



Development prospects for the Horn of Africa countries to 2040

Economy

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Economy

GDP growth and sectoral contribution

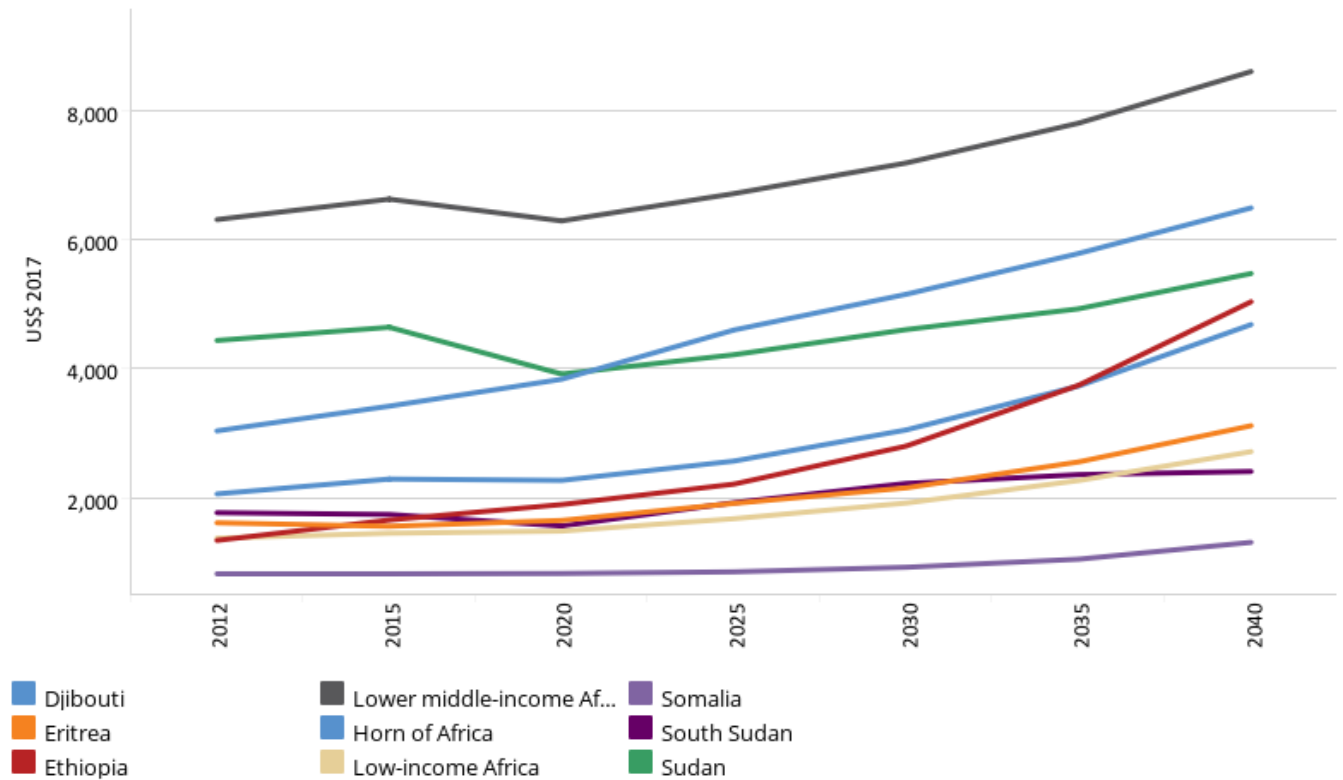
Since the second half of the 1990s, average GDP growth rates have been high across the Horn, especially in Ethiopia, which has become one of the fastest-growing economies in the world. Ethiopia is followed by Djibouti, although it experienced its first economic contraction in two decades in 2020 as a result of the global health pandemic.

Over the period 2000–2010, Sudan experienced an average growth rate of 7% induced mainly by oil extraction. However, this decade of high economic growth ended abruptly in 2011 following South Sudan's secession when Sudan lost 75% of its oil resources.[1]

On average, Ethiopia, Djibouti and Eritrea have recorded between 5% and 9% GDP growth per annum over the past decade. However, conflict and political instability have led to the South Sudanese economy shrinking while the Somalian economy is now growing slowly.

The region had a total GDP of about US\$160 billion in 2019, and most economic activities are concentrated in Sudan and Ethiopia, which account for 89% of the total GDP of the Horn. With the exception of Djibouti, which was recently classified as lower middle-income, the rest are all categorised as low-income by the World Bank. The average GDP per capita of the region (adjusted for purchasing power parity, or PPP) was about US\$2 070 in 2019. It is projected to be US\$3 030 in 2030 and US\$4 685 in 2040, above the projected average of US\$2 725 for other low-income countries in Africa in the same year (Chart 7).

