



## CHAPTER 1

# PROGRESS AND PERIL



## Chapter 1: Progress and Peril

*Growth in South Asia is on track to exceed earlier expectations and reach 6.6 percent in 2025, but is expected to slow to 5.8 percent in 2026. The region is making progress toward addressing vulnerabilities but risks remain. South Asian economies would be affected by spillovers from a persistent global economic slowdown and export market dislocations, labor market disruptions from artificial intelligence (AI), social unrest, or geopolitical tensions. Over the longer term, new technologies such as AI and more open trade regimes could catalyze renewed growth momentum by encouraging private investment and productivity. Policymakers can foster both growth and job creation by enhancing the flexibility of their economies, improving connectivity, encouraging upskilling of the workforce, and providing an appropriate safety net.*

### Introduction

Growth in South Asia is expected to slow sharply from 6.6 percent in 2025 to 5.8 percent in 2026 (figure 1.1). The forecast for 2025 has been revised up amid higher-than-anticipated public investment in India and a broad-based recovery in Sri Lanka. For 2026, the forecast has been downgraded, as some of these effects unwind and India continues to face higher-than-expected tariffs on goods exports to the United States. Despite this slowdown, growth in the region is expected to remain more robust than in other emerging market and developing economies (EMDEs). Vulnerabilities remain, particularly in terms of high debt levels and low foreign exchange buffers in some countries, but most South Asian countries are making progress toward addressing macroeconomic imbalances such as current account deficits.

Inflation in the region is either within central bank targets or trending toward them. Central banks are generally easing monetary policy, although a growing share of central bank communications has expressed caution about moving too quickly in an environment of elevated uncertainty.

Financial markets around the world, including in South Asia, appear to be placing little weight on downside risks. Stock market valuations in major markets dipped temporarily earlier this year in response to new tariff announcements but have

more than recovered in recent months. Borrowing costs for both sovereigns and corporates remain above their pre-pandemic average but spreads over U.S. Treasury yields have remained narrow. Credit ratings for EMDE sovereigns have generally been improving.

South Asia's growth prospects could be derailed in a variety of ways. The region has faced several public uprisings, such as those that led to the collapse of the government in Nepal in September, in Bangladesh in 2024, and in Sri Lanka in 2022. With continued trade tensions, weak global trade and investment could lead to a period of slow global growth, which could spill over to South Asia. High debt makes several South Asian countries' fiscal positions vulnerable to an increase in interest rates or a decline in growth rates, with any stresses quickly transmitted to the financial system because of banks' sovereign debt holdings. Artificial intelligence (AI) could boost productivity, but also has the potential to disrupt labor markets. Rising tariffs in major export markets may undermine efforts to improve manufacturing. Mounting geopolitical pressures might raise energy costs and weaken energy security.

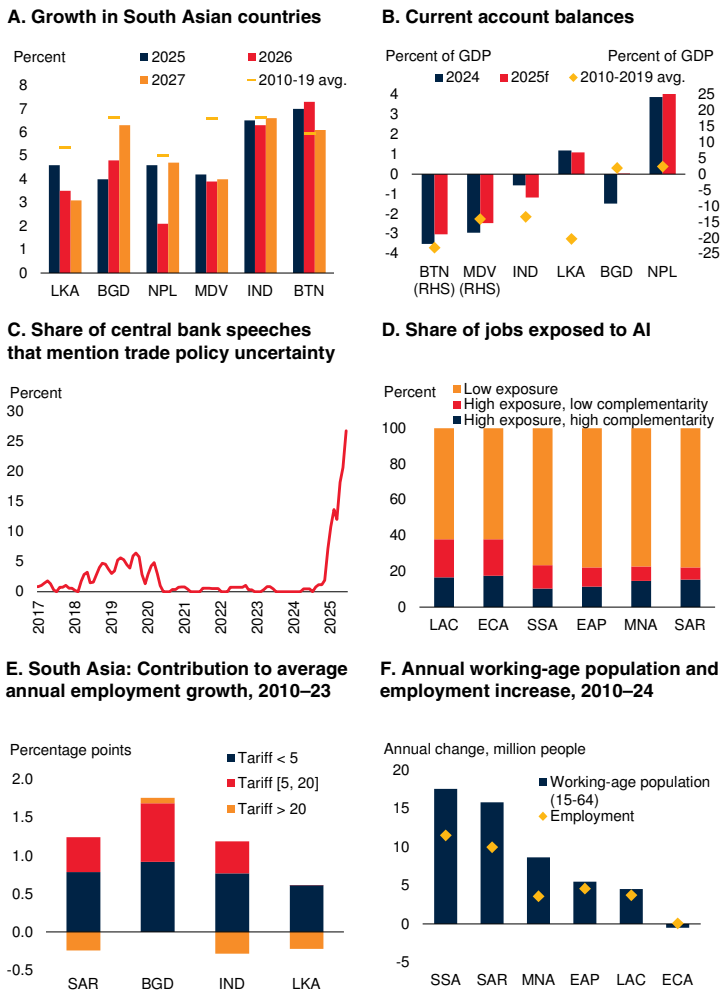
While some of these forces create short-term risks, they could also accelerate longer-term growth. Carefully sequenced reductions in tariffs—ideally in the context of broader free trade agreements—could especially benefit the sectors whose outputs have the lowest tariff protections but face higher tariffs on intermediate inputs than in other EMDEs. Effective, sustained public investment can crowd in private investment, which has been

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*Note:* This chapter was prepared by Patrick Kirby.

**FIGURE 1.1 Overview**

Growth is expected to decelerate in South Asia in 2026. The region remains vulnerable to social unrest and macroeconomic disruptions, even as most countries have reined in current account deficits from pre-pandemic highs. Inflation is generally contained, both globally and in South Asia, but central banks are moving cautiously because of high trade policy uncertainty. South Asia may be well placed to benefit from artificial intelligence, because a larger share of exposed jobs could improve productivity rather than be replaced. The most job-creating sectors have been those least protected by tariffs, but aggregate job creation has been slower than needed to absorb the growing working-age population.



Sources: Bank for International Settlements (BIS); Global Labor Database; International Labour Organization; International Monetary Fund; Lightcast (database); Penn World Table (database); Pizzinelli et al. (2023); United Nations World Population Prospects (database); World Bank Macro Poverty Outlook; World Development Indicators (database); World Trade Organization Analytical Database; World Bank.

Note: BGD = Bangladesh; BTN = Bhutan; EAP = East Asia and the Pacific; ECA = Europe and Central Asia; IND = India; LAC = Latin America and the Caribbean; LKA = Sri Lanka; MDV = Maldives; MNA = Middle East and North Africa; NPL = Nepal; RHS = right-hand side; SAR = South Asia; SSA = Sub-Saharan Africa.

A. For India, "2025", "2026", and "2027" refer to FY25/26, FY26/27, and FY27/28. For other countries that use fiscal rather than calendar years, "2025", "2026" and "2027" represent FY24/25, FY25/26 and FY26/27.

B. Chart shows current account balances as a share of GDP.

C. Chart shows the share of central bank speeches at <https://www.bis.org/cbspeeches> that reference trade policy uncertainty. A speech refers to trade policy uncertainty if it contains at least one trade-policy-related term (such as tariff, trade agreement, and import duty) within 10 words of an uncertainty-related term (such as risk, uncertainty and concern). The full list of search terms and proximity rules follows Caldara et al. (2020). Last observation is September 18th 2025.

D. Bars show the percentage of occupations exposed to artificial intelligence across EMDE regions. See chapter 2 for more details.

E. See chapter 3 for more details.

F. Working age population defined as individuals between the ages of 15 and 64.

sluggish for several years (World 2024b). Private investment could generate productivity gains through the adoption of new technologies. For example, the rapid adoption of AI—in which computers perform activities generally associated with human intelligence—could significantly boost productivity in the long term, though it may lower demand for some types of tasks and occupations (chapter 2).

Pursued in tandem, these policy reforms could be transformative. Trade openness and labor market flexibility can support successful, productive sectors like business services. Greater public and private investment can put in place the transportation, energy, and telecommunications infrastructure underpinning greater trade and use of AI. Firms and workers made more productive by AI and inexpensive foreign inputs can pay taxes that sustain continued public investment and strong social welfare systems. Progress along multiple fronts can help South Asia sustain its record of strong growth and boost the pace of job creation, which has been slower than needed to absorb the growing working-age population.

**Global developments and outlook**

Global growth is showing early signs of being damaged by rising uncertainty over tariffs and trade policy (figure 1.2). Forecasts for 2025 growth rates of major economies dipped in April after major economies announced new tariffs. Except for the United States, the forecasts recovered after tariff implementation was delayed and moderated.

Global trade policy uncertainty has retreated from its April highs but remains elevated by historical standards. This largely reflects changing U.S. import tariffs, which have been introduced, delayed, and adjusted frequently in recent months. The net effect has been that U.S. tariffs have risen to their highest level in nearly a century, from 2.4 percent in 2024 to 17.4 percent in September 2025.

The effects of changing trade policy are apparent in some categories of trade. Bilateral merchandise trade between the United States and China, for example, has been subjected to significant tariff

increases, and U.S. imports from China being down by about one-quarter since April. Aggregate global trade volumes have remained resilient so far, growing 3.6 percent in the 12 months ending in June, as companies increased and stockpiled imports prior to the imposition of new tariffs.

Financial markets appear to be placing little weight on downside risks. Stock market valuations in major markets dipped in response to new tariff announcements in April, but have generally rebounded since then (figure 1.3). U.S. technology stocks have been especially buoyant. Borrowing costs for both sovereigns and corporates remain above their pre-pandemic average, even as spreads over U.S. Treasury yields have generally been small. Credit ratings for EMDE sovereigns have been improving.

Inflation remains close to central bank targets in most countries but has been trending up in 2025. Import prices are being pushed up in some countries by tariffs, and pushed down in others by the falling price of goods coming from China and currency appreciation against the U.S. dollar. Commodity prices have been volatile without a clear trend.

Central bank decisions around the world have been highly synchronized since the pandemic but are now becoming more varied as inflation dynamics become more country specific. In countries imposing tariffs, central banks must balance the risk that tariffs trigger persistent price increases against any need to support demand. The majority of central banks are still easing policy, often at a very gradual pace. Central bank communications are increasingly expressing caution about moving too quickly in an environment of elevated uncertainty.

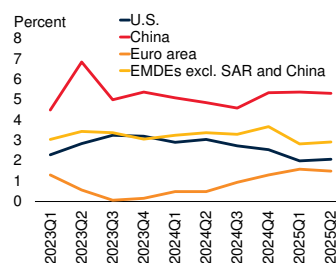
**United States.** U.S. activity in the first half of the year showed significant swings in trade and inventories as businesses adjusted purchases to accelerate imports in advance of tariff increases. Domestic consumption has slowed as labor markets have cooled. Investment has been supported by strong AI-related investment, but has otherwise weakened.

