HIGHLIGHTS from Chapter 3:
The Magic of Investment Accelerations

Key Points

- *Rapid and sustained investment accelerations can be transformative for emerging market and developing economies (EMDEs). Since 1950, EMDEs have seen many episodes in which investment growth surged to 10 percent per year—more than three times the growth rate in other years.*
- *During such episodes, output and productivity grew significantly. Other benefits also materialized: inflation fell, fiscal and external positions improved, and poverty declined.*
- *Most accelerations followed—or were accompanied by—policy shifts intended to improve macroeconomic stability or structural reforms, or both. When combined with well-functioning institutions, these policy actions were particularly conducive to sparking investment accelerations.*

Weak investment growth impedes progress on climate-related and other development goals. Investment growth in EMDEs has been going through a prolonged, broad-based slowdown since the 2007-09 global financial crisis. Substantial investment is required to fill infrastructure gaps, enable adaptation to climate change, facilitate the energy transition away from fossil fuels, accelerate poverty reduction, and advance shared prosperity. Against this background, it is essential to accelerate investment growth.

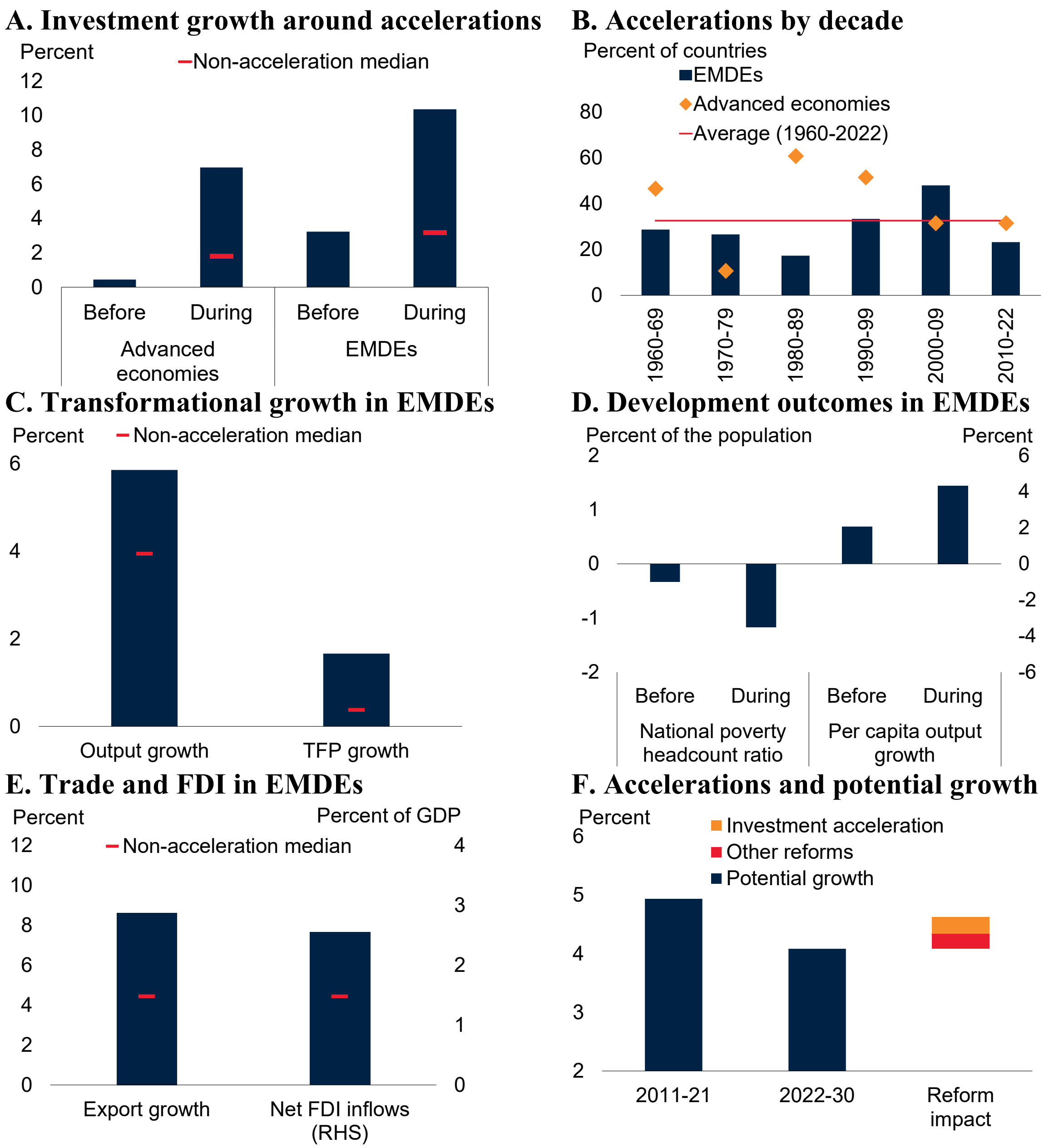
Investment accelerations have happened in many EMDEs, but they have become less common recently. For a country to experience an investment acceleration, average investment (per capita) growth must exceed 4 percent per year for at least six years. Between 1950 and 2022, 192 investment accelerations occurred in a sample of 104 economies. During accelerations, investment growth jumped more than threefold, from around 3 percent per year to over 10 percent (figure 1.A). Usually, both public and private investment growth increased during these episodes. Amid a slowdown in investment growth since the global financial crisis, the number of EMDE investment accelerations also declined (figure 1.B).