Chart 7: GDP per capita (PPP), Horn of Africa and other groups



Source: Forecast in IFs version 7.63, historical data from World Development Indicators, World Bank

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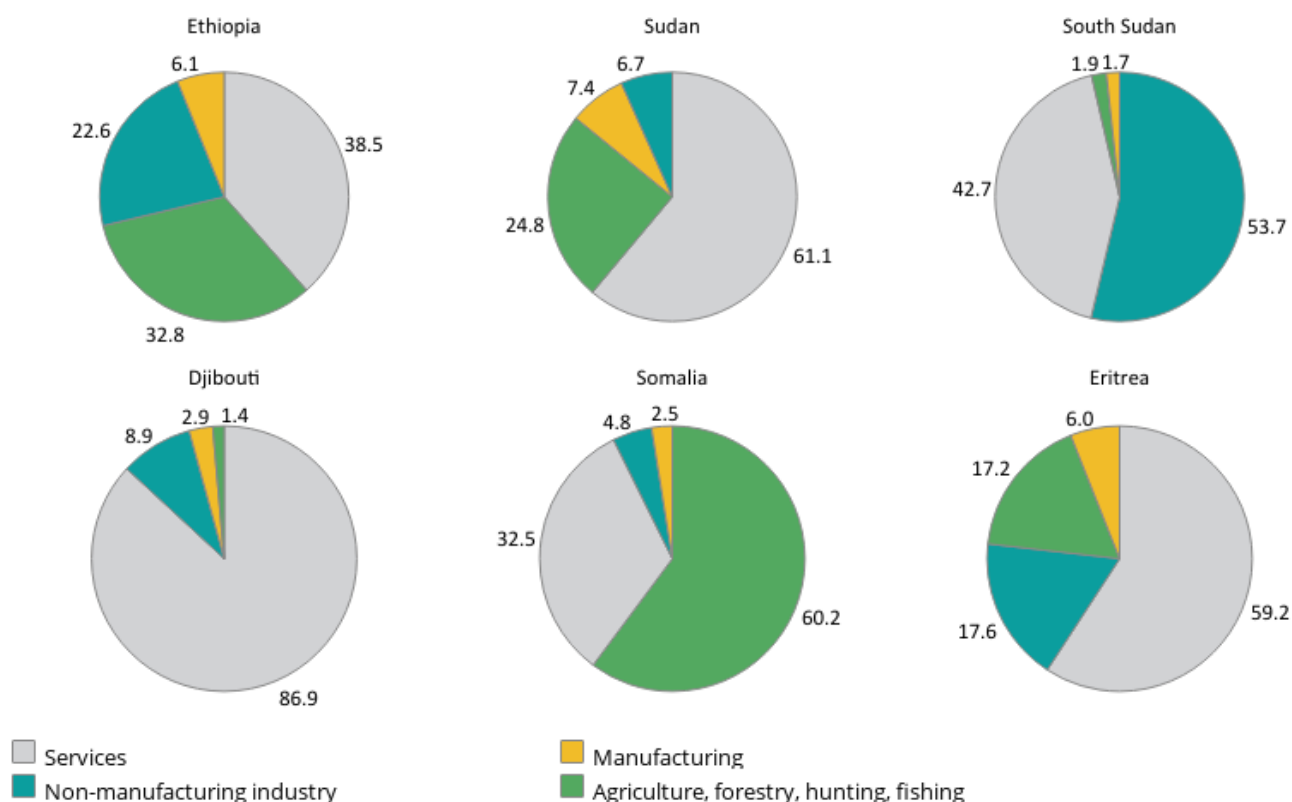
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GDP per capita for Djibouti is below the average for its African lower middle-income peers, but has recently overtaken that for Sudan, which is above the average of other low-income countries in Africa. Currently all the countries except Somalia have their GDP per capita (in PPP) above the average for low-income Africa.

Somalia currently has the lowest GDP per capita in the Horn of Africa and, on the Current Path, will still have the lowest per capita income in the region by 2040. The slow pace of GDP growth in Somalia is not enough to keep pace with population growth, and hence constrains improvements in income per capita.

The economies of the Horn of Africa countries have experienced some structural change but, like many other African countries, this transformation is mainly between subsistence agriculture and low-end services. The share of the agriculture sector in total regional GDP declined from 46.7% in 1997 to 28.9% in 2019. The contribution of the manufacturing sector increased slightly from 7.8% to 11.3% over the same period. The service sector has become the dominant economic activity in the Horn, with its contribution to total regional GDP increasing from 35.9% in 1997 to 48.4% in 2019. However, this regional picture masks large differences between countries (see Chart 8).

Chart 8: Sectoral breakdown of GDP in the Horn of Africa countries (% GDP), 2018



Source: United Nations National Accounts Main Aggregates Database

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Djibouti’s economy relies heavily on the service sector as it accounts for nearly 87% of GDP. The country’s geographical location, its political and economic stability and dynamic port sector offer the opportunity to strengthen its position as a regional hub for various financial, information and communications technology (ICT), and logistics services.

Recognising the need for economic transformation, the government of Djibouti has initiated, through its Vision 2035, a programme to boost economic transformation and diversification. Through this development plan, Djibouti aims to develop a digital technology hub, promote light manufacturing, create more than 200 000 jobs and triple its GDP per capita by 2035[2]. Djibouti also has enormous tourism potential that remains untapped due to obstacles such as insufficient tourism-related infrastructure.[3]

Mining and agriculture constitute the main drivers of economic growth in Eritrea. These sectors are highly dependent on commodity prices and hazards associated with climatic change, and hence create significant volatility in the growth performance of the country. Economic opportunities in the country are mainly in mining, tourism and agriculture. However, agriculture, which accounts for 17% of GDP, is still very rudimentary and subject to recurrent droughts.

The dependence of two-thirds of the population on subsistence agriculture coupled with indefinite military service make the labour market almost non-existent.[4] Increased investment in mining is expected to drive growth. However, Eritrea is already at high risk of debt distress. Although the large share of this debt is domestic, external debt represents 64.4% of GDP.[5] This difficult macroeconomic situation limits the country’s growth prospects.

