allowing them greater control over the market. This dominance in the private sector, which spans over two-thirds of the national economy, enables these business elites to wield influence over political governance and finance campaigns against unfavourable post-conflict changes.

As the majority of imports are redirected to Al Hodeidah, the IRG has lost a source of essential public revenue. The DFA also continues to demand that the international community address unloading capacity issues at Al Hodeidah because of damage by SLC air strikes, as well as the removal of all remaining non-DFA clearance procedures, including those overseen by UNVIM.

Facilitating increased LPG imports via the Red Sea ports (from April 2023) and the subsequent ban on Ma'rib LPG (May 2023)

From April–September 2023, LPG imports significantly increased via Al Hodeidah and Ras Issa by over seven times more than in the previous six months (October 2022 to March 2023) or 275,745MT compared to 36,405MT. This surge in LPG imports coincided with the introduction of a DFA ban on the use of Ma'rib-produced LPG in DFA areas, which was introduced in May 2023 and was still in effect as at November 2023 (ACAPS 07/12/2023).

Figure 3. LPG Imports (in MT) via Al Hodeidah and Ras Issa – October 2022 to September 2023



Source: ACAPS

On 30 July 2023, the DFA-run Yemen Gas Company (YGC) announced a reduction in LPG prices in Amanat Al Asimah (Sana'a City), with LPG cylinders sold via YGC agents (with support from the heads of neighbourhoods, the Aqel al-Harah) at a rate of YER 5,500 (USD 10.38) per cylinder. LPG sold elsewhere – e.g. at fuel stations for vehicles – came in at the slightly higher rate of YER 6,500 (USD 12.26 based on the 30 July exchange rate of YER 530 per USD 1) (Boqash Telegram 30/07/2023). The price reduction led LPG prices in DFA areas to be among the ten cheapest rates in the world, although still not the cheapest in Yemen. The official price, as determined by either the DFA-run or IRG-run YGC, of LPG per cylinder (and per litre) was cheaper in USD values in Aden, Al Mukalla, and Ma'rib (under IRG control). The price of Ma'rib LPG in DFA areas prior to May 2023 was higher than the current price of imported LPG.

Table 1. Official LPG prices in Yemen per cylinder and per litre as at September 2023

LOCATION	PRICE PER CYLINDER (IN YER)	EXCHANGE RATE (YER/USD) ON 4 SEPTEMBER 2023	PRICE PER CYLINDER (IN USD)	PRICE PER LITRE (IN YER)	PRICE PER LITRE (IN USD)
Sana'a City (official price)	5,500	530	10.38	155.81	0.29
Sana'a City (commercial price)	6,500	530	12.26	184.14	0.35
Ma'rib	5,000	1,465	3.41	141.64	0.10
Al Mukalla	6,400	1,465	4.37	181.30	0.12
Aden	7,000	1,465	4.78	198.30	0.14

Note: there are 35.3L of LPG in an 18kg LPG cylinder (the standard size of a cylinder sold in Yemen).
Source: Boqash Telegram (04/09/2023)

On 19 August 2023, the DFA-run YGC called on large consumers – e.g. businesses/fuel station owners selling LPG used in vehicles (cars and buses), as well as business owners using LPG in bakeries or poultry farms – to specify their LPG needs (Boqash Telegram 19/08/2023). The DFA-run YGC added that it was not obliged to provide LPG to consumers who did not submit a request in advance and warned against obtaining LPG from unauthorised sources – i.e. LPG produced in Ma'rib.

Implications for the private sector

The new DFA LPG strategy – i.e. substituting Ma'rib LPG with imported LPG and the subsequent LPG price reductions in DFA areas – will affect several private sector stakeholders, such as importers, distributors, and businesses requiring large LPG quantities. Ma'rib LPG supply was rationed through multiple channels, with the biggest share sold on the black market in DFA areas at a high price. Private sector stakeholders operating in DFA areas may be in a position to purchase (imported) LPG at a lower rate than before when they were purchasing Ma'rib LPG. This has translated into a 35% reduction in the LPG sale price (based on the percentage change between the Ma'rib LPG black market price before May 2023, sold at YER 10,000, and the current commercial sale price of imported LPG sold at YER 6,500). The extent to which benefits are passed onto consumers remains unclear, however, as a result of a lack of data on profit margins on imported LPG.

Implications for the peace process

LPG policy changes have affected the peace process in two main ways. First, it can be assumed that, by relying on imported LPG, the DFA has shown increased foreign reserve capacity. In the past year, reports suggested an increased foreign currency shortage in DFA areas (Aawsat 29/04/2023), something the DFA highlighted when seeking to convince Saudi Arabia to inject foreign currency to cover part (if not all) of the DFA-area salary bill. If regional backers are providing LPG instead and pressure on the DFA budget is reduced, the argument for external support to pay public sector salaries also loses strength.

