SOUTH ASIA

Economic activity in South Asia expanded by an estimated 6.8 percent in 2016, buoyed by robust domestic demand. India continued to post strong growth, reflecting ongoing tailwinds from low oil prices and support from structural reforms. Excluding India, regional growth is estimated at 5.3 percent in 2016; however, there were notable differences within the region depending on security issues, domestic policies, and reliance on remittance flows. Looking ahead, growth in the region is projected to edge up to an average of 7.3 percent in 2017-19, supported by dividends from ongoing policy reforms and strong domestic demand. Sluggish recovery in key export markets, weak private investment, and security challenges pose headwinds to the outlook. Risks are tilted to the downside, including reform setbacks, heightened domestic insecurity and political tensions, and unexpected tightening of financing conditions. Structural reforms, aided by supportive macroeconomic policies, could help mitigate some of the risks, and bolster the region's long-term growth prospects.

Recent developments

Growth

South Asia's growth remained steady at an estimated 6.8 percent in 2016, the same pace as in 2015, buoyed by robust domestic demand (Figure 2.5.1). South Asia is now the fastest-growing emerging market and developing economy (EMDE) region. Since 2013, the region has consistently exceeded its long-term growth average of 6 percent during 2000-14, benefitting from mutually reinforcing tailwinds of sustained low commodity prices, infrastructure investment, and generally accommodative monetary and fiscal policies. Limited global integration has shielded South Asia from negative external spillovers (World Bank 2016e). Growth in *India* (a country that represents four-fifths of South Asia's GDP) is estimated to reach 7.0 percent in FY2017 (ending on 31 March 2017), accounting for much of the region's expansion. Excluding *India*, the region grew 5.3 percent, with wide variations among countries (Table 2.5.1). Regional growth is slightly below June projections, mainly reflecting a modest downgrade to *India's* brisk expansion.

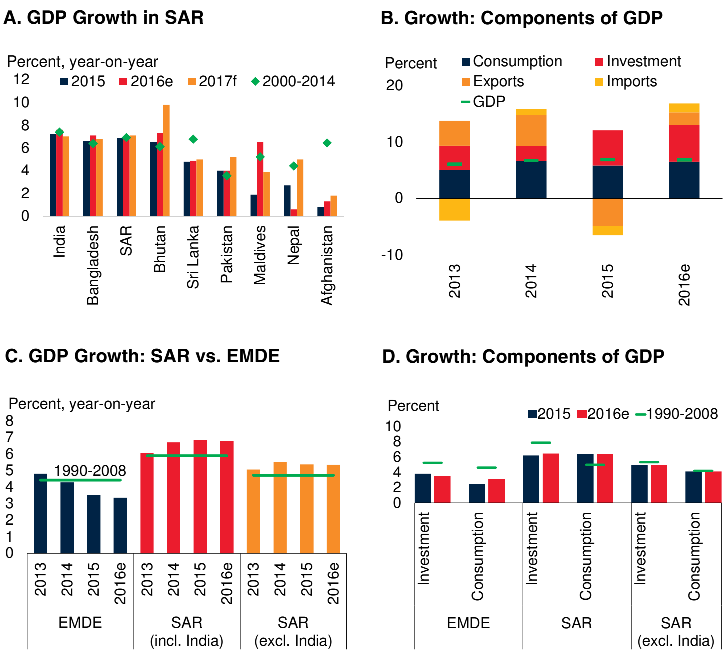
India's growth in the first half of FY2017 was underpinned by robust private and public consumption, which offset slowing fixed investment, subdued industrial activity, and lethargic exports (Figure 2.5.2). Consumption was supported by lower energy costs, public sector salary and pension increases, and favorable monsoon rains, which boosted urban and rural incomes. Economic activity also benefitted from a pickup in foreign direct investment (FDI) and an increase in public infrastructure spending. Unexpected 'demonetization'—the phasing out of large-denomination currency notes which were subsequently replaced with new ones—weighed on growth in the third quarter of FY2017.[1] Weak industrial production and manufacturing and services purchasing managers' indexes (PMI), further suggest a set back to activity in the fourth quarter of FY2017. A retrenchment in private

Note: This section was prepared by Boaz Nandwa with contributions from Jongrim Ha and Hideaki Matsuoka. Research assistance was provided by Anh Mai Bui and Shituo Sun.

[1]On November 8, 2016, the Indian government announced phasing out of large-denomination currency notes (Rs. 500 and Rs. 1,000, representing 86 percent of the total currency in circulation) as legal tender. They were immediately replaced with new Rs. 500 and Rs. 2,000 currency notes. This was undertaken to curb corruption, tax evasion, and counterfeiting. The withdrawal from circulation started immediately and ended on December 30, 2016.

FIGURE 2.5.1 Economic activity in South Asia

Growth in South Asia region (SAR) is estimated to remain steady at 6.8 percent in 2016, supported by robust domestic demand. South Asia's strong growth, driven by solid activity in India, exceeded the average of EMDEs. Excluding India, growth edged up to 5.3 percent, with significant heterogeneity across the countries. The region's growth is projected to strengthen to an average of 7.3 percent during 2017-19, benefitting from policy reforms and accommodative monetary and fiscal policies.



Sources: Haver Analytics, World Bank.
A.-D. SAR is the South Asia region, comprised of the following: Afghanistan, Bangladesh, Bhutan, India, Pakistan, Maldives, Nepal, and Sri Lanka. 2016e is the estimated value and 2017f is forecast value.
C.D. EMDE refers to emerging market and developing economies.

investment, reflecting excess capacity, corporate deleveraging, and credit constraints due to impaired commercial banks' balance sheets, also had an adverse effect on activity (Chapter 3; Box 2.5.1). For the whole of FY2017, growth is expected to decelerate to a still robust 7.0 percent.

In *Pakistan*, GDP growth (at factor cost) is expected to rise to 5.2 percent in FY2017 (ending 30 June 2017; Table 2.5.1). The uptick in activity was spurred by a combination of low commodity prices, rising infrastructure spending, and reforms that lifted domestic demand and improved the business climate (World Bank 2016p). The successful conclusion of Special Drawing Rights (SDR) 4.393 billion IMF Extended Fund Facility (EFF) program, aimed at supporting reforms and reducing fiscal and external sector vulnerabilities, lifted consumer and investor confidence. On October 5th, 2016, *Pakistan* tapped the international market and issued a $1 billion five-year dollar-denominated Sukuk (Islamic) bond. The interest rate paid on the bond was lower compared to what the country paid two years ago for raising a similar amount using the same instrument. These positive factors more than offset weak industrial activity, the adverse impact of unfavorable weather on agriculture output, and terrorist attacks in urban areas.

In *Sri Lanka*, growth remained steady at 4.8 percent in 2016 from the previous year, boosted by strong activity in the construction and services (particularly tourism) sectors, as well as resumption of the $1.4 billion Colombo Port City real estate project. In addition, a loan of $1.5 billion from the IMF, under the EFF program, relieved balance of payments stress (IMF 2016q). However, flooding, a slowdown in exports, and a deceleration in private investment weighed on activity. *Bangladesh's* growth is expected to ease to a still solid 6.8 percent in FY2017 (ending on 30 June 2017), from the official estimate of 7.1 percent in the previous fiscal year. Domestic security challenges compounded weak external demand and a mild pickup in private investment, offsetting an uptick in infrastructure spending and increased public sector wages (World Bank 2016q).[2] A slowdown in oil-rich Gulf Cooperation Council (GCC) economies has led to receding remittances inflows to both *Bangladesh* and *Sri Lanka*, dampening private consumption and investment (De et al. 2016).

Elsewhere in the region, growth was mixed (Table 2.5.2). *Nepal* is set to rebound to an estimated 5.0 percent growth in FY2017 (ending on 15 July 2017), up from 0.6 percent posted in FY2016. An acceleration in post-earthquake reconstruction, together with favorable monsoon rains, will support economic activity. Lifting of the southern border blockade with India has normalized trade and eased supply-side bottlenecks. A slowdown in growth of remittances inflows from the GCC countries, however, has weighed on consumption and investment. *Bhutan's* growth ticked up to an

[2]Bangladesh became one of the first countries to receive financing of a $165 million loan in 2016 from the Asian Infrastructure Investment Bank (AIIB) for electricity grid coverage expansion and an additional $60 million to build a gas transmission pipeline from Chittagong to Bakhrabad.

estimated 7.4 percent in 2016, lifted by tourism and construction of three major hydropower projects. Growth in *Maldives* rose to 3.5 percent in 2016, driven by construction and public infrastructure spending. *Afghanistan* recorded the weakest growth in the region, estimated at 1.2 percent in 2016. This is largely due to slowing domestic demand, deteriorating security, and drought which affected agriculture output. Resettlement of returning refugees from *Pakistan* further exerted fiscal pressure, constraining infrastructure investment.

