

White Paper

The South Asia Risks Landscape

In partnership with Marsh & McLennan Companies and Zurich Insurance Group

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Cover photo: Men feed seagulls along the Yamuna river in New Delhi, India,. REUTERS/Saumya Khandelwal

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Contents

An intersection of global and local risks	4
Water: A risk across South Asia	5
Leading country-level risks	6
Methodology	10
Endnotes	11

An intersection of global and local risks

The first step for stakeholders looking to build resilience in their region is to gain a holistic sense of the risk environment and the way in which global and local risks intersect with one another. Following this approach, *The South Asia Risks Landscape* incorporates data from the 2018 Global Risks Perception Survey and 2019 Executive Opinion Survey to offer an overview of the risk environment in South Asia.

The paper begins by examining the risk ranked highest in the region – “water crises” – and explores the global and local dynamics of the issue, including the effect of climate change, the politicization of water and a lack of coordination among governments. The multifaceted nature of water risks comes as the region is growing rapidly and looking to exert more geopolitical influence.

The paper then explores the top risks for doing business in each of the five countries in the region: Bangladesh,

India, Nepal, Pakistan and Sri Lanka. These risks primarily relate to environmental concerns and governance challenges. The paper identifies linkages between these risks and other socio-economic challenges in each country.

A note on the surveys used in this paper

Two separate surveys designed by the World Economic Forum are used to inform this briefing paper: the Global Risks Perception Survey, which polls the Forum’s multistakeholder community of experts, policy-makers and members of the private sector and NGO community about global risks; and the Executive Opinion Survey, which polls business leaders and includes a question about risks to doing business in their respective countries. Additional details of the two surveys can be found in the methodology section at the end of this paper.



Residents fill their containers with drinking water from a municipal tanker in New Delhi, India. REUTERS/Anushree Fadnavis

Water: A risk across South Asia

South Asia is one of the least economically integrated regions in the world, but water is a rare factor that ties countries in the area together.¹ With the Himalayan range in the north feeding some of the world's largest river systems, South Asia is home to close to 20 major rivers and numerous other smaller waterways. The Indian Ocean and the Bay of Bengal on the region's southern and eastern maritime boundaries serve as connection ways between mainland South Asia and Sri Lanka and the Maldives.

Within this geographic context, executives in the region ranked "water crises" as the number one risk for doing business in South Asia, according to the World Economic Forum's 2019 Executive Opinion Survey. At a country level, "water crises" ranked as the topmost risk in India, second in Pakistan and fourth in Sri Lanka. (Interestingly, despite the

Additionally, water storage is low by global standards, making it difficult to manage the floods and droughts that afflict the region and that are expected to increase with climate change – "extreme weather events" have been ranked the leading global risk for three years in a row, according to the World Economic Forum Global Risks Perception Survey. Therefore, heatwaves that would likely result from rising global temperatures will likely compound what is an already challenging situation when it comes to drinking water. Climate conditions will also cause challenges along the coastlines, where rising sea levels will flood cities and bring risk to industries and communities reliant on safe access to oceans.

Water in the South Asian context can also be categorized as an economic and geopolitical risk. The three main

Figure 1: Top 10 risks for doing business in South Asia

- | | |
|--------------------------------------|------------------------------------|
| 1. Water crises | 6. Deflation |
| 2. Terrorist attacks | 7. Unemployment or underemployment |
| 3. Manmade environmental catastrophe | 8. State collapse or crisis |
| 4. Failure of urban planning | 9. Fiscal crises |
| 5. Energy price shock | 10. Asset bubble |

Source: World Economic Forum, *Regional Risks for Doing Business 2019*

fact that Bangladesh is a deltaic part of the region, thereby being naturally vulnerable to any change to the flow of water in the upper riparian areas, executives in that country did not rank the risk among their top five.) This risk comes amid a broader global situation in which over 2 billion people live in countries that have, what the United Nations calls, "high water stress".²

