A Selection of Reports and Statements

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By International Crisis Group

Avoiding an Even Worse Catastrophe in Ukraine

With the war in Ukraine grinding on, Western governments should pursue a strategy that raises costs to Russia while urgently exploring the contours of a negotiated solution. Such an approach is imperative to halt Ukraine's decimation – and to ward off the gravest threat of nuclear confrontation in decades.

As large-scale war in Ukraine enters its fourth week, Western governments backing Kyiv are balancing several imperatives. On one hand, they must support Kyiv as it resists a Russian invasion that is destroying much of the country and raise the costs of aggression to Moscow. On the other, they have to minimise risks of the war spiralling into a wider confrontation between Russia and the North Atlantic Treaty Organization (NATO) – a scenario both sides have worked for decades to avoid because of the possibility that it could all too easily turn nuclear. A third factor is no less important. The longer the war lasts, and the higher the human toll, the harder it will be for the West to leave room for a negotiated solution and the graver the risks of escalation. Western governments should not aim for a complete, but likely unattainable, victory that includes a return to the pre-2014 status quo and war crimes investigations, let alone Russian President Vladimir Putin's departure. Their main objective should rather be an agreement that both sides can accept and that will bring the war to a close.

This objective should inform all of Western governments' actions with respect to the war. With weapons supplies to Ukraine, they should aim to help its resistance hold off Russia's assault long enough that Moscow accepts a settlement that is as palatable to Kyiv as possible. Western leaders should, as they have done so far, avoid tactics – like a no-fly zone – that would be tantamount to war with Russia. Sanctions should aim to encourage a negotiated deal and, as far as possible, constrain Moscow; this requires communicating to the Kremlin that a settlement acceptable to Kyiv will mean an end to at least some of the restrictions crippling Russia's economy. Open lines of communication with Moscow remain vital, both for testing options for a deal between Russia and Ukraine and for signalling NATO's own red lines, averting as best possible miscalculation by Moscow and managing incidents.

A Terrible Toll

The war has confounded expectations to date. Most analysts – Ukrainian, Russian and Western – expected Russia's larger, better-equipped army to rapidly overcome Ukraine's smaller numbers. Instead, Russian forces turned out to be ill prepared and quickly demoralised, while Ukrainian soldiers and civilians have been far more determined and resourceful than Moscow appears to have anticipated. Ukraine has also used Western-supplied anti-tank weapons, air defences such as Stinger missiles, ordnance and body armour to dash Russian hopes of an easy win. Russian forces are having difficulty seizing and holding territory. Their advance from the north is long stalled; those in the east and south are encountering significant Ukrainian pushback. Ukraine's information campaign of visual evidence of abandoned or destroyed Russian equipment and stories of Ukrainian heroism has been extremely effective with Western audiences, if less so in some other parts of the world.

In the face of Ukraine's resistance, Russia has turned to ever more brutal tactics. At first, Moscow seemingly sought to avoid civilian casualties in the expectation of a friendly reception by Ukrainians. Now Russian forces are bombarding cities and towns, killing and maiming thousands of civilians. Their record in Chechnya (within Russia itself) and in Syria gives good reason to fear that the civilian toll could get much worse.

The West's response, unprecedented in both unity and scope, appears to have taken the Kremlin aback almost as much as Ukraine's resilience. Having spent the weeks leading up to the attack working to avert the war through diplomacy, once Russian tanks were rolling, Western states shifted gears fast, pivoting to a strategy of maximising the invasion's costs to Russia. They have imposed severe sanctions, sent substantial supplies of weapons and other aid to Kyiv, and worked to isolate Russia on the international stage. In this way, the U.S., the European Union (EU) and their allies made good on the threats they issued prior to the invasion and arguably have gone further, inspired in part by the fierce struggle Ukrainians themselves have put up.

As weapons shipments have helped Ukrainians slow Russia's battlefield advance, Western policies have rendered Russia the most sanctioned country worldwide and wreaked havoc on its economy. The U.S., the EU, the UK, Japan and other countries banned national banks from doing business with the Russian Central Bank and put in place sanctions on a number of major Russian banks, seven of which were cut off from the SWIFT financial transactions system. Western countries froze $300 billion of the Russian Central Bank's $640 billion in reserves, which led to a sharp decrease in the ruble's exchange rate. The U.S. and EU also blocked the flow of cash dollars and euros to Russia and constrained that of potentially dual-use technologies and electronic chips. The U.S. and UK have banned imports of Russian oil and gas, while the EU has proscribed steel product imports. Finally, international payment systems such as Visa, Mastercard, American Express and JCB have disconnected from all Russian banks.

Many Russians have already felt the pinch. They can no longer pay with bank cards abroad, cannot easily withdraw cash from foreign currency accounts and face steep inflation, particularly for foreign-made goods. More than 300 foreign companies have left Russia, ceasing their production, services and sales. International shipping and logistics companies and foreign ports are also refusing to work with Russia. All these steps will both increase unemployment and worsen commodity shortages in the Russian domestic market. The EU's plans to wean itself off Russian hydrocarbons, if carried out, will also hit the Russian economy hard. Already, grocery stores are rationing staples, such as flour and sugar.

Ukrainians are, of course, paying the heaviest price. As Russia's assault razes buildings, city blocks, villages and towns, over three million refugees have fled the country. These are overwhelmingly women, children and the elderly: men between the ages of eighteen and 60 are allowed to exit Ukraine only in rare circumstances. (As Crisis Group has separately noted, how much this policy – which adds family separation and heightened risks to war's trauma – helps Ukraine defend itself is unclear.) Millions have also fled within Ukraine, to the western part of the country, where shelling is less, though Russian strikes have hit the western city of Lviv, where many of the displaced have taken shelter, suggesting that could change. Those who stay in cities under fire face shortages of food, water and heat. Especially shocking are images from the southern port city of Mariupol, whose civilians are trapped under bombardment that increasingly recalls Russia's levelling of Grozny in Chechnya and Aleppo in Syria, and have been forced to bury the dead in mass graves. On 16 March, airstrikes destroyed a theatre in Mariupol that was reportedly sheltering hundreds of civilians and was marked with the Russian word for "children" in letters that could be seen from the air.

Neither side shows any sign of backing down or giving up. Direct negotiations between representatives of Moscow and Kyiv have yet to include the senior-level negotiators needed to conclude a deal. Neither those talks nor shuttle diplomacy by French, German, Israeli and Turkish leaders have revealed much moderation in Moscow's stance or much overlap between Russian and Ukrainian positions. True, there are minor indications of movement. Ukrainian leaders, including President Volodymr Zelenskyy, say Russia's positions have become more "realistic". Zelenskyy has also indicated that while the country will continue to seek EU admission, he may stop asking to join NATO – a long-stated red line for Moscow. As for Russia, the Kremlin may have dropped its demand that Ukraine "denazify", which is to say remove Zelenskyy, who is Jewish, from power, along with his government. But Moscow continues to insist on its sovereignty over Crimea, which it annexed in 2014, and the independence of the self-proclaimed Donetsk and Luhansk People's Republics within their Soviet-era borders, that is, three times more territory than that held by Russia-backed separatists as of 23 February. It still demands Ukraine's neutrality and demilitarisation, though perhaps would be flexible about what that means were other aspects of a deal in place. While it is positive that talks continue, they have thus far yielded little concrete benefit. Even some of the humanitarian corridors agreed upon by negotiators have failed, as evacuating civilians found themselves instead under Russian fire or travelling through mined areas.

Avoiding the Escalation Trap

As the West piles more assistance into Ukraine, Russia has pushed back with threats, both tacit and explicit. The most jarring of these involves nuclear menacing, playing on NATO's desire to avoid escalation. President Putin early on threatened outside actors with "consequences far greater than any of you have faced in history" if they intervened in Ukraine – a barely veiled nuclear threat – but left vague what actions would cross the line. He also announced that his deterrent forces would henceforth operate under a heretofore unknown alert status (which, in the end, appeared to amount to dispatching more personnel to already well-staffed command centres). Russia held nuclear exercises after the invasion was under way (the U.S., by contrast, cancelled a scheduled drill to avoid unintended signalling). Putin and other Russians (including Moscow's permanent representative to the UN Security Council) have, meanwhile, alleged with no evidence that Ukraine was developing nuclear capabilities or had plans to use chemical or biological weapons, raising fears that Russia may seek a pretext to use such weapons itself and point the finger at Ukraine.

Beyond nuclear threats, the Kremlin has also declared that NATO weapons supplies are legitimate targets, though what it means by this warning is unclear. For now, it is sticking to targets in Ukraine rather than risk an attack on NATO territory and the response that could invite, although it may seek to engineer deniable accidents and otherwise disrupt supply efforts in countries staging weapons deliveries. On 13 March, Russia bombed the Yavoriv military training site in western Ukraine, only 20km away from the Polish border. The site has symbolic importance – in that NATO member state officers had trained Ukrainian soldiers there in years past – but was not actually a supply depot or a Western facility, suggesting either bad intelligence or restraint.

As for Western leaders, they have largely walked a line between imposing the sorts of costs that they threatened in an effort to deter the war (sanctions, arms supplies to Ukraine and troop build-ups on Russia's western flank) and taking steps that might cause the war to spin beyond Ukraine. These leaders have stated clearly that they do not intend to fight Russia directly, because doing so could lead to broader war pitting nuclear-armed states – Russia, on one side, and three NATO members (the U.S., the UK and France) on the other – against each other.

But as the war grinds on, pressure is mounting for a stronger Western response. The sheer numbers of displaced, images of Ukrainian suffering and growing evidence that Russian military operations – perhaps not intentionally but certainly with insufficient care – are doing tremendous harm to civilians and civilian infrastructure have deepened sympathy for Ukraine, particularly in NATO and EU countries. Having won enormous public admiration for his courage under fire, Zelenskyy has appealed directly to the U.S. Congress and other Western legislatures – broadcasting in fatigues from war-torn Kyiv – and implored the West to become directly involved. He and other Ukrainian officials continue to press NATO countries to "close the sky" over Ukraine – alluding to the imposition of a no-fly zone that would likely put Western and Russian forces in combat with each other, and which Western officials have wisely taken off the table. But civil society groups, parliamentarians and opinion leaders throughout the West increasingly echo Kyiv's calls for more help and the intensive media coverage ensures that the topic remains in the public eye.

Those promoting a stronger Western line offer several arguments to bolster their case. Some hold that the moral imperative of helping Ukraine, whose civilians are dying under Russian bombardment, should make Western capitals less risk-averse. Some argue that if Russia is not stopped in Ukraine, its appetite for aggression elsewhere, including against NATO member states, will only grow. Others believe that the risk of nuclear use by the Kremlin is in any case difficult to predict and manage, especially given that Moscow sees itself as at war with the West already. Still others hold that it is the Kremlin that will back down if faced with the risk of war with NATO.

What these arguments share is an uncomfortable element of guesswork and wishful thinking. While the Ukraine conflict triggering a nuclear confrontation might appear unfathomable, given the consequences of such a war, measures that invite a direct battle between Russia and NATO would run a perilous risk of just that. Throughout the Cold War, Russia and the U.S. avoided direct clashes precisely because of fears that the danger of a struggle turning nuclear would be unmanageable. While debates have long raged over whether, in fact, a conventional war between the two sides could be contained, with terror of nuclear annihilation restraining either or both, policymakers have historically erred on the side of caution.

This logic remains as valid today as it was then. While some elements of Moscow's current nuclear strategy are intentionally ambiguous, and President Putin's choices are his own, Russia does have a stated doctrine for possible nuclear weapon use. This doctrine allows that Russia may use nuclear force in the event of nuclear, chemical or biological weapon attack on itself or its allies; if it faces conventional aggression that threatens the very existence of the state; if it is under ballistic missile attack; or if there is a risk to its nuclear command and control capabilities.

A conventional war with NATO could too easily fall within this framework. For Moscow, a war with NATO would be inherently existential. The alliance's military capacity dwarfs Russia's – as the latter's struggles in Ukraine vividly illustrate – and could do the country tremendous damage. Once the fight is under way, it would be tough if not impossible to convince Kremlin officials that NATO's aims are limited. Moscow would expect the alliance, if only for its own defensive reasons, to both hit targets inside Russia and take early steps to eliminate the Russian capacity for a nuclear strike. It would also assess NATO's goals in a war as including regime change – an impression that can only be exacerbated by Western rhetoric calling for Putin to be deposed by coup or assassination or discussions of putting him and members of his inner circle on trial for war crimes (reinforced recently when U.S. President Joe Biden called his Russian counterpart a war criminal). Such calculations could push Russia toward using nuclear weapons while it can, as the only possible way to force NATO to back down. It is not hard to see that action provoking a harsher, potentially nuclear, NATO response, as the alliance, too, tries to demonstrate resolve.

What Now?

So how should Western powers balance potentially competing imperatives – punishing and deterring aggression, on one hand, and avoiding profoundly dangerous escalation on the other – as the war proceeds? Thus far, they are largely on the right path but it is important they bear in mind the purposes of each tool they are already or considering using.

The conventional arms that the U.S. and NATO partners have supplied are appropriately helping Ukraine resist Moscow's assault; the goal of these transfers should be to improve Kyiv's position and allow it to negotiate more palatable terms to end the war with Russia when both parties are truly ready for talks. The escalatory risks that these transfers present thus far seem limited, while the difference they make is crucial. A steady supply of portable air defences such as Stingers, and potentially some heavier missile batteries, would help Kyiv maintain the superiority it now enjoys in the sky over government-controlled Ukraine. Armed drones will continue to be valuable, including as anti-artillery systems. Maintaining a flow of ammunition for all of these capabilities, as well as body armour and personal weapons for the hundreds of thousands of Ukrainians now under arms, is possibly the most important thing Ukraine's partners can do.

At the same time, Western weapons provision needs to minimise the risk of direct engagement with Russia. Enforcing a no-fly zone, for example, would require militarily engaging Russian aircraft and potentially taking out Russia's own air defences, including on Russian territory. It would, in other words, be an act of war. NATO would also be sensible to refrain from transferring equipment that would require the presence of member state personnel to service it – as might be the case with fighter jets that some Western officials suggest providing – as they could then be in the line of fire.

Minimising risks of escalation also means finding ways to convey to Russia the dangers of overstepping NATO's own red lines and heading off, to the extent possible, Moscow's potential miscalculations. The Kremlin appears to have badly misjudged how Western governments would respond to (and Ukrainians resist) its invasion. That experience should, in principle, leave Moscow somewhat chastened and more cautious. Western leaders should, however, still do their part to make clear what actions they see as crossing their own red lines. They might even leverage the reality that they, themselves, cannot perfectly predict their reactions. Even as the Kremlin reminds the world of its nuclear arsenal, Western capitals can remind Moscow that in the event of certain Russian actions, their responses may be difficult to control. Chemical weapons use, for example, would inevitably bring Russia's further isolation, but it may also set off an inexorable march toward NATO military action. Already, members of the U.S. Congress are among those arguing that such tactics should trigger direct Western involvement. Pointing these statements out to Moscow might help it understand the danger.

As for the unprecedented sanctions and other political and economic pressure on Russia, these should also be part of a policy that aims to end the war through a deal and, as best possible, gives Moscow incentives to de-escalate. For now, Western leaders appear to hold out divergent hopes of what sanctions will achieve. They should clarify their goals and adjust their policies accordingly.

Western leaders' expectations of sanctions' impact inside Russia need to be realistic. They cannot count on economic penalties to end the war by turning Russia's public or elite against it. Indeed, sanctions may well harden many Russians' positions and increase, rather than decrease, support for the invasion and Putin himself. The Kremlin is long practiced at deflecting antipathy for sanctions against the Western governments enforcing them. A draconian Russian government crackdown on free speech and protest that has already led tens of thousands to flee the country also diminishes prospects for mass unrest in opposition to the war. Sanctions and a failing military campaign may turn elites against the war, and it is perhaps not completely inconceivable that they motivate some form of palace coup. But that is a long shot, not a reasonable assumption for planning. Besides, the more that Kremlin officials believe that Western policy in Ukraine aims to provoke their overthrow, the likelier they are to view the war as existential, potentially triggering even greater violence, increasing the risks of war with NATO and putting compromise further beyond reach. Constraining Moscow's ability to prosecute the war by shrinking its economy has a more compelling logic. In that sense, sanctions do have value, if paired with continued global diplomacy to maintain pressure on Moscow. But simply weakening Russia will not end the war, at least not quickly.

More important is for Western governments to use the limited leverage that sanctions offer to best effect. Too often they fail to do so because of a reluctance to lift restrictions unless maximalist demands are met; they should not repeat that mistake this time around. If the aim is peace in Ukraine, the right message to send to Moscow, however unsatisfactory it might seem, is that a deal Kyiv accepts will yield a measure of sanctions relief. In the war's aftermath, such relief will not return Russia's economy to its prior state, particularly if the Kremlin maintains its harsh domestic policies. Many firms and investors will continue to avoid the country for some time, if nothing else because they will distrust its markets. Nonetheless, the restoration of foreign payment systems and lifting of blocking sanctions against some Russian banks could help partly restore the Russian financial system's normal functioning.

As for the nature of a deal that would lead to those steps, Western capitals should, broadly speaking, take their cue from Kyiv. A ceasefire alone would not be enough, as it would leave large numbers of Russian forces on Ukrainian soil with a continuous risk of the shooting starting again. (Indeed, a pause in fighting could enable Russia to resupply its troops.) But a ceasefire coupled with verifiable Russian withdrawals might appropriately trigger some sanctions relief. Ukraine's Western partners should also be willing to consider other outcomes that seem suboptimal – Ukraine regaining control of the self-declared republics in Donbas, for example, but in effect accepting the loss of Crimea – if Kyiv itself swallows such an arrangement, with all its attendant problems. A deal that puts in place a process for resolution of the Donbas question over time, although it would be fraught, would also be worth considering, notwithstanding the deadlock in Donbas negotiations over recent years. Ukraine's full demilitarisation seems out of the question, but Russian-Ukrainian conventional arms control could limit both sides' deployments in border areas. Kyiv has already spoken of eschewing pursuit of NATO membership. As NATO is not planning to invite Ukraine to join, it should be ready to accept this step. As for the EU, Ukraine may also need to propose a relationship that falls short of membership, particularly as that organisation, too, seems unlikely to enlarge any time soon.

Lastly, Western leaders need to keep open lines of communication to Moscow, both to make their red lines as clear as possible and do whatever they can to promote an end to the war. The shuttle diplomacy of the leaders of France, Germany, Israel, Turkey and others, although seemingly not immediately effective, could lay the groundwork for compromise later. Ideally, open channels would include military-to-military links, so as to better protect against misunderstandings – whether related to the supply of weapons or NATO's troop build-ups along the alliance's eastern flank – blowing up.

Conclusion

For now, Western governments have largely charted the right course in their response to Russia's invasion, factoring in risks of escalation even while helping Ukraine fight back. But the moment is extraordinarily dangerous. Not only is the war destroying Ukrainian cities, forcing millions from their homes and potentially upending Europe's security architecture. It also pits one nuclear power against a smaller neighbour backed by other nuclear powers, with only murky red lines separating nuclear-armed states from direct confrontation. After at least a decade of worsening bad blood between Russia and the West, and as understandable outrage mounts in Western capitals at Russia's aggression and Ukraine's suffering, that bulwark is hardly reassuring.

Some caution still guides calculations on both sides, with Western leaders sensibly rejecting a no-fly zone and Russia thus far not targeting weapons convoys outside Ukraine itself. But the room for miscalculation is frightening, particularly if the Kremlin again misreads the mood in Western capitals. How bad things get depends largely on President Putin himself. But Western leaders can make their own red lines and their own domestic pressures as clear as possible and do everything within their power to create incentives for a settlement. Keeping doors open to ending the conflict is not just about stopping Ukraine's decimation. It is about stepping back from a standoff that poses the gravest threat of nuclear confrontation for at least half a century.

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By International Crisis Group

10 Conflicts to Watch in 2022

Troubling undercurrents in 2021 – from the U.S. to Afghanistan, Ethiopia or the climate emergency – didn't send battle deaths soaring or set the world ablaze. But as our look ahead to 2022 shows, many bad situations round the world could easily get worse.

After a year that saw an assault on the U.S. Capitol, horrific bloodshed in Ethiopia, a Taliban triumph in Afghanistan, great-power showdowns over Ukraine and Taiwan amid dwindling U.S. ambition on the global stage, COVID-19, and a climate emergency, it's easy to see a world careening off the tracks.

But maybe one could argue things are better than they seem.

After all, by some measures, war is in retreat. The number of people killed in fighting worldwide has mostly declined since 2014 – if you count only those dying directly in combat. According to the Uppsala Conflict Data Program, figures through the end of 2020 show battle deaths are down from seven years ago, mostly because Syria's terrible slaughter has largely subsided.

The number of major wars has also descended from a recent peak. Despite Russian President Vladimir Putin menacing Ukraine, states rarely go to war with one another. More local conflicts rage than ever, but they tend to be of lower intensity. For the most part, 21st-century wars are less lethal than their 20th-century predecessors.

A more cautious United States might also have an upside. The 1990s bloodletting in Bosnia, Rwanda, and Somalia; the post-9/11 Afghanistan and Iraq wars; Sri Lanka's murderous campaign against the Tamils; and the collapse of Libya and South Sudan all happened at a time of – and, in some cases, thanks to – a dominant U.S.-led West. That recent U.S. presidents have refrained from toppling enemies by force is a good thing. Besides, one shouldn't overstate Washington's sway even in its post-Cold War heyday; absent an invasion, it has always struggled to bend recalcitrant leaders (former Sudanese leader Omar al-Bashir, for example) to its will.

Still, if these are silver linings, they're awfully thin.

Battle deaths, after all, tell just a fraction of the story. Yemen's conflict kills more people, mostly women and young children, due to starvation or preventable disease than violence. Millions of Ethiopians suffer acute food insecurity because of the country's civil war. Fighting involving Islamists elsewhere in Africa often doesn't entail thousands of deaths but drives millions of people from their homes and causes humanitarian devastation.

Afghanistan's violence levels have sharply dropped since the Taliban seized power in August, but starvation, caused mostly by Western policies, could leave more Afghans dead – including millions of children – than past decades of fighting. Worldwide, the number of displaced people, most due to war, is at a record high. Battle deaths may be down, in other words, but suffering due to conflict is not.

Moreover, states compete fiercely even when they're not fighting directly. They do battle with cyberattacks, disinformation campaigns, election interference, economic coercion, and by instrumentalizing migrants. Major and regional powers vie for influence, often through local allies, in war zones. Proxy fighting has not so far sparked direct confrontation among meddling states. Indeed, some navigate the danger adeptly: Russia and Turkey maintain cordial relations despite backing competing sides in the Syrian and Libyan conflicts. Still, foreign involvement in conflicts creates the risk that local clashes light bigger fires.

Standoffs involving major powers look increasingly dangerous. Putin may gamble on another incursion into Ukraine. A China-U.S. clash over Taiwan is unlikely in 2022, but the Chinese and U.S. militaries increasingly bump up against each other around the island and in the South China Sea, with all the peril of entanglement that entails. If the Iran nuclear deal collapses, which now seems probable, the United States or Israel may attempt – possibly even early in 2022 – to knock out Iranian nuclear facilities, likely prompting Tehran to sprint toward weaponization while lashing out across the region. One mishap or miscalculation, in other words, and interstate war could make a comeback.

And whatever one thinks of U.S. influence, its decline inevitably brings hazards, given that American might and alliances have structured global affairs for decades. No one should exaggerate the decay: U.S. forces are still deployed around the globe, NATO stands, and Washington's recent Asia diplomacy shows it can still marshal coalitions like no other power. But with much in flux, Washington's rivals are probing to see how far they can go.

Today's most dangerous flash points – whether Ukraine, Taiwan, or confrontations with Iran – relate in some way to the world struggling for a new equilibrium. Dysfunction in the United States hardly helps. A delicate transition of global power requires cool heads and predictability – not fraught elections and policy seesawing from one administration to the next.

As for COVID-19, the pandemic has exacerbated the world's worst humanitarian disasters and propelled the impoverishment, rising living costs, inequality, and joblessness that fuel popular anger. It had a hand this past year in a power grab in Tunisia, Sudan's coup, and protests in Colombia. The economic hurt COVID-19 is unleashing could strain some countries to a breaking point. Although it's a leap from discontent to protest, from protest to crisis, and from crisis to conflict, the pandemic's worst symptoms may yet lie ahead.

So while today's troubling undercurrents haven't yet set battle deaths soaring or the world ablaze, things still look bad. As this year's list shows all too starkly, they could easily get worse.

"Foreign involvement in conflicts creates the risk that local clashes light bigger fires."

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1. Ukraine

Whether Russia, which has been massing troops on the Ukrainian border, will again invade its neighbor remains unclear. But dismissing the menace as a bluff would be a mistake.

The Ukraine war began in 2014 when Putin, angered at what he saw as a Western-backed overthrow of a president friendly to Moscow, annexed Crimea and backed separatists in Ukraine's eastern Donbass region. Facing a military rout, Ukraine signed two peace accords, the Minsk agreements, largely on Russia's terms. Since then, separatists have held two breakaway areas in the Donbass.

What was for several years a simmering conflict heated up in 2021. A truce agreed to by Putin and Ukrainian President Volodymyr Zelensky, who came to power in 2019 promising to make peace, fell apart. In the spring of 2021, Putin amassed more than 100,000 troops near the border, only to withdraw many of them weeks later after a meeting with U.S. President Joe Biden. Since November, he's built up similar numbers.

Russia's grievances are clear enough. Moscow is upset at Ukraine's lack of follow-through with the Minsk agreements, particularly its denial of "special status" to the breakaway regions – which entails autonomy and, as Moscow defines it, a say in foreign policy.

Putin, angry at what Moscow sees as decades of Western encroachment, has drawn a new red line on NATO, rejecting not only the idea that Ukraine would join the alliance, which (in reality) won't take place any time soon, but also growing military collaboration among Kyiv and NATO members, which is already happening. Russia proposes a new European order that would prevent NATO's further enlargement east and curb its military deployments and activities.

Russia may intend for the buildup to force concessions. But given Putin's track record and underestimation of the hostility Moscow inspires among Ukrainians outside separatist-held areas, no one should rule out another military adventure. If Russia plans to fight, its options vary from limited support of separatists to a full-scale assault.

Western powers, which too often have relied on bluster packaged as strategic ambiguity, need to clarify what they would do to support Ukraine, relay that to Moscow, and hold fast to red lines. Biden, who will meet Putin one-on-one in early January, has made a start by threatening damaging sanctions and a larger military buildup on NATO's eastern flank. Western leaders might also warn of reactions they don't intend but might struggle to control, perhaps including NATO members deploying more personnel to Ukraine itself, with all the attendant risks.

"Russia may intend for the buildup to force concessions, but given Putin's track record no one should rule out another military adventure."

But deterrence will be short lived without efforts to de-escalate and lay the groundwork for more sustainable settlements in Ukraine and beyond. Choreographed de-escalation could involve Moscow pulling back forces, both sides limiting military exercises in the Black and Baltic Seas, a return to Minsk agreement negotiations, and talks on European security – even if the one-sided arrangement Russia proposes is out of the question.

In reality, no one will get what they want from the standoff. Kyiv may not like the Minsk agreements, but it signed them, and they remain the internationally accepted way out of the crisis. Putin hopes for a pliant neighbor in Ukraine, but that's a pipe dream – unless he's ready for a painful and costly occupation. Europe and the United States can neither deter without some risk of escalation nor resolve the Ukraine crisis without grappling with broader European security. As for Biden, he may want to focus on China but can't relegate Russia to the back burner.

2. Ethiopia

Two years ago, Ethiopia was a good news story. Ethiopian Prime Minister Abiy Ahmed appeared to be turning the page on decades of repressive rule. Instead, more than a year of fighting between Abiy's federal army and forces from the northern Tigray region has torn the country apart. A small window may have just opened up to bring the war to a close.

Battlefield dynamics have fluctuated dramatically. Abiy first ordered federal troops into Tigray in November 2020 following a deadly attack on a military garrison there by loyalists of the region's ruling party, the Tigray People's Liberation Front (TPLF). Federal forces, supported by troops from enemy-turned-friend Eritrea, quickly advanced alongside forces from Ethiopia's Amhara region, which borders Tigray, installing an interim administration in the Tigrayan capital, Mekele, in December 2020.

Over subsequent months, TPLF leaders regrouped in the countryside, mobilizing Tigrayans livid at massacres, rapes, and havoc wreaked by federal and Eritrean troops. In a startling reversal, the rebels drove their enemies out of most of Tigray at the end of June before marching south. They then formed an alliance with an insurgent group in Ethiopia's populous, central Oromia region. An assault on the capital, Addis Ababa, appeared in the offing. Mid-November, however, brought another about-face. A counteroffensive by federal troops and allied militia forced Tigray forces to withdraw back to their home region.

But if federal forces, for now, are ascendant, both sides command strong support and could drum up more recruits. Neither is likely to deliver a mortal blow.

Brutal fighting has embittered an already acrimonious dispute. Abiy casts the war as a battle for the Ethiopian state's survival. Many Ethiopians outside Tigray revile the TPLF, which dominated a repressive regime that ruled Ethiopia for decades before Abiy's election.

Abiy paints TPLF leaders as power-hungry spoilers, bent on trashing his modernized vision for the country. In contrast, Tigrayan leaders said their initial attack that triggered the war preempted a campaign to subjugate Tigray by Abiy and the TPLF's old foe, Eritrean President Isaias Afwerki, with whom Abiy signed a 2018 peace deal. They see Abiy's reforms as an attempt to water down Ethiopian regions' rights to self-rule.

More war would spell more disaster. Fighting has already killed tens of thousands of people and uprooted millions of Ethiopians from their homes. All sides stand accused of atrocities. Much of Tigray, denied aid by federal authorities, is nearing famine. The wounds the bloodletting has left on Ethiopia's social fabric will be hard to heal. Neighbors beyond Eritrea could get pulled in. Sudan, another good news story that turned sour in 2021 when its generals grabbed power, has its own disputes with Ethiopia over territory in the fertile borderlands of al-Fashqa and the Grand Ethiopian Renaissance Dam on the Nile, where Addis Ababa has started to fill the reservoir. With Ethiopia in

"The wounds the bloodletting has left on Ethiopia's social fabric will be hard to heal."

turmoil, Sudan – along with Egypt – could see a moment to press its advantage.

Recent battlefield developments may have opened a small window. Tigrayan leaders have dropped a key condition for talks, namely that Amhara forces leave disputed areas they seized in western Tigray. In late December, federal authorities announced they would not advance further to try and vanquish Tigrayan forces. Diplomats should now push for a truce to get humanitarian aid into Tigray and explore whether compromise might be feasible. Without that, bloodshed and hunger will continue, with terrible consequences for Ethiopians and, potentially, the region.

3. Afghanistan

If 2021 brought one chapter of Afghanistan's decades long tragedy to a close, another is starting. Since the Taliban's seizure of power in August, a humanitarian catastrophe has loomed. U.N. data suggests millions of Afghan children could starve. Western leaders shoulder much of the blame.

The Taliban's win was swift but long in the making. For years, and especially since early 2020, when Washington signed a deal with the Taliban pledging to withdraw U.S. forces, insurgents advanced through the countryside, encircling provincial and district centers. In the Spring and Summer of 2021, they began seizing towns and cities, often persuading Afghan army commanders demoralized by the impending end of Western support to surrender. The government collapsed in mid-August, and the Taliban entered Kabul mostly without a fight. It was a stunning end to a political order Western powers had spent two decades helping to build.

The world responded to the Taliban's takeover by freezing Afghan state assets, halting budgetary aid, and offering only limited sanctions relief for humanitarian purposes. (The Taliban are sanctioned by the United Nations and Western governments.)

The new government can't pay civil servants. The economy has tanked. The financial sector is paralyzed. All this comes on top of a punishing drought. Although overall violence levels are significantly down from a year ago, the Taliban face a vicious fight against the Islamic State's local branch.

The new regime has done little to endear itself to donors. Its interim cabinet includes almost exclusively Taliban figures, no women, and mostly ethnic Pashtuns. Early Taliban decisions, notably closing girls' schools in many provinces, sparked international outrage (some have since reopened). Reports have emerged of extrajudicial killings of former soldiers and police.

Still, Western decision-makers bear the lion's share of responsibility for Afghans' plight. The sudden cutoff of funds to an entirely aid-dependent state has been devastating. The United Nations estimates 23 million people, more than half the population, will suffer from hunger this winter. Humanitarian support alone can't stave off disaster. Donors are squandering genuine gains their funds helped deliver over the past two decades, notably in health and education.

There is another way. International financial institutions, having released a small part of the almost $2 billion earmarked for Afghanistan, should disperse the rest. The United Nations and United States, which have now lifted some sanctions to allow in humanitarian aid, should go further by easing restrictions to permit regular economic activity. Biden should release Afghanistan's frozen assets, with an initial tranche to test the waters.

If the White House, loath to underwrite Taliban rule, won't take that step, internationally supervised currency swaps could infuse dollars into the economy. Propping up health care, the education system, food provision, and other basic services should be priorities – even if this requires Western policymakers to work through Taliban ministries.

The alternative is to let Afghans die, including millions of children. Of all the blunders the West has made in Afghanistan, this one would leave the ugliest stain.

4. The United States and China

Shortly after pulling out of Afghanistan, the United States announced a new pact with Australia and the United Kingdom to counter China. Known as AUKUS, the deal will help Canberra acquire nuclear-powered submarines. It was a stark illustration of Washington's aspirations to move from combating Islamist militants to major power politics and deterring Beijing.

In Washington, one of the few views shared across the aisle is that China is an adversary the United States is inexorably at loggerheads with. U.S. leaders see past decades of engaging China as enabling the rise of a rival that exploits international bodies and rules to its own ends, repressing opposition in Hong Kong, behaving atrociously in Xinjiang, and bullying its Asian neighbors. Competition with China is becoming an ordering principle of U.S. policy.

Biden's China strategy, while not precisely articulated, entails keeping the United States the dominant power in the Indo-Pacific, where Beijing's military capacity has ballooned. Biden appears to see the costs of Chinese regional primacy as graver than the risk of confrontation. Concretely, that meant shoring up U.S. alliances and partnerships in Asia as well as elevating the importance of Taiwan's security to U.S. interests. Top officials also make stronger statements backing Southeast Asian countries' maritime claims in the South China Sea.

Beijing sees things differently. Chinese leaders, having hoped at first for improved ties with Washington under Biden, now worry more about him than they did about former U.S. President Donald Trump, a leader they hoped was an anomaly. They express disappointment at Biden's decision not to roll back trade tariffs or sanctions as well as his efforts to mobilize other countries. They recoil at rhetoric about democracy and human rights, which they view as ideological bombast that implicitly calls their government's legitimacy into question.

"Beijing wants a sphere of influence in which its neighbors are sovereign but deferential."

In essence, Beijing wants a sphere of influence in which its neighbors are sovereign but deferential. It views dominance of the first island chain – which stretches from the Kuril Islands, past Taiwan, and into the South China Sea – as vital to its growth, security, and ambition to be a world naval power.

Over the past year, while not disavowing its official "peaceful reunification" policy, Beijing escalated military activity near Taiwan, flying record numbers of jets and bombers as well as conducting drills near the island. Beijing's growing military clout and assertiveness have provoked more dire assessments in Washington about the threat of a Chinese assault on Taiwan.

A virtual meeting in November between Biden and Chinese President Xi Jinping took some of the edge off the frosty rhetoric of previous months. It could yield more working-level engagement, including the resumption of defense dialogues. In 2022, with the Beijing Winter Olympics, the 20th Party Congress, and U.S. midterm congressional elections, both sides likely want quiet fronts abroad, even if they rattle sabers for audiences at home. The nightmare scenario – a Chinese attempt to seize Taiwan, potentially forcing the United States to come to Taipei's defense – is unlikely for now.

Still, the two giants' rivalry casts a long shadow over world affairs and heightens dangers across flash points in East Asia. Beijing sees scant benefits in cooperating on issues like climate change when Washington frames the relationship as competitive. Along the first island chain, things are particularly frightening. Warplanes flying close to one another near Taiwan, for example, or warships crossing paths in the South China Sea are more common. A mishap would ratchet up tensions.

When U.S. and Chinese planes collided in 2001 during a period of reasonable calm between Beijing and Washington, it took months of intense diplomacy to resolve the spat. Today, it would be harder – and the danger of escalation greater.

5. Iran vs. the United Stated and Israel

The nail-biting brinkmanship between Tehran and Washington instigated under Trump may be over. But as hope of reviving the Iran nuclear deal fades, another escalation looms.

Biden took office pledging to rejoin the nuclear deal. His predecessor had unilaterally withdrawn Washington in 2018, reimposing sanctions on Iran – which, in turn, stepped up its nuclear development and power projection across the Middle East. The Biden administration lost time posturing about who should make the first move and refusing substantive goodwill gestures. Still, for a few months, talks made some progress.

Then, in June, Ebrahim Raisi won Iran's presidential election, giving hard-liners control of all the Islamic Republic's key power centers. After a five-month hiatus, Iran returned to the table, driving a harder bargain. At the same time, it is accelerating nuclear development. When the deal took effect six years ago, Iran's breakout time – the time it would take to enrich enough fissile material for a nuclear weapon – was around 12 months. It's now estimated at three to six weeks and shrinking.

Although Tehran hasn't unilaterally pulled out of the deal like Trump did, it's still playing with fire. Failure to restore the deal in the months ahead would likely make the original agreement moot, given Iran's technological advances. There are options: Diplomats could pursue a more comprehensive deal, though that would be a hard slog given the bad blood the original deal's demise would entail, or they could seek an interim "less-for-less" arrangement that caps Iran's continued nuclear progress for limited sanctions relief. But a collapse of negotiations is a real possibility.