External balances

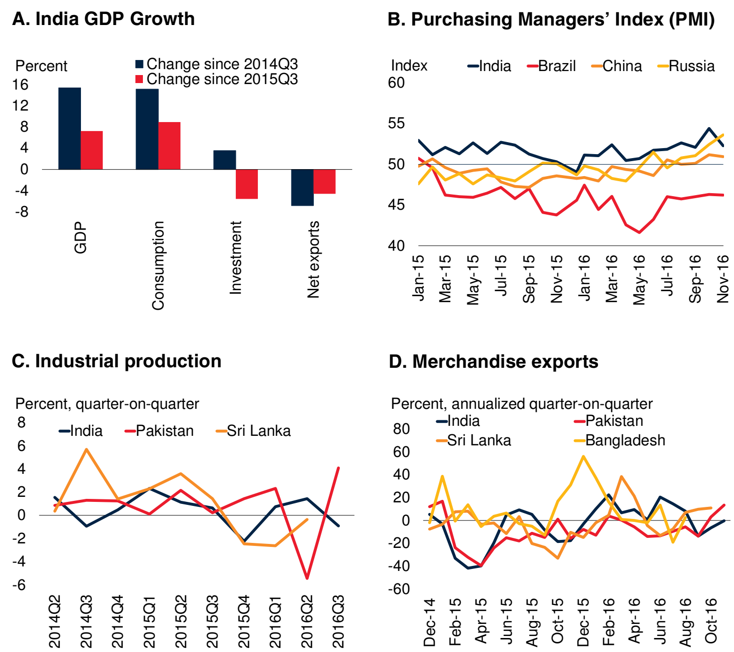
Lower energy import bills mitigated the negative impact of reduced exports and remittances on current account balances which, except for *Bangladesh*, mostly continued to be in the deficit (Figure 2.5.3). Higher capital inflows contributed to reserves accumulation and helped stabilize the value of local currencies against the U.S. dollar. In a few countries (India, Pakistan), the trade-weighted real exchange rate appreciated, weakening export competitiveness (Eichengreen and Gupta 2013). Subdued external demand and increased non-energy imports in *Sri Lanka* weighed on its current account balance. In *Bhutan*, the current account deficit remained elevated, reflecting increased imports for the construction of hydropower projects. Increased imports for post-earthquake reconstruction amid receding remittances in *Nepal* worsened its current account balance.

Inflation

Regional inflation decelerated from 8.9 percent in 2015 to 5.7 percent in 2016, aided by improved harvests after favorable monsoon rains (Bangladesh, India, Sri Lanka), fiscal restraint (India, Pakistan), and pass-through of nominal exchange rate appreciation (Bangladesh, Pakistan). Reductions in administered prices (India) and lower energy costs contributed to easing inflationary pressures (Chinoy, Kumar, and Mishra 2016). With inflation in most countries within central bank target bands (Figure 2.5.4), monetary policy stances across the region remained broadly accommodative, except for *Sri Lanka,* where policy was tightened in the second

FIGURE 2.5.2 Economic activity in India

India accounts for almost four-fifths of SAR GDP. Robust private and public consumption is likely to offset slowing fixed investment, weak manufacturing activity, and lethargic exports In India.



Sources: Haver Analytics, World Bank.
A. Real GDP growth change since 2014Q3 is the two-year quarterly change. The latest data point is 2016Q3.
B. Index numbers greater than 50 denotes expansion and vice versa.
C. Industrial production data is seasonally adjusted. The last observation is 2016Q3 for India and Pakistan, and 2016Q2 for Sri Lanka.
D. Exports measured in values. The last observation is October 2016 for India and Pakistan, September for Sri Lanka and August for Bangladesh.

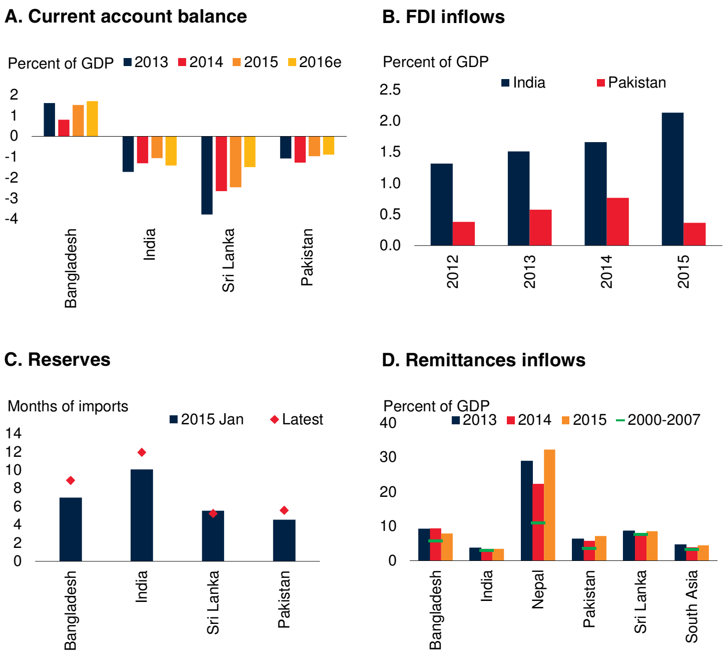
half of 2016 to contain rising inflation and to stabilize the Sri Lankan rupee.

Fiscal positions

Budget consolidation in *Pakistan* and *Sri Lanka* helped lower structural fiscal deficits in 2016, bringing them below the 2010-13 average of 7 percent of GDP (Figure 2.5.5). Reductions in energy subsidies and an increase in excise taxes eased spending pressures (India, Pakistan, Sri Lanka), but this was partly offset by public sector wage increases (Bangladesh, India), as well as political disagreements in the coalition government on spending priorities (Sri Lanka). Some efforts were made across the region to raise revenues. In *India*, a one-off revenue windfall from the Income Disclosure Scheme was offset by shortfalls from the telecommunication spectrum auction. Besides curbing discretionary spending, *Sri Lanka's* revenue-raising efforts gained traction under the IMF's EFF program, notably by

FIGURE 2.5.3 External sector developments

Lower energy import bills helped contain current account deficits but were partly offset by diminished remittances from the GCC countries. FDI inflows, mainly to India and Pakistan, contributed to an accumulation of reserves.



Sources: Haver Analytics; World Development Indicator, World Bank; World Economic Outlook, International Monetary Fund.
C. Reserves coverage are months of imports covered. The last observation is October 2016.

lowering the value-added tax (VAT) threshold for wholesale and retail trading, reduced exemptions, and greater tax collection efficiency (World Bank 2016r). In several economies, privatization receipts from state-owned enterprises (SOE) fell short of expectations (India, Pakistan). Large-scale borrowing to fund infrastructure projects (Maldives, Pakistan, Sri Lanka) has led to elevated public debt (Benno and Ramayandi 2015).

Reforms

Notwithstanding remaining room for an improvement in regional business climates, investor confidence in South Asia has been lifted by positive progress in the policy environment (Lopez-Acevedo, Medvedev, and Palmade 2016; Borin and Di Stefano 2016; World Bank 2016p).

Four key reforms in *India* were passed in 2016. First, a bankruptcy and insolvency code was enacted, making it easier to close failing businesses and recover debts. Second, rules governing FDI underwent sweeping liberalization, allowing for 100 percent ownership in previously restricted sectors. Third, the Goods and Services Tax (GST) Amendment Bill was passed; this aims to streamline the country's complex tax system, reduce fragmentation in markets for goods and services, lower business costs, and widen the tax base. Fourth, the government and the Reserve Bank of India agreed on a monetary policy framework that includes setting up a monetary policy committee and agreeing on a flexible inflation target, with a 2–6 percent range. This should enhance the Reserve Bank of India's operational independence, and help to anchor inflation expectations (Mishra, Montiel, and Sengupta 2016; Cabral, Carneiro, and Mollick 2016; Samarina, Terpstra, and De Haan 2014). In addition, the Reserve Bank of India strengthened bank resolution procedures by establishing a single Financial Resolution Authority (FRA) that brought state-owned banks under the resolution framework and placed restrictions on the usage of bail-ins clause resolutions. Robust implementation of these legislative changes will be key to transforming the accompanying boost to confidence into greater activity.

Pakistan implemented various reforms under the IMF's EFF program and World Bank's Development Policy Credits; tackling key structural challenges, such as, reforms to ease energy constraints, tax policy and administrative reforms to raise revenues, and strengthening independence of the State Bank of Pakistan to reduce vulnerabilities. In addition to undertaking reforms under the IMF's EFF program, *Sri Lanka* received $100 million from the World Bank in mid-2016 to support the government's reform agenda in reducing impediments to private sector competitiveness, increasing transparency, and improving fiscal sustainability (World Bank 2016s). *Bhutan's* government approved a debt policy in 2016 aimed at ensuring public debt sustainability by establishing an external debt threshold and implementing a Medium-Term Debt Management Strategy. Despite these improvements, critical land and labor reforms have largely stalled in most of the region.

Outlook

Growth prospects for South Asia remain robust, albeit uneven, across the region. Regional growth in 2017 is projected at 7.1 percent, firming to 7.4 percent during 2018-19, with continued support from strong growth in *India*. Excluding *India*, growth will pickup to 5.5 percent in 2017 and remain broadly stable at an average pace of 5.8 percent thereafter. The growth pickup is predicated on robust private and public consumption, infrastructure spending, and a rebound in private investment.