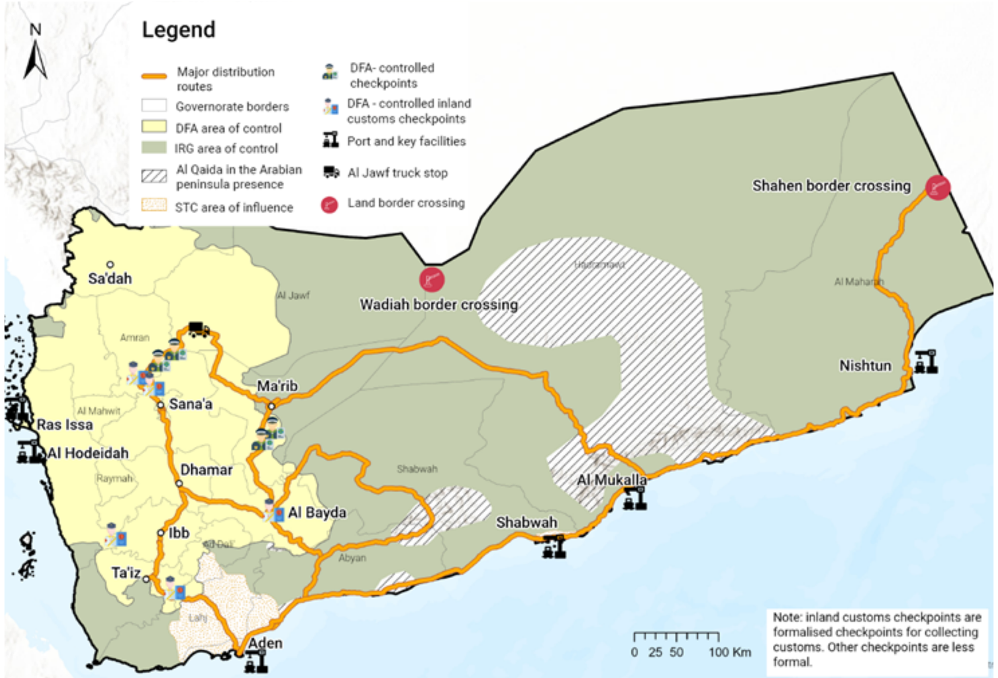
Second, by reducing IRG revenue, the DFA has essentially increased its bargaining position. Continued disruption to crude oil exports and the DFA ban on Ma'rib LPG exert increasing pressure on the IRG to engage in discussions on cooperative resource management and revenue distribution mechanisms. Challenges have arisen, however, from IRG internal divisions, particularly the opposition of the Southern Transitional Council (STC) to share resources with the DFA, posing a hurdle to potential discussions led by Saudi Arabia or the UN (ACAPS 07/12/2023).

Disincentivising imports via seaports and land border crossings outside DFA territory

Alongside policies promoting and incentivising traders to import goods via Al Hodeidah, the DFA has also sought to disincentivise traders from using seaports and land border crossings located in IRG territories by imposing further costs and delays.

Throughout the conflict, the DFA has applied double taxation on imported goods entering its areas via land border crossings or seaports outside DFA control. On 6 August 2023, the DFA tweaked its existing double taxation regulations by applying a 6% import tax rate and a 2.5% customs rate, as well as other fees (Arab News 16/08/2023). For example, a shipment of goods imported via a seaport or land border crossing in IRG-controlled territories and destined for DFA-controlled governorates worth YER 500,000,000 will incur a YER 30,000,000 import tax and a YER 12,500,000 customs fee, after already being subjected to IRG-imposed tax and customs fees.

Figure 4. DFA checkpoints on major routes for the double taxation of goods imported from IRG-controlled ports



Source: ACAPS discussions with key stakeholders

Before these added taxation costs were applied, traders and truck drivers would already have reported various disruptions when transporting goods from IRG to DFA territories (Arab News 13/02/2023). Between February–March 2023, wheat trucks prevented from entering Al Bayda, Ta'iz, and Sana'a governorates, the latter deeper inside DFA territory, led to a build-up at DFA-manned checkpoints (Arab News 30/03/2023; Al-Masdar Online 29/03/2023; KIIs February and March 2023). The DFA appeared to target wheat trucks loaded at Aden's silo and mill facilities as part of wider attempts to promote the use of Al Hodeidah port for all commercial imports.

