

# Expanding Opportunities: Toward Inclusive Growth



## LATEST ECONOMIC DEVELOPMENTS AND OUTLOOK

- South Asia's outlook is shaped by a combination of good and bad news in the global economy. Lower commodity prices, a strong recovery in the services sector, and reduced disruptions in value chains are aiding South Asia's recovery but rising interest rates and uncertainty in financial markets are putting downward pressure on the region's economies.
- Growth prospects have weakened due to tightening financial conditions, with large downside risks in most countries given limited fiscal space and depleting reserves.
- Regional growth is expected to average 5.6 percent in 2023, a slight downward revision from the October 2022 forecast, and remain moderate at 5.9 percent in 2024, following an initial post-pandemic recovery of 8.2 percent in 2021.
- All countries except Bhutan have downgraded their forecasts.
  - **Afghanistan's** economy has settled around a fragile low-level equilibrium. If the economy continues to receive humanitarian and basic service support, real GDP could move to an annual growth of between 2 and 3 percent during 2023-25.
  - In **Bangladesh**, real GDP growth is expected to decelerate to 5.2 percent in FY2022/23, as still-high inflation, tight financial conditions, disruptive import restrictions, and rising global economic uncertainty weigh on growth.
  - **Bhutan's** economy is expected to grow by 4.5 percent in FY2022/23, supported by the further reopening of borders last year. However, growth will likely remain subdued in FY2023/24 as slow global growth and a new tourism levy will keep tourist arrivals low.
  - **India's** real GDP growth is projected to moderate to 6.3 percent in FY2023/24 and 6.4 percent in FY2024/25, as rising borrowing costs, slower income growth, and fiscal consolidation dampen consumption and global slowdown weighs on export growth.
  - **Maldives** is expected to grow by 6.6 percent in 2023 and 5.3 percent in 2024, supported by robust tourism. Global shocks remain a potential risk, and high external debt and tightening global financing conditions pose risks to the fiscal and external accounts.
  - In **Nepal**, real GDP growth is expected to decelerate to 4.1 percent in FY2022/23 before rising to 4.9 percent in FY2023/24 due to import restrictions, monetary policy tightening, political turbulence, and shrinking government expenditure.
  - In **Pakistan**, real GDP growth is downgraded to 0.4 percent in FY2022/23, due to tight fiscal policy, the impacts of last year's floods, high energy prices and import controls. The industrial sector is expected to shrink due to supply chain disruptions, deteriorating investor confidence, and higher borrowing and input costs.

- **Sri Lanka's** real GDP is expected to contract by 4.3 percent in 2023 following a sharp contraction in 2022, due to the ongoing economic crisis. Real GDP is projected to grow slowly at 1.2 percent in 2024, supported by debt restructuring and growth-enhancing structural reforms.
- Inflation in South Asia is set to fall to 8.9 percent this year, and to below 7 percent in 2024. However, weaker currencies and delayed domestic price adjustments are contributing to a slower than anticipated decline in inflation.
- Elevated global and domestic food prices are contributing to greater food insecurity for South Asia's poor who spend a larger share of income on food.

### **TOWARDS INCLUSIVE GROWTH**

- Sustained economic growth over the past two decades in South Asian has lifted some 250 million people out of extreme poverty and considerably improved average living standards. However, economic growth has not benefited all groups equally, and social progress remains elusive.
- South Asia has among the world's highest inequality of opportunity. Between 40 and 60 percent of total inequality (in education and consumption) in the region is driven by circumstances out of an individual's control such as place of birth, family background, caste, ethnicity, and gender.
- Intergenerational mobility in South Asia is also among the world's lowest. On average, the education attainment rank of a child born to parents in the bottom half of the education attainment distribution is the 37th percentile. This is substantially lower mobility than in other regions.
- Such disparities lead to differences in access to jobs, earnings, consumption, and welfare and to calls for redistributive policies.
- While the region as a whole experiences unfair disparities, there is considerable variation between countries. India and Pakistan display high inequality of opportunity and, correspondingly, low intergenerational mobility; Nepal and Afghanistan show intermediates levels; Bangladesh, Sri Lanka and Bhutan have somewhat better mobility and equality of opportunity.
- Within countries, there is an urban premium, which also favors girls more strongly than boys. Being born in a city translates into higher chances to move further ahead than one's own parents (in terms of education) and, more generally, other circumstances do not constrain achievement as tightly as in rural areas.
- Not only is inequality of opportunity unfair, but it is also inefficient. It prevents an optimal allocation of talent and reduces incentives to accumulate human capital, and derails long-term economic growth.

## **POLICY RECOMMENDATIONS**

- Policymakers in South Asia face difficult trade-offs as they respond to balance-of-payment pressures, using foreign exchange interventions, raising domestic interest rates, and imposing import restrictions and tightened capital controls to reduce the pressures. These restrictions can be circumvented and can even backfire.
- Going forward, broad reform programs are needed to put countries in South Asia on a robust growth path.
  - Countries should use the opportunity of lower energy prices and improving trade balances to move away from ad hoc measures such as fuel subsidies and import restrictions.
  - A sustainable fiscal outlook must be at the center of reform programs and will require not only reducing expenditures but also increasing revenues.
  - This can only be achieved by broadening the tax base, which means more people should be given opportunities to participate in the productive economy.
- Reducing inequality of opportunity and increasing economic mobility is an essential part of broadening the tax base. Therefore, eliminating obstacles to mobility is not merely a long-term agenda, but should be a central part of current reform programs that aim to make the fiscal outlook more sustainable. To this end, countries should:
  - Continue improving the quality of primary education and expanding access to secondary and higher education.
  - Evaluate and strengthen affirmative action policies targeted to “low opportunity” groups.
  - Help improve the business climate for small and medium enterprises, which account for the bulk of job opportunities for those who are less well off.
  - Reduce barriers to labor mobility because it can have a powerful equalizing impact as urban areas tend to offer more opportunities for social mobility.