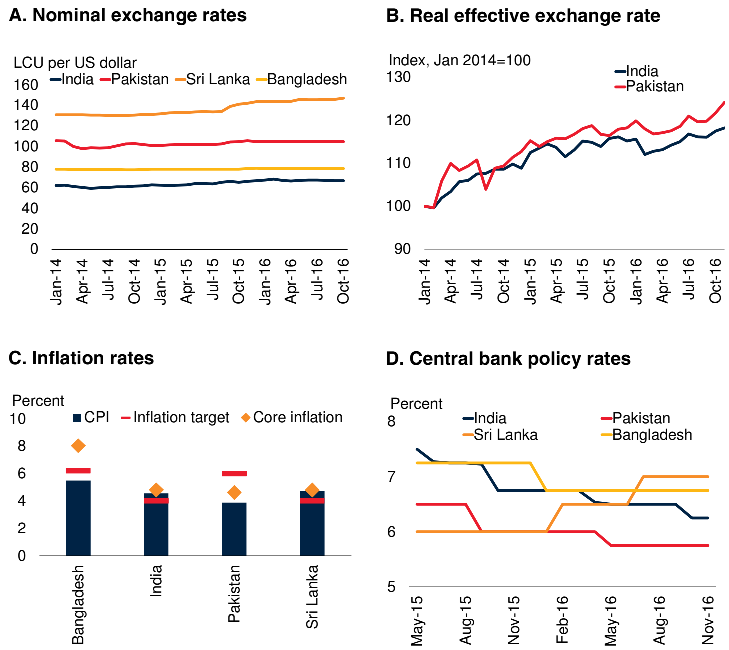
Accommodative monetary policy stance is expected to support activity (Bangladesh, India, Pakistan). With oil prices projected to stay subdued (World Bank 2016t), regional inflation is forecast to remain below an average of 6 percent during 2017-19, providing space for ongoing monetary policy accommodation and supporting real incomes and consumption. Fiscal policy is also likely to become more accommodative as a result of additional fiscal spending due to public sector wage hikes (Bangladesh, India) and approaching general elections in 2018 (Pakistan) and 2019 (India).

India is expected to regain its momentum, with growth rising to 7.6 percent in FY2018 and strengthening to 7.8 percent in FY2019-20. Various reform initiatives are expected to unlock domestic supply bottlenecks and raise productivity. Infrastructure spending should improve the business climate and attract investment in the near-term (Calderon, Moral-Benito, and Servén 2011). The "Make in India" campaign may support *India's* manufacturing sector, backed by domestic demand and further regulatory reforms (Siddhartha 2015). Moderate inflation and a civil service pay hike should support real incomes and consumption, assisted by bumper harvests after favorable monsoon rains. A benefit of 'demonetization' in the medium-term may be liquidity expansion in the banking system, helping to lower lending rates and lift economic activity.

In *Pakistan*, growth (at factor cost) is forecast to accelerate from 5.5 percent in FY2018 to 5.8 percent a year in FY2019-20, reflecting improvements in agriculture, infrastructure, energy, and external demand. Construction of the new Khanki barrage in the province of Punjab is set to be completed in early 2017. This is

FIGURE 2.5.4 Exchange rate and inflation developments

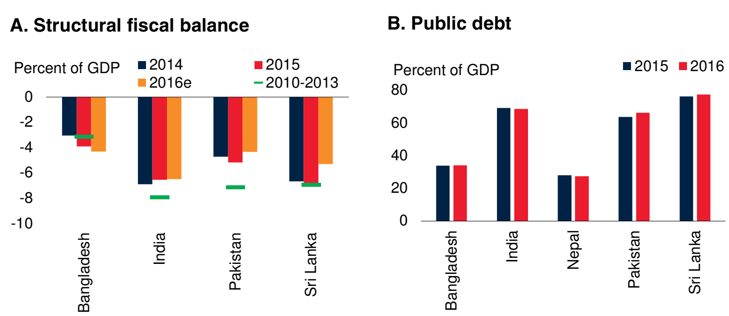
Nominal exchange rates remained broadly stable, with trend appreciation in the real effective exchange rate in India and Pakistan. Modest domestic inflation reflected low energy prices and good monsoon rains. Central banks responded by easing monetary policy.



Sources: Haver Analytics, National Central Banks, World Bank.
A. Last observation is November 2016.
B. Last observation is November 2016.
D. Last observation is November 2016.

FIGURE 2.5.5 Fiscal developments

Lower energy prices enabled some countries to reduce energy subsidies (India, Pakistan), or eliminate tax exemptions (Pakistan, Sri Lanka). However, increases in public sector wage (Bangladesh, India) and fiscal slippages (Pakistan, Sri Lanka) could imperil the path to fiscal sustainability.



Sources: Haver Analytics; International Monetary Fund; World Economic Outlook, World Bank.
A.B. 2016e means estimated value.

expected to provide irrigation to one million hectares of fertile farmland, boosting agriculture. Ongoing progress on the gas pipeline and electricity imports from the Islamic Republic of Iran, will ease energy constraints. The Chinese-Pakistan Economic Cooperation (CPEC) project will increase investment in the medium-term, and alleviate transportation bottlenecks and electricity shortages.[3]

Weak remittances inflows and subdued consumption are foreseen to weigh on *Bangladesh's* growth, projected to edge down to 6.5 percent in FY2018, but rebound to 6.7 percent in FY2019 and 7.0 percent thereafter in the forecast horizon, supported by infrastructure spending and a pickup in exports. An improved security situation is also expected to attract private investment and FDI. Construction of Padma Bridge connecting southwest of the region with the rest of the county and a liquefied natural gas terminal will alleviate infrastructure and energy bottlenecks in the medium-term. However, *Bangladesh's* high recurring expenditures and a stagnant revenue-to-GDP ratio will likely pose obstacles for the funding of needed infrastructure development. In *Sri Lanka*, growth is expected to climb to an average of 5.1 percent in 2017-19, supported by increased private consumption and an uptick in FDI. Fiscal consolidation amounting to 3.5 percent of GDP by 2020 will lift investor sentiment, but weigh on growth and, especially, infrastructure spending in the near-term (World Bank 2015t). Political deadlock in the coalition government, on near-term spending priorities, could hinder the pace of reforms.

Following the rebound in FY2017, *Nepal's* growth is expected to ease in the forecast period in line with the country's potential. Continued post-earthquake reconstruction efforts, uptick in manufacturing activity, and resumption of tourism will support economic activity. A slowing growth of remittances—which account for a third of the GDP—will continue to weigh on growth. Inflation is projected to subside to an average pace of 8 percent in the medium-term. Continuing reconstruction-related imports, and slowdown in remittances, are expected to turn current account surpluses into deficits in the forecast period.

Growth in *Bhutan* is projected to rise to an average of 11.1 over the forecast horizon. The strong rise in capital equipment spending in for major hydropower projects will widen the current account in the near-term, but improve growth in the medium-term. With the commissioning of hydropower plants in 2017-19, and increased exports of electricity to India, the current account deficit is expected to narrow. Since the currencies of *Bhutan* and *Nepal* are pegged to the Indian rupee, their exports could suffer from a loss of competitiveness should *India's* currency appreciate against major currencies (Burke and Paudel 2015). *Maldives* is foreseen to post an average growth of 4.3 percent in 2017-19, following a rebound in tourism.

Afghanistan faces a difficult path to recovery. Even though growth is projected to climb to 1.8 percent in 2017 and 3 percent in 2018-19, deteriorating security, a surge in return of displaced persons, and adverse weather conditions will be a drag on activity. Under-execution of budget plans and reductions in foreign aid will dampen domestic demand and widen the current account deficit. This may be partially mitigated by the lifting of sanctions on the *Islamic Republic of Iran*, which could boost trade and investment for *Afghanistan* (Devarajan, Ianchovichina, and Lakatos 2016). In addition, low prices of oil and gas imports from the *Islamic Republic of Iran* could also ease energy constraints and alleviate current account pressures.

Risks

Risks to the outlook are tilted to the downside. Domestic risks include: slippages in addressing fiscal imbalances, further deterioration in financial and corporate sector stability (Bangladesh, India), rising debt levels (India, Maldives, Pakistan, Sri Lanka), and persistent security and political tensions (Afghanistan, Bangladesh, Maldives,

[3] An additional $5.5 billion was committed by China in 2016 towards the construction of Peshwar-Karachi railway line, a major cargo and human transit corridor. Further, Pakistan became one of the first countries to receive financing of $100 million from the AIIB towards the M-4 motorway, considered vital to the CPEC transportation project.

Pakistan) (Figure 2.5.6). External risks are moderate, given South Asia's limited global integration. They include heightened policy uncertainty in the United States and Euro Area, unexpected tightening of financing conditions, a jump in energy prices, and a prolonged slowdown in key export markets (Figure 2.5.7).