Elsewhere, DFA attempts to delay and discourage indirect imports have also affected traders and truck drivers importing goods via the Al Wadiah land border crossing. An estimated 80% of goods imported via Al Wadiah would be transported overland to DFA-controlled territories and largely comprised food, construction materials, and other commodities (plastics and electronics). Since April 2022, however, movement at Al Wadiah has decreased notably (KIIs July and November 2023). DFA-affiliated forces are pressuring truck drivers arriving from Al Wadiah – making them wait for extended periods (sometimes days) at checkpoints and demanding extra levies. Delays and added costs appear designed to pressure traders to switch their import operations to Al Hodeidah port.

Implications for the private sector

Some private sector traders (importers and distributors) and truck drivers whose assets and headquarters are based in DFA-controlled areas but who have been importing or receiving goods via ports in the Gulf of Aden will inevitably feel compelled to use Al Hodeidah, Ras Issa, or Saleef to avoid further delays and costs. Some private sector stakeholders, especially major traders operating from port facilities in IRG-controlled areas and companies headquartered in IRG-controlled areas, are unlikely to make the switch. Private sector stakeholders involved in the import of goods via land border crossings at either Al Wadiah in Hadramawt governorate (on the Saudi border) or Shahin in Al Maharah governorate (on the Omani border) are unlikely to switch to the Red Sea ports unless this change makes practical or economic sense.

The August 2023 modification of double taxation regulations introduced during the conflict is likely to continue and unlikely to be removed in the short to medium term.

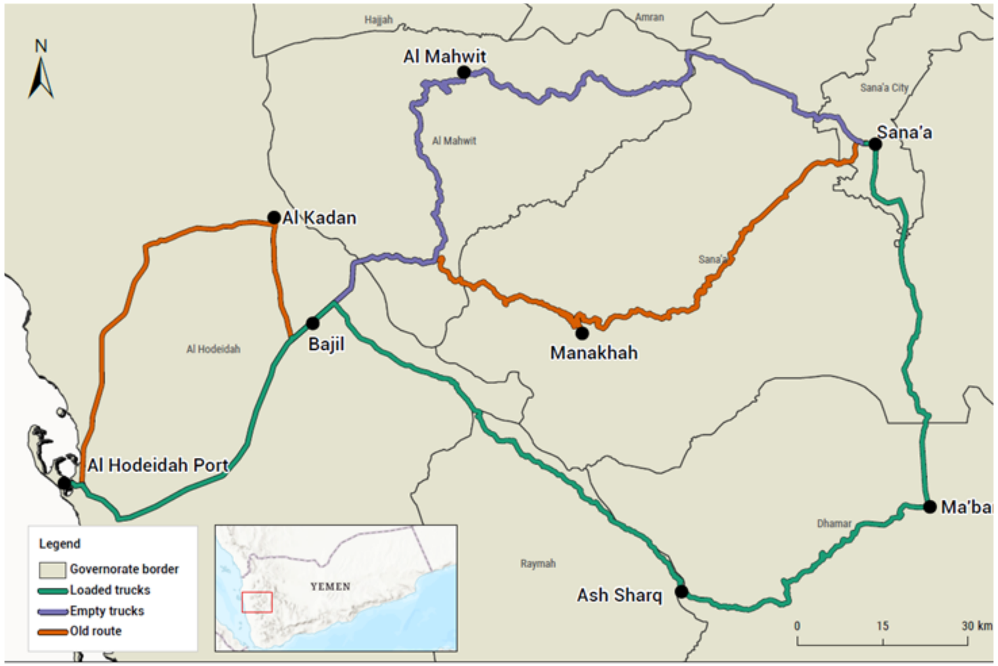
Implications for the peace process

The DFA's double taxation regulations complicate discussions of how two divergent economic zones and systems (the DFA versus the IRG) can coexist within an overarching post-conflict setting. It would be difficult to secure an equitable revenue-sharing agreement, as non-oil revenues in DFA-controlled areas have increased significantly from their pre-conflict marginal share of public revenues. The DFA is likely unwilling to disclose the actual figure of their non-oil public revenues, as compared to known revenues from natural resources in IRG-controlled areas. As taxation is considered one of the DFA's main revenue streams, these regulations also affect the respective calculation of DFA revenues.

The relevance of DFA revenue calculations to the peace process relates to the payment of public sector salaries (and public service provision costs). The public sector salary and pension issue has been a significant barrier to brokering a lasting agreement between conflict parties. DFA demands related to this issue, as well as its desire for access to IRG oil and gas revenues, influenced the non-renewal of the UN-sponsored truce on 2 October 2022. There is still no agreement over who should pay and which funding should be used to cover these costs in DFA-controlled areas. A resolution on public sector salaries in DFA-controlled areas could serve as a crucial short-term confidence-building measure, potentially leading to a renewed truce and fostering wider political negotiations.