Investment accelerations are periods of transformative growth. Median output growth in EMDEs accelerated to nearly 6 percent during accelerations, compared with 4 percent in other years. Total factor productivity growth improved to 1.7 percent from 0.4 percent (figure 1.C). The employment rate increased significantly, and economic activity shifted toward more productive sectors: manufacturing and services output grew faster than agricultural output. Other benefits also materialized: inflation fell, fiscal and external positions improved, and economies made faster progress on development outcomes as poverty fell faster and per capita income growth increased (figure 1.D.E).

Comprehensive reforms have been instrumental in sparking investment accelerations. The likelihood of sparking an acceleration increases with improvements in fiscal and monetary-policy frameworks and with structural reforms to expand cross-border trade and financial flows. Such reforms are more effective when combined with well-functioning institutions. Over the past two decades, there has been a broad-based slowdown in potential growth in EMDEs, which is expected to continue through the remainder of this decade. If EMDEs were to spark investment accelerations and implement labor-market and other reforms, the combined impact could mitigate the slowdown in potential growth (figure 1.F).

Figure 1. The Magic of Investment Accelerations

Investment accelerations are periods in which there is a sustained increase in investment growth to a relatively rapid rate. In EMDEs, investment growth increased more than threefold during accelerations. Between 1950 and 2022, EMDEs on average experienced about two accelerations. The share of EMDEs starting an acceleration fell sharply in 2010-22 compared with the 2000s. Accelerations were often periods of transformative growth with significantly higher output and productivity growth, among other beneficial outcomes, including a faster decline in poverty and strengthening fiscal and external balances. Comprehensive reforms to spark accelerations, along with labor-market and other policy interventions, could reverse the projected slowdown in potential growth.



Sources: Dieppe (2021); Feenstra, Inklaar, and Timmer (2015); Haver Analytics; IMF, International Financial Statistics; Kose and Ohnsorge (2023); WDI (database); World Bank.

Notes: EMDEs = emerging market and developing economies; FDI = foreign direct investment; TFP = total factor productivity; investment refers to gross fixed capital formation.

A. Bars show period medians. “Before” refers to the six years before an acceleration, “During” refers to the full duration of accelerations. Red tick mark shows the median investment growth rate during all non-acceleration years. Sample includes 93 countries (34 advanced economies and 59 EMDEs) that experienced an acceleration between 1950 and 2022.

B. Bars and diamonds show the share of countries starting an investment acceleration during the corresponding decade. The red line shows the long-run average share of countries starting an investment acceleration over the past seven decades.

C. Bars show the median growth rates of output and total factor productivity (TFP) during accelerations. Red tick marks show the median growth rates of output and TFP during all non-acceleration years. Sample includes 59 EMDEs that experienced an acceleration between 1950 and 2022.

D. “Before” refers to the six years before an acceleration, “During” refers to the full duration of accelerations. The chart shows the change in the national poverty headcount ratio which shows the percentage of the population living below the national poverty lines(s). Per capita output growth shows output growth adjusted for population growth.

E. Export growth is measured in median annual percent growth during accelerations. Net FDI inflows refer to the median annual ratios in percent of GDP during accelerations. Red tick mark shows the median investment growth rate during all non-acceleration years.

F. The scenario assumes that in 40 EMDEs (excluding China) that experienced an investment acceleration between 2000 and 2022, investment growth will increase to 10.4 percent per year from 2023-28 before returning to 0.4 percent per year in 2029-30. The 40 EMDEs were chosen because they have the highest expected average investment growth for 2021-25. Other reforms include social benefit and labor market reforms as well as health and education reforms.