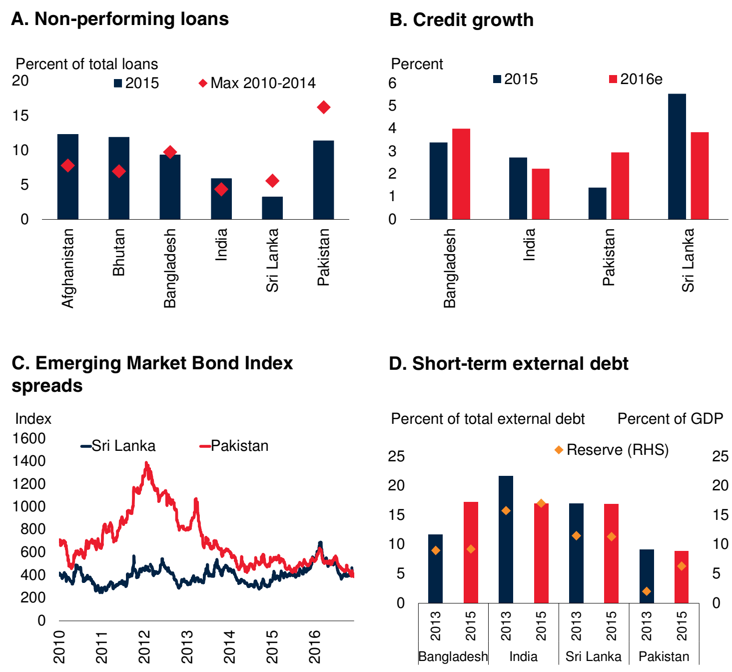
In *India*, cash accounts for more than 80 percent of the number of transactions. In the short-term, 'demonetization' could continue to disrupt business and household economic activities, weighing on growth (Rogoff 2016). Further, the challenges encountered in phasing out large currency notes and replacing them with new ones may pose risks to the pace of other economic reforms (e.g., Goods and Services Tax, labor, and land reforms). Spillovers from *India* to *Nepal* and *Bhutan*, through trade and remittances channels, could also negatively impact growth to these neighboring smaller economies.

Uncertainty about fiscal consolidation could weigh on confidence in the near-term. Increases in public sector salaries (Bangladesh, India), and other slippages in fiscal consolidation (Sri Lanka), cast doubt on commitment to reduce public debt growth to more sustainable levels. Furthermore, a sudden rebound in energy prices could contribute to a reintroduction or an increase in expenditures on subsidies, raising fiscal deficits. Impaired commercial banks' balance sheet, especially of state-owned banks (Bangladesh, India, Pakistan), would contribute to fiscal strain should recapitalization by the government become necessary.

High levels of non-performing bank loans (Bangladesh, India, Pakistan) make banks vulnerable to financial stress and weigh on new lending. In addition, excess capacity in *India* has led to sizable losses by corporations, heightening loss provisions by banks, and limiting credit expansion for consumption and investment. In *Pakistan*, sovereign guarantees associated with the CPEC project elevate fiscal risks over the medium-term. Finally, upcoming general elections in 2018 (Pakistan) and 2019 (India) could lead to expansionary fiscal policy and widening fiscal deficits.

FIGURE 2.5.6 Vulnerabilities

Increased provisions for non-performing loans highlight risks to financial stability, credit growth, and investment. In India, credit to corporates declined in 2016, reflecting distressed bank assets. Bond spreads for Pakistan and Sri Lanka narrowed in 2016, due to improvements in the investment climate. Elevated short-term external debt in Bangladesh and Sri Lanka, relative to their reserves, is a source of concern.



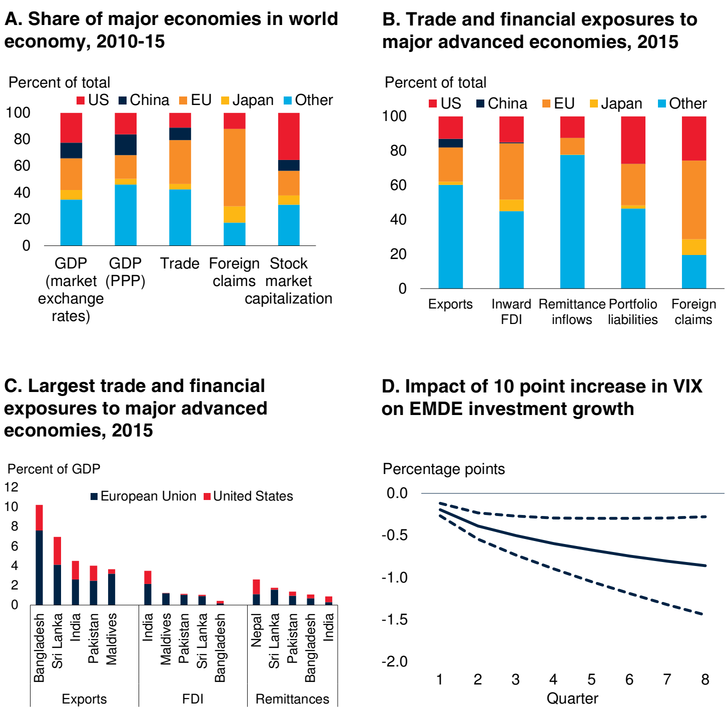
Sources: Bloomberg, Haver Analytics, World Bank.
A. Last observations are 2015.
B. e refers to estimated value.
C. Last observations are December 2016.

Security and geopolitical tensions in the region could derail growing regional integration, including in the apparel sector (Lopez-Acevedo, Medvedev, and Palmade 2016). Terrorist and militant attacks (Afghanistan, Bangladesh, Pakistan), political unrest (Bangladesh, Maldives, Nepal), and border disputes (India-Pakistan) presents risks to the region. If these intensify, risk premiums and financing costs could rise sharply. Furthermore, increased spending on security could exacerbate fiscal vulnerabilities.

Although South Asia is less integrated globally than other EMDE regions, external risks could arise from weaker growth in key export markets—the United States, the United Kingdom, European Union, Russia, and the GCC countries (World Bank 2016e; Figure 2.5.8). Moreover, an unexpected tightening of financing conditions

FIGURE 2.5.7 Risks of uncertainty in major advanced economies

Compared to other EMDE regions, SAR is less integrated in the global economy, constrained by poor business environment that weighs on competitiveness and investor sentiment. Some countries have trade (Bangladesh India, Pakistan, Sri Lanka) and finance (India) exposure to advanced economies, and most of them have remittances inflow exposure to the GCC economies. A prolonged period of heightened uncertainty in advanced economies would have adverse impact on investment in EMDEs.



Sources: World Bank, International Monetary Fund, Haver Analytics.
A. Trade (A) includes both exports and imports. Exports (B) include goods exports only. Foreign claims refer to total claims of BIS-reporting banks on foreign banks and nonbanks. Stock market capitalization is the market value of all publicly-traded shares. “FDI data (C) only available to 2014.
D. Cumulative responses of EMDE investment to a 10 percent increase in the VIX. Solid lines indicate the median responses and the dotted lines indicate 16-84 percent confidence intervals. Vector autoregressions are estimated for the sample for 1998Q1-2016Q2. The model includes, in this order, the VIX, MSCI Emerging Markets Index (MXEM), J.P.Morgan Emerging Markets Bond Index (EMBIG), aggregate real output and investment growth in 18 EMDEs with G7 real GDP growth, U.S. 10-year bond yields, and MSCI World Index as exogenous regressors and estimated with two lags.

amid further normalization of monetary policy in the United States could exert upward pressure on financing costs (Gertler and Karadi 2015) and lead to currency depreciation (Arteta et al. 2015; Clark et al. 2016). Besides impacting inflation, currency pressures could make short-term debt rollover expensive (Patra et al. 2016; Chow 2015; Davis 2015).

As a net energy-importing region, continued low energy prices have provided support to disposable incomes and domestic demand (World Bank 2016t). A sudden increase in energy prices could raise inflation above targets and de-anchor inflation expectations. This would compel central banks to tighten monetary policy, which would reduce credit growth and investment. Furthermore, an uptick in energy prices could raise the energy import bill, exacerbating current account deficits. An increase in energy costs could also lead to reintroduction of subsidies, with detrimental consequences for fiscal deficits.

Policy challenges

South Asia has been a success story in recent years, with high growth, and considerable progress in poverty reduction (Romer 2016). The key challenge is to sustain that success in the face of future headwinds. Removal of structural barriers to growth, pursuit of greater international integration, improved productivity, and further fiscal and financial reforms are imperative (Figure 2.5.9).

Fiscal risks

Continued fiscal consolidation and an acceleration of SOE reforms is a priority to help ease budgetary pressures, to contain rising debt levels, and to lift investor confidence. A transparent medium-term framework for the budget would help build fiscal buffers (India, Pakistan) and stabilize public debt (Nepal, Sri Lanka). Improved public financial management and efficiency at national and subnational levels (e.g., through fiscal rules), would help to anchor expectations of fiscal sustainability. Revenue ratios in the region are low by comparison with other EMDE regions (World Bank 2016a). In addition, to meet fiscal targets without substantially reducing public investment needs, better revenue collection is important. This can be achieved through streamlining direct and indirect taxes (Bangladesh, Sri Lanka), by expanding the tax base (India, Pakistan, Sri Lanka), further rationalizing subsidies (Bangladesh, India, Pakistan), and by improving the efficiency of tax collection (Bangladesh, Sri Lanka). Reforming and privatizing SOE could also lessen strains on the budget and reduce fiscal risks (e.g., rising contingent liabilities in state-owned banks in *India*). Revenue-led fiscal consolidation needs to take into consideration its impact on poverty and inequality.