The fiscal deficit is expected to average 5.8 percent of GDP over the next decade, well above the

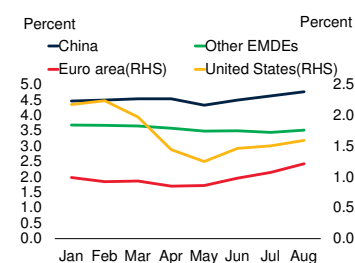
## FIGURE 1.2 Global economic activity

Expectations for growth in major economies dipped after trade policy uncertainty spiked in April before rebounding. Trade uncertainty remains extremely elevated as the number of tariffs grows, particularly in the United States. Some categories of trade have fallen, but broader impacts from the increase in tariffs are not yet apparent.

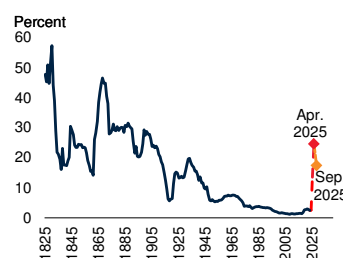
### A. Growth in major economies



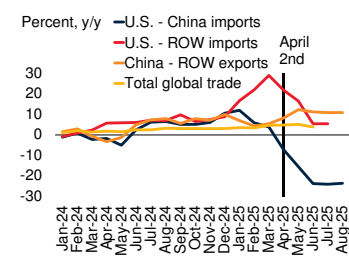
### B. Evolution of consensus forecasts, 2025



### C. U.S. tariff rate history



### D. U.S. tariffs and trade volume growth, 3-month moving average



Sources: Budget Lab at Yale; Consensus Economics; Haver Analytics; Tax Foundation; UN Comtrade; World Bank Macro Poverty Outlook; World Bank.

Note: EMDEs = emerging market and developing economies; RHS = right-hand side; ROW = Rest of the World; SAR = South Asia; U.S. = United States; y/y = year to year.

A. Year-on-year growth. "EMDEs excluding SAR and China" is the average growth of 25 countries, weighted by real GDP.

B. "Other EMDEs" includes 45 economies. The horizontal axis shows the month of 2025 in which the forecast was prepared.

C. Values prior to 2025 from Tax Foundation. 2025 values are average effective tariff rates estimated by the Budget Lab at Yale.

D. U.S. and China lines show growth in nominal trade values, while the global line reflects growth in the trade volume index.

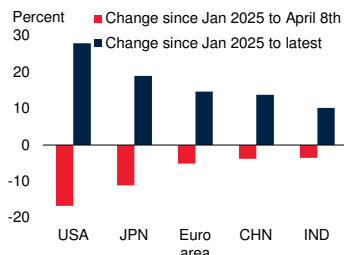
average of 4.8 percent of GDP in the decade before the pandemic, as recent tax cuts and increased interest expenditures outweigh the revenues from tariffs (CBO 2025). Inflation expectations have jumped and inflation itself has been trending up as tariffs and a weakening U.S. dollar push up import prices.

**Euro area.** Growth was more robust than expected in the first half of the year. Consumption growth has been supported by a strong labor market. Wage growth has been robust, and in July unemployment declined to 6.2 percent, its lowest point since the introduction of the euro in 1999. Going forward, tariffs, trade policy uncertainty, and the appreciation of the euro are expected to weigh on exports and investment.

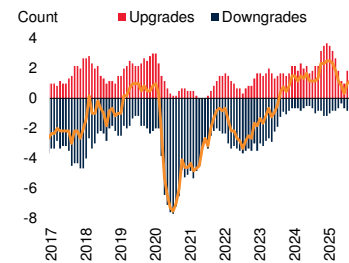
### FIGURE 1.3 Financial markets, inflation, and monetary policy

Stock market valuations in major markets dipped in response to new tariff announcements in April but have since generally rebounded. Financial conditions have been easing as credit ratings of EMDEs continue to improve. Inflation has stabilized, and the appreciation of many EMDE currencies may give central banks room to continue easing. Central bank communications suggest a high degree of caution amid elevated uncertainty.

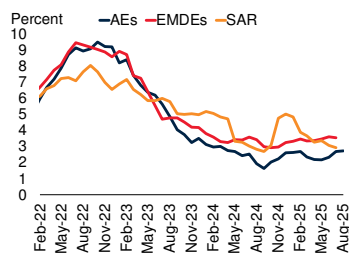
#### A. Stock market valuations



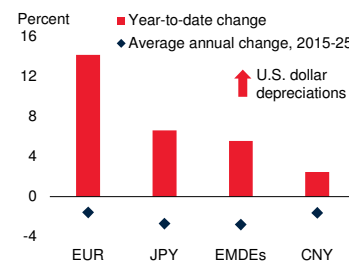
#### B. Movements in EMDE credit ratings



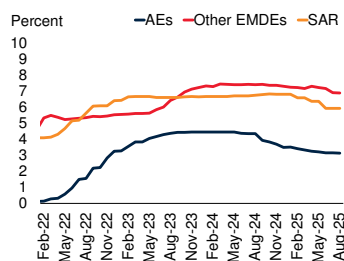
#### C. Median CPI Inflation



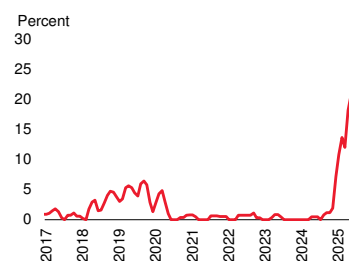
#### D. Major currency exchange rates movements against U.S. dollar



#### E. Monetary policy rate



#### F. Monthly share of central bank speeches referring to trade policy uncertainty



Sources: Bank for International Settlements (BIS); Federal Reserve economic database (FRED); Fitch; Haver Analytics; Moody's; S&P; World Development Indicators (database); World Bank.

Note: AEs = advanced economies; CHN = China; CNY = Chinese yuan; CPI = consumer price index; EMDEs = emerging market and developing economies; EUR = Euro; IND = India; JPN = Japan; JPY = Japanese yen; SAR = South Asia; U.S. = United States.

A. January 2025 value is the monthly average of national stock market benchmarks. Last observation is September 18th, 2025.

B. Chart shows 6-month moving average of sovereign credit rating changes across 104 EMDEs, using average of available Moody's, S&P, and Fitch ratings. Last observation is September 18th, 2025.

C. Inflation calculated as the median rate across 116 EMDEs, 30 AEs, and 6 South Asian countries.

D. "EMDEs" is the Nominal Emerging Market Economies U.S. Dollar Index calculated by the U.S. Federal Reserve Board. Last observation is September 18th, 2025.

E. Monetary policy rate for each region is a weighted average, using 2023 real GDP in U.S. dollars as weights. Sample includes 20 EMDEs, 34 AEs, and 4 South Asian countries—India, Bangladesh, Nepal, and Sri Lanka.

F. Chart shows the share of central bank speeches at <https://www.bis.org/cbspeeches> that reference trade policy uncertainty. A speech refers to trade policy uncertainty if it contains at least one trade-policy-related term (such as tariff, trade agreement, and import duty) within 10 words of an uncertainty-related term (such as risk, uncertainty and concern). The full list of search terms and proximity rules follows the methodology in Caldara et al. (2020). Last observation is September 18th, 2025.

**China.** In China, growth in the first half of 2025 averaged just above 5 percent, a modest acceleration from 2024. Exports have contributed an unusually large proportion of growth. This reflects both an acceleration of shipments before tariff increases and lower import prices, themselves the result of the yuan's real depreciation and falling manufactured goods prices. The economy is benefiting from fiscal support and the bottoming out of its property market after three years of substantial contraction.

Growth in other EMDEs has been decelerating, particularly in countries with greater trade openness. Domestic demand across countries remains generally robust, supported by easing financial conditions and rising real incomes.

### Developments in South Asia

Growth remained robust in the region in the first half of 2025. Recent GDP data from South Asian countries met or exceeded market expectations, and growth has continued to outpace that in other EMDEs (figure 1.4). Stock markets in the region have responded with broad-based increases, although these increases have mostly been more moderate than in the average EMDE.

U.S. tariffs on South Asia were announced on April 2, then delayed and adjusted, and finally implemented in August. These additional tariffs, as of the date of publication, are 50 percent on India, 20 percent on Bangladesh and Sri Lanka, and 10 percent on Nepal, Bhutan, and Maldives. As a result of these increases, most goods exported from Bangladesh to the United States face a tariff totaling 35 percent; from Sri Lanka, 30 percent; and from India, 52 percent. Some categories of goods are subject to product-specific tariffs that are currently generally lower than the country-specific tariffs, but may increase in the future. These goods include generic pharmaceuticals and electronics, both of which make up an important part of U.S. imports from India.

For all three countries, the United States is the single largest export market. Some weakness in manufacturing purchasing manager indexes in the region may be linked to uncertainties surrounding U.S. trade policy and the prospects for global trade. Incoming trade data so far do not show a

substantial negative impact on South Asian exports, although the underlying situation may be obscured by data lags and by importers accelerating purchases in anticipation of higher tariffs.

Inflation in most of the region is either within central bank targets or trending toward them. Inflation in Bangladesh remains elevated but has slowed since peaking last year. Sri Lanka has recently emerged from deflation, which was largely driven by reductions in administered energy prices.

As in the rest of the world, central banks in South Asia are generally cautiously easing, with the notable exception of Bangladesh Bank. Currencies in the region have been less volatile than in other EMDEs, possibly because they are relatively closed to trade.

Fiscal balances are improving in most countries in the region, even if debt levels and interest payments remain elevated in some cases. Current account positions continue to narrow from the large deficits in the years following the pandemic.

## Country developments

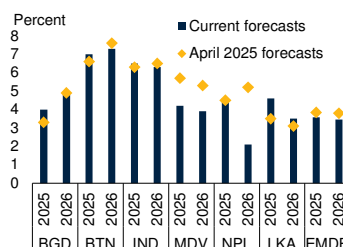
In **Bangladesh**, growth bottomed out at around 2 percent in mid-2024, after a public uprising against the government disrupted activity. In the first quarter of 2025, growth rebounded to 4.9 percent year-on-year—the fastest pace in nearly two years, although still well below the country's pre-pandemic rate. Inflation, which peaked above 11 percent in the second half of 2024, has steadily declined to 8.3 percent in August 2025. The central bank tightened monetary policy repeatedly in the second half of 2024 and has held rates steady since. It has indicated that it will begin easing once the real interest rate reaches 3 percent.

Economic weakness is primarily the result of weak investment, as the country faces elevated political uncertainty, law and order challenges, and a high cost of doing business. The financial sector is also burdened with a high level of non-performing loans and is struggling to meet the private sector's demand for credit. Healthy remittance inflows have kept consumption resilient in the face of rising unemployment and falling real wages. Export growth has been solid, and the exchange rate has remained stable since the adoption of a flexible regime in May 2025 (figure 1.5).

