

Public Investment as a Catalyst: Crowding in Private Capital in Europe and Central Asia

Europe and Central Asia in Focus

Office of the Chief Economist

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WORLD BANK **EUROPE AND CENTRAL ASIA IN FOCUS**

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Abbreviations

EAP	East Asia and Pacific
ECA	Europe and Central Asia
EBRD	European Bank for Reconstruction and Development
EMDEs	emerging market and developing economies
EU	European Union
GDP	gross domestic product
IFC	International Finance Corporation
IMF	International Monetary Fund
IPO	initial public offering
LAC	Latin America and the Caribbean
OECD	Organisation for Economic Co-operation and Development
PFR	public finance review
PHI	private health insurance
PIM	public investment management
PPI	private participation in infrastructure
PPPs	public-private partnerships
SMEs	small and medium-sized enterprises
SOE	state-owned enterprise
UNESCO	United Nations Educational, Scientific and Cultural Organization
VC	venture capital

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Introduction

Public investment is crucial for economic growth, as is its ability to help mobilize private investment. Is public investment in Europe and Central Asia (ECA) adequate? Does it help mobilize private capital and under what conditions? What should governments in ECA do to ensure that government spending is more productive and helps mobilize private investment rather than crowd it out? These are the key questions governments in the region face.

A recent empirical study estimated that across developing countries, an increase in public investment by 1 percent of GDP results in an increase in private investment by 2.2 percent over five years (Adarov, Clements, and Jalles 2026). Public investment crowds in private capital when it addresses genuine market failures and infrastructure gaps, particularly in transport, energy, and digital connectivity, and when it is deployed in economies with adequate fiscal space, strong governance, and credible institutions. In countries where institutions are weak and fiscal space is limited, the impact on private capital mobilization is near zero. Crowding out is more likely when fiscal space is tight, when public investment substitutes for viable private activity, or when it is poorly planned and executed.

Challenges in the business environment and the prevalence of state-owned enterprises (SOEs) remain important considerations in ECA. Elevated public debt and large off-budget liabilities from SOEs and improperly structured public-private partnerships (PPPs) limit the fiscal space for productive capital spending and increase borrowing costs. In many countries in ECA, SOEs are an important conduit for government policies in crucial sectors such as transport and energy. But fiscal risks from SOEs are substantial in more than half of the region. Where SOEs are financially viable, by contrast, and operate under cost-reflective tariffs and transparent regulations, and where there is a level playing field for private and public enterprises, they can help anchor PPPs and blended finance that mobilize private capital into both core and enabling infrastructure.

ECA's bank-dominated financial systems leave a significant gap in the provision of long-term private capital that the region needs to sustain growth and innovation. Insurance markets are thin, pension fund assets are modest outside Poland and a few Central European countries, venture capital lags comparator regions by an order of

magnitude. Equity and bond markets remain underdeveloped, reflecting a legacy of SOE dominance, privatizations to strategic investors rather than through public listings, and limited growth of new private firms. Addressing this gap requires a multi-pronged policy agenda: deepening insurance regulation and demand incentives, reforming pension fund investment mandates to allow greater allocation to domestic infrastructure and corporate bonds, building venture capital (VC) ecosystems through catalytic public co-investment programs, and creating the conditions for broader capital market development. IPO-friendly listing rules and reduced state dominance in financial intermediation should help accelerate this development, with EU members and candidate countries able to leverage the EU's Savings and Investment Union.

Governments across ECA have a growing toolkit of instruments to mobilize private capital alongside public investment, but the region's use of these instruments remains well below its potential. The instruments include guarantees, blended finance structures, PPPs, and direct equity co-investment by development finance institutions. Guarantees and blended finance have proven most effective in energy and transport, where sovereign backing can shift project risk into the range private investors require, with leverage ratios of four dollars or more of private capital per dollar of public contingent liability when well-structured. PPPs have delivered strong results where government commitment and transaction capacity are sustained, as in Türkiye's hospital program, but have generated fiscal stress where project preparation and contract management have been weak. Instruments can only work where the regulatory environment is credible, tariff frameworks are commercially viable, and there is a well-prepared pipeline of projects. These instruments are complements, rather than substitutes, for a solid regulatory and fiscal environment.

Crowding in and crowding out

An essential issue for governments is whether public investment crowds in (or mobilizes) or crowds out (displaces) private investment. The most widely cited mechanism through which public investment crowds in private capital is the complementarity of public and private capital. Research has demonstrated that the stock of public infrastructure helps raise the marginal product of private capital by reducing production costs and expanding the productive frontier (Aschauer 1989). Public investment has a positive impact on economic growth which, in turn, raises private firms' expectations of future profits and crowds in private investment (Blanchard and Perotti 2002; IMF 2014; Adarov, Clements, and Jalles 2026). The effects are much larger in capital-scarce economies and during economic downturns.

Another channel involves the role of public investment in addressing a market failure (for example, a coordination failure or an externality). Crowding in is also more likely if public investment helps de-risk economic activity, whether it stems from political risk, regulatory instability, currency volatility, or poor information about project viability.