Financial sector risks

In view of concerns about impaired bank asset quality in the region, it is necessary to enhance financial sector stability and to minimize spillovers to the rest of the economy from possible banking sector stress (Claessens 2015). Reforms in corporate governance are important; to reduce leverage and to improve the quality of bank lending. Banking sector reforms can improve the efficiency in allocation of credit (Bangladesh, India), and help to curtail excessive credit growth (Sri Lanka). Appropriate reforms include strengthening supervision and raising capital requirements. In *India*, a network of 27 listed public sector banks account for almost three-quarters of the banking system by assets. Increasing competition in the banking sector could improve corporate governance and reduce non-performing loans. In some cases, consolidation of commercial banks is warranted (Hariyama, Montgomery, and Takahashi 2014). Capital market development would allow firms to use debt instruments (bonds), thereby easing reliance on borrowing from banks but could increase vulnerabilities to external shocks (World Bank 2016v; Sophastienphong, Mu, and Saporito 2008).

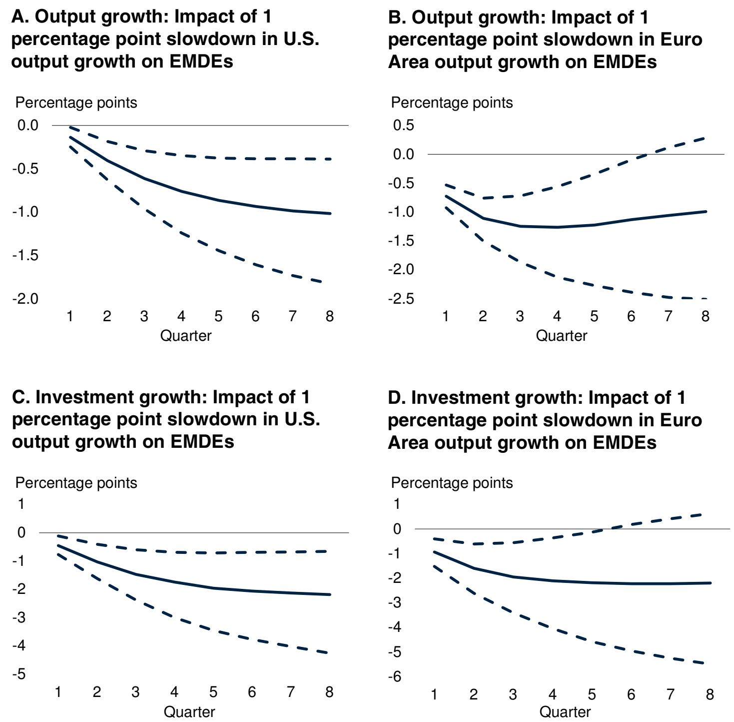
Structural reforms

Structural reforms to raise potential growth and increase productivity are a priority. This can be accomplished through global value chain integration, investments in human capital, improved labor markets, and greater labor force participation by female, and in the formal sector. Measures to counter high youth unemployment in the region would have a large pay-off over time (Dabla-Norris, Ho, and Kyobe 2016).

Integration in global value chains has been associated with higher growth in other regions (Farole and Pathikonda 2016). South Asia is one of the least internationally integrated regions. Poor infrastructure connectivity and a weak business environment weigh on competitiveness. Reducing infrastructure gaps and an improving business climate would allow new productive sectors to develop, generate jobs, and foster their integration into global value chains (Lopez-

FIGURE 2.5.8 Spillovers from the United States and the Euro Area

A slowdown in U.S. or Euro Area output growth would reduce output growth in EMDEs considerably. EMDE investment would respond more strongly, possibly reflecting investor concerns about long-term growth prospects.



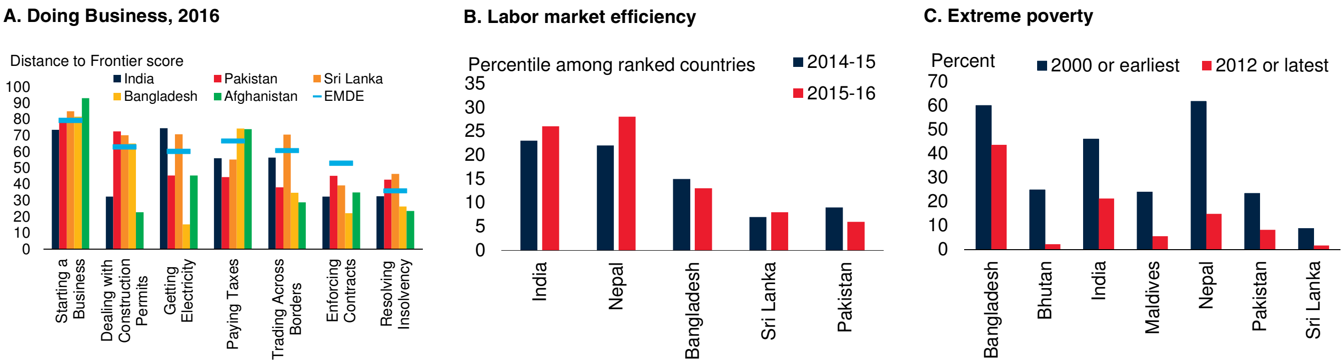
Sources: Haver Analytics, International Monetary Fund, World Bank.
Notes: Cumulative impulse response of weighted average EMDEs output growth (A.B.) or investment growth (C.D.) at 1-8 quarter horizons to a 1 percentage point decline in growth in real GDP in the United States (A.C.) and Euro Area (B.D.). Growth spillovers based on a Bayesian vector autoregression of world GDP (excluding the source country of spillovers), output growth in the source country of the shock, the U.S. 10-year sovereign bond yield pulse JP Morgan's EMBI index, investment (C.D.) or output (A.B.) in EMDEs, excluding, China and oil price as an exogenous variable. Solid lines indicate the median responses and the dotted lines indicate 16-84 percent confidence intervals.

Acevedo and Robertson 2016). Improved global and intra-regional integration could further encourage the developments of South Asian supply chains, and broaden export opportunities. South Asian economies should be able to leverage their low-cost, labor-intensive, manufacturing sectors to this end.

Investment in human capital will help raise potential growth and productivity as the region shifts from basic manufacturing to more innovative, knowledge-based industries (Aturupane et al. 2014). Improvements in the formal education system and other training programs will be needed to prepare workers for jobs in the modern manufacturing and services

FIGURE 2.5.9 Policy challenges

Further structural reforms to improve the business environment and labor market efficiency are imperative to attract investment and create jobs. This will contribute to a continuation of the poverty reduction experienced over the past decade.



Sources: Haver Analytics; World Development Indicator, World Bank.
A. An economy's distance to frontier is reflected on a scale from 0 to 100, where 0 represents the lowest performance and 100 represents the frontier.
B. Higher score means more efficient.
C. Extreme poverty is calculated by the rule: Poverty headcount ratio at $1.90 a day (2011 PPP) (percent of population).

industries (Romer 2016). While access to basic education is generally adequate, quality is a concern and access to higher levels of education remain low compared to the East Asia and Pacific region (UNESCO 2014). Greater workplace-based and vocational training can help build skills that are relevant in changing economies. Lifting labor market barriers are needed to increase the mobility and flexibility of workforce (Shirke and Srija 2014). Reforms should create new opportunities for female workers to participate in the labor force, introduce greater flexibility in labor markets and reduce taxes on low-paid workers. Easing entry restrictions in the product and services markets (India, Pakistan) and easing regulatory burdens (Bangladesh, India, Pakistan) would encourage investment and growth in export -led sectors (Alfaro and Chari 2014).

Regulatory reforms to promote household enterprises in retail and wholesale trades (Bangladesh, Pakistan) can unlock the potential of small- and medium-size enterprises (Abeberese 2016; Pachouri and Sharma 2016). Appropriate reforms would reduce the number of permits (and the associated delays) required to start and operate a business. For example, compared to an average of 103 days in EMDEs, connecting to electricity can take 429 days in Bangladesh and 181 days in Pakistan (World Bank 2016w). In addition, lower collateral requirements would improve access to finance and decrease the cost of credit for small businesses (Loayza 2016). Under the right conditions, small and medium-sized firms can be major creators of jobs.

Over two-thirds of the population in South Asia resides in rural areas (World Bank 2016u). Almost 70 percent of *India's* population live in villages, and 75 percent of this population constitute the majority of the extreme poor (Tewari 2015). Reforms to raise agricultural productivity, and thereby rural incomes, therefore, have a major role to play in poverty alleviation (Maitra et al. 2016). Increased access to irrigation, use of high-yield varieties, and improved market access could boost productivity. Encouraging diversification through labor-intensive agri-business activities such as food processing, and fostering greater value added agricultural production will create job opportunities, and lessen incentive to move to already densely-populated cities.