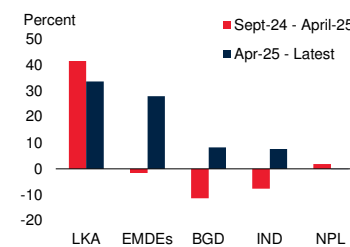
## FIGURE 1.4 Regional economic activity

Growth in South Asia remains strong. Stock markets in the region have rebounded from tariff-related losses despite substantial increases in U.S. tariffs. Central banks in the region are generally easing monetary policy, except in Bangladesh, and exchange rates in the region have been less volatile than in other EMDEs. Current account positions are moving away from the large deficits of recent years.

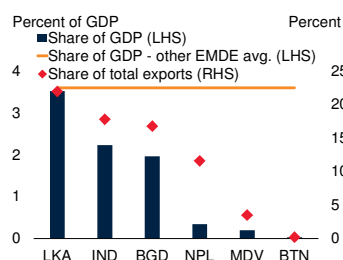
### A. Growth in South Asian countries



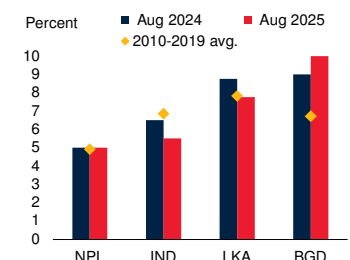
### B. Stock market movements



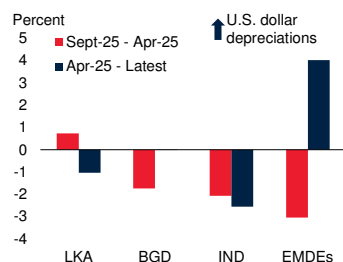
### C. South Asian exports to the U.S. as a percentage of GDP and total exports



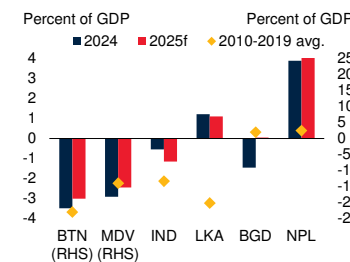
### D. Monetary policy rates in South Asia



### E. Exchange rate movements in South Asia relative to U.S. dollar



### F. Current account balances



Sources: CEPII, Database for International Trade Analysis (BACI); Federal Reserve economic database; Haver Analytics; Morgan Stanley; World Bank Macro Poverty Outlook; World Trade Organization (WTO), tariff analysis facility; World Bank.

Note: avg. = average; BGD = Bangladesh; BTN = Bhutan; EMDEs = emerging market and developing economies; IND = India; LKA = Sri Lanka; NPL = Nepal; MDV = Maldives; RHS = right-hand side.

A. For India, "2025" and "2026" refer to FY25/26, FY26/27. For other countries that use fiscal rather than calendar years, "2025" and "2026" represent FY24/25 and FY25/26. EMDE average includes 141 economies.

B. Listed dates are monthly averages of stock indices. "EMDEs" is the Morgan Stanley Capital International Emerging Markets Index. Last observation is September 18th, 2025.

C. Chart shows 2023 values. EMDE average calculated using total nominal exports and total GDP of 153 EMDEs.

D. Rate in Nepal is the overnight repo rate. Rate in Sri Lanka is the standing lending facility rate.

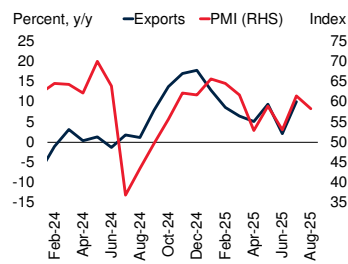
E. Listed dates are monthly averages of currency valuations. "EMDEs" is the Nominal Emerging Market Economies U.S. Dollar Index calculated by the U.S. Federal Reserve Board. Last observation is September 18th, 2025.

F. Chart shows the current account balance as a share of GDP.

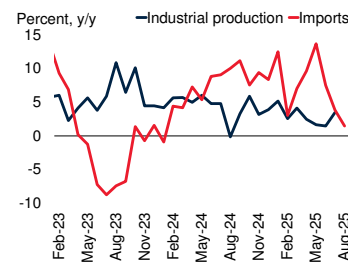
## FIGURE 1.5 Country developments

Exports in Bangladesh remain resilient. Domestic demand in India shows signs of continued momentum. The central bank has loosened monetary policy as inflation has slowed. Fiscal and current account deficits in Maldives remain sizable. Activity in Nepal has been supported by hydropower production. Prices in Sri Lanka have only recently emerged from deflation.

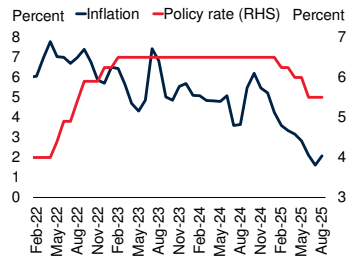
### A. Export growth and PMI in Bangladesh



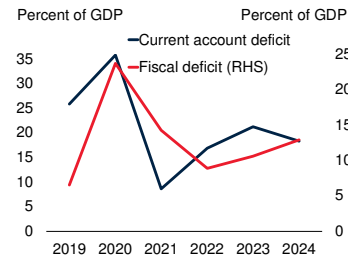
### B. Industrial production and imports in India



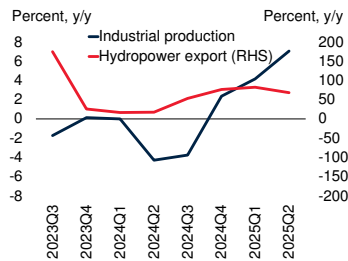
### C. Inflation and monetary policy in India



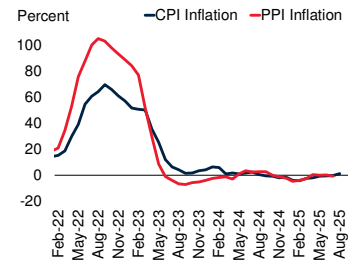
### D. Fiscal and current account deficits in Maldives



### E. Industrial production and hydropower export growth in Nepal



### F. Inflation in Sri Lanka



Sources: Haver Analytics; Metropolitan Chamber of Commerce and Industry, Dhaka (MCCI); World Bank Macro Poverty Outlook; World Development Indicators (database); World Bank.

Note: avg = average; CPI = consumer price index; PPI = producer price index; PMI = Purchase Manager Index; RHS = right-hand side; y/y = year-to-year.

A. Export growth is 3-month moving average of export growth in nominal U.S. dollars. PMI from MCCI, Dhaka.

B. Figure shows 3-month moving averages of imports.

E. Electricity exports are nominal 4-quarter moving average.

F. Figure shows year-on-year Colombo CPI and PPI inflation in Sri Lanka.

to 7.8 percent (year-on-year). Growth was supported by strong private consumption and investment and boosted by lower-than-expected prices. Investment growth remains robust, supported by public infrastructure projects, strong credit growth, and loosening monetary policy. Strong rural wage growth has offset slowdowns in urban consumption, as seen in weakness in car sales and personal credit. Industrial production and imports have largely maintained their strong momentum.

Inflation was 2.1 percent in August, within the central bank's 2–6 percent range. After holding its policy rate steady at 6.5 percent since early 2023, the central bank has cut it by a full percentage point since the beginning of 2025.

Stock market valuations struggled at the beginning of the year but have rebounded more recently. Net foreign portfolio investment into India turned negative in June amid rate cuts and geopolitical uncertainty.

In **Maldives**, increasing tourist arrivals continue to fuel growth in 2025, as was the case in 2024. Inflation surged in late 2024, rising from about 1 percent to a peak of 5.9 percent in April 2025. Although the country maintains a fixed exchange rate, import prices have surged due to limited access to foreign currency and depreciation in the parallel market. The fiscal deficit in 2024 was 12.9 percent of GDP, with particularly large expenditures on widespread subsidies, capital expenditures, and interest payments. The current account deficit was 18.3 percent of GDP in 2024, putting pressure on scarce foreign exchange reserves. Domestic banks have helped finance these deficits to some extent, increasing their exposure to sovereign debt.

In **Bhutan**, electricity production and exports were stronger than expected in the first half of 2025 thanks to high water levels. Hydro construction projects are contributing significantly to growth.

In **India**, real GDP growth exceeded expectations in the April-to-June quarter of 2025, accelerating

**Nepal** experienced its worst unrest in decades in September. A social media ban triggered protests against corruption, followed by widespread unrest causing significant human and economic losses. The damage to public and private infrastructure is still being assessed. An interim prime minister was appointed in September with the objective of organizing elections in March 2026.

The protests reflected frustration with governance and deeper discontent over the lack of economic opportunities for Nepal's youth. This lack of opportunity stems from structural weaknesses holding back private enterprise, including a complex and uncertain business environment, corruption, high trade and transport costs, and inadequate infrastructure. As a result, growth has been slower than peers—averaging 4.3 percent over FY12–24—and job creation has been limited. Youth unemployment reached nearly 22.7 percent in FY23, one of the highest levels in South Asia. Labor migration has become a dominant livelihood strategy and remittances—which average nearly one-quarter of GDP—have sustained basic consumption.

Prior to these developments, economic growth had increased to 4.6 percent in FY25, up from 3.7 percent in FY24. Activity was supported by robust hydropower production, a rebound in industrial output, and a pickup in agricultural activity.

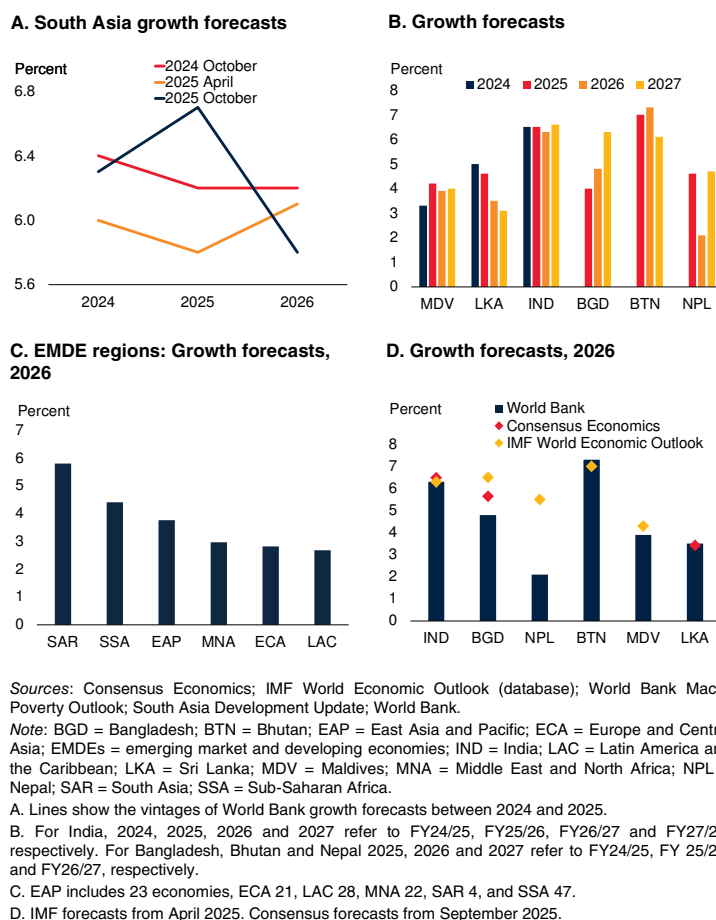
**Sri Lanka** continues to recover from the economic crisis of 2022–23, which featured a sovereign debt default and the country's worst recession since independence in 1948. The economy grew 4.9 percent in 2025Q2, maintaining essentially the same pace since 2023Q4. Prices declined between September 2024 and July 2025, driven by downward adjustments in energy prices, currency appreciation, and subdued household demand. Prices have increased since August but inflation remains low. The central bank is easing monetary policy, which has improved profitability and capital adequacy in the financial sector. Healthy corporate earnings have helped push Sri Lanka's domestic stock market to an all-time high. Revenue overperformance, structural reforms, and consistent growth—particularly of services exports—have improved current account and fiscal positions.

