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EXCHANGE RATES' IMPACT IN ACHIEVING ECONOMIC STABILIZATION OF YEMEN

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Abstract
The researcher focuses on the impact of stable exchange rates on the economy of Yemen by many ways. First, is to make clear the importance of stable exchange rates on the balance of payments. Second, is to study the impact of cash inflows on the liquidity and investment opportunities for stabilization of Yemen Economy. Third, the researcher also focuses on the impact of the stable exchange rates on the formal and informal cash inflows. The impact of migrants' remittances on the banking sector of Yemen has not been explored in academic work. Fund received from migrants who work abroad are perceived to be used for survival purposes such as shelter, consumption, saving, and building human capital. The impact of these remittances on the development of the banking sector in the recipient country "Yemen" is the purpose of this study. Third, the researcher also focuses on the impact of the financial policies on the formal and informal exchange rates for the Yemeni Rial against the US Dollar. This study must contribute to enhancing the economic aspect procedures to ensure achievement of stabilization and start structural reforms and social protection programs. It must contribute to make special financial policies in the Republic of Yemen.

To sum up, this paper mainly investigates the exact impact of stable exchange rates and cash inflows in foreign currencies managed by the Yemeni financial system. This paper also managed to evaluate the role of the changes in exchange rates in Yemeni currency as well as its share in covering the commercial obligations of Yemen. This paper shed light on the banking sector's investment's opportunities outside Yemen. The Central Bank of Yemen shows exchange rates that are not near to the real rates that is used in the real market. It must be shown by the exact figures to highlight the importance of this factor in the Yemeni economy. By proving the correct number, the researcher made some important suggestions and recommendations to the government represented by the ministry of finance as well as to the Central Bank of Yemen to update their data and to focus on managing the exchange rates correctly. It is important to pay attention to the cash inflows in foreign currencies to Yemen by establishing some rules and some facilities that encourage the incoming foreign currencies to be settled Yemen.

Key findings of this paper include

1. Liberalization and stability of prices.
2. Control budget deficit.
3. Cuts and floating of exchange rates.
4. Control inflation and reduce it.
5. Encourage the local investments.
6. Enhance the banking systems and banking investments abroad.
7. Create new financial policies for that can be used easily that lead to avoid nonsystematic exchange rates.
8. To improve living standard for the people in Yemen.
9. To help in supporting the public budget structure to reduce dependence on oil revenues and abandon aid support of non- oil important sectors.

10. Increase the importance of the exchange rates and addressing the Ministry of Finance affairs and the Central Bank of Yemen to facilitate any difficulties in fixing exchange rate.

1. Exchange Rates' impact and Economic Stabilization.

Definition of Exchange Rates

Exchange rates are a measure element that assigned between two different currencies. Every country has its local currency. Exchange rate is the amount of unites that needed to be to get one unite from the main currency. Exchange operations and deals can be done within or between different countries. However, in this paper the term exchange rates will mean international swaps of currencies. In most of the literature, exchange rate is defined in terms of cash or financial operations done by sellers and buyers for the deal of goods or services. The term of cash inflows is also confined to worker cash inflows transmitted to their families and their communities back home excluding transfers from refugees and other sources that do not benefit from legal status of workers (Abdul- Ghaffar Mughal, 2005).

Interest in Exchange rates

Exchange rates became international phenomena. It has been growing rapidly in the past years and now represents the largest source of foreign income for many developing countries. It becomes the migrant workers who are now by far the largest suppliers of development aid to their communities of origin in the developing World.

Exchange rates play an important role in Economic stabilization in any country. We will try to identify whether or not exchange rates promote financial development in general and supporting economy in particular in the case of Yemen. In this paper, we will try also to identify the extent to which cash inflows promote in making stable exchange rate of Yemeni Rial currency. By identifying the causality traceable between exchange rates and banking sector development in Yemen regarding liquidity and investments opportunities as indicators for stable Economy. This paper will focus on the impact of stable exchange rates in liquidity, banks foreign investments and the Balance of Payments for the Republic of Yemen. We will measure the most important factors that affect the size of cash inflows in foreign currencies to the economy in the Republic of Yemen.