TABLE 2.5.1 South Asia forecast summary

(Real GDP growth at market prices in percent, unless indicated otherwise)

	2014	2015	2016	2017	2018	2019	2015	2016	2017	2018
			Estimates	Projections			(percentage point difference from June 2016 projections)			
EMDE South Asia, GDP[a, b]	**6.7**	**6.8**	**6.8**	**7.1**	**7.3**	**7.4**	**-0.2**	**-0.3**	**-0.1**	**0.0**
(Average including countries with full national accounts and balance of payments data only)[c]										
EMDE South Asia, GDP[c]	6.7	6.9	6.8	7.1	7.4	7.4	-0.2	-0.4	-0.2	0.1
GDP per capita (U.S. dollars)	5.3	5.5	5.4	5.7	6.0	6.1	-0.2	-0.4	-0.2	0.0
PPP GDP	6.7	6.8	6.8	7.1	7.4	7.4	-0.3	-0.3	-0.1	0.1
Private consumption	6.2	6.4	6.4	6.7	7.2	7.4	0.4	-0.3	-0.1	0.7
Public consumption	8.9	2.2	7.0	7.2	7.5	7.6	-7.4	0.4	0.7	0.9
Fixed investment	2.7	6.2	6.5	7.4	7.4	7.3	-1.0	-0.6	-0.7	-1.4
Exports, GNFS[d]	5.5	-4.9	2.2	5.6	7.1	7.4	-2.0	-0.5	-0.3	-0.4
Imports, GNFS[d]	1.0	-1.6	1.6	5.1	6.6	6.9	0.2	0.0	0.1	0.3
Net exports, contribution to growth	1.0	-0.7	0.1	-0.1	-0.2	-0.2	-0.5	0.0	0.0	-0.2
Memo items: GDP[b]	**14/15**	**15/16**	**16/17**	**17/18**	**18/19**	**19/20**	**15/16**	**16/17**	**17/18**	**18/19**
South Asia excluding India	5.4	5.3	5.3	5.5	5.7	5.8	0.0	0.0	0.0	0.3
India	7.2	7.6	7.0	7.6	7.8	7.8	0.0	-0.6	-0.1	0.1
Pakistan (factor cost)	4.0	4.7	5.2	5.5	5.8	5.8	0.5	0.7	0.7	0.7
Bangladesh	6.6	7.1	6.8	6.5	6.7	7.0	0.6	0.5	-0.3	0.7

Source: World Bank.
World Bank forecasts are frequently updated based on new information and changing (global) circumstances. Consequently, projections presented here may differ from those contained in other Bank documents, even if basic assessments of countries' prospects do not differ at any given moment in time.
a. EMDE refers to emerging market and developing economy. GDP at market prices and expenditure components are measured in constant 2010 U.S. dollars.
b. National income and product account data refer to fiscal years (FY) for the South Asian countries, while aggregates are presented in calendar year (CY) terms. The fiscal year runs from July 1 through June 30 in Bangladesh and Pakistan, from July 16 through July 15 in Nepal, and April 1 through March 31 in India. 2017 data for Bangladesh, India, and Pakistan cover FY2016/17.
c. Sub-region aggregate excludes Afghanistan, Bhutan, and Maldives, for which data limitations prevent the forecasting of GDP components.
d. Exports and imports of goods and non-factor services (GNFS).
For additional information, please see www.worldbank.org/gep.

TABLE 2.5.2 South Asia country forecasts

(Real GDP growth at market prices in percent, unless indicated otherwise)

	2014	2015	2016	2017	2018	2019	2015	2016	2017	2018
			Estimates	Projections			(percentage point difference from June 2016 projections)			
Calendar year basis[a]										
Afghanistan	1.3	0.8	1.2	1.8	3.0	3.6	-0.7	-0.7	-1.1	-0.6
Bhutan	5.7	6.5	7.4	9.9	11.7	11.7	-0.2	0.6	1.9	3.7
Maldives	6.5	1.9	3.5	3.9	4.6	4.6	0.0	0.0	0.0	0.0
Sri Lanka	4.9	4.8	4.8	5.0	5.1	5.1	0.0	-0.5	-0.3	-0.2
Fiscal year basis[a]	**14/15**	**15/16**	**16/17**	**17/18**	**18/19**	**19/20**	**15/16**	**16/17**	**17/18**	**18/19**
Bangladesh	6.6	7.1	6.8	6.5	6.7	7.0	0.6	0.5	-0.3	0.7
India	7.2	7.6	7.0	7.6	7.8	7.8	0.0	-0.6	-0.1	0.1
Nepal	2.7	0.6	5.0	4.8	4.7	4.7	0.0	0.3	0.4	0.3
Pakistan (factor cost)	4.0	4.7	5.2	5.5	5.8	5.8	0.5	0.7	0.7	0.7

Source: World Bank.
World Bank forecasts are frequently updated based on new information and changing (global) circumstances. Consequently, projections presented here may differ from those contained in other Bank documents, even if basic assessments of countries' prospects do not significantly differ at any given moment in time.
a. Historical data is reported on a market price basis. National income and product account data refer to fiscal years (FY) for the South Asian countries with the exception of Afghanistan, Bhutan, Maldives, and Sri Lanka, which report in calendar year (CY). The fiscal year runs from July 1 through June 30 in Bangladesh and Pakistan, from July 16 through July 15 in Nepal, and April 1 through March 31 in India. 2017 fiscal year data, as reported in the table for India, Pakistan, Bangladesh, Nepal, cover FY2016/17.
For additional information, please see www.worldbank.org/gep.

BOX 2.5.1 Recent investment slowdown: South Asia

Investment growth slowed from 11 percent in 2011 to 6 percent in 2015, and is expected to weaken further in 2016. While subsiding political tensions and sharply lower oil prices have supported investment, long-standing structural bottlenecks continue to pose an obstacle to investment growth. Sizable investment needs remain in transport and energy, as well as in human resources, especially health and education.

South Asia (SAR) accounted for 4 percent of global investment, on average, over 2010-15. Despite an uptick in public investment spending, a deceleration in the private sector resulted in a substantial decline in overall investment growth, from 11 percent in 2011 to 3 percent in 2014. A rebound, to 6 percent in 2015, still left the growth rate below the long-term (1990-2008) average of 8 percent.

This box discusses the following questions:

- How has investment growth in the region evolved?
- What were the main sources of the investment slowdown?
- What are the remaining investment needs?
- Which policies can help address investment needs?

Recent investment weakness in South Asia reflects the legacy of weak output growth during 2010-13, excess manufacturing capacity in the face of sluggish external demand, and some uncertainty about government policy. These factors have compounded the long-term problems of structural bottlenecks, weak banking systems, and bouts of political tension. Needs for capital formation remain sizable, especially in the energy and transport sectors; the region also lags in the provision of health and education services. Governments can help directly, and by encouraging private sector participation. More broadly, improvements to the general business environment (e.g., through more streamlined regulations and reduced corruption) would enhance incentives for productive investment.

How has investment growth in the region evolved?

Weak investment has been a drag on South Asia's recent, consumption-driven expansion (World Bank 2016u). Across the region, investment growth slowed sharply from 11 percent in 2011 to 3 percent in 2014, with only a modest rebound to 6 percent in 2015—barely half its 2011 pace and well below the long-term (1990-2008) average of 8 percent (Figure 2.5.1.1). The downward trend reflects a slackening in *India*, (which accounts for more than three-quarters of the region's total investment), offsetting a pickup in *Bhutan*, *Nepal*, and *Pakistan*. Preliminary data suggests continued investment weakness in 2016.

In *India*, gross fixed capital formation has been on a downward trend since 2011, with a shift in the composition from private to public. While public investment rose by 21 percent in FY2016, private investment (which accounts for two-thirds of the total) contracted by 1.4 percent, reducing overall investment growth to 4 percent. Infrastructure demand is expected to go up to $1 trillion under the 12th Five-Year Plan (2012-2017). Going forward, public and private investment should be supported by higher allocations in the FY2017 federal government budget to build and upgrade infrastructure, and the setup of a $3 billion National Investment and Infrastructure Fund.

In *Pakistan*, investment surged in 2015, mainly reflecting the China-Pakistan Economic Partnership (CPEC) infrastructure project (worth $45 billion). This has more than compensated for sluggishness in private investment. The project is part of *China's* "One Belt, One Road" initiative, and consists of a network of highways, railways, and pipelines to connect Western China to the Arabian Sea through the Gwadar Port in Pakistan. The *Islamic Republic of Iran* expressed interest in early 2016 to join the CPEC project. Combined with the ongoing gas pipeline project from the Islamic Republic of Iran, Pakistan should be able to maintain robust public investment growth in the near-term, while private investment is expected to pickup in the medium-term.