Years of conflicts and political division have destroyed much of the Somalian economy. The country’s exposure to

recurrent shocks and crises, including drought and insecurity, locust infestation, and more recently the COVID-19 pandemic, pose many challenges for the economy.

Agriculture/livestock remains the backbone of the economy, accounting for around 60% of GDP and employing around 65% of the labour force.[6] The economy is however slowly transitioning from traditional rural pastoralism to urban trade and services. This offers several opportunities for investment and job creation. Most economic activities are centred around Mogadishu, the capital city, and security concerns continue to dominate business in the country.

Somalia's economy is also highly dollarized. According to the International Monetary Fund (IMF), about 90% of currency in circulation in the economy is US\$, and this makes it difficult for the Central Bank of Somalia to conduct effective monetary policy. Also, the country is in debt distress, with external debt estimated at 99.5% of GDP in 2019. However, Somalia is in a debt relief process through the Heavily Indebted Poor Countries initiative, and this could free up vital financial resources to support growth and reduce poverty.

The Sudanese economy, which was suffering from US sanctions, received a huge blow with South Sudan's secession, losing two-thirds of its export earnings and over half the fiscal revenues, resulting in high macroeconomic imbalances.[7] The service sector accounts for about 60% of GDP while agriculture contributes a quarter of GDP and employs 80% of the workforce.

A year after former president al-Bashir was overthrown, Sudan is still trapped in economic mire; with currency depreciation, rising inflation and food shortages. According to Jonas Horner of the International Crisis Group, 'economic recovery in Sudan will be a long road and will require sustained and coordinated technical and financial support of its traditional donors such as EU, US, UK and the Gulf states.'[8] Prime Minister Abdalla Hamdok has noted that the country needs up to US\$8 billion in support over the next two years to rebuild the economy given its high levels of external debt estimated at 88% of GDP.[9]

The removal of Sudan from the US State Sponsors of Terrorism list, reportedly in exchange for its recognition of Israel, opens the door for aid, debt relief, trade and investment. These are badly needed to pull the country out of its severe economic crisis compounded by COVID-19.

As for South Sudan, oil extraction continues to be the backbone of its economy, accounting for nearly 90% of government revenue and more than 30% of its GDP.[10] The country's production potential has been drastically reduced by ongoing conflicts and economic mismanagement, and the economy is highly vulnerable to weather, oil conflicts and related shocks. Outside the oil sector, economic activities are concentrated in rudimentary agriculture and pastoral work.

The average inflation rate peaked at almost 380% in 2016 before declining to an estimated 27% in 2020.[11] Sustainable economic recovery in South Sudan will require long-term peace and comprehensive macroeconomic reforms to combat inflation, addressing foreign exchange distortions, and policies to diversify the economy away from oil.

With the exception of Ethiopia, which has determinedly pursued policies to attract investment in its manufacturing sector, the contribution of manufacturing to GDP in the Horn of Africa countries is marginal. For example, over the period 2005–2017, on average, output in Ethiopia's manufacturing sector grew by 11% annually. However, the sector is still at the embryonic stage and its contribution to job creation and output is far from being an engine for growth and economic transformation.

The agriculture sector has historically been the backbone of the Ethiopian economy, although it has recently been overtaken by the service sector. Agriculture's share in GDP has been falling, but it still employs more than 70% of the country's workforce.[12] Manufacturing contributes to less than 10% of Ethiopia's GDP. However, the ongoing conflict in

the Tigray region will probably reduce investors' appetite for Ethiopian destinations, and this could slow the growth in the manufacturing sector as it is mainly driven by foreign direct investment.

Agriculture and climate change

Agriculture is the backbone of the economies of the Horn and the source of livelihoods for the majority of the population. The sector is, however, poorly developed and faces numerous challenges as well as climatic and conflict impediments. The region is highly food insecure, owing to recurrent droughts, natural disasters and poor governance that hamper crop and livestock production.

Out of Djibouti's 23 200 km² of land, only 1 000 km² are arable, and the country receives an average annual rainfall of only 130 mm. Djibouti has the biggest food deficit in the Horn of Africa and imports up to 90% of foodstuffs. As a result, the country is highly dependent on international market prices. Any variation in international prices has a considerable impact on the poorest segment of the population, who spend 77% of their household budget on food.[13]

Agriculture contributes about 4% of GDP. Approximately 30% of Djibouti's rural population depends on this sector, and because most of the country is semi-arid to arid and water resources are limited, pastoralism is the main form of agriculture.[14]

In Eritrea, nearly 75% of the population depends on agriculture. Out of the 26% arable land, only 4% is actually under cultivation. The country is highly dependent on rainfall thus frequent droughts make crop farming even more difficult.[15] In fact, 70% of Eritrea's land is hot and arid and it receives less than 350 mm of rainfall annually. As an acknowledgment of the situation, the Eritrean government has agreed to reserve US\$17 million to administer solutions for drought effects in rural communities.[16]

Between 80% and 85% of Ethiopians are engaged in agriculture and account for about 33% of GDP.[17] In Somalia, crop and livestock farming remain the main source of economic activity, constitute about 75% of GDP and represent 93% of exports.[18]

Somalia is a fragile state but has huge agriculture and livestock potential. The country's arable land is estimated at 8.5 million hectares with only 2.3 million hectares under rain-fed agriculture and 630 000 hectares under irrigation.[19] Somalia also exports more than 50 million livestock and about 1.8 million tons of fish annually.[20] In the current Somalia National Development Plan (2020–2024), agriculture is at the centre of the strategies to promote growth and reduce poverty.