That would be a disaster. Iran's nuclear program would continue unhindered. For Washington, accepting Iran as a threshold nuclear state – one able to build a bomb even if not yet having done so – will likely prove to be too bitter a pill to swallow. The alternative would be to approve or join Israeli strikes aimed at setting back Tehran's nuclear capability.

If that happened, Iran's leaders – whose calculations are likely informed by the toppling of former Libyan leader Muammar al-Qaddafi, who forfeited his nuclear weapons program, and the respect Trump showed toward nuclear-armed North Korea – may well sprint toward weaponization.

Tehran would also likely lash out across the Middle East. Nascent efforts at de-escalation between Iran and Persian Gulf monarchies may help lower risks, but Iraq, Lebanon, and Syria would all be in the crossfire. Incidents could heighten the danger of direct confrontation between Iran and the United States, Israel, or the two allies together, which the parties have thus far avoided despite provocations. Such

"Although Tehran hasn't unilaterally pulled out of the deal like Trump did, it's still playing with fire."

clashes could easily spin out of control on the ground, at sea, in cyberspace, or through covert operations.

Talks fizzling could, in other words, combine all the dangers from the period before the 2015 deal with the worst worries of the Trump years.

6. Yemen

Yemen's war faded from headlines in 2021 but remains devastating and could be poised to get worse.

Houthi rebels have encircled and advanced into the oil- and gas-rich governorate of Marib. Long underrated as a military force, the rebels appear to be running an agile and evolving multifront campaign, pairing offensives with outreach to soften local tribal leaders' resistance. They now control Al-Bayda, a governorate neighboring Marib, and have made inroads into Shabwa, farther east, thus cutting off supply lines to Marib. Of Marib governorate itself, only the main city and hydrocarbon facilities nearby remain in the hands of President Abed Rabbo Mansour Hadi's internationally recognized government.

Should those sites fall, it would mark a sea change in the war. The Houthis would score an economic as well as a military victory. With Marib's oil and gas, the Houthis will be able to bring down fuel and electricity prices in areas under their control, thus bolstering their image as a governing authority deserving of international legitimacy. The loss of Marib, the Hadi government's last bastion in the north, would likely herald the president's political demise.

Some nominally Hadi-aligned Yemenis already mutter about replacing him with a presidential council. That would further undercut the government's international status, likely reinforcing the Houthis' resistance to peace talks.

Anyone hoping that a Houthi win would presage the war's end is banking on an illusion. In southern Yemen, anti-Houthi factions outside Hadi's coalition – namely southern separatists backed by the United Arab Emirates and a faction led by Tareq Saleh, nephew of Yemen's late long-serving leader – would battle on. The Houthis, who see the war as pitting their nationalist forces against neighboring Saudi Arabia – which backs Hadi with air power – would likely continue cross-border attacks.

The United Nations' new envoy for Yemen, Hans Grundberg, who assumed his role at the helm of international peacemaking efforts last September, needs to do two things at once. First, he should seek to avert a battle for Marib city by hearing out, without necessarily accepting, Houthi proposals and pushing for a government counteroffer that reflects the reality of today's power balance. The U.N. also needs a new peacemaking approach that goes beyond two-party talks between the Houthis, on the one hand, and the Hadi government and its Saudi backers, on the other. Yemen's war is a multiparty conflict, not a binary power struggle; any hope of reaching a genuine settlement requires more seats at the table.

7. Israel-Palestine

This past year saw the fourth Gaza-Israel war in just over a decade, illustrating again that the peace process is dead and a two-state solution looks less likely than ever.

The trigger for this latest outbreak was occupied East Jerusalem. The threatened eviction of Palestinian residents of the Sheikh Jarrah neighborhood coincided in April 2021 with clashes during Ramadan between stone-throwing youth and Israeli police using lethal force on the compound that comprises the Haram al-Sharif, holy to Muslims, and the Temple Mount, holy to Jews.

That set off a chain reaction. Hamas, which controls Gaza, fired long-distance rockets indiscriminately into Israel. Israel responded with a harsh aerial assault, sparking an 11-day conflict that killed more than 250 people, almost all Palestinians, and left in ruins what remained of Gaza's civilian infrastructure. West Bank Palestinians demonstrating in solidarity were met with the Israeli army's live fire. In Israeli cities, Palestinian citizens took to the streets, sometimes clashing with West Bank settlers and other right-wing Jews, often supported by Israeli police.

While hostilities were all too familiar, this bout brought new elements. Palestinians, for the first time in decades, transcended their fragmentation by joining voices across the West Bank, East Jerusalem, Gaza, and Israel itself. Also striking was debate in Western capitals, Washington especially. Democrats, including mainstream figures, used unusually stern language about Israel's bombardment, suggesting that, among the party, views of the conflict are evolving.

Still, fundamentals remain unchanged. Though Israelis were apparently taken aback by the intensity of Hamas's rocket fire, the war provoked no rethink of Israel's Gaza policy – economic strangulation to weaken Hamas and divide Palestinians; "mowing the grass" every few years to stifle attacks – or its general treatment of Palestinians. Abroad, most capitals wrung their hands but did little. The Biden administration, despite Democrats' new tone, claimed to conduct "quiet, intensive diplomacy" but more or less allowed the conflict to run its course.

Nor have the months since brought hope. A hodgepodge coalition ousted Israel's longest-serving prime minister, Benjamin Netanyahu, in June. After Netanyahu's belligerence, the new government put a softer face on Israel's foreign relations and declared its hope to "shrink" the conflict by improving the occupied territories' economies and marginally strengthening the Palestinian Authority, which partly rules the West Bank. Yet it continues to expand illegal settlements and repress Palestinians much as its predecessors did. In October, it outlawed six respected Palestinian civil society groups on specious terrorism charges.

For anyone still eager to renew negotiations, the last year was cause for despair. The center of gravity in Israeli politics has long since shifted away from peace, as successive governments have abandoned talks in all but name. Most Palestinians have lost faith they will win statehood through negotiations.

"Palestinians, for the first time in decades, transcended their fragmentation by joining voices across the West Bank, East Jerusalem, Gaza, and Israel itself."

There are ways to buy quiet: a longer-term truce and opening up of Gaza; ending expulsions of Palestinians in East Jerusalem; returning to preexisting arrangements that kept the holy sites reasonably calm.

But those can only stave off the next war for so long. Diplomats' lip service to a two-state solution that is all but out of reach gives cover for Israel to advance de facto annexation of the West Bank. Better now would be to try to end Israeli impunity for violations of Palestinian rights. It's time, in other words, to address the situation on the ground as it is.

8. Haiti

The Caribbean nation has long been tormented by political crises, gang warfare, and natural disasters. Nevertheless, this past year stands out for many Haitians as particularly bleak. Few expect a brighter 2022.

In July, hit men assassinated President Jovenel Moïse in his home; his security detail apparently did nothing about it. Shellshocked elites squabbled over who would run the country. (Succession lines were muddled as Moïse had appointed Ariel Henry as his new prime minister but Henry had not yet been sworn in.) Henry eventually became the country's interim leader but has struggled to assert authority.

An earthquake in August destroyed much of southern Haiti. Rampant kidnappings by gangs that lord over much of the capital of Port-au-Prince have hampered international relief efforts. Criminals' seizure of oil terminals brought the country to a standstill in early November. Haiti, meanwhile, lags behind the rest of the Americas in distributing COVID-19 vaccines. Increasing numbers of Haitians are seeking better prospects abroad; many new departures – and indeed many Haitians who left the island some time ago – are camped out along the southern U.S. border.

As for the post-Moïse transition, two factions propose competing plans. Henry and several parties have inked a deal allowing him to rule until elections in 2022. In contrast, the Commission for a Haitian Solution to the Crisis, an umbrella group of civil society organizations and political parties, insists the country's wounds cut so deep that only root-and-branch reform can stanch the bleeding. They want a two-year transition, with a council more representative of society holding power until new polls. With the constitution largely a dead letter (postponed elections mean two-thirds of Senate seats are empty) and responsibility for Moïse's killing unclear, Haiti's immediate stability requires reconciling these two options.

Gangs also have political clout. Jimmy "Barbecue" Chérizier, a former police officer who is capo of the so-called G9 criminal alliance that seized the oil terminals, has demanded that Henry resign. Police corruption, an enfeebled judicial system, and the hemisphere's highest poverty rates provide ideal conditions for gangs to recruit and expand. Chérizier himself combines brute force with politicking designed to appeal to impoverished, unemployed young men.

Many Haitians bristle at the idea of a new U.N. peacekeeping mission, let alone U.S. military intervention, but without some overseas help it is hard to see Haiti escaping its predicament. Donors supporting a specialized joint Haitian-U.N. office tasked with prosecuting top officials, police, and judges accused of serious crimes could help reduce violence and sever ties between criminals and politicians.

The first priority, though, is for Haitians to agree on a new transition plan. Without it, they will face another year of gridlock, crime, and unrest as more depart in search of better lives elsewhere.

9. Myanmar

Since the February 2021 coup, a crackdown by the country's military (known as the Tatmadaw) on mostly peaceful protests has fueled broad-based resistance, ranging from civil disobedience to armed clashes with security forces. A deadly stalemate exacts a terrible human toll.

If the generals hoped to reboot Myanmar's politics, they miscalculated. Piqued at Aung San Suu Kyi and her National League for Democracy's landslide win in the November 2020 elections, military leaders called the vote rigged and detained civilian politicians. Their plans for new elections seemingly aimed to install friendlier faces to power. Instead, mass protests against military involvement in politics rocked towns and cities. A crackdown resulting in hundreds of deaths fueled fiercer resistance.

Since then, deposed lawmakers set up their own National Unity Government (NUG) and in September called for revolt against the regime. While the NUG is still developing its own military capability, resistance forces, many of which support the NUG but are mostly not under its direct control, stage attacks daily, ambushing military convoys, bombing regime-linked targets, and assassinating local officials, suspected informants, and others they see as junta loyalists.

Myanmar's ethnic armed groups, some of which comprise tens of thousands of fighters and control vast upland areas, have themselves adapted. Some have remained aloof; others, responding to constituents' anger at the coup, have resumed fighting the Tatmadaw. Some shelter dissidents, provide them military training, and are negotiating with the NUG. For its part, the NUG has sought to win over armed groups, including by promising a federal system for Myanmar.

Majority views about ethnic minorities are also changing: Long blamed for Myanmar's problems, minorities' demands for a fairer share of power today enjoy more support. While a united front against the regime is unlikely, given rebels' historical rivalries, significant political and military cooperation is taking place.

For its part, the Tatmadaw has doubled down. It detains, sometimes executes, and routinely tortures opponents, often abducting kin as hostages. Battalions have crushed urban dissent, using tactics that aim to kill as many people as possible. (A U.N.-backed investigation's preliminary analysis suggests crimes against humanity.)

In rural areas, the army fights new resistance groups with old counterinsurgency methods, namely its "four cuts" strategy, aimed at denying rebels food, funds, intelligence, and recruits. It targets civilians; in the latest of many reported incidents, credible accounts suggest that at the end of December the military massacred dozens of civilians fleeing violence in eastern Myanmar. The regime has also attempted to persuade armed groups from entering formal alliances with the NUG, in some cases keeping groups – including the Arakan Army, with which it fought a brutal war in 2019-2020 – off the battlefield.

Having locked up their rivals – Aung San Suu Kyi has already been sentenced to two years' imprisonment and could end up locked up for life – the generals are moving to amend electoral rules in their favor and hold a vote in 2023. However, any poll that would usher in a military-backed government would be seen as a farce.

The standoff's human cost is devastating. Myanmar's economy is freefalling, the national currency has crashed, health and education systems have crumbled, poverty rates are estimated to have doubled since 2019, and half of all households cannot afford enough food. Myanmar's generals, convinced of their role at the country's helm, are steering it off a cliff.

For the most part, the world is losing interest. While outside actors have little influence on the Tatmadaw, it is critical that they keep trying to get aid in without empowering the regime. They can also usefully throw greater weight behind the diplomatic efforts of the Association of Southeast Asian Nations, which have so far been mostly dysfunctional, and the new U.N. special envoy. Beyond the human toll, a collapsed state in the heart of the strategically vital Indo-Pacific region serves no one's interests.

10. Islamist militancy in Africa

Since 2017, when the Islamic State lost its so-called caliphate in the Middle East, Africa has suffered some of the world's most ferocious battles between states and jihadis. Islamist militancy on the continent is nothing new, but revolts linked to the Islamic State and al Qaeda have surged in recent years.

Weak states struggle against nimble militant factions across vast hinterlands where central governments hold little sway. Parts of the Sahel have seen spiraling bloodshed, mostly due to fighting involving jihadis, whose reach has extended from northern Mali to the country's center, into Niger, and across rural Burkina Faso.

Boko Haram's insurgency has lost the swaths of northeastern Nigeria it controlled some years ago, and the movement has fractured. But splinter groups still wreak tremendous harm around Lake Chad. In East Africa, al-Shabab, the continent's oldest-surviving Islamist rebellion, remains a potent force, despite more than 15 years of efforts to defeat it. The group holds large parts of Somalia's rural south, operates shadow courts and extorts taxes beyond those areas, and occasionally mounts attacks in neighboring countries.

Africa's newest jihadi fronts – in northern Mozambique and eastern Democratic Republic of the Congo – are also troubling. Insurgents who claim a new Islamic State province in Mozambique's Cabo Delgado region have stepped up attacks on security forces and civilians. Nearly a million people have fled the fighting. Militants have loose ties to Islamic State networks that stretch both up the continent's east coast and into Congo's war-torn east. There, another Islamist rebel group – a faction of the Allied Democratic Forces, a Ugandan militia that has long operated in Congo – now declares itself an Islamic State affiliate. It launched attacks in the Ugandan capital of Kampala last November.

Mozambique's government, which long resisted outside involvement in Cabo Delgado, finally agreed last year to let in Rwandan troops and units from the Southern African Development Community (SADC), a regional bloc. Those forces have reversed insurgent gains, though militants appear to be regrouping. Rwandan and SADC forces risk a protracted war.

In Somalia and the Sahel, Western impatience could be decisive. Foreign forces – the EU-funded African Union Mission in Somalia, or AMISOM, and French and other European forces in the Sahel – help keep jihadis at bay. Yet military operations often alienate locals and further erode relations between them and state authorities.

There's little to show for years of foreign efforts to build up indigenous armies. Malian colonels have seized power in Bamako twice in the space of just over a year, while the regional G5 Sahel force, comprising troops from Mali and its neighbors, also struggles against jihadis. (Chad recently pulled out some of its troops from the force, fearing upheaval at home.) As for the Somali security forces, units, caught up in political bickering, often shoot at each other.

If foreign efforts wind down, battlefield dynamics would undoubtedly shift, perhaps decisively, in the militants' favor. In Somalia, al-Shabab could seize power in Mogadishu much as the Taliban did in Kabul. Intervening foreign powers are caught as they were in Afghanistan: unable to achieve their goals but fearful of what will follow if they exit. For now, they appear set to stay.

Even so, a rethink in both places – entailing a greater civilian role alongside military campaigns – is overdue. The Sahel governments need to improve their relations with citizens in the countryside. Somalia needs to repair relations among elites; late December saw another eruption in a drawn-out election feud. More controversial is talking to jihadis. It won't be easy: Somalia's neighbors, which contribute troops to AMISOM, oppose any engagement; and while Sahel governments have been more open, France rejects negotiations. No one knows whether compromise with militants is feasible, what it would entail, or how populations would view it.

But the military-centric approach has mostly spawned more violence. If foreign powers don't want the same dilemma haunting them in a decade's time, they need to prepare the ground for talks with militant leaders.

This text was changed on 2 February 2022 to remove text that characterised the latest Gaza-Israel war as the "most destructive" since 2008. We changed the text to avoid any misunderstanding. In the recent conflict, tactics that overtly targeted civilian infrastructure and human psychology made the most psychological devastation particularly high. But the 2014 war did more physical damage.

Brokering a Ceasefire in Yemen's Economic Conflict

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Preventing War. Shaping Peace.

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Principal Findings

What's new? UN-led efforts to broker a ceasefire in Yemen have repeatedly stalled due to a standoff between Huthi rebels and the internationally recognised government over who has authority to control goods, particularly fuel, entering the Red Sea port of Hodeida. With the conflict escalating, the UN is struggling to make headway.

Why does it matter? The economy has become an integral part of the parties' efforts to strengthen their own positions while weakening their rivals. The economic contest has fuelled the fighting at the front and impeded attempts at peacemaking. But diplomats working to stop the war have too often sidestepped the issue.

What should be done? Yemen needs an economic ceasefire as much as a military one. In concert with other UN actors, the new UN envoy should launch a mediation track to identify the economic conflict's key players and begin to lay the groundwork for an economic truce even while the shooting continues.

Executive Summary

Yemen is caught up in overlapping emergencies that have defied mediation. In the north, bloody battles rage for control of Marib governorate between the internationally recognised government of Abed Rabbo Mansour Hadi and the Huthi rebels who ousted him in 2015. Hadi's government prevents fuel from entering the Huthi-held port of Hodeida, and a tug of war over the riyal, Yemen's currency, has led to its collapse in nominally government-controlled cities. These crises form part of a struggle over the economy – call it an economic conflict – that has compounded Yemen's humanitarian crisis, accelerated its political and territorial fragmentation, and stymied peacemaking. To date, mediation efforts have tended to treat economic matters as technical issues or sought to address them as "confidence-building measures" enacted in service of political dialogue. The new UN envoy should recognise them as core to the conflict and negotiate an economic ceasefire at the same time, and in much the same way, he seeks to arrive at a military truce.

The economic conflict pits the Hadi government against the Huthi rebels for control of the country's natural resources, trade flows, businesses and markets. State and non-state institutions that facilitate and hinder trade, such as banks, customs authorities and other regulatory bodies, along with the parties' respective security services, play supporting roles. The Huthis' advantage in this struggle is their growing control of territory and population centres; the Yemeni government's is its international legal authority.

The economic conflict's roots trace back to the country's failed political transition, which began in 2012 and collapsed in the face of the Huthi rebellion in 2014, setting in motion seven years of civil war and foreign intervention. The economic and military conflicts did not progress at the same pace. Some aspects of the former were held at bay during the war's early phases by an informal, technocrat-led economic truce that helped to protect pre-war economic institutions that remained highly centralised even as, in other ways, the country broke apart. Civil servants in Sanaa engaged with political leaders on both sides of the conflict and the parties quietly allowed the central bank to maintain a level of neutrality. The truce was never meant to be more than a stopgap measure, however, and it did not last.

Since the economic truce collapsed over the course of 2016 and 2017, the economic conflict has become sharper and more entwined with Yemen's shooting war. Its most visible features are the splitting of the central bank into rival authorities in Sanaa and Aden, a power struggle over control of trade flows and taxation of fuel in particular, and the precipitous drop of the riyal's value in nominally government-controlled areas. The riyal's depreciation has pushed the price of imported necessities such as food and fuel out of reach for many people. As a result, Yemen is the site of what the UN says is one of the world's largest humanitarian crises. By the end of 2021, the war had cost around 377,000 Yemeni lives, according to the UN Development Programme. Of this number, most were killed not by front-line fighting, shelling or airstrikes, but by hunger and preventable disease, the overwhelming majority of them young children and women.

The parties' tactics in the economic conflict have often backfired. The government's initiatives to wrest control of the economy from the Huthis have tended to rebound against it, in large part because the Huthis control Yemen's main population centres and hence its biggest markets. Diplomats have struggled to convince the government of the folly of its actions, in part because the economy is one of the few remaining sources of perceived leverage for President Hadi and his inner circle. Considering what is at stake – its very survival – the government is unlikely to stand down from economic warfare without major concessions by the Huthis, who perceive that they have the upper hand in the conflict and therefore see no reason to compromise. Yet, by delaying a settlement further, the government risks ceding still more ground to the Huthis.

The parties' economic tactics have bedevilled the succession of UN envoys who since 2015 have been charged with ending the war. For better or worse, their efforts have tended to focus on the political and military aspects of the conflict while viewing the economic conflict as a subplot even when it is fundamentally bound up with core political issues dividing the parties. The Stockholm Agreement, which prevented a battle for Hodeida, skated over rather than resolved important economic issues. More recent efforts to resolve the Marib crisis and Hodeida embargo have similarly stumbled in treating profoundly important proposed economic concessions as "confidence-building measures".

This approach needs to change. While the economic dimensions of Yemen's conflict are not the only impediments to peace, it is difficult to imagine the parties reaching a durable military truce if they fail to reach an economic one alongside it. The new UN envoy, Hans Grundberg, who assumed his post in September, is considering how his office can address the economic conflict. He has some useful models to follow. In Libya, for example, the UN envoy's office initiated a separate track for economic issues that fall within the framework of broader conflict resolution efforts. Grundberg should take a page from this book, establishing a formal track to address the economic challenges that have become interwoven with the toughest political issues that separate the parties. The concrete objective would be an agreement in which the conflict parties pledge to stop working to damage each other economically and to cooperate in the interests of ordinary Yemenis who desperately need both economic opportunity and better services.

In early 2022, the conflict for Marib escalated. Without progress on the economy, Grundberg is unlikely to be able to stop the shooting. Many of the same obstacles to agreement that have dogged mediators in their pursuit of a military ceasefire will encumber their efforts to achieve an economic truce. Even with international support – which outside actors should certainly lend him – the envoy faces an uphill climb. But that climb will almost surely be steeper still without a dedicated effort that allows mediators to better understand and deal with the economic issues that are so fundamentally bound up with the political drivers of Yemen's civil war. Seven years into this brutal conflict, it is past time to give this task a try.

Amman/Cairo/Aden/Sanaa/New York/Brussels, 20 January 2022

Brokering a Ceasefire in Yemen's Economic Conflict

I. Introduction

In September 2014, a coalition of Huthi rebels and loyalists of former President Ali Abdullah Saleh seized Sanaa, Yemen's capital, after several days of fighting on the city's outskirts. The fall of Sanaa marked the end of a transitional period that had begun in February 2012, when Abed Rabbo Mansour Hadi – Saleh's successor – assumed the presidency. Saleh had been forced from office following a popular uprising against his corrupt and sometimes brutal 33-year reign. Elected in a non-competitive process, and enjoying international recognition, Hadi was to be a caretaker leader while a National Dialogue Conference prepared recommendations for a constitutional drafting committee in anticipation of fresh elections. But this ambitious program failed. Buttressed by popular frustration with economic conditions and supported by Saleh and his allies, the Huthis took advantage of state weakness to expand their territorial control, until they captured Sanaa itself.

As most of Yemen's national institutions were in the capital, it seemed that the Huthi-Saleh alliance had taken over the Yemeni state. Certainly, they tried to do so. After taking Sanaa, their combined forces moved to gain control of most of the country's main population centres, commercial hubs and natural resources.[1] Six years later, a senior official of the transitional government that the allies had deposed reflected:

> They did what you do when you stage a coup. … The Saleh people had run Yemen for three decades, so they knew what was important and where to go to make sure they could finance their operations. … And they almost succeeded.[2]

But the Huthi-Saleh coalition failed in its drive to bring the entire country to heel. In February 2015, President Hadi, whom the alliance had placed under house arrest in Sanaa a month earlier, and who resigned in response, fled to the southern port city of Aden. There, Hadi rescinded his resignation, which he said he had made under duress, called for international military intervention to restore his government to power and named Aden the interim capital.[3] In March 2015, a Saudi Arabia-led coalition launched a military intervention with U.S. support that by mid-year had pushed the combined

[1] The Huthi-Saleh alliance relied on a mixture of force and negotiations, which in many cases began long before the rebels entered the capital. In October 2014, after seizing Sanaa, the Huthis, along with Saleh loyalists, took the Red Sea port of Hodeida and separately began intensive (and fruitless) talks with tribal leaders in Marib seeking entry to the oil-rich governorate. Huthi officials travelled to Aden in October-November 2014 to meet with southern separatist leaders and others in an effort to broker a similar compact, meeting with similar rejection. They also launched negotiations with leaders in Taiz and Ibb governorates before capturing Sanaa.
[2] Crisis Group telephone interview, former Yemeni government official, December 2020.
[3] The Huthis, who had announced they were replacing the presidency with a Revolutionary Council, dismissed Hadi's move.

Huthi-Saleh forces out of most of the south.[4] The UN and foreign powers continued to recognise the transitional government as Yemen's rightful rulers, allowing President Hadi to lead anti-Huthi Yemeni forces, albeit mostly as a figurehead based outside the country.[5]

In April 2015, the UN Security Council passed Resolution 2216, in which it recognised Hadi as Yemen's legitimate president, called upon the Huthi-Saleh alliance to hand over weaponry and, in effect, surrender, and imposed an arms embargo on Saleh and two Huthi leaders. The two-party framework for negotiations established by 2216 was aspirational at best, even at the time. It is now significantly outdated, not least because the Huthis killed Saleh in December 2017 after the alliance frayed. Armed groups that are not subordinate to either the Huthis or the Hadi government have proliferated since 2015 and the country has been split into multiple zones of military and political control.

Given the significant strengths of the sides the UN engages in talks in Yemen – the Huthis' control of most national institutions and increasingly dominant military position on the ground versus the Hadi government's foreign backing and international legal standing – it is not surprising that neither has been able to achieve a decisive political or military victory. To gain an edge, the Huthis, the Hadi government and the Saudi-led coalition all have increasingly turned to economic tools. Over time, their economic interventions against each other, which this report refers to in the aggregate as Yemen's "economic conflict", have both complicated efforts to end the shooting war and deepened what the UN has long described as one of the world's largest humanitarian crises.

This report explores Yemen's economic conflict and offers recommendations for preparing to address it as part of UN-led peace talks. Blending qualitative and quantitative research methodologies, it is based on around 80 interviews with Yemeni businesspeople, bankers, civil servants and political leaders, as well as regional and international officials, conducted between June 2020 and November 2021. Its quantitative analysis uses district-level control mapping checked against similar data gathered by the Armed Conflict Location & Event Data Project (ACLED); analyses of pricing and currency data collected by the World Food Programme (WFP); and figures collated by a private trade data collection firm. It also draws on work conducted by the Assessment Capacities Project (ACAPS), a humanitarian analysis consortium.[6] Lastly, it benefits from unpublished work by the International Growth Centre's State

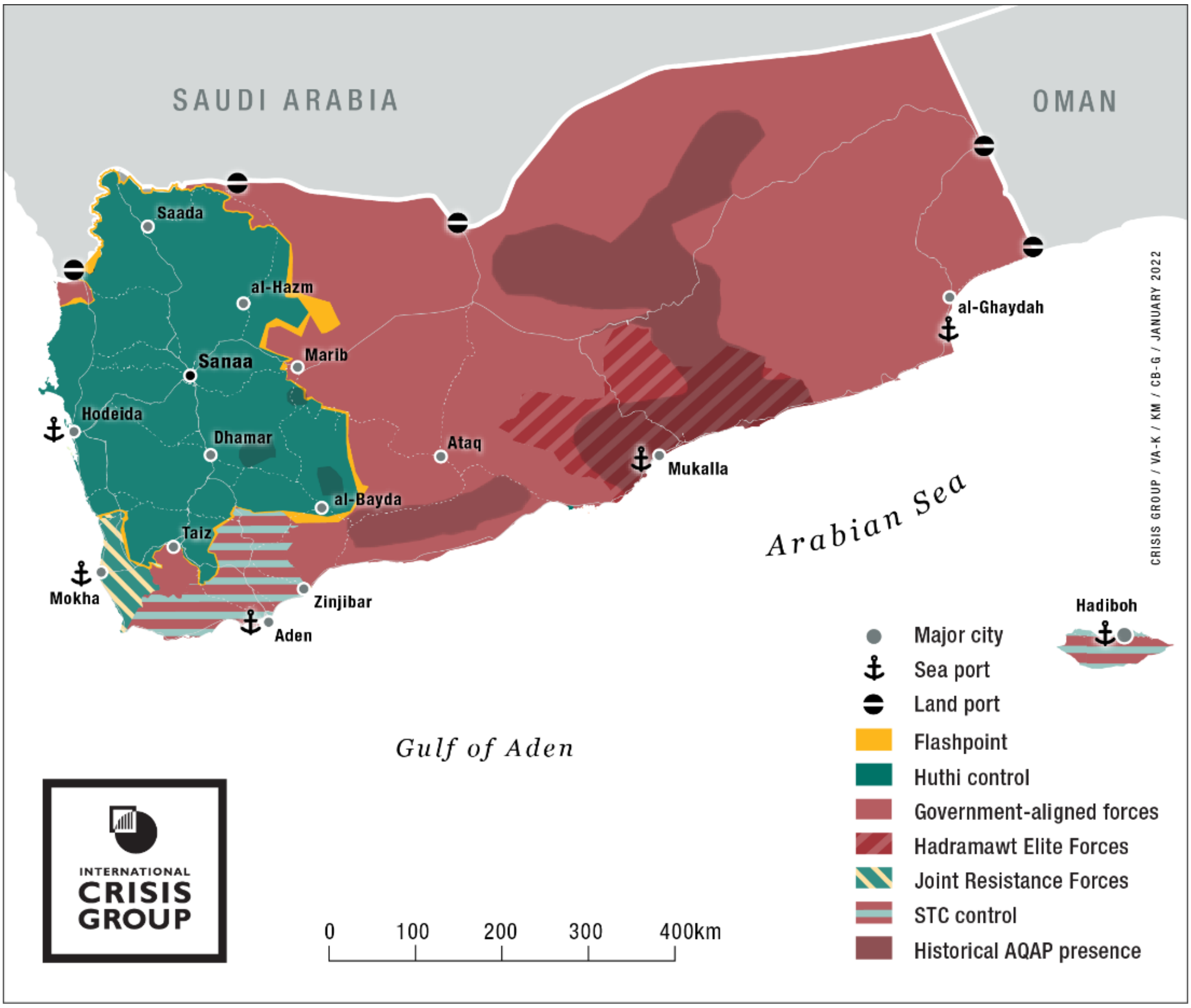
[4] The Huthi-Saleh alliance faced stiffer-than-expected resistance from local fighters accompanied by those national forces that had not joined their side in Aden, Marib and Taiz. On 25 March, Riyadh announced the formation of a 22-country military coalition to support Hadi, launching an intensive campaign of airstrikes along with a naval blockade of Yemen's ports. Only a handful of the countries Riyadh said were part of the coalition actually participated in the war, and several capitals said they had not agreed to participate in the campaign. The United Arab Emirates (UAE) and, to a lesser extent, Bahrain became the kingdom's main military allies in Yemen.

[5] See Crisis Group Middle East Briefing N°52, *Instruments of Pain (I): Conflict and Famine in Yemen*, 13 April 2017.

[6] The ACLED data is from its interactive dashboard online. The WFP data is from its Humanitarian Data Exchange. The ACAPS data is from its Yemen crisis webpage.

Fragility Initiative. The report builds on Crisis Group's extensive previous research aimed at ending the Yemen war and blunting its humanitarian impact.[7]

Figure 1: Map of political control, December 2021



[7] See, most recently, Crisis Group Middle East Reports N°s 216, *Rethinking Peace in Yemen*, 2 July 2020; and 221, *The Case for More Inclusive – and More Effective – Peacemaking in Yemen*, 12 March 2021; as well as Crisis Group Middle East Briefing N°84, *After al-Bayda, the Beginning of the Endgame for Northern Yemen?*, 14 October 2021.

II. Economic Truce, Economic Warfare

A. *Weak Economic Foundations*

Already before the war, Yemen's factious elites were competing over an economy that rested on weak and crumbling foundations.[8] Economic output relied heavily on dwindling hydrocarbon exports, import-led trade – the country purchased some 90 per cent of its wheat and all its rice from overseas – and services such as banking and telecommunications. To pay for imports and support the Yemeni currency, the riyal, the government relied on foreign currency earned through oil and gas exports and on remittances from Yemeni workers abroad. Oil and gas revenues underwrote a large public-sector wage bill and costly fuel subsidies. This setup fostered corruption, left Yemen in a near-permanent fiscal and monetary crisis, and made the country vulnerable to international commodity price shocks. When oil prices fell on global markets, state revenues plummeted. When they rose, income increased but so, too, did the cost of fuel subsidies, which by 2014 outstripped oil export income.

Against this backdrop, political stability was largely dependent on patronage networks, which formed around a regime that had only tenuous control of national territory and splintered during Yemen's 2011 uprising.[9] Regime infighting that year caused an economic downturn and exacerbated unemployment. Yemen's poverty rate topped 50 per cent by the end of 2011.[10] The main geographic node in this unstable and unsustainable system was Sanaa, with its government institutions. The finance ministry and central bank provided importers with letters of credit, managed hard currency supply to maintain the riyal at a stable exchange rate to the dollar, oversaw the payment of fuel subsidies to a state-run firm that held a near-monopoly on domestic fuel distribution, and managed salary payments.[11] The private sector, almost exclusively headquartered in Sanaa, was reliant on favourable treatment from political allies in the capital.

Although they had been expanding their territorial footprint for months, the Huthis framed their push to Sanaa in 2014 as a response to the Hadi government's decision to cut almost all fuel subsidies overnight in August of that year. The Huthis, citing corruption, economic mismanagement and foreign control of policy decisions, launched what they termed a "revolution" against the government of President Hadi, setting

[8] Ginny Hill, Peter Salisbury, Léonie Northedge and Jane Kinninmont, "Yemen: Corruption, Capital Flight and Global Drivers of Conflict", Chatham House, September 2013.
[9] In its 2014 Country Economic Memorandum on Yemen, the World Bank noted: "The country has long been hostage to a short-term rent extraction frenzy by multiple elites who have undermined any possibility of sustainable development, have been able to distort economic policy and block reforms, and have continued to seek rents aggressively that might otherwise have been recycled into development. This has occurred in the most profitable or most strategic economic subsectors such as oil and gas, agriculture, water, telecommunications and financial services". "The Republic of Yemen: Unlocking the Potential for Economic Growth", World Bank, October 2015.
[10] The state employed around 1.25 million Yemenis, up to 10 per cent of them "ghost workers", who were on the payroll but rarely if ever showed up to work, while it also heavily subsidised the cost of fuel, and carefully controlled fuel supply and distribution via state-owned companies. Peter Salisbury, "Yemen's Economy: Oil, Imports and Elites", Chatham House, October 2011.
[11] Ibid.

up protest encampments in and around Sanaa while launching a military offensive from their base in the northern Saada governorate.[12]

After the Huthis and their allies took Sanaa, they appointed loyalists to oversee work at ministries and the central bank. These new *mushrifeen* (supervisors) paid particular attention to the finance ministry, which held data on the government's cash reserves and revenue-generating operations – the state's financial lifeblood.[13]

The outbreak of the war with the Saudi-led coalition in 2015, sparked by Huthi-Saleh expansion from Sanaa earlier in the year, split Yemen into several zones of territorial control and further buffeted the ailing economy. Front-line fighting, shelling and airstrikes badly damaged infrastructure and agricultural output.[14] Oil and gas exports ground to a halt, gross domestic product fell by an estimated 28 per cent in 2015, and the country descended into simultaneous fiscal, monetary and financial crises. In June 2015, financial officials in Sanaa wrote in a note to international institutions that "the fiscal situation is catastrophic!!!"[15]

Yet for all the surrounding chaos, the war did not, at first, cause irreparable fractures in state economic institutions. Technocrats in ministries brokered an informal institutional arrangement between Huthi-Saleh-controlled Sanaa and the Hadi government, which had by that time largely relocated to Riyadh despite naming Aden Yemen's temporary capital.[16] The deal aimed primarily to protect the finance ministry and central bank from being politicised and ensure that the economy continued to function.[17] The deal was supported by a World Bank official seconded to the UN envoy's office in 2014 and other international officials who recognised the risk to the economy of allowing institutions to crumble or fragment.[18] Civil servants in Sanaa remained in direct contact with ministers in the Hadi government, then headed by Prime Minister Khaled Bahah.[19] Who had the authority to issue instructions to staff, and who did not, was opaque, and the setup clearly could not last for long.

But it was not intended to endure: the stopgap arrangements, which officials described as an "economic truce", were based on the assumption that a political settlement was inevitable and imminent.

[12] Peter Salisbury, "From outcasts to kingmakers", *Foreign Policy*, 10 October 2014.
[13] Crisis Group interviews, former ministry officials, Amman, September 2019; Cairo, January 2021.
[14] "Assessing the Impact of War of Development in Yemen", UN Development Programme, 1 May 2019.
[15] "Yemen's Status Update as of June 28, 2015", note from finance ministry officials on file with Crisis Group. In late 2014, at the tail end of the country's abortive UN-overseen political transition, before and after the Huthi takeover, finance ministry officials began to raise the alarm about a foreign currency crunch and fiscal crisis, warning that they would soon be unable to pay salaries or import goods. See Peter Salisbury, "Yemen's astonishing financial meltdown", *Foreign Policy*, 11 December 2014.
[16] Crisis Group interviews, individuals involved in negotiating and maintaining the "economic truce" and later such efforts, Amman, Cairo, Oxford and by telephone, September 2019-May 2021.
[17] The bank continued to collect revenues, managed foreign exchange mechanisms including the letters of credit used to underwrite imports, and paid state salaries using the last parliament-approved state budget, from 2014, as a guide. Throughout 2015 and into mid-2016, the central bank chartered cargo flights to transport large numbers of riyal notes from Huthi-controlled Sanaa to other parts of the country in order to pay salaries. See Peter Salisbury, "Bickering While Yemen Burns", Arab Gulf States Institute in Washington, 22 June 2017.
[18] Crisis Group telephone interview, former official in the UN envoy's office, November 2021.
[19] Crisis Group interviews, individuals involved in negotiating and maintaining the "economic truce", Amman, Cairo, Oxford and by telephone, September 2019-May 2021.