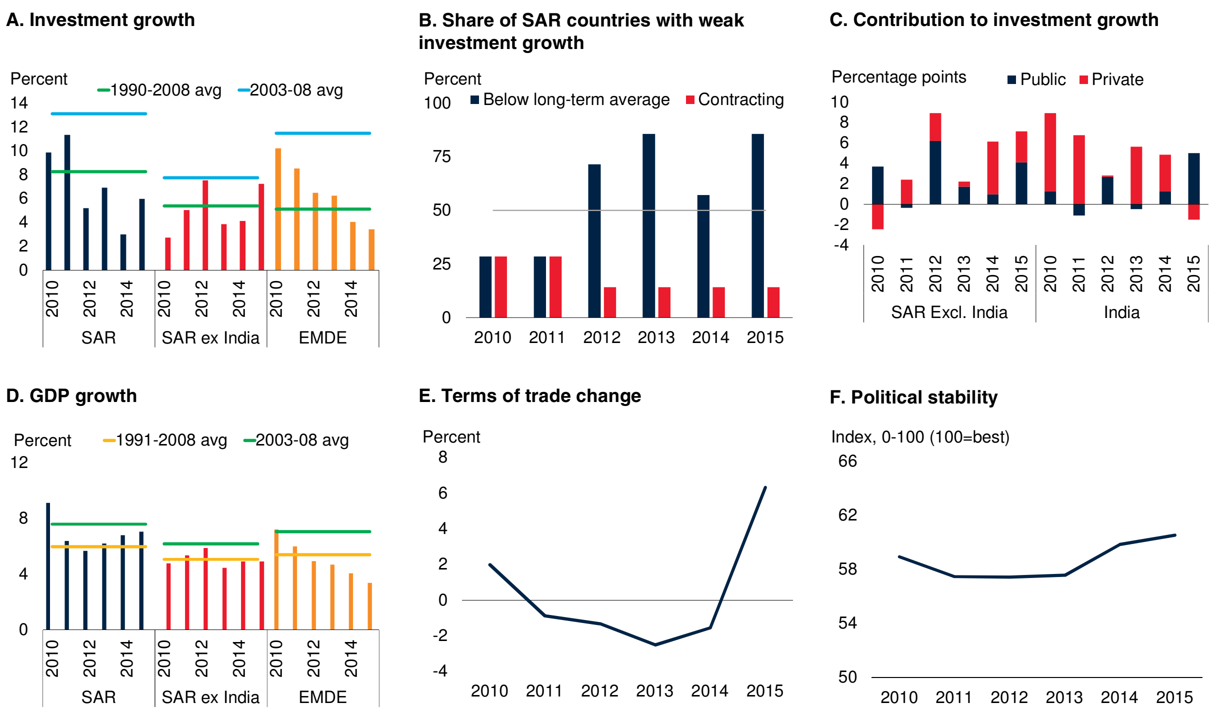
In *Bangladesh*, capital formation is estimated to remain weak in 2016, partly as a result of heightened political tensions and security concerns. *Sri Lanka's* investment contracted by 2 percent in 2016, following the suspension of the $1.4 billion Colombo Port City real estate project for over one year in 2015. In the near-term, investment growth in Sri Lanka is expected to continue on a downward trend, following the tightening of monetary policy in mid-2016 that raised financing costs. Fiscal consolidation, aimed at reducing the fiscal deficit to 3.5 percent of GDP by 2020 under the IMF's $1.5 billion

Note: This box was prepared by Boaz Nandwa.

BOX 2.5.1 Recent investment slowdown: South Asia *(continued)*

FIGURE 2.5.1.1 Investment growth slowdown in South Asia

Investment growth has been below the long-term average in more than half of SAR economies since 2012. Its composition has shifted away from private sector-driven investment growth during 2013-14 towards public sector-driven investment growth in 2015. While lower oil prices and easing political tensions supported investment, weak activity during 2010-12 and long-standing structural bottlenecks constrained investment.



Sources: Haver Analytics, International Country Risk Guide (ICRG), Ministry of Finance of Sri Lanka, Reserve Bank of India, World Bank.
A. Weighted averages. Includes annual data for Afghanistan, Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan, and Sri Lanka.
B. Share of SAR economies with investment growth below its long-term average or with negative investment growth.
C. Weighted average for Bangladesh, Bhutan, India, Nepal, Pakistan, and Sri Lanka.
D. GDP-weighted averages.
E. Investment-weighted averages. An increase denotes terms of trade improvements.
F. Investment-weighted averages of ICRG index of Political Risk. An increase denotes greater political stability.

Extended Fund Facility program, will weigh on infrastructure spending (IMF 2016q).

What were the main sources of the investment slowdown?

During 2010-13, weak economic activity weighed on investment and business confidence. Since 2014, however, investor sentiment in the region has benefited from sharply lower oil prices, easing political tensions, and revived reform agendas in *India*, *Pakistan*, and *Sri Lanka*, as well as easing vulnerabilities in *Bangladesh*, *India*, and *Pakistan*. This uptick has yet to translate into a robust rebound in private investment. Structural bottlenecks (e.g., power shortages, poor road and rail networks) and administrative requirements constitute barriers to investment, and weak banking sectors constrain investment finance.

India's steep private investment slowdown has been attributed to several factors (World Bank 2016u; Anand and Tulin 2014; Tokuoka 2012). First, the need to unwind excess capacity built during the pre-financial crisis growth boom amid weak external demand (e.g., in the manufacturing sector) has discouraged new projects and caused investors to shelve existing projects. Second, policy uncertainty has been a factor. For example, the stalled Land Acquisition Bill has extended project development timelines. Lack of federal and state government coordination, on compensation for land acquisition and environmental clearances, has contributed to cost and time

BOX 2.5.1 Recent investment slowdown: South Asia *(continued)*

overruns. Third, lenders have been less willing to finance overleveraged corporates, especially in infrastructure-related sectors (e.g., power and other utilities, steel, and cement firms). In particular, the Reserve Bank of India's 2015 corporate governance reforms in state-owned banks (which represent two-thirds of the total banking sector lending) has adversely affected lending to leveraged corporates and conglomerates.

What are the remaining investment needs?

South Asia is the second most densely populated region in the world, behind East Asia and Pacific, with large and pressing investment needs for infrastructure improvement (Bloom and Rosenberg 2011; Figure 2.5.1.2). Metrics of human capital provision (e.g., expenditure on education and healthcare, teacher-pupil ratios, doctor-patient ratios, water and sanitation in rural areas), fall below the EMDEs average (World Bank 2016w). This suggests that sizable additional outlays on human capital could effectively alleviate poverty (Romer 2016; Estache and Garsous 2012). Rapid urbanization and the maintenance of growth momentum, call especially for improvement of energy and transport infrastructure (Ellis and Roberts 2016; Inderst 2016; Battacharya 2012; ADB 2009, 2012; Andres, Biller, and Dappe 2014).

South Asia is one of the least integrated regions in the world (World Bank 2016e). This has been attributed to inadequacies in transport and power infrastructure (ADB 2009). Coverage differs within countries and across the region, with *India* and *Pakistan* somewhat better positioned than other countries.

Energy shortages (electricity, diesel) remain a critical constraint to activity in the region. Underdeveloped within-country and cross-border electricity grid network connectivity and, in some cases, geopolitical tensions have contributed to significant energy shortfalls, compounding regular electricity outages. In *India*, dependence on imported fuels for power generation, and low electricity tariffs have hampered power generation capacity, which now requires significant expansion to meet energy shortfalls (McKinsey 2011).

Bangladesh's infrastructure quality lags behind other countries in the region: power shortages and poor transport infrastructure have affected investment and productivity (World Bank 2015t). The 7th Five Year Plan estimates that about $410 billion in financing—twice the size of 2015 GDP—is needed for developing Bangladesh's infrastructure. Investment is also needed in public health care, where expenditure has declined from 1.1 percent of GDP in 2010 to 0.7 percent of GDP in 2014 (World Bank 2015f, 2016t).

In *Sri Lanka*, fiscal consolidation, coupled with priority spending to rebuild infrastructure after a 25-year civil war, has crowded out expenditure for human capital-building purposes. Government spending on education fell from 2.7 to 1.8 percent of GDP during 2006-2013, while spending on health declined from 2.0 to 1.4 percent of GDP over the same period (World Bank 2016x).

Which policies can help address infrastructure needs?

The alleviation of some longstanding obstacles to growth would help increase the level and productivity of investment of all forms. A more targeted, multi-pronged, policy strategy could also encourage investment by increasing returns to investment, and by expanding the financing envelope (Henckel and Mckibbin, 2010; Nataraj 2007).

Private investment. Under the right conditions, public investment can crowd-in private investment (World Bank 2016u; Chapter 3).[1] For example, private firms may be able to reap the benefits of large scale, if public infrastructure facilitates market access (Calderón, Moral-Benitob, and Servéna 2010). However, in the SAR, only *India* appears to have experienced a positive crowding-in effect (Jesintha and Sathanapriya 2011; World Bank 2006).