Revision of heavy truck transport routes between Al Hodeidah and Sana'a

Figure 5. New and old routes between Al Hodeidah and Sana'a for heavy trucks



Source: Saba Net 08/10/2023 b

Note: the new routes for loaded and empty trucks coincide between Al Hodeidah and Bajil.

In October 2023, the DFA announced a change in the main route used by heavy trucks to transport goods overland from Al Hodeidah to Sana'a and their subsequent return (Saba Net 08/10/2023 a). Loaded heavy trucks travelling from Al Hodeidah to Sana'a were instructed to use the following route: Al Hodeidah–Bajil–Jabal Ash Sharq–Ma'bar–Sana'a. Empty heavy trucks travelling from Sana'a to Al Hodeidah are instructed to use the following route: Sana'a–Al Mahwit–Al Hodeidah. The DFA-run Traffic Police stated that the decision to reroute and divert heavy truck traffic was made as a result of safety concerns and to ease traffic along the Al Hodeidah–Sana'a route (as shown in figure 5), although truck drivers consider the alternative route more damaged and unsafe (Saba Net 08/10/2023 b). According to a DFA heavy trucks syndicate statement, the transportation cost per metric ton between Al Hodeidah and Sana'a has increased by YER 3,400 (USD 6.40) (Al-Asimah 10/10/2023).

This is a further example of the DFA's reconfiguring of supply lines and remapping of distribution points for private sector traders (importers, distributors, and truck drivers).

Implications for the private sector

For private sector stakeholders involved in the movement of imported goods from Al Hodeidah to Sana'a, the newly designated routes add marginally to their time and fuel costs, including for the return trip.

Implications for the peace process

This revision has no major implications for the peace process.

FINANCIAL SECTOR INTERVENTIONS

This section explores various DFA regulatory measures for the financial sector, focusing on import financing access, the tightening of money exchange regulations, restrictions on financial services providers processing financial aid transactions, and the prohibition of interest-based finance and trade. Here, this report discusses how conflicting directives from CBY-Sana'a and CBY-Aden have affected private sector access to foreign exchange funding and how CB-Sana'a's regulatory interventions have disrupted the money exchange sector. This section also examines the banking sector's shift towards an exclusively Islamic banking model in DFA-controlled areas.

Access to import financing

Throughout 2023, conflicting directives from CBY-Sana'a and CBY-Aden intensified. CBY-Aden required banks applying for foreign exchange auctions from the DFA headquarters or branches to deposit an equivalent cash amount in Yemeni rial at CBY-Aden on behalf of their DFA-based food import clients. This deposit is a prerequisite to applying for foreign exchange funding through weekly auctions. Since January 2023, the DFA has restricted Sana'a-headquartered banks from participating in CBY-Aden's weekly auctions on behalf of food importers. CBY-Sana'a argues that this measure is crucial to countering the continued transfer of hard foreign currencies to the IRG foreign exchange market. The DFA has also directed that only imports financed by CBY-Sana'a are permitted to unload at the Red Sea ports, extending the prohibition to importers acquiring their foreign currency through banks participating in CBY-Aden funding initiatives (ACAPS 02/08/2023).

Despite CBY-Aden's weekly foreign currency auctions, held since November 2021 and aimed at addressing fluctuations, challenges to foreign exchange funding stability have constrained its ability to maintain currency stability. CBY-Aden's auction system provides qualified banks with regular USD funding for basic commodity import financing (SCSS 02/03/2023).

The pre-conflict structural concentration of public and private institutions in Sana'a, as well as the fact that the majority of the population resides in DFA-controlled areas (and Yemeni migrants in Saudi Arabia are also from DFA governorates), gives the DFA control over most of the foreign exchange supply. In contrast, maintaining foreign exchange reserves has been an increasing challenge for CBY-Aden since late October 2022. This difficulty arose when DFA attacks on IRG oil terminals suspended crude oil exports, which had been the main source of IRG foreign exchange and public revenue income. Despite this, CBY-Aden has managed to secure foreign exchange funding through the IMF's Special Drawing Rights and partial disbursements from regional bilateral commitments from Saudi Arabia and the United Arab Emirates.

Implications for the private sector

Private businesses, particularly those involved in food imports, may face difficulties in accessing foreign exchange funding as a result of CBY-Aden's and CBY-Sana'a's conflicting directives. The contradictory monetary and foreign exchange requirements aggravate economic divisions within businesses, as their headquarters and branches must follow different directives based on where they operate. For instance, banks and importers based in DFA-controlled areas cannot meet the CBY-Aden pre-condition of depositing new Yemeni rial banknotes at CBY-Aden to participate in the weekly foreign exchange auctions for import funding. Similarly, CBY-Sana'a does not recognise IRG-based new banknotes and banks licensed by CBY-Aden.