2. Paper Methodology

The present study is entirely based on secondary data. The researcher personally visited the Central Bank, Sana'a, Yemen during the course of study and collected the data figures related with various aspects of the study from the published and unpublished reports of the Central Bank of Yemen. The researcher also supplemented the study with data collected from various published reports of ministry of Planning, Yemen.

The data collected from secondary sources was further exposed to statistical analysis. The statistical tools like arithmetic mean, percentage analysis, coefficient of correlation, and SPSS were applied to draw meaningful conclusions from the data. Hypotheses testing were done by administrating F- test. Regarding sample of this study, the present study is based on data collected from Central Bank of Yemen as well as the working banks and exchange companies in Yemen. Presently Yemen has seventeen working banks. These banks report to the Central Bank of Yemen. The researcher has collected data from C.B.Y. obviously this data is a compilation of the authentic data submitted by these fifteen banks. Hence, the data sample spreads over these fifteen banks. Further the data has been collected for the period of thirteen years from 2008– 2020. For verifying the accuracy and reliability of data collected from C.B.Y, the researcher chose Cooperative and Agricultural Credit Bank as a sample. The data figures of the said bank were compared with those provided by C.B.Y. After being satisfied about the authenticity and reliability of secondary data, the researcher used it for study.

3. Importance of Stable Exchange Rates in Economic Development

1. It saves the investors and savers. It helps in allocating and mobilizing the savings effectively and efficiently. It plays a crucial and important role in economic development through saving- investment process. This savings – investment process called capital formation.
2. It helps to monitor and control corporate performance in the economy.
3. It provides a mechanism for managing uncertainty and controlling risk.
4. It provides a mechanism for the transfer of resources across geographical boundaries.
5. It offers portfolio adjustment facilities, which provided by financial intermediaries and financial markets.
6. It helps in lowering the transaction costs and increase returns. This will motivate people to save more and increase their investments.
7. It promotes the process of capital formation.
8. It helps in promoting the process of financial deepening and broadening.

Financial deepening means increasing financial assets as a percentage of GDP and financial broadening means building an increasing number and variety of instruments and participants.

In short, a exchange rates contributes to the acceleration of economic development. It contributes to growth through technical progress. The researcher focused on the impact of cash flows in the economy of Yemen. In addition, during this paper the researcher highlighted on the economic stabilization. The strategic location of the Republic of Yemen is the most important factor of such cash inflows.

3. Banking System in Yemen

The banking sector is the lifeblood of any modern economy in any country. It is one of the most important pillars of the Exchange Market, which plays a vital and crucial role in the success or failure of the economy. The banking system reflects the economic strength of the Republic of Yemen. Strength of a country’s economy depends primarily on the strength and foreign currencies reserves, which in turn depends on a sound banking system and good services as well.

The traditional role of banks has been to acceptance of deposits from the surplus and lending of funds to the investors or the people who need this money. For centuries, banks have lent and borrowed money to business, trade and people, charging interest on loans and paying interest on deposits [1]. Banks in this concept act as brokers between supply and demand of securities, and they transform short-term deposits into medium- and long-term credits. One of the main difficulties faced by the banks is the lack of ability to repay the obligations in the appropriate times. Therefore, banks faced several risks of lending the money and the repay the obligation. Specialized information on financial products gathered by banks to improve investment decisions and to manage the risk [2].

The studies regarding the cash flows in this way creates the demand for various Stakeholders, especially the financial institutions, researchers, Diaspora and policy makers to be engaged in finding the better ways increasing such cash flows to the economy. It is argued in that cash flows that are transferred through informal means are less effectively used because they do not contribute to the receiving country's foreign reserves and also are not included in the development initiatives and priorities which could benefits the individual receivers and the nation at large. In the developing countries where small cash flows reach households possess bank accounts, formalization of cash flows would not only reduce the risks and costs of banking services, it would also could help them to save and in this way raise the national savings rate.

Another critical issue regarding the informal cash inflows channels is that, they provide a convenient way for money laundering and funding criminal and terrorist activities. Understanding the operations of informal and underground cash movement channels could help countries to put in place well-coordinated measures for monitoring and information sharing to prevent money laundering and financing of terrorist activities.