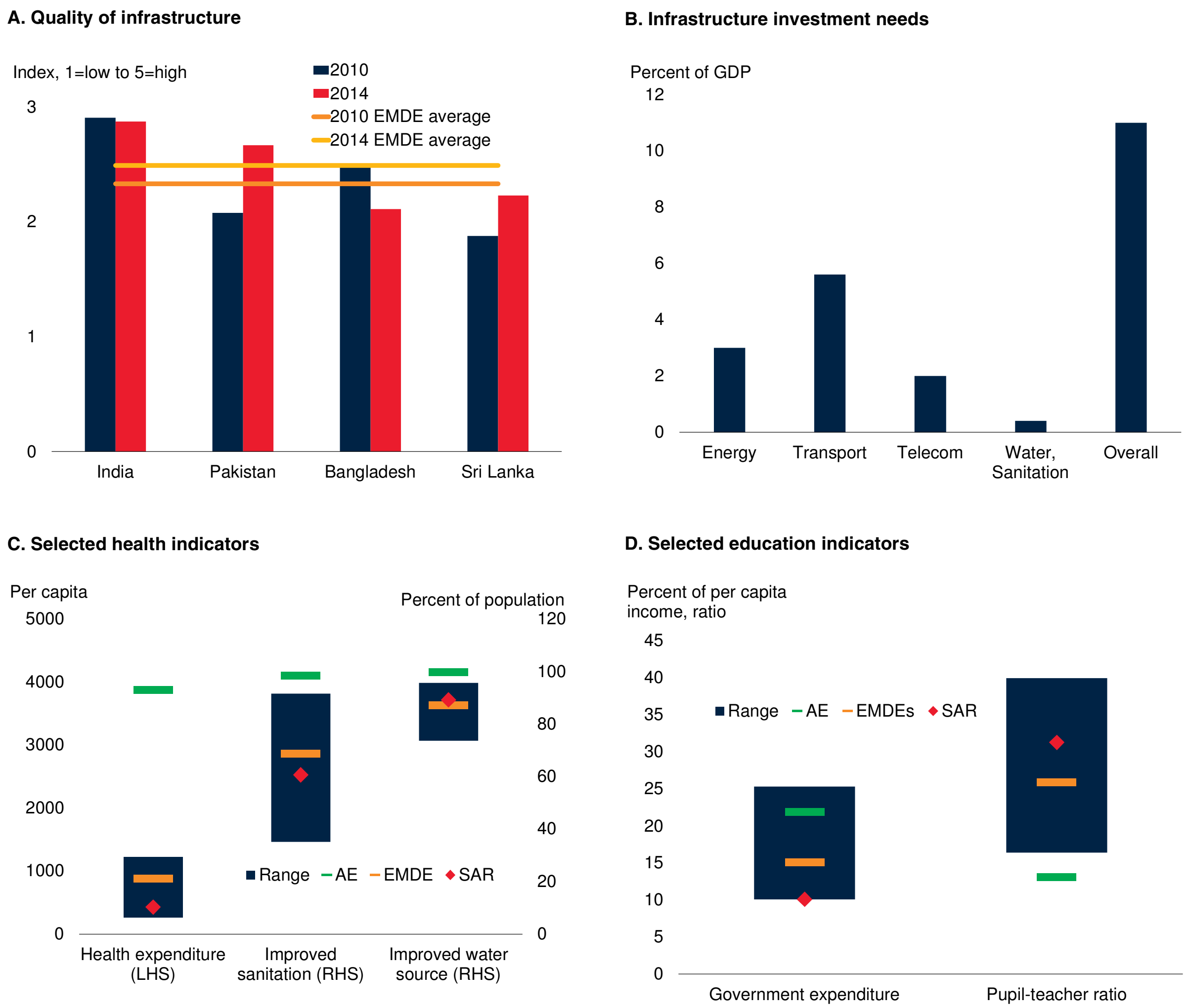
Financing. Financing for public and private investment can be expanded in a number of ways to narrow the investment financing gap (Deutsche Bank 2016; Andres, Biller, and Dappe 2014; McKinsey 2013; ADB 2012, 2009). First, public-private partnership may offer efficiency gains and cost-effectiveness (e.g., infrastructure funds), and at the same time alleviate fiscal pressures (Anadon and Surana 2015; Nataraj 2007). This can help reallocate government spending to socially desirable projects that cannot, in practice, be undertaken by the private sector, for instance, because of an unduly low private rate of return (e.g., water supply and sanitation projects). Second, domestic savings can be mobilized by improving access to the financial system (e.g., encouraging pension funds) and by broadening and raising government revenue collection. Third, banks' lending capacities can be increased by strengthening their balance sheets, and the

[1]Public investment could also lead to crowding-out of private investment, e.g. Pakistan (World Bank 2016s).

BOX 2.5.1 Recent investment slowdown: South Asia *(continued)*

FIGURE 2.5.1.2 Investment needs in South Asia

Despite improvements since 2010, sizable investment needs remain in public infrastructure (energy, transport) and human capital development.



Sources: Battacharya (2012), Haver Analytics, Inderst (2016), World Bank.
B. This represents investment as a share of GDP required every year during 2010-2012 to meet investment needs. The authors use "bottom-up" approach based on identified pipeline regional infrastructure projects across SAR.
C. Latest available data available during 2011-15. Blue bars denote range of unweighted regional averages across EMDE regions. Health expenditure per capita in purchasing power parity terms, unweighted averages of 199 EMDEs, 34 AEs, and 6 SAR economies. Access to improved sanitation facilities (in percent of population), unweighted averages for 150 EMDEs, 33 AEs, and 8 SAR economies. Access to improved water sources (in percent of population), unweighted averages for 148 EMDEs, 34 AEs, and 8 SAR economies.
D. Latest available data available during 2011-15. Blue bars denote range of unweighted regional averages across EMDE regions. Government expenditure per primary student (in percent of per capita income), unweighted averages of 87 EMDEs, 32 AEs, and 5 SAR economies. Pupil-teacher ratio in primary education (headcount basis), unweighted averages for 165 EMDEs, 31 AEs, and 8 SAR economies.

efficiency of capital allocation may be improved by increasing the commercial orientation of banks, including through privatization and governance reforms. Fourth, greater commercial orientation (through privatizations or concessions to private investors) of state-owned enterprises could raise efficiency and increase investment. Fifth, reducing asset-liability mismatches through greater use of funding through capital markets (e.g., infrastructure bonds), can be an alternative to heavy reliance on bank lending for infrastructure-related projects. Finally, foreign

BOX 2.5.1 Recent investment slowdown: South Asia ***(continued)***

direct investment in infrastructure can be encouraged by removing regulatory obstacles to doing business in restricted sectors (Kirkpatrick, Parker, and Zhang 2006; World Bank 2000).

Reforms to foster an enabling environment. South Asia is just ahead of Sub-Saharan Africa, but behind the other regions in terms of a conducive business climate (World Bank 2016p; Lopez-Acevedo, Medvedev, and Palmade 2016). Entry and administrative barriers in many sectors (construction, finance, retail and wholesale, telecommunication, and health care) in *Bangladesh*, *India*, and *Pakistan* have hampered investment in these sectors. The burden of regulatory compliance, delays in utility connections, difficulties in obtaining permits to start and operate business, higher taxes, and rigid labor markets raise the cost of doing business and discourage investment (Pachouri and Sharma 2016; Shirke and Srija 2014). Compared to an average of 103 days in EMDE, obtaining services from utilities (e.g., electricity) can take four time as long in *Bangladesh* and almost twice as long in *Pakistan* (World Bank 2016p). In *India*, investors point to restrictive labor laws as contributing to lower productivity in the manufacturing sector, restricting employment opportunities for women, and discouraging the adoption of new technologies.

Reforms that promote competitiveness and reduce barriers to trade can encourage investment in the tradable export-oriented sectors (e.g., services and manufacturing). This can also level the playing field and increase profitability of exporting, or of competing with imports in hitherto protected industries (Alfaro and Chari 2014). More generally, reforms to reduce regulatory burdens (e.g., land acquisition, environmental impact assessment) and to strengthen public-private partnerships legislation (e.g., consistent regulations, transparent bidding procedures) can foster investment. Strengthening public investment management processes, integrating infrastructure projects in budget cycles, and curbing corruption in infrastructure projects will not only improve quality of the infrastructure, but also improve the efficiency of government spending (KPMG 2011; Ali 2009).

Stability. Policy and political uncertainty represents a deterrent to investment in parts of the region (Chapter 3). Security challenges (Afghanistan, Pakistan) and geopolitical tensions (India, Pakistan) remain a formidable obstacle to creating a more conducive investment climate (Dash, Nafaraj, and Sahoo 2014) especially for cross-border projects that could increase regional economic integration. Stalled reforms on land (acquisition, compensation, and environmental clearances) remain a drawback on infrastructure-related private investment. Reforms to enhance efficiency of labor market—encouraging greater female labor market participation, facilitating hiring and redundancy procedures, and reducing taxes on low-paid workers—would increase the mobility and flexibility of the work force (Shirke and Srija 2014). In turn, the resulting increase in profitability, as well as the improvement in household incomes, would provide incentives for the expansion of businesses, including small and medium-size enterprises.

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