## Outlook for South Asia

Growth in South Asia is expected to slow sharply from 6.6 percent in 2025 to 5.8 percent in 2026 (table 1.1). Despite this deceleration, growth will remain stronger than in other EMDE regions (figure 1.6). Inflation is expected to continue within or trend toward central bank targets.

## FIGURE 1.6 Outlook

Growth forecasts for South Asia have been upgraded slightly relative to April and have largely evolved as expected in recent years. Countries in the region generally are growing briskly, and the region's economy is expected to remain stronger than other EMDE regions.



Growth forecasts for 2026 have been downgraded for India, Maldives, and Nepal, driven by weaker export prospects, growing foreign exchange pressures, and social unrest, respectively. The forecasts for Bangladesh and Sri Lanka have been upgraded as crises in these countries recede, and current account and fiscal balances improve, putting future growth on a stronger footing.

In the baseline forecast, the increase in U.S. tariffs has a manageable adverse impact on activity. Expectations for U.S. tariffs are essentially unchanged relative to the April edition of this report and, by themselves, do not warrant changes in country-level forecasts. The exception is India,

**TABLE 1.1 Growth in South Asia**

Country fiscal year		Real GDP growth at constant market prices (Percent)				Revision to forecast (Percentage points)	
		2024	2025(e)	2026(f)	2027(f)	2025(e)	2026(f)
<b>Calendar year basis</b>							
<b>South Asia region</b>		<b>6.4</b>	<b>6.6</b>	<b>5.8</b>	<b>6.5</b>	<b>+0.5</b>	<b>-0.6</b>
<b>South Asia region, excluding India</b>		<b>4.2</b>	<b>4.4</b>	<b>5.1</b>	<b>5.7</b>	<b>+0.3</b>	<b>+0.1</b>
Maldives	January to December	3.3	4.2	3.9	4.0	-1.5	-1.4
Sri Lanka	January to December	5.0	4.6	3.5	3.1	+1.1	+0.4
<b>Fiscal year basis</b>		<b>23/24</b>	<b>24/25(e)</b>	<b>25/26(f)</b>	<b>26/27(f)</b>	<b>25/26(e)</b>	<b>26/27(f)</b>
Bangladesh	July to June	4.2	4.0	4.8	6.3	-0.1	+0.6
Bhutan	July to June	6.1	7.0	7.3	6.1	-0.3	+0.8
India	April to March	9.2	6.5	6.5	6.3	+0.2	-0.2
Nepal	July to June	3.7	4.6	2.1	4.7	-3.1	-0.8

Sources: World Bank, Macro Poverty Outlook, and staff calculations.

Note: (e) = estimate; (f) = forecast. As of July 1st, 2025, Afghanistan and Pakistan have been made part of the Middle East and North Africa (MENA) region, and are no longer grouped in the World Bank's South Asia region. GDP is measured in average 2010–19 prices and market exchange rates. Because quarterly GDP forecasts for Bangladesh, Bhutan and Nepal are unavailable, the average of two consecutive fiscal years is used for regional aggregates.

which had been expected to face lower tariffs than its competitors in April and now faces considerably higher tariffs.

Because South Asia is the EMDE region that is least open to trade, it is less exposed to tariff changes and trade policy uncertainty than other regions. A significant proportion of South Asia's trade is in services or categories of goods unaffected by tariffs, such as business services, tourism, or pharmaceuticals.

There is considerable uncertainty, however, about future tariff developments relating to both South Asia and countries that export similar goods. There is also considerable uncertainty about the extent to which U.S. importers are able to absorb higher prices—more likely for goods such as electronics, less so for textiles—and the extent to which South Asian exporters are able to divert their products elsewhere.

## Outlook for South Asian countries

In **Bangladesh**, growth is expected to continue accelerating as it recovers from the disruptions around the collapse of the government last year. Nevertheless, the growth forecast remains below

the country's pre-pandemic average—the result of financial system fragilities, fiscal consolidation, and a challenging external environment.

The forecast depends on continued growth in the ready-made garment industry, which accounts for about 10 percent of GDP, one-third of manufacturing employment, and more than four-fifths of exports (Islam and Halim 2022). The removal of Bangladesh's "least-developed country" status under the Multi-Fiber Arrangement in November 2026 is not expected to halt export momentum. Bangladesh will retain duty-free access to several major markets, including its largest market, the European Union, until 2029.

On the domestic side, the financial sector is being weakened by a large number of non-performing loans, weak deposit growth, and tight monetary policy. As a result, the financial sector is providing little support to private investment, which is also being burdened by political uncertainty and high input costs. The government is focusing on fiscal consolidation and structural reforms, which may take time to yield growth dividends. A more pronounced acceleration in growth is expected in the 2026/27 fiscal year, to 6.3 percent, as investment picks up amid easing political uncertainty.

In **Bhutan**, delays to hydropower construction projects have contributed to a 0.3-percentage-point downgrade to growth in 2025/26. This is reversed in 2026/27 as construction speed picks up.

**India** is expected to remain the world's fastest-growing major economy, underpinned by continued strength in consumption growth. Domestic conditions, particularly agricultural output and rural wage growth, have been better than expected. The government's reforms to the Goods and Services Tax (GST)—reducing the number of tax brackets and simplifying compliance—are expected to support activity.

The forecast for FY26/27 has been downgraded, however, as a result of the imposition of a 50 percent tariff on about three-quarters of India's goods exports to the United States. India had been expected to face lower U.S. tariffs than its competitors in April but as of the end of August it faces considerably higher tariffs. Almost one-fifth of India's goods exports went to the United States in 2024, equivalent to about 2 percent of GDP.

In **Maldives**, tourism is expected to be the main source of growth. The substantial current account and fiscal deficits give rise to downside risks to the baseline forecast. The government has substantial upcoming debt repayment obligations, which it may struggle to meet given low foreign exchange reserves. The forecast incorporates a contraction in activity for the non-tourism parts of the economy.

In **Nepal**, recent unrest and heightened political and economic uncertainty is expected to cause growth to decline to 2.1 percent in FY25/26, with a potential range of 1.5–2.6 percent. International tourist arrivals are expected to decline sharply and asset losses will affect the insurance industry. Weaker investor confidence is expected to impede private investment and non-hydro construction. Delayed rainfall in a major rice-producing province will hamper the agricultural sector. Reconstruction efforts are expected to support the recovery in FY26/27 and gain momentum in FY27/28.

In **Sri Lanka**, the growth of tourism and remittances has been stronger than expected, and the economy is expected to regain its 2018 level of

real output in 2026. Tariffs on exports to the United States are expected to have a modest impact on the growth of overall exports—their impact will be mitigated by the depreciation of the Sri Lankan rupee, efforts at market diversification, and strong growth of service exports (which are unaffected by tariffs). Consumption is expected to remain strong. While industry is rebounding in the short term, medium- to long-term industrial growth will continue to be restrained by shortages of skilled workers and other scarring effects from the recent recession and sovereign default. Fiscal consolidation is also expected to weigh on growth.

## Risks and vulnerabilities

South Asia's growth prospects face heightened downside risks from an uncertain global environment, labor market shocks from AI, geopolitical shocks, and social unrest. Each of these shocks could interact with elevated debt levels and weaknesses in the financial sector to create financing pressures. These forces present downside risks to growth in the short term but, in some cases, may promise productivity gains in the long term, beyond the forecast horizon of this report.

### Persistent global economic slowdown

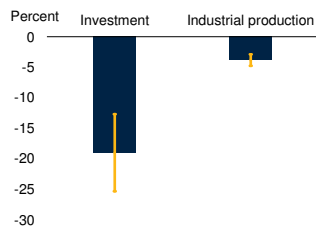
After decades of gradual deceleration, the pace of global growth appears to have stabilized. However, the global stabilization of growth may be undermined by a variety of factors, with negative spillovers to South Asia.

Investment is a critical pillar of long-term growth because it builds capital stock and enables the adoption of productivity-enhancing new technologies. Globally, investment growth has been slowing steadily since around 2007. Recent policy uncertainty may further deter investment if it leads businesses to postpone capital expenditures. In the United States, for example, a rise in policy uncertainty comparable to the increase observed between the 2022–23 average and the first six months of 2025 has been associated with a peak decline in gross investment of nearly 20 percent (figure 1.7; Baker, Bloom, and Davis 2016).

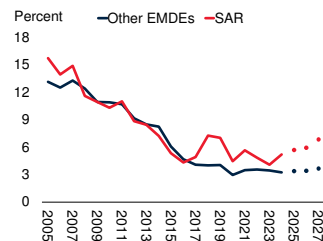
## FIGURE 1.7 Persistent global economic slowdown

Global growth could slow if policy uncertainty further undermines investment. Rising trade barriers could slow the diffusion of innovation and hamper productivity growth. South Asia's tariffs are in the top quartile among EMDEs. Income gains could double if tariff cuts are accompanied by reforms to facilitate job switching. Minimally protected jobs have been the main source of employment growth in South Asia and have offered higher wages, particularly for more skilled and younger workers.