This assumption proved mistaken. The war dragged on, and as it did, officials in Sanaa began to speak urgently of the need for emergency measures to prevent complete economic collapse. Central Bank Governor Mohammed bin Humam and his staff – in written correspondence and meetings with President Hadi, government officials, international institution representatives and foreign diplomats – warned from late 2015 onward that hard currency and riyal banknotes were running low.[20] The shortages risked weakening the currency – thereby reducing the inflow of basic goods and threatening the government's ability to pay public-sector salaries. They recommended that the bank suspend letters of credit for fuel and sugar imports in order to slow the pace at which it was using up its dwindling supply of hard currency; that the government liberalise the fuel trade by ending the state monopoly and allowing private firms to import and distribute it; and that the bank be authorised to print new riyal notes to make payroll.[21]

Mistrust between the Hadi government and central bank staff in Sanaa also became a growing impediment to managing the economic crisis. Amid UN-led efforts to broker a ceasefire and political settlement in early 2016, the government began to accuse bin Humam of allowing the Huthi-Saleh alliance to plunder the bank and its international accounts to underwrite their war effort. It blocked the bank from printing new riyals by sending a note instructing the Russian firm tasked with printing the bills to cancel the order.[22]

The bank continued to struggle. By mid-2016, it was having trouble paying state salaries. With bin Humam's term as governor up for renewal in August 2016, the economic truce's sponsors worried that a policy vacuum was emerging. Bank staff protested that they were working to prevent a Huthi takeover of the institution.[23] The UN envoy's office brought bin Humam to Kuwait to discuss the economy on the sidelines of peace talks.[24] But the government was increasingly hostile to him. Explaining the government position, a government economist noted:

> Bin Humam and his office couldn't guarantee the bank's independence. The government requested a suspension of payments to the [Huthi-Saleh-controlled] defence ministry at the very least. He said: "Listen, if I suspend the payments to the defence ministry, the Huthis will come over, take over the central bank and arrest my staff". … The central bank's leadership was in a very peculiar position.[25]

[20] Notes on file with Crisis Group.
[21] In July 2015, the Huthi-Saleh authorities in Sanaa unilaterally liberalised the fuel sector, ending subsidies and allowing the private sector, in effect, to replace the government in the state-dominated business of importing and distributing fuel, easing pressure on authorities in Sanaa to pay subsidies. See Abubakar al-Shamahi, "Yemen returns full circle as Huthis end fuel subsidies", *The New Arab*, 28 July 2015.
[22] Crisis Group interviews, former central bank officials, New York and by telephone, January and February 2021. See also Yara Bayoumy, "Exclusive: Yemen's central bank denies irresponsible use of external reserves", Reuters, 8 August 2016.
[23] Crisis Group telephone interviews, former central bank officials, April and May 2021.
[24] Crisis Group telephone interview, former official in the UN envoy's office, New York, November 2021.
[25] Crisis Group interview, Yemeni economist, Washington, March 2021.

Seeking to sustain the bank's neutrality, some senior officials in Sanaa, Riyadh and Aden, including Prime Minister Bahah, proposed establishing a coordinating office outside of Yemen under bin Humam or someone else.[26] By mid-2016, however, Yemeni government officials in Riyadh had also begun discussions with their Saudi and Emirati counterparts about reconstituting the central bank in Aden under new leadership. UN, U.S. and UK officials warned that doing so could prove economically catastrophic because the Hadi government lacked the resources or manpower needed to operate the bank. But they said they remained hopeful that UN-led talks in Kuwait between the government, the Huthi-Saleh alliance and the Saudis would resolve differences between the two sides.[27] As discussed below, those talks ended without producing a settlement in August 2016.

B. *The Saudi Blockade and the UN Verification Mechanism*

Control of Yemen's inbound trade also became caught up in the war during the conflict's first months. When, in March 2015, Saudi Arabia launched a naval blockade of Yemen's ports, diplomats scrambled to ensure that food, fuel and other basic goods could still get into the country.[28] The Saudis said the blockade was meant to stop the Huthis from acquiring Iranian weapons smuggled aboard cargo ships. Foreign officials tried to reassure Riyadh that allowing imports into the Huthi-controlled Hodeida port would not facilitate such smuggling, citing intelligence that showed most weapons were coming into Yemen on dhows, small boats mooring in coves along the coast, rather than cargo vessels. The UN appointed a veteran official to negotiate design of an inspection system for commercial ships docking in Yemen, known as the UN Verification and Inspection Mechanism (UNVIM).

This mechanism, which became operational in May 2016, allowed more goods into Hodeida but did not remove all obstacles.[29] In 2015, Saudi Arabia had created a unit in its defence ministry charged with monitoring maritime and airborne trade entering Yemen, calling it the Emergency Humanitarian Operations Cell.[30] The Hadi government authorised the cell to inspect vessels and detain them in what is known as the Coalition Holding Area, off the Red Sea coast of Saudi Arabia, and to oversee their

[26] Crisis Group interviews, individuals involved in negotiating and maintaining the economic truce, Amman, Cairo, Oxford and by telephone, September 2019-May 2021. See also Noah Browning, "How Yemen's wartime central bank keeps country afloat", Reuters, 10 June 2016.

[27] Crisis Group telephone interviews, Western official, December 2020; Yemeni economist, March 2021.

[28] Saudi officials argued that the resolution retroactively justified their naval blockade of Hodeida and other ports, even as UN officials lobbied successfully for ships to be allowed to enter. See Crisis Group Briefing, *Instruments of Pain (I)*, op. cit.

[29] The inspection mechanism's design posed a challenge, because the Hadi government insisted that it not infringe upon its internationally recognised sovereignty. "In hindsight: The story of the UN Verification and Inspection Mechanism in Yemen", *Security Council Report*, September 2016. On one hand, UNVIM was an "integral part" of the UN, aimed to facilitate "the unimpeded flow of commercial items to Yemen", according to the UNVIM website. But according to the same source it also "provide[d] support to the legitimate Government of Yemen for verification and inspection of … shipments intended for Yemeni ports that are not under the control of the legitimate Government".

[30] "Letter dated 22 January 2016 from the Panel of Experts on Yemen established pursuant to Security Council resolution 2140 (2014) addressed to the President of the Security Council", UN Security Council, 26 January 2016.

passage into Yemeni waters once the government had signed off on shipments separately as part of the UNVIM regime.[31] Coalition naval forces under the government's authority often delayed ships in the holding area and subjected them to intrusive searches even if they had received UNVIM clearances.[32] Businesspeople accused government officials of soliciting bribes in exchange for approval of shipments.[33] Citing regular delays in approvals, the Sanaa-based Huthi-Saleh authorities argued that this tangle of requirements and protocols still constituted a blockade, or siege, of their areas.[34]

C. *2016-2017: Ending the Economic Truce*

By mid-2016, as UN-led talks in Kuwait teetered on the verge of collapse, the technocrats' economic truce had become untenable. In July of that year, the Huthis and Saleh's pre-2011 ruling party, the General People's Congress (GPC), announced the formation of a new Supreme Political Council to perform presidential duties in Hadi's place, as well as a National Salvation Government, including a new finance minister who under usual circumstances would have assumed the position of central bank vice chair.[35] Days later, the Hadi government's Aden-based prime minister, Ahmed Obeid bin Dagher, issued a letter to the International Monetary Fund (IMF) and major international private and state-run banks, informing them that bin Humam and the Sanaa central bank no longer represented the Yemeni state.[36] The Kuwait talks ended inconclusively in August.

With the Huthis taking measures to cement their authorities' status as de facto rulers in Sanaa, the Hadi government responded by seeking to loosen the rebels' grip on economic institutions. In September 2016, President Hadi announced that his government was relocating the central bank's headquarters to Aden and installing as its governor a close ally, Monasser al-Quaiti, who had served as finance minister in Riyadh since 2015.[37] But the announcement did not translate into tangible changes at first. The Huthis did not recognise the move, and central bank staff at the Sanaa headquarters continued work as normal. Moreover, the government did not initially have

[31] At first, UNVIM staff simply checked paperwork. But from November 2017 onward, after a series of Huthi missile attacks on Saudi Arabia, Riyadh again cut off shipping to Hodeida. In order to resume bringing in cargo, UNVIM agreed to perform physical inspections of ships. UNVIM officials note that, as of September 2021, none of their inspections has turned up illicit weapons. Crisis Group interview, UN official, Djibouti, March 2021.
[32] Crisis Group telephone interviews, traders, shipping industry official, February and March 2021.
[33] Salisbury, "Bickering While Yemen Burns", op. cit.
[34] Crisis Group interview, senior Huthi official, Sanaa, July 2019.
[35] Jaber Ali, "Yemen: Ansar Allah signs agreement with Saleh's party creating supreme political council", *Middle East Confidential*, 29 July 2016. Earlier, in April, Hadi had named the powerful military leader Ali Mohsen al-Ahmar as his vice president, in what many Yemeni insiders saw as a signal of a shift toward a more hardline approach to the conflict. Crisis Group interview, former Yemeni official, Abu Dhabi, November 2019. Crisis Group telephone interview, former government official, Cairo, March 2021.
[36] Letter on file with Crisis Group.
[37] "Yemen president names new central bank governor, moves HQ to Aden", Reuters, 18 September 2016. Quaiti was director of the state-owned Cooperative Agricultural Credit Bank at the time of his appointment.

access to the bank's SWIFT system, used to make international transfers. Nevertheless, over time, the government began to staff the Aden branch of the bank and sought to claim control of international accounts and the SWIFT code.

The government said moving the bank to Aden was necessary, in part because bin Humam's term was expiring, but the decision was made hastily and without planning.[38] President Hadi offered a strategic rationale, namely, that the move would help to cut funding to his rivals.[39] A former government official said:

> It wasn't very complicated. They wanted to turn the tables so that they had the money and the Huthis had none, and so that the Coalition wasn't on the hook to finance them in the future. But there wasn't a plan in 2016, there wasn't a strategy beyond that desire, to move the bank.[40]

The move also prompted speculation about Hadi's political intentions. The new governor primarily hired southerners to run the bank in Aden and elevated a number of staff from what had been a local branch of the central bank to senior positions, convincing some Yemenis that he was, in effect, building a southern institution to break away from the north. A central bank official said: "We honestly were unsure ourselves if this was going to be a central bank for the south or for Yemen as a whole".[41]

In 2017, the new bank started printing riyal notes in a new format, giving rise to additional rumours – propagated by some in the government camp – that it planned to remove from circulation the old currency used by the Sanaa central bank. (Government officials now deny that they ever considered that step.[42]) The government said the new notes would be used to pay salaries, but it did not publish either figures on how much money had been printed or an annual budget, complicating the task of tracking what it was doing with the notes.

Many, on both sides of the war, came to wonder if the government was trying to fully control Yemen's monetary policy to the detriment of the Huthi-run economy.[43] The Huthis in particular accused the government and the Saudi-led coalition of seeking to decimate the economy in order to starve the Huthis into submission. A senior official at the Huthi-run Sanaa Central Bank of Yemen said:

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[38] In the telling of government officials, as well as diplomats and international institution staff who discussed the matter with the government at the time, the government had no plan either to place bank staff in Sanaa under the new leadership in Aden or to replicate the bank headquarters' activities at the branch in the southern port city. Crisis Group interviews, diplomats, international financial institution official and former central bank officials, September, November and December 2020; March and May 2021.

[39] In an address to the UN Security Council, President Hadi argued that the central bank move was designed to "end the war by restricting the flow of funds to the militias". "Yemen-President Addresses General Debate, 71st Session", speech to the 71st Session of the UN General Assembly, 23 September 2016.

[40] Crisis Group telephone interview, former government official, December 2020.

[41] Crisis Group interview, New York, September 2017.

[42] Crisis Group interview, government official, New York, November 2011.

[43] "Moving the central bank to Aden, Saudi Arabia's card to recruit Yemeni people", *Yamaniyoun*, 4 October 2016 (Arabic).

> All economic sectors have been targeted by the coalition of the aggression against Yemen. They do whatever they can to destroy the economy in general. The coalition was planning the total economic collapse of the economy and government institutions so we would arrive at a state of hunger and violence.[44]

Saudi and government officials deny such claims. But the economy had clearly become politicised and was now more entwined than ever with the conflict.

D. *2017-2018: A Regulatory Vacuum*

By early 2017, the Hadi government and the de facto authorities in Sanaa had each taken measures to ease the financial burden of costly pre-war import and currency support mechanisms – in each case by drawing back from certain roles it had played. In August of that year, the government liberalised the foreign exchange sector by halting efforts to defend the riyal against the U.S. dollar by selling hard currency into the local market at set rates, building on bin Humam's earlier decision to allow the riyal to decline from 215 to 250 against the dollar.[45] The move protected the bank's dwindling foreign currency reserves but eroded the influence it had wielded over markets when it was the primary source of hard currency.[46] The de facto authorities in Sanaa and the government also each announced moves to open up the fuel import sector, hitherto largely monopolised by state companies.

Combined with the central bank rift, which seeded confusion over who set monetary policy, oversaw private banks and regulated money exchangers – tasks the government was ill equipped to do given its lack of skilled staff or presence on the ground – the rivals' new laissez-faire approach to the financial and import sectors created the perception of a regulatory vacuum.[47] Yemeni financial institutions and businesses thus became seen as riskier partners for their international counterparts. Foreign banks in particular were already alarmed by the UN arms embargo on Huthi leaders and former President Saleh, which they feared could be a precedent for the U.S. or other countries to impose their own bilateral punitive measures. After the central bank

[44] Crisis Group telephone interview, senior Central Bank of Yemen Sanaa official, Sanaa, November 2021.
[45] "Central bank in war-torn Yemen floats currency", Reuters, 15 August 2017.
[46] The central bank and another state-run bank were the main sources of foreign currency before the conflict, a position which gave them leverage with currency changers. The government also elected to leave the currency conversion rate for its budget, customs and other duties unchanged at 250 riyals to the dollar, in effect discounting the cost of taxes and duties, while creating still-unaddressed irregularities in its budgeting practices. See "The central bank publishes today's foreign exchange rates against the riyal", Yemen Press, 20 April 2016 (Arabic); and "The Yemeni central bank fails to maintain the exchange rate of the riyal against the dollar, and banks are threatened with bankruptcy", *al-Taghyir*, 4 April 2016 (Arabic).
[47] In July 2015, the Huthi-Saleh alliance's Supreme Revolutionary Committee fully liberalised the fuel market in its areas by ending fuel subsidies and removing the state monopoly over fuel imports previously held by Aden Refinery Company and Yemen Petroleum Corporation. The government sustained the monopoly in its areas until it announced its own fuel market liberalisation policy in June 2016, although it did not enforce this measure until 2018. When UAE-backed forces drove al-Qaeda affiliates out of Mukalla in April 2016, they introduced their own independent import policies, ending the state monopoly and applying lower customs duties than were in effect at Hodeida or Aden.

move, they accelerated a process of risk-averse compliance measures, cancelling many Yemeni businesses' accounts. For this reason, many Yemeni businesses lost access to correspondent banking relationships abroad, which are key to their ability to transfer funds to pay for imports and other associated services.[48]

Moreover, with oil exports having collapsed in 2015, Yemen was increasingly dependent on remittances from abroad, which in turn were subject to regular interruptions due to transfer agencies' concerns over sanctions and running afoul of money-laundering and counter-terror financing laws.[49] Remittances and imports are vital to ordinary Yemenis' survival. With foreign currency in short supply and the international banking sector increasingly leery of doing business with Yemeni partners, informal money transfer networks, known as the *hawala* system, filled the void.[50] Imports became a crucial cog in the *hawala* machine, as they could be moved from other countries into Yemen and sold into local markets for cash, effectively sidestepping formal money transfers. Since fuel was the highest-value import item and a dollarised commodity whose price was no longer set by local authorities, and the removal of subsidies had made competing in the local market more profitable, it became a high-demand, transferrable store of value.[51] "Fuel became better than gold", a Yemeni businessman said.[52]

By 2017, economic battle lines had been drawn around Hodeida in particular. Fuel imports represented a copious and stable source of revenue at the Huthi-Saleh alliance-controlled port.[53] In the view of government officials, the alliance's collection of taxes and customs at the port, particularly but not only on fuel, was tantamount to plunder-

[48] Molly Anders, "Aid to Yemen blocked by banks, suffocating local organizations, report finds", Devex, 9 February 2018.

[49] Ibid. Pre-war remittance transfers took place through a mix of Yemeni and international banks; conventional money transfer organisations like Western Union or MoneyGram, which work in tandem with the formal banking and money exchange sector; and smaller money exchange and transfer firms.

[50] *Hawala* is a money transfer mechanism that circumvents the formal banking sector. Businesses and individuals often perform these transfers by collecting money intended for transfer from one country to another and using the accumulated funds to pay for goods that are transported to a second country. These goods are then sold into local markets. The money made from the sale is handed to the recipients stipulated in the original transaction. A Yemeni banker explained: "There is a very basic story with transfers, which operate around a form of the *hawala* system. People live in Saudi Arabia, the Gulf countries, Asia and so forth. Everyone outside of Yemen is transferring money home using money exchangers. The money builds up money exchangers' accounts in the countries they [Yemeni expatriates] are in, and they transfer it to traders. When they sell their goods in Yemen, the traders give the exchangers the cash they owe them in Yemeni riyals, and [the exchangers] give the recipients of the remittances their money minus a fee. It is a very old story, a common practice for Yemenis". Crisis Group telephone interview, Yemeni banker, March 2021.

[51] In approximate dollar terms, fuel accounted for more than 42 per cent of all imports into Yemen in 2020, but for only 27 per cent of trade volume in metric tonnes.

[52] Crisis Group telephone interview, Yemeni businessman, Dubai, November 2020.

[53] By 2017, customs represented around 15 per cent of revenues collected by the Sanaa authorities, the majority from fuel entering Hodeida port. Customs data on file with Crisis Group. Fuel allowed for businesses in Huthi-Saleh-held areas to operate machinery. It also permitted electricity to be generated, goods to be transported and water to be pumped – all activities that the Sanaa authorities taxed, contributing some 80 per cent of Sanaa's revenues in 2017. Lastly, it let the Huthi-Saleh armed forces keep waging war.

ing state resources; for their part, the de facto authorities in Sanaa argued that they were simply fulfilling their governing duties.[54] Hadi government officials and the Saudi-led coalition further alleged that Iran was boosting Huthi revenues by sending fuel shipments to Hodeida via the United Arab Emirates (UAE) at low or zero cost, which the rebels could sell in the local market.[55]

The duelling monetary policies of the rival authorities also caused friction.[56] The deregulation of markets, and delays in the Saudi-led coalition making a promised large dollar deposit at the Aden central bank, had led to a depreciation in the riyal's value against the dollar.

From early 2017, the fall in the riyal-dollar exchange rate accelerated, prompting tit-for-tat accusations from the rival parties.[57] The Huthis argued that the devaluation stemmed from the government's printing of banknotes to fund its budget.[58] The Huthis further argue that from 2017 onward the government was receiving income from customs and fuel exports that could have been used to stabilise the economy but were instead being plundered.[59] For its part, the government accused the Huthis of manipulating the riyal by pressuring traders to sell notes in large quantities in order to artificially depress the currency's value so that they could profit when it returned to earlier levels.[60] The government also alleged that the high volume of fuel imports into Hodeida were being used to transfer Iranian funds to the Huthis, a claim both the Huthis and Tehran deny.[61] In reality, both parties were to blame: all these factors and more played a role in accelerating the country's economic collapse.

E. *2018-2019: Conflicts Converge*

Yemen's economic and military conflicts converged in 2018. In December 2017, the Huthis had killed their erstwhile ally, Saleh, after months of rising internal tensions. Calculating that the Huthis had been weakened by their continuing battles with Saleh loyalists, the UAE announced that it was reinvigorating its year-old military campaign along the Red Sea coast with the goal of taking the port city of Hodeida.[62]

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[54] "Yemeni minister says Houthis looting of central bank left state employees without salary", *Arab News*, 28 July 2020.
[55] The Huthis deny that they use Iranian fuel to finance their operations. But a 2019 UN panel of experts reported it had "identified a small number of companies, both within Yemen and outside, which operated as front companies" for the transfer of Iranian oil to Yemen at low or no cost at all to the Huthi authorities. "Letter dated 25 January 2019 from the Panel of Experts on Yemen addressed to the President of the Security Council – Final report of the Panel of Experts on Yemen", UN Security Council, 13 February 2019.
[56] "Volatility of the Yemeni riyal: Drivers and impact of Yemen riyal's volatility", ACAPS, January 2020.
[57] Amal Nasser and Alex Harper, "Rapid Currency Depreciation and the Decimation of Yemeni Purchasing Power", Sanaa Center for Strategic Studies, 31 March 2017.
[58] "Yemen's rial plummets as government and Houthis battle over banknotes", *Middle East Eye*, 9 January 2020.
[59] Crisis Group telephone interviews, senior Central Bank of Yemen Sanaa official, Huthi economic adviser, Sanaa, November 2021.
[60] Nabil Abdullah al-Tamimi, "Houthis' manipulation of currency prices threatens stability in Yemen", *Al-Mashareq*, 14 June 2019.
[61] Crisis Group telephone interview, Central Bank of Yemen official, Cairo, March 2021.
[62] "Saudi-UAE alliance launches fresh offensive on Yemen's Hodeidah", Al Jazeera, 18 September 2018.

From late 2016 onward, UAE officials had made three arguments for seizing Hodeida, claiming that with it under their control they could prevent Iranian arms smuggling through the port; secure the Red Sea shipping lanes from Huthi and Iranian attack; and be able to disrupt the Huthis' financing and logistical capabilities. This last point was, in Western officials' view, a way of suggesting that they would seek to wrest control of imports into Yemen via Hodeida from the Huthis, for whom it provided vital revenue. After the Kuwait talks' collapse in 2016, U.S. and British military officials, who rated the chances of success of a maritime assault on Hodeida poorly and worried that a battle for the city could deepen the humanitarian crisis, dissuaded the UAE from launching the operation.[63]

In parallel, the government began to discuss other plans to cut off the Huthis from revenues they earned from Hodeida, using its internationally recognised legal status as Yemen's sovereign authority. It was aided by Saleh loyalists, many of them senior members of the GPC (which as noted above was the pre-2011 ruling party), who left the important roles they had played in the Huthi-Saleh alliance and joined the anti-Huthi camp after Saleh's death.[64] Armed with economic expertise and knowledge of how the authorities in Sanaa raised revenues, they proposed a series of initiatives to weaken the Huthis' revenue collection capabilities and bolster the government's.

At the same time, the government sought to make itself a more reliable economic player and improve its governance. It increased the number of state salaries it paid, including some in Huthi-controlled territory.[65] It calculated that a battle for Hodeida, along with better security and service delivery in Aden, would lead Yemen's major businesses to move their headquarters to the interim capital, where the government could tax their profits.[66] In January 2018, Riyadh announced but held back disbursement of a $2 billion deposit for the central bank in Aden.[67] Government officials began to draft a series of conditions for access to letters of credit paid for through the Saudi deposit.[68]

Combined, a UAE-led takeover of Hodeida, an aggressive push to control fuel imports and remittance flows, and a recapitalised central bank could have dented the Huthis' ability to finance their operations in Sanaa while burnishing the government's economic governance capabilities. Some viewed the plan to sever the Huthis' revenue stream as designed mainly to improve the GPC's weakened position, rather than to bolster Hadi's.[69] Yemeni and foreign observers perceived an emergent if brutal eco-

[63] Crisis Group interviews, UK and U.S. officials, London and Washington, October and November 2016.
[64] Mohammed Ali, "Pro-government forces in Yemen bolstered by an unlikely ally", *Arab News*, 29 May 2018.
[65] Crisis Group interviews, Yemeni government officials, Washington and Cairo, April and May 2021. See also "The salaries of Hodeida employees, a decision by Hadi, a Saudi international welcome and a Huthi objection", *Al-Muqawama Post*, 28 December 2018 (Arabic).
[66] Crisis Group interviews, government officials, Aden, March 2019.
[67] "Saudi Arabia announces $2bn bailout for Yemen government", Agence France Presse, 17 January 2018. After a trial disbursal of $20 million in July 2018, Saudi Arabia and the Hadi government began to disburse the deposit that October, using an agreed-upon approval process for batches of payments.
[68] Crisis Group telephone interviews, government officials, February and March 2021.
[69] Some GPC insiders posited that Hodeida could become the party's new base of operations once the UAE-backed forces had seized it from the Huthis, making it a "GPC" city in the same way Sanaa had become a "Huthi" city. Crisis Group interviews, GPC officials, Cairo, Amman, UAE, 2018, 2019.

nomic strategy.[70] In line with comments from numerous other observers, a Western diplomat working closely on economic issues in Yemen at the time said:

> Moving the central bank to Aden was the first move in the economic war, but the real economic strategy was born in 2018. It was much bigger than anything Hadi could have come up with. The banks were essential to this part of the war, and so was Hodeida. You would get the revenues from Hodeida and then [once UAE-backed forces seized Hodeida from the Huthis] have the GPC bankers running things from branches in Hodeida, which is in the north, and move the whole economic infrastructure there.[71]

But the economic strategy floundered in the face of events on the ground. The Hodeida offensive did not take place. Amid the uproar over the Saudis' killing of Saudi journalist Jamal Khashoggi in October 2018, and fears of a humanitarian disaster voiced by Crisis Group and many others, the UN and U.S. intervened to stop a battle for the port and city.[72] Meanwhile, the central bank was unable to get access to the Saudi deposit until nine months after it was announced, also in October 2018, due to bureaucratic wrangling over the technical requirements for disbursal. By that time, the country was in the midst of a full-blown humanitarian and currency crisis.

F. *2019-2020: The Stockholm Agreement and Its Aftermath*

1. UN involvement

Before the Hodeida standoff, UN Envoy Martin Griffiths, who succeeded Ould Cheikh Ahmed in April 2018, had sought to avoid direct entanglement in economic disputes. He and his senior staff argued that their job was to end the war, not to get caught up in granular disputes over the minutiae of the economy.[73] But the agreement that he brokered to prevent a battle for the port city made such a stance untenable. In December 2018, Griffiths mediated a deal, the Stockholm Agreement, between the government and the Huthis, whose centrepiece, negotiated during indirect talks in Sweden, was a sub-agreement on Hodeida. The Huthis and the Hadi government committed to a ceasefire around Hodeida and neighbouring Red Sea ports, a redeployment of forces from Hodeida, an enhanced UNVIM inspection regime including a larger UN presence at Red Sea ports, and a new mechanism to collect port revenues and pay civil service salaries via the central bank branch in Hodeida, which the Huthis controlled.[74]

The agreement achieved the UN's primary goal – preventing a battle for Hodeida – but the text was loosely written and lacking in detail, particularly with respect to

[70] Crisis Group telephone interviews, Yemeni economic experts and Western diplomats, March and April 2021.
[71] Crisis Group telephone interview, Western official, April 2021.
[72] Bethan McKernan, "Yemen: Saudi-led coalition orders halt to Hodeidah offensive", *The Guardian*, 15 November 2018.
[73] Crisis Group interviews, senior officials in the UN envoy's office, March and October 2019; January 2020.
[74] "Stockholm Agreement", Office of the Special Envoy of the Secretary-General for Yemen, 13 December 2018.

the management of revenues generated at the Hodeida port.[75] The government interpreted the agreement as an assertion of its sovereign authority over Hodeida. Thus, it argued that it had the right to select the local security forces whom the agreement made responsible for securing Hodeida and its environs, and to control the central bank's Hodeida branch and hence port revenues.[76] The Huthis contended that the agreement stipulated that the existing police and coast guards (largely aligned with them) would remain in place following the withdrawal of rival military forces from Hodeida. The Huthis' interpretation was closer to the UN negotiation team's than was the government's.[77] But the government argued that what the Huthis wanted was an unacceptable violation of its sovereignty, as recognised in UN Security Council Resolution 2216.[78]

In brokering the Stockholm Agreement, the UN necessarily adopted a ceasefire-first approach to mediation on the basis that preventing famine was the absolute priority.[79] But perhaps because of the urgency of the task at hand, the text of the agreement was light on detail. It treated security and economic provisions as addressing technical problems, to be resolved by mid-level officials through follow-up negotiations. Yet these provisions touched upon the fundamental question of who should have sovereign state authority – the heart of the political conflict. Problems would thus arise when it was time to implement the deal.

Once the Stockholm Agreement was brokered, the UN envoy focused on restarting high-level political talks, leaving the deal's security and economic aspects to less senior officials to deal with. He and his senior-most political adviser continued to argue that the economy was not within their office's remit, and that economic disputes would be settled as part of a national political agreement that would come at a much later stage of the mediation process.[80] Although they had brokered an agreement that dealt directly with the economic conflict, this dimension of the hostilities was clearly of a lower order of priority than, for example, a military ceasefire or political talks, even if it was a barrier to political progress.

In January 2019, the UN Security Council passed Resolution 2452, establishing the Mission to Support the Hudayda Agreement (UNMHA) to observe the ceasefire and coordinate force redeployments outlined in the Hodeida provisions of the Stock-

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[75] The agreement reads: "The revenues of the ports of Hodeidah, Salif and Ras Issa shall be channelled to the Central Bank of Yemen through its branch in Hodeidah as a contribution to the payment of salaries in the governate of Hodeidah and throughout Yemen". But it does not clarify who would have authority over the bank branch despite the central bank split. Nor does it explain how salaries will be paid.
[76] See Crisis Group Middle East Report N°203, *Saving the Stockholm Agreement and Averting a Regional Conflagration in Yemen,* 18 July 2019.
[77] Crisis Group interviews, Huthi representatives, UN officials, December 2018; January 2019.
[78] Crisis Group interviews, government officials, December 2018; January 2019.
[79] The need for ceasefires – in Hodeida and nationwide – was also a major thrust of Crisis Group's writings at the time. See, for instance, Peter Salisbury, "Making Yemen's Hodeida Deal Stick", Crisis Group Commentary, 19 December 2018; Peter Salisbury, "Five Steps to Save Yemen's Stockholm Agreement", Crisis Group Commentary, 15 January 2019; and Crisis Group Report, *Saving the Stockholm Agreement and Averting a Regional Conflagration in Yemen,* op. cit.
[80] Crisis Group interviews, UN officials, Amman, 2019, 2020.

holm deal.[81] Although UNMHA was a special political mission with a Security Council mandate, in practice its head reported to the UN envoy and relied upon him for contact with senior political officials among both the government and the de facto authorities. It dealt mainly with military and security officials who needed signoff from these same political leaders to make decisions.[82] Staff from the special envoy's office, meanwhile, sought to initiate technical talks about a revenue collection and sharing mechanism.[83] But they, too, dealt mainly with technocrats who lacked decision-making power or direct access to senior leaders. Both processes were troubled from the start, as the rival parties sought to litigate the Stockholm Agreement's meaning. UNMHA staff quickly saw that their efforts to implement the deal would be impotent without renewed political dialogue.[84]

Problems with the Stockholm Agreement bled over into other areas. Throughout 2018, the special envoy's staff had repeatedly attempted to coordinate a face-to-face meeting between the Sanaa and Aden authorities over economic management in the hopes of reintegrating the central bank and restarting national salary payments.[85] But after the Sweden talks, they were forced by the deal and the parties to narrow their focus to the opaque and contested revenue-sharing provision outlined in the Stockholm Agreement. A meeting held in Amman in March 2019 ended inconclusively after a series of spats over control of the central bank's Hodeida branch.[86] Still, the UN envoy's office continued to see its mandate as primarily focused on achieving a political settlement rather than placing greater emphasis on questions of economic sovereignty that were multiplying and becoming ever larger obstacles to peace.[87]

2. Wresting control by other means

As international opposition to a battle for Hodeida had become more evident over the course of 2018, the government began to take legal measures to wrest control of the economy by other means, many of them proposed by the GPC economic experts who had split from the Huthis after Saleh's death. In September 2018, President Hadi issued Decree 75, which called for a newly formed economic committee to approve all fuel imports and for the central bank in Aden to oversee all dollar transactions tied to imports.[88] The committee also set more stringent criteria for approval of import licences.[89]

Government officials involved with this and other similar decrees argue that they were simply attempting to impose regulatory structures after a period of lawlessness

[81] "UNMHA, Hudaydah Agreement", UN, January 2019.
[82] Crisis Group interview, senior UNMHA official, New York, September 2019.
[83] Crisis Group telephone interview, UN officials, April 2021.
[84] Crisis Group interviews, senior UNMHA officials, March and May 2019; February 2020.
[85] Crisis Group telephone interview, UN officials, Amman, December 2020.
[86] Crisis Group telephone interviews, UN, Huthi and government officials, December 2020; February-March 2021. See also "Yemen warring parties hold fresh talks as Houthis withdraw from Hodeidah", Reuters, 13 May 2019.
[87] Crisis Group interviews, two senior officials within the UN envoy's office, March, October 2019, January 2020.
[88] "The Most Important Indicators and Results of the Implementation of Government Decree No. 75 of 2018 and Its Executive Mechanism to Control and Regulate the Trade in Oil Products During the First Quarter of 2019", Economic Committee, March 2019.
[89] Ibid.

that, among other things, had seen the riyal's rapid depreciation.[90] But businesspeople and other economic observers believed the new regulations sought to curtail the operations of Huthi-affiliated traders.[91]

Over the course of 2019, as the government sought to enforce Decree 75, it also introduced Decree 49; the latter required the payment of customs and taxes to the government before shipments entered Yemeni ports, which the Huthis claimed ran counter to Yemeni law.[92] A series of standoffs ensued over fuel imports into Hodeida. The Huthis pressured importers not to submit applications to the newly formed Technical Office of the Economic Committee, which authorised ships to move into Hodeida from the coalition's maritime holding area.[93] The government responded by blocking ships from entering the port even after they had received clearance from UNVIM, unless they followed the new rules.

Following the promulgation of Decree 49, Hodeida's fuel imports fell sharply, and fuel shortages soon became commonplace in Huthi-controlled areas.[94] Fuel prices almost tripled in some of these areas, from 7,300 riyals (about $12) to more than 20,000 riyals (about $33) per 20 litres.[95] By October 2019, the coalition was detaining fuel vessels bound for Hodeida that UNVIM had cleared for passage in the holding area but that had not complied with the new regulations for an average of just under 30 days.[96]

In September and October 2019, worried that fuel shortages and price hikes would deepen the humanitarian catastrophe, the UN envoy's team pressured the government to release some fuel shipments. In November, it negotiated a temporary revenue collection and sharing mechanism. Under the new mechanism, fuel importers were to deposit all customs and tax payments in an account at the central bank's Hodeida branch; the Huthis were to regularly provide UN-verified bank statements showing the funds remained in the account until such a time as the two sides could reach an agreement on salary payments, which on paper was the main sticking point for both sides.[97] In return, the government suspended the two decrees' enforcement.

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[90] Crisis Group telephone interviews, government officials, October 2018, October 2020 and February-March 2021.
[91] A month before announcing Decree 75 in July 2019, the government also banned imports from al-Hamriya port in Sharjah, UAE, as well as Iraq and Oman, arguing that shipments from these locations were of Iranian origin, in an apparent effort to hurt Huthi-affiliated traders. See also "The Yemen Review – October 2019, Economic Developments", Sanaa Center for Strategic Studies, 10 November 2018. An adviser to the government's economic committee said: "One of the reasons for Decree 75 was that most of the importers were Huthis, and it was Iranian fuel coming to Hodeida. They were trying to stop Iranian fuel coming in". Crisis Group interview, Cairo, March 2021.
[92] "Demanding to collect revenues in advance before it enters Hodeida is against Yemeni law. You cannot take taxes before unloading goods and merchandise. You can only collect revenues at the port," a Huthi economic adviser said. Crisis Group telephone interview, April 2021.
[93] Crisis Group telephone interviews, fuel traders, Dubai and Cairo, March and May 2021.
[94] Data on file with Crisis Group, provided by a private trade data collection firm.
[95] See "Yemen Economic Bulletin: Another Stage-Managed Fuel Crisis", Sanaa Center for Strategic Studies, 11 July 2020.
[96] C4ADS, a U.S.-based NGO, tracked waiting times in the Coalition Holding Area and in anchorage off Hodeida throughout 2019. Ships entering Hodeida during the standoff over Decree 75 and the implementation of the Hodeida Agreement in October 2019 had waited an average of just under 30 days in the Coalition Holding Area before being granted permission to enter Huthi-controlled waters.
[97] "Temporary arrangements for fuel imports to Hodeidah", note on file with Crisis Group.

Fuel flowed into Hodeida and prices fell, but the web of requirements governing fuel imports at the port grew more tangled.[98]

As the economic conflict escalated over the course of 2019, the government's economic strategy – and credibility – was further disrupted by tensions between Hadi loyalists and the Southern Transitional Council (STC), a self-styled government-in-waiting that seeks an independent southern Yemen. The two sides had clashed for several days in the streets of Aden in January 2018. Cooler heads prevailed but only for a time. In August 2019, STC forces fought a week-long battle that gave them near complete control of the government's temporary capital. The STC encircled but did not enter the central bank headquarters.[99] Despite Saudi-led efforts to broker a compromise between the two sides, the government subsequently has been unable to spend more than a few weeks at a time in Aden, departing during tensions with the STC and local protesters, while senior bank staff have in many cases chosen to operate from elsewhere in Yemen or even outside the country.[100] The government no longer controlled (and to this day does not control), in any meaningful sense, the temporary capital it had hoped to make Yemen's new financial and economic hub.