The DFA's control over the majority of foreign exchange supplies leaves the private sector highly dependent on DFA policies and directives. Any disruptions or changes in the DFA's approach can have a direct impact on businesses reliant on these sources of foreign exchange.

Implications for the peace process

CBY-Sana'a's and CBY-Aden's conflicting directives and challenges contribute to economic instability, a significant obstacle to the peace process. Reliance on external funding, aligned with different factions, may affect negotiations and post-conflict reconstruction. Economic challenges affecting food imports and currency stability directly affect the humanitarian situation, worsening existing crises and linking humanitarian concerns to overall stability, which is essential to a meaningful peace process. For the IRG, the lack of foreign exchange funding has created a currency crisis, rampant inflation, and civil unrest, driving fragmentation within the anti-DFA camp. For the DFA, the lack of foreign exchange funding has caused prices to rise, which, compounded with a reduction in aid and remittances, has increased pressure on the DFA to resolve the issue of public sector salary payments. The DFA may seek to instigate a new round of conflict to add pressure on wider peace negotiations and come to an agreement on the salary issue.

CBY-Sana'a's tightening of regulations on the money exchange sector

Since 2015, banks' capacity to serve their clients has steadily declined, particularly resulting from the collapse of the national financial system and the IRG-DFA division. As banks' influence contracted, the money exchange sector experienced growth in both numbers and scale, expanding its services to include accepting deposits, managing current accounts, extending credit, and facilitating cross-border trade financing transactions. In effect, the money exchange sector took over a significant portion of local and foreign currency markets, generating substantial earnings, particularly during periods of currency volatility. This was achieved by capitalising on currency arbitrage and engaging in speculation amid fluctuating exchange rates (WB 30/05/2023). As money exchange services are suited to the context of Yemen, and given the sector's growing size and functionality during conflict, a well-regulated and transparent money exchange sector is vital to fostering private sector engagement in the economy.

In early 2023, a major financial scandal was exposed involving billions of unpaid transfers in the Al-Emtiyaz financial network. This prompted increased scrutiny of Yemen's money exchange networks, and CBY-Sana'a instructed such networks to transfer these funds to its control. This revelation caused upheaval in the sector, with leaked financial details and subsequent public calls for transparency (News Yemen 06/02/2023).

From January–June 2023, CBY-Sana'a issued a series of directives for the money exchange sector. In early January, it ordered the freezing of accounts and restricted financial transactions for certain money exchanges and their clients. Later in the same month, CBY-Sana'a suspended the operations of money exchange businesses, including unlicensed entities and those losing access to foreign exchange market networks with frozen accounts (SCSS 09/03/2023).

On 30 April 2023, to reduce bankruptcy risks, CBY-Sana'a increased its minimum capital requirements and imposed a cash deposit collateral for money exchange entities. These measures, however, further aggravated liquidity challenges in the sector. As a guarantee, a 25% cash deposit by money exchange companies with CBY-Sana'a was required within eight months of the decree's publication (SCSS 14/04/2023).

Table 2. CBY-Sana'a and CBY-Aden 2023 capital requirements and growth in sector participants

CATEGORIES	UNIT	PRE-CONFLICT	2023	
			CBY-SANA'A	CBY-ADEN
Total licensed money exchange stakeholders	number	605	1,122	379
Capital requirements – money exchange company with a network	billion YER		1.25	1.5
Capital requirements – money exchange shops	million YER		100	500
Cash collateral deposit payment	% of capital		25%	33%
Fulfilment timeline	months		8	12

Sources: SCSS (25/05/2023); CBY (12/06/2023); Regain Yemen (accessed 11/01/2024)

While the imposed capital raise aimed to mitigate risk, it ended up aggravating liquidity challenges for the sector. The capital raise appeared to benefit both larger and DFA-affiliated entities, while smaller stakeholders struggled. In attempting to claim lost account balances, depositors faced risk and illegal practices as unauthorised depositors took advantage of the market.

Implications for the private sector

CBY-Sana'a's directives – including freezing accounts, restricting financial transactions, and suspending certain money exchange businesses' operations – have disrupted the sector. This regulatory intervention has affected businesses' ability to operate smoothly and maintain financial stability. CBY-Sana'a's imposition of higher minimum capital requirements and a prerequisite cash collateral are perceived as worsening liquidity challenges, particularly for smaller entities, affecting their ability to meet regulatory compliance. As the money exchange sector is not mandated to hold deposits or accounts of any type for any customer, depositors also face uncertainties and lack the legal basis for recovering lost account balances.