Estimates suggest that under the right conditions, public investment crowds in private investment (figure 1). However, inefficient public investment projects may impose large fiscal costs and lead to debt sustainability issues. In the worst cases, inefficient public investment may generate infrastructure that is unproductive and costly to maintain, leading to greater sovereign risks and straining fiscal positions.

In contrast, crowding out happens when large government or SOE borrowing to finance public investment absorbs savings that would otherwise fund private projects. The Ricardian equivalence argument is a version of this argument: economic agents anticipate that the government will raise taxes in the future to cover repayments of public debt; thus, they reduce current consumption and investment. Crowding out is more likely when an economy is operating near full potential and where public projects are directed at sectors where private investment is already viable without government subsidies. Higher SOE concentration also significantly reduces private investment (Cevik 2019).

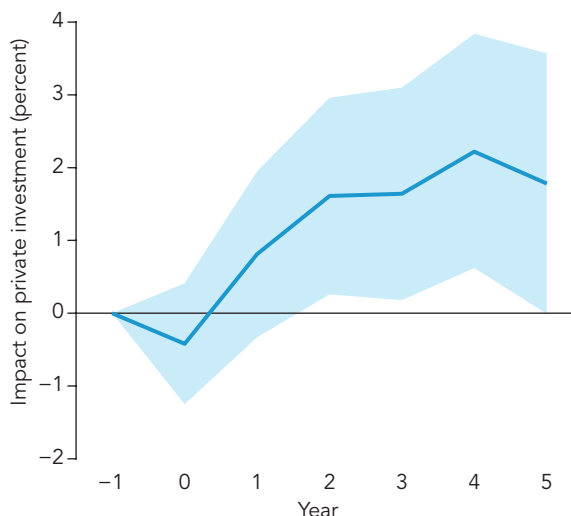
The public investment landscape in Europe and Central Asia

Public investment relative to GDP in ECA has averaged about 5.6 percent of GDP per year during 2020–24. This is higher than the 3.5 percent average in the European Union (EU), but lower than the 7 percent threshold achieved by high-growth economies.¹ In fact, except for Central Asia and the South Caucasus, governments across ECA invest less than EAP and LAC or an average middle-income country (figure 2).

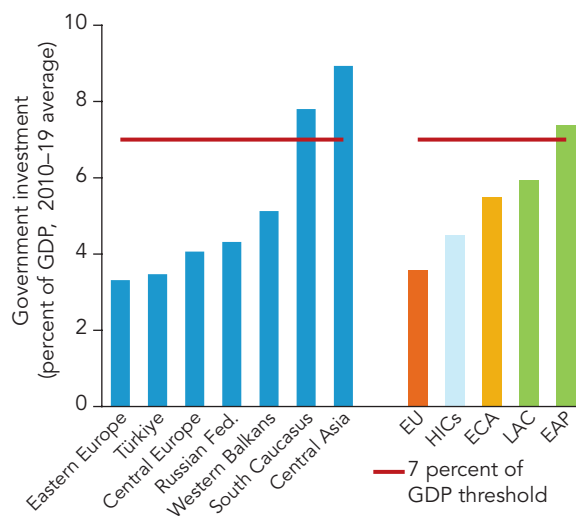
Across ECA, public capital spending varies substantially. Amounts included in government budgets range from 7–8 percent of GDP on average in the Kyrgyz Republic and Tajikistan (not including SOE spending, for example, by Barki Tojik in Tajikistan and other quasi-fiscal entities), to 4.8 percent in the Western Balkans and 3–4 percent in Central Europe and Türkiye. Public capital spending is primarily allocated to building transport and energy infrastructure. Routine maintenance is often underfunded.

Public investment in education and health is much higher in ECA than in EAP and LAC. This reflects historical precedent from the time of the planned economy with deep-rooted traditions of public service provision and universal access. Private participation in those sectors, by contrast, is more limited owing to the dominance of the public sector in most countries, political economy barriers to privatization and deregulation, and, in many countries, unfavorable demographic pressures that reduce the addressable market for private providers of healthcare and education services (see section on private investment).

1. Commission on Growth and Development (2008).

FIGURE 1. Public investment crowding in private investment

Sources: Adarov, Clements, and Jalles 2026; World Bank.
 Note: Cumulative responses of private investment to a public investment shock equivalent to 1% of GDP. Shaded areas denote 90% confidence bands.

FIGURE 2. Public investment varies across countries and regions

Sources: IMF; World Bank.
 Note: Aggregates are averages. Investment denotes gross fixed capital formation by the general government. EAP = East Asia and the Pacific; EU = European Union; HICs = High-income countries; LAC = Latin America and the Caribbean. EAP and LAC samples exclude high-income countries.

Public capital budgets are regularly underexecuted by about 20 percent (selected IMF Article IV consultation reports and World Bank public finance reviews (PFRs)). Countries in EAP and LAC have similar numbers for underexecution. For most ECA countries, this underexecution has typically reflected challenges with planning and procurement. For some countries, notably Türkiye, underexecution has been used to meet fiscal targets. Moldova appears to be the ECA country with the most chronic underexecution of as much as 25–40 percent (IMF 2025). The situation was similar in Albania, where lagging capital budget execution caused the 2025 fiscal surplus to exceed the budget target.