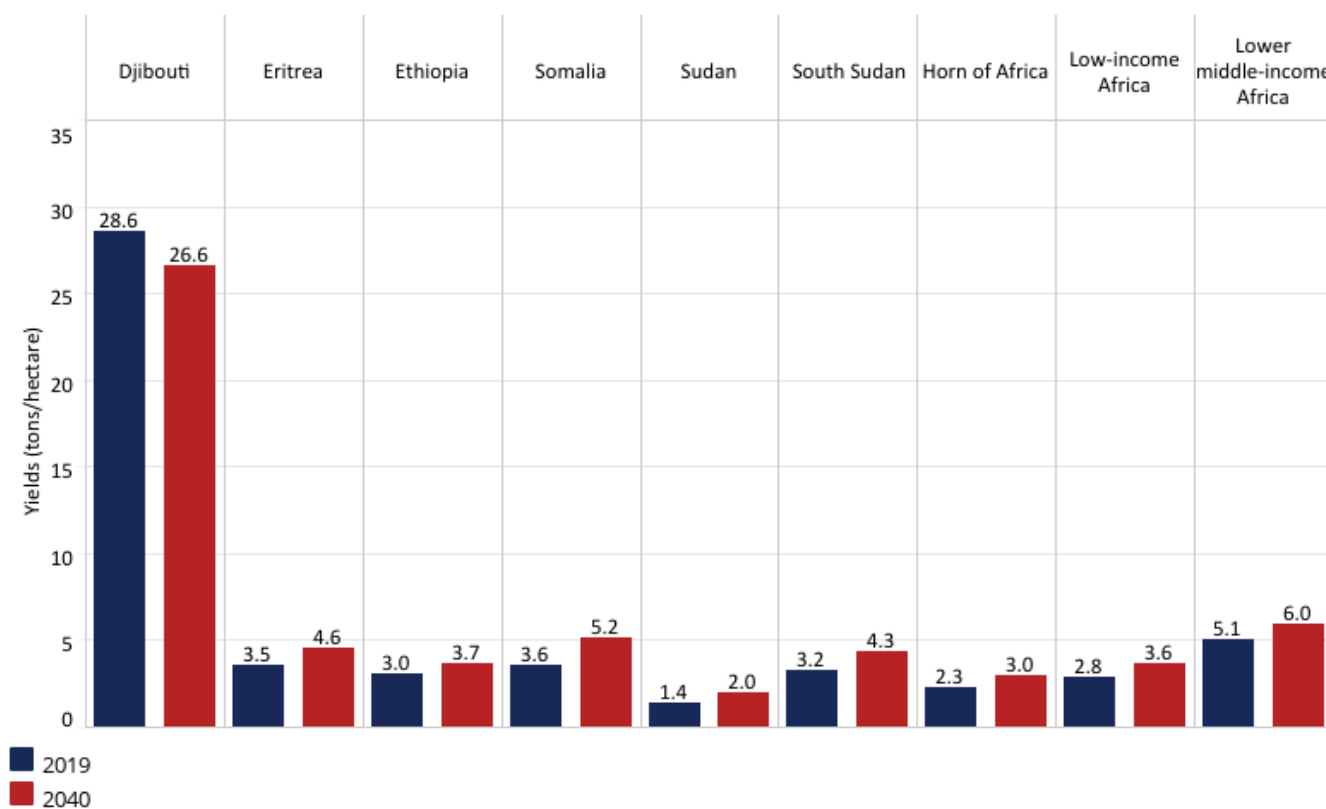
South Sudan also has huge agricultural potential. Favourable soil, water and climatic conditions make 75% of its total land area suitable for agriculture. However, only 4% of the total land area is cultivated continually.[21] Limited use of productivity-enhancing technologies, capacity constraints, poor infrastructure and protracted conflict have constrained agriculture production and the country continues to face recurrent episodes of acute food insecurity. In South Sudan, over 80% of the rural population depend on agriculture.[22]

In Sudan, agriculture is the main economic sector, contributing 25% to the GDP and employing about 80% of the workforce.[23] It has vast areas of agricultural land (about 200 million acres of arable land) and adequate water resources (25% share of Nile water resources under regional agreements). In fact, due to Sudan's loss of access to most of its oil revenue with South Sudan's secession, and Sudanese authorities' desperate need for revenue, a new focus on agriculture has resurrected its long-standing dream of becoming an agricultural powerhouse.[24]

Because of harsh climatic conditions, dependence on rain-fed agriculture, lack of infrastructure and investment in

agriculture, poor governance, and persistent violent conflicts, agricultural yields and thus productivity are quite low in the Horn countries. As a result, many people suffer from food insecurity and malnutrition.