As at 2015, the number of money exchanges had expanded tremendously to the thousands. The widening, contradictory supervisory and regulatory competition between CBY-Sana'a and CBY-Aden has allowed the money exchange sector to take on a significant risk, which could lead to extensive financial loss for the private sector and individuals. During the conflict, money exchangers illegally accumulated large liquidity from public and private sector deposits but struggled with a growing liquidity shortage. In 2023, CBY-Sana'a imposed multiple regulations, including capital and collateral raises and the deposit the cash amount of unpaid transfers to safety accounts with CBY-Sana'a.

Implications for the peace process

Excessive regulatory hurdles may affect sectors crucial to the peace process, such as trade and cross-border transactions, and hinder private sector growth and participation in reconstruction efforts.

Prohibition on interest-based finance and trade

On 21 March 2023, the DFA enacted a law banning 'usury transactions', which aims to completely align financial services with Shari'a principles (WB 26/10/2023). This law bans all types of interest on deposits, loans, letters of credit, and letters of guarantee, not only with financial service providers but also among individuals and civil and commercial entities (UN 21/02/2023). Banks in Yemen must also terminate existing agreements and cease transactions with correspondent banks that involve interest (SCSS 14/04/2023).

Prior to the conflict, banks in Yemen invested over 65% of deposits in government treasury bills. Since the split between CBY-Sana'a and CBY-Aden in September 2016, control over records and the management of these investments have remained with CBY-Sana'a. There was an opportunity for banks to avoid heavy potential losses in their treasury bills investment portfolios by responding to a 2019 CBY-Aden offer to register these debts. Unfortunately, this was not a viable option, as CBY-Aden required banks to relocate their headquarters to Aden – an action not permitted by CBY-Sana'a (UN 21/02/2023).

Implications for banks and banking customers

The DFA's March 2023 ban on usuary transactions has created panic and confusion in the banking sector. The law mandates banks to immediately transition to a different approach, requiring substantial resources to launch new instruments and dismiss conventional banking activities (YBA 07/06/2023). Banks are exposed to penalties, including fines of up to YER 3 million and imprisonment for up to two years. This legal constraint, alongside the 1998 banking law that prohibits commercial activities, makes it difficult for banks to cover operational costs and diversify investments, increasing bankruptcy risks.

Revenue from interest is commercial banks' main source of income, comprising 70–75% of their total income (YBA 26/01/2023). The new law threatens to remove this income and hamper banks' ability to recover outstanding treasury bills and balance accounts, affecting investments in public debt totalling over USD 3 billion (I'm Arabic 15/03/2023). At the same time, the law relieves business debtors of interest on their bank loans. The law also complicates compliance with different financial sector supervision and regulation regimes, aggravating difficulties for banks operating in both DFA-controlled and IRG-controlled areas.

As commercial banks have invested customer deposits in public debt treasury bills, banks have lost credibility with regard to their ability to allow depositors access to their balances. Up to 1.2 million depositors, including pensioners, risk losing their livelihoods and primary source of income (Asharq Al-Awsat 07/04/2023). This loss is compounded by the inability to retrieve full deposit balances for alternative livelihood projects and living expenses (I'm Arabic 15/03/2023).

The law banning interest-based transactions undermines trust in banks for saving and transfers and diminishes their involvement in trade financing activities, a result of blocked agreements with correspondent banks with regional and global interests. Restricted deals with these banks prevent their extension of free credit to businesses. This, in turn, leads to a decline in investment projects reliant on bank credit financing.

Implications for the peace process

The transformation of the DFA-controlled banking sector towards an Islamic banking model aggravates the divide in the national financial system and diminishes prospects for coordination among banks in both areas of control, hindering efforts to reunify the banking sector. Within the current regulatory framework, DFA banks are not allowed to work with conventional banks (interest-based banking). On the other hand, CBY-Aden – as the legitimate Central Bank – does not recognise DFA changes, including the ban on interest. Enforcing this legislation in the DFA financial market would result in the formal banking system's further marginalisation, favouring compliant banks and money exchange service providers aligned with DFA business elites.

MARKET CONTROL AND THE FULL CAPTURE OF PRIVATE-SECTOR GOVERNANCE

This section discusses how the DFA – by imposing price caps, orchestrating SCCI leadership changes, and transferring tax amendment powers to the Executive Authority – has consolidated control over the private sector by directly intervening in market dynamics.

Imposition of price caps on food commodities

In November 2022, the DFA-run MOIT introduced food price controls to regulate prices in DFA-controlled territories (ACAPS 02/08/2023). Bread prices were the first to be regulated, followed by a wider set of price controls for various food commodities in December 2022 and further introductions in February, March, May, and June 2023 (Boqash Telegram 23/05/2023).

