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SITUATION REPORT: YEMEN'S PUBLIC SALARY DISBURSEMENT EFFORTS

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Situation Report: Yemen's Public Salary Disbursement Efforts

This paper highlights the Government of Yemen (GoY) 's efforts and the challenges it faces in disbursing public salaries with the coordination of the Central Bank of Yemen (CBY) as of February 2017. For an overview of Yemen 's economy, refer to the following report: Economy of Yemen: Background, Challenges and Key Issues¹

Background

Yemen's public sector constitutes the biggest employer in the economy, employing more than 1.2 million civil and military workers, and supporting millions more dependent family members. The GoY expends almost 75 billion Rials per month on state wages and salaries, which does not include government employees' retirement benefits. As of summer 2016, CBY has been unable to fully pay salaries of state employees due to shortages in banknote liquidity²-- rendering thousands of employees in destitute conditions. Since relocating CBY to Aden, payment of public salaries was prioritized. As an initial step, CBY's leadership succeeded in obtaining a batch of newly printed banknotes from Goznak³ during January 2017, setting in motion the disbursement process of public salaries across all of Yemen—including areas not under the control of the GoY.

Disbursement Mechanism and Challenges

For the past two decades, CBY has acted as a treasurer on behalf of the Ministry of Finance, disbursing budgeted state salary funds to government entities—but not directly to individual state employees. Up to the current crisis, most public sector workers received their salaries in cash provided directly from their governorate's local CBY branch. Few public sector offices paid their employees by way of a transfer via a Yemeni bank.

The onset of the political crisis contributed significantly to the current challenges in disbursing public sector salaries. The takeover of Sana'a by the Houthi and Saleh anti-government militias in September 2014 led to the overrunning of government institutions therefore compromising the integrity of public sector payroll lists. Payroll lists in a number of GoY ministries were either altered or inflated with the addition of individuals loyal to the Houthi and Saleh militias.

The crisis intensified in January 2015 after the Houthi and Saleh militias staged a coup against the GoY leading to further challenges. The militias took over the Ministry of Defense, put the GoY leadership on house arrest, and coerced CBY to deliver the Ministry's budget to their representatives in block grants. The amount was approximately 25 billion Yemeni Rials a month. This led to widespread alterations to military salaries with the aim of integrating Houthi and Saleh militia members into the security forces.

Problems in paying public sector salaries increased as the Houthi and Saleh militias pressured CBY management in Sanaa into using monetary policy for collective punishment. Monopolizing of liquidity in the CBY branches of Sanaa and Hodeidah, under the control of the Houthi and Saleh militias, was used to limit CBY branches in GoY controlled areas from

1- <http://www.yemenembassy.org/wp-content/uploads/2017/02/Final-Eco.pdf>

2- More details on the state of Yemen's economy: <http://www.yemenembassy.org/wp-content/uploads/2017/02/Final-Eco.pdf>

3- Company contracted by the GoY to manufacture paper security products including bank notes.





paying public sector wages. By the Summer of 2016, a number of liberated governorates had gone nearly 8 months without receiving salaries.

Under pressure, CBY was forced to pursue policies that led to the mismanagement of FX reserves and domestic liquidity, with large amounts re-routed for the "war effort" or other Houthi and Saleh militia projects. By Summer 2016, CBY branches in areas under the control of the Houthi and Saleh militias were unable to pay public sector salaries due to a lack of the bank notes. By September 2016, after Yemenis all over the country spent months of not receiving public sector salaries, GoY had no choice but to relocate CBY to Aden and attempt to ameliorate the situation. The top priority was the payment of public sector salaries in a sustainable, consistent, and transparent manner.

CBY will continue to follow the guidelines of the government's last parliamentary approved budget of 2014⁴, and it will adhere to the budget's expenditure ceilings. On the grounds that CBY does not maintain detailed payroll records and most payroll lists remain in the possession of the Houthi and Saleh militia loyalists or have been significantly altered, CBY's only option from its headquarters in Aden is to decentralize the collection process of the payroll database by

delegating the collection to governorates' administrations. The process of compiling a payroll list is supervised by a 10 member committee led by and made up of officials from the Ministry of Finance and the Ministry of Civil Service. This committee collects payroll lists from governorates' administrations and cross-checks these lists with any other data it has at its disposal to identify persons unlawfully employed in government institutions by the Houthi and Saleh militias in areas under their control. These lists will undergo a vetting procedure to verify that they haven't been altered in order to minimize the risk of illegal recruitment. Once a payroll list for a particular office or ministry is fully vetted, the Prime Minister's office and the Ministry of Finance jointly approve the disbursement of salaries in accordance with the liquidity available at CBY. Finally, CBY intends to reach beneficiaries directly to ensure minimal disruption of payment or the re-routing of the funds to the "war effort" by the Houthi and Saleh militias. CBY will channel salary payments through financial intermediaries including but not limited to money transfer companies, state owned banks, and the postal service. The GoY signed an agreement with CAC Bank, and Alkuraimi Co to carry out the transfer of salaries. Direct payment to beneficiaries ensures transparency and guarantees that payment will be sent to the intended lawful state employee.