Transport

Transport investment absorbs the largest share of public capital across ECA, reflecting the region's need to improve connectivity and reduce trade costs. The evidence on returns is mixed and depends heavily on project selection. Incremental upgrades to existing networks tend to deliver high economic returns by easing bottlenecks and improving reliability. Poland's road and rail modernization is widely regarded as one of the most successful infrastructure transformations in Central and Eastern Europe. By integrating previously fragmented routes into coherent national and trans-European networks, it directly enabled export growth and integration into EU supply chains.

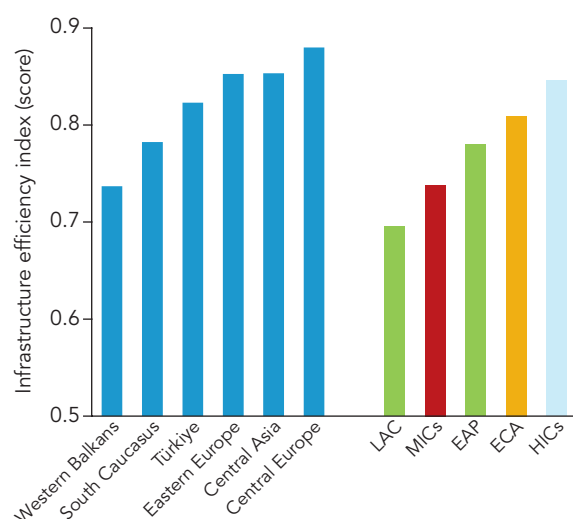
Energy

Energy investment has become increasingly important. SOEs dominate the sector in most ECA countries, but their investments remain heavily concentrated in traditional, high-carbon generation rather than cleaner alternatives (World Bank 2023a). In Central Asia, large hydropower projects offer long-term benefits but expose countries to hydrological risks and fiscal pressures if projects underperform. In Central Europe and Moldova, grid upgrades and cross-border interconnections are critical for integrating renewable energy, yet these investments often receive less political attention than new generation capacity despite higher economic returns.

Infrastructure quality

Public investment does not automatically translate into productive public capital. Poor project selection, corruption, cost overruns, and lack of maintenance mean that accumulated public capital stocks could overstate the actual infrastructure services delivered to firms and households. For example, even if a country has a dense transportation network, inadequate maintenance may leave roads in poor condition. Water and electricity losses through distribution systems also represent public services that never reach final consumers. And even though ECA outperforms other developing regions on infrastructure efficiency, performance varies considerably within the region, with the Western Balkans lagging behind Central Europe (figure 3).

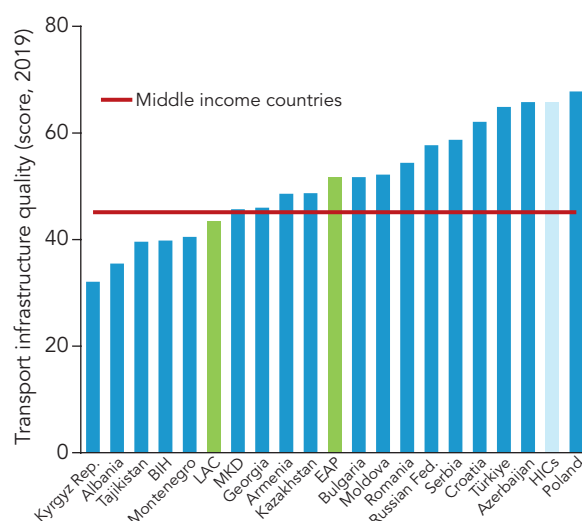
FIGURE 3. Public infrastructure efficiency varies substantially across ECA ...



Sources: Devadas and Pennings 2018.

Note: Aggregates are averages. ECA = Europe and Central Asia; EAP = East Asia and the Pacific; GDP = gross domestic product; HICs = high-income countries; LAC = Latin America and the Caribbean; MICs = middle-income countries. Infrastructure efficiency index (IEI) was constructed to reflect the proportion of public capital spending that delivers useful public capital/infrastructure services (Devadas and Pennings 2018).

FIGURE 4. ... as does the quality of transport infrastructure



Source: World Bank.

Note: Aggregates are averages. BIH = Bosnia and Herzegovina; EAP = East Asia and the Pacific; HICs = high income countries; LAC = Latin America and the Caribbean; MKD = North Macedonia.

ECA's infrastructure combines legacy assets with ongoing transitions toward modern and efficient systems. ECA countries have high levels of physical infrastructure per capita, including extensive road and rail networks, consistent with their relatively more advanced stages of development. The quality of transport infrastructure varies substantially: in many countries in Central Asia and the Western Balkans, the quality of transport infrastructure is lower than in LAC and EAP on average (figure 4).

Amortized legacy assets weigh on the efficiency of electricity transmission and distribution systems. Chronically low tariffs have also constrained investment, maintenance, and undermined system reliability. Average transmission and distribution losses in ECA at about 10 percent of output are moderate by global standards but are nearly double the levels in high-income countries. Energy losses are particularly high in Central Asia and the Western Balkans.