What is it about the region that makes water a part of its identity but also a significant risk? As aptly framed by the Asia Foundation, South Asia's water resource management is "a problem of scarcity amid abundance" – despite major transboundary rivers, residents in many places must queue for limited supplies of drinking water.³ The region is home to around a quarter of the global population but has less than 5% of the world's renewable water resources. Low per-capita water availability and a high relative level of water use makes South Asia one of the most water-scarce regions of the world.

river systems in South Asia are the Indus, the Ganga or Ganges, and the Brahmaputra. The Indus Basin includes areas in China, Afghanistan, India and Pakistan. While there are bilateral arrangements on the Indus (India and Pakistan) and Ganges (India and Bangladesh), water is a potential weapon in cross-border disputes, as countries have at times threatened cutting off flows because of outbreaks of violence in disputed territories.⁴ Additionally, China, where the headwaters of several major rivers sit, has been building hydroelectric dams that have caused frictions, particularly with India.⁵

As economic growth accelerates in the region, water resources will continue to come under pressure from urbanization, industrialization and population growth. Further, the increased geopolitical tension between its two largest economies – India and Pakistan – will make regional cooperation on water issues difficult.

Leading country-level risks

While “water crises” ranks as the number one risk regionally, an examination of country-level data reveals additional concerns among business leaders. In addition to “water crises” ranking as the leading risk in India, other environmental and governance-related concerns predominate elsewhere, with business leaders pointing to “energy price shock”, “failure of national governance” and “food crises” as the leading risks for business in their countries.

Energy challenges in Bangladesh

For the second year in a row, “energy price shock” came in as the top risk for doing business in Bangladesh, according to respondents of the Executive Opinion Survey. The ranking reflects the fact that much like the rest of its neighbours in South Asia, Bangladesh is a net importer of crude oil. Considering the country does not have enough natural gas resources to meet growing demand for electricity – fuelled by the recent acceleration of economic growth (in 2018 the country grew at over 8%) – Bangladesh has resorted to switching from natural gas-based power plants to the more volatile and expensive crude oil-based plants.

Initially, the crude oil-power plants benefited from significant government subsidies as well as relatively low international oil prices, but these subsidies declined over the past three years due to domestic price adjustments. However, with global commodity prices rising again, energy subsidies also started to rise during 2019.⁶ This trend will shrink the fiscal space to meet critical spending gaps in infrastructure, health and education;

in addition to the difficulty that the volatile price of this commodity places on fiscal planning. As a result, respondents in the Executive Opinion Survey may be taking into account the expectation that the government will be forced to make upward adjustments to the price of natural gas and begin to ease energy subsidies. In line with that expectation, the Bangladesh Energy Regulatory Commission, in July 2019, raised gas prices on average by 32.8% for all users with further increases expected in early 2020.

Multifaceted water risks in India

“Water crises” ranks as the leading risk for doing business in India. The country faces a complex, multifaceted risk when it comes to water, both contending with diminishing supplies and having to address damaging inflows.

According to the World Resources Institute’s Water Risk Atlas, India is one of 17 countries that face “extremely high” water stress and the northern part of the country “faces severe groundwater depletion”.⁷ With a population of 1.3 billion people, prolonged water stress in India has the potential to affect three times the population of the other 16 countries combined. This year, India has faced a drought in Chennai, the country’s sixth-largest city that is home to over 10 million people. Chennai’s reservoir faced such an acute shortage of water that the municipality had to reduce water flows by 40% and bring in water from other parts of the country.⁸ While not as extreme, other southern cities such as Bangalore and Hyderabad have experienced similar issues.

Figure 2: Top 10 risks for doing business in South Asia, by country

	Risk 1	Risk 2	Risk 3	Risk 4	Risk 5
Bangladesh	Energy price shock	Failure of national governance Unemployment or underemployment	...	Failure of financial mechanism or institution	Failure of urban planning
India	Water crises	Manmade environmental catastrophes	Terrorist attacks	Deflation	State collapse or crisis
Nepal	Failure of national governance	Unemployment or underemployment	Failure of urban planning	Failure of financial mechanism or institution Unmanageable inflation	...
Pakistan	Energy price shock	Water crises	Unemployment or underemployment	Terrorist attacks	Fiscal crises Data fraud or theft
Sri Lanka	Food crises	Misuse of technologies	Cyber attacks	Natural catastrophes Water crises	...