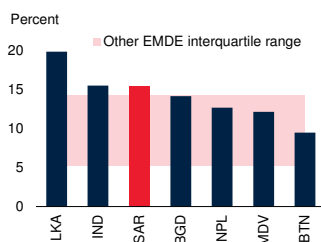
### A. Predicted impact of uncertainty on U.S. investment and industrial production



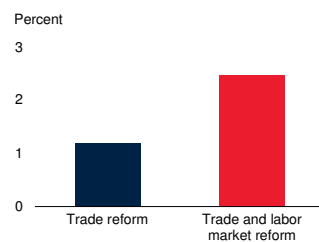
### B. Real private investment growth and forecasts



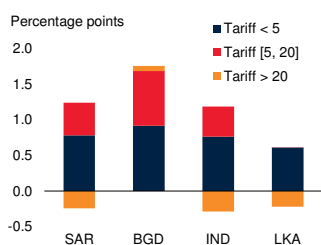
### C. Tariffs on manufacturing products, 2024



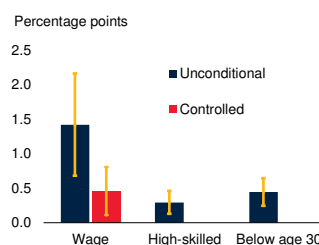
### D. Real GDP per capita gain from tariff cuts and labor reform



### E. South Asia: Contribution to average annual employment growth, 2010–2023



### F. South Asia: Change in worker characteristics with 1 percentage point lower tariff



Sources: ADB Multiregional Input-Output Tables (database); Baker, Bloom, and Davis (2016); Global Labor Database; Government of Sri Lanka; IMF World Economic Outlook (database); Kilic Celik, Kose, and Ohnsorge (2023); Kose and Ohnsorge (2024); World Bank Macro Poverty Outlook; World Development Indicators (database); World Trade Organization Analytical Database; World Bank.

Note: BGD = Bangladesh; BTN = Bhutan; EMDEs = emerging market and developing economies; IND = India; LKA = Sri Lanka; MDV = Maldives; NPL = Nepal; SAR = South Asia; TFP = total factor productivity.

A. Chart shows the impact on U.S. investment and industrial production from an increase in economic policy uncertainty equivalent to the rise between the 2022–2023 average and the average of the first 6 months of 2025, based on VAR estimates.

B. Figure shows MPO projections of real private investment growth of India, Bangladesh, Bhutan and 70 other EMDEs. Regional growth is calculated using total private investment in real dollars. The line represents the 5-year moving average of growth, while points indicate projections.

C. Figure shows average of ad valorem most favored nation duties on manufacturing products. South Asia is the nominal GDP weighted average of 6 economies. Other EMDEs include 29 economies.

D. Chart shows the effects on real GDP per capita of a halving of the gap from the EMDE average for trade policy cost in each country and sector and labor market reform (5 percent reduction in the cost of switching jobs) in South Asian countries. General equilibrium effects are estimated using a dynamic quantitative multi-sector open-economy model following Caliendo, Dvorkin, and Parro (2019). Model calibrated in changes relative to data in 2023 for 73 economies.

E. South Asia sample includes only Bangladesh, India, and Sri Lanka due to availability of employment data on the 2-digit level between 2010 and 2014. See chapter 3 for more details.

F. See chapter 3 for more details. Whiskers indicate 90 percent confidence intervals. Regression results in annex tables 3.1.11 and 3.1.12.

Much of the current policy uncertainty centers on trade policy. The expansion of global trade has been an engine for technology diffusion, growth, and poverty reduction (Goldberg and Reed 2023). Many poorer countries have rapidly increased per capita income through export-led development strategies (World Bank 2020). Technology diffusion and other benefits were already waning when global trade plateaued around 2008, but may evaporate entirely if uncertainty leads to trade declines (Nana, Ouedraogo, and Tapsoba 2025). Increasing restrictions on international trade could result in the slower diffusion of productive technologies and less efficient resource allocation, resulting in weaker-than-expected growth.

South Asia would not be immune to a period of global trade weakness. The region's high growth is predicated on continued improvements in capital accumulation and productivity. Improvements in both could be undermined by weak growth in investment and trade. Investment growth in the region already shows signs of chronic weakness. Uncertainty has particularly damaging and persistent effects on investment in countries with weaker institutional quality and financial markets (Ahir, Bloom, and Furceri 2022; Carrière-Swallow and Céspedes 2013).

Conversely, South Asian governments may seize the opportunity of global tariff uncertainty to lower their own tariffs, ideally in the context of broader free trade agreements, as a tool to unlock higher long-term growth potential. South Asia's tariffs are in the top quartile among EMDEs: at 16 percent on average, they are double the EMDE average of 8 percent. High tariffs increase the cost of production, damage South Asia's competitiveness, and discourage foreign direct investment in traded sectors (chapter 3). For intermediate inputs used in the manufacturing sector, for example, tariffs on intermediate inputs amount to 11 percent compared with 4 percent in other EMDEs. If tariff cuts are undertaken in the context of broader free trade agreements that broaden access to export markets, employment and output gains could be considerable.

The experience with past episodes of major trade liberalizations suggests that ambitious tariff cuts could generate significant output and employment gains, particularly if combined with reforms to facilitate the relocation of workers across firms, sectors, and locations. South Asia's main source of employment has been the one-third of jobs with the lowest tariffs: they have accounted for three-quarters of employment growth. These jobs have also offered significantly higher wages and employed more skilled and younger workers. Broad-based tariff cuts could also trigger disruptive shifts in labor markets, which could be mitigated by improvements in social safety nets (see below).

## Labor market disruptions from AI

The rapid development of AI—in which computers perform activities generally associated with human intelligence—has the potential to transform the global economy and could significantly boost productivity. In the short term, however, these benefits must be weighed against the risk of many people losing their jobs.

Maintaining and creating jobs is crucial for South Asia, given its rapidly-growing working-age populations. Although South Asian labor market exposures to AI are less than in other EMDEs, the effects differ across segments of the workforce, and the region's economies generally score poorly on AI readiness indicators, suggesting that they may struggle to reap the full benefits of the technology.

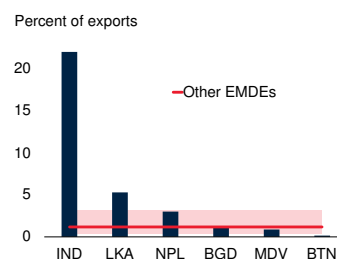
Previous technological revolutions have caused major labor market disruptions. For example, automation through industrial robots and information and communication technologies (ICT) has depressed employment and wages in advanced economies over recent decades and contributed to labor market polarization (Acemoglu and Restrepo 2020; Autor and Dorn 2013).

AI would be most disruptive to a broad range of non-routine, white-collar service sector jobs, such as call centers, data entry, payroll processing, business process management (BPM), and ICT (Webb 2020). These jobs tend to be held by

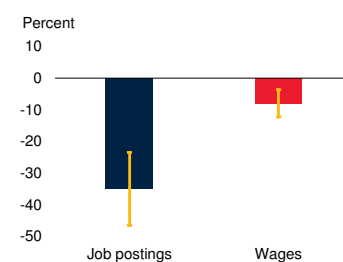
## FIGURE 1.8 Labor market disruptions from AI

ICT services are an important element of South Asia's exports. The proportion of jobs benefiting from AI, in terms of productivity and earnings, exceeds those that are substitutable by AI. India's AI readiness outperforms EMDEs' median value, although a gap remains compared to AEs. The expected rapid growth of the working-age population in South Asia will support human capital development.

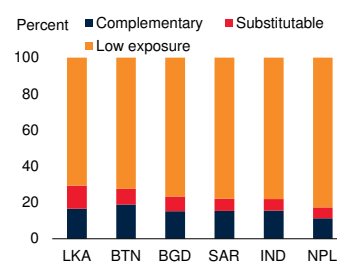
### A. ICT service exports as percent of total exports



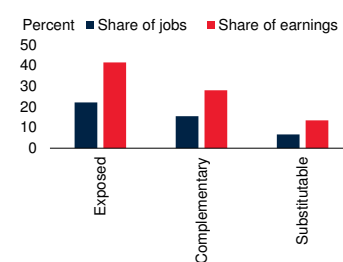
### B. Impact of ChatGPT on business services jobs and wages



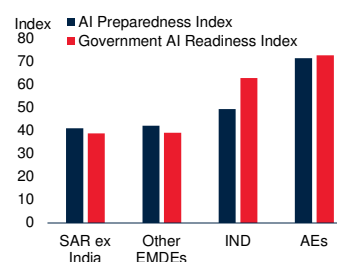
### C. Share of jobs exposed by country



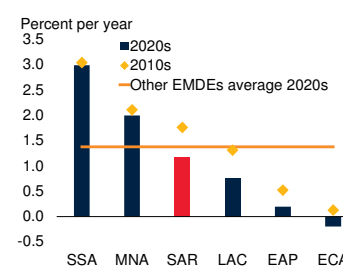
### D. Share of jobs and labor earnings exposed to, and complementary with, AI in South Asia



### E. AI preparation indexes



### F. Expected working-age population growth, 2010s and 2020s



Sources: Felten, Raj, and Seamans (2023); Global Labor Database labor force surveys; Kilic Celik, Kose, and Ohnsorge (2023); Lightcast (database); Pizzinelli et al. (2023); World Development Indicators (database); World Bank.

Note: AEs = advanced economies; BGD = Bangladesh; BTN = Bhutan; EAP = East Asia and the Pacific; ECA = Europe and Central Asia; EMDEs = emerging market and developing economies; ex. = excluding; ICT = information and communication technology; IND = India; LAC = Latin America and the Caribbean; LKA = Sri Lanka; MDV = Maldives; MNA = Middle East and North Africa; NPL = Nepal; SAR = South Asia; SSA = Sub-Saharan Africa.

A. Data for 2024, except for Sri Lanka which is for 2023. Pink area indicates the interquartile range for "Other EMDEs".

B. Bars show coefficients from occupation-month regressions of log of job postings and log of wages on the interaction between post-ChatGPT and a business services occupation indicator, conditional on occupation and month fixed effects (annex table 10 from chapter 2).

C. Bars show the percentage of occupations exposed to AI across countries in SAR. Exposure defined as a composite AIOE score greater than the median score across occupations. Complementary (substitutable) jobs are defined as a complementarity score above (below) the median score across occupations and above-median exposure.

D. Bars show the share of jobs and total wage earnings that are either exposed to AI, complementary with AI, or substitutable with AI.

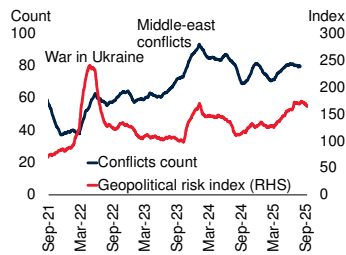
E. The AI Preparedness Index (API) has 4 key dimensions: digital infrastructure, human capital, technological innovation, and legal frameworks. The numbers represent the median index value for each region. The Government AI Readiness index examines 40 indicators across government, the technology sector, and data and infrastructure. "Other EMDEs" includes 143 economies.

F. Working-age population is the number of people between the ages of 15 and 64. Regions use population-weighted averages.

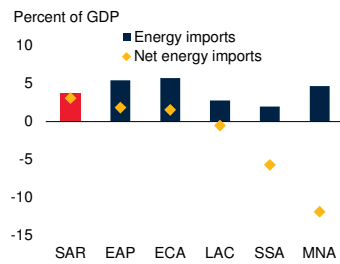
**FIGURE 1.9 Geopolitical pressures and energy security**

The number of conflicts in the world is rising which, alongside other geopolitical pressures, could raise energy prices in South Asia. Heavy reliance on imported fossil fuels makes the region vulnerable to global energy price shocks. The region can protect against this risk through greater energy efficiency and investments in renewable energy, the price of which has fallen rapidly as global capital expenditures have surged.