G. *2020-2022: Riyal Ban, Marib Battle*

Hopes that the UN mechanism would resolve the fuel standoff, or that a Huthi-Saudi back channel that reopened in September 2019 would signal the beginning of the end of the war, were soon dashed.

In December 2019, the authorities in Sanaa reintroduced a ban on new riyal notes printed by the central bank in Aden, delivering a blow to the economy in government-controlled areas.[101] The move came as Saudi Arabia's $2 billion deposit with the Aden bank, the government's principal tool for combating the currency's depreciation, began to dwindle, and the riyal began to lose value against the dollar in government-controlled areas.[102] Government officials had been hopeful that Riyadh would deposit more funds at the bank, which might have helped prop up the currency, but that did not happen. Media reports that the first tranche of currency had been mismanaged and an anti-corruption drive in the kingdom that ensnared senior Saudi military leaders

[98] In order to bring fuel into Hodeida, shipping companies had to pass UNVIM inspection before submitting documentation to an importers' association, which in turn would send the paperwork to the UN special envoy's office, which then would pass it on to a government technical office. Once the government had cleared a shipment, the Saudi oversight body would allow the ship to pass. Authorities in Sanaa and Hodeida would also need to give authorisation. Imports were subject to UN Resolution 2216, the Stockholm Agreement's terms and the UN-brokered temporary import mechanism, and also had to clear a series of legal hurdles imposed by Decrees 49 and 75, which the Hadi government lifted only partially.

[99] See Crisis Group Middle East Briefing N°71, *After Aden: Navigating Yemen's New Political Landscape,* 30 August 2019.

[100] "The Yemeni Central Bank almost doubles the interest rate to stop the decline of the riyal", Reuters, 19 September 2019.

[101] Ahmed Al-Haj, "Yemen officials: Rebel ban on banknotes stops gov't salaries", Associated Press, 31 December 2019. The Huthis had previously announced the ban in 2018 but had not enforced it widely.

[102] "Saudi Arabia injects $2bn to prop up struggling Yemeni economy", *Financial Times*, 17 January 2018.

involved in Yemen, among others, dampened Saudi interest in providing more funds to the government.

While nominally government-run areas made up more of Yemen's overall territory, the overwhelming majority of the country's population – more than 70 per cent – lived in Huthi zones of control. The Huthi ban thus essentially concentrated the new bills the government had printed since the beginning of the war in these much less populous areas, oversaturating the local currency markets that were starved of hard currency with riyals. The supply mismatch acted as an accelerant to the riyal's decline in government-controlled areas.

A military escalation in the north soon followed. In January 2020, skirmishes blew up into pitched battles between the Huthis and the government and its local allies in three northern governorates, al-Jawf, Sanaa and Marib. By March, the Huthis had seized al-Hazm, al-Jawf's provincial capital, and begun to push east toward Marib city, the government's last urban stronghold in the north, and nearby oil and gas facilities.[103] As the fighting intensified, the UN personnel who might otherwise have conducted face-to-face diplomacy had been grounded by the coronavirus.

In February 2021, the rebels stepped up their campaign in Marib and neighbouring governorates, and in September they started tightening the military noose around the governorate after seizing territory in its south.[104] A victory there would both provide supplies of fuel, electricity and revenue, and also, in the view of some Sanaa officials, allow them to export oil from Marib to a terminal at Ras Issa, north of Hodeida.[105] It would also deprive the government of significant funds and boost the Huthis' credibility among the population under rebel governance at Hadi's expense.

Overlap between the military and economic conflicts now became yet more significant. In February 2020, the Huthis stopped providing statements from the Hodeida central bank branch, later saying they had withdrawn funds to pay public-sector employees half their salaries amid a breakdown in negotiations over a salary payment agreement.[106] At the same time, the rebels reportedly purged remaining unaffiliated staff from senior bank positions, turning it into an entirely "Huthi" institution in the eyes of many officials, a charge the Huthis deny.[107]

In response, from June 2020 onward, the government intermittently halted approval for fuel shipments entering Hodeida, causing a steady decline in fuel entering the port and, as a result, a sharp price rise in Huthi-controlled areas despite falling global prices.[108] UN diplomatic intervention led to stop-start fuel shipment clearanc-

[103] See Crisis Group Middle East Briefing N°74, *Preventing a Deadly Showdown in Northern Yemen,* 17 March 2020.
[104] See Crisis Group Briefing, *After al-Bayda, the Beginning of the Endgame for Northern Yemen?*, op. cit.
[105] See Crisis Group Statement, "Crisis in Marib: Averting a Chain Reaction in Yemen", 22 February 2021.
[106] Crisis Group interviews, Huthi, government and UN officials, January-June 2021.
[107] Crisis Group telephone interviews, Yemeni businessmen, UN official, April 2021; September 2021.
[108] Fuel imports to Hodeida in January-May 2021 were only 15 per cent of imports over the same period in 2020. Diesel prices in Huthi-controlled areas increased dramatically during this period (rising $0.35/litre or 42 per cent in March 2021 versus March 2020, compared to a $0.17/litre rise in non-Huthi areas over the same period). The riyal's relative weakness in government-controlled areas masked the growing difference in fuel and food pricing in the two areas. In dollar terms, fuel

es in July and October-December 2020. But fuel import volumes at Hodeida continued to decline anyway as traders sought to avoid further disruption by shipping fuel to other Yemeni ports.

At the same time, infighting among the anti-Huthi ranks continued to hinder the government in imposing its will on the economy in areas under its nominal control. In April 2020, the STC declared self-rule in Aden, and surrounded the Aden central bank headquarters, although it did not enter the building. Two months later, the STC reportedly seized some 64 billion riyals in banknotes (more than $250 million at the exchange rate at the time) from bank authorities who were transporting them from Aden port to the central bank. Saudi Arabia again intervened, to prevent the bank's takeover by the STC, stationing its forces around the Aden bank's perimeter. In January 2021, the government again stopped most fuel shipments following a Huthi attack on Aden airport, in which a missile nearly struck the plane carrying Prime Minister Maen Abdulmalek Saeed's newly formed cabinet.[109] By mid-2021, fuel imports into Hodeida had slowed to a trickle.

Since early 2021, the economic and military conflicts have become yet more intertwined. In February and then again beginning in September, the Huthis made significant territorial gains in Marib and neighbouring governorates, getting closer to Marib city and the nearby Safer oil and gas facilities as well as a connected power plant. By mid-November, they controlled most of twelve of Marib's fourteen districts. As the Huthis moved deeper into the governorate, they became more vocal in arguing that life under their rule was superior to other parts of the country, fairer and more stable. They claimed that the government's local allies, particularly Islah, a Sunni Islamist party, were looting oil, gas and electricity, which the rebels said should be shared among all Yemenis, with the sharing controlled by the Huthis' de facto authorities.[110] They also burnished their reputation for responsible economic governance, for example by hastening to stabilise the riyal's value in areas they had captured.[111]

The government and their Saudi allies meanwhile sought new forms of economic leverage with the Huthis. In late 2020 and early 2021, officials from both governments lobbied the outgoing Trump administration to designate the Huthis a Foreign Terrorist Organization. In January 2021, in one of the administration's last acts, it obliged.[112] The designation's main effect would have been economic, forcing U.S. businesses to halt all commercial relationships with counterparts working in Yemen, diminishing trade flows and driving commodity prices up further. It would probably have achieved through legal means what the government and the coalition had earlier sought to do militarily – cut off Hodeida – but given businesses' risk aversion would also likely have curtailed trade to Aden, Mukalla and other nominally government-controlled

prices in Huthi areas were on average 70 per cent higher than in government-controlled areas in the first three months of 2021, whereas they were only 22 per cent higher in riyal terms over the same period.
[109] Nima Elbagir and Angela Dewan, "First fuel ship this year docks in Hodeidah as Saudi-led coalition relaxes blockade", CNN, 26 March 2021.
[110] Crisis Group telephone interview, Huthi supporter close to group's leaders, Sanaa, October 2021.
[111] Crisis Group telephone interviews, two local residents, Shebwa, October 2021.
[112] Bill Chappell and Colin Dwyer, "Trump administration moves to brand Houthis in Yemen a terrorist group", NPR, 11 January 2021.

ports, cutting off the government's nose to spite its face. In any event, the new U.S. administration of President Joe Biden quickly reversed the decision.[113]

The government, meanwhile, has struggled to cope with an escalating economic crisis in its own areas. But the government appears to have remained more focused on wresting control of the economy from the Huthis than on improving governance in the territory it controls. Since January 2021, protests have roiled Mukalla, Aden, Ataq and Taiz – the major cities under the government's control apart from Marib – over living conditions. The riyal fell to new lows against the dollar in Aden in December 2021, reaching a 1,700 to one exchange rate, despite the government having secured access to about $100 million held at the Bank of England and several hundred million dollars of IMF funding. The government responded by shuttering local exchange firms and asking foreign banks to freeze cooperation with a major Sanaa-based bank on the grounds that it refused to share data with Aden, and by auctioning limited amounts of hard currency on the local market. Aid officials saw the bank move in particular as disruptive to aid flows and an effort to strong-arm the UN into routing money via the Aden central bank.[114]

In early 2022, the government's situation appeared to improve and the Huthis' to worsen. Hadi's appointment of a new governor and board at the central bank, and rumours that a new deposit might soon be forthcoming from the Gulf states, led to a temporary rally in the riyal-dollar exchange rate to less than 1,000 riyals to the dollar, although by mid-January the rate had again sunk below 1,300 to one.[115] Around the new year, the Huthis were pushed out of Shebwa governorate by coalition-backed forces, the first time they had lost territory since they began their advance on Marib in 2020.[116] A Huthi-claimed drone attack on Abu Dhabi, finally, drew international ire and talk of new sanctions against the rebels.[117] But these developments have not yet changed the war's overall trajectory and are more likely to make the rivals entrench their positions in the economic conflict than seek compromise.

[113] See Crisis Group Statement, "The U.S. Should Reverse Its Huthi Terror Designation", 13 January 2021.
[114] Crisis Group telephone interviews, UN officials, INGO official, Amman, October 2021.
[115] "Yemen replaces central bank governor, deputy governor amid currency collapse", Reuters, 6 December 2021.
[116] Samy Magdy, "Yemeni government says southern province retaken from rebels", Associated Press, 1 January 2022.
[117] Ghaida Ghantous and Alexander Cornwell, "U.S. condemns deadly Houthi attack on Abu Dhabi; UAE reserves right to respond", Reuters, 17 January 2022.

III. Understanding the Impact of Economic Conflict

A. *The Conflict's Fallout*

Falling income was the main factor depressing ordinary Yemenis' purchasing power during the war's early years. As the economy contracted, many Yemenis lost full-time jobs and sought irregular alternative work, leading to a fall in household incomes and placing stricter limits on budgets for food and other necessities.[118] A series of additional shocks have since pushed basic goods out of reach for many Yemenis.[119] Among these are the cessation of many public-sector salary payments, natural disasters and the COVID-19 pandemic.[120]

The combined hunger-humanitarian crisis does not result from a lack of basic goods, such as food, clean water and medicine, which have been generally available, but from most people's inability to pay for such goods because of lower incomes and higher prices. Rising prices have been the primary problem since 2018. The economic conflict between the government and the Huthis has been an important contributing factor to the resulting increase in living costs. The World Food Programme estimates that the cost of the basic food basket purchased by an average Yemeni family has increased by more than 170 per cent over the course of 2020 and 2021 in government-controlled areas while increasing by 40 per cent in Huthi-held territory.[121]

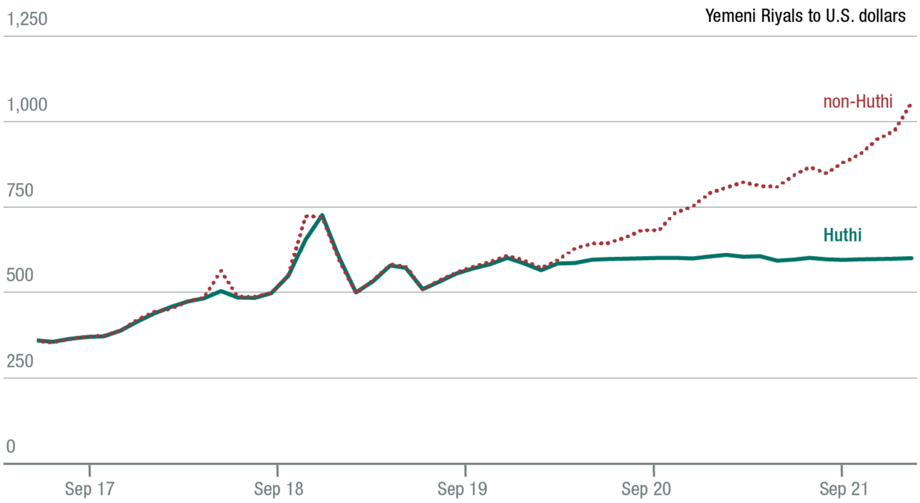
1. The currency split and its effects

The economic conflict's most visible effect is the growing divergence in the riyal's value in different parts of Yemen, which has in turn affected the price of basic goods like wheat and oil. This divergence was triggered by the above-referenced December 2019 Huthi ban on government-printed new-format banknotes. In effect, the move split the country into two economic zones: Huthi-held areas, where "old" riyals are the main currency available; and territory under the government's nominal control where "new" banknotes printed by the Aden central bank have circulated.[122] As Figure 2 shows, the riyal functioned as a single currency in both the Huthi and non-Huthi-controlled economic zones before January 2020. But as noted above, by November 2021, $1 traded for almost 1,500 "new riyals", while the U.S. dollar traded at less than 600 "old riyals" in Huthi-controlled areas.[123] Overall, the riyal has depreciated by about 64 per cent against the dollar since January 2015 in the Huthi-controlled eco-

[118] Sharad Tandon, "When Rebels Attack: Quantifying the Impacts of Capturing Territory from the Government in Yemen", *The World Bank Economic Review*, June 2019.
[119] Sharad Tandon, "Evolution of Poor Food Access over the Course of the Conflict in the Republic of Yemen", working paper, World Bank, April 2019.
[120] Ibid.
[121] "Yemen Food Security Update November 2021", World Food Programme, 21 November 2021. The update estimates that the cost of a "minimum food basket" rose from around 5,000 riyals in January 202 to 13,540 in November 2021 on average in nominally government-controlled areas; and from the same starting point to around 7,084 on average in Huthi areas during the same time period.
[122] "Volatility of the Yemeni riyal", op. cit.
[123] Data viewed via Yemen money exchanger WhatsApp group, May, June, July, October and November 2021. See Appendix A for detail on data sources and analysis.

nomic zone, and by more than 80 per cent over the same period in nominally government-controlled territory.

Figure 2. Riyal-U.S. dollar exchange rates by territorial control actor



Source: World Food Programme Price Data (https://dataviz.vam.wfp.org/economic_explorer/prices)

As mentioned above, the divergence in the value of riyals in the two zones derives in part from mismatched supplies of local currency and foreign exchange in those zones after the Huthi ban. Foreign currency has consistently been available in greater supply in Huthi-controlled areas than in the rest of the country. Most major banks, businesses and money changers are headquartered in Sanaa, the country's historical commercial hub, as are UN agencies and most major international non-governmental organisations, which transfer hundreds of millions of dollars per year into Yemen to fund their operations. As a result, most of the country's hard currency trade still moves through Sanaa, and businesses with foreign holdings are subject to Huthi oversight.[124] The Huthis' principal financial challenge since 2019 has been a liquidity crunch – their authorities lack the physical notes required to keep the economy in their areas running efficiently.[125]

The government's monetary challenges are the mirror image of the Huthis'. Growing income from oil exports and domestic oil and gas sales, and the now-exhausted 2018 Saudi $2 billion deposit, have proven insufficient as sources of foreign currency to cover even the modest volume of imports the government underwrites with letters of credit. Following the Huthi ban on newly formatted riyals, areas under the government's nominal control have also suffered from oversaturation of new banknotes. Making matters worse, to pay salaries and cover operational costs, the government has printed what some of its officials estimate is more than 3 trillion riyals in new banknotes since 2016, a doubling of the money supply compared to January 2015,

[124] The mismatch at least partly explains the government's preoccupation with coercing banks into compliance with its Aden-headquartered central bank's rules even as it struggles to provide stable governance in its areas.
[125] Crisis Group telephone interview, senior official at the Central Bank of Yemen Sanaa, November 2021.

when the central bank last issued money supply data.[126] The Huthis claim that the real figure is 5.32 trillion riyals, which would be a tripling of total money supply.[127] The rebels point to the government's money printing both to explain the riyal's decline and to justify their ban on the new notes, arguing that the new bills are part of a plot to "destroy" Yemen's economy.[128]

The government, in turn, blames the Huthis for the riyal's decline in the areas it controls and argues that it had no choice but to print the new bills in order to pay civil service salaries. It has repeatedly sought to shutter money exchanges it believes are working with the rebels to profit by pushing down the currency's value in areas they hold.[129] While there is likely truth to accusations of currency manipulation, the decision to fund the budget by printing new format bills, in particular, along with economic mismanagement, weak regulation and a general decline in economic output have played more important roles.

Indeed, confidence in the government's abilities as a monetary authority has fallen since the central bank move and the Saudi deposit.[130] Allegations that the government mismanaged the deposit, including a UN Panel of Experts report that alleged money laundering (the findings of which have since been placed under review), have further damaged the government's credibility.[131] As a result, many Yemenis are trying to dispose of unstable new banknotes, further weakening the currency.[132]

The government's appointment of a new central bank governor in December 2021, accompanied by rumours that Riyadh planned on making a new multibillion dollar deposit to the central bank, helped temporarily boost the riyal's value in December 2021 to around 1,000 riyals to the dollar.[133] Absent a new deposit and meaningful reform within the bank, however, the reprieve is likely to prove temporary.

[126] This figure appeared in the government's banking developments newsletter. "Monetary and Banking Developments, Jan. 2015", Central Bank of Yemen, January 2015. Crisis Group telephone interviews, government officials, February and May 2021.
[127] Crisis Group telephone interview, senior Central Bank of Yemen Sanaa official, Sanaa, November 2021.
[128] Crisis Group telephone interview, senior Central Bank of Yemen Sanaa official, Sanaa, November 2021.
[129] "Yemen shuts exchange firms in Aden as currency collapses", *Middle East Monitor*, 3 December 2020.
[130] Crisis Group interviews, Yemeni bankers, businessmen, government bureaucrats, Aden, Marib, Cairo, Amman, UAE, New York and by telephone, 2019-2021.
[131] "EXCLUSIVE: U.N. report accuses Yemen government of money-laundering, Houthis of taking state revenue", Reuters, 27 January 2021; "U.N. monitors backtrack on Yemen money-laundering accusations – document", Reuters, 29 March 2021.
[132] Businesses and ordinary Yemenis holding new riyals often buy old riyals to avoid depreciation and conduct trade with businesses in Huthi-held areas. They do so by working with money changers to first sell these riyals for foreign currency in government-controlled areas before using the hard currency to buy old riyals. Crisis Group telephone interviews, Sanaa residents, February-March 2021; businessmen based in Cairo and Dubai, December 2020-January 2021; Sanaa-based banker, April 2021.
[133] "Yemen replaces central bank governor, deputy governor amid currency collapse", Reuters, 6 December 2021.

2. Wheat prices

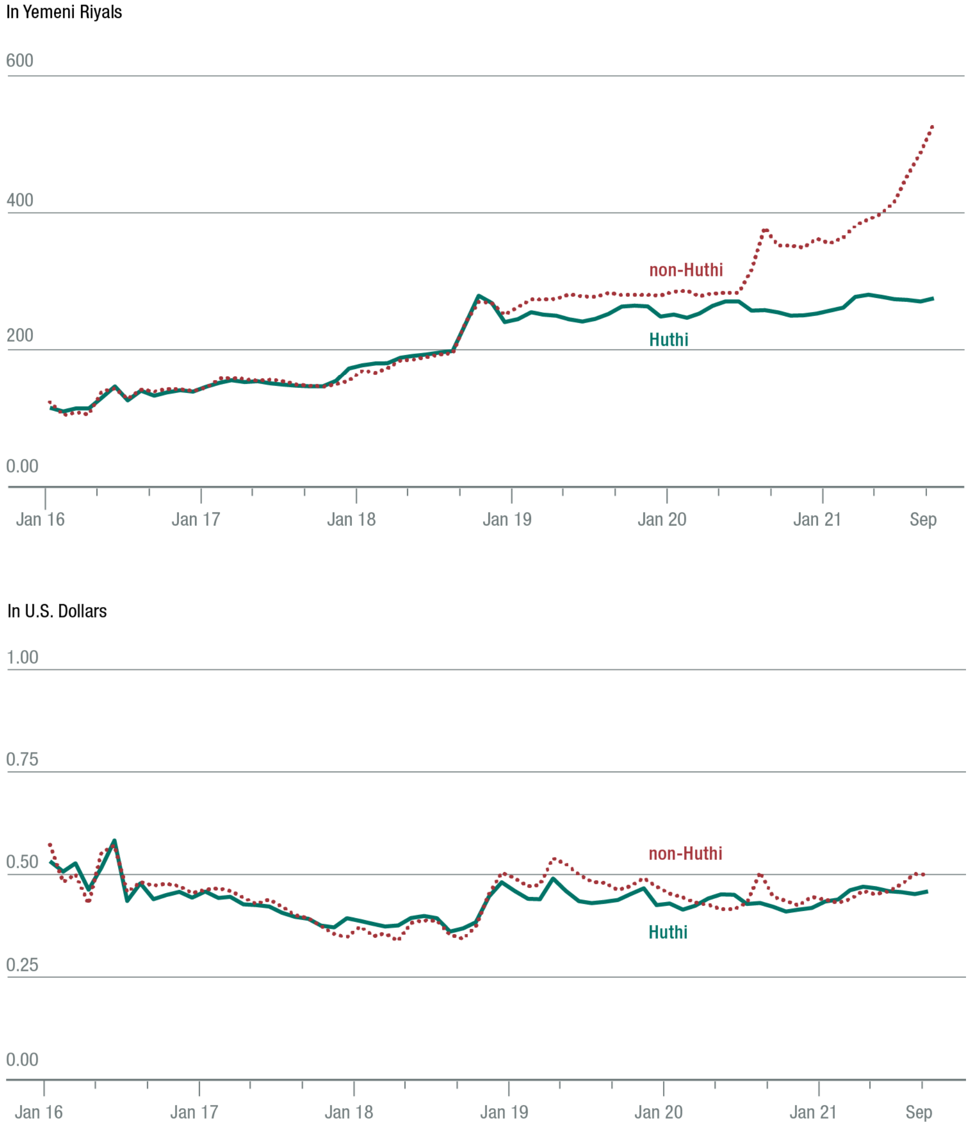
Changes in the price of wheat, more than 90 per cent of which is imported, show the impact of the central bank split on ordinary Yemenis. Consumers buying wheat in Huthi-controlled areas paid 4 per cent more in riyals in June 2021 than in November 2019, just before the currency split in two. But riyal wheat prices increased by 49 per cent in government-held areas during the same period. While four factors could contribute to rising wheat prices – reduced supply, higher global prices, profiteering and the depreciating riyal – the last appears to be the most important.[134]

The figures below illustrate the evolution of wheat prices in government-controlled areas. Before the Huthi ban on the new riyal note, local riyal-denominated wheat and flour prices largely moved in lockstep (Figure 3a). Since the ban, wheat prices have risen more sharply in areas under the government's nominal control than in those held by the Huthis. Wheat flour changed hands in government-held areas at a 22 per cent premium over its price in Huthi-controlled areas in April 2021. Prices have diverged in nominal riyal terms because of the currency's depreciation from late 2019. When market prices are converted back to dollars using local exchange rates that account for the different valuations of the riyal (Figure 3b), they continue to move roughly in unison and in line with market prices.[135] That is little comfort to ordinary Yemenis in government-controlled areas, however, whose buying power in riyals has been badly affected by the currency's decline in value.

[134] "Rising prices continue to make food increasingly unaffordable for many households", ReliefWeb, July 2021.

[135] Although wheat imports fell during the war's first year, they have since recovered to, and at times exceeded, pre-war levels. Import data on file from private trade data-gathering firm. Wheat prices increased by 21 per cent in dollars on global commodity markets between January 2015 and June 2021. But when local wheat prices in Yemen are converted from riyals to dollars at local exchange rates over the same period, they equate to a price decrease of 20 per cent in both Huthi- and non-Huthi-controlled areas. Yemeni businesspeople, traders and officials explain that the wheat market's relative cohesion is the product of pre-war import and distribution networks controlled by a small, oligarchic food-importing elite who have remained key players in the market. Before 2015, these businesses imported and milled wheat, then packaged grain and derivative products ranging from flour to biscuits. These businesses were headquartered in Sanaa, and used industrial infrastructure in Hodeida, Aden, Sanaa and Taiz's Hawban district, which is controlled by the Huthis. Import and distribution networks remain largely intact to this day. Even when wheat is imported to Aden or Mukalla ports, it is often transported to Huthi-controlled areas, where price controls are in place, and onward to Sanaa and Taiz. Not all food commodity prices fell in dollar terms; the cost of rice rose 44 per cent in Huthi-controlled areas and 11 per cent in non-Huthi-controlled areas over the same period (compared to an 11 per cent rise on global markets), while the cost of tomatoes, which are mostly grown domestically, fell 50 per cent in Huthi-controlled areas and 44 per cent in non-Huthi-controlled areas.

Figure 3. Wheat prices by control actor



Source: World Food Programme Price Data (https://dataviz.vam.wfp.org/economic_explorer/prices)

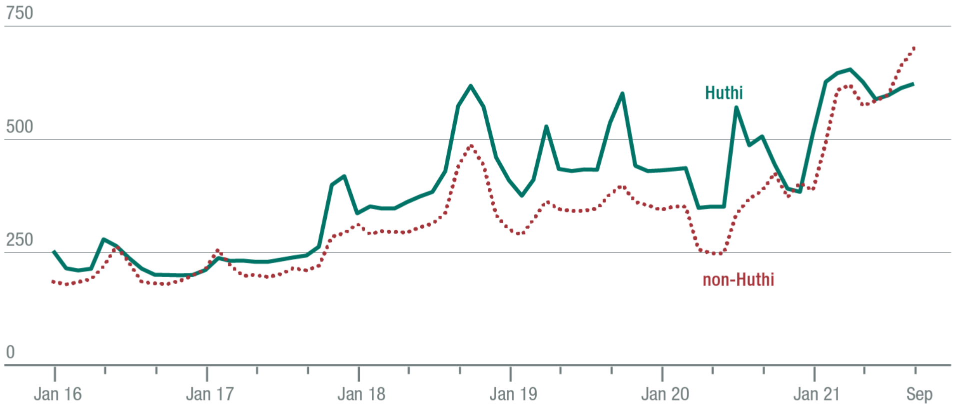
3. Fuel prices

After spiking in the war's early days, fuel prices normalised in 2016 but have risen since early 2017. Unlike wheat, fuel pricing was divided along lines of territorial control long before the Huthi currency ban. Whereas food import and distribution networks, which are operated mainly by private-sector actors, remain to this day tightly integrated at the national level, the historically state-run fuel supply chain fragmented down lines of territorial control early on.

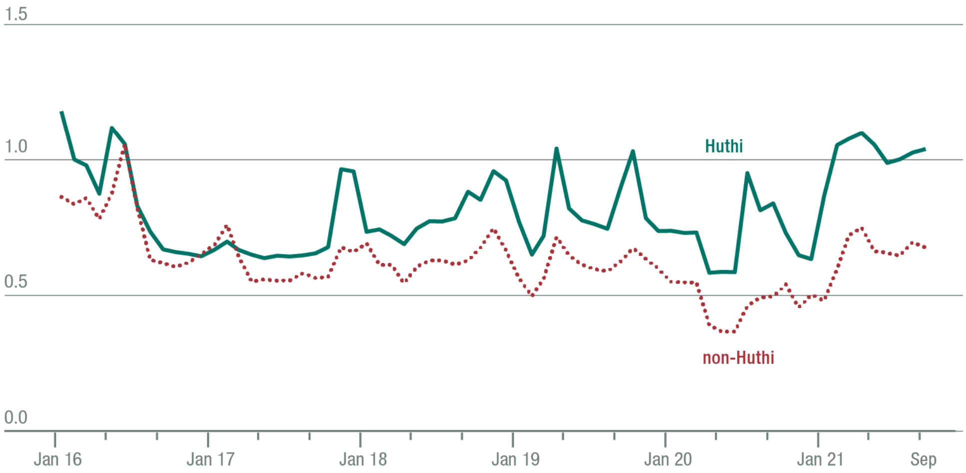
Also unlike wheat, the currency's divergence has served to mask – rather than highlight – the differences in pricing in the two economic zones. Riyal diesel prices have been significantly higher in Huthi-held areas since late 2017, with the gap growing consistently from early 2018 onward, coinciding with the Hodeida offensive and the battle over legislative control of fuel imports and currency. It appeared to close somewhat in riyal terms in 2020 and 2021 (Figure 4a), due to the currency's depreciation in government-held areas, but dollarised prices rose significantly in Huthi-controlled areas during this period. When diesel prices are converted to dollars (Figure 4b), prices in Huthi-held areas have risen 34 per cent since January 2018, but prices have fallen by 5 per cent in non-Huthi-controlled areas (versus a 10 per cent increase on international markets over the same period).[136]

Figure 4. Diesel price per litre by control actor

In Yemeni Riyals



In U.S. Dollars



Source: World Food Programme Price Data (https://dataviz.vam.wfp.org/economic_explorer/prices)

Traders, businesspeople and Huthi and government officials offer a range of explanations for this growing gap. The Huthis argue that higher prices in their areas are driven by shortages because of the coalition and government's restrictions on fuel imports at Hodeida port (widely referred to as the fuel embargo), rising shipping costs and demurrage fees imposed on coalition-held vessels, along with double taxation and transportation costs for the growing volume of fuel that first enters government-

[136] Figures from the U.S. Energy Information Administration website.

held areas and is later transported to Huthi-controlled territory overland.[137] The government and its allies claim that there are no shortages in Huthi-held areas and that higher prices stem from Huthi profiteering, a charge the Huthis deny.[138]

Each side appears to be partly correct. Imports into Hodeida in 2020 represented around 35 per cent of Yemen's diesel and motor gasoline supply, and 32 per cent of heavy fuel oil imports, a lower proportion of the total than in the war's early days when more than 50 per cent of all fuel entered via Hodeida. By October 2021, the volume of fuel imports entering Hodeida had halved compared to the same month four years earlier. Just 17 per cent of Yemen's fuel imports came into Hodeida in October 2021, compared to 43 per cent in October 2017, and the proportion was even lower earlier in the year.[139] This change has resulted from some re-routing of fuel and several short but sharp interruptions of delivery from Hodeida; these shocks to the supply chain can only have exacerbated fuel scarcity and therefore pushed up pricing in Huthi-controlled areas.[140]

Yet the government is correct in arguing that, until 2021, trade disruptions around Hodeida were limited; moreover, total fuel inflows to all Yemeni ports increased over the course of 2020 as importers rerouted shipments to nominally government-controlled Aden and Mukalla ports. They were higher in the first ten months of 2021 than the same period in 2019, which should have eased the pain of disruptions at Hodeida.[141] It also seems that the Huthis themselves were responsible for some fuel shipment delays at Hodeida: during August and September 2019, the Huthi authorities at the port held ships in anchorage for an average of almost eleven days in what some traders claim was a rebuke to importers who were complying with government regulations.[142]

Statistical analysis of territorial control and diesel prices suggests that, when all other factors are held equal, Huthi control of a district is associated with a 67 per cent increase in the cost of diesel in dollar terms, compared to what the price would be in the same district if controlled by the government or other local actors.[143] Yet an examination of monthly fluctuation in fuel prices in key Huthi-controlled markets

[137] Crisis Group telephone interviews, Huthi official, February 2021; Huthi official, April 2021; Huthi supporters and affiliates, April and July 2021; senior official at the Central Bank of Yemen Sanaa, November 2021. See also, "The Saudi occupation prevents the entry of commercial ships and fuel to the port of Nishtun", *al-Masira*, 19 October 2020 (Arabic).

[138] The government's Supreme Economic Committee claims that 60 per cent of fuel imports to Aden and Mukalla found their way to Huthi-controlled areas in 2020, rising to 70 per cent by mid-2021. Crisis Group interviews, government official, Riyadh, March 2021; Economic Committee official, Cairo, January 2021. See also Aziz Al-Ahmadi, "Houthis blame Saudi-led coalition for Yemen crises", Anadolu Agency, 1 February 2021.

[139] Data provided by a private trade data-gathering firm. On file with Crisis Group.

[140] An unpublished World Bank paper argues credibly that supply chain disruptions have played a significant role in driving economic insecurity in Yemeni households over the course of the conflict. On file with Crisis Group.

[141] Fuel import volumes for the first four months of 2021 increased compared to the same period in 2020. Data provided by a private trade data-gathering firm. On file with Crisis Group.

[142] Several fuel tankers were forced to wait for as many as 29 days in April-December 2019, despite Huthi claims of urgent fuel shortages. Figures compiled by C4ADS, a Washington-based NGO. On file with Crisis Group.

[143] For methodology, see Appendix A.II.

casts doubt on the Huthi claim that the cost differential is purely due to shocks to the Hodeida fuel supply. While such a shock appears to have caused fuel prices to jump in Sanaa during the initial naval blockade in 2015 and then during a short November 2017 supply interruption caused by an announced Saudi blockade of Hodeida, there was a persistent if much narrower gap between prices in Huthi-controlled and other areas of the country throughout periods when there were no such blockade-induced shortages (Figure 4).

In general, high fuel costs in Huthi-controlled areas appear to result from a combination of factors, of which the embargo is only one. These include higher global prices, the riyal's depreciation, supply disruptions because of the embargo, double taxation (because fuel is being taxed at the port of entry and then at Huthi-controlled inland customs points), higher transport costs and, more than likely, Huthi profit seeking through increased retail prices.

B. *The Hodeida Strategy and Its Failings*

The Hodeida fuel embargo has brought some financial and other benefits to the government, generating relatively small amounts of customs revenue and forcing the Huthis to depend on supply lines traversing territories its rivals control. At the same time, it is also demonstrably not helping weaken the Huthis financially or economically; it is most visibly rebounding on ordinary Yemenis. But the government, rightly or wrongly, believes that the Hodeida embargo provides it with much-needed leverage over the Huthis, even as its own international image, and that of Saudi Arabia, is increasingly tarnished by what appears to be the collective punishment of the twenty million or so Yemenis living under Huthi rule.

Imports entering Hodeida declined over the course of 2021 as the result of both government regulations on imports and the fuel embargo. On average, Hodeida accounted for 8 per cent of Yemen's fuel imports in the first ten months of 2021, a sharp decline from previous years.[144] Ports under the government's nominal control, principally Aden and Mukalla, benefited from the Hodeida decline. By October 2021, Aden accounted for more than 60 per cent of all fuel entering Yemen.[145] The government earned 100 billion riyals from duties levied on fuel in the first six months of 2021, according to a senior government official.[146] At local exchange rates, this sum would be equivalent to about $100 million, or $16.6 million per month, and should net the government roughly $200 million for the year from these ports. The sum compares favourably to the 120 billion riyals the government says it earned from fuel imports in the entirety of 2020. Government income is now similar to what Hadi officials believe the Huthis earned from fuel taxes and customs at Hodeida port in 2019 and 2020.[147]

[144] Data provided by a private trade data-gathering firm. On file with Crisis Group.
[145] Ibid.
[146] Crisis Group telephone interview, government official, July 2021. Also note on file with Crisis Group.
[147] The Huthis recorded revenues of around 39 billion riyals in the joint account at the Hodeida central bank during the four months when the temporary fuel mechanism was in place, or $16.25 million per month at the prevalent exchange rate in Huthi-controlled areas. Crisis Group telephone interviews, government official and UN official, July 2021. Also note on file with Crisis Group.

But the victory is likely hollow, as it is unclear how much of this income accrues to the government, given that the Aden and Mukalla ports are controlled by local forces that in the past hung on to local revenues.[148] Moreover, as a former government official noted: "I doubt that either a few weeks without fuel or $200 million a year is going to change the course of the war. It's a small victory at a big political cost".[149]

Furthermore, the embargo has not damaged the Huthis operationally, in large part because fuel appears to be flowing into Huthi areas despite the falling volume of imports to Hodeida. Since it began, the Huthis have made significant territorial gains.[150] In 2020 and 2021, a number of allegedly Huthi-affiliated fuel importers began to bring in quantities of fuel via nominally government-controlled ports at Aden and Mukalla.[151] Traders and local merchants report seeing large volumes of fuel being transferred from government-held ports to Huthi-controlled areas. Because fuel prices are higher in the Huthis' economic zone and the old riyal is largely stable there, merchants in government-held areas, where prices are lower and the currency is less stable, have a strong incentive to sell fuel into Huthi-controlled areas.