Improving cash flows would require studies on money cash behavior on how people respond to social, political and economic changes of receiving and sending countries. That information could help policy makers in these countries to design policies aimed at improving the banking and financial services. However, the biggest challenge is how these financial institutions would prevent illegal transactions, ensure safety and efficiency of transfers and at the same time be able to reduce illegal money reaching the wrong ones.

4. How Exchange rates are determined?

There are at least three views on how exchange rates are determine and their effect on banking development. The first view see exchange rates as fungible and are determine at the margin just like income from any other source. It is mainly determine by the supply and demand. For example; a dollar of Exchange rate income is treated by the household just like a dollar from wage income (Adams & Cuecuecha 2010). Empirical studies generally do not count the Exchange rate income as a separate and different source of income. So, the distinction between the effects of Exchange rate income and other source of income is not made explicit.

The second view argues that the receipt of exchange rates can cause behavioral hangs at the household level and that exchange rates tend to get spent on consumption rather than on investment goods like the purchase of a livestock unit or setting up a small retail shop. The significant and even the majority portion of the exchange rates are spent on status oriented consumption goods like buying a mobiles, television or radio. The explanation of moral hazard problem highlights this view. The proponents of this hypothesis focus on the negative effects of migration and Exchange rate on the economies of origin. According to Lipton (1980), migration is concentrated among young men and requires harder work by the women and children to replace absent young men. The Exchange rate income is spent on everyday needs and the received Exchange rate encourages leisure for work. Survey data from North Yemen shows that the more insurance is provided by the migrants in the form of exchange rates, the household members left behind will have an less incentive to work.

The third, and more recent view, is that since exchange rates are a transitory type of income, households tend to spend them more at the margin on investment goods-human and physical capital investments- than consumption goods. For example, Adams (2010) using nationally representative household data set from Guatemala finds that households receiving international exchange rates spend marginally less on consumption goods like food and spend marginally more on investment goods such as education and housing compared to what they would have spent on these goods without the exchange rates. A study in the uses of Exchange rate income in rural Pakistan, Adams (1998) concludes that the availability of Exchange rate income helps to increase investment in rural assets by raising the marginal propensity to invest for migrant households. The external exchange rates have a more important statistical effect on the accumulation of rural assets than total labor income has.

5. What are the Effects of Exchange rates on the Banking Sectors in Yemen?

The effect of exchange rates on banking sector development is often controversial regarding the valuation of brain drain or income gain. Through the brain drain, a poor country loses a scare factor (e.g., human capital), but gains another scare factor, financial resources. The detrimental effect of brain drain is that in underdeveloped countries migration mainly happens with people who are in the upper end of the human capital distribution (Kapur 2009).

The effects of exchange rates to the macroeconomic variables are always debatable because the exchange rates are the flow of money from one individual to another individual. The use of these funds depends on household decisions. So, exchange rates will always have microeconomic effects but the total volume of individual transfers may indicate different situations. The Exchange rate income can affect the receiving country’s economy in many spheres both at the macro and micro levels. At the macro level, the flow of exchange rates can influence the determination of inflation, exchange and interest rate, and the growth rate of the economy. At the micro level, an increase in the flow of exchange rates can contribute to reducing liquidity constraints of the household, which often prevail in rural areas of most of the developing countries.

Modern migration economics considers migration as an exchange of abundant unskilled labor for scarce foreign exchange in the form of exchange rates (Glytsos 2002). A monetary transfer in the form of Exchange rate directly increases the availability of foreign exchange in the country of origin. A positive transfer of resources like exchange rates to a country hurts its competitiveness in world markets by reducing the value of export as the exchange rates increases the real exchange rate (Amuedo-Dorantes & Pozo 2004). Appreciation of exchange rate is thought to harm the tradable sector of the banking sector. Exchange rates tend to increase household aggregate wealth which leads to decrease in household labor supply. The decreased labor supply, in turn, puts upward pressure on wages; and hence to production costs and reduction in competitiveness.