Chart 9: Crop yields



Source: IFs version 7.63, historical data from Food and Agriculture Organization

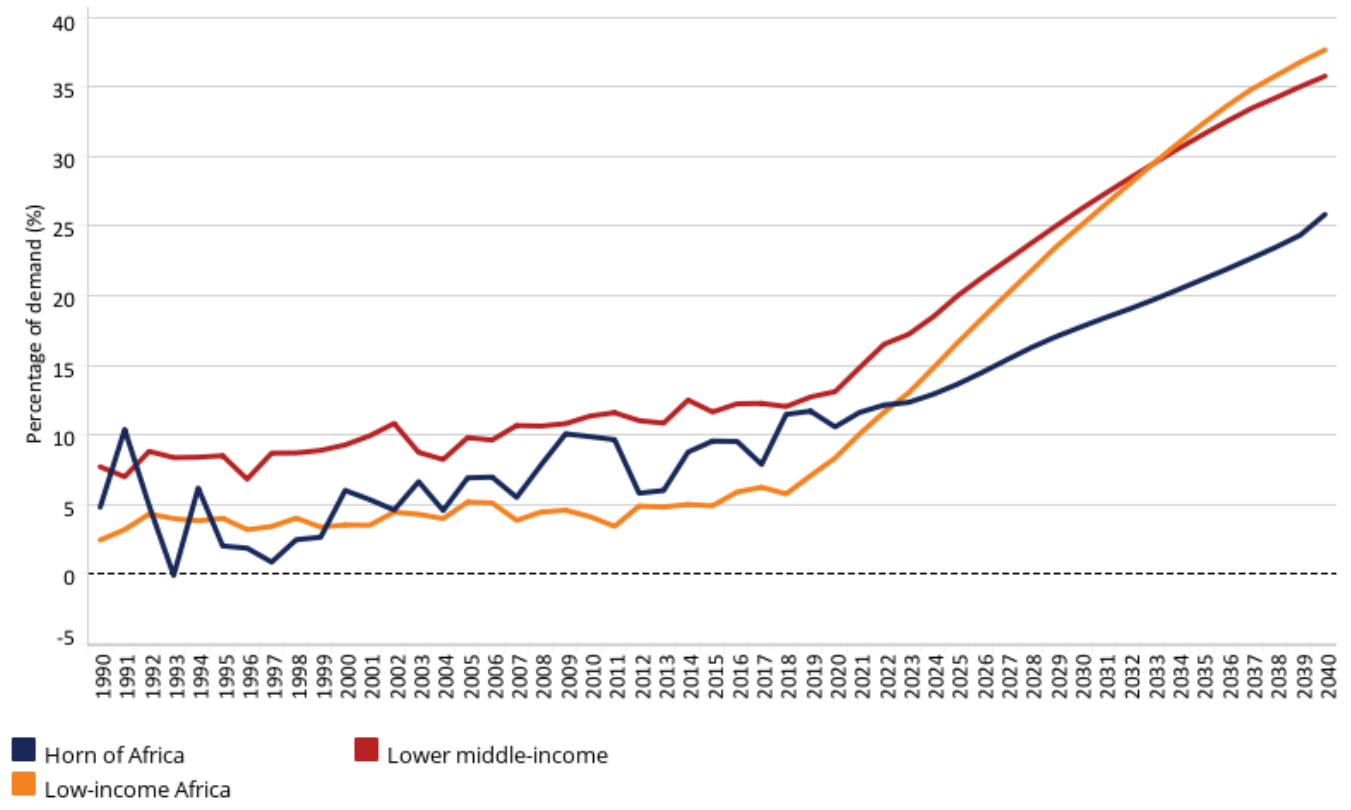
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The combination of poor domestic crop production and increased domestic food demand, driven by rapid population growth and urbanisation, has led to a massive increase in food imports. From a food-security perspective, the Horn countries are in a precarious situation due to volatile international prices. It is therefore no surprise that the region is one of the most food-insecure regions in the world.[25]

IFs forecasts import dependence on crops to be about 10.6%, and that by 2040 it will have increased to roughly 25.8%, an increase of more than 15 percentage points in 20 years. Djibouti has a very high import dependence that has increased during the COVID-19 pandemic.

The situation is probably worse in South Sudan, where an unprecedented economic crisis, drop in oil prices and conflict have even made it difficult for the country to export, leaving many in need of humanitarian assistance. Prior to 2016, the country imported virtually everything. However, given the range of challenges in the country, the government is urging its citizens to turn to agriculture as an extreme poverty-alleviation strategy.[26]

Chart 10: Import dependence (crops)



Source: IFs version 7.63, historical data from Food and Agriculture Organization

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Despite the poor performance in the agriculture sector, there is considerable scope for expansion and improvement. For example, in its National Development Plan, Djibouti hopes to increase domestic production, including seafood, and encourage value addition with the aim of exporting to Gulf countries. By 2035, Djibouti aims to have its agriculture sector contributing 5% of GDP.[27]

Irrigation could ensure that more land is used for crop farming, although water access is an obvious constraint. Some projects have identified interventions that could moderate this challenge through improved collection, storage and use of surface water for drinking, agriculture and livestock farming. Efforts at sustainable agriculture have also attracted ideas to access and save water, such as importing palm trees for the production of dates, and to provide shade for other produce to be farmed. Djibouti, for example, is also experimenting with drip irrigation.[28]

Improving agricultural productivity is possible. In Ethiopia, the agriculture sector has seen the fastest expansion of land under irrigation of any African country by nearly 52% between 2004 and 2014. This is due to the Ethiopian government’s prioritisation of agriculture.[29] To complement irrigation, other factors to consider in the development of agriculture include reform of land ownership, better farming practices, efficient use of fertilisers and less reliance on seasonal variability of production.[30]