Nor is the embargo hurting the Huthis' financial bottom line. Senior officials in Sanaa say customs, tax and other revenues are largely unchanged in 2021 compared to 2020.[152] The government's focus on customs revenues fails to take into account how the Huthis make money. The rebels' economic power increasingly derives from controlling the country's main population centres, as well as their ability to control and set prices in local markets. Huthi-controlled areas are home to around 70 per cent of the country's population (10 per cent in Sanaa alone), if not more, and hence its major markets.[153] Moreover, the Huthis operate something akin to a police state in northern Yemen, exerting strong control over locals including businessmen. This degree of control over their areas allows the Huthis to regulate prices in local markets in a way the government cannot match.[154]

A Yemeni researcher characterised the Huthis' zone of control as a "walled garden", noting that ironically the more isolated Huthi areas are, the more influence the group has over the local economy, and the greater freedom it has to extract money via taxes and sales of goods like fuel at a markup.[155] This control has also allowed them to set prices for fuel to their benefit. In July 2018, the Huthis reversed their above-

[148] Crisis Group interviews, government officials, central bank staff, local authorities, Aden, Mukalla, Marib and by telephone, March 2019; January, October and November 2020; and February-March 2021.
[149] Crisis Group telephone interview, Yemeni researcher, January 2021.
[150] See Crisis Group Briefing, *After al-Bayda, the Beginning of an Endgame for Northern Yemen?*, op. cit.
[151] Crisis Group review of data held by a private trade data-gathering firm comparing shipment financiers, with note on file outlining major Huthi fuel importers.
[152] Crisis Group interview, senior official at the Central Bank of Yemen Sanaa, November 2021.
[153] Based on Crisis Group estimates comparing district-level control with data provided by the Integrated Food Security Phase Classification Population Tracking Tool.
[154] The government's economic strategy of wresting control of the economy from the Huthis would have worked, a former senior central bank official said wryly, had it only pulled off the impossible feat of moving "this 70 per cent of the population from Huthi areas to Aden". Crisis Group telephone interview, former senior central bank official, April 2021.
[155] Crisis Group telephone interview, Yemeni researcher, January 2021.

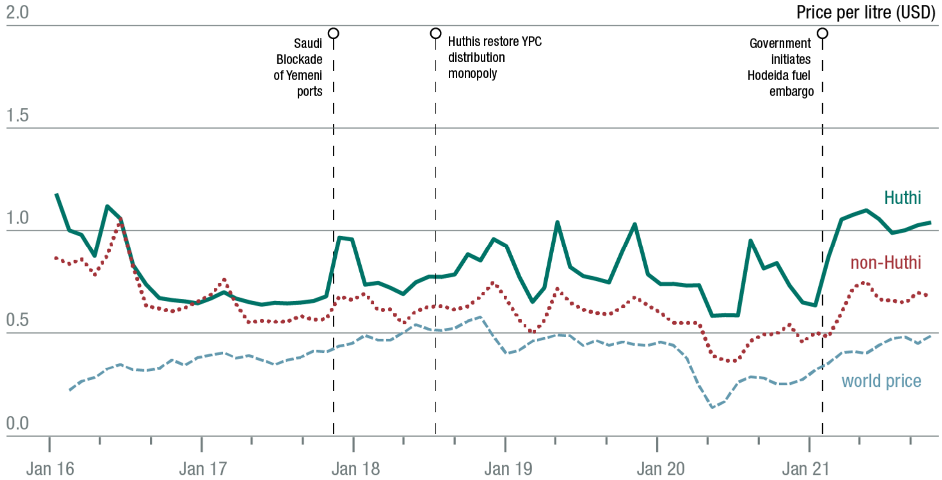
referenced earlier liberalisation of fuel markets, ending the private sector's role in selling fuel to consumers. The Huthi-controlled Yemen Petroleum Corporation, restored as the sole authorised distributor in Huthi areas, began paying importers a set price for fuel shipments arriving at Hodeida and internal customs points. It sells the fuel at its own gas stations.

The Huthis also play an important role in setting prices in a grey market that operates alongside formal state-run fuel stations. Grey market vendors who would not be able to operate without the Huthis' tacit approval maintain supply at informal locations during shortages, selling fuel at significantly higher prices than are charged at state-run fuel stations. As a result, the Huthis now control, and profit from, each link in the fuel supply chain.

Since restoring the Yemen Petroleum Corporation's fuel distribution monopoly, the Sanaa de facto authorities have generated more revenues from selling fuel directly to consumers than from customs duties, taxes and other fees levied at Hodeida combined.[156] During this period, the dollar margin between global fuel prices and the cost at Huthi-controlled gas stations has widened (Figure 5). Conservatively, the Huthis earned around $524 million from taxes and other fees on fuel and point-of-sale revenues for diesel and gasoline in 2020.[157] This amount is more than half of all revenues the Huthis reported collecting in 2019.[158] The bulk of Huthi fuel income in 2020 and 2021, in other words, likely came not from taxes and fees at Hodeida, but from their control of the supply chain and sales via the Yemen Petroleum Corporation and the parallel market.

[156] Based on a wide range of official statements, publicly available data and data gathered by private sources shared with Crisis Group. The Huthi authorities earned approximately $40 million from taxes, customs and other fees levied on diesel imports entering Hodeida in 2020, whereas the total profits earned by the Huthis on diesel imported to Hodeida were an estimated $220 million. Supply-chain revenue figures are based on official fuel prices, which are often significantly lower than prices in the parallel market; actual income generated through fuel sales in Huthi-controlled areas is likely significantly higher. Residents of Huthi-controlled areas note that fuel is available on a Huthi-sanctioned parallel market at a significant markup from prices at fuel stations run by the Huthis' de facto authorities, generating much higher revenues than Crisis Group estimates, which are based on official local prices. Crisis Group telephone interviews, Huthi-controlled area residents.
[157] This figure is based on a conservative estimate of point-of-sale revenue and liberal estimates of transportation and other distribution costs; it tallies with estimates made by ACAPS. See Appendix A.III for further detail on assumptions and methodology.
[158] The Huthis have not released an estimate of revenues for 2020.

Figure 5. Diesel price per litre by control actor versus world price in U.S. dollars



Source: World Food Programme Price Data (https://dataviz.vam.wfp.org/economic_explorer/prices)

Huthi officials and supporters deny that their side has artificially inflated prices in the areas the group controls, citing transportation costs and double taxation as explanations for the price hikes.[159] But the Huthis' account of the fuel price dynamics in their areas does not add up entirely. Even when these factors are accounted for, at a minimum the Huthis have been able to maintain an income from fuel in 2021 similar to 2020 despite the Hodeida embargo, negating its effects. Using the same estimates above, which account for transportation costs and double taxation, Huthi revenues from diesel and gasoline imports and sales were $219 million amid rising prices in their local market in the first four months of 2021.[160] If the Sanaa authorities were to sustain similar revenues through 2021, they would earn an estimated $657 million over the course of the year, a $153 million, or 29 per cent, increase over 2020.[161]

Thus, by disrupting supply into Hodeida, the government did little to benefit itself financially and made itself the scapegoat for supply shortages, even if they were partly manufactured by the Huthis, and price hikes that were not in fact wholly its fault. In a war that is often fought through narratives, the Huthis have been able to come out on top by telling a story of victimhood. At the same time, Huthi income may well have increased as a result of its actions in the face of the Hodeida embargo. The government now finds itself in a bind: if it allows trade to flow freely through Hodeida, the Huthis will likely benefit economically while cutting the cost of living in its areas,

[159] Crisis Group telephone interviews, Huthi officials, October 2021; Huthi supporter with ties to the leadership, October 2021; senior official at the Central Bank of Yemen Sanaa, November 2021.
[160] See Appendix A.III for further detail on assumptions and methodology.
[161] In their efforts to prove that the fuel embargo should not have led to higher prices in Huthi areas, Hadi officials claim that 60 per cent of fuel entering ports under the government's nominal control was transported into Huthi territory in 2020, a figure they say rose to 70 per cent by mid-2021. If correct, these government estimates indicate significantly higher Huthi profits from fuel sales than Crisis Group's conservative estimates: a potential $697 million in 2020 (33 per cent higher) and a potential $996 million for 2021 (52 per cent higher). Under these assumptions, Huthi fuel-related profits would have increased by $329 million or 47 per cent year-on-year since the embargo began in earnest. See Appendix A.III for detail on calculations.

selling more fuel imported via Hodeida (albeit at a lower margin, if prices are cut to mollify the local population). But if it sustains the embargo, the Huthis can make large sums of money through the arrangements they have created in response, while blaming the government for higher prices as its international image is further tarnished.

C. *The Government's Weakening Position*

On the other side of the Huthis' garden wall, the situation in territory nominally controlled by the government is in deep disorder and may deteriorate further because of the Hodeida embargo and the Marib fight.

The combination of fuel shortages, the currency crisis and worsening humanitarian conditions is deepening divisions among anti-Huthi elements. Fuel and electricity shortages combined with a collapsing currency and the resulting skyrocketing cost of living in Mukalla, Shabwa, Aden and Taiz have led to sustained and often violent protests against government economic mismanagement. The STC has accused the government of waging a "war of services" in its areas, deliberately making conditions unbearable as a way to undermine its cause.[162] Protests by pro-independence southerners over the declining economy and a lack of services have in turn precipitated violence between government-aligned forces and STC supporters.[163]

Government authorities have tried to stabilise the situation but to little avail. In October 2021, the central bank in Aden initiated new measures to slow down the riyal's decline, including by suspending the work of exchange companies and releasing new banknotes into the market.[164] But continued volatility sparked widespread protests.[165] Crowds protesting the currency's decline in Taiz, where the government has previously enjoyed some support, called for President Hadi to be removed.[166]

Food insecurity also continues to rise. According to the World Food Programme, a similar proportion of the population in Yemen's two economic zones, just under 40 per cent, were not getting enough to eat in August 2020. By November 2021, this percentage was largely the same in Huthi territory and had risen to 48 per cent in non-Huthi areas.[167]

In addition to being a source of instability, the government's tensions with the STC and other anti-Huthi elements have undermined its efforts to convince big businesses to relocate to Aden (where authority is still unclear following the STC's August 2019 takeover, after which the STC physically controlled the city with the government maintaining a light-touch presence there) from Sanaa. The Hadi-STC spat comes on top of the business risks created by rampant inflation, currency depreciation and the possibility that relocating from Sanaa to Aden would mean severing ties with the

[162] Crisis Group telephone interview, STC official, May 2021. See also "Al-Zubaidi accuses the Yemeni government of waging a war of services and disrupting the Riyadh Agreement", Debriefer, 21 May 2021.
[163] Aziz Yaakoubi, "Temperature rising in south Yemen as rivalries fuel power shortage", Reuters, 7 June 2021.
[164] "Yemen… Central Bank suspends licences of 54 money exchange companies", Anadolu Agency, 16 October 2021 (Arabic).
[165] "Closure of exchange shops in Wadi Hadramawt", *al-Mushahid*, 13 October 2021 (Arabic).
[166] "Taiz… Hundreds protest against the deterioration of the local currency and demand the dismissal of the government", *al-Mahra Post*, 16 October 2021 (Arabic).
[167] World Food Programme data on file with Crisis Group.

Huthis, leaving businesses unable to operate in the country's biggest and most lucrative markets.[168]

While these developments have already eroded the government's position relative to the Huthis', the situation could deteriorate further still. If the Huthis were to seize control of Marib city or the nearby state-run oil, gas and electricity facilities, they would gain a significant economic advantage, as they could then profit from fuel and gas sales and reduce the hard currency cost of fuel imports for their areas. They would also be well positioned to improve their standing with the population living in areas under their control by bringing down the cost of fuel, improving the exchange rate, and providing regular electricity supply to Sanaa and its environs for the first time since the war began.

While the government is hardly responsible for all of the setbacks it has faced – and the fundamental causes of Yemen's economic and humanitarian morass are decades of economic mismanagement and corruption followed by seven years of brutal, destructive war – it has not always helped its situation. Diplomats, government officials, businesspeople and other Yemeni observers broadly agree that the government has consistently – and often counterproductively – put damaging the Huthis over getting its own house in order. In doing so, it has undermined the moral high ground it initially occupied in the eyes of partners as a result of its international legal status as Yemen's sovereign authority. The government has also faced repeated accusations of economic mismanagement, malfeasance and under-regulation.[169] The central bank reportedly lacks anti-money laundering and counter-terror finance capacity, making foreign banks and donors wary of cooperation.[170] Asked to sum up the challenges that faced his side, a former government central bank official noted wearily:

> The strength of the Huthis is the weakness of their enemy. When the government is not working well, the Huthis look good. And if the government continues to be weak, they will continue to look even stronger, and for this reason the war will continue.[171]

[168] Businesses making such a move might also be cut off from port facilities in Hodeida and the Hawban district of Taiz, which remains the country's industrial hub.
[169] "Yemen's central bank dismisses UN corruption allegations", *The Independent*, 28 January 2021. A January 2021 UN Panel of Experts report – since placed under review – accused the bank and Yemeni businesses of cronyism and fraud. "Final report of the Panel of Experts on Yemen", UN Security Council, S/2021/79, 29 January 2021. While the businesses named in the report, and the central bank, have denied the allegations, numerous bank officials argue that the panel's findings were broadly correct in their diagnosis of the problem, if not in labelling prevalent practices as money laundering per se. Crisis Group telephone interviews, government and central bank officials, February 2021.
[170] Sherine El Taraboulsi-McCarthy and Camilla Cimatti, "Counter-terrorism, De-risking and the Humanitarian Response in Yemen: A Call for Action", Overseas Development Institute, February 2018.
[171] Crisis Group telephone interview, central bank official, March 2021.

IV. Diplomatic Doldrums

From early 2020 onward, the UN sought to deal with two interlinked problems with deep economic dimensions: the Huthi offensive on Marib and the continued standoff over Hodeida.

As the battle for Marib waxed and waned in early 2020 and the coronavirus spread, the UN redoubled its efforts to at least bring a temporary halt to the war. At the time UN Secretary-General António Guterres called for a global ceasefire to allow for a coordinated international response to the COVID-19 pandemic on 23 March, his special Yemen envoy, Martin Griffiths, was attempting to negotiate a cessation of hostilities around Marib.[172]

Mismatched expectations and hostility from both sides hampered the effort from the outset. The government, which at the end of 2019 had argued against further "single-issue" agreements with the Huthis in the mould of the Stockholm Agreement that had fended off a battle for Hodeida the previous year, demanded a unilateral Huthi ceasefire and withdrawal from areas the movement had seized since the beginning of the year. The government also, at first, refused reciprocal concessions.[173]

The Huthis, for their part, made it clear that they were similarly uninterested in limited deals like the Stockholm Agreement. They stipulated instead that any future agreement include a comprehensive roadmap for ending the war and initiating political talks over the country's future. They demanded, as they have since the war's early days, that any ceasefire include an end to what they term the siege of their areas (the closure of Sanaa airport and restrictions on trade flows into Hodeida) which they see as part and parcel of the Saudi-led coalition war effort.[174]

Over the course of 2020, UN Envoy Griffiths and his team sought to broker a deal that packaged the government's call for a ceasefire, the Huthis' demands for the end of what they termed the siege of the Hodeida ports and Sanaa airport, and the mediators' own hopes for national political talks into a single initiative: the push for a Joint Declaration that would achieve these goals.

The UN proposal called for a nationwide ceasefire first, including a halt to aerial and maritime attacks, to come into effect within 72 hours of the document's signing by both parties.[175] The agreement also stipulated what the UN described as humanitarian confidence-building measures: the formation of a joint cell to work on a coordinated response to COVID-19, and for the release of prisoners of war and other detainees held by the parties over the course of the war. It also laid out a series of further eco-

[172] "Yemen: UN envoy calls for 'immediate and unconditional' freeze on military activities", UN News, 7 November 2020.
[173] Crisis Group interviews, senior Yemeni government officials, Amman and Cairo, September 2019 and January 2020. See also Khaled Al-Humairi, "The Yemeni government calls for a ceasefire and opening of the crossings in Hodeida", *al-Mushahid*, 14 July 2019 (Arabic).
[174] Crisis Group interviews, Huthi representatives, Sanaa and Muscat, March, July and October 2020.
[175] Shuttle negotiations during this period yielded multiple drafts of an agreement. Two drafts, one in English, the other in Arabic, from August and September 2020, respectively, are on file with Crisis Group. The ceasefire would be overseen by a Military Coordination Committee, made up of military representatives of both parties and chaired by the UN, and would in turn form governorate-level ceasefire committees. As part of the ceasefire, the agreement also calls for the reopening of access roads throughout the country, notably those around Taiz city, Hodeida, Marib, Saada and al-Jawf.

nomic confidence-building steps: first, a framework for a joint salary payment mechanism, to pay civil servants across the country regardless of controlling authority, which also had been part of the Stockholm Agreement; then, an end to restrictions on imports entering through Hodeida; and lastly, a plan to reopen Sanaa International Airport to commercial flights.[176]

During shuttle negotiations that began in March 2021, the government at first rebuffed the UN proposal, seeing it as attempting to relitigate the Stockholm Agreement in favour of the Huthis, and concerned about what they perceived as Huthi efforts to use the deal to secure legal authority over the ports and airport.[177] The Stockholm Agreement talks had left Yemeni officials wary of UN negotiators' use of "creative ambiguity" to forge the impression of consensus.[178] The Huthis and the government had left Sweden with wildly different interpretations of the deal, which each claimed was supported by the way UN negotiators had represented what they were agreeing to. Both sides soon had misgivings about the vague language used in the final text and lack of a dispute resolution mechanism.

While shuttle negotiations over the Joint Declaration had largely ground to a halt by late 2020, in February 2021, the new Biden administration gave mediators some reason for hope when it threw its weight behind UN efforts.[179] At first, UN officials thought that U.S. pressure on Riyadh might convince the Saudis to lean on the government to make concessions on the ports and airport. Yet it quickly became clear that by the time the Biden administration got behind the initiative, it was already dead in the water.

At present, the parties' positions are far apart. For their part, the Huthis have suggested they will consider talks about a nationwide ceasefire after a separate agreement that ends restrictions on Hodeida port and leads to Sanaa International Airport being reopened. The Huthis have also been clear that when they speak of negotiating a ceasefire, they mean a halt to the cross-border war with Saudi Arabia and other coalition partners and the departure of foreign troops from the Yemeni battlefield, but not a halt to the civil war that has manifested itself in front-line fighting in Marib and elsewhere. The government and Saudi Arabia consider this notion of ceasefire a non-starter.[180]

[176] Drafts of the Joint Declaration on file with Crisis Group.

[177] Drafts of the agreement show a progression from a broad agreement to "[p]romote and facilitate the entry of commercial container ships to Hudaydah port" in April 2020, to a more detailed description of "lifting restrictions on the entry of commercial container ships" that would mean cutting out the government and Saudi approvals of shipments once UNVIM had cleared them.

[178] Government officials claim the UN, misleadingly, had assured them that the Stockholm Agreement – which says undefined "local security forces" should take control of the city – provided for the government to regain control of Hodeida. For this reason, they say, they now insist on detailed agreements on the ports and airport, which the UN has been unable to deliver as part of its mediation efforts. They also reject what they see as the UN's overall approach to the talks, which, they say, assumes parity between the government and the rebels. Crisis Group interviews, government officials, Cairo, February 2021; New York, March 2021.

[179] Alexandra Stark, "Biden announced a major policy shift on Yemen. What happens now?", *The Washington Post*, 8 February 2021.

[180] Crisis Group telephone interviews, government official, January 2021; Saudi official, February 2021.

As for the Hadi government, it continues to resist proposals that it sees both as chipping away at its internationally recognised sovereignty, and as asking it to give up its remaining leverage with the Huthis for what government officials see no return beyond, at best, a temporary halt to a war it is clearly losing. The government perceives that its control over Hodeida port and the airport are among the few bargaining chips it has in negotiations with the Huthis. Perhaps because they lack any other form of leverage with the Huthis, government officials have resisted arguments from UN officials and other diplomats that the Hodeida fuel embargo is counterproductive, and that reopening Sanaa airport and lifting restrictions on Hodeida would in any event be reversible in the event of Huthi backsliding. They also appear unmoved by the backlash to the embargo that has mounted at the UN and in some quarters in Washington.[181] A government adviser told Crisis Group:

> We are not stupid. We are being asked to give up all of our leverage. And if we try and put these measures back afterward, we will be attacked and pressured not to do it. So, we will be handing our sovereignty over to the Huthis, and of course they will not stop at Marib.[182]

There are likely more fundamental reasons besides. Simply put, by mid-2021, many UN officials and diplomats saw the Huthi-government disputes over the contents and sequencing of the proposed deal as an excuse to avoid negotiations that neither side believes are in its interest. The Huthis have for some time believed they have the upper hand in the war and, until January 2022 at least, anticipated victory in Marib, which would strengthen their bargaining and likely leave the government mortally wounded.[183] Government officials fear that any negotiation that would lead to a compromise on government sovereignty over the country's ports and airports would spell the beginning of the end for President Hadi.[184] They also no doubt fear that Hadi will be removed as part of any national political settlement. Many foreign diplomats agree that the formation of a unity government, which is a principal political aim for the UN, is more likely to mean the absorption of Hadi government officials and local administrations into Huthi institutions than vice versa, given the government's weakness and the Huthis' relative strength.[185]

The UN and outside powers appear increasingly confounded by the question of how they should approach Hodeida and the economic file. UN and other mediators are struggling with the extent to which the war economy, questions of sovereignty,

[181] In Washington, a vocal section of Congress has laid responsibility for Yemen's economic situation at Riyadh's feet and started pressing U.S. officials to find a solution. Ryan Nobles, "Congressional Democrats call on Biden administration to demand Saudi Arabia lift blockade on Yemen", CNN, 7 April 2021. At the UN, pressure is growing on the U.S. and other Western governments to persuade the Saudis to allow all ships with UNVIM clearance to enter Yemeni waters unmolested. Crisis Group telephone interview, Western diplomats, June and July 2021. A U.S. official said: "I really don't understand what they hope to achieve with this [the fuel embargo]. It is utterly self-defeating". Crisis Group interview, U.S. official, June 2021.
[182] Crisis Group telephone interview, government adviser, December 2020.
[183] Crisis Group telephone interview, Huthi representative, May 2021.
[184] Crisis Group telephone interview, government official, October 2021.
[185] Crisis Group interviews, diplomats, New York, March and September 2021. Crisis Group telephone interviews, diplomats, January, March and October 2021.

humanitarian concerns, and military and international political calculations are intertwined. The UN's initial framing of the initiative's different components – treating solutions for the Hodeida and Sanaa airport problems as "confidence-building measures" to be achieved through U.S. pressure on Riyadh – looked at these highly contentious, politically inflected issues as low-hanging fruit that could be addressed through quick technical fixes. The initiative thus disregarded the government's perspective and likely sowed the seeds of its own demise.

Going forward, if the fighting is to be stopped the same mistake cannot be made again. Even if the parties are motivated more than anything by winning the war and gaining sovereignty over as much of the nation's territory as they can manage, the economy is a crucial piece of the puzzle. Under-examining the war's economic facets – and failing to better take into account the economic conflict when considering mediation strategies – unnecessarily limits the UN's ability to navigate the parties' strategies. It will also erect barriers to progress when time is short.

A Western diplomat summed up the challenge as follows:

> It's going to be hard to address the war's economic aspects until there has been a political deal and new political arrangements; otherwise, why would the government give up their most important lever? But then for the Huthis, it is the most important issue and central to a ceasefire.

In order to break the impasse around these issues a new approach will likely be required.

V. Moving Toward an Economic Ceasefire

The economic conflict is not the only factor driving Yemen's war or preventing its resolution. The war is a complex, multiparty conflict rife with local and regional rivalries. But as stalled efforts to implement the Stockholm Agreement and negotiate the Joint Declaration made clear, the shooting war in Yemen cannot be resolved without a parallel effort to address the economic issues that shape the parties' political and military calculations, underlie the country's humanitarian crisis, and relate to essential questions of sovereignty.

This task will hardly be easy, with the conflict parties seeing the economic conflict as a zero-sum struggle for the sovereign authority to control, tax and regulate trade and to reap the financial benefits thereof. But the UN has encountered a challenge of this nature before. In other UN-led peace processes, such as in Libya, where the UN operates an "integrated" mission structure, UN envoys have developed mediation tracks to deal with conflicts' economic dimensions as part and parcel of their overall conflict resolution approach.[186] UN officials focused on peacebuilding analysis in New York see such structures as "best practice" for UN political missions.[187]

Against this backdrop, the UN's new Yemen envoy, Hans Grundberg, who took office in September 2021, is considering ways his office can address the conflict's economic dimensions, already signalling his interest by recruiting an economic affairs officer to the team. Perhaps the most important step he could take, drawing a page from the Libya precedent, would be to establish a formal economic consultation and mediation track. This track would bring together the envoy's political heft and the expertise of a yet-to-be-hired team in order to identify solutions for economic issues that are bound up with the most sensitive political issues driving the conflict and have thus far proven intractable.

In giving the team its marching orders, the new envoy should look to how the UN has prepared to deal with the war's military dimensions. In late 2019, Martin Griffiths brought a British military expert onto his team to develop a detailed, phased ceasefire plan that envisioned an initial truce, conflict management mechanisms, de-escalation measures, interim security planning, and an innovative series of cooperative agreements among military forces and local groups.[188] While the parties can carry out few if any of these plans until they are much closer to a settlement, negotiators can draw upon the ideas therein when politics allow for a ceasefire.

Following this model, the envoy's office could use the economic track to prepare for the economic equivalent of a ceasefire, while also looking for issues where progress might be possible even before the parties are ready to bring fighting to a halt. The ultimate objective would be an overarching agreement by the conflict parties to halt efforts to damage each other economically; to cooperate with one another to use the economic levers at their disposal to improve the lot of ordinary Yemenis; and to create a so-called peace dividend – economic growth coupled with improved service delivery – that would be used by the parties to generate popular support for a political

[186] See Crisis Group Middle East and North Africa Report N°222, *Libya Turns the Page*, 12 May 2021.
[187] Crisis Group interview, UN Peace and Mediation Division official, New York, October 2021.
[188] Crisis Group telephone interviews, UN officials, March, May and June 2021.

settlement to at least temporarily end the war. It would also lay the groundwork for the gradual reintegration of the economy and state institutions, to the extent that the country's factious politics allows.

Concretely, the key elements of such an agreement would need to grapple with, as a matter of priority, revenue collection and salary payments, government-imposed limits on fuel imports to Hodeida, the Huthis' ban on new riyal notes and, relatedly, government regulation of the notes it has printed, along with domestic and international deconfliction mechanisms for bank regulation across the different zones of control. As outlined above, these are the issues of greatest importance to – and with the greatest impact on – ordinary Yemenis' day-to-day lives.

To begin moving in this direction, the economic team could start by identifying the key disputes within each of the areas described above and related topics – from import restrictions to competing currencies – working in coordination, where possible, with their humanitarian agency colleagues and officials at the World Bank, International Monetary Fund and other international organisations. They would then need to identify the decision-makers on all sides who could negotiate an economic truce and agree on the necessary steps toward de-escalation, in particular around the banking and import sectors, and concerning Hodeida and all of Yemen's airports. Much as the UN has identified prospective members of a military committee to plan a ceasefire, it will need to convince the economic war's decision-makers to engage in UN-led consultations now and, later, to form their own committee to coordinate an economic truce.

As is the case with the military ceasefire, these consultations cannot be limited to the two parties identified in UN Security Council Resolution 2216. All parties with a stake in and control of resource and trade centres will have to be involved at a minimum in the consultations, but ideally in the negotiation of an economic truce as part of a broader settlement. The STC is one such party; others are local authorities or representatives from Taiz, Marib, Shebwa and Hadramawt; and still others might be military authorities on the Red Sea coast, along with key private-sector actors (as discussed further below).

Once the UN has initiated these consultations, it should identify aspects of the economic conflict that can be at least partially addressed in the near term, and those that can only be resolved as part of a political process that settles questions of sovereign authority. For both purposes it will be important to adopt a coordinated rather than unified approach – that is, getting different economic institutions and bodies like the rival central banks to work with one another rather than pushing for one set of integrated national institutions straight away. The extent of Yemen's political, military and territorial fragmentation as well as the deep-rooted grievances shared by the numerous rival parties mean that an attempt by any central authority to assert its authority over all Yemen will almost certainly lead to rebellion by one group or another and renewed conflict.

It will also be important to ensure that de-escalatory measures are negotiated at the appropriate level of detail and agreed upon at a senior political level rather than sketched out in generalities with details delegated to mid-ranking officials who lack decision-making power, and that robust dispute resolution mechanisms are put in place. As noted above, prior arrangements that lacked these, including the Stockholm Agreement and the temporary fuel import mechanism negotiated in 2019 and

2020, are widely regarded to have failed in part because of loose wording, which negotiators chalked up to constructive ambiguity, but which left the parties to quibble with the deal's meaning once inked.[189]

In practice, the UN team should proceed through consultation and mediation. It should initiate discussions on tax and customs at ports and internal customs points and checkpoints, and on revenues generated by selling oil and gas on local and international markets. It should consult with and then attempt to foster dialogue between the rival central banks and finance ministries. It should also develop a deep understanding of the rival parties' budgetary structures, in particular their wage bills, and to look for areas of potential common interest on both sides of the conflict divide, like gaining greater capacity to pay teachers and medical workers. The team should share feedback from these consultations with the envoy, who will likely need to constantly advocate for dialogue on the economy with senior Yemeni political leaders and regional officials. Because those leaders and officials are unlikely to agree to discussions that they think could hurt their bottom line or improve their rivals', another important task will be identifying the payoffs and incentives for compromise.

For example, by allowing new banknotes, people, goods and hard currency to flow between their and rival areas, the Huthis would be surrendering considerable control over their walled garden economy.[190] But such a move could help resolve their internal liquidity problems and increase economic activity in Sanaa, cementing the city's status as the country's economic centre of gravity. For its part, the government would benefit by improving the riyal's value against the dollar in areas under its nominal control.

Efforts to de-escalate and then end the economic conflict will invariably be plagued by the same issues that have made a political settlement impossible until now. The UN envoy can do two things to facilitate work along the economic track: first, he can consult, and where possible include, interested private-sector parties in negotiations. It is in the interest of Yemen's major importers and banks (most of which are partly or mostly owned by the importers) to improve the flow of goods and funds in and out of Yemen. Private-sector actors have often walked a fine line with the conflict parties, but they are among the few groups that have maintained regular, if at times unsteady, relations with both the Huthis and the government. Their input and assistance will be invaluable. But the UN will need to approach its interactions with private-sector players carefully, given how politically sensitive the economy has become and the parties' willingness to punish businesses they believe are politically slanted toward their rivals.

[189] Ibrahim Jalal, "Yemen's Stockholm Agreement One Year On: Imaginary Progress?", Middle East Institute, 22 January 2020.

[190] In some cases, the economic team will find that the components of an economic ceasefire overlap with the military one, necessitating coordination among the economic, military and political leads within the envoy's office and the wider UN system. Reopening key roads and removing internal and international barriers to the movement of people, goods and money like checkpoints would be of fundamental importance to the reintegration of the economy and would help normalise prices nationwide. The UN-led military track already involves efforts to secure roads bisected by front lines, while the initiative the UN pursued in 2020-2021 included provisions on reopening Hodeida port and Sanaa airport.

Secondly, the envoy, in coordination with UN humanitarian agencies and international institutions, can seek ways to unlock new funding for import financing and currency stabilisation. With the controversy of the government's alleged mismanagement of the Saudi deposit, most outside powers do not trust the government to administer large amounts of hard currency. Nor, under present circumstances, would they allow the Huthis to oversee a new hard-currency import facility. For these reasons, a new mechanism overseen by international institutions like the UN and World Bank could be the best way forward. Money provided to the new import facility might be used to support imports and the riyal but would not be directly overseen by the government or the Huthis.

The envoy will also need international support. Crisis Group has repeatedly advocated for formation of an international contact group chaired by the envoy's office.[191] This group's primary objective should be to endorse a long-term vision for the conflict's resolution, coordinate different mediation tracks, jointly determine steps that will maximise chances of successful UN-led negotiations and establish a division of labour among its members to support the peace process, including the economic track. The contact group should at a minimum include the UN Security Council's five permanent members and representatives of the Gulf Cooperation Council states, with the European Union perhaps joining as well.

[191] See, for example, Crisis Group Reports, *Rethinking Peace in Yemen;* and *The Case for More Inclusive – and More Effective – Peacemaking in Yemen*, both op. cit.

VI. Conclusion

It has been seven years since the Huthis seized Sanaa in an assault they justified by citing the economic plight of ordinary Yemenis. Yet as the war has dragged on, what was the Arab world's poorest country has become one of the poorest places on the planet. More people have died during the war from hunger and preventable disease than in combat or aerial bombardment. A political solution to the war looks far off, and the humanitarian crisis is set to deepen.

Yemen's economic predicament is evidence that warfare comes in many forms, some of them harder to see or grasp than others, but no less deadly for it. To end the conflict, UN mediators and outside powers will have to grapple with each of the war's aspects at once, and work toward a mediation approach that places equal weight on its political, military and economic dimensions.

Amman/Cairo/Aden/Sanaa/New York/Brussels, 20 January 2022

Appendix A: Data and Method

The analyses in section III of this report draw on commodity price data and a newly constructed dataset of monthly changes in territorial control at the district level compiled by Crisis Group and validated against other similar datasets including one formulated by the Armed Conflict Location & Event Data Project (ACLED). The figures in the body of the report describe the correlation between prices and territorial control. To address the possibility that the observed relationships between territorial control and commodity prices are determined by other factors, Appendix A.II presents two statistical tests –two-way fixed effects and synthetic control regression analysis – that isolate the effect of territorial control on pricing and find a significant difference for diesel but not for wheat. Details on the calculation of fuel revenue and profit estimates are presented in section A.III.

I. Data

These analyses rely on several data sources:

1. a dataset tracking territorial control;
2. data on commodity prices from the 23 governorate capitals;
3. data on fuel and food imports.

The territorial control dataset tracks the "dominant actor" in a given territory over time, which we define as the political entity monopolising the use of violence over that territory.[192] Its unit of analysis is the district-month (n=27,805), meaning that it is collected at the administrative district level (n=335), on a monthly basis beginning with the outset of conflict in January 2015. It was collated by Crisis Group and validated against a similar database constructed by ACLED.[193]

The commodity price data cover several key commodities, including wheat flour, rice, sugar, diesel and gasoline. The level of analysis is the governorate-month; data are collected in each of the governorate capitals (n=23), beginning in June 2016.[194] The data are taken from the Global Food Prices Database of the UN World Food Programme (WFP).

Data on imports track the movement of goods into Yemen, disaggregated by type (food, fuel, other non-food) and point of entry (n=7). The unit of analysis is the port-month, and coverage begins in August 2017. The data were given to Crisis Group by a trusted third party, a private trade data-gathering firm.

II. The control actor-commodity price relationship

Figures 3 and 4 plot commodity prices, averaging the prices in markets controlled by a given political actor by month. These trends suggest a correlation between the dominant actor in a given market and commodity prices, but do not exclude the pos-

[192] Where several organisations share control or engage in open conflict, Crisis Group coded the "dominant actor" as the one estimated to be most able to command the local population and inflict damage on other political actors.
[193] Shared privately with Crisis Group.
[194] The governorate of Hajjah is excluded from analyses presented here because the city in which WFP collects data in the governorate shifts in early 2020.

sibility that other features of a given market could be influencing commodity prices – or determining both patterns of political control and commodity prices.

To address these unobserved factors, Crisis Group fit a statistical model regressing commodity price in a given district-month on territorial control and a panel of other covariates, including whether there has been recent fighting or contestation in the district (see Table A.1). This report employs an ordinary least squares (OLS) regression model with two-way fixed effects, for market and period, on repeated observations of the same unit (commodity prices in a given market) to account for unobserved time and unit confounders.[195] This model allows for measuring the impact of territorial control on diesel prices absent the effect of unobserved market-specific factors, such as proximity to ports or other static characteristics inhering in a market. The same goes for variables that change across all units over time – for example, seasonal changes in prices that may be unobserved in the data but affect all markets in a similar way. Combining this model with observed time-varying covariates, such as violence levels, generates a more rigorous estimate of the effect of territorial control on commodity prices.

The model suggests that, all else being equal, when a territory moves from non-Huthi to Huthi control, the price of diesel fuel increases by $0.41 per litre, from a base of $0.62 – a 67 per cent difference in pricing. When the same model is used for wheat, the cost increases by only $0.05 per kilogram and is not statistically different from zero.

[195] Joshua D. Angrist and Jörn-Steffen Pischke, *Mostly Harmless Econometrics: An Empiricist's Companion* (Princeton, 2009).

Table A.1 – OLS Regression of U.S. dollar commodity price on territorial control, with two-way fixed effects

Commodity	Diesel	Wheat
	(1)	(2)
Shift to Houthi	0.414***	0.047
	(0.156)	(0.031)
Remote violence previous month	–0.005	0.001
	(0.004)	(0.001)
Remote violence previous year	–0.001*	–0.0001
	(0.0004)	(0.0001)
Battle previous month	0.003	0.002**
	(0.005)	(0.001)
Contested	0.114***	0.011*
	(0.035)	(0.006)
2016	–1.395***	–0.171***
	(0.054)	(0.009)
2017	–1.471***	–0.229***
	(0.055)	(0.009)
2018	–1.429***	–0.256***
	(0.054)	(0.009)
2019	–1.450***	–0.175***
	(0.055)	(0.009)
2020	–1.547***	–0.212***
	(0.055)	(0.009)
2021	–1.338***	–0.204***
	(0.067)	(0.011)
Observations	1,477	1,498
R2	0.441	0.414
Adjusted R2	0.427	0.400
F Statistic	103.248***	93.888***
	(df = 11; 1442)	(df = 11; 1463)

To make this general relationship more concrete, Crisis Group also conducted a synthetic control analysis, comparing the trajectory of prices in a market captured by the Huthis to a simulated counterpart that is similar in all respects except that the military actor controlling it did not change over the period of interest. The report compares the market in al-Hazm – which came under Huthi control in February 2020 – to a "synthetic" al-Hazm constructed from a weighted combination of other markets throughout the country that never fell to the Huthis.