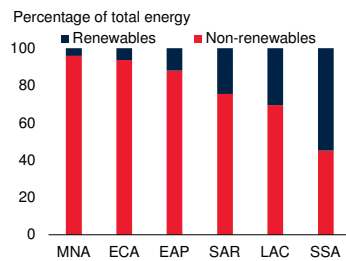
**A. Geopolitical risk index and global conflicts**



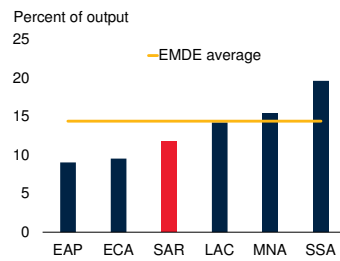
**B. Energy imports, 2021**



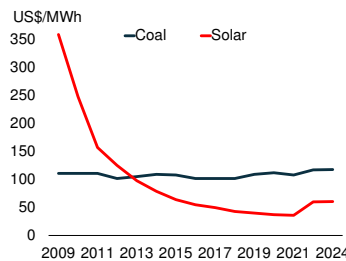
**C. Mix of renewable and non-renewable energy supply sources, 2022**



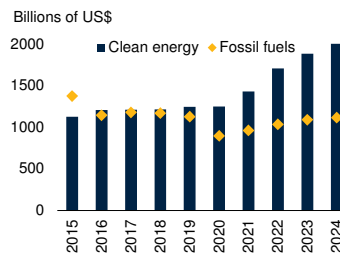
**D. Electric power transmission losses, 2022**



**E. Price of solar power generation**



**F. Global capital expenditure in energy**



Sources: Caldara and Iacoviello (2022); CEPII CHELEM trade database; International Energy Agency, Global Energy Investment (2024); Lazard 2024 LCOE+ Report; OECD Green Growth database; RHS = right-hand side; Sundberg and Melander (2013); United Nations Energy Balances (2022); Uppsala Conflict Data Program (UCDP); World Bank; World Development Indicators (database).

Note: EAP = East Asia and Pacific; ECA = Europe and Central Asia; EMDEs = emerging market and developing economies; LAC = Latin America and the Caribbean; MNA = Middle East and North Africa; SAR = South Asia; SSA = Sub-Saharan Africa; US\$/MWh = U.S. dollars per megawatt hour.

A. Lines are 3-month moving averages. Conflicts are defined as "an incident where armed force was used by an organized actor against another organized actor, or against civilians, resulting in at least 1 direct death at a specific location and a specific date." Last observation is September 18th, 2025.

B. Chart shows energy as a share of total imports, net of re-exports, as the single bar for each region. Energy imports include imports of coal, crude oil, natural gas, coke, refined petroleum products, and electricity. Regional values are simple averages of country-level data. SAR includes Bangladesh, India, and Sri Lanka. LAC includes 10 countries, EAP 7, MNA 6, SSA 5, and ECA 13.

C. Renewable energy sources include biomass, geothermal, and solar thermal electricity production. Regional values are simple averages. SAR includes 6 countries, MNA 18, ECA 21, LAC 20, EAP 10, and SSA 30.

D. Electric power losses include those in transmission between sources of supply and points of distribution and in the distribution to consumers, including pilferage. Regional values are simple averages. SAR includes 6 countries, SSA 44, MNA 15, LAC 23, ECA 17, and EAP 21.

E. Price of energy sources is calculated as the levelized cost of energy (LCOE) which captures the cost of building the power plant itself as well as the ongoing costs for fuel and operating the power plant over its lifetime. Values reflect the average of the high and low LCOE for each technology in each respective year. No data for 2022.

F. 2024 data are estimates.

younger, mid-skilled workers. White-collar services work is critical for South Asia—it accounts for an unusually high share of GDP, exports, and formal sector job growth in India, Sri Lanka, and Nepal (figure 1.8; chapter 3; Liu 2024). A slowdown in labor demand for some of the occupations that are most exposed to AI can already be observed from trends in job postings before and after the public release of ChatGPT in November 2022 (chapter 2).

Across South Asia, around 22 percent of jobs are exposed to AI, as measured by the overlap between the skills required in an occupation and the capabilities of generative AI (chapter 2; Felten, Raj, and Seamans 2021). These jobs are disproportionately well-paying, and account for 42 percent of all wage earnings.

A large share of exposed jobs in South Asia are also complementary with AI, in that they are more likely to enjoy productivity gains from AI adoption and are less likely to be replaced. These jobs include doctors and managers, for example. They tend to require the highest levels of skills and experience, and involve tasks such as face-to-face communication, decision-making responsibility, and domain expertise.

Benefiting from AI requires that countries have the right preconditions in place, however, and this is often not the case, particularly outside India. South Asia scores below the EMDE average in indexes of five key dimensions of AI readiness: government readiness, digital infrastructure, human capital, technological innovation and economic integration, and legal frameworks and regulations. Investing in the technological and institutional framework for a supportive digital economy could help boost growth and avoid job losses from the spread of AI.

**Geopolitical pressures and energy security**

The number of conflicts around the world has been rising steadily for several years (figure 1.9). Conflict can have a ruinous impact on those directly affected, including loss of life and destruction of property. On a national level,

conflicts can lead to recessions and a significant worsening of fiscal positions through a combination of greater expenditures, weaker growth, and higher borrowing costs (Federle et al. 2024).

International spillovers from conflict can come in the form of disruptions to trade, higher prices, reduced confidence, increased uncertainty, and financial market volatility. Even the threat of conflict can have similar consequences, and persistent tensions between countries can cause the fragmentation of trading blocs, which can lead to decreased competition, specialization, and economies of scale that ultimately result in worse economic and fiscal outcomes.

South Asia has particular vulnerability to rising energy cost spillovers from conflict. The region has large and growing energy needs, and relies heavily on imported nonrenewable energy. The energy intensity of its output is twice the global average (World Bank 2023a). India is expected to be the world's fastest-growing source of energy demand in the medium term and surpass China to become the single largest source of energy demand by 2050 (IEA 2024).

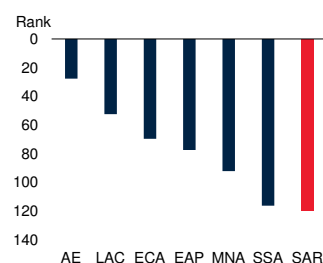
At present, South Asia depends on imported energy more than any other EMDE region. Outside of Nepal and Bhutan, domestic energy production is modest and consists mostly of fossil fuels. Net energy imports are equivalent to about one fifth of the region's imports and 4 percent of GDP. The region's domestic energy industry is small and heavily dependent on nonrenewables.

South Asia's vulnerability to global energy market disruptions is amplified by significant leakage in electricity transmission and frequent power outages. A shift toward more decentralized renewable energy production would improve South Asia's energy security, make access to electricity more reliable, and reduce air pollution. This shift would be hastened by low tariffs on intermediate imports such as solar panels, regulatory streamlining, modernization of the electric grid, reduction of fossil fuel subsidies, and pricing terms that de-risk private green energy investments.

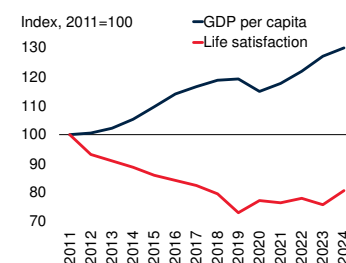
## FIGURE 1.10 Worsening social unrest

*Life satisfaction in South Asia is low and has not improved as per capita incomes have increased. Some of this dissatisfaction may be because the economy is not generating enough jobs for the region's rapidly growing working-age population. Social unrest can have substantial negative impacts on activity.*

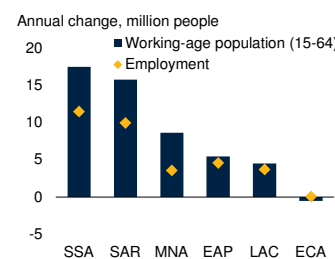
**A. Happiness across all ages, average ranking of countries**



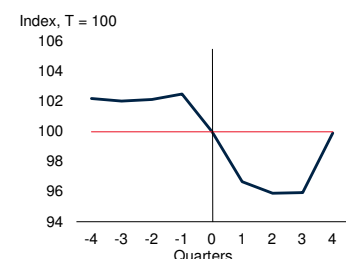
**B. Trends in life satisfaction and GDP per capita in South Asia relative to other EMDEs**



**C. Annual working-age population and employment increase, 2010–24**



**D. Quarterly real GDP growth, around social unrest events**



Sources: CEIC; Haver Analytics; Helliwell et al. (2025); International Labour Organization; Penn World Table (database); United Nations World Population Prospects (database); Wellbeing Research Centre (2025); World Development Indicators (database); October 2024 South Asia Development Update; World Bank.

Note: AE = Advanced economies; EAP = East Asia and Pacific; ECA = Europe and Central Asia; EMDEs = emerging market and developing economies; LAC = Latin America and the Caribbean; MNA = Middle East and North Africa; SAR = South Asia; SSA = Sub-Saharan Africa.

A. Average life evaluation rank by region (whole population). Happiest country has a rank of 1, with increasing unhappiness as rank increases.

B. Lines show the development of GDP per capita and self-reported life satisfaction (from the Wellbeing Research Centre) in South Asia compared to other EMDEs. The South Asia group includes India, Bangladesh, Sri Lanka, and Nepal, while the comparison group covers 90 other EMDEs. For both groups, weighted averages are calculated using population size.

C. Working age population defined as individuals between the ages of 15 and 64.

D. GDP growth rate is the median of 7 countries around major episodes of social unrest (those with a peak crowd size above 10,000 people).

The economic rationale for shifting toward renewable energy sources is becoming more compelling. The cost of solar power generation has fallen precipitously in recent years, such that solar energy is now cheaper than coal-fueled energy by some metrics. Globally, investment in clean energy has exceeded that in fossil fuels since 2016—and by an increasing amount, such that it was twice as large in 2024. Unlike coal, renewables produce energy intermittently. This shortcoming can be partially overcome by energy storage technologies such as batteries, the price of which has declined by 97 percent in the past three decades (Ziegler and Trancik 2021).

## Worsening social unrest

Many countries in South Asia have experienced bouts of social unrest in recent years. Public uprisings led to the collapse of the government in Nepal in September, in Bangladesh in August 2024, and in Sri Lanka in July 2022.

Despite South Asia's rapid economic progress, life satisfaction in the region is low. In the latest World Happiness Ranking of 143 countries, Bangladesh ranks 129th, Sri Lanka 128th, and India 126th (figure 1.10). The region's life satisfaction has trended down over time relative to other EMDEs.