Aside from crop farming, the Horn region has the largest population of nomadic pastoralists in the world. The pastoralists in the region are shifting to more commercial systems as populations grow and markets change. This trend is not uniform

across the region and will probably create a mix of long-term challenges given the economic, environmental and demographic dilemmas faced in the region. As such, policies that support pastoralists opting out of the lifestyle as a means of earning their livelihood and those venturing into commercial systems need to be supported.[31]

The agriculture sector also faces risks associated with climate change that will likely affect crop and livestock production. Aside from affecting agricultural production, the International Food Policy Research Institute highlights the relationship between global warming and conflict in East Africa. The research finds that higher temperatures greatly affect the risk of conflict due to livestock price shocks and the stress on water and feed sources. It is projected that without intervention, the risk of conflict could increase by up to 30% in Sudan and South Sudan, and up to 50% in Somalia by 2030 as temperatures continue to rise.[32]

Natural resources

Natural resources such as oil, gas and minerals have significant potential to contribute to economic growth and development, provided the necessary regulatory frameworks and policies are in place, coupled with visionary and accountable leadership. Experiences in countries such as Norway, Canada and Botswana corroborate the view that natural resources can boost development.

The Horn of Africa region has not been known for huge natural resources endowment, especially extractives. For example, Djibouti's natural resources are very limited. The country has no proven oil or natural gas reserves, and only 1% of the territory is forest. Djibouti's main natural asset is probably its strategic location.

However, in recent years, some countries in the region have shown a mineral boom. With a significant discovery of gold, copper and silver, Eritrea is one example. With a new Chinese majority shareholder, the country's largest mine (the Bisha mine) is expected to continue operation at least until 2024. Two other major mining projects, the Asmara mining project and the Colluli potash mine, will enter production in 2021/2022.[33]

Ethiopia on the other hand has operational gold mines and the potential for the discovery of oil and huge natural gas as well as salt and potash. The Adola gold mine in southern Ethiopia, currently owned by a private company (MIDROC) through a concession from the Ethiopian Mineral Resources Development Corporation, is the largest gold mine in Ethiopia with an average annual production of 4.5 tons of gold.[34]

However, there are concerns on the part of local government authorities, members of the opposition and the local community that the right to mine gold has been granted to MIDROC without clearly stipulating corporate social responsibility guidelines. There are also other concerns such as corruption and clientelism. In addition, the company's mining activities have seen the dumping of toxic chemicals and, given the lack of compensation and engagement with the local community, this could lead to instability.[35]

Promising test wells, seismic and gravimetric surveys, actual oil seeps and the geological resemblance to oil-rich Yemen strongly indicate the presence of oil in commercial quantities in Somalia.[36] Somalia is significantly underexplored and the Horn is considered by many as one of the last remaining oil frontiers in Africa.[37] However in the immediate future security concerns limit oil exploration activities in the country as clan militias frequently ambush oil exploration teams.

Prior to the secession of South Sudan, Sudan as a whole was estimated to have six billion barrels of oil and three trillion cubic feet of natural gas reserves. As most oil blocks are in the territory of South Sudan, the oil-producing capacity of Sudan was heavily diminished by the secession. Crude oil production declined from about 130 000 barrels per day (bpd) in 2013 to 72 000 bpd in 2019. According to the BP Statistical Review of World Energy for 2019, Sudan's oil reserves stand at 1 500 million barrels only.

In 2012, South Sudan shut down all its oil production for 15 months in response to the action by Khartoum, which confiscated the oil as it flowed through the pipeline to Port Sudan. This was in an effort to recover unpaid fees related to oil transportation through the pipeline on its territory.[38] At the end of 2019, South Sudan owed Sudan US\$574 million for the transfer of oil.[39]

According to experts' assessment, oil production in Sudan could get to 100 000 barrels a day by investing in primary oil recovery techniques. However most foreign investors chose to leave Sudan by 2020 after their contracts ended. There was no interest by international investors in exploring the market when the authorities offered 15 oil blocks to international investors after the US eased economic sanctions in 2017.[40]

This lack of interest in the Sudanese offer reflects low expectations of large new oil finds in the country, governance and policy weaknesses as well as ongoing concerns about the threat of a resumption of conflict. Due to resource constraints, it will be very difficult for the Sudanese government to develop the oil sector without foreign investment.

Aside from the poor governance that continues to plague the extractive sector in the Horn of Africa, a large part of the resources is found in peripheral and border areas of the region where political marginalisation is compounded by conflicts and economic deprivation of local communities. Here literacy rates are among the lowest and poverty rates the highest.[41] This existing pattern of resource extraction characterised by local communities' exclusion and absence of positive trickle-down effects is likely to be confrontational unless appropriate policy frameworks are put in place and genuinely implemented by Horn governments.

International trade

The trade pattern of countries in the Horn of Africa is similar to that of many other African countries that rely on a few key commodity exports while importing higher-value manufactured goods, consumer items and foodstuffs.

Historically in deficit, the trade balance of the Horn of Africa region partially depends on weather phenomena, which sometimes forces the countries to import grains during drought. For instance, in the IFs database, the total exports and imports of the region amounted to respectively 13.3% and 24.6% of the regional total GDP, resulting in a trade deficit of about 11% of the regional total GDP in 2019.

The region is relatively open to trade with a foreign trade-to-GDP ratio of 38% in 2019, and Middle East countries, especially the Gulf countries, are among the key trading partners for most of the Horn nations.

Overall, China is the main destination of Horn export mainly due to fossil fuels from South Sudan, and the Gulf states are the main trading partner for goods (excluding fossil fuels) from Djibouti, Somali, South Sudan and Sudan.