Source: *Regional Risks for Doing Business 2019*; where there is a tie, both risks are listed alphabetically, with an ellipses in the following ranking slot.

Governance challenges in Nepal

Over the past three decades, Nepal has been gripped by political instability, with 26 prime ministers holding office during this period of time. It was only the election of the current Left Alliance government in 2017 that created some level of continuity. The Left Alliance received an unprecedented super majority in parliament and governing majorities in six out of the seven provinces at a subnational level, after bringing together the country's previously fragmented left-wing parties.

However, despite what appears to be some recent political stability, respondents to the Executive Opinion Survey identified "failure of national governance" as the top risk for doing business in Nepal. The reason executives would rank the issue so high may stem from Nepal having recently transformed itself from a unitarian state into a federal democratic republic, as mandated by the 2015 constitution. While the transition to a federal system could help make policies more sustainable and inclusive, there is concern among important development partners, such as the World Bank, that the central government could be quickly overwhelmed. Close to 300 existing laws need to be amended and another 100 need to be enacted to implement constitutional mandates.⁹

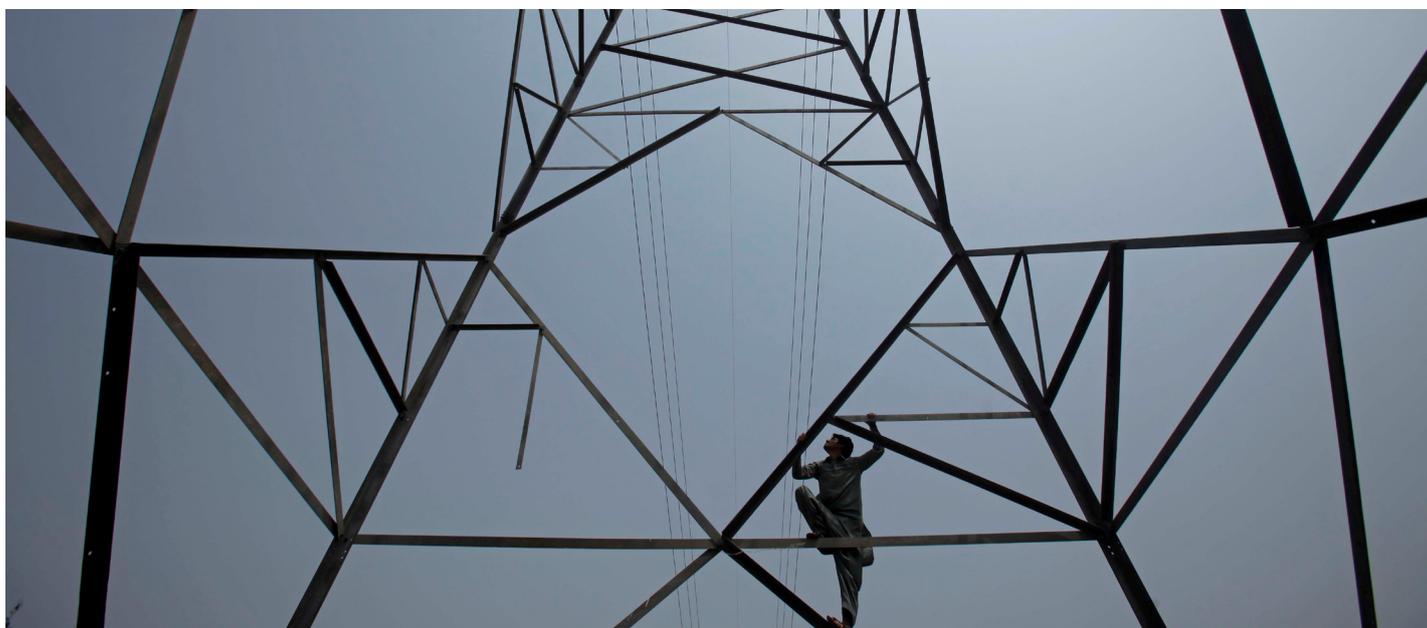
In addition to the legislative challenges, according to the International Monetary Fund (IMF), Nepal faces concerns about the broader management of its macroeconomic framework.¹⁰ Specifically, Nepal's swift implementation of a federal governing structure, while offering "unprecedented opportunities to reset Nepal's development storyline", has been linked to the central government's weakening fiscal position.¹¹ At the same time, with a large part of the population still living in poverty, there has been no marked improvement in the delivery of government services such as health, education, infrastructure and public safety. Mitigating these risks and plugging the gaps in the existing framework will allow Nepal to reassure investors and restore confidence in the country's broader governance structure.