Popular uprisings may provide an opportunity for countries to implement necessary economic and social reforms. In the short term, however, they often disrupt economic activity. In the 24 EMDEs where social unrest has toppled the government between 2000 and 2022, GDP has fallen by an average of 5 percent in subsequent quarters. Countries typically also see an acceleration in inflation and sharp declines in financial market valuations (Acemoglu, Hassan, and Tahoun 2018; Barrett et al. 2021; Ghosh 2016).

These impacts tended to be more pronounced following more prolonged periods of unrest, larger in more authoritarian regimes, and larger around violent uprisings than around collective protests (Ghate, Le, and Zak 2003). Impacts can also be mitigated by stronger institutions (Bernal-Verdugo, Furceri, and Guillaume 2013).

In South Asia, some governments' ability to respond to social unrest with expansive fiscal policy is limited by the region's elevated debt levels. Policymakers might instead focus on ensuring that sufficient jobs are being created to absorb the large number of new job entrants. Over 2010–24, the working age population in South Asia grew by about 16 million every year, but the economy created fewer than 10 million new jobs annually. Harnessing the ability of trade openness and AI to create new opportunities may help create more jobs and stem public dissatisfaction.

## Policy challenges

South Asia faces the considerable challenge of creating enough jobs for its rapidly growing population. At the same time, it must also sustainably boost per capita incomes while adjusting to major shifts in the economic environment. Adapting to the spread of AI and a changing global trade environment will require workers to be able to move easily between shrinking and growing sectors, firms, and regions. A number of policies can facilitate such movement, including investment in connectivity, upskilling, streamlining size-dependent regulations that discourage firm growth, more efficient housing markets, and better job matching. Robust safety nets for those in between jobs can also encourage job switching.

### Sustaining public investment

Most South Asian countries have stocks of public capital well below the average of other EMDEs (figure 1.11). Additional public investment can deliver substantial benefits, both directly and indirectly. Infrastructure projects, for example, can improve connectivity, expand market access, and reduce transaction costs, resulting in stronger long-term growth. A 10 percent increase in the public capital stock can increase long-run aggregate productivity by 0.7–1.0 percent (Calderón, Moral-Benito, and Servén 2015).

The region is catching up, however, thanks to growing public investment. In Nepal and India, for example, public investment growth averaged 12 and 10 percent, respectively, from 2022 to 2024, substantially higher than the EMDE average of 0.6 percent. In the right circumstances, these expenditures can crowd in private investment. In India, central government capital expenditures increased aggregate activity by 3–4 times as much as was spent (World Bank 2025a). Similarly, investments in climate resilience can generate benefits four times as large as expenditures (World Bank 2023b).

South Asia has a number of challenges with respect to public investment. Foremost among these is limited government revenues to finance

such investments. During 2019–23, South Asian governments’ revenues (excluding grants) averaged 18 percent of GDP, the lowest among all EMDE regions and well below the EMDE average of 24 percent of GDP (World Bank 2025b). More than one-quarter of this revenue goes to interest payments, constraining funding capability for basic government services or public investment.

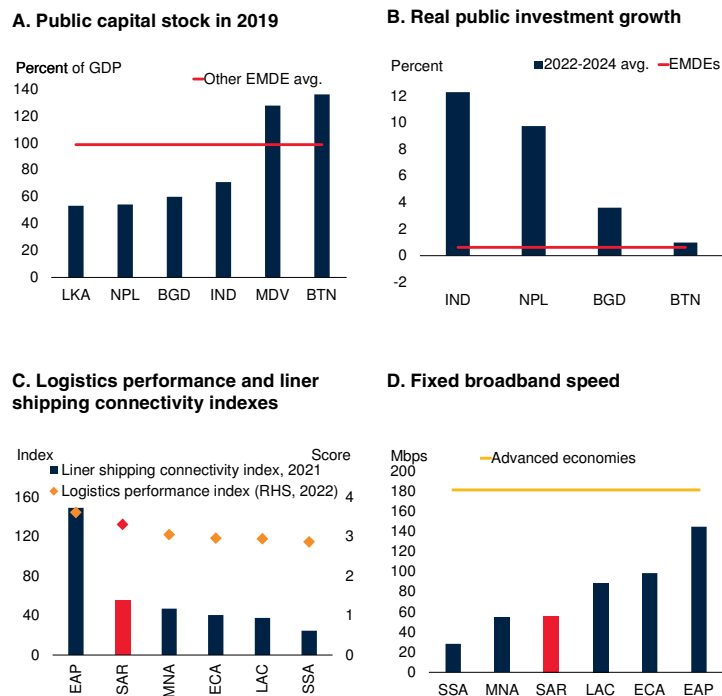
Even when resources are available for public investment, many countries have a low execution rate of capital expenditures, meaning that they are unable to effectively spend as much as is budgeted. In some cases, this is due to insufficient project management expertise in public bureaucracies. In other cases, such as with the expansion of the international airport in Maldives, it is due to financing challenges caused by high levels of debt. In Nepal, large infrastructure projects are delayed for years by cumbersome procedures that make it difficult to acquire land or even simply cut down trees.

To benefit from changes in global trade patterns, additional public investment is needed in transport infrastructure. The cost of trading goods between South Asia and the rest of the world has been measured at around 140 percent of the cost of trading them domestically, the second highest among EMDE regions (Ohnsorge and Quaglietti 2023). This is partly due to tariff and non-tariff trade barriers, but also to poor transport connectivity. South Asia has made rapid progress in recent years on increasing the quality of its transport infrastructure, but it remains less advanced than in the East Asia and Pacific region. Trade between countries is easily impeded by the delays caused by poor shipping connectivity and inadequate logistics infrastructure (Freund and Rocha 2011). A 10 percent increase in transport times can reduce trade by 5–25 percent (Ohnsorge and Quaglietti 2023).

High-quality, well-maintained transport infrastructure—at ports, airports, and on land—together with efficient shipping services can lower transport and logistics costs. Improvements to roads, railways, ports, and airports—whether

## FIGURE 1.11 Public investment

South Asia has a lower stock of public capital than other EMDE regions but is catching up. The region’s transport connectivity has improved but remains below that of the East Asia and Pacific region. Fixed broadband speeds are slow.



Sources: IMF Investment and Capital Stock database; Ookla (database); Macro Poverty Outlook; World Development Indicators (database); World Bank.

Note: avg. = average; BGD = Bangladesh; BTN = Bhutan; EAP = East Asia and Pacific; ECA = Europe and Central Asia; EMDEs = emerging market and developing economies; IND = India; LAC = Latin America and the Caribbean; LKA = Sri Lanka; MDV = Maldives; MNA = Middle East and North Africa; NPL = Nepal; SAR = South Asia; SSA = Sub-Saharan Africa.

A. “Other EMDE average” is calculated using real GDP in U.S. dollars as weights.

B. EMDE growth reflects total public investment growth across 87 EMDEs, measured in real U.S. dollars.

C. Linear Shipping Connectivity Index is set to 100 for the country with the highest value in 2004. Logistics Performance Index ranges from 0 to 5, with 5 indicating the highest performance. Regional aggregates are weighted using average real GDP from 2010–19. Sample includes 117 EMDEs.

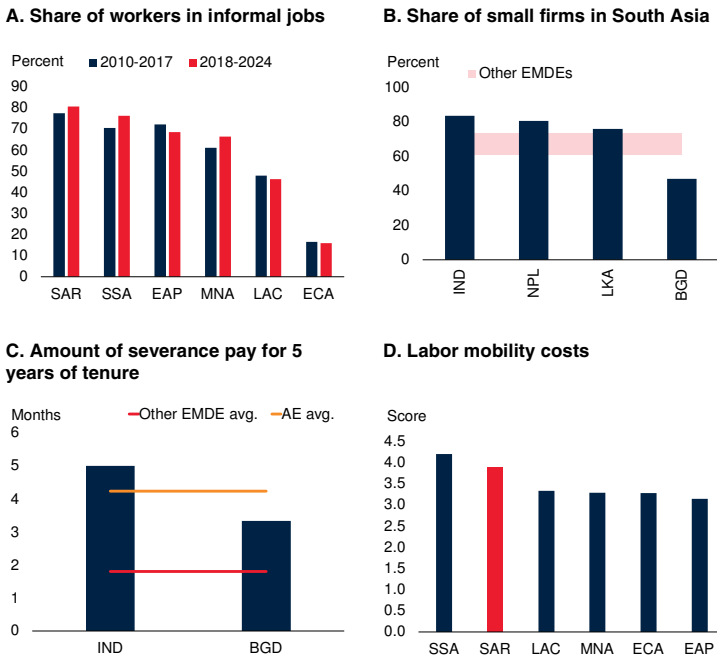
D. Median download speeds are shown for each region.

through direct public investment or private sector participation—can help countries integrate into global supply chains, increase productivity, and flexibly access global sources of demand.

AI applications access, process, and transmit large volumes of data. To maximize the benefits of AI, additional investment is needed in digital infrastructure, including reliable sources of electricity, high-speed internet, and data processing services. South Asia has made rapid progress by these metrics in recent years. Nearly 100 percent of the population has access to electricity and about 67 percent uses the internet.

**FIGURE 1.12 Creating more jobs**

South Asian labor markets are characterized by a high level of informality and the predominance of small firms. Some firms stay small and informal to avoid burdensome regulations, such as high levels of mandated severance pay. Labor mobility costs in the region are high, discouraging workers from seeking opportunities in rapidly growing hubs within their own countries.



Sources: Artuc, Lederman, and Porto (2015); International Labour Organization International Labour Statistics (database); IMF Government Financial Statistics (database); World Bank Enterprise Survey; World Development Indicators (database); World Bank.

Note: AE = Advanced economies; avg. = average; BGD = Bangladesh; BTN = Bhutan; EAP = East Asia and Pacific; ECA = Europe and Central Asia; EMDEs = emerging market and developing economies; IND = India; LAC = Latin America and the Caribbean; LKA = Sri Lanka; MDV = Maldives; MNA = Middle East and North Africa; NPL = Nepal; SAR = South Asia; SSA = Sub-Saharan Africa.

A. Chart shows weighted averages across 68 countries, using the working-age population as weights for each region and time period. South Asia average is based on Bangladesh, India, Maldives, and Sri Lanka.

B. Sampled among formal firms. Small firms have 20 employees or fewer. For World Bank Enterprise Surveys, South Asia sample includes Bangladesh and India for 2022, Nepal for 2023, and Sri Lanka for 2011. "Other EMDEs" shows interquartile range for 71 countries between 2017 and 2023.

C. Averages calculated using working-age population as weights: advanced economy sample includes 13 countries, other EMDE sample include 48 countries.

D. Higher scores indicate higher mobility costs. Bars show the median level across regional economies. SAR includes Bangladesh and India. Sample includes 33 EMDEs.