Synthetic control models assign a weight to each potential unit of comparison (in this case, several other markets throughout Yemen) and produce a combined average of those units that most closely resemble the observed characteristics of the unit of interest, constituting the baseline or "synthetic" control version of the unit of interest. If observed and synthetic markets follow a similar trajectory in the pre-treatment period, it is reasonable to assume they would have had a matching trajectory in the post-treatment period, had the unit of interest (ie, al-Hazm) not experienced the "treatment" of interest (ie, capture by the Huthis). Thus the report is able to measure the causal effect of a change in territorial control from the divergence of prices in the treated market from that of the control market.[196]

Compared to the baseline in which the market remained under government control, diesel prices in the actual al-Hazm market were on average $0.51 higher than those in the synthetic control in the seven months following the Huthi takeover (prices in al-Hazm fell compared to the synthetic control, and government-controlled areas generally, beginning October 2020, as growing volumes of fuel entered the governorate overland from Marib to replace reduced fuel supply into Hodeida, creating a glut in local supply).

III. Calculation of fuel revenue and profit estimates

The Huthis impose customs and other fees on all fuel entering their areas. Through the Yemen Petroleum Corporation (YPC), the state-run oil and gas distributor, they also control all fuel sales in areas under their control, purchasing fuel at a set price and selling it via state-held petrol stations and the parallel "grey" market (for more detail, see the discussion in footnote 156). A simple formula allowed Crisis Group to estimate the share of revenues accruing to the de facto authorities in Sanaa attributable to customs, taxes and sales.

Crisis Group estimated potential profits from diesel and petrol sales by multiplying (1) the estimated total volume of fuel passing into Huthi-controlled areas by (2) the price of fuel at the point of sale, and subtracting (3) estimated costs not recouped by the governing authorities. Crisis Group also counts customs and other fees toward Huthi fuel income. In estimating volumes and total income, Crisis Group has used conservative assumptions on the volume of fuel entering Huthi-controlled territory – in many cases lower than those stated publicly by actors involved in the fuel trade. Due to the many factors influencing fuel pricing and transport in Yemen, and the challenges of collecting the pertinent information, the figures in the text are illustrative estimates and should not be read as definitive.

To calculate fuel import volumes (item 1 above) Crisis Group used data gathered by a private trade data-gathering firm on fuel imports to all major Yemeni sea and land ports, and gathered data on local production from contacts in-country. For the purpose of the revenue estimates used in the report, Crisis Group assumes that all fuel imported through Hodeida is sold in Huthi-controlled areas, and that a portion of fuel imported through other ports and produced in areas outside of Huthi control passed into areas of Huthi control.[197] Point-of-sale price estimates in each gover-

[196] See Alberto Abadie, Alexis Diamond and Jens Hainmueller, "Comparative Politics and the Synthetic Control Method", *American Journal of Political Science*, vol. 59, no. 2 (2015), pp. 495-510.
[197] The amount of fuel passing from Hadi government- to Huthi-controlled territory was capped at 40 per cent of the total national inflow. In other words, fuel imported to Aden and Mukalla was counted as passing into Huthi-controlled areas only when imports to Hodeida constituted less than 40 per cent of total imports. In such cases, Crisis Group calculations subtract imports to Hodeida and 60 per cent of the national total from the total of imports to Aden and Mukalla, and count the remainder as passing from Aden and Mukalla ports into Huthi-controlled areas. This assumption is conservative; the government itself has publicly stated that 60 per cent of fuel coming into ports under its control passes to Huthi-run areas (see the discussion at footnote 138). For Marib, Crisis Group assumed (conservatively) that 10 per cent of diesel and petrol produced in Marib passes into Huthi-controlled areas, based upon discussion with oil and gas executives and other traders.

norate capital (item 2 above) are drawn from WFP data, to calculate total fuel revenues.[198] Costs not recouped by governing authorities (item 3 above) include the world price, demurrage, in-country transport and compensation to importers; they differ by site of import, as explained in the footnote.[199]

[198] See Appendix A.I for detail on WFP data. Average point-of-sale prices by control actor were calculated using a weighted average of governorate prices, based upon the last six years of available fuel sales volume data, from the YPC (2008-2013). Data on file with Crisis Group. The WFP prices employed for point-of-sale revenue estimates are a conservative means of estimating Huthi revenue in that they use only officially posted point of sale prices rather than parallel market prices.

[199] For Hodeida, Aden, and Mukalla, costs subtracted from the total revenue gained at point-of-sale are the following: (i) world fuel prices, Gasoil 0.5 per cent Mideast Gulf Singapore close for diesel and Gasoline 95r Mideast Gulf Singapore close for petrol, taken from Argus, an energy and commodity price-tracking firm; (ii) transport costs, assumed to be 6 per cent of the cost at point of sale for Hodeida and Marib, and 9 per cent for Aden and Mukalla to account for the additional distance fuel trucked from these ports into Huthi-controlled areas; Crisis Group telephone interviews, fuel transport industry experts specialised in Yemen, March, May and September 2021; (iii) compensation to fuel importers, $80 per metric tonne (converted at 1,351 liters per metric tonne for petrol and 1,192 MT/L for diesel, per Don Hofstrand, "Energy Measurements and Conversions", Iowa State University Extension and Outreach Ag Decision Maker, undated). Some $50 of this amount is recaptured as customs and taxes by YPC in Huthi-controlled Hodeida (and is paid to local authorities in Aden and Mukalla). Crisis Group telephone interviews, businessmen involved in the fuel trade, July and October 2021, and ACAPS; (iv) taxes and customs duties paid to government of Yemen and local authorities (Aden and Mukalla only), 21.4 per cent of world price for petrol (11.4 per cent taxes, 10 per cent customs), 16.4 per cent for diesel (11.4 per cent taxes, 5 per cent customs), converted to Yemeni riyals at the rate of 250 riyals per dollar, per ACAPS; (v) demurrage costs, computed via a per-metric-tonne cost of demurrage based upon total import tonnage and demurrage costs for all Yemeni ports in 2020, obtained from a private data-gathering firm and on file with Crisis Group; (vi) other in-country processing and logistical costs borne by the distributor in Huthi-controlled areas, the YPC, estimated to be $0.12 per liter, per the 2018 Panel of Experts report to the UN Security Council (Annex 47) and interviews with individuals involved in the fuel trade. See "Effects of the fuel embargo at Al Hodeidah port on fuel supply dynamics and fuel prices", ACAPS, 17 August 2021. For Marib: Input cost of fuel brought to Huthi-controlled areas is priced based upon the WFP point-of-sale price in Marib, rather than world prices. Unlike for the other three ports, only the retail price and YPC costs ($0.12 per liter) are deducted from the point-of-sale price in Huthi-controlled areas in calculating revenue because this fuel does not go through the same international import process as fuel coming through the other three ports. Crisis Group telephone interviews, Safer official in Marib, June 2021; oil and gas industry officials, 2020-2021.

Appendix B: About the International Crisis Group

The International Crisis Group (Crisis Group) is an independent, non-profit, non-governmental organisation, with some 120 staff members on five continents, working through field-based analysis and high-level advocacy to prevent and resolve deadly conflict.

Crisis Group's approach is grounded in field research. Teams of political analysts are located within or close by countries or regions at risk of outbreak, escalation or recurrence of violent conflict. Based on information and assessments from the field, it produces analytical reports containing practical recommendations targeted at key international, regional and national decision-takers. Crisis Group also publishes *CrisisWatch*, a monthly early-warning bulletin, providing a succinct regular update on the state of play in up to 80 situations of conflict or potential conflict around the world.

Crisis Group's reports are distributed widely by email and made available simultaneously on its website, www.crisisgroup.org. Crisis Group works closely with governments and those who influence them, including the media, to highlight its crisis analyses and to generate support for its policy prescriptions.

The Crisis Group Board of Trustees – which includes prominent figures from the fields of politics, diplomacy, business and the media – is directly involved in helping to bring the reports and recommendations to the attention of senior policymakers around the world. Crisis Group is co-chaired by President & CEO of the Fiore Group and Founder of the Radcliffe Foundation, Frank Giustra, as well as by former Foreign Minister of Argentina and Chef de Cabinet to the United Nations Secretary-General, Susana Malcorra.

Comfort Ero was appointed Crisis Group's President & CEO in December 2021. Ero first joined Crisis Group as West Africa Project Director in 2001 and later rose to become Africa Program Director and Interim Vice President. In between her two tenures at Crisis Group, she worked for the International Centre for Transitional Justice and the Special Representative of the Secretary-General, UN Mission in Liberia.

Crisis Group's international headquarters is in Brussels, and the organisation has offices in seven other locations: Bogotá, Dakar, Istanbul, Nairobi, London, New York, and Washington, DC. It has presences in the following locations: Abuja, Addis Ababa, Bahrain, Baku, Bangkok, Beirut, Caracas, Gaza City, Guatemala City, Jerusalem, Johannesburg, Juba, Kabul, Kiev, Manila, Mexico City, Moscow, Seoul, Tbilisi, Toronto, Tripoli, Tunis, and Yangon.

Crisis Group receives financial support from a wide range of governments, foundations, and private sources. The ideas, opinions and comments expressed by Crisis Group are entirely its own and do not represent or reflect the views of any donor. Currently Crisis Group holds relationships with the following governmental departments and agencies: Australian Department of Foreign Affairs and Trade, Austrian Development Agency, Canadian Department of National Defence, Danish Ministry of Foreign Affairs, Dutch Ministry of Foreign Affairs, European Union Emergency Trust Fund for Africa, European Union Instrument contributing to Stability and Peace, Finnish Ministry of Foreign Affairs, French Development Agency, French Ministry of Europe and Foreign Affairs, Global Affairs Canada,, Irish Department of Foreign Affairs, Japan International Cooperation Agency, Ministry of Foreign Affairs of the Principality of Liechtenstein, Luxembourg Ministry of Foreign and European Affairs, Norwegian Ministry of Foreign Affairs, Qatar Ministry of Foreign Affairs, Swedish Ministry of Foreign Affairs, Swiss Federal Department of Foreign Affairs, United Arab Emirates (Ministry of Foreign Affairs and International Cooperation and Anwar Gargash Diplomatic Academy), United Nations Development Programme, United Nations World Food Programme, UK Foreign, Commonwealth and Development Office, and the World Bank.

Crisis Group also holds relationships with the following foundations and organizations: Carnegie Corporation of New York, Ford Foundation, Global Challenges Foundation, Henry Luce Foundation, John D. and Catherine T. MacArthur Foundation, Open Society Foundations, Ploughshares Fund, Robert Bosch Stiftung, Rockefeller Brothers Fund, Stiftung Mercator, and Wellspring Philanthropic Fund.

January 2022

Appendix C: Reports and Briefings on the Middle East and North Africa since 2019

Special Reports and Briefings

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Seven Opportunities for the UN in 2019-2020, Special Briefing N°2, 12 September 2019.

Seven Priorities for the New EU High Representative, Special Briefing N°3, 12 December 2019.

COVID-19 and Conflict: Seven Trends to Watch, Special Briefing N°4, 24 March 2020 (also available in French and Spanish).

A Course Correction for the Women, Peace and Security Agenda, Special Briefing N°5, 9 December 2020.

Ten Challenges for the UN in 2021-2022, Special Briefing N°6, 13 September 2021.

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Defusing the Crisis at Jerusalem's Gate of Mercy, Middle East Briefing N°67, 3 April 2019 (also available in Arabic).

Reversing Israel's Deepening Annexation of Occupied East Jerusalem, Middle East Report N°202, 12 June 2019.

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Gaza's New Coronavirus Fears, Middle East Briefing N°78, 9 September 2020 (also available in Arabic).

Beyond Business as Usual in Israel-Palestine, Middle East Report N°225, 10 August 2021 (also available in Arabic).

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After Iraqi Kurdistan's Thwarted Independence Bid, Middle East Report N°199, 27 March 2019 (also available in Arabic and Kurdish).

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After al-Bayda, the Beginning of the Endgame for Northern Yemen?, Middle East Briefing N°84, 14 October 2021 (also available in Arabic).

The Iran Nuclear Deal at Six: Now or Never, Middle East Report N°230, 17 January 2022.

Appendix D: International Crisis Group Board of Trustees

Beyond Emergency Relief: Averting Afghanistan's Humanitarian Catastrophe

Asia Report N°317 | 6 December 2021

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Preventing War. Shaping Peace.

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Principal Findings

What's new? The Afghan state is collapsing after the world responded to the Taliban takeover by freezing state assets, cutting aid and offering only limited sanctions relief for humanitarian purposes. Government employees lack salaries, basic services are not being delivered and the financial sector is paralysed. The economy is in freefall.

Why does it matter? Economic strangulation is unlikely to change the Taliban's behaviour but will hurt the most vulnerable Afghans. The rising number of people fleeing the country could provoke another migration crisis. State collapse would mark a terrible stain on the reputation of Western countries, which is already tarnished by chaotic withdrawal.

What should be done? Donors agree on sending humanitarian aid, but emergency relief is not enough. If they wish to avoid state failure and mass starvation in Afghanistan, the governments that battled the Taliban must decide to help state institutions provide essential services, including health care, education and a basic financial system.

Executive Summary

The end of the world's deadliest war has not put a stop to the suffering of the Afghan people. To the contrary, hunger and destitution following the Taliban's takeover of the country seem poised to kill more Afghans than all the bombs and bullets of the past two decades. The Afghan state is teetering on the edge of full collapse, as the UN warns that the country is fast becoming the world's worst humanitarian disaster. Some of the escalating misery cannot be avoided: when a war economy disintegrates, the adjustments will always be hard, especially when crops are failing as they are in 2021. Not surprisingly, the Taliban were better at fighting an insurgency than running a modern economy and have shown little sign of compromise since seizing power. But donors' decisions to cut off all but emergency aid is the biggest culprit. International actors must revisit that fateful choice, finding ways to work with the Taliban in restoring crucial public services, if they are to stave off a calamity for which they would shoulder much of the blame.

The enormity of the economic shock that hit Afghanistan in August is a consequence of donors, first, building an extremely aid-dependent Afghan state since 2001 and then, after the Taliban takeover on 15 August, dramatically curtailing that aid. Before U.S. and international troops withdrew, virtually every essential state function depended on donor money. With the troops' departure, the Afghan political order collapsed, and the Taliban swept into Kabul. Immediately, donors refused direct cooperation with the new Taliban regime, cutting off the funds that had paid salaries for civil servants and other costs of government institutions. They also froze Afghan state assets and allowed pre-existing sanctions on the Taliban to become de facto sanctions on the Afghan government.

Today, donors are providing humanitarian aid, but this limited type of emergency assistance is insufficient to arrest the worsening humanitarian and economic crises. The human cost is already immense. Hundreds of thousands or even more deaths, and unspeakable scenes of deprivation, seem likely over the winter months. The devastation is born in large part of Western politics: donors adopted isolation policies calculating that voters would react badly to headlines about aid money propping up the Taliban regime. So far, the U.S. has decided that not a single penny can be spent on programs that materially assist the new government, even for girls' schools. The tragic reality is that most of the disaster now unfolding in Afghanistan would not have occurred with a different set of decisions by foreign donors.

There are arguments for allowing the Taliban to fail. Western governments may want to punish the Taliban for their violent takeover. The U.S. and others had warned the Taliban repeatedly over several years that gaining power through military means rather than a political settlement would make them a pariah regime starved of resources. The Taliban captured a territory with millions of vulnerable people, but rich countries chafe at the idea of, in effect, paying the regime ransom. After watching decades of investment in Afghanistan go up in smoke, and already observing incompetence in how the Taliban is governing, beleaguered donors might conclude that their money is better spent elsewhere – for example, on efforts to help neighbouring

states cope with migrants rushing to escape. Moreover, the Taliban bear tremendous responsibility for failing to take steps – such as building an inclusive government and better respecting human rights, including girls' right to education – that would go far in enabling donors to work with them.

A stance against engagement with a Taliban-run state based on such considerations requires accepting the cruel and dangerous implications, however. The consequences are already visible: growing risk of famine; surging migration; rising threats of terrorism; and rising supply of illicit drugs. The burdens of social breakdown are falling most heavily on women and other vulnerable members of society, while the Taliban themselves remain secure in their victory and comfortably in control of the shadow economy. Whatever pressure the world applies to the Taliban, they seem capable of enduring it for the foreseeable future. Meanwhile, the population feels the pain.

There is a better way: working with the state apparatus to preserve its basic functions. Some of the solutions are free, or cheap, and could be implemented in a matter of days. The political costs are considerable, however, as they involve tacitly accepting that designated terrorists now control some Afghan ministries. Still, in the middle ranks of the Afghan civil service, many officials remain in their posts and could quickly resume working, with donor support. The following steps could ease restrictions on the Afghan economy and mitigate suffering:

- The World Bank, the International Monetary Fund and other international financial institutions should re-engage with Afghanistan to sustain a few essential services. A good start would be disbursing the $1.5 billion in unspent funds in the World Bank's Afghanistan Reconstruction Trust Fund.

- Health-care funding is uncontroversial because implementing partners are outside the Afghan state – but health programming cannot stand alone. Donors should revive a broader set of assistance programs for education, food security, basic infrastructure and rural livelihoods. To do so, they will often have to work with the Taliban authorities and fund civil servants' salaries.

- Sanctions for years aimed to weaken the Taliban insurgency (which they failed to do), not to crush Afghanistan's public sector and choke its economy, but those are now the perverse effects. The United States, the UN Security Council and other sanctioning entities should amend or more clearly interpret their sanctions to avoid targeting the entire Afghan government or the whole economy. Exemptions are needed for activities such as development aid, banking transactions, overflight fees, electricity purchases and regular trade of commercial goods.

- The U.S. government and its allies should find ways of injecting liquidity into Afghan currency markets. Ideally, Washington would greenlight the phased return of frozen reserves to the Afghan central bank (Da Afghanistan Bank), releasing an initial tranche on a trial basis to monitor for unintended effects. This step would allow the central bank to regulate the Afghan currency and run U.S. dollar auctions. If the Biden administration is not prepared to do that, currency swaps supervised by the World Bank or a UN agency might serve as a temporary fix.

- Easing restrictions as outlined above would slow the pace of the growing crisis, but Afghanistan will still require emergency aid. The next UN appeal for funding is expected to be the largest in the world. Western donors should prepare to fund humanitarian appeals while taking steps to buttress the Afghan state, shifting from an abrupt brake on aid to a more gradual glide path downward.

No one should think of returning to the staggering aid dependency that reigned in Kabul during the last two decades. No donor will want to spend money on that scale, in any case. Still, no state could survive the sudden loss of 43 per cent of gross domestic product without grave effects on the population. Donors should adopt more gradual measures that wean Afghanistan from the billions of dollars in aid funding that underwrote most aspects of the state. Doing so would mitigate the depth of the humanitarian crisis and leave the remnants of Afghanistan's professional civil service with some opportunity to rebuild. With temperatures falling and snows deepening, the fate of millions of Afghans over the winter hangs on the survival of their state.

London/Washington/Brussels, 6 December 2021

Beyond Emergency Relief: Averting Afghanistan's Humanitarian Catastrophe

I. Introduction

The United States and its allies withdrew the last of their military forces from Afghanistan on 30 August 2021, ending two decades of war against the Taliban.[1] Before the last soldiers boarded transport aircraft, they helped evacuate more than 120,000 Afghans and foreigners, including officials from the Islamic Republic of Afghanistan, the U.S.-backed government that collapsed with the international troops' exit.[2] Panicked crowds clung to the fuselages of departing planes.[3] Only a few officials remained at their desks in Afghan ministries, watching anxiously as Taliban insurgents took down the tricolour flags of the Republic and hoisted their own white banners.[4]

Horrified by the scenes in Kabul, the world responded with a series of policies aimed at isolating the Taliban regime. The U.S. decided that pre-existing sanctions on Taliban leaders would remain in effect, with only minor exemptions to allow limited forms of humanitarian aid. Billions of dollars in development assistance halted overnight. Neighbouring states complained that the countries that invaded Afghanistan should pay for the consequences of Kabul's fall and said the change of regime should be handled pragmatically, but none of them rushed to recognise the Taliban government.

Exiled from the global financial system, Afghanistan's beleaguered economy tipped toward full-blown crisis. A humanitarian disaster was already brewing in the war's final months, as fighting forced hundreds of thousands of people from their homes and recurrent droughts impoverished farmers. The conclusion of major armed conflict started a new struggle for survival as the abrupt cutoffs in foreign assistance revealed the fragility of state systems.

The Taliban appealed for help, but without much effort to make themselves appealing to international donors. They set up a nominally interim government that included designated terrorists and excluded most constituencies outside their secretive cliques. Their cabinet included no women and they closed girls' secondary schools in many provinces. The Taliban's new government was arguably less regressive than their earlier version in the 1990s, but still far short of expectations from the outside world.

This report describes the aftermath of the war in Afghanistan and the looming threat of state collapse and humanitarian catastrophe, worsened by the Taliban's mismanagement but driven primarily by external factors as outside powers turn away from the disaster. A section of the report considers the reasons why foreign donors

[1] "Defense, military officials hold news conference", U.S. Department of Defense, 30 August 2021.
[2] "The last U.S. military planes have left Afghanistan, marking the end of the United States' longest war", CNN, 31 August 2021.
[3] "'He saw the panic': The Afghan men who fell from the U.S. jet", *The Guardian*, 16 September 2021.
[4] Crisis Group interviews, former Afghan officials, August 2021.

might want the Taliban to fail at governing and outlines the likely consequences of such a failure. The concluding sections offer an alternative course of action that would require engagement with the Taliban government to assist with provision of essential services. The report is based on dozens of interviews with current and former Afghan officials, aid workers, diplomats, economists, business executives and other interlocutors, most of them contacted remotely from August to November 2021.

II. The Aftermath of War

A. *Humanitarian Disaster in a Parched Land*

Crisis Group and others raised the alarm about a growing humanitarian emergency right after the Taliban advanced into the capital on 15 August.[5] Record-breaking numbers of Afghans fled their homes in the war's final months, and the surge of violence preceding the Taliban's victory killed more people than had died in the entire previous year.[6] The displaced have started trickling back to their homes, but their villages are ravaged by conflict.[7] The UN said the chaos increased the number of people in need of food assistance by one million, in addition to 7.3 million already "food insecure" when the year began.[8] Hunger spread as winter neared, with the UN projecting that 22.8 million would suffer varying levels of food insecurity in the coming months, a 35 per cent increase over 2020 and the worst levels recorded in a decade.[9] Aid workers made plans to care for an additional 100,000 Afghans who need clothing, fuel and other supplies to survive the winter, on top of an estimated 670,000 who needed shelter before the Taliban takeover.[10] A UN household survey found deep hunger in the cities, at rates similar to rural areas stricken by drought.[11]

The turmoil unfolded in a parched landscape where farmers were already struggling with the second drought in the last few years.[12] The wheat harvest is expected to be as much as 25 per cent below average, as drought afflicts 25 of 34 provinces.[13] Not all parts of the country suffered from dry conditions, and Taliban-affiliated media boasted of bumper crops in some locations, especially in the east.[14] Satellite imagery of fields showed large parts of the country with no significant change in crop yields.[15] But the southern, western and north-western parts of the country are badly affected,

[5] Crisis Group Briefing Note, "Afghanistan's Growing Humanitarian Crisis", 2 September 2021. See also "Afghanistan: Humanitarian Crisis Needs Urgent Response", Human Rights Watch, 3 September 2021; Hannah Duncan and Kate Clark, "Afghanistan's looming economic catastrophe: What next for the Taleban and the donors", Afghanistan Analysts Network, 6 September 2021; and Mark Bowden and Martin Barber, "Backing the UN Can Help Afghans Facing a Tough Winter", Chatham House, 26 August 2021.
[6] See "Afghanistan: Conflict-Induced Displacements", UN Office of the Coordinator for Humanitarian Affairs (OCHA), 15 November 2021; and Therese Pettersson, "Fewer Choices and Uncertain Future in Afghanistan", Uppsala University, 1 October 2021 (Swedish).
[7] At its peak in 2019-2020, the war in Afghanistan ranked as the deadliest in the world. "Strange quiet arrives in Afghanistan after decades of war", *The Wall Street Journal*, 11 October 2021.
[8] "Flash Appeal: Afghanistan", OCHA, September 2021.
[9] "Afghanistan: Acute Food Insecurity Situation September-October 2021 and Projection November 2021-March 2022", Integrated Food Security Phase Classification (IPC) portal.
[10] "Flash Appeal: Afghanistan", op. cit.
[11] "Educated urban Afghans are new face of hunger as jobs and incomes dry up", press release, World Food Programme (WFP), 21 September 2021.
[12] See tweet by Liaison Office of the UN Food and Agriculture Organization (FAO) in New York, @FAONewYork, 12:48pm, 14 September 2021.
[13] "Afghanistan: FAO urges G20 countries to increase support for rural farmers", press release, FAO, 23 September 2021.
[14] See tweet by Nunn Asia, @nunnasia, 10:02am, 7 October 2021; and (about the east) tweet by Shamshad News, @Shamshadnetwork, 5:50am, 19 October 2021.
[15] See tweet by Alcis Geo, geographic information service, @AlcisGeo, 5:00am, 8 October 2021.

hurting harvests and livestock.[16] Reports of rural deprivation were widespread, and UN officials said the fast-moving situation outpaced assessments of the rising humanitarian needs.[17] An evaluation in September found 40 per cent of Afghan districts experiencing drought conditions.[18] Some humanitarian officials predicted the worst drought in a generation in 2021, as long-range weather forecasts showed a risk of below-average rainfall throughout the winter.[19]

B. *Economic Shock*

The proximate cause of the grave worsening of the population's suffering since August is the economic shock that followed the war's climax and denouement.[20] The Taliban's blitzkrieg in mid-2021 deprived the government in Kabul of customs revenue, its largest domestic source of funding, and the besieged authorities suspended salaries for many state employees during their final months in power.[21] Silence descended upon the hallways of semi-abandoned state institutions, where many employees went unpaid for months. Swathes of the public sector were at a standstill.

The situation remained dire after Kabul fell. Life returned to some ministries as the Taliban coaxed civil servants back to work and paid small portions of their wages.[22] Tens of thousands of government workers had fled the country as the Taliban advanced, but a Western official estimated that about 380,000 civilian employees remained after the evacuations. A Taliban official put the number higher, saying more than 500,000 employees on state payrolls were owed salaries.[23] Those jobs are a large share of overall employment, especially in cities; the next largest civilian employer is the telecommunications sector, with 200,000 employees.[24] The Taliban complain to Western officials that they inherited a bankrupt government that struggles to cover payroll, because their predecessors relied on foreign grants to finance 75 per cent of public spending.[25] Donors halted grants after the Taliban took over, immobilising

[16] Mohammad Assem Mayar, "Global warming and Afghanistan: Drought, hunger and thirst expected to worsen", Afghanistan Analysts Network, 6 November 2021.
[17] Crisis Group interviews, UN officials in Kabul, September and October 2021. See also "'We won't eat tonight': Hunger plagues Afghans in historic valley", Al Jazeera, 6 October 2021; and Shadi Khan, "From rural drought to urban shortages: Afghanistan's new hungry", *The New Humanitarian*, 6 October 2021.
[18] "Afghanistan Drought Bulletin", World Bank Group, 28 September 2021.
[19] "Severe drought adds to Afghanistan's woes, endangering millions as economy collapses", *The Wall Street Journal*, 10 October 2021. See also the IPC food insecurity portal, op. cit.
[20] "Strange quiet arrives in Afghanistan after decades of war", op. cit.
[21] See Eltaf Najafizada, "Taliban seizes customs posts, draining Afghanistan government's key revenue source", *The Print* (India), 5 August 2021; and Kate Clark and Roxanna Shapour, "The Khaled Payenda interview (2): Reforms, regrets and the final bid to save a collapsing Republic", Afghanistan Analysts Network, 9 October 2021.
[22] Crisis Group interviews, Kabul residents, September-November 2021.
[23] Crisis Group interviews, Taliban and Western officials, September 2021. The Taliban foreign minister subsequently said some overdue salary payments were being provided to government employees. "A conversation between Mawlawi Muttaqi and Sultan Barakat", video, Center for Conflict and Humanitarian Studies (Doha), 11 October 2021.
[24] Graeme Smith, "Resource Flows and Political Power in Afghanistan", ODI, November 2020.
[25] Crisis Group interviews, Western and Taliban officials, September 2021. See also the overview on the World Bank's Afghanistan country page.

both bilateral aid programs and mechanisms such as the Afghanistan Reconstruction Trust Fund, administered by the World Bank, which had been the previous government's largest source of funding.[26]

Donor funding for civilian government payrolls was overshadowed in recent years by the bigger costs of paying for Afghanistan's security forces. Security institutions employed several hundred thousand people, at least on paper, whose salaries evaporated along with the institutions in August. Corruption siphoned off large amounts of security assistance, and covert budgets made it difficult to know the war effort's full size, but as of July the U.S. had appropriated almost $89 billion for the Afghan forces and other donors had contributed significant amounts, including $145 million a year for police payrolls.[27] A meaningful part of the spending on security remained in the country.[28] As the wartime economy grew, it contributed significantly to pushing Afghanistan's per capita GDP up to $509 in 2020 from $179 in 2002.[29] The population size also climbed during the two decades of foreign intervention, to an estimated 39 million, from about 21 million before the 2001 invasion.[30] A whole generation grew up in cities where some of the biggest industries were military contracting, trucking and fuel supply.

That wartime economy has staggered to a halt. According to one UN expert, no modern economy has ever faced such an abrupt shock, with an overnight loss of foreign assistance that amounted to 43 per cent of gross domestic product.[31] The World Bank notes that the collapse of public spending has had a knock-on effect on the private sector, hurting the services and construction sectors that give jobs to 2.5 million people, accounting for 77 per cent of urban employment.[32] The International Monetary Fund forecasted a 30 per cent contraction in economic output in 2021.[33] About half the Afghan population lived in poverty before the Taliban takeover.[34] Forecasts vary as to how many Afghans may fall into poverty in the coming year, but some economists talk about the prospect of "universal poverty", with nearly all Afghans

[26] "Afghanistan's health crisis: The system is functional – now donors need to fund it", press release, Reliefweb, 8 October 2021; "Afghanistan Reconstruction Trust Fund steering committee meets", press release, World Bank, 2 September 2020.
[27] "Report to the United States Congress", Special Inspector General for Afghan Reconstruction, 30 July 2021, section II; "Fact Sheet: Law and Order Trust Fund for Afghanistan", UN Development Programme (UNDP), 16 November 2021.
[28] Some of the war spending was smuggled into offshore portfolios. One study of tax havens concluded that "leakage" of aid in countries such as Afghanistan could be 7.5 per cent of foreign assistance. J. Andersen, N. Johannesen and B. Rijkers, "Elite Capture of Foreign Aid: Evidence from Offshore Bank Accounts", World Bank, 2020. But much of the foreign money served to maintain a tangled web of patronage within the country. See Smith, "Resource Flows and Political Power in Afghanistan", op. cit.
[29] World Bank data.
[30] World Bank data. No census has been completed in Afghanistan, and population estimates vary.
[31] Crisis Group interview, UN consultant, 12 November 2021.
[32] Crisis Group interview, World Bank official, September 2021.
[33] "Regional Economic Outlook: Middle East and Central Asia", International Monetary Fund, October 2021.
[34] Poverty rates are based on the cost of food (with 2,100 calories per day considered adequate) and minimal non-food costs such as rent. In 2019-2020, the food and other costs were equivalent to $0.94 per person per day. World Bank data.

lacking money for basic necessities.[35] Within weeks of the Taliban victory, some city streets turned into flea markets as Afghans sold possessions.[36] Landlords started offering apartments for half the previous rents.[37]

C. *Trade and Market Disruptions*

Interruptions of transnational commerce have dealt another blow to the Afghan economy, driving up prices of basic consumer goods, many of which are in short supply. Disquieted by Taliban advances in mid-2021, Afghanistan's neighbours slammed borders shut, allowing only a partial resumption of trade as the war ended.[38] Afghans fleeing the country after the Taliban takeover temporarily overwhelmed some crossings, often though not always impeding the flow of goods.[39]

The closures added to the economic damage. Afghanistan depends heavily on imports, with official inbound trade worth ten times more than exports in recent years, according to World Bank data.[40] Pakistan, one of the country's largest trading partners, reported figures for the July-September period showing a 42 per cent decline in goods imported by Afghanistan as compared with the same period a year earlier.[41] Later, border issues slowed the flow of goods to local bazaars, and pharmacies reported that truckloads of medicine were stalled at crossings.[42]

Not all the numbers were alarming. One source told Crisis Group that an average of 254 cargo trucks crossed from Pakistan into Afghanistan each day in July and August, only a 14 per cent decrease from the average for the year.[43] Afghan exports to Pakistan remained relatively stable as local fruits and vegetables continued selling across the border.[44] Iran's official statistics showed no significant change in trade, with exports to Afghanistan rising 1.7 per cent during the tumultuous five months ending in October.[45] Traders at the main crossing with Uzbekistan said shipments had resumed after initial disruptions.[46] Official trade is sometimes surpassed by smuggling, making it difficult to measure trends. Nonetheless, it is clear that the Taliban takeover had a negative impact on cross-border businesses: even when not dealing with closures, Afghan traders said they could not get loans to make transactions due to banking restrictions.[47]

[35] "97 percent of Afghans could plunge into poverty by mid-2022, says UNDP", press release, UNDP, 9 September 2021.
[36] "Kabul streets full of Afghans selling anything to survive", *TOLO News*, 6 November 2021.
[37] Crisis Group interviews, Kabul residents, October 2021.
[38] "Trucks rolling across Afghanistan border as trade resumes", Reuters, 19 August 2021.
[39] "Torkham border remains closed for hours", *Dawn*, 24 September 2021.
[40] "Afghanistan Trade Summary", World Integrated Trade Solution, 2019.
[41] "Afghanistan Economic Monitor", World Bank Group, 1 November 2021.
[42] "Truckloads of medicine stopped at customs borders", *TOLO News*, 15 October 2021.
[43] Crisis Group interview, regional trade expert, September 2021.
[44] "Afghanistan Economic Monitor", op. cit.
[45] "Iran joy at U.S. withdrawal from Afghanistan fades quickly", *Nikkei Asia*, 22 September 2021.
[46] "Uzbek traders learn to do business with the Taliban", France 24, 1 November 2021.
[47] See Nafey Chowdhury, "Afghan money exchangers are the economy's last, best hope", *Foreign Policy*, 5 September 2021; and "Afghan crisis: What impact Taliban takeover is having on Indian MSMEs, traders", *Financial Express* (India), 22 September 2021.

The resulting shortages drove up prices in Afghan markets. Panic buying also contributed to the problem as Afghans reacted to the turmoil by hoarding food and other supplies. Rising prices for basic commodities started to make headlines in September, as fuel prices in Kabul went up 20 per cent in a few months and outlying areas reported similar surges.[48] The World Food Programme's regular monitoring of prices showed that wheat, rice, cooking oil, diesel and other essentials were more expensive in September and October than in June; by the third week of October, a day's wages for a labourer purchased 25 per cent less wheat flour than before the Taliban victory.[49] The national currency, the afghani, lost about 13 per cent of its value in the same period, trading at 90 to the U.S. dollar.[50] That left the currency weaker than at any point since the government launched a new version of the afghani in 2002, reducing the ability of Afghans to buy imported goods. The World Bank estimated that Afghanistan was suffering year-on-year inflation of almost 32 per cent.[51]

[48] See "Sales of cheap, low-quality fuel increase on Kabul streets", *TOLO News*, 21 September 2021; and "Rising fuel prices ahead of winter worry Helmand residents", Pahjwok Afghan News, 12 October 2021. Prices are tracked at the Global Petrol Prices website.
[49] "Afghanistan: Countrywide Weekly Market Price Bulletin", WFP, 24 October 2021.
[50] Exchange rates are drawn from WFP monitoring. Anecdotally, currency depreciation has been worse in some parts of the country. Crisis Group interviews, October 2021.
[51] World Bank analysis based on WFP price monitoring of ten critical household goods from all provinces, weighted for consumption and population. "Afghanistan Economic Monitor", op. cit.