Table 3. Official prices (as issued in May 2023) compared to market prices (in YER) of main food imports

COMMODITIES	QUANTITY	OFFICIAL PRICE	MARKET PRICE
Wheat grains (milled)	50kg bag	13,700	14,400
Wheat flour	50kg bag	14,700	15,600
Sugar	50kg bag	22,500	24,500
Rice (from Thailand)	50kg bag	17,000	18,000
Oil	4L	3,600	3,700

Source: Boqash (accessed 11/02/2024); Boqash 23/05/2023

Although some food traders have denounced the price caps, which are alleged to distort market dynamics, the DFA MOIT has demonstrated its determination to continue enforcing the measures, with non-compliant businesses forced to suspend trade (ACAPS discussion with market actors; Saba Net 03/06/2024).

Price reductions introduced in March and May 2023, before and after the holy month of Ramadan, prompted significant criticism from private sector stakeholders expecting a return to pre-Ramadan levels after Eid al-Fitr. Private sector stakeholders objected to increasing DFA market interventionism, with the SCCI spearheading criticism (SCSS 15/08/2023 a). The DFA responded by changing the SCCI leadership and continuing the implementation of existing price caps, with further reductions ordered in June 2023 (Arab News 04/06/2023).

Implications for the private sector

The implementation of price caps was a turning point for the relationship between the DFA and large private-sector importers. Throughout the war, the DFA continued to levy both legal and illegal fees on the food import supply chain, which the private sector passed on to consumers as higher prices. With the imposition of price caps, however, the private sector was unable to recover costs by passing on increased prices to the ocnsumers. The SCCI issued a rejection statement, which led the DFA to replace its board. Many businesses risked insolvency by absorbing continued losses or were forced to reduce activities. If maintained, the price cap policy could make food import and distribution unprofitable for certain food traders, especially those who lack the resilience to weather operational or financial disruptions and have limited political support.

The DFA does, however, appear determined to implement price caps in the short term. While food traders and other private sector stakeholders may object to DFA market interventionism, public criticism is unlikely to be tolerated; if businesses wish to continue operating in DFA areas, they will need to comply with DFA price (and other market) regulations. DFA official and market prices in USD terms are higher than IRG prices for staple imported food commodities, as shown in Table 4.

Table 4. USD comparison between IRG market prices and DFA official prices

COMMODITIES	UNIT	IRG MARKET PRICE		DFA PRICE CAPS	
		YER NEW	USD	YER OLD	USD
Wheat grains milled	50kg bag	33,200	23	13,700	26
Wheat flour	50kg bag	37,600	26	14,700	28

Source: Saba Net 23/05/2023; Boqash (accessed 11/02/2024)

Note: exchange rate used for conversion is YER 1,436 per USD 1 for the IRG new Yemeni rial, and YER 530 per USD 1 for the DFA old Yemeni rial.

Implications for the peace process

The implementation of price caps stands in direct contrast to the open-market dynamics found in IRG-controlled areas, compounding the fragmentation between IRG and DFA areas. The majority of the population has positively received price caps, however, strengthening DFA public support.

Over the medium to long term, the DFA market will become less attractive and more unprofitable for traders forced to sell at price caps while also being exposed to increasing costs and levies, as compared to affiliated competitors waived from such fees. In such a case, the privileged private sector would push their political elites to stand against peace to maintain their market dominance.

SCCI reconfiguration

Despite growing resentment around DFA measures, business people have been reluctant to relocate their operations to IRG-controlled areas, as the majority of Yemen's population (their customers) reside in DFA-controlled governorates (Arab News 28/05/2023). The extent of DFA encroachment into the private sector and imposition of price controls, however, has left the private sector with no choice but to respond to avoid the collapse of the business environment in DFA-controlled areas.

The SCCI has led this response. On 30 May 2023, the SCCI issued a strongly worded statement against price caps and DFA reprisals against those refusing to accept the new conditions (Arab News 04/06/2023). The statement criticised the MOIT for taking arbitrary measures against the private sector, in clear violation of constitutional orders and market competition and trade laws. The statement also argued that DFA controls and other punitive measures would lead to substantial and unmanageable losses, the wider destruction of the business sector, and the suspension of imported commodities in local markets, potentially affecting food security in DFA-controlled areas (SCSS 15/08/2023 a).

On 1 June 2023, in response, the MOIT carried out an armed takeover of the SCCI building and appointed Ali al-Hadi, who emerged as a prolific businessman during the conflict, as the new SCCI Chairman of the Board (SCSS 15/08/2023 b; Arab News 04/06/2023). Starting in October 2023, the newly appointed SCCI leadership swiftly implemented measures aimed at reshaping the private sector, such as integrating new sectors into the SCCI, establishing new shareholding companies, and encouraging the local private sector's integration into certain regional and global trade networks.