The economic shocks are frequent in underdeveloped countries because of normal business cycles, imported business cycles from the donor/developed countries, financial shocks and economic restructurings. Such shocks make many individuals and households experience periods of unexpected reduction in income. In the periods of shocks in the developed countries, these countries cannot finance their international aid. So, the flow of foreign aid tends to decline. The official foreign aid flows tend to rise during the favorable economic conditions and fall in bad times, exchange rates appear to react less violently and show remarkable stability over time (Ratha 2003).Even in the economic shock in the origin country, the exchange rates flow may be rising showing the countercyclical flow of funds as the family members back to the origin are in financial problem and the emigrants think that it is their responsibility to help to the left behind members in the situation of hardship.

The major impacts of exchange rates on origin occur directly through changes in the patterns of expenditure and investment of the household members having migrant members and indirectly through multiplier effects. Exchange rates serve as the market flow of foreign exchange, it is used partly for consumption and partly for investment and has strong positive and negative effects on development (Glytsos 2002). If exchange rates are invested, they contribute for output growth, and even if they are consumed, they generate strong positive multiplier effects (Stahl & Arnold 1986).

Exchange rates can have a positive impact as a development tool for the recipient countries with effects on saving, investment, growth, consumption, poverty, and income distribution. The impact on growth of exchange rates in receiving country is through saving and investment as well as short run effects on aggregate demand and output through consumption. Workers' exchange rates are a component of foreign saving and they complement national savings by increasing the total pool of resources available to investment (Solimano 2003).

Recent evidence reveals that the significant portion of the international exchange rates is invested in the origin community (Adams 1991; Osili 2007). Exchange rates may finance investments in the country of origin in the form of land and housing acquisition, financial assets and microenterprises (Adams 1991). The temporary and permanent migrants may have different motives to remit the savings made in the host country but the migrants always face a trade- off between saving in host country and remitting the money to the origin country. Migrants send exchange rates not only to provide economic support to their origin households but also to accumulate savings in the origin country often in the form of investments such as land, housing, microenterprises, and financial assets.

According to permanent income hypothesis, individual households should be able to smooth consumption by saving in the normal times and depleting savings during shocks so that they can maintain their consumption level constant for their whole life period. When a household has a migrant household member, it is the prime period to make savings as they have regular income in the form of exchange rates. Saving as the method to smooth consumption is used by the rural households. Consumption smoothing is achieved not only by the relatively liquid financial saving and credit transactions, but also by lumpy and possibly costly changes in stocks of physical assets. The choice of saving instrument depends on access to credit and other economic circumstances. So, household's saving or not saving in terms of financial and physical assets depends on the economic condition and the nature of economic shock which the household anticipates. There is debate whether the international transfers are saved and if they are saved whether they are used in the form of durables or not.

6. Concluding and Results.

How can we make exchange rates a strong tool to be used in productive investments, micro activities because exchange companies are badly use exchange rates to manage the foreign currency market on their benefits? For the case of Yemen, we need to suggest and recommend some experienced countries that already managed their economy in stable exchange rates policy. There are many experienced countries in this regards like India, Nepal and Pakistan. These countries have enough experience in this regard. They can manage their economy very well.

As many studies confirm that 90% of the third world countries belongs to low skill category average of their banking policy management. One of the recommendations is that there must be managed-policy programs between Yemen and other countries in sharing knowledge. Such programs might combine short-term courses with incentives for return for the skilled banking labor

Finally, different factors contribute to growth and development in any country, but their importance alters over time. Exchange rates management is not the panacea for low-income countries but neither should we underestimate its importance. Managing exchange rates is playing significant and positive role in improving Yemen’s overall economic level.Inclusive policy can decrease inequality. Government should support and manage exchange rates. This helps to reduce non- systematic exchange rates in black market in the long-run. Yemen must create jobs in its territory. Every Yemeni should work hard to build the nation. The role of managing exchange rates on household, health and education sector will be a suitable research area in Yemen for future study. Improving exchange rates policy would require studies on exchange rates trends behavior on how they respond to social, political and economic changes in the country. That information could help policy makers in Yemen to design policies aimed at improving the banking and financial services. However, the biggest challenge is how these financial institutions would prevent illegal transactions, ensure safety and efficiency of exchange rates and at the same time be able to reduce transactions margin of exchange currency operations.

The future studies that I had already recommended must focus to:

- To help Yemen economy adopting good policies.
- We need fresh thinking to direct exchange rates to development impact.
- How to reduce the cost of margin between bids and ask and how to cancel the gap between the parts of Yemen.

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