Executive Summary

South Asia is expected to continue to be the fastest-growing emerging market and developing economy (EMDE) region over the next two years. This is largely thanks to robust growth in India, but growth is also expected to pick up in most other South Asian economies. However, growth in the near term is more reliant on the public sector than elsewhere, whereas private investment, in particular, continues to be weak. Efforts to rein in elevated debt, borrowing costs, and fiscal deficits may eventually weigh on growth and limit governments’ ability to respond to increasingly frequent climate shocks. Yet, the provision of public goods is among the most effective strategies for climate adaptation. This is especially the case for households and farms, which tend to rely on shifting their efforts to non-agricultural jobs. These strategies are less effective forms of climate adaptation, in part because opportunities to move out of agriculture are limited by the region’s below-average employment ratios in the non-agricultural sector and for women. Because employment growth is falling short of working-age population growth, the region fails to fully capitalize on its demographic dividend. Vibrant, competitive firms are key to unlocking the demographic dividend, robust private investment, and workers’ ability to move out of agriculture. A range of policies could spur firm growth, including improved business climates and institutions, the removal of financial sector restrictions, and greater openness to trade and capital flows.

Chapter 1: Deceptive strength. Output growth in South Asia, projected at 6.0–6.1 percent in 2024–25, continues to exceed that in other emerging market and developing economies, but this is largely due to strong growth in India. In the rest of the region, while picking up, it is expected to remain mostly well below pre-pandemic averages. More than in other emerging market and developing economies, growth is being driven by the public sector. Many of the underlying vulnerabilities that had previously caused balance-of-payments pressures remain, and point to downside risks to growth. Stronger job creation and the easing of financial market restrictions could help boost growth, private investment, and government revenues and put in place conditions conducive to climate adaptation.

Box 1.1: Accelerating private investment. Private investment growth has slowed sharply from pre-pandemic averages in all South Asian countries, hampering the region’s efforts to meet development and climate objectives. Historically, sustained accelerations in private investment were most likely to occur when institutional quality was strong, the real exchange rate was competitive, and economies were more open to trade and capital flows.

Spotlight: Who bears the burden of climate adaptation and how? South Asia is highly vulnerable to climate change. However, severely constrained fiscal positions will limit the scope for public policies to facilitate climate change adaptation. This means that the burden of adaptation will fall disproportionately on firms, farmers, and households and, especially, poor households, which typically suffer greater damage from climate shocks. A comprehensive and systematic review of climate change research identifies a variety of adaptation strategies used by households, firms, and farmers, which have offset 46 percent of climate damage, on average. Firms have access to the most effective adaptation strategies, typically technology-related, whereas the least effective strategies are employed by households and farmers, often in the form of labor market adjustments. Adaptations that involve public support tend to be more effective than purely private strategies. The analysis suggests that policy should be guided by three principles: (i) implementing a comprehensive package of policies; (ii) prioritizing policies that generate “double dividends”; and (iii) designing policies that target non-climate goals in a manner that does not set back climate-related goals.

Chapter 2: Jobless development. South Asia’s labor markets stand out among EMDEs for having suffered for decades from declining employment ratios (that is, employment relative to the total working-age population) and exceptionally low shares of women in employment. While agriculture has shed labor, as it has in other EMDEs, the non-agriculture sector has been unusually slow in creating jobs. This
partly stems from challenging institutional and economic environments that have held back firms’ growth. As a result, the region has relied on labor productivity and population growth as engines of output growth. However, working-age population growth is expected to slow, and labor productivity growth has already slowed sharply since the COVID-19 pandemic. Sustaining growth will require increasing employment ratios, especially in the non-agriculture sector and among women, through measures to remove obstacles to growth for businesses, increase openness to international trade, ease labor market and product market restrictions, build human capital, and strengthen equality of women’s rights.