Energy and resulting macroeconomic risks in Pakistan

Executives ranked "energy price shock" as the highest risk for doing business in Pakistan, perhaps not surprising, given that the World Economic Forum's *Global Competitiveness Report 2018* ranked Pakistan 115th of 137 economies in the reliability of electricity supply.¹² In addition to suffering from systemic leakages from the national grid, the broader energy sector, particularly the downstream electricity sector, remains heavily subsidised. The situation of the energy sector has negative repercussions for the broader macroeconomic environment.

According to the World Bank, for the fiscal year 2015 the total economic cost of market distortions in Pakistan's power sector was \$17.7 billion (about 6.5% of GDP).¹³ The IMF said policy-makers have launched IMF-backed reforms to "deliver the improvements needed to make Pakistan's energy sector an engine of growth rather than a hindrance."¹⁴ Still, despite this promising trend, executives are likely concerned that the electricity tariff increase of 10% that Pakistan initiated in preparation for the IMF programme and to generate additional revenue, with a second adjustment expected to be announced in the latter half of 2019, can pose a challenge for the business environment. Additionally, as a net importer of crude oil, Pakistan is also exposed to the price volatility in the international market.

These risks in the energy sector are exacerbated by the State Bank of Pakistan's move to introduce a flexible market-determined exchange rate (required ahead of the IMF programme). In the two months since the introduction of a floating exchange rate, the Pakistan rupee has depreciated by close to 15% against the US dollar, which has further increased the cost of crude oil in the country.¹⁵



A worker of Peshawar Electric Supply Company (PESCO) climbs up a high-voltage pylon in Peshawar, Pakistan. REUTERS/Fayaz Aziz



Labourers push a cart with food items to deliver near a main market in Colombo, Sri Lanka. REUTERS/ Dinuka Liyanawatte

A risk of food crises in Sri Lanka

Nearly 42% of respondents in Sri Lanka to the World Economic Forum's Executive Opinion Survey ranked "food crises" as the number one risk for doing business in the country. This is a significant jump of 25 spots from the 2018 survey.

One possible reason why executives in Sri Lanka are concerned with the issue of food crises is the growing risk that climate change poses to the country – water crises and natural catastrophes (tied for fourth) also feature within the top five risks in Sri Lanka. Indeed, according to the *Global Climate Risk Index 2019* report, launched at the Climate Summit in Katowice, Poland, in December 2018 (COP 24), Sri Lanka ranks second among countries and territories most affected by extreme weather events (Puerto Rico ranks first).¹⁶

Extreme weather conditions such as floods and droughts impacted the food sector in Sri Lanka. In 2017, for example, a

severe drought followed by floods caused a 40% drop in the production of rice, the country's staple food.¹⁷ A similar trend was also observed in 2011 when natural disasters, including floods and landslides, precipitated a food crisis in the country.

More recently, in January 2019, the northern region of Sri Lanka experienced a flash flood, affecting over 100,000 people. This was followed by a prolonged dry spell over many parts of the country during the first half of the year.¹⁸ The erratic weather pattern has meant that 2019 rice production in Sri Lanka, at 2.8 million metric tons, is marginally above the 2018 level but still significantly below the 2016 level.¹⁹ With rising commodity prices caused by these patterns, survey respondents are likely concerned with the country's ability to cope with a crisis such as that of 2017.

Macroeconomic headwinds

Climate and governance risks to countries in the region come as slowing global growth numbers have had an impact on India and other countries in South Asia. While the overall South Asian outlook remains robust, with growth projected at 6.6% in 2019 and 6.7% in 2020, according to the Asian Development Bank (ADB), deepening trade tensions between the US and China and a potential Brexit in Europe constitute the major external risks.²⁰

Both the IMF's World Economic Update and the ADB's Asian Development Outlook Supplement have lowered their forecasts for 2019 and 2020 for the region.²¹ The lower growth forecast in South Asia by both these institutions is in line with a downgraded forecast for India: GDP growth in India in Q1 of fiscal year 2019-2020 dropped to 5%, a decline of 0.8 percentage points compared to the last quarter of fiscal year 2018-2019. This has been the slowest growth in India in the past six years. The lower growth forecast for India can be attributed to a slowdown in domestic demand as well as investment. On the private consumption side, there has been a significant drop in sales of motor vehicles, which has also led to the industry shedding close to 1 million direct and indirect jobs.²²

Official estimates released by Pakistan show economic growth has deteriorated to 3.3%. The country is also suffering

from twin deficits in both the fiscal and current accounts, which are also dampening its economic outlook. While economic growth in Sri Lanka remained stable for Q1 of 2019, terrorist attacks in late April 2019 have significantly brought down tourist arrivals and the ADB predicts it will lower the GDP outlook by as much as one percentage point.

Among the other major economies in South Asia, projections are stronger: growth in Bangladesh accelerated from 7.9% in 2018 to 8.1% in 2019. This acceleration was mainly driven by strong performance from the export sector as well as growth in the services sector. This strong economic performance has made Bangladesh the fastest growing economy across the wider Asia Pacific region and one of the top five in the world.²³

Building resilience through integration

Deeper integration across the region is one step stakeholders can take to more effectively manage risk and build resilience. Policies and practices that promote regional connectivity, including effective management of shared waterways and knowledge-sharing on strengthening infrastructure, can mitigate the damages caused by climate change and reduce the severity of water crises. Greater integration can also strengthen food and energy security while boosting national economies – all of which will lead to an even stronger, more dynamic and more innovative region.



A boy with friends, flies a kite along the dry bed of Lyari River in Karachi, Pakistan. REUTERS/Akhtar Soomro

Methodology

The findings presented in this report are based on data from two surveys designed by the World Economic Forum.

- 1. The Global Risks Perception Survey.** This is the World Economic Forum's source of original risks data, harnessing the expertise of the Forum's extensive network of business, government, civil society and thought leaders. The survey was conducted from 6 September to 22 October 2018 among the World Economic Forum's multistakeholder communities, the professional networks of its Advisory Board and members of the Institute of Risk Management. The survey received 916 responses. More details can be found in *The Global Risks Report 2019*, http://www3.weforum.org/docs/WEF_Global_Risks_Report_2019.pdf
- 2. The Executive Opinion Survey.** This is the survey that feeds into the Forum's annual *Global Competitiveness Report*. Each year it canvasses the views of business leaders from around the world on the state of the business environment where they are based. The Executive Opinion Survey was conducted in 2019 between January and April and the survey's risk-related question received 12,879 responses. The respondents were presented with a list of 30 global risks and asked to select "the five global risks that you believe to be of most concern for doing business in your country within the next 10 years". More details can be found in *Regional Risks for Doing Business 2019*, http://www3.weforum.org/docs/WEF_Regional_Risks_Doing_Business_report_2019.pdf

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