Djibouti mainly exports cattle to the Gulf states and re-exports vehicles, machinery, food and cement. According to the latest UN Conference on Trade and Development (UNCTAD) data,[42] the top five major export destinations of Djibouti in 2019 were Yemen, Ethiopia, Saudi Arabia, Egypt and the US. The country imports mainly petroleum products, food, vehicles and other capital goods from the EU, UAE, Japan and Ethiopia.

The economies of Ethiopia and Djibouti are highly interdependent since the Port of Djibouti constitutes the only maritime outlet for the landlocked territory of Ethiopia. However, the recent peace between Ethiopia and Eritrea, with the resulting opportunity for Ethiopia to use Eritrea's ports, may change this situation.

Coffee is the main export product of Ethiopia. In 2018, the share of coffee in the country's export was 29.5%, followed by

oilseeds (14.9%), pulses (9.5%), cut flowers (8%) and gold (3.5%). Manufacturing accounts for less than 8% of Ethiopia's total exports but this is likely to increase in the near future as the country is doing relatively well in developing its manufacturing sector. The top five major destinations for Ethiopia's exports in 2019 were China, the US, Sudan, Switzerland and Saudi Arabia. Imports mainly come from Asia (64.2%, of which China accounts for 39.3%) followed by Europe (19.3%), the US (9.4%) and Africa (7%).^[43]

Eritrea's export basket is made up of livestock, coffee, cotton and leather, which makes it very dependent on variable weather conditions given its underdeveloped irrigation systems, textile products and limited minerals (copper and gold). The country imports virtually all of its capital goods, oil/petroleum and food products. About 90% of its consumption of food is imported. Eritrea's main trading partners are China, the Republic of Korea, India, the UAE and Myanmar.

The peace deal signed with Ethiopia in July 2018 will probably improve Eritrea's trade relations with Ethiopia. However, the government maintains strict control on foreign exchange reserves, and this severely limits the freedom of trade and undermines the country's economic progress.^[43] At the time of writing this report, it is unclear as to the impact of the security alliance between Ethiopia and Eritrea that saw the latter provide substantial military resources in support of Ethiopia in the subjugation of Tigray.

Before South Sudan's secession, especially during the period 2000–2011, Sudan was highly dependent on the revenues from oil exports. The loss of oil following secession eventually forced the government to boost non-oil exports to compensate for the loss of oil export revenue. Certain commodities such as sugar, cotton, wheat, edible oil, livestock and gum arabic, among others, were targeted for export and import substitution. As a result, exports in agriculture raw materials increased from 9% of total exports in 2011 to 57% in 2018.^[44]

Despite this improvement, government policies did not materialise in diversifying exports from agriculture raw material and natural resources to manufactured goods. The US sanctions also had negative impacts on promoting manufacturing in Sudan since it complicated cross-border payments, and the recent lifting should allow the country to increase exports.^[45]

Sudan mainly exports fuels, gold, oilseeds, live animals and cotton, and imports capital goods and foodstuffs. Sudan's main export partners are the UAE (40% of total exports), China, Saudi Arabia, India, Egypt and Ethiopia (4%), while imports are from China (22% of total imports), the UAE, Saudi Arabia, India, Japan and Egypt (5%).^[46]

Since its independence in 2011, the government of South Sudan has been struggling to integrate the young country into the international trade network. The country has gradually moved closer to the East African Community, becoming its latest member in 2016.

South Sudan is one of the most oil-dependent countries in the world; oil exports accounted for 98% of total exports in 2019. The top five major export destinations in 2019 were China, the US, India, UAE and Spain. South Sudan mainly imports vehicles, machinery, electrical appliances, pharmaceuticals, plastics and food and beverages. The peace agreement signed in September 2018 aimed at ending the civil war has led South Sudan and Sudan to open four border crossings, which is likely to increase formal trade between the two.

Somalia has a systemic and large trade deficit which is estimated at over 70% of GDP per annum. This external deficit is the result of the country's high dependence on food imports, which is the result of a chronic food crop deficit. It is also as a result of the import of construction materials, fuel and manufactured goods.

Livestock, bananas, skins, fish, charcoal, frankincense and scrap metal constitute Somalia's main exports. According to UNCTAD data, in 2019 Somalia's top five export destinations were Yemen, India, Japan, Bulgaria and Turkey, while imports

were from China, India, Turkey, Malaysia, Indonesia, Brazil, Pakistan and the US. The absence of a stable customs authority, the poor quality of road and port infrastructure, as well as high levels of insecurity are some of the main factors that impede Somalia's participation in international trade.[47]

Somalia's prospects for expanding trade, both within the region and internationally, are contingent upon its accession to the World Trade Organization (WTO). Somalia has submitted its accession application but WTO membership has not yet been granted.

Accession could boost trade for the country and increase its participation in the global value chains provided the country undertakes the necessary structural and institutional reforms required to liberalise trade and build strong economic institutions. However, this is highly unlikely to happen soon because Somalia not only lacks a manufacturing base, but also the political capacity to implement the necessary reforms.

The official cross-border trade within the Horn region is low. Over 95% of cross-border trade within the region is informal, carried out by pastoralists trading livestock. For instance, the unofficial trade of live cattle, camels, sheep and goats from Ethiopia to other countries in the Horn is estimated to be between US\$250 million and US\$300 million annually. This is 100 times more than the official figure.[48] The formalisation of this trade could bring important additional tax revenue to the governments of the region but would require significant improvements in border control and management.