But the region’s capacity for intensive data processing and transmission is limited: fixed broadband data transmission rates average about one-quarter of the speed of advanced economies, and the number of secure internet servers per capita is only 1.4 percent of the advanced-economy average. Even where digital capacity exists, uptake has not necessarily followed. Across South Asia, only 33 percent of people have made or received a digital payment (compared to 93 percent in high-income countries), and less than 10 percent have ever bought something online (World Bank 2024a).

To remedy this, governments could provide a combination of direct public investment in telecommunications alongside policies that encourage private investment and competition in broadband deployment. Private investment is often burdened by excessive costs of regulatory compliance, and inputs such as land and credit are often difficult to obtain—public support and guarantees can help ease these constraints and fund public investments without straining public finances. Updating power grids and investing in renewable energy sources are already critical priorities for the region to safeguard energy security, meet the needs of its growing economy, expand access, and eliminate shortages (Zhang 2019). Effective reforms in the energy sector would also help provide the reliable, cheap power needed by AI.

Many of these reforms require increased expenditures, to some extent, and would therefore benefit from reforms to improve government fiscal positions. This could be done by cutting unproductive expenditures, such as some subsidies, or by raising revenues through eliminating tax exemptions, and unifying, simplifying, and harmonizing tax rates.

### Creating more jobs

Creating employment opportunities for rapidly-growing working-age populations is a major challenge. Across Africa, the Middle East, and South Asia, job creation is struggling to keep pace with the number of people joining the working-age population between 2025 and 2050.

South Asia is the fastest-growing EMDE region, but job creation is still slower than needed to absorb the growing working-age population. Since 2010, the economy has created an average of about 10 million jobs for about 16 million new labor market entrants every year.

Increasing labor demand is critical for realizing South Asia’s demographic dividend. Countries where workers are able to leave jobs with the confidence of finding another job are less likely to experience public unrest (World Bank 2013). A

three-part approach could support job creation: building strong foundations of human and physical capital, creating business-friendly environments, and mobilizing private capital (Development Committee 2025).

**Growing firms** are a critical engine of job creation. In South Asia, however, firms often stay small, with few workers, and often remain informal. Close to 90 percent of workers in South Asia work in the informal sector, compared with 50 percent in other EMDEs (figure 1.12). Young small- and medium-sized enterprises in South Asia grow more slowly than in other EMDEs, both in terms of sales and employment (World Bank 2025a).

The drivers of firms' small size and informality are varied and complex. Local markets can be small and fragmented in South Asia, giving firms little incentive to expand. Small firms often lack access to the credit needed to grow. Sometimes small firms lack the skills needed for growth, such as formal management training.

**Burdensome regulations** encourage people and firms to operate informally, and are associated with lower entry and exit of firms (Bottasso, Conti, and Sulis 2017; Bussolo and Sharma 2022). Many firms in South Asia stay small rather than hiring workers and becoming subject to complex regulatory burdens—even among formal firms, those with fewer than 20 employees make up a greater proportion of firms in most South Asian countries than in other EMDEs.

In India, the Industrial Disputes Act requires official permission for any layoffs in factories above certain thresholds, and 90 days' advance notice for closure. Many manufacturing firms have fewer than 10 employees in order to avoid registering and becoming subject to taxes or regulations (Fattal-Jaef 2022; World Bank 2025a). Once firms cross this threshold, complying with regulations increases firms' unit labor costs by an estimated 35 percent (Amirapu and Gechter 2020). This may be one reason why garment-exporting plants in India are one-fifth the size of similar plants in Bangladesh (Muralidharan 2024). Similarly in Bhutan, firms report that compliance with government regulations is a considerable expense, and most small firms do not do so (Alaref

et al. 2024). In Sri Lanka, land is predominantly owned by the state and governed by complex institutional and legal arrangements, with inefficient or non-existent markets; in this environment, large firms face greater difficulties obtaining land to expand production than smaller ones (Kumari et al. 2023).

Some labor market regulations can make it difficult or costly for firms to hire or dismiss workers, resulting in inefficiently long time spent in both employment and unemployment (Betcherman 2012). Prior government approval is sometimes needed to dismiss workers and can be denied or granted only after long delays. Laid-off workers can be entitled to substantial severance payments. Exit barriers of this type can trap resources in unproductive firms (Chatterjee et al. 2025).

Removing policies that stunt firm size could boost productivity and employment growth. Such policy changes often require coordination between different levels of government and therefore require buy-in from stakeholders at the municipal, state, and federal levels, alongside effective management and resource sharing.

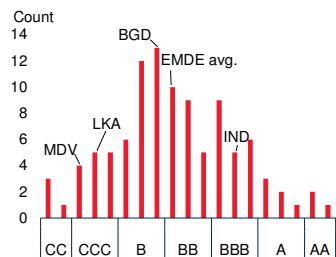
**Creating jobs for women** is particularly important. Female labor force participation in South Asia is exceptionally low: it stood at 32 percent in 2023, well below the EMDE average of 54 percent, and South Asia's male labor force participation rate of 77 percent (World Bank 2024b). Women are more able and willing to join the labor force in the presence of supportive social norms and if they are able to access affordable and safe options for commuting, childcare, and education. Firms' demand for female labor can be linked to economic transformations such as urbanization, the shift to services, and increasing trade openness. The rapid growth of Bangladesh's export-oriented ready-made garment sector, for example, attracted many women into the labor market.

**Facilitating internal worker migration** can help people access higher-productivity jobs in booming regions. In India, five states account for more than half of India's value added in manufacturing and modern market services, more than half of total

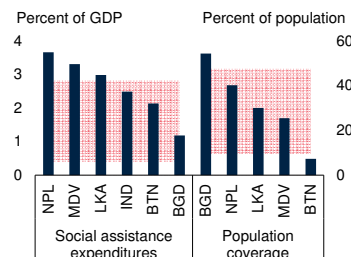
### FIGURE 1.13 Protecting displaced workers

Expanding social safety nets may be challenging given the high debt and low credit ratings of many South Asian countries. Almost all South Asian countries spend more of GDP on social assistance than the EMDE average, but social assistance coverage is often low.

#### A. Distribution of EMDE credit ratings



#### B. Expenditure and coverage of social assistance



Sources: Fitch; IMF Government Financial Statistics (database); Moody's; S&P; World Bank; World Development Indicators (database).

Note: avg. = average; BGD = Bangladesh; BTN = Bhutan; EMDEs = emerging market and developing economies; IND = India; LKA = Sri Lanka; MDV = Maldives; NPL = Nepal.

A. Credit ratings from S&P, Moody's, and Fitch mapped to a unified 1–22 scale (1 = lowest, 22 = highest), and averaged for each country. X-axis labels show rating categories (e.g., CC, CCC, B) corresponding to numeric brackets.

B. Red shading represents the range of 108 EMDEs for expenditures and 113 for population. Expenditure data represent the latest available year: Bangladesh, Maldives and Nepal for 2021; India and Sri Lanka for 2022; Bhutan for 2020. For coverage in population: 2010 for Nepal; 2019 for Maldives and Sri Lanka; 2022 for Bangladesh and Bhutan.

merchandise exports, and over three-quarters of total foreign direct investment. AI innovation is concentrated in a handful of cities characterized by high levels of innovation, ample capital, and an educated workforce (McElheran et al. 2023). These include several cities in southern India, such as Bangalore and Hyderabad.

Migration to these hubs would boost employment and output. Labor mobility costs in South Asia, however, are the second-highest among EMDE regions. In India, average migration between neighboring districts in the same state is at least 50 percent larger than between neighboring districts on different sides of a state border, even after accounting for linguistic differences (Kone et al. 2018). In Bangladesh, rural job seekers overwhelmingly migrate to higher-productivity work in Dhaka, but the city is struggling with increasing congestion.

Reallocating labor across states may be inhibited by poor infrastructure in some areas, as well as the poor portability of informal insurance and social welfare programs (World Bank 2025a). Investments in transportation, housing, and basic services could alleviate these problems,

even if they are made in secondary cities to increase their attractiveness to migrants. Reducing migration costs can help workers relocate to where they can be most productive, alleviate skill constraints, and mitigate the costs of disruption from new technologies.

Both trade reform and the growing adoption of AI could spark major shifts in labor market opportunities. Seizing these opportunities requires efficient labor markets. Workers should be able to switch jobs easily, and productive firms should be able to grow and hire.

### Protecting displaced workers

When safety nets are insufficient, the loss of a job can mean a devastating loss of income for a household. Some regulations have been put in place in an attempt to protect against this risk and to substitute for social protection programs. Programs that directly address redistribution, risk-sharing, and economic inclusion can cause fewer economic distortions and protect more people, but lower-income countries may lack the capacity to fund and manage them (World Bank 2025c).

Making investments in safety nets and skills programs can build this capacity and is a critical accompaniment to efforts to increase labor market flexibility (World Bank 2019). Adaptive social protections—an interlinked system of social safety nets, social insurance, and labor market programs that can adjust the size and coverage of its benefits rapidly in response to shocks—can help build the resilience of poor and vulnerable households against losses not only from unemployment, but also from natural disasters, sickness, or other disruptions (Bowen et al. 2020).

It can be expensive for governments to transition from a heavily regulated labor market and weak social protections to a flexible labor market and a strong system of adaptive social protections. This poses a challenge for countries in South Asia with high debt levels and weak credit ratings (figure 1.13). In the long term, however, this transition can pay continued dividends. These include stronger future growth and higher revenues as more of the economy operates formally, and as more workers feel safe enough for productive risk-taking and job-switching.

A switch of social benefits (including implicit benefits such as input subsidies) from support for specific activities to income support could be combined with a binding commitment to the gradual removal of obstacles to trade and domestic production (Muralidharan 2024). This would allow workers time to adjust and support those who cannot, while ensuring that productivity gains are eventually realized.

Safety nets can be designed to cover informal workers, who make up 79 percent of non-agricultural workers in South Asia. Digital payment systems can be leveraged to limit opportunities for waste and fraud, and can help programs scale up or down quickly in response to economic disruptions.

Except for Bangladesh, all South Asian countries spend more of their GDP on social assistance than the EMDE average. Nevertheless, only 43 percent of the population is covered by social protection systems, the second-lowest share among EMDE regions (World Bank 2025d).

Active labor market policies such as retraining programs can help ease the transition of workers from sectors threatened by AI or trade reform to those that benefit from new developments. Empirical evidence on the effectiveness of such programs is mixed, however (Crépon and van den Berg 2016; McKenzie 2017). Strengthening primary and secondary education systems to ensure that workers across the economy have key foundational skills that are not job specific can increase flexibility (Sharma and Winkler 2017). In Nepal, for example, businesses have identified a cross-cutting need for language, financial planning, and time management skills, as well as digital skills for an increasingly tech-driven economy (World Bank 2025e). The ability of AI to provide customized tutoring at scale could help improve educational outcomes in South Asia and ease difficult labor market transitions (Chiu et al. 2023; De Simone et al. 2025).

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