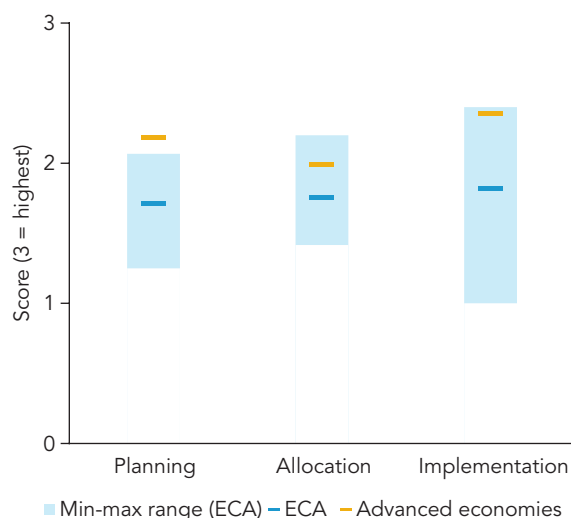
Public investment management in ECA

The quality of public investment management (PIM) remains a binding constraint on infrastructure outcomes and private capital crowding in. Gaps persist across the full public investment cycle, from planning and appraisal to selection, implementation, and asset maintenance and monitoring (figure 5).

Project appraisal and selection are especially weak. In many countries, rigorous economic analysis is applied mainly to projects financed by the EU or international financial institutions, while domestically financed projects are often screened less systematically and may be selected on political or ad hoc grounds. Standardized appraisal methods are unevenly used, project pipelines are often underprepared, and climate and resilience assessment is still not consistently considered in decision-making despite increasing exposure of many ECA countries to heatwaves, droughts, floods, and energy transition pressures.

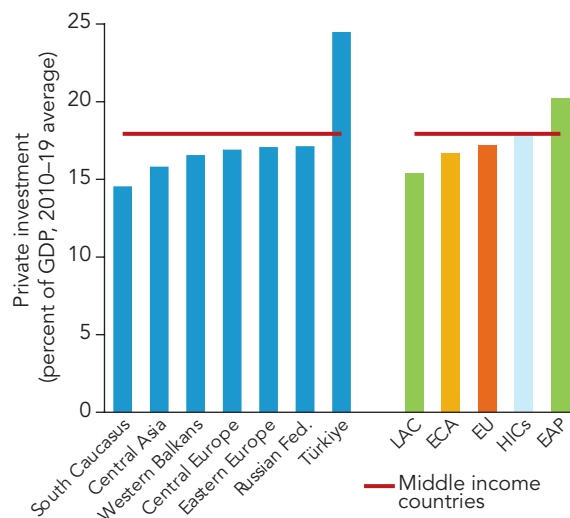
National public investment strategies often exist, but they are not coherently reflected in budget spending. The link between sector plans, medium-term fiscal frameworks, and annual budgets is often weak, producing long project lists that exceed realistic financing and implementation capacity. In EU member states, the coexistence of national plans, EU programs, and recovery instruments can further complicate prioritization and dilute strategic focus.

Implementation is a recurring bottleneck. Large transport and energy projects across the region continue to face delays, procurement disputes, and cost overruns. In several countries, ambitious infrastructure expansions have outpaced institutional and technical capacity, increasing the risk of slippage and inefficient spending.

FIGURE 5. There is significant room to improve PIM in ECA

Sources: IMF; World Bank.

Note: Aggregates are averages. Sample includes 8 ECA countries.

FIGURE 6. Private investment in most ECA countries is lower than in HICs and EAP

Sources: IMF; World Bank.

Note: Aggregates are averages. Investment denotes gross fixed capital formation by the private sector.

EAP = East Asia and the Pacific; EU = European Union; HICs = High-income countries; LAC = Latin America and the Caribbean. EAP and LAC samples exclude high-income countries.

Private investment

Private investment in ECA has dropped since the global financial crisis. Apart from Türkiye, private investment levels in most ECA economies have lingered below the averages in middle-income countries, particularly those in EAP (figure 6). This reflects deep-rooted structural constraints, including an unfavorable business environment, elevated geopolitical tensions, limited private sector dynamism, declining competitiveness, and shallow domestic capital markets that constrain access to long-term financing.

Structural barriers continue to constrain private investment across much of ECA. As a result, firm growth and innovation have slowed, weakening the region's long-term productivity and competitiveness:

- Elevated political and geopolitical risks, including regional conflicts, have increased risk, discouraged FDI inflows, and shortened investors' planning horizons.
- Most ECA economies have small domestic markets, limiting opportunities to scale up.
- Weak competitive pressures, the continued presence of SOEs in key sectors, and regulatory unpredictability further discourage private capital mobilization.