Implications for the private sector

The above initiatives have the potential to influence business profitability, organisational structure, and capacity to engage with companies beyond DFA-controlled areas.

- By expanding the number of economic sectors under SCCI control, the DFA aims to gain greater economic control and a corresponding increase in membership revenues and other rent seeking behaviours. The new sectors under SCCI control are largely informal or semi-formal, such as construction, power generation, and distribution for malls and supermarkets.
- By consolidating ownership in key profitable business activities via the forming of joint-stock companies focused on electricity power generation, current electricity power station owners – whether market-based or non-affiliated business stakeholders – could be compelled to shut down their stations in exchange for minimal shares in newly established solar energy-producing companies intent on dominating the market.
- The DFA is promoting economic ties between businesses and specific countries, such as Iran, Oman, and Russia. For instance, the DFA has mandated businesses to participate in events such as the Arab-Russian Business Council in Oman in January 2024 and the inaugural round of the China International Show for Supply Chain in Beijing from 28 November to 2 December 2023.

Implications for the peace process

The DFA's domination of the most influential segment of the private sector, as manifested in the composition of the SCCI board, hinders the private sector's autonomous expression. Designated private sector representatives involved in peace initiatives are likely to echo DFA elite-aligned perspectives and interests, as well as those of their associated private sector affiliates, limiting the diversity of viewpoints and independent input.

The DFA has strategically consolidated their power and controls various revenue streams, notably through a few trusted affiliated leaders. This monopolisation has led to internal dissent, particularly among factions within the DFA who feel marginalised but dependent on inner circle resources to fund the war effort. To consolidate economic power, the implementation of laws and levies and the establishment of parallel financial centres and companies have alienated local business families and accelerated capital flight from DFA-controlled areas. This isolation has extended to traditional allies, such as tribal leaders, leading to a decline in local partnerships and a rise in new adversaries. Overall, these actions have not only isolated the DFA internally but also raised significant challenges to any potential peace process – as peace could intensify internal conflicts and spark waves of revenge, further destabilising the region (Abaad Studies 23/07/2023).

Transfer of tax amendment power from parliament to the Executive Authority

Since the beginning of the conflict, the DFA has enforced substantial taxes on the business sector. As at October 2023, the DFA parliament had approved legislative amendments authorising the President of the Superior Political Council to make changes to the Sales Tax Law, Income Tax Law, and Customs Law, including rate increases, without parliamentary approval. Given the current circumstances, the president's only power is to bypass long procedures and delays hindering the DFA's progress in implementing its national plan (Yemeni Parliament 10/11/2023).

The legal power shift aims to legitimise the executive administration's future use of designated powers. In the past, the private sector initiated legal action against the MOF for unauthorised changes in tax and customs legal frameworks, leading to the imposition of levies without parliamentary approval. The proposed change aims to empower executive authorities to offer incentives and exemptions to affiliated private sector entities entering key economic sectors. This could potentially result in unfair competition, placing non-affiliated businesses at a disadvantage as they contend with increased fees.

Implications for the private sector

In this altered landscape, non-affiliated private sector entities could face challenges in dealing with substantial levies and restrictions, as compared with their privileged competitors. For example, recent complaints by private health facility owners in Sana'a indicate that the MOF has imposed added taxes on them – taxes not levied on similar facilities owned by prominent DFA leaders. This case highlights the potential adverse effects of these legal changes, enabling the ministry's selective targeting in favour of or against specific sectors and stakeholders and affecting the private sector (UN 21/02/2023).

Implications for the peace process

The nationalisation of legal and governance frameworks is an anticipated result of the peace process, necessitating the annulment of any recent modifications or additions to the legal structure in place before the war. Influential private sector figures who have profited from the legal provisions introduced – legal provisions designed to optimise their gains and enhance their businesses' scope and scale – may rally political supporters against the peace agreement. Their aim is to continue exploiting the strategically crafted legal foundations.

Annex 1. Estimates of transportation costs

	AL HODEIDAH-SANA'A	ADEN-SANA'A
Travel distance in km	226	1,300
Litres of diesel consumed	168.7	970.1
Diesel market price per litre in YER in city of departure	475.00	1,366.67
Total diesel cost in YER	80,132.50	1,325,806.57
YER/USD exchange rate (as at the end of December 2023)	525	1,527
Total diesel cost in USD	152.59	868.29

Source: FAO (accessed 14/02/2024); Crown Oil (accessed 15/03/2023)