Overall, the exports of the Horn of Africa nations are poorly diversified. The share of manufacturing exports is very low. IFs estimated the value of total manufacturing exports at about 4% of the regional GDP in 2019. This overreliance on exports of low-value raw materials puts the economies at the mercy of fluctuating international markets and makes macroeconomic and budgetary planning difficult. The Africa Continental Free Trade Area agreement, once implemented, offers an opportunity to promote regional trade and manufacturing in particular, and hence diversify their economies away from commodity exports.

Foreign direct investment, aid and remittances

Access to international finance offers a possibility for countries to augment domestic savings for investment. Particularly, foreign direct investment (FDI) can be an important catalyst for growth and development as it brings much-needed capital and technology into the recipient economies.

Chart 11 shows the trends in external financial flows in the Horn of Africa countries from official data. In percentage of GDP, Djibouti and Ethiopia are the highest recipients of FDI inflows in the region while South Sudan and Eritrea are the lowest. In percentage of GDP, Somalia is by far the largest recipient of aid and remittances followed by South Sudan while Ethiopia receives the least remittances.

However, in absolute terms, most FDI and ODA into the region goes to Ethiopia. For example, in 2018, FDI inflows and ODA to Ethiopia were respectively US\$3.3 billion (64% of regional total FDI inflows) and US\$4.9 billion (50% of regional total aid). Official remittance flows to Ethiopia reached US\$5 billion in 2018, a large increase from only US\$140 million in 2002/3. The actual amount is likely much larger as informal remittances are not captured in official data.

Chart 11: Financial flows as % of GDP in the Horn of Africa countries, 2016-2018



Geography	FDI inflows			*Net ODA, all donors			Workers' remittances		
	2016	2017	2018	2016	2017	2018	2016	2017	2018
Djibouti	6.10	5.90	5.80	7.10	5.20	5.80	2.20	2.10	2.00
Eritrea	1.00	0.90	0.90	3.00	4.10	4.20			
Ethiopia	5.70	5.20	4.10	5.50	5.00	5.80	1.00	0.50	0.50
Somalia	4.80	5.20	5.50	18.40	28.90	26.60	19.70	23.50	20.40
South Sudan	-0.10	0.02	0.70	8.60	14.20	10.60	5.80	4.10	8.50
Sudan	1.20	0.80	2.70	1.50	1.90	2.90	0.30	0.40	1.20

Source: Data from World Bank, UNCTAD, Somalia National Development Plan 2020-2024
 *ODA includes humanitarian aid

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Due to scarce domestic resource availability, Somalia remains highly dependent on aid and remittances. As a share of GDP, ODA in 2018 was 26.6% while the domestic revenue represents 2.5% of GDP. ODA combined with remittances represented more than 50% of Somalia's GDP in 2017. Aid to Somalia has increased fourfold from US\$26.9 million in 2015 to US\$124.6 million in 2018. Turkey, the World Bank and the EU are the major source of grants for the country.[49]

Overall, aid is the largest source of external finance in the Horn of Africa, and most Horn states rely heavily on investment and aid from the Gulf countries. From 2000 to 2017, for example, the Gulf states' investment and ODA in the Horn region amounted respectively to US\$13 billion and US\$6.6 billion. The substantial deposits in hard currency by Gulf countries are crucial for Horn governments' economic solvability and currency stability.[50]

Future prospects are less certain, however. COVID-19 has dramatically reduced Gulf states' oil revenues, and budgets for foreign assistance will probably shrink. Reduced Gulf spending requires Horn states to look for other ways to plug the gaps in their budget or may lead to dramatic rises in prices of staple foods and place additional pressures on government budgets to increase subsidies.

The Gulf states' investments are uneven across the Horn region. Ethiopia and Sudan are the main destinations of Arab countries' investments in the Horn of Africa. These two countries accounted for about 95% of total investment by the Gulf states (Saudi Arabia, the UAE, Kuwait and Qatar) in the Horn between 2000 and 2017.[51] This reflects the importance of these two countries for the Gulf countries' geopolitical strategy.

However the Horn of Africa nations have not been able to attract sufficient FDI that could be a game-changer for their

development, probably due to the high levels of instability in the region. In 2019, FDI flows to the Horn region accounted for about 3% of the regional total GDP, below the average of 4.2% for low-income Africa in the same year.

FDI is key to increasing their capital stock and level of technology that would help to boost growth and development.

The poor business climate and the recurrent political instability and military conflicts deter investment as these countries rank near the bottom in terms of rankings on business and investment climate. For instance, in the 2020 Doing Business report by the World Bank, Djibouti has the best business environment in the region, but it only ranked 110 out of 190 countries. It was followed by Ethiopia (159/190), Sudan (171/190), South Sudan (185/190), Eritrea (189/190) and Somalia (190/190).[52] The business environment remains particularly poor in Somalia, South Sudan and Eritrea.

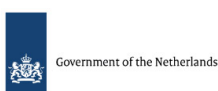
Recent attacks in Mozambique's northern Cabo Delgado province brought the largest FDI in Africa to a standstill, despite much of the investment being off-shore. This should indicate that huge FDIs in potential conflict zones, such as the Horn, are unlikely to materialise in the future.

Endnotes

1. Congressional Research Service, Sudan in Focus, 2017.
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