Executive Summary

Growth prospects for South Asia are dimming. The global economic environment has become more challenging and is a source of heightened downside risks. After a decade of repeated disruptions, South Asia's buffers to cushion new shocks are slim. Tackling some of its greatest inefficiencies and vulnerabilities could help South Asia navigate this unusually uncertain outlook: unproductive agriculture sectors, pressures from rising global temperatures, and fragile fiscal positions. For most South Asian countries, increased revenue mobilization is a prerequisite for strengthening fiscal positions. Even taking into account the particular challenges of collecting taxes in South Asian economies—such as widespread informal economic activity and large agriculture sectors—South Asian economies face larger tax gaps than the average emerging market and developing economy (EMDE). This suggests the need for improved tax policy and administration. Until fiscal positions have strengthened, the burden of climate adaptation will disproportionately fall on the private sector. If allowed sufficient flexibility, private sector adaptation could offset about one-third of the likely climate damage by 2050. This may, however, require governments to remove obstacles that prevent workers and firms from moving across locations and activities. As growth prospects dim, the challenge grows to create jobs for South Asia's rapidly expanding working-age population. South Asia's large diasporas could become a source of strength if their knowledge, networks, and other resources can be better tapped for investment and trade.

Chapter 1. A precarious path: Building resilience amid uncertainty. Growth prospects are dimming across South Asia. Tariffs, policy uncertainty, and financial market volatility have increased substantially. After an unexpectedly weak outturn of 6.0 percent in 2024, growth in South Asia is expected to soften further to 5.8 percent in 2025—0.4 percentage point below October forecasts—before ticking up to 6.1 percent in 2026. The region's economies face heightened downside risks, including from a highly uncertain global landscape. After a decade of shocks, South Asian economies have limited capacity to cushion new ones. In particular, South Asia's high debt remains a source of vulnerability to rising borrowing costs or declining funding inflows from private or official sources. The more challenging global environment, combined with domestic fragilities, could be navigated more easily if the region tackled areas of particularly large inefficiency or vulnerability. Domestic revenue mobilization could lessen South Asia's vulnerability to fiscal and external pressures. The region's unproductive agriculture sectors could benefit from more efficient pricing of inputs, as well as broader access to modern technologies and practices.

Box 1.1. Branching out: The economic potential of South Asians abroad. Dimming growth prospects across South Asia amplify the challenge of creating jobs. Many in South Asia's rapidly growing workforce are likely to continue to seek opportunities abroad. Migrants from South Asian countries—mainly to countries outside the region—account for about 3 percent of South Asia's working-age population. About one-half of them work in Gulf Cooperation Council countries, are typically low-skilled, and on short-term contracts. Another one-quarter work in advanced economies and tend to be highly skilled and longer-term migrants. While the challenges of emigration have been well documented, South Asian countries' large diasporas also bring economic benefits to the home countries, both while workers are abroad and after they return home—through remittances, improved skills, investments, and trade ties.

Spotlight. Clear the way: Climate resilience in South Asia's private sector. While South Asia has better growth prospects than other EMDE regions, it is also one of the regions that is most vulnerable to rising global temperatures and most affected by extreme weather events. Because of South Asia's already high average temperature and reliance on rain-fed agriculture, rising global temperatures could lead to output and per capita income losses by 2050 that are larger than those in the average EMDE. Higher temperatures would cause large damage in the most vulnerable sectors, such as agriculture, but more limited damage in the most resilient sectors, such as services. About one-third of the total climate damage could be reduced if the private sector could flexibly shift resources across activities and locations in response to these climate-induced changes in relative prices and incomes. Even South Asia's fiscally constrained governments have scope to facilitate these shifts, including by expanding access to finance, improving transport and digital connectivity, and providing well-targeted and flexible social benefit systems.

Chapter 2. Bridging the gap: Revenue mobilization in South Asia. South Asian governments need to raise revenues to shore up their fiscal positions. Although tax rates in South Asia are often above the EMDE average, most tax revenues are lower. On average during 2019–23, South Asian government revenues totaled 18 percent of GDP—well below the 24 percent of GDP average in EMDEs. Controlling for tax rates and the size of potential tax bases, tax revenues in the region are 1–7 percentage points of GDP below potential, with shortfalls in five of the region's eight countries larger than in the average EMDE. Revenue shortfalls are particularly pronounced for consumption taxes but are also sizable for personal income taxes and, in the larger economies, corporate income taxes. Weak revenue collection has only partly reflected country characteristics, such as widespread informal activity outside the tax net and large agriculture sectors. Even after accounting for these characteristics of South Asian economies, sizable tax gaps remain—highlighting the need for improved tax policy and administration. There is scope to raise tax revenues by eliminating loopholes, streamlining tax codes, strengthening enforcement, and facilitating compliance. The introduction of pollution pricing could also both boost revenues and help address the region's high pollution.