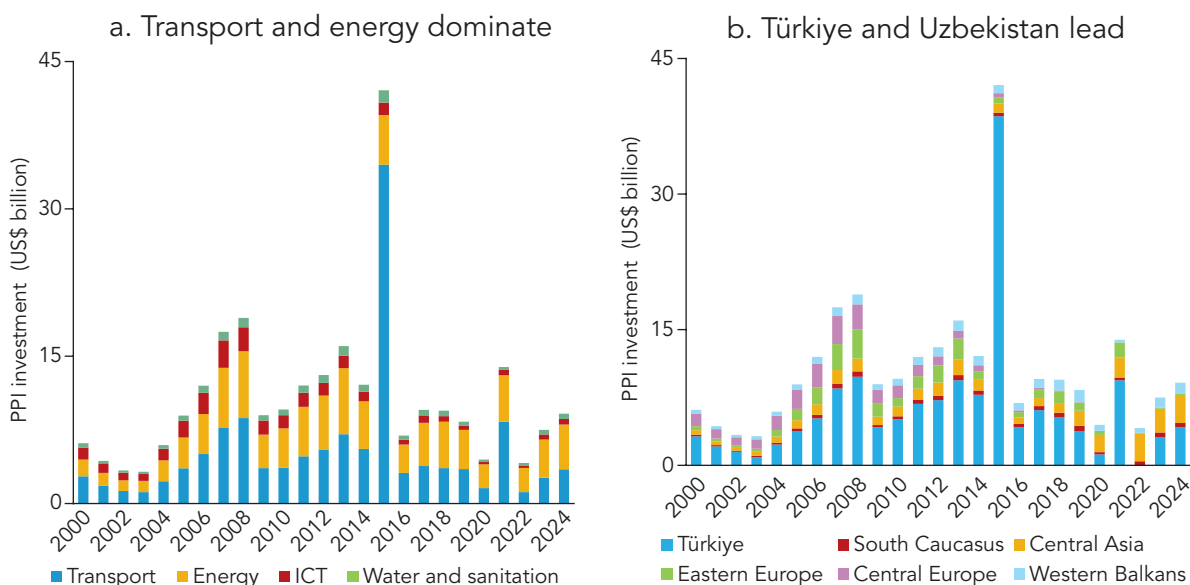
- Frequent changes in regulations, complex licensing and permitting processes, inconsistent enforcement of rules, and weaknesses in contract enforcement increase transaction costs and undermine investor confidence.
- Shallow domestic capital markets constrain access to financing, especially long-term loans. Bank lending remains the dominant source of finance, while local bond and equity markets are still nascent in many countries.

Private participation in infrastructure

Private participation in infrastructure (PPI) has averaged about 20 percent of total infrastructure spending in ECA during 2000–24.² This is comparable to the number for LAC and well above EAP excluding China. Overall, for ECA, transportation accounts for more than half of PPI during 2000–24, and energy for more than one third (figure 7).

- Türkiye accounts for nearly 60 percent of the ECA total, with the IGA Istanbul Airport project (\$35.6 billion) representing the largest single PPI commitment ever recorded.
- Georgia, Armenia, and the Kyrgyz Republic have the highest shares of PPI in ECA.
- Uzbekistan has seen substantial scale-up of recent PPI, with three-fourths of it concentrated in renewable energy. The rapid expansion of PPI in energy in Uzbekistan has increased the need for robust management of contingent liabilities and fiscal risks, more generally.

FIGURE 7. PPI in ECA is concentrated both by sector and by country



Source: World Bank.

Note: ICT = information and communications technology.

2. The discussion on PPI investment commitments is based on World Bank data. PPI records total investment committed at financial closure in infrastructure projects with private participation (energy, transport, telecom, water/sanitation).

- Kazakhstan is one of the countries with the lowest shares of PPI. Despite substantial infrastructure needs, the dominant role of SOEs and quasi-state entities limits PPI.

ECA shows real promise in attracting private investment into infrastructure, yet flows remain volatile, concentrated in a handful of large countries and sectors, and too often represent one-off transactions rather than deep, repeatable markets. Outside Türkiye and Uzbekistan, weak project preparation, regulatory uncertainty on tariffs and contract enforcement, governance fragmentation, and shallow domestic capital markets keep promising opportunities off the market.

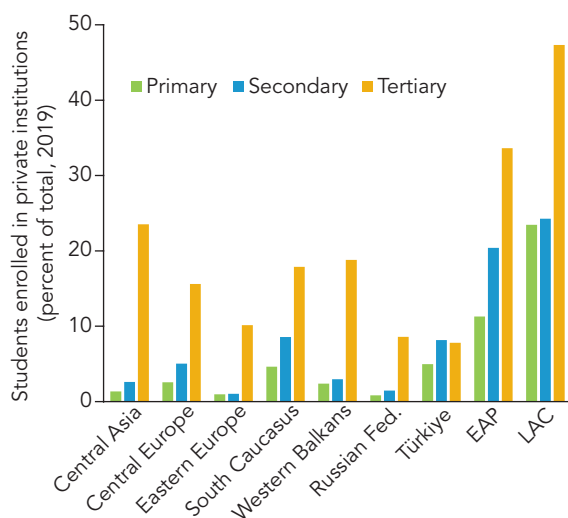
Private investment in education

Private investment in education is much lower than in EAP and LAC, but demand for private provision is growing strongly given limited government fiscal space, declining public education quality, and rapidly evolving demographics. Only 17 percent of all students in tertiary education in ECA are enrolled in private institutions. This share is twice as high in EAP and almost 50 percent in LAC. The constitutional guarantee of free public education through the secondary level is the key obstacle to private investment in pre-tertiary education. In LAC and EAP, with embedded tutoring culture, large fee-paying private school markets have developed at primary and secondary levels. In ECA, pre-tertiary private schooling is largely limited to international schools, elite preparatory schools, or religious schools (figure 8). Türkiye is an exception: private schools and tutoring have historically been prominent, thus private spending on education is among the highest in ECA.