Expenditures (In millions of Yemeni Rials)	Budgeted 2014	Actual 2014
Workers payroll and compensations	977,085	927,792
Wages and salaries	923,699	877,713
Contributions for social causes	53,386	50,079
Expenditures on goods and services	708,251	728,614
Goods and services	262,323	185,238
Maintenance	30,218	18,979
Debt obligations:	415,253	524,090
Interest obligations on domestic debt	396,234	507,636
Interest obligations on external debt	19,019	16,454
Property expenditures	457	307

4- Law requires the government to adopt the last parliamentary approved budget in the event that the government is unable to pass a new budget through the parliament.





Subsidies, grants and social benefits	560,978	699,055
Cash subsidies	385,925	524,416
Fuel subsidies	330,816	479,413
Other subsidies	55,109	45,003
Grants	2,805	815
Social benefits	144,072	151,942
Other transfers	28,176	21,882
Unclassified expenditures	51,912	52,730
Total operational expenditures	2,298,226	2,408,191
Capital expenditures	512,284	170,212
Capital expenditures from external financing	161,695	91,284
Capital expenditures projects financed from foreign grants	123,970	47,867
Capital expenditures projects financed from external loans	37,725	43,417
Capital expenditures using domestic financing	350,589	78,928
GOY contribution to multilateral organizations and other organizations	2,157	2,193
Total amount of expenditures	2,812,667	2,580,596
Obligation on domestic loans	2,005	1,939
Obligations on foreign loans	68,860	59,863
Total expenditures and debt obligations	2,883,532	2,642,398

Table 1 GoY Budgeted and Actual Expenditures during 2014.

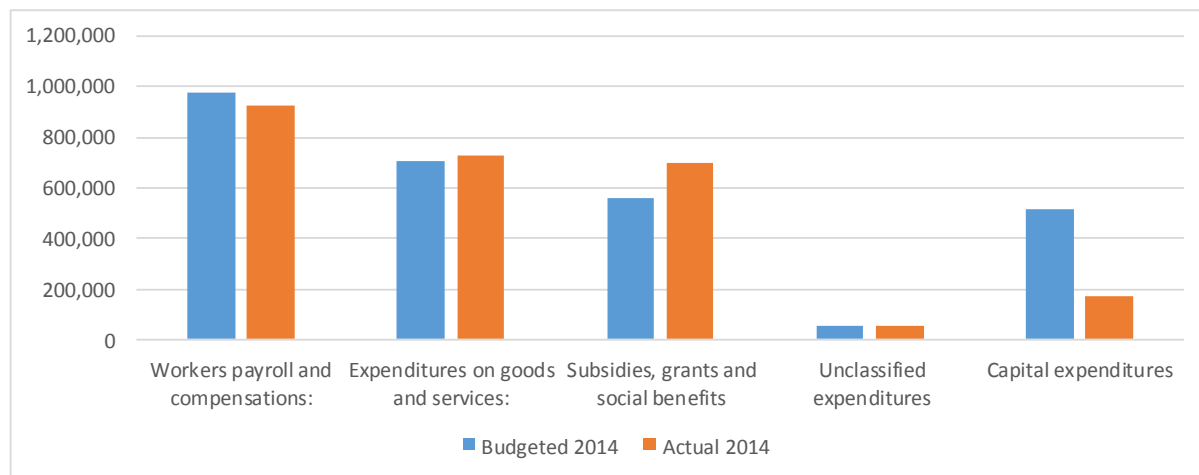


Figure 1 Budgeted Expenditures Compared to Actual. Figures. During 2014. (In millions of Yemeni Rials).

The following challenges have emerged for the GoY and CBY to address the payment of public sector salaries: Collection of payroll database, retaining government revenues in areas controlled by militias, sterilizing new injection of bank notes, and payment of retirement benefits.

1- Collection of Payroll Database

Upon learning of the GoY's payroll collection efforts, the Houthi and Saleh militias forbade Sanaa based government authorities to provide details of beneficiaries residing in their jurisdiction. To date, they continue to obstruct government agencies from





providing payroll details to the GoY. This has resulted in lengthening the time required to collect the payroll database for the GoY from Aden. Although, the decentralization process has helped in circumventing this obstruction, the GoY is trying to identify efficient means to collect the payroll database in a timely manner.

2- Retaining Government Revenues in Areas Controlled by Militias

Branches of CBY in areas under the control of Houthi and Saleh militias are under pressure not to report daily activity, whether it be the disbursement of salaries or the amount of government revenues collected, to CBY management in Aden. There are increasing reports that Houthi and Saleh militia representatives are embezzling government revenues and pressuring CBY local staff to make unauthorized payments, further straining liquidity in those areas. CBY is exploring ways to track local government revenue in areas controlled by the militias by encouraging those branches to share their daily account activity electronically. It is worth noting that the militias have embezzled 581 billion Riyals during 2016 from the Tax Authority, the Customs Agency and other state owned revenue generating enterprises. Before the relocation of the CBY's headquarter to Aden, the GoY continued to adhere to the public finance laws by depositing any public revenues at the CBY in Sanaa for a year and a half in spite of Houthi's presence. During that period, Houthis resisted to pay salaries of state employees in areas under the control of the government.

3- Sterilizing New Injection of Bank Notes

Without replenishing CBY's foreign exchange reserves, the injection of the newly printed bank notes will eventually instigate a rise in inflation and thus

will erode consumers' purchasing power. Hence, there is an urgent need to replenish CBY's FX reserves, which would provide the bank enough leverage to intervene in the FX market to curb foreign exchange driven inflation. Additionally, the FX injection will assist CBY to secure food imports for the market place. The GoY has announced on February 23rd 2017 that it has successfully reached an agreement with the Saudi authority to back CBY with a 2 billion USD deposit. Additionally, the GoY is working to secure further financial support from donor countries as Yemen requires 250 million USD a month for food imports alone.

4- Payment of Retirement Benefits

Yemen has a public sector social security and benefits system that covers state employees and quasi-public agencies. There is an independent system for military and members of security apparatuses. Additionally, Yemen has a private sector social security system that covers nationals and foreigners. Public sector minimum monthly pension is 20.000 Rials; maximum payout for retirees is 100% of the insured last gross monthly salary with at least 35 years of contributions. Since Houthi takeover of the capital Sanaa, and in an effort to finance their military campaign, assets of these benefit systems were compromised by the militia. The CBY and the GoY is currently investigating the losses sustained by the benefit systems. Tens of thousands of civil and military retirees have been largely left unpaid since mid-2016.

Recent Examples of GoY Salary Disbursements to Houthi Controlled Areas

Since receiving the first batch⁵ of the newly printed banknotes in January 2017, CBY has started making salary payments to state employees residing in a

5- As of February 24 2017, CBY has received 100 billion Rials worth of banknotes from Goznak.



number of governorates including the governorate of Sanaa. The GoY has made payments to state employees working in the educational and health sector across Sanaa and prioritized the payment of salaries

of civil servants in the ministries of Education and Health. The table below is a break down example of salary payment activity to governorates under the control of Houthi and Saleh militias as of February 2017.

Governorate ⁶	Public Institutions
Sanaa	<p>GoY signed an agreement with Al Kuraimi Co and CAC Bank to undertake the transfer of salaries to civil state employees residing in Sanaa and neighboring governorates. Employees of the Ministry of Education, Ministry of Health, Ministry of Legal Affairs, Ministry of Agriculture and the Central Organization for Control and Accounting were the first to receive their salaries as of February 2017 and the disbursement covered salary payment for December 2016.</p> <p>Subsequently, the GoY disbursed salaries of the Ministry of Water and Environment employees via Al Kuraimi Co. Additionally, the GoY directed CBY to complete the transfer of salaries of the Ministry of Local Affairs employees'. Employees' salaries working for state owned Al Thawra newspaper and Saba news agency were paid.</p>
Amran	<p>Governor of Amran submitted payroll beneficiaries' database to the GoY in early February 2017. The beneficiaries include civil state employees working in the governorate of Amran, a region controlled by the Houthis.</p>
Al Baida	<p>Payroll database for state employees in the educational sector was submitted to the GoY and funds have been wired to the beneficiaries via Al Kuraimi Co.</p>
Dhamar	<p>GoY directed the Ministry of Finance to effect payment of salaries for civil servant workers residing in Dhamar.</p>
IBB	<p>GoY directed to pay the salaries of state employees working in the public educational sector. Moreover, the disbursement was used to clear late salary payments for the month of December 2016.</p>
Other	<p>GoY disbursed scholarship stipends in arrears for students abroad and transferred allocated budgets of Yemen's diplomatic missions.</p>

⁶-This is a list of examples and does not include the full list of recipient governorates.





Areas of Assistance from the International Community

The international community can support the GoY and CBY to address the payment of public sector salaries through providing a foreign exchange grant, pressuring Houthi and Saleh militias to leave CBY and GoY institutions, and providing technical assistance to CBY and the Ministry of Finance.

As the GoY and CBY are able to make larger disbursements of public salaries and clear arrears, the mass injection of Yemeni Rials will need to be offset by additional foreign exchange in the market. Foreign exchange grant support is critical to limit exchange rate driven inflation and the erosion of purchasing power. Furthermore, replenishing the FX

reserves will enable the CBY to continue supporting imports and ensure stable food prices in the markets. Additionally, the international community could support efforts to pressure the Houthi and Saleh militias to leave GoY institutions and CBY branches in areas under their control. The independence of these institutions will improve coordination with the GoY and CBY in Aden and facilitate the payroll data compilation process. Finally, the international community could provide direct technical assistance to CBY and the Ministry of Finance in the areas of payment systems, improving AML/CFT capability and personnel capacity building through training programs. Technical assistance will contribute in streamlining the payment of public salaries and will strengthen transparency measures.⁷

7- A separate paper on CBY's technical needs is currently being updated to be available by late April 2017.



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