III. Taliban Responses

A. *Empty Coffers Lead to Poor Choices*

The Taliban were unprepared for such challenges. The insurgents expressed surprise as their opponents melted away in mid-2021 and then shock when the government folded.[52] Further revelations awaited: Taliban officials said they were astounded by the lack of currency reserves in Kabul when they captured state institutions. The previous government had almost emptied the central bank.[53]

The Taliban may have not understood how the economy worked. The central bank had been dependent on regular shipments of dollars from the U.S. Federal Reserve, which assisted the Afghan central bank's management of foreign assets. The shipments supplied currency auctions in Kabul that traded U.S. dollars for afghanis. These auctions raised as much as $45 million per week in cash, supporting the afghani's value and injecting liquidity into an economy in which foreign currencies (mostly U.S. dollars) represented 60 per cent of all bank deposits.[54] Afghans used their own currency to buy bread, for instance, but they imported wheat flour – and most other products – using U.S. dollars.[55] Taliban officials had known before marching on Kabul that the economy was dependent on foreign aid, and they had discussed options for cutting the state budget to become less reliant on outsiders, but the cash shortages caught them off guard.[56]

B. *Banking Restrictions*

Freshly appointed officials in the new Taliban cabinet appeared to lack the expertise to run a modern economy, but even the brightest minds in finance would have concluded they faced an impossible bind.[57] Demand for U.S. dollars had already started to overwhelm the central bank in the final days of the previous administration, forcing the imposition of currency controls. The Taliban's only viable option was tightening the tourniquet to stem the bleeding. Their first published regulatory statements required that financial transactions be settled in afghanis, while offering vague assurances that Afghan banks retained enough cash to be "completely secure".[58] The banks themselves seemed less confident, with dollar auctions halted and Afghans mobbing branches to make withdrawals. The banks warned that they could run out of U.S. dollars altogether, despite Taliban-imposed limits that prevented individuals

[52] "Taliban surprised by speed of its takeover", Anadolu Agency, 16 August 2021.
[53] Crisis Group interviews, Taliban officials, September 2021.
[54] World Bank data.
[55] Crisis Group interviews, academics and former Afghan officials, September-October 2021. See also Manuel Bautista-Gonzalez, "Cash during the fall of Kabul", Cash Essentials, 6 September 2021.
[56] Crisis Group interviews, Taliban-affiliated figures, Doha and Kabul, 2020-2021.
[57] Crisis Group interview, World Bank official, 12 November 2021. See also Ibraheem Bahiss and Graeme Smith, "Who Will Run the Taliban Government?", Crisis Group Commentary, 9 September 2021.
[58] "Da Afghanistan Bank Notification", 9 September 2021; "Message of Mr Alhaj Abdul Qahir, the Acting Governor of Da Afghanistan Bank", 15 September 2021.

from taking out more than $200 per week.[59] (In November, the Taliban raised the limit to $400 per week.[60])

The limits acted as a drag on the economy. Some of Afghanistan's biggest companies said they could not pay their taxes or major suppliers because they could not withdraw enough money from their own accounts. The Taliban also restricted international money transfers, and factories shut down as industrialists complained that the banking sector's paralysis prevented them from purchasing raw materials abroad.[61] The Taliban banned the export of U.S. dollars from the country, and currency smuggling increased.[62] Some found workarounds: reports from border provinces suggested that many businesses ignored the Taliban edict to use the national currency, preferring the Pakistani rupee or Iranian toman.[63] A few charities started paying salaries using *hwaladars*, traditional currency brokers, but executives worried about running afoul of sanctions or anti-money-laundering rules. "It's not sustainable", an aid worker said.[64]

The banking restrictions stemmed the afghani's slide, but at the cost of paralysing the financial sector. Even the benefit could be temporary: the currency's collapse remains a serious risk whenever the Taliban lift the restrictions. A Western official concluded: "The banking sector is dead on the current trajectory".[65]

C. *Edicts for Businesses*

The Taliban's heavy-handed management of the banking crisis might have been unavoidable, but in other sectors the new authorities seemed to be testing the levers of modern government by trial and error. They showed a preference for a command economy, trying to control the behaviour of private businesses by edict – with only partial success. In early September, irritated by press attention to protests, often mounted by women angered at the reimposition of constraints on their rights, the Taliban decided to switch off telecommunications in restive areas of the capital. Mobile phone companies complied with the Taliban orders, but the blackout was temporary. Protests continued, as did the media coverage.[66]

The Taliban government also discovered that it could not simply instruct telecommunications firms to improve mobile services for its supporters in southern provinces. The Taliban made the request to the companies in September, blurring the

[59] "Running out of dollars, Afghan banks ask Taliban for more cash", Reuters, 15 September 2021.
[60] "Afghanistan central bank raises limit on bank withdrawals to $400 a week", Reuters, 3 November 2021.
[61] Crisis Group interviews, Afghan business executives, September and October 2021. On the transfer restrictions, see tweet by Kawoon Khamoosh, journalist, @KawoonKhamoosh, 10:47am, 18 October 2021.
[62] "Dollar smuggling out of Afghanistan increases: Money changers", *TOLO News*, 10 October 2021.
[63] Crisis Group interviews, Kandahar and Helmand residents, September 2021.
[64] Crisis Group interview, veteran aid worker, London, 12 October 2021.
[65] Crisis Group interview, Western official responsible for Afghan economic issues, 11 October 2021.
[66] See, for example, "Afghan activists protest outside shuttered women's affairs ministry", Reuters, 19 September 2021. The Taliban did succeed in reducing the number of protests, as the new bureaucracy imposed a system of permits for demonstrations. See "Protests get harder for Afghan women amid risks and red tape", Reuters, 4 October 2021.

line between public and private sectors, but the firms did not immediately obey. The companies were not sure they would profit by building more towers to improve reception, and even if they had been, they could not get enough hard currency to import the necessary equipment.[67]

The Taliban encountered similar problems when they tried to dictate terms to other private firms. The Taliban asked Pakistan International Airlines to reduce its fares; flights halted when the carrier failed to comply, prompting a meeting between the Pakistani ambassador and the new Taliban aviation minister to discuss ticket prices.[68] (Flights had not yet resumed by November.) The Taliban also tried to shut down the mining of lapis lazuli, a semi-precious stone whose export had generated tens of millions of dollars per year, saying that mining concessions granted by the previous government were no longer valid.[69] They do not yet appear successful at setting up their own large-scale exports of lapis.[70]

The Taliban seem to prefer strong regulation of the private sector. In some places, they have taken a hands-off approach, with lower taxes than their predecessors: at the border, the Taliban cut duties 70 per cent on food items and 30 per cent on non-food items.[71] But their conduct during their years as insurgents suggests that, for the most part, they will be hands-on managers. In areas under their control, they limited prices for essential goods such as bread and meat; inspected petrol stations to check for fraudulent pumps; checked the expiry dates of medicines sold in markets; weighed loaves of bread to ensure that bakers were not short-changing customers; and investigated local allegations of butchers selling dog or donkey meat. These regulatory approaches might continue under the Taliban government, in part because such actions are often popular.[72]

D. *Empty Ministries*

Much less popular were the Taliban's demands that civil servants continue working, even though they had not been paid in months. Many government staff did not show up at their offices, while others wandered the hallways of office buildings without a clear purpose. The new Taliban director of a government office said he inherited a depleted staff, as half the roster had evacuated. The remaining half lacked any understanding of the Taliban's program or a budget to spend on carrying it out. "We have no money, and not that much power", the mid-level Taliban official said.[73] The Taliban boasted of restarting infrastructure projects, but in practical terms not much

[67] Crisis Group interview, Afghan telecommunications firm employee, September 2021.
[68] See tweet by Mansoor Ahmad Khan, Pakistani ambassador to Afghanistan, @ambmansoorkhan, 9:39am, 15 October 2021.
[69] See tweet by Franz Marty, journalist, @franzjmarty, 10:17am, 23 October 2021. For background, see "War in the Treasury of the People: Afghanistan, Lapis Lazuli and the Battle for Mineral Wealth", Global Witness, 2015.
[70] Victoria Gomelsky, "Afghan gems have a future, a longtime dealer says", *The New York Times*, 22 November 2021.
[71] David Mansfield, "A Taxing Narrative: Miscalculating Revenues and Misunderstanding the Conflict in Afghanistan", Afghanistan Research and Evaluation Unit, October 2021, p. 38.
[72] Crisis Group interviews, Afghan businessmen, June and July 2021.
[73] Crisis Group interview, Taliban official, 23 October 2021.

construction could go ahead without funding.[74] The new foreign ministry asked freshly appointed diplomats to start working at the embassy to Pakistan, but the staff received no salary for three months and the mission failed to pay rent.[75]

E. *Searching for Revenue*

The retreat of donors who provided most of the state budget has left the Taliban scrambling for alternatives. A Taliban political official predicted that customs payments would return to previous levels "as usual, like the previous government", but early estimates of Taliban revenues suggested that domestic sources would fall short. Forthcoming research from a leading expert forecasts that the Taliban will not raise more from customs than $750 million per year at first.[76] The World Bank has suggested that the "absolute maximum" for Taliban revenues might be $2.2 billion a year, which would imply at least a 60 per cent contraction in government spending without infusions of donor money.[77] Other experts with regular contacts among Taliban officials predicted that the new finance ministry would indeed cut the annual budget by 60 to 70 per cent.[78] Unofficial numbers from the finance ministry suggested that Taliban revenues fared better than some experts feared in the first three months, with daily tax and non-tax collections of 400 to 500 million afghanis, equivalent to $1.5 to $2 billion in potential annual revenues.[79]

The Taliban appealed to non-Western donors such as China, Qatar, Pakistan and Turkey during their first months in power, but pledges from those countries were meagre. The richest among them, China, offered only $31 million in humanitarian aid.[80] (The Taliban still hope that China will invest "billions", especially in mines.[81])

Meanwhile, the Taliban also ran a vigorous program of asset recovery. That entailed, first, hunting for the riches of the previous government elites, and trumpeting their purported discoveries such as a cache of $12 million "and a number of gold bricks" allegedly stored at a former vice president's residence.[82] The Taliban's search for money also included confiscation of cash reserves held by NGOs and international agencies, although some of the seized assets were later returned.[83] Aid workers complained of paying hundreds of dollars in "additional fees" to the Taliban for visas and work permits.[84]

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[74] "Afghanistan: Taliban road construction projects stall without foreign funding", Deutsche Welle, 18 October 2021.
[75] "Taliban install diplomats in Pakistan embassy, missions", VOA News, 29 October 2019.
[76] Initial estimates based on trade volumes observed at border crossings. Crisis Group interviews, David Mansfield, September and October 2021.
[77] Crisis Group interviews, World Bank official, September 2021.
[78] Crisis Group interviews, Taliban experts, October 2021.
[79] Crisis Group interview, Western official based in Kabul, 22 November 2021.
[80] "Economic sanctions on Afghanistan must end, humanitarian aid is of great urgency: Chinese FM Wang Yi", *Global Times*, 23 September 2021.
[81] "Taliban: China is ready to invest billions in Afghanistan", VOA, 14 October 2021.
[82] "A Certain Amount of Cash Seized from the Previous Govt Officials Submitted to DAB", Da Afghanistan Bank, 15 September 2021.
[83] Crisis Group interviews, Western officials overseeing Kabul-based operations, September 2021.
[84] Crisis Group interview, Kabul-based aid worker, 7 November 2021.

Lacking money, the Taliban have found other ways of rewarding their supporters. Locals report mass evictions in several provinces, as the Taliban seized property, redistributing it to followers.[85] In some cases, the seizures reversed land grabs under the previous administration, when "land mafias" affiliated with government leaders manipulated the system of deeds, sometimes taking property by force.[86] Yet the pattern of the Taliban's actions suggested their aim was not only to correct past injustices. Many of the evictions target ethnic Hazaras, a form of "collective punishment" of the predominantly Shia minority by the mostly Sunni Taliban.[87] In some places the confiscations were cash grabs, as Taliban commanders seized compounds where NGOs paid monthly rents.[88] In others they seemed like welfare measures for Taliban fighters garrisoned in unfamiliar cities. An Afghan from the northern city of Mazar-e Sharif said impoverished Taliban forced a shop owner to feed 50 fighters once a week, although the fighters insisted that they would not ask for any cooked dishes, subsisting mostly on tea and bread.[89]

F. *Requesting Help from Former Enemies, and Blaming Them*

The Taliban have been unabashed in asking for help from the same countries that until recently were sending money and troops to defeat them. After seizing power, the Taliban held dozens of high-level meetings with Western interlocutors and requested financial aid in exchange for collaboration on issues such as migration and counter-terrorism. Participants from both sides say the Taliban genuinely seem to think that Western embassies could reopen in Kabul, bringing back the cascades of support for past governments. For example, when Taliban Deputy Prime Minister Abdul Ghani Baradar met with UN humanitarian chief Martin Griffiths on 5 September, the UN official was seeking guarantees that humanitarian staff would be safe. The Taliban leader followed up on 10 September with a letter to Griffiths offering the requested assurances plus a dozen "asks" for development aid. A Taliban official with knowledge of the letter said the "asks" included assistance for Taliban security forces. He could not envision Western personnel returning to offer military training but said Qatari or Turkish trainers might be acceptable.[90]

Over the following weeks, the Taliban's demands did not get more realistic; however, their tone shifted toward dark warnings that hinted at calamity without foreign aid. Foreign Minister Amir Khan Muttaqi on 11 October called for "positive relations" with European states and claimed that the Taliban share their concerns about Afghan migration. "We do not want Europe to be burdened by our migrants", he said, urging donors to invest in Afghan prosperity to keep people from leaving.[91] Taliban-

[85] Crisis Group interviews, Kandahar residents and Western officials, September 2021. See also Sune Engel Rasmussen and Ehsanullah Amiri, "Taliban evict Hazara Shiite Muslims from villages, rewarding loyalists", *The Wall Street Journal*, 30 September 2021.
[86] A. Larson and N. Coburn, "Resources over Reform in Afghanistan: How Changes in the Political Economy are Reshaping Local Politics", U.S. Institute of Peace, 2016.
[87] "Afghanistan: Taliban Forcibly Evict Minority Shia", Human Rights Watch, 22 October 2021.
[88] Crisis Group interview, Kabul-based aid worker, 7 November 2021.
[89] Crisis Group interview, former Afghan official, 12 October 2021.
[90] Crisis Group interview, Taliban official, 17 September 2021.
[91] "A Conversation between Mawlawi Muttaqi and Sultan Barakat", op. cit.

affiliated media highlighted concerns about the resurgent Islamic State affiliate, claiming that it might flourish because aid cutoffs weakened the Taliban's counter-terrorism efforts.[92] The Taliban also organised social media campaigns and street protests, blaming donors for the economic shambles.[93]

[92] "Muttaqi: ISIS has been crushed, but sanctions and pressure on Afghanistan are strengthening its morale", Nunn Asia, 18 October 2021.
[93] The #unfreezeafgmoney hashtag on Twitter is one such campaign. On protests, see, for example, "Hundreds protest in Kabul to demand release of Afghan foreign reserves", Reuters, 24 September 2021.

IV. Donors Hold Back

A. *No Recognition, Limited Humanitarian Aid*

Donors that bankrolled previous governments reacted cautiously to the insurgents' victory, hewing to policies such as sanctions and non-recognition even as they engaged in limited dialogue with the new regime. The Taliban wrote to the UN on 20 September asking to represent Afghanistan at the General Assembly, but Western diplomats demurred, saying acceptance would depend on the Taliban's behaviour.[94] Thus far, that behaviour has not been endearing: the Taliban severely restricted girls' education; hunted down former government officials; thrashed demonstrators and journalists; and lionised suicide bombers.[95] The new Kabul administration consists entirely of men, many of whom are designated by the UN and Western governments as terrorists.[96] Misogyny and violence do not disqualify a regime from sitting at the UN, but such actions could discourage bilateral recognition and influence the rotating nine-member committee that confers UN credentials. No government seems in a hurry to officially recognise the regime, even as many are treating it as the de facto authority and not fussing about its legitimacy.[97]

In the meantime, without a recognised government, and with donors suggesting that satisfaction of conditions should precede any support, major flows of development aid have halted.[98] The International Monetary Fund said the lack of recognition forced it to pause assistance to Afghanistan.[99] The World Bank has occasionally worked with non-state actors (in the 1980s in El Salvador and in the past decade in Yemen), but it usually insists on dealing with a recognised state.[100] Other international financial institutions also remain unwilling to invest; among these, the Taliban have expressed disappointment with the Asian Development Bank and Islamic Development Bank.[101] These decisions, in addition to bilateral and European Union

[94] "UN and Afghanistan's Taliban: Figuring out how to interact", AP, 26 September 2021.
[95] Adam Nossiter, "Taliban fighters crush a women's protest amid flickers of resistance", *The New York Times*, 4 September 2021; "Watchdog: 30 recent cases of violence against Afghan journalists", Al Jazeera, 28 October 2021; Thomas Gibbons-Neff, Sharif Hassan and Ruhullah Khapalwak, "Taliban honor suicide bombers' 'sacrifices' in bid to rewrite history", *The New York Times*, 23 October 2021.
[96] See "Who Will Run the Taliban Government?", op. cit. Several of these men appear on the Specially Designated Nationals and Blocked Persons list maintained by the U.S. Treasury Department.
[97] "Russia's Lavrov says Taliban recognition not on the table", Reuters, 25 September 2021.
[98] U.S. National Security Advisor Jake Sullivan said in early November that direct aid would remain suspended "until we see a substantially improved approach to everything from inclusive government to other elements that we are discussing with them". Quoted in "US envoy starts trip to discuss way forward on crisis-hit Afghanistan", VOA, 8 November 2021.
[99] "Special drawing rights, Afghanistan, Ukraine", press briefing, International Monetary Fund, 16 September 2021.
[100] See "Post-Conflict Reconstruction: El Salvador Case Study Summary", World Bank Operations Evaluation Department, Summer 1998; and Afrah Alawi al-Ahmadi and Samantha da Silva, "Delivering Social Protection in the Midst of Conflict and Crisis: The Case of Yemen", World Bank Group, October 2018.
[101] See tweet by TOLO News, @TOLONews, 8:23am, 14 September 2021.

(EU) aid suspensions, took big money off the table: since 2007, annual development assistance for Afghanistan had ranged from $3.8 billion to $6.7 billion.[102]

Humanitarian aid alone has continued to flow. That aid has been a relatively small portion of overall assistance to Afghanistan, amounting to $1.56 billion in 2021.[103] Lacking consensus about how they should react to the Taliban takeover, and inclined to take a wait-and-see approach to engagement with the new regime, international donors focused at first on a narrow agenda of sending food and other urgent support.

The humanitarian response has lagged behind the growing crisis and directed money at spillover effects rather than root causes. A conference on 13 September drew promises of hundreds of millions of dollars, but donors have been slow to fulfil the pledges.[104] A large part of the funding was earmarked for Afghanistan's neighbours, intended to help them accommodate an expected influx of asylum seekers – so that fewer will go on toward Europe. The EU said it was "determined" to "prevent the recurrence of uncontrolled large-scale illegal migration".[105] On 12 October, when the EU announced a humanitarian aid package "for the Afghan people", about half the money went to regional migration programs rather than projects inside Afghanistan.[106]

Still, spending went up: the $1.5 billion budgeted for humanitarian aid in 2021 is an increase from $730 million in 2020 and $585 million in 2019. Even more ambitious fundraising seems inevitable after UN Secretary-General António Guterres declared that the situation in Afghanistan is "becoming the world's largest humanitarian crisis".[107] A renewed UN appeal for humanitarian funding, expected in December, will probably rank Afghanistan as the neediest country in the world.[108]

Thus far, donors appear set on withholding the funds that kept the former Afghan government afloat and enabled key public services, pending decisions in world capitals about engagement with the Taliban. Meanwhile, donors are addressing only the most basic needs of the Afghan population in a manner that cannot keep pace with the economic impact of isolation.

B. *Humanitarianism Has Limits*

Emergency aid, however, only goes so far. Humanitarian efforts are bandages, not cures, and even these temporary remedies are hard to deliver in a failing economy. Arguably, the biggest success of emergency aid occurred in the health sector, but this example also shows the limits of humanitarianism. Two thirds of the health facilities in Afghanistan lost their funding when the World Bank retreated from a major support program, leaving doctors and nurses without salaries, reducing medicine sup-

[102] World Bank data.
[103] As of the time of publication. Figures from OCHA's Afghanistan Country Summary page.
[104] "Afghanistan crisis worsening as temperatures drop, warns UNHCR", UN News, 12 October 2021.
[105] "Statement on the Situation in Afghanistan", Council of the EU, 31 August 2021.
[106] "Afghanistan: Commission announces €1 billion Afghan support package", press release, European Commission, 12 October 2021.
[107] See tweet by António Guterres, UN secretary-general, @antonioguterres, 12:33pm, 26 October 2021.
[108] Crisis Group interview, UN official in Kabul, 20 November 2021.

plies and forcing some clinics to shut their doors.[109] A coalition of humanitarian agencies filled the gap left by the Bank, saying they would "scale up" support for the health system.[110] Still, a UN health official said, the stopgap solution will run out of money in early 2022. "Humanitarians can only do so much", the official said.[111] Paying hospital staff is necessary but not sufficient: the UN predicts that health facilities will suffer blackouts, for example, because more than 80 per cent of electricity on Afghan grids is imported from neighbouring countries, previously funded by donors at a cost of $280 million a year.[112]

Faced with wide-ranging needs, European officials announced a "humanitarian plus" strategy to keep supporting essential programs under the rubric of humanitarianism, though these activities previously depended on development budgets.[113] They did not define "plus", however: could education be considered "humanitarian?" What about other ministries where salaries had been donor-funded? Some answered "all of the above". "It is misleading to suggest that financial support to teachers, health care or food security workers in state institutions is somehow not entirely humanitarian", said a UN consultant.[114] A U.S. diplomat disagreed, saying funding with ancillary benefits to the Taliban government remains out of bounds: "The challenge is that what we are talking about isn't purely humanitarian".[115] Leaving aside the debates over nomenclature, more and more observers have started expressing concern that humanitarian aid would be insufficient. Aid experts said UN agencies and NGOs simply cannot replace all government systems for delivering education, sanitation, electricity, road maintenance, central banking and other services.[116]

C. *America the Gatekeeper*

The principal arbiter of Kabul's economic relationship with the world remains the United States, despite the withdrawal of U.S. troops. President Joe Biden has declared that he will "support the people of Afghanistan", but his administration appears to be searching for, and not yet identifying, assistance options that will entirely circumvent the country's Taliban rulers.[117] Almost three months after the Taliban victory, the Biden administration has, by all appearances, not decided whether to persist in

[109] "Nearly 1 in 4 hospitals treating Covid in Afghanistan have shut down, the WHO warns", *The New York Times*, 9 September 2021; "Salaries for Afghanistan health workers 'send message of hope' to millions", UN News, 10 November 2021.
[110] "Joint Statement by the UN Resident and Humanitarian Coordinator and Heads of ICRC, OCHA, UNICEF and WHO in Afghanistan", 27 September 2021.
[111] Crisis Group interview, UN health official, Geneva, 2 October 2021.
[112] "Economic Instability and Uncertainty in Afghanistan after August 15: A Rapid Appraisal", UNDP, 9 September 2021. See also Adam Tooze, "Don't abandon Afghanistan's economy, too", *Foreign Policy*, 27 August 2021.
[113] "Afghanistan: Commission announces €1 billion Afghan support package", op. cit.
[114] Crisis Group interview, UN consultant, 12 November 2021.
[115] Crisis Group interview, U.S. diplomat, 9 November 2021.
[116] Sarah Rose, Michael Pisa and Mark Lowcock, "On the brink: Enabling urgent financial aid flows to Afghanistan", Center for Global Development (blog), 25 October 2021.
[117] "Full transcript: Biden addresses 76th UN General Assembly", ABC News, 21 September 2021; Brian Bennett, "Biden administration grapples with how to send aid to Afghanistan without supporting the Taliban", *Time*, 22 September 2021.

its present posture or allow material support for the Taliban government on a conditional basis. Other donors have not either, as they are waiting for signals from Washington. Three main points of leverage give the U.S. an outsized role in shaping the policies of Western donors toward the Taliban regime: frozen assets, sanctions and influence in multilateral settings.

1. Frozen assets

The United States holds most of Afghanistan's $9.4 billion in overseas assets, a major form of U.S. leverage over a government whose central bank held few reserves locally and depended on U.S. cash shipments. Taliban officials told Crisis Group that they were "negotiating" with the U.S. for access to the frozen assets, but U.S. officials say their conversations with the Taliban on the topic have been brief, with the U.S. bluntly informing the Taliban that the assets will stay out of their reach.[118] U.S. Treasury Deputy Secretary Wally Adeyemo testified on 19 October: "I see no situation in which we would allow the Taliban to have access to the reserves".[119] He blamed the economic crisis in Afghanistan on climate factors and Taliban mismanagement. The U.S. has not publicly spelled out its legal justification for the asset freeze, and could face a court challenge, but for the time being the majority of the funds are stored in the Federal Reserve Bank of New York on behalf of the central bank of the erstwhile Islamic Republic of Afghanistan.[120]

2. Sanctions

The world faced a legal puzzle when the Taliban conquered Kabul, because it was the first time that a sanctioned group including individually designated terrorists had taken over an entire country. The Taliban, the group's Haqqani faction and some individual members are subject to a variety of sanctions imposed by the UN and EU, as well as the U.S. and many other countries.[121] The purpose of these sanctions is to prohibit material support of or benefit to the Taliban. But it is unclear whether that prohibition now applies to all Afghan ministries; some individuals in government; or the whole territory of Afghanistan under Taliban control. Authorities who manage the sanctions regimes have not yet clarified how they will enforce pre-existing rules.

The sanctions that matter the most, in practical terms, are those enforced by the U.S. Treasury's Office of Foreign Assets Control (OFAC), because of their wide-ranging effects on transactions touching the U.S. financial system. Aid agencies, businesses, European governments and other concerned actors pushed OFAC for answers after

[118] Crisis Group interviews, Taliban and U.S. officials, September 2021.
[119] "Department of State sanctions policy review", video, C-SPAN, 19 October 2021.
[120] A former U.S. Treasury official has called for greater clarity about the reasons for the asset freezes: "For the sake of not just Afghanistan policy, but also to protect the Federal Reserve's role as a banker to central banks, providing clarity in this regard would be prudent". Adam M. Smith, testimony to the U.S. Senate Committee on Banking, Housing, and Urban Affairs, 5 October 2021. One possible legal challenge could hinge on the question of whether the Taliban now have signing authority on behalf of Da Afghanistan Bank. See "Does the U.S. have leverage in restricting Taliban access to assets?", University of Miami, 30 August 2021.
[121] Adam Smith, "The Humanitarian and Policy Challenges of U.S. Sanctions on the Taliban", Just Security, 23 August 2021.

the Taliban takeover, asking how the U.S. would apply Taliban sanctions to the Afghan state. The need for clarity was urgent: studies by humanitarian agencies have shown that U.S. sanctions can have a "chilling effect" on aid programs at real or perceived risk of violating U.S. sanctions.[122] OFAC responded quickly, issuing two sanctions exemptions on 24 September to allow humanitarian work and basic imports such as medicine and agricultural supplies. OFAC added that it would handle other requests on a "case-by-case basis".[123]

Such a limited set of exemptions left a series of unanswered questions: would the U.S. consider it legal for traders to pay customs duties to the Taliban authorities? What about airlines paying for landing rights in Kabul or overflight fees? Are banks allowed to conduct business? The short-term effect of the uncertainty was that some firms avoided Afghanistan altogether. "The banking industry is reading this as, 'the entire government is now the Taliban'", a former U.S. Treasury official said.[124] One result was that overseas banks froze private Afghan bank deposits, at least in effect; the overseas accounts of a single bank might be worth hundreds of millions of U.S. dollars.[125] Other firms that could not cut their connections to the country found themselves in complex discussions with their lawyers and OFAC officials. One major business was advised that OFAC would allow payment of regular taxes and fees to the Taliban government, but not penalties such as fines for overdue taxes – a ruling complicated by the fact that the banking sector's paralysis made it impossible to pay taxes on time.[126]

For NGOs working on development, the problem was likewise vexing. The former head of the UN Office for the Coordination of Humanitarian Affairs co-authored a warning that OFAC's two licences restrict "crucial activities" including work on human rights, education and economic development: "Prohibitions on funding these activities make it more likely that the development gains achieved over the last twenty years will be lost."[127] In his Senate testimony, Deputy Secretary Adeyemo acknowledged that the OFAC rules are a work in progress and that the U.S. Treasury is "consulting these groups on specific issues".[128]

3. U.S. influence

No less important than direct U.S. control of frozen assets and sanctions is U.S. influence over allies and multilateral institutions. Washington's global leadership has diminished since the peak of the Afghan war, when the U.S. led a military coalition that included 51 countries. Still, the U.S. remains the biggest donor to Afghanistan

[122] Kate Mackintosh and Patrick Duplat, "Study of the Impact of Donor Counter-Terrorism Measures on Principled Humanitarian Action", OCHA, July 2013.
[123] "Treasury issues general licenses and guidance to facilitate humanitarian assistance in Afghanistan", press release, U.S. Treasury Department, 24 September 2021.
[124] Crisis Group interview, former U.S. Treasury official, 23 October 2021.
[125] Crisis Group interview, U.S. Treasury official, 1 December 2021. One example is the Afghanistan International Bank, whose assets held by foreign banks were worth $334 million in 2020. "Annual Report 2020", Afghanistan International Bank, 2020, p. 52.
[126] Crisis Group interview, Afghan businessman, 19 October 2021.
[127] Sarah Rose, Michael Pisa and Mark Lowcock, "On the Brink: Enabling Urgent Financial Flows to Afghanistan", Center for Global Development, 25 October 2021.
[128] "Department of State sanctions policy review", op. cit.

and is prominent in multilateral forums on Afghan policy. For example, if the International Monetary Fund were considering a lifeline for the Afghan central bank, restoring access to its $460 million allocation of Special Drawing Rights, the U.S. would be the only country that could veto such a decision because of its voting rights on the Fund's Board of Governors. It may be an exaggeration to say the U.S. dominates the international financial institutions, as some scholars have observed, but the U.S. does wield substantial clout at the International Monetary Fund and World Bank.[129]

UN, World Bank and aid agency officials said technical staff have been scrambling in recent months to develop fixes for the many overlapping crises affecting Afghanistan, but that it is difficult to make policy without any clear sense of what the U.S. and its allies want to achieve. The U.S. government knows what it does *not* want, forbidding multilateral funding to pay Afghan civil servants – "not even a school janitor".[130] At the same time, the U.S. and other donors must decide whether (and how) to continue supporting the basic services financed by international aid for the past twenty years. "The Americans need to decide if they want the state to collapse, or not", said a UN official.[131]

D. *A Divided World*

It is not only U.S. officials who lack direction on the way ahead. The Taliban takeover sparked vehement debates in foreign capitals about what to do next.

Three basic approaches have emerged. First, many European states lean toward going beyond humanitarian relief to support essential services, but they are still determining the parameters. For their part, regional powers call upon Western donors to pay for the disaster and unfreeze assets. A third group – a minority – comprise countries such as Tajikistan and France, who are even more hostile to the Taliban government than the U.S., seeking to deny the Taliban legitimacy and impose strict limits on aid. These broad categories are useful for understanding the disagreements among governments, though some (the UK, Canada, Japan) do not fall neatly into them. It is also important to note the dissent within bureaucracies and policymaking circles in the first months of Taliban rule. A senior European official, for instance, said his own colleagues' views ranged from "brutally pragmatic", calling for collaboration with the Taliban, to others who favoured "rights-based" approaches that would hold back assistance until after the Taliban met conditions, especially on the treatment of women.[132]

1. European re-engagement, with caveats

Fearing another migration crisis, some European states re-engaged quickly after evacuating their diplomats and others from Kabul in August. The European Union reached conclusions on 15 September that paved the way for EU staff to re-establish

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[129] Mark Copelovitch, Daniel Nielson, Ryan Powers and Michael Tierney, "The Unipolar Fallacy: Common Agency, American Interests and the International Financial Institutions", presentation at the American Political Science Association Annual Meeting, August 2014.
[130] Crisis Group interview, UN consultant, 4 November 2021.
[131] Crisis Group interview, UN official, Geneva, 2 October 2021.
[132] Crisis Group interview, senior European official, Berlin, 22 September 2021.

a "minimal" presence in Kabul and restart work on humanitarian operations.[133] The EU decision did not set hard conditions for the resumption of non-humanitarian aid, but laid out five principles: freedom of movement; respect for human rights, including women's rights; respect for humanitarian norms; support for counter-terrorism efforts; and inclusion of women and ethnic minorities in government. Putting those ideas into practice proved challenging, as the Taliban showed no inclination to negotiate away their policy preferences and clearly disagreed with the EU's understanding of human rights.

Still, some donors forged ahead. Germany, the largest European donor to Afghanistan, considered plans for reopening its embassy and became the first supporter of a UN trust fund that aimed to pool donor funding for essential services and promotion of economic development. The Special Trust Fund for Afghanistan included six UN agencies, funds and programs at its inception in October, with plans to expand from a primarily humanitarian effort in the first twelve months into a development fund in the coming years.[134] At a virtual G20 meeting, German Chancellor Angela Merkel spoke about the need for donors to support not only food and medicine but also Afghan state services such as electricity and the financial system.[135] Italy, which chaired the meeting, published a summary calling for help with the provision of basic services "that go beyond delivering emergency aid, provided those services are open to all".[136]

2. Region blames West, legitimises Taliban

The Chinese and Russian presidents did not join the G20 meeting on Afghanistan, focusing their attention on an alternative conference in Moscow the following week that brought together regional powers and Taliban leaders. At that gathering, and elsewhere, regional governments voiced demands for the U.S. and its allies to cover the costs of Afghanistan's humanitarian and economic catastrophe. Russia, China, Pakistan, India, Iran and the five Central Asian states made a joint plea for a UN funding conference, saying the "main burden" of Afghanistan's collapse should fall upon the countries that deployed troops.[137] Several regional actors – China, Pakistan, Iran, Russia – had wanted U.S. troops out of Afghanistan and granted the Taliban dignified, high-level meetings before and after their victory. China held a series of meetings with Taliban leaders, emerging with calls for the U.S. and its allies to lift sanctions and engage with the Taliban "in a rational and pragmatic manner".[138]

The willingness of regional actors to work with the new rulers of Kabul represented a sharp reversal for several of them. Indian officials opened dialogue with the Taliban – the clients of their nemesis, Pakistan – and hosted a regional conference that concluded with a joint statement calling for urgent humanitarian assistance.[139] The shift

[133] "Council Conclusions on Afghanistan", Council of the EU, 15 September 2021.
[134] "Meeting on Special Trust Fund for Afghanistan", slide deck, 22 October 2021.
[135] "Afghanistan crisis: G20 leaders pledge to avert economic catastrophe", BBC, 12 October 2021.
[136] "G20 Leaders' Extraordinary Meeting on Afghanistan: Chair's Summary", 12 October 2021.
[137] "Regional powers back aid for Afghanistan, say U.S. and allies should pay", Reuters, 20 October 2021.
[138] "Foreign Ministry spokesperson Zhao Lijian's regular press conference", Embassy of the People's Republic of China in the U.S., 27 October 2021.
[139] "Delhi Declaration on Afghanistan", Indian Ministry of External Affairs, 10 November 2021.

was especially abrupt for Uzbekistan, which had backed the anti-Taliban strongman Abdul Rashid Dostum in recent decades; by contrast, the Uzbek foreign minister visited Kabul in October and promised cooperation with the Taliban, including a continued supply of electricity despite not getting paid in full.[140] Turkmenistan also held discussions with the Taliban about development of energy corridors and railways.[141]

Little of practical value came from the meetings, however. China did not announce any major financial backing for the Taliban government. Beijing has interests in mining Afghan gold and copper, and extracting oil and gas, but these are long-term prospects and Chinese industry remains wary of the risks.[142] When regional ministers met in Tehran at the end of October, issuing another statement expressing "great concern" for the Afghan economy, their focus appeared to be containment of terrorism threats and refugee flight.[143] Most regional actors also stopped short of calling for diplomatic recognition of the Taliban government: Russia signalled that recognition would be premature.[144] Even the Taliban's most ardent supporter, Pakistan, has called for help to "strengthen and stabilise" the new government but has not yet recognised it.[145] The most tangible steps by regional actors were logistical, as Qatar, Tajikistan and Kazakhstan opened their doors to UN and other aid agencies and Qatari technical teams reopened the Kabul airport.

3. Hosting rebels: France, Tajikistan

If most countries argued about how to help the Afghan population, others questioned the value of stability under the Taliban. Their reasons seemed to vary from principled opposition to long-time ties with Afghan factions opposed to the former insurgent group. France declared within weeks of the Taliban takeover that Paris would have no relationship with Kabul's new rulers.[146] French authorities supported their old allies in Jamiat-e Islami, an anti-Taliban northern faction, as they held protests in Paris.[147] Ahmad Massoud, son of a Jamiat leader, announced himself as head of the National Resistance Front (NRF) and vowed to fight the Taliban.[148] The NRF skirmished with Taliban forces throughout the autumn, with Massoud and other

[140] Crisis Group interview, Taliban official, 20 October 2021. See also tweet by Da Afghanistan Breshna Sherkat, national utility, @DABS_official, 11:17am, 23 October 2021.
[141] See tweet by Shafi Azam, Turkmenistan foreign ministry official, @ShafiOriakhil, 10:00am, 31 October 2021.
[142] "Taliban's troubles are canaries in the mines for Chinese investors", *South China Morning Post*, 19 September 2021. Early announcements of trade cooperation between China and the Taliban have been modest: for example, the Taliban foreign minister announced in October that Afghanistan would start exporting pine nuts to China "very soon". "A Conversation between Mawlawi Muttaqi and Sultan Barakat", op. cit.
[143] "Joint Ministerial Statement of the Second Meeting of Foreign Ministers of Afghanistan's Neighbouring Countries", Mission of the People's Republic of China to the European Union, 28 October 2021.
[144] "Russia signals not ready to let Afghanistan's Taliban into the UN", Reuters, 29 October 2021.
[145] "Statement by Prime Minister of Pakistan H.E. Imran Khan to the 76th Session of the UN General Assembly", 24 September 2021.
[146] "The Taliban are lying, France's foreign minister says", Reuters, 11 September 2021.
[147] Crisis Group observations, Paris, 20 September 2021.
[148] Ahmad Massoud, untitled letter, 12 October 2021.