Nevertheless, private institutions play an important role in increasing enrollment opportunities across the region, especially in Central Asia. In Central Asia, informal tutoring fees and private school enrollment are growing as public quality deteriorates. In Uzbekistan, the share of students enrolled in private universities increased to a third from almost none in the early 2010s. This growth, however, was concentrated in fields with relatively low investment needs and low barriers to entry, for example, in law, business, and social sciences. Education quality often lagged expansion, raising concerns about academic integrity, standards, and outcomes. Meanwhile, demographic decline reduced demand for education across many countries, limiting participation opportunities for private providers (figure 9).

Private provision of education will play a more substantial role in the future—but it needs better government policies to ensure that it happens by design rather than by accident. Among the key factors to consider are reduced fiscal space, deteriorating quality of public education (everywhere but Türkiye), a growing and more demanding middle class, and a growing premium on skills. With the demographic transition in most of ECA, building new schools is not an attractive proposition. It is not that countries are missing schools; it is that schools are in the wrong places, in places that are quickly losing population.

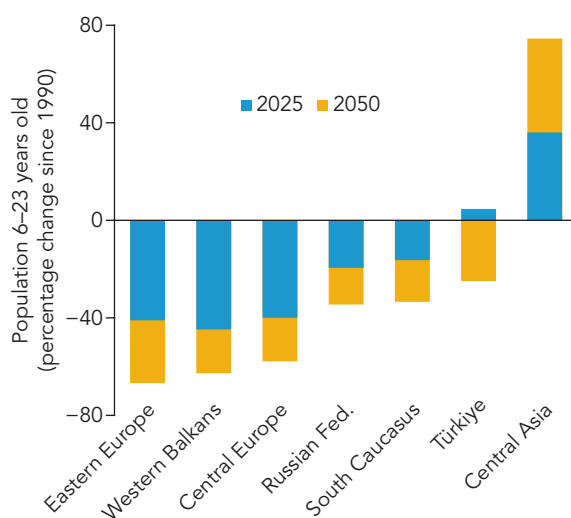
FIGURE 8. Enrollment in private institutions is low relative to EAP and LAC



Source: United Nations; UNESCO; World Bank.

Note: Aggregates are averages. EAP = East Asia and the Pacific; LAC = Latin America and the Caribbean. EAP and LAC samples exclude high-income countries.

FIGURE 9. School-age population is projected to shrink in most countries



Source: United Nations; UNESCO; World Bank.

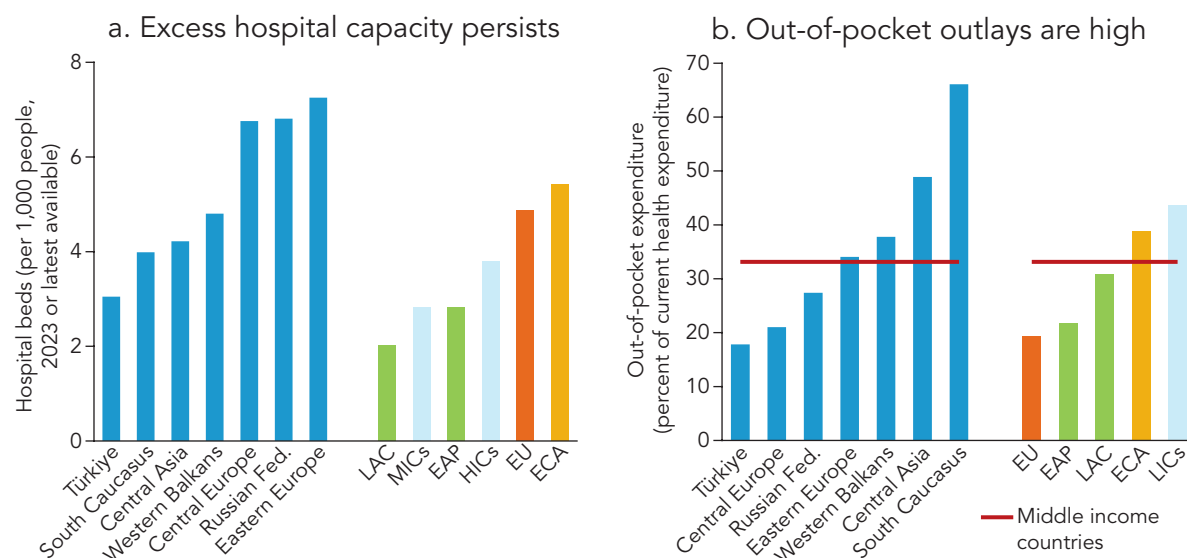
Note: Figure shows change in the total school-age population for each ECA subregion.

