HIGHLIGHTS from Box 1.1:

ACCELERATING PRIVATE INVESTMENT

Key Points

- *Private investment growth has slowed sharply from pre-pandemic averages in all South Asian countries, hampering the region's efforts to meet development and climate objectives.*
- *Historically, sustained accelerations in private investment were most likely to occur when institutional quality was strong, the real exchange rate was competitive, and economies were more open to trade and capital flows.*
- *Private investment accelerations might be more likely to start in South Asia if the region was more open to trade and finance and had stronger institutional quality.*

Private investment: Weak. Private investment growth has slowed sharply from pre-pandemic rates in all countries in South Asia (figure 1). At 3.5 percent per year, South Asia's private investment growth since 2020 has averaged only about half its pace in the five years preceding the pandemic. In addition, private investment makes up a smaller share of output in South Asia (23 percent of GDP, on average since 2020) than in other EMDEs (31 percent of GDP). With private investment weak, several South Asian countries have relied heavily on public investment for growth. This is unlikely to be sustainable given high debt-to-GDP ratios and poor revenue collection in most countries in the region.

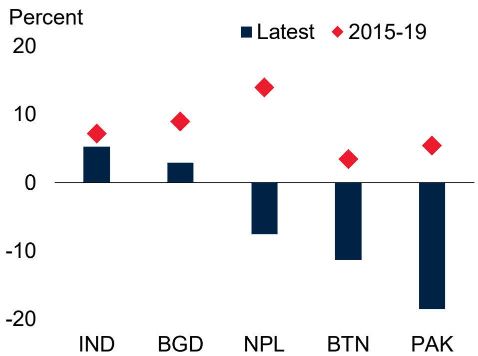
Episodes of sustained private investment acceleration. A sustained acceleration of private investment is a policy priority to meet climate and development goals in South Asia. In the past, episodes of sustained private investment accelerations in EMDEs have lasted about eight years, during which private investment growth has averaged 12 percent a year. Most private investment accelerations in EMDEs tapered off gently rather than ending in crisis. Only about one-tenth of private investment accelerations in EMDEs ended in financial crises.

Preconditions for onsets of private investment accelerations. Private investment accelerations are infrequent. As observed in a sample of 105 EMDEs during 1960-2022, the probability of the onset of a private investment acceleration in the average EMDE in an average year is only 4.5 percent. Private investment accelerations have been more likely to start when institutional environments were strong, when countries were more open to global trade and finance, and when real exchange rates were competitive.

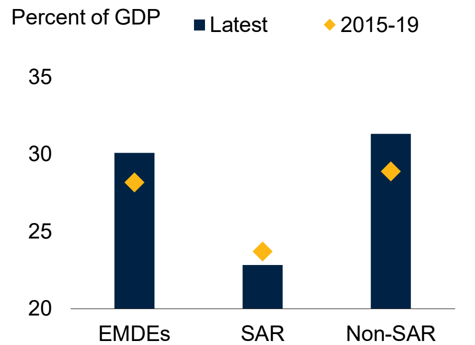
Implications for South Asia. On average, South Asian countries ranked below the average EMDE in trade and capital account openness and in the ICRG's law and order index. The probability of the onset of a private investment acceleration in South Asia could be almost two-thirds higher if the region moved to the EMDE average in its openness to global trade and finance and if its institutional quality were brought in line with the top quartile of EMDEs.

FIGURE 1. Private investment accelerations

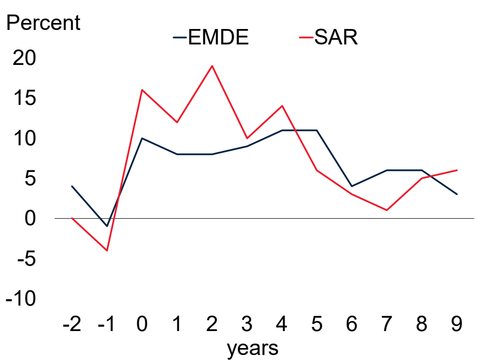
A. Private investment growth in South Asia



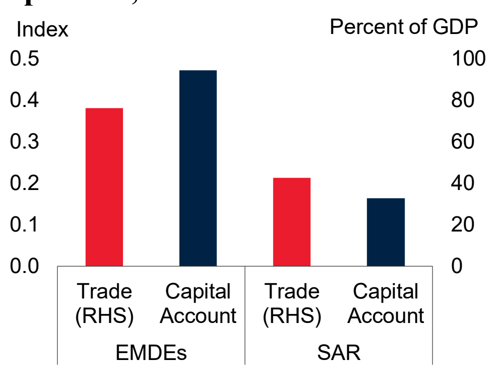
B. Private investment share



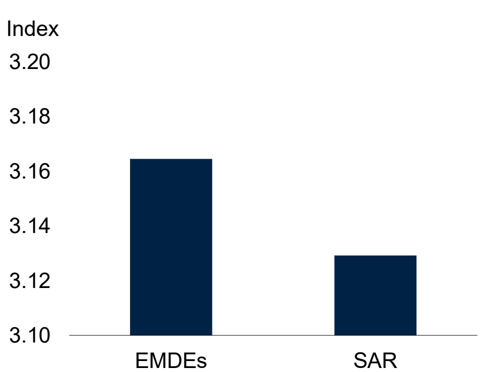
C. Investment growth around private investment accelerations



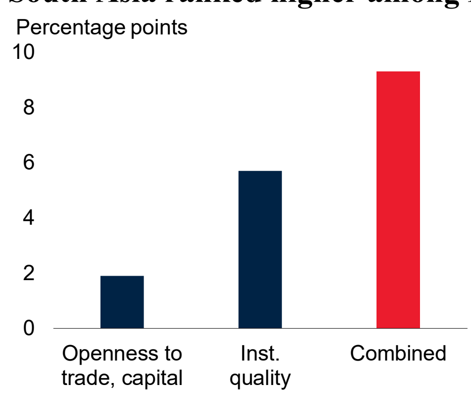
D. Trade openness and capital account openness, latest data



E. Institutional quality



F. Difference in marginal probability of private investment acceleration starting, had South Asia ranked higher among EMDEs



Sources: Haver Analytics; OECD, Green Growth database; UN Population Division database, WDI (database); World Bank: Firm Adoption of Technology (FAT) Surveys Wave 2; World Bank (2023a).

Note: BGD = Bangladesh; BTN = Bhutan; EMDEs = emerging market and developing economies; IND = India; NPL = Nepal; PAK = Pakistan; SAR = South Asia. Geometric annual averages. Aggregates computed using GDP in U.S. dollars (at 2010–19 average prices and exchange rates) as weights.

A. B. Charts show real private fixed investment growth (A) or in percent of GDP (B). 2015-19 is the annual average. "Latest data" in A refers to 2023, except for Bhutan, which is based on the 2020–21 average, and for India, which is based on 2022. "Latest data" in B refers to 2020–21 average.

C. Lines show the median annual private investment growth rate around the start of private investment acceleration episodes. Year 0 refers to the start year of an acceleration.
D. Latest available data are from 2022 for trade in percent of GDP and from 2021 for capital account restrictions.
E. Bars show institutional quality as captured by the law and order index of the International Country Risk Guide ICRG, 2010-19 average.
F. Panel based on regression results shown in table B.1.1 of chapter 1. "Inst. quality" = institutional quality. Bars show the impact of improvements in economic policies on the probability of initiating a private investment acceleration. Policies consist of raising the trade and capital account openness in SAR to the EMDE average over ten years and moving institutional quality to the top quartile of EMDEs. The combined reform impact estimates the effect of implementing all policies concurrently.