NRF leaders sheltering in Tajikistan.[149] A politician linked to the NRF said Massoud was a personal guest of Tajik President Emomali Rahmon, who has been lobbying regional capitals not to recognise the Taliban government.[150] French media reported that Rahmon's pro-resistance stance earned him an invite to meet French President Emmanuel Macron.[151]

It is unclear, however, to what extent Tajik or French support for the NRF might assist rebel operations, if at all. Other longstanding allies of the anti-Taliban northern factions in Afghanistan, notably India, do not appear so far to have decided to back the small insurgency against the Taliban.[152] Only a small minority of Western policymakers advocate backing the armed resistance; U.S. Senator Lindsey Graham called for supporting the northern rebels, but despite his prominence in the Republican caucus, the concept did not gain traction.[153] Even among the Afghan factions opposing the Taliban, some politicians say the NRF cannot win militarily – but that armed struggle might prompt the new rulers of Kabul to make concessions, such as including non-Taliban figures in government or devolving power to allow for greater autonomy in the provinces.[154]

[149] "How Tajikistan became a hub for Afghanistan's resistance", *Irish Times*, 29 September 2021.
[150] Crisis Group interview, Jamiat-e Islami politician, 10 October 2021. See also Catherine Putz, "Emomali in Paris: Tajikistan, Europe and the Afghanistan Problem", *The Diplomat*, 20 October 2021.
[151] "Afghan resistance has sanctuary in Tajikistan, but fighting Taliban a non-viable prospect", France 24, 4 October 2021.
[152] Lt. Gen. Prakash Menon, "Instead of Taliban talks, India must stand up for Afghan resistance despite Panjshir fall", *The Print* (India), 7 September 2021.
[153] Andrew Desiderio, "Lindsey Graham, one-man PR shop for the Afghan resistance", *Politico*, 15 September 2021.
[154] Crisis Group interviews, ethnic Tajik politicians, October 2021.

V. The Default Option: Let Them Fail

Though scholars debate how to define "state collapse", the Taliban regime does not yet appear to have reached the tipping point because the fledgling government makes rules, collects taxes and (mostly) controls the means of violence.[155] All the same, recent visitors to the ghostly corridors of defunct government offices might be forgiven for concluding that the country is sliding toward some form of collapse. Major institutions are stagnant, the economy is shrinking and citizens are not receiving services. The Taliban government is failing.

Some donors seem willing to let the Taliban founder rather than offer material support to the country that might have the effect of propping up the regime. "There are lots of people in our system who would happily watch the Taliban fail", a Western diplomat said.[156] Any financing that the Taliban could divert to discretionary uses is especially disfavoured. Sanctions, asset freezes and aid cutoffs are already having devastating effects, compounded by the Taliban's mismanagement. After two decades in which donors set up a heavily aid-dependent state, Afghanistan has been exiled to an economic wilderness. Some U.S. lawmakers proposed further banishment with a series of bills calling for tighter sanctions on the regime; forbidding assistance to the Taliban; and imposing secondary sanctions on any state or non-state actor that gives support to the Taliban or any government offices under Taliban control.[157] A policy aimed at isolating the Taliban is the default option for key donors, including the U.S., because it is the status quo and requires no controversial choices.

A. *Reasons to Let Them Fail*

Proponents of isolating the Taliban deploy several arguments. The first is that insurgents who seize power have no right to expect assistance from the outside world. Moreover, policymakers who were dedicated to fighting the Taliban might hesitate before committing funds that would have the effect of helping them govern. For many years, in negotiations with the Taliban and other donors, the U.S. told the group's leaders that gaining power through military means rather than a political settlement would make them an impoverished pariah regime once again, as in the 1990s. Following through with that warning is defensible in several respects. Insurgents abroad might feel emboldened if the Taliban receive donor assistance, generating a perception among armed groups that military conquest could result in aid. Support could also be construed as de facto acquiescence in the group's past and present human rights violations. The Taliban grabbed territory that is home to millions of vulnera-

[155] One test of statehood is "making and enforcing binding rules, monopolising the means of violence and collecting taxes". Daniel Lambach, Eva Johais and Markus Bayer, "Conceptualising State Collapse: An Institutionalist Approach", in Rachel M. Gisselquist (ed.), *Fragility, Aid and State-building: Understanding Diverse Trajectories* (New York, 2017), p. 31.
[156] Crisis Group interview, Western diplomat, 9 November 2021.
[157] The 22 Republican senators who co-signed the secondary sanctions bill focused on Pakistan's support for the Taliban, proposing restrictions on many businesses, especially in the financial sector.

ble people, but that should be no guarantee of the support the last government enjoyed. A former Afghan ambassador compared it to a "hostage" situation.[158]

Another reason for letting the Taliban government fail might be to avoid inspiring Islamist militants elsewhere. Crisis Group's initial research into the way such groups view the Taliban victory was inconclusive, finding that events in Afghanistan might give some jihadists a morale boost, but with unclear effects on militants' recruitment and funding, and the balance of forces on the battlefields where they are fighting, which depends much more on local factors.[159] The degree of inspiration for Islamist movements around the world might depend on whether the Taliban stumble out of the gate, and Western governments might reasonably seek to deny them a triumphant start.[160]

The Taliban stand for a set of values antithetical to Western ideals, directly opposing the "feminist foreign policy" and "democracy promotion" written into the mandates of major donors. For this reason, some argue that the Taliban should be treated like permanent enemies, to be opposed and undermined.[161]

Another motivation for letting the Taliban fail could be the global scarcity of aid dollars. For decades, Afghanistan has absorbed an outsized share of the resources available for poverty reduction. Since 2002, the EU, for example, has provided more than €4 billion in development aid to Afghanistan, more than to any other country in that period.[162] Afghanistan has also consistently ranked as the largest beneficiary of U.S. foreign aid to low-income countries, despite a steady decline over the last decade.[163] The priority given to Afghanistan was even more impressive on a per capita basis. In 2020, Afghanistan's population of 39 million received 43 per cent of U.S. aid for the entire region of South and Central Asia, with 1.9 billion people. Despite such a high concentration of aid dollars, poverty worsened in recent years.[164] If donors are looking for locations where their dollars go the furthest toward lifting people out of misery, there are valid reasons for looking elsewhere.

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[158] "EU pledges $1.15 billion in Afghan aid as U.S. talks to Taliban", *The New York Times*, 12 October 2021.
[159] Crisis Group Commentary, "How Islamist Militants Elsewhere View the Taliban's Victory in Afghanistan", 27 October 2021.
[160] The opposite argument could also be plausible, however: Western-imposed sanctions and asset freezes might result in mass starvation that fuel grievances and jihadist recruitment across the region.
[161] Ahmed Massoud, "The mujahideen resistance to the Taliban begins now. But we need help", *The Washington Post*, 18 August 2021.
[162] See the Afghanistan page on the Council of the EU website.
[163] For fiscal year 2021 (which ended 30 September), U.S. development and governance aid totaled $358 million and humanitarian aid $258 million. Although humanitarian aid fluctuated around a similar level over the prior decade, development and governance assistance had fallen from $5.3 billion in fiscal year 2010. The cumulative total from 2002 through fiscal year 2021 of $36.2 billion for development and governance and $4.4 billion for humanitarian was far outstripped over the same period by $89.4 billion in U.S. Department of Defense assistance for Afghan security forces. "Quarterly Report to the United States Congress", Special Inspector General for Afghanistan Reconstruction, 30 October 2021, Appendix B.
[164] Shubham Chaudhuri, "The latest poverty numbers for Afghanistan: A call to action, not a reason for despair", World Bank (blog), 7 May 2018.

A last reason relates to migration. Donors (particularly European) already spend a large part of their time and money on policies aimed at keeping Afghans inside their country and discouraging those who flee across borders from travelling onward. The share of resources focused on constraining migration, and forging partnerships with regional actors for that purpose, could increase as Afghanistan falls deeper into chaos. Having just witnessed enormous investments in state building evaporate, and anticipating another state collapse, donors might reasonably draw the conclusion that no institutions remain in Kabul with any prospect of being revived. A total loss of control would render moot any debates about how to deliver services with the Taliban in charge.

B. *Consequences of Failure*

If donors have reasons to countenance state failure in Afghanistan, the consequences of doing so are likely to be dire. No one knows what will happen if Afghanistan sinks further into impoverishment, but the best-informed predictions tend to focus on the risks of famine, increased migration, renewed transnational terrorism and greater narcotics supply, as well as the human toll – especially for women and girls. The Afghan people will likely bear the worst of these consequences, while others could pose dangers outside Afghanistan. None would likely threaten the Taliban's grip on power under foreseeable circumstances.

1. Risks to Afghan civilians

The biggest and most immediate consequence of state failure in Afghanistan would almost certainly be mass hunger, as joblessness throws more and more people into penury and essential services wither. Women and girls are likely to suffer the most in this scenario, though men and boys would suffer greatly as well.

Famine already looms. Already the economic and humanitarian disasters enveloping Afghanistan may seem like the worst calamities a country could suffer, but it can get much grimmer. The UN has not yet declared a famine in Afghanistan, although many people are already starving to death.[165] Haunting pictures of skeletal babies are becoming a staple of international media coverage.[166] Ordinary Afghans are the main victims, of course, but famine would have political repercussions as well. In particular, the reputational damage to Western countries implicated in the debacles of the last two decades will get more severe as hunger grows.

Beyond the spectre of famine lies the long-term impact of state failure, as institutions providing health care, education and other services close for lack of resources, combining with poverty to trap large segments of the population in dire circumstances.

The disappearance of basic services disproportionately affects women and girls. Shutting clinics increases the risks of women dying in childbirth, after decades of medical advances that reduced the danger to new mothers by more than half.[167] School-

[165] "The world must act now to stop Afghans starving", *The Economist*, 13 November 2021.
[166] See, for example, "Afghan children face death from malnutrition without intervention, advocatess warn", NBC News, 15 October 2021; and "Afghans facing 'hell on earth' as winter looms", BBC, 8 October 2021.
[167] Bhav Jain et al., "Global Health Responsibilities in a Taliban-led Afghanistan", *Nature Medicine*, no. 27 (2021).

ing for girls would also be imperilled: UN officials emerged from talks with the Taliban in October expressing hope that girls' secondary schools could be re-opened across the country in "a month or two", continuing the slow easing of the Taliban's initial ban on schooling for girls after sixth grade.[168] But the Taliban's permission – if they do give it elsewhere in the country, which is not certain – will not matter if no funding exists for schools or other services. Some families will scrape together money for the private schooling of boys, but many girls will not be allowed to learn.

Even with schooling, a state collapse would affect the lives of women in profoundly negative ways. More and more young brides would be sold off to cover household debts.[169] Electricity blackouts and the shutdown of internet services would leave millions of women largely confined to their homes in the dark, literally and figuratively. Telecommunications providers already warn they will start pulling the plug because of banking restrictions, depriving remote villages of a link to the world.[170] Crisis Group has interviewed dozens of women throughout Afghanistan in recent years, and one of the major findings is that access to radio, television and the internet has opened horizons for women and gradually changed the prevalent values in Afghan society, a trend that could reverse.[171]

2. Risks for other countries

The three major consequences of state failure for neighbouring and other foreign states are likely to be increasing emigration, a heightened threat from transnational jihadist groups operating from Afghanistan, as al-Qaeda did in the late 1990s, and greater outflow of illegal drugs including opium.

Afghans are already one of the largest migrant populations in the world, with 2.6 million registered Afghan refugees, according to the UN High Commissioner for Refugees, and many more unregistered. The war's conclusion sharply reduced the number of people internally displaced by conflict, although an estimated 677,000 people remain uprooted from their homes.[172] The pain of a shrinking economy is worsened by demographic pressures, as about 400,000 youth enter the job market every year,

[168] "Taliban to allow girls to attend schools, says UNICEF official", *Hasht-e Subh*, 18 October 2021; "Taliban allow teenage girls back in some provincial schools – but not in Kabul", *The Wall Street Journal*, 12 October 2021.

[169] "As Afghanistan sinks into destitution, some sell children to survive", *The Wall Street Journal*, 16 October 2021.

[170] "Afghanistan's lack of dollars threatens internet infrastructure", Bloomberg, 4 October 2021. Only about 26 per cent of the 39 million people in Afghanistan live in cities, but villagers had been getting online quickly: the country has about 27 million mobile phones and about 8.6 million internet users, with about a million additional users each year. Simon Kemp, "Digital 2021: Afghanistan", Data Reportal, 11 February 2021. Among other things, connectivity gave women information about health care; research also suggests that women in conservative societies are more likely to find jobs and suffer less domestic violence when they have internet access. See Fazal Yamin et al., "Women's Perceptions of Using Mobile Phones for Maternal and Child Health Support: Cross-sectional Survey", *JMIR mHealth and uHealth*, vol. 6, no. 4 (2018); and Mariana Vollaz and Hernan Winkler, "Does the Internet Reduce Gender Gaps? The Case of Jordan", unpublished paper presented to World Bank conference, 30 May 2019.

[171] Crisis Group interviews, women in fourteen Afghan provinces, 2019-2020.

[172] "Afghanistan: Snapshot of Population Movements (January-September 2021)", OCHA, 22 October 2021.

according to World Bank data. Instead of seeking shelter in the cities, Afghans are now fleeing the country: observers at the border say the number of emigrants has "increased exponentially".[173] Human traffickers at one major crossing said their business had doubled as Afghans escape toward Europe.[174]

As for transnational terrorism, the main worry seems to be the Islamic State-Khorasan Province, the ISIS franchise in Afghanistan. The Taliban are battling this group daily, primarily in the east. But they say economic pressures have weakened their capacity for combat.[175] Former U.S. Envoy Zalmay Khalilzad echoed that claim, warning as well that, absent foreign assistance to Afghanistan, a variety of other threats could emerge in the coming years.[176] To be sure, the Taliban have an incentive to promote this notion, knowing that Western and regional states are concerned above all with terror threats. Whether such fears are justified is hard to say: small numbers of foreign militants have reportedly settled in Afghanistan, but experts disagree about the scale of their capabilities and the Taliban's ability (or willingness) to honour their promise to contain them.[177] At a minimum, isolation policies will put the Taliban in no mood to contemplate counter-terrorism cooperation with the West. They will certainly withhold what the U.S. and others want most if their interests receive no consideration in exchange.

The issue of narcotics supply is clearer: opium, hashish and methamphetamines will remain major exports in the coming years. Despite their claims to have taken action to curb the narcotics industry, the Taliban have few practical means of reducing the scale of production. Production volumes could grow further as other sectors of the Afghan economy collapse, leaving hundreds of thousands of people unemployed. Cheap farm labour has been a key ingredient that made Afghanistan the world's largest producer of opium in recent decades.[178] Experts predict that urban economic collapse would push more labourers into farmlands, expanding the global supply of narcotics.[179]

3. Fewer consequences for the Taliban

Although allowing the state to fail might incur substantial future costs and consequences for the Afghan people and for foreign interests, it is far from clear that the Taliban's grip on the country would weaken. Taliban supreme leader Hibatullah Akhundzada has not bothered to spend time in the capital city since his movement took power, preferring to hold court in the southern province of Kandahar, where he was born.[180] Some experts speculate that Taliban leaders feel comfortable with a scenario of semi-collapse in which their domestic opponents – concentrated in cities – are impoverished, while Taliban supporters in the countryside are less affected.

[173] See tweet by David Mansfield, economist, @mansfieldintinc, 2:44pm, 11 October 2021.
[174] See tweet by Secunder Kermani, journalist, @SecKermani, 8:59am, 9 November 2021.
[175] "A Conversation between Mawlawi Muttaqi and Sultan Barakat", op. cit.
[176] "Lessons from America's Afghanistan withdrawal", CNN, 31 October 2021.
[177] Crisis Group interviews, terrorism experts, October 2021.
[178] Christopher Ward, David Mansfield, Peter Oldham and William Byrd, "Afghanistan: Economic Incentives and Development Initiatives to Reduce Opium Production", World Bank, February 2008.
[179] Crisis Group interviews, narcotics expert, 2 and 3 November 2021.
[180] "Taliban's reclusive supreme leader appears, belying rumours of his death", Reuters, 31 October 2021.

Rural areas were somewhat disconnected from the urban economy during the last two decades, separated by the front lines of battle.[181]

The Taliban are resilient, and outsiders may struggle to shape their behaviour by isolating them. Their leaders spent twenty years learning how to survive under military pressure and punishing sanctions, and their new economic team has experience with hiding money and circumventing banking restrictions.[182] Even with the world's most sophisticated armies pursuing them, the insurgents gained control over a lucrative shadow economy. Taliban profits from the drug industry have been exaggerated, but still amount to tens of millions of dollars annually, in addition to greater revenues from "taxes" on trade and agriculture.[183] The chances of the Taliban losing power if the economy falls apart and their opponents gain traction should not be dismissed entirely, but for the time being they are secure in their victory.

Moreover, lessons from elsewhere strongly suggest that sanctions tend to squeeze the citizens of states being punished while doing little to alter leaders' calculus. The effects of sanctions are foreseeable, but Western policymakers often fail to anticipate the consequences until it is too late to avoid humanitarian crises.[184] Insulated by illicit wealth and sometimes support from other governments, those in power are usually less affected. In places as varied as Cuba, Iraq, Venezuela and Gaza, sanctions had few of the intended effects on governments but did severe damage to civilian livelihoods and fuel off-the-books trade.[185]

[181] Crisis Group interviews, Taliban experts, October 2021.
[182] Crisis Group interviews, Taliban officials and Taliban experts, September-October 2021.
[183] David Mansfield and Graeme Smith, "War Gains: How the Economic Benefits of the Conflict are Distributed in Afghanistan and the Implications for Peace", Alcis and ODI, August 2021.
[184] In Somalia, the threat of U.S. sanctions impeded aid delivery in 2010 and 2011 until the UN declared a famine, at which point Washington belatedly eased sanctions. Such a disaster was narrowly averted in northern Yemen, where UN agencies and NGOs asked President Biden to suspend U.S. sanctions on humanitarian grounds – and he did, without formally reversing earlier findings that the Huthis are terrorists. When considering the Yemen decision in early 2021, the U.S. government was presented with a scenario like what is now unfolding in Afghanistan: the UN warned that sanctions on the Huthis would halt salaries for civil servants, cripple the economy, devalue the currency, increase food prices and hobble the banking system. Crisis Group interviews, UN officials who worked in Yemen, October 2021. See also Kate Mackintosh and Patrick Duplat, "Study of the Impact of Donor Counter-terrorism Measures on Principled Humanitarian Action", Norwegian Refugee Council, July 2013.
[185] Crisis Group analysis of sanctions' effects in Iran and Venezuela appears in "U.S. Sanctions: An Overused Tool?", Hold Your Fire! (podcast), 21 January 2021. See also Juan Zarate, *Treasury's War: The Unleashing of a New Era of Financial Warfare* (New York, 2013).

VI. A Better Option: Preserve State Functionality

State collapse is not inevitable, but appears increasingly likely; indeed, the plunge is already in progress. Major changes in approach to Afghanistan policy, especially by the United States, would be necessary in the coming weeks to keep a modicum of essential services working under the Taliban.

The main challenge is the political climate in Western capitals. For some governments it will be impossible to sell parliamentarians and voters on a head-spinning course reversal from battling the Taliban to helping the former insurgents provide services to millions of people.[186] Deborah Lyons, the special representative of the UN secretary-general, identified the problem in the early weeks of the crisis: "A modus vivendi must be found, and quickly, that allows money to flow to Afghanistan to prevent a total breakdown of the economy and social order".[187] Such declarations are easier for officials not worried about elections; she was later echoed by her boss, UN Secretary-General António Guterres, and the outgoing German chancellor, but other politicians have been more subdued. After two decades of war, Western voters find the Taliban so odious that the topic of Afghanistan is too hot to touch; one European official observed: "Nobody wants to burn their fingers".[188]

Nonetheless, the political costs need to be weighed against the harm, outlined in previous sections, resulting from an isolation policy. The fallout would not be limited to the millions of Afghans who suffer first-order consequences. Second-order effects could include regional instability, unmanageable migration and further disrepute for rich countries that could have mitigated the human disaster but chose not to. The political price of moving now with bold action to address the situation pales in comparison to the political cost of allowing Afghanistan to descend into utter catastrophe.

There is an alternative approach that focuses on preserving at least a minimal degree of state functionality. A path toward salvaging the state remains open, but donors must choose to engage rather than isolate the Taliban. They cannot do both and have a coherent policy that achieves clear objectives. There is no precedent for a state that has functional essential public services, and economic activity that depends upon such services, under a failed or failing government.[189]

A. *Move Beyond Emergency Relief*

Neither the U.S. approach of narrowly restricted humanitarian aid nor the European "humanitarian plus" concept will be sufficient to avoid collapse. The world will need to unlock the larger budgets and broader purposes of development funds to address the scale of the problem. Food shipments are necessary as short-term relief, but such

[186] "'Send the bill to Blair!' Britons furious as Taliban demand billions in war reparations", *Express*, 11 October 2021.
[187] "Briefing by Special Representative Deborah Lyons to Security Council", UN Assistance Mission in Afghanistan, 9 September 2021.
[188] Crisis Group interview, European official, Berlin, 21 September 2021.
[189] A small example exists in Gaza, but the model of UN service delivery in that territory would be difficult or impossible to scale up for the larger population of Afghanistan. Crisis Group interview, UN official who served in Gaza and Afghanistan, 6 October 2021.

emergency measures cannot be a substitute for basic services. Some U.S. officials believe that giving money to UN agencies and NGOs to address urgent humanitarian needs while imposing restrictions on other forms of assistance can avert the worst human suffering, but they are mistaken. The suffering will grow more quickly than humanitarian agencies can supply aid, unless there is support for restarting the Afghan economy.

The largest support mechanism before the Taliban takeover was the World Bank's Afghanistan Reconstruction Trust Fund (ARTF), backed by 34 donors. Immediately restarting ARTF disbursements is the most vital and easiest step donors could take to move beyond narrow humanitarian relief. The fund has about $1.5 billion in unspent money waiting to be disbursed, which could be allocated right away to health, education, food security and community resilience programs.[190] The U.S. has signalled that it might allow ARTF funds for UN and NGO health-related activities, but would block disbursements for programming via Afghan ministries.[191] This restriction is cruel as hunger deepens and the best existing options for avoiding large-scale destitution are ARTF projects in partnership with the three Afghan ministries responsible for agriculture, local governance and rural development.[192] The U.S. has also not laid out the restriction in a way that suggests it is based on an analysis of the specific risks of Taliban diversion of funds. The U.S. should drop its objection to Afghan civil servants receiving donor money.[193]

No matter what funding mechanism they prefer, donors must consider which functions of the Afghan state are "essential" and require some level of support. Health, education, central banking, electricity, water supply and many other basics will need financial support from the outside world for a period of years. How many years will depend on whether the Taliban and donors can construct a new economy not predicated on war spending. The Taliban have already been dusting off plans from previous governments to build railways and mines, along with gas pipelines and electricity corridors for Central and South Asia.[194] Such projects may or may not deliver results in the coming decades, but in the short term there is certainly a deep chasm of immediate needs. In the coming years, donors should consider continuing the gradual reduction of aid of the last decade, decreasing foreign assistance to more sustainable levels (as outlined below) at a speed that allows adaptation to the changes.

B. *Prioritise the Financial Sector*

Perhaps the most urgent actions required of donors, and especially the U.S., relate to the liquidity crisis and the financial sector's paralysis. Major traders cannot drive truckloads of paper currency across borders to purchase imports with local afghanis;

[190] Crisis Group interviews, UN consultant, 4 and 5 November 2021.
[191] Crisis Group interviews, UN and World Bank officials, November 2021.
[192] In the past, Afghan government partners for ARTF food security programs included the ministry of rural rehabilitation and development, the Independent Directorate for Local Governance and the ministry of agriculture, irrigation and livestock. "Afghanistan: New grants to cushion impact of COVID-19 on poor households and protect food security", press release, World Bank, 4 August 2020.
[193] Crisis Group interviews, Western officials, 22 November 2021.
[194] "A Conversation between Mawlawi Muttaqi and Sultan Barakat", op. cit.

they need U.S. dollars and financial services. Afghans depend on imports for their daily bread after shortfalls in local harvests resulted in demand for 2.7 million tonnes of imported wheat in 2021.[195] Even the delivery of basic humanitarian aid is hamstrung by the shortage of paper currency.[196] By one estimate, the humanitarian sector needs about $3 million per day, an amount too large to be supplied by traditional *hawala* currency dealers.[197] UN Secretary-General Guterres has called for resolving this problem quickly: "I urge the world to take action and inject liquidity into the Afghan economy to avoid collapse".[198]

The first – and most effective – option would be to revive the central bank. Regulation of the financial sector is the responsibility of the central bank, Da Afghanistan Bank. Before the Taliban takeover, that bank supervised dollar auctions that injected about $45 million per week into Kabul's currency markets; some economists say $15 million per week might now be sufficient for the diminished level of commerce under the Taliban.[199] The technically simplest way to restart the dollar auctions would be unfreezing the assets of Da Afghanistan Bank, but the U.S. is very reluctant to do that and it is unclear whether the Taliban would have the financial acumen to run their own monetary policy. Some Western officials have floated the idea of sending technical experts to help the Taliban administer the central bank, but that prospect remains distant, in part because of U.S. resistance.[200] In the meantime, the Taliban continued issuing edicts forbidding the use of foreign currencies in November, and local businesspeople continued warning that the rules are impractical because they need U.S. dollars for imports.[201]

A second option would entail establishing a parallel central bank. Externally imposed sanctions and other restrictions might prevent the Taliban from running their central bank effectively, even if they had the skills, because the bank suffers from shortages of both U.S. dollars and afghanis. Afghanistan lacks printing presses for its own currency, and it would eventually need permission to resume ordering banknotes from international printers.[202] In the meantime, some entity must act as a central bank. A former U.S. Treasury official has proposed a parallel system, empowering the strongest of Afghanistan's private banks to provide some central banking func-

[195] Mayar, "Global warming and Afghanistan", op. cit.
[196] The liquidity shortages fuelled speculation about Afghans turning to cryptocurrencies and mobile money, but such alternatives remain at the fringes of the economy. About 85 per cent of Afghans do not use banks, making the country dependent on paper currency. See "A pathway to financial inclusion in Afghanistan", World Bank (blog), 19 February 2020.
[197] Sue Eckert, testimony before the U.S. Senate Committee on Banking, Housing and Urban Affairs, 5 October 2021.
[198] See tweet by António Guterres, UN secretary-general, @antonioguterres, 10:37 am, 12 October 2021.
[199] Crisis Group interviews, economic experts, September 2021.
[200] Crisis Group interviews, European and World Bank officials, November 2021.
[201] Crisis Group interview, Afghan businessman, Jalalabad, 3 November 2021. See also "Taliban bans use of foreign currency across Afghanistan", Al Jazeera, 2 November 2021.
[202] A French company, Abirtour Fischer, was hired to supply Afghanistan's banknotes in 2021. "A French company to print 390mn afghani banknotes for Afghanistan", MenaFN, 28 May 2021.

tions as a short-term way of easing the liquidity crisis.[203] Such an arrangement would be a novelty in modern history but would not be without precedent: even the Bank of England started as a private institution, hundreds of years ago.[204] Early indications suggest that the Taliban might reject the idea of parallel institutions regulating their currency, and diplomacy would be required to convince them that no alternatives exist.[205]

A third option would entail currency swaps managed by an international entity such as the World Bank or a UN agency. In the absence of a functioning central bank, with continued paralysis in the financial sector, Afghan businesses are collecting bushels of paper afghanis in warehouses because they are reluctant to make deposits. Humanitarian agencies have the opposite problem, with foreign accounts holding U.S. dollars and few efficient mechanisms for transferring cash into the country. Improvised deals have started between them, as major UN agencies make currency swaps with large Afghan businesses. Humanitarians get bundles of paper cash, and businesses replenish their overseas bank accounts. Already, a cash distribution program for impoverished families involved a deal worth hundreds of thousands of dollars with one of Afghanistan's wealthiest business owners.[206] Such arrangements could be systematised under a UN proposal for currency swaps, with the World Bank or another institution serving as matchmaker for dollar-to-afghani trades.

The Biden administration's best option would be the most courageous one: careful unfreezing of Afghan assets to revive the central bank. But absent the will for such decisions the quickest fix is expanding the volume of currency swaps. As of November, U.S. officials were reviewing the concept.[207]

C. *Ease Sanctions*

There is no point sending foreign aid while choking the economy with sanctions; it is a waste of money and lives. As discussed above, the U.S. remains the most important gatekeeper to the Afghan economy because many financial institutions, private firms and humanitarian agencies are loath to risk violating U.S. sanctions. The UN Security Council and EU also play significant roles; if the U.S. eases sanctions, they should, too. Still, the impetus needs to come from Washington.

The White House should instruct the U.S. Treasury's OFAC to go far beyond the two general licences issued in September. At minimum, OFAC should issue more general licences that allow activities such as development aid, overflight fees, electricity purchases and regular trade of commercial goods.[208] Afghan banks should

[203] Current and former U.S. officials usually refer to Afghanistan International Bank as the leading candidate. See, for example, Adam Smith's testimony before the U.S. Senate Committee on Banking, Housing and Urban Affairs, op. cit.
[204] Andreas Michael Andréadès, *History of the Bank of England* (London, 2013).
[205] Crisis Group interviews, UN official and UN consultant, October and November 2021.
[206] Crisis Group interviews, November 2021.
[207] Crisis Group interviews, UN consultant, 4 and 5 November 2021.
[208] OFAC's general licences have proliferated for dealing with countries under heavy sanctions. Venezuela has more than 30 such licences. "Venezuela-Related Sanctions", Office of Foreign Assets Control.

be allowed access to their overseas holdings and the global financial system. A more comprehensive approach would see the U.S. government clarifying its policy, limiting sanctions to listed members of the Taliban and not the Afghan government – even ministries run by sanctioned individuals.[209] U.S. policymakers might consider lifting some sanctions altogether, given that, as described above, such sanctions are unlikely to change the Taliban's behaviour and tend to hurt ordinary people more than the regimes they target.

D. *Empower the UN to Manage Risks in Aid Delivery*

Providing services under the shadow of a potentially predatory government or armed groups always involves risks: officials or militants steal aid, extort humanitarian agencies and exploit aid operations to collect information and reward supporters. Already, Afghans complain about the Taliban misappropriating aid for their own followers.[210] UN staff remember the experience with the Taliban in the 1990s as plagued by problems with diverted funds, compromised humanitarian norms and outright corruption.[211] In Yemen, too, the Huthis have profited from foreign aid (though Crisis Group still advocates sending more aid to Yemen to avert famine).[212]

Experienced aid workers concur that mitigating such risks requires a strategy and a dedicated focal point – like an empowered UN office in Kabul – to lead talks with local authorities about gaining access without being used. Donors should give authority to on-the-ground UN leadership to coordinate such efforts, including steering money away from areas susceptible to misuse and informing donor decisions to withhold aid when necessary.[213]

Still, even with the UN playing such a role, it will be necessary to consult the Taliban in planning. The UN leadership cannot decide the future course of Afghan development. Aid agencies are scrambling to fill the gaps of a crumbling state, but this work will not succeed piecemeal. If donors want to support essential state functions on a large scale, such as schooling for millions of girls and boys, they will need to talk to the Taliban on national plans. Policymakers should be clear-eyed about the limits of parallel systems created by aid delivery. Aid experts criticise funding that bypasses local leaders as counterproductive in the long term and sometimes inefficient in the short term.[214] Planning should also include a gradual tapering of assistance to

[209] See Adam Smith's Senate testimony, op. cit.
[210] Crisis Group interview, aid worker in Mazar-e Sharif, 15 October 2021. See also "Afghans accuse Taliban of misappropriating foreign aid", RFE/RL, 27 October 2021.
[211] Crisis Group interviews, UN officials who served in Afghanistan in the 1990s, September and October 2021.
[212] See "Deadly Consequences: Obstruction of Aid in Yemen during COVID-19", Human Rights Watch, 14 September 2020; Crisis Group Commentary, "Arresting Yemen's Freefall", 26 May 2021.
[213] A variety of UN structures could be employed for risk mitigation, including a team working under the UN Assistance Mission's special representative or the resident coordinator. Crisis Group interviews, current and former UN officials, October and November 2021.
[214] By one estimate, donors delivered some 85 per cent of all grants since 2001 outside of government systems, although over the decades of Western intervention, they started to direct a greater share of aid to on-budget support for the Afghan government itself. See Nigel Roberts, "When things fall apart", ODI Lessons for Peace Afghanistan (blog), 3 August 2021; and Tobias Haque, "Where

kick the habit of extreme aid dependency. Again, that would require working with the Taliban: for example, investments in irrigation and water management – not traditional "humanitarian aid" – would help reduce the likelihood of drought crises and lead to fewer appeals for donations in the future.[215]

E. *Hard Negotiations Ahead*

Whichever essential services donors decide to fund, for whatever period of years, development aid will give them a greater – even if limited – degree of negotiating leverage with Kabul than would be available in a response limited to the narrowest forms of emergency relief. Holding back lifesaving aid as a bargaining chip contravenes humanitarian norms. Donor agreements on development assistance should not be unconditional, however. Italian Prime Minister Mario Draghi hinted as much in his comments at the G20, emphasising that renewed aid must be accessible to all Afghans. At minimum, that would imply setting conditions for the Taliban that prevent them from offering services in a way that discriminates based on gender, religion or ethnicity.

Enforcing such basic conditions will be hard enough. Capitals should not burden their teams in Afghanistan with unrealistic demands, such as wishing away the Taliban victory. Some observers have argued that aid conditionality could be used as leverage to coax the Taliban into forming an "inclusive" government, but donors should temper expectations for cabinet shuffles.[216] Inclusivity should remain a point to press on when diplomats sit down with the Taliban, not a condition for keeping the lights on. Donors' high-level decision-makers need to weigh the limited prospects of getting the Taliban to include in their regime – much less empower – representatives of constituencies other than their own supporters against the likelihood of many Afghan lives lost and diminished in a protracted humanitarian and economic crisis.

UN officials had initial successes in some locations as they negotiated with Taliban officials about reopening girls' secondary schools, but countless similar negotiations will be required in the coming years as the Taliban's hardline views collide with international norms. Working with the Taliban is already exhausting some aid workers, as the new masters of Kabul demand jobs for their relatives and impose restrictions such as refusing face-to-face meetings with women.[217] Experts who have studied Taliban negotiations say the best approach would be breaking the problems down into many small discussions on particular issues, rather than seeking grand bargains, and bracing for years of frustrating follow-up meetings.[218] The Taliban will continue be-

does the money go? Examining public spending in Afghanistan", World Bank (blog), 29 July 2019. A former finance minister said about 60 per cent of foreign aid in 2021 was off budget. Clark and Shapour, "The Khaled Payenda interview", op. cit.

[215] Mayar, "Global warming and Afghanistan", op. cit.

[216] Sarah Chayes, "The Taliban is vulnerable. Here's how to seize the moment", *Politico*, 13 November 2021.

[217] Crisis Group interview, Kabul-based aid worker, 7 November 2021.

[218] Lessons could also be drawn from the UN experience in Yemen, where negotiations with the Huthis were centralised under the resident coordinator but required persistent follow-up on long lists of concerns gathered from aid workers in the field. Crisis Group interviews, UN officials, October 2021.

having like Taliban. There is little evidence of them softening their ideological views. Still, they may be ready to cooperate on a "to do" list of practical tasks and appear more likely to move gradually on donors' demands as aid comes in than offer major concessions up front.[219] The tiresome reality will be a need for daily negotiations, coordinated by the UN.

[219] Crisis Group interviews, Taliban experts, October 2021.

VII. Conclusion

No donor wanted to see the Taliban rise to power to Afghanistan, and accepting the reality of their ascent is difficult. Rich nations were inspired to spend hundreds of billions of dollars over the last two decades because they hoped to transform the country into a self-sustaining democracy capable of providing for its own security in ways aligned with the donors' security interests. That effort failed, and the choices now confronting donors in the aftermath of the Taliban takeover are exceptionally grim. They can allow economic strangulation to drive the Afghan state into a messy collapse that causes dramatic impoverishment, potentially kills hundreds of thousands of Afghans and strains regional stability, or they can avoid that outcome by finding ways to work with the Taliban regime. There cannot be a reasonably functional state and economy under an isolated government.

Devoting billions of dollars to keep the Afghan state on life support under Taliban rule is not an option that will rouse applause in many countries – but it is the best choice available for the moment. It is not a permanent solution, only a short-term way of cushioning the enormous economic blow the country has absorbed. Pakistan, the Taliban's biggest supporter, has called for a "roadmap" toward full recognition of the new government.[220] Most countries are not convinced that the Taliban deserve a place on the world stage, and global acceptance of the new regime might never happen. Yet even absent formal recognition of the Taliban, nearly 40 million Afghans need a government. They need schools, electricity and a banking system. They do not have the luxury of waiting for the Taliban to pass muster with foreign capitals. Temperatures are falling and snows are deepening. For millions of people, the chances of surviving the winter hang on the survival of the Afghan state.

London/Washington/Brussels, 6 December 2021

[220] "Don't isolate the Taliban, Pakistan urges", AP, 23 September 2021.

Appendix A: Map of Afghanistan

Appendix B: About the International Crisis Group

The International Crisis Group (Crisis Group) is an independent, non-profit, non-governmental organisation, with some 120 staff members on five continents, working through field-based analysis and high-level advocacy to prevent and resolve deadly conflict.

Crisis Group's approach is grounded in field research. Teams of political analysts are located within or close by countries or regions at risk of outbreak, escalation or recurrence of violent conflict. Based on information and assessments from the field, it produces analytical reports containing practical recommendations targeted at key international, regional and national decision-takers. Crisis Group also publishes *CrisisWatch*, a monthly early-warning bulletin, providing a succinct regular update on the state of play in up to 80 situations of conflict or potential conflict around the world.

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After President & CEO Robert Malley stood down in January 2021 to become the U.S. Iran envoy, two long-serving Crisis Group staff members assumed interim leadership until the recruitment of his replacement. Richard Atwood, Crisis Group's Chief of Policy, is serving as interim President and Comfort Ero, Africa Program Director, as interim Vice President.

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A Sustainable Policy for Rohingya Refugees in Bangladesh, Asia Report N°303, 27 December 2019.

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