Private investment in health

The barriers to private investment in healthcare in ECA are rooted in a system dominated by large public hospital networks with high bed density and centralized administration. Despite decades of reform, public providers remain dominant, and persistent excess hospital capacity makes greenfield private investment commercially unviable without guaranteed patient volume from public payers (figure 10). Though private expenditure on health is higher in ECA than in other EMDEs, this often reflects elevated out-of-pocket costs and informal payments rather than organized private markets.

Provider payment reforms across ECA have advanced but have not yet resolved the principal challenge: reimbursement rates that are set below the cost of efficient service delivery. Under rate-setting processes that consistently undervalue services, only providers willing to accept below-cost reimbursement, typically public facilities with access to supplementary budget support, can sustain participation in publicly funded schemes. Private providers are effectively excluded or choose not to participate.

Private health insurance (PHI) markets across ECA remain underdeveloped. When public health systems offer nominally comprehensive benefit packages, even if actual access is rationed through informal payments, long waiting times, or quality differentials, consumers

FIGURE 10. Healthcare systems in ECA are dominated by large public hospital networks

Sources: World Bank; World Health Organization.

Note: Aggregates are averages. EAP = East Asia and the Pacific; ECA = Europe and Central Asia; EU = European Union; HICs = High-income countries; LAC = Latin America and the Caribbean; MICs = middle-income countries. EAP and LAC samples exclude high-income countries.

are not willing to pay PHI premiums for duplicative coverage.³ In many ECA countries, household incomes are also insufficient to sustain premium-paying PHI markets. Meanwhile, employer-sponsored group insurance, which has supported private insurance market development in LAC and EAP, is not systematically incentivized through tax treatment and regulations across most ECA countries, leaving insurers without the stable demand base needed to achieve scale.

Private investment is difficult to mobilize when reimbursement rates are below cost and user fee-paying populations are too small. Where private investment has succeeded, for example, in Türkiye's hospital sector, Poland's and Romania's private health chains, Kazakhstan's emerging hospital PPP, and Albania's diagnostic program, the common factors have been: viable revenue models, including adequate reimbursement rates, private insurance depth, or out-of-pocket (OOP) willingness to pay in quality-differentiated markets; sustained government commitment to PPP frameworks; support and co-financing by international financial institutions (IFI); and robust quality assurance systems that maintain public credibility. Successful examples in ECA indicate that private participation in healthcare is also higher in countries with robust PPP frameworks, dedicated institutions with strong transaction

3. Most OECD countries, other than the United States, have universal or near-universal coverage for a core set of health services provided through the government (compulsory) health insurance. Universal health coverage has traditionally been financed through national health services or social health insurance. A few countries (the Netherlands and Switzerland) have achieved universal coverage through mandatory private insurance, backed by public subsidies and strong regulation of benefits and coverage (OECD 2025).

capacity, transparent procurement rules, and effective management of fiscal risks and contingent liabilities. For example, Türkiye's City Hospital PPP program, where the private sector finances and constructs the facility, then leases it back to the government, is the largest health infrastructure PPP program in ECA and demonstrates that private financing of health infrastructure at scale is achievable.

The role of SOEs

State-owned enterprises (SOEs) are a critical conduit for government action in the economy and often the main obstacle to private capital mobilization in ECA. In some parts of the region, notably Central Asia and the South Caucasus, SOEs act as the primary vehicle through which governments translate policy priorities into capital formation, particularly in energy, transport, and utilities.

The fiscal risks associated with SOEs are systemic. SOEs often perform quasi-fiscal operations that weaken their financial position and erode their capacity to finance investment, leading to persistent inefficiencies and deteriorating asset quality. Rather than one-off bailouts, they typically require continuous fiscal support, accumulating sizable long-term fiscal costs. In Kazakhstan, SOE liabilities are around 30 percent of GDP; quasi-fiscal deficits in utility SOEs in Almaty and Astana alone exceed an estimated 2 percent of GDP (World Bank 2023b). In Serbia, more than half of the largest SOEs are in financial distress, and energy SOEs required support of over 2 percent of GDP in 2022 (World Bank 2025a). Georgia's SOEs have negative aggregate returns on assets, and their borrowing and PPP (World Bank 2025a) liabilities significantly amplify fiscal risks (World Bank 2025b).

SOEs dominate fixed investment in Central Asia. In the Kyrgyz Republic, SOEs hold assets equal to roughly half of GDP and are active across all major infrastructure sectors. In Tajikistan, they remain major employers and account for a large share of fixed capital formation. Preferential access to financing, regulatory advantages, and implicit state backing tilt the competitive playing field, discouraging private entry and reducing innovation. This helps explain why high public investment ratios in several ECA countries coexist not just with weak infrastructure outcomes, but also with weak private investment responses: the public sector is not complementing private capital but crowding it out through SOE dominance of key sectors.

The implications for private capital mobilization are significant. Reducing SOE quasi-fiscal activity, improving SOE governance, and integrating SOE investment decisions into public investment management frameworks would simultaneously improve investment efficiency and create space for private co-investment in sectors currently dominated by the state. Without reform, SOEs will remain a drag on investment, business dynamism, and job creation.

Nonbank finance for private capital mobilization

ECA, like much of Western Europe, has bank-dominated financial systems, and its non-bank financial sector lags well behind comparator regions. Insurance premiums in Kazakhstan and Romania, for example, two ECA countries with the lowest share of credit to GDP, amount to 1 percent of GDP, compared with 1.8 percent for ECA as a whole, nearly 3 percent for LAC, and 11 percent for South Korea. Pension fund assets outside of Poland and a handful of Central European countries are modest. Equity and bond markets are especially underdeveloped, exacerbated by the continued dominance of state-owned enterprises and the tendency to privatize state assets to strategic foreign investors rather than through public listings. Venture capital is nascent: ECA lags LAC by a factor of ten in VC investment relative to GDP. Fintechs have begun to emerge, but their contribution to broadening access to productive capital remains limited.⁴

The underdevelopment of nonbank finance in ECA reflects a combination of historical legacy, regulatory gaps, and macroeconomic constraints. The dominance of state-owned banks (which still account for a large share of banking assets in Kazakhstan, Uzbekistan, and others) has crowded out capital market development by absorbing the most creditworthy borrowers at subsidized rates, reducing the supply of bankable assets available to market investors. Regulatory frameworks governing insurance, asset management, and securities markets have typically lagged banking regulation in rigor and coverage, leaving institutional investors without the instruments and legal certainty needed to deploy long-term capital. In several countries, episodes of financial instability have eroded household and corporate trust in nonbank instruments, further suppressing demand. And the relatively small size of most ECA economies limits the liquidity and scale needed for efficient capital markets.

Pension funds represent a particularly important gap. Mandatory funded pension systems were introduced across much of ECA in the 2000s, but assets under management remain well below the levels needed to anchor domestic bond and equity markets. In Poland and Romania, partial reversals of pension reforms reduced private pillar assets, weakening a potential source of long-term infrastructure and equity financing. In Kazakhstan, one of the earliest reformers to introduce second pillar pensions, the Unified Accumulative Pension Fund under the management of the central bank centralized all private pension assets in 2013. Its restrictive investment mandate has historically limited deployment into domestic private capital markets and infrastructure. Reforming the investment regulations for pension funds to allow greater allocation to domestic infrastructure, private equity, and corporate bonds could unlock a significant source of long-term local currency financing currently absent from ECA's capital markets.

4. Credit to GDP amounts to about 27 percent in high-income Romania and upper middle-income Azerbaijan and Kazakhstan, just a third of the level in Austria and the Netherlands and only a fourth of the level in Chile or Malaysia. For the region as a whole, credit to GDP is lower than in LAC on average and only a third of the levels in China and South Korea.

Venture capital in ECA remains nascent relative to the region's innovation potential.

Total VC investment in ECA is a small fraction of that in comparable OECD economies and the Baltic states and is heavily concentrated in Poland and Romania. The ecosystem suffers from a thin pipeline of fund managers with sufficient track records and sector expertise to attract institutional capital. There is limited co-investment by public development finance institutions. The "exit" market is shallow given underdeveloped stock exchanges. The EU's European Investment Fund has been an important catalyst in EU member states, and national fund-of-funds programs modeled on Poland's PFR Ventures demonstrate that targeted public intervention can crowd in private VC at scale. Extending similar frameworks to non-EU ECA countries, where the financing gap is the largest, would be a high-priority policy action.

Fintechs in ECA have shown particular strength in payments and digital lending, but their broader contribution to private capital mobilization remains limited.

Georgia and Poland have emerged as regional fintech hubs, driven by high mobile penetration and open banking frameworks. However, the sector's reach into business financing beyond consumer credit remains shallow. The integration of fintech credit scoring into bank underwriting and the development of revenue-based financing and invoice discounting platforms for micro and SMEs represent near-term opportunities to expand access to finance for firms currently excluded from formal bank credit. Micro and SME financing gaps are among the largest constraints on private sector dynamism in ECA, and fintech is the most scalable tool available to address them.

For EU member states and candidate countries in ECA, the European Commission's Savings and Investment Union initiative offers a structural opportunity to deepen capital markets and mobilize private finance at scale.

The initiative aims to reduce the fragmentation of EU capital markets, lower barriers to cross-border investment, and channel household savings currently held in low-yielding bank deposits into productive investment. For ECA countries, deeper integration into this framework could significantly expand the supply of equity and bond financing for mid-sized firms and infrastructure projects. EU candidate countries should begin aligning their capital market regulations now to enable rapid integration once accession is achieved.

The policy agenda for non-bank finance in ECA is clear in its broad contours, even if country-specific priorities differ.

Insurance markets need deepened regulatory frameworks, mandatory product requirements (such as third-party liability), and tax-advantaged structures to stimulate demand. Pension fund investment mandates need reform to allow greater allocation to domestic productive assets. Venture capital ecosystems require catalytic public co-investment and fund-of-funds programs. Capital markets need IPO-friendly listing rules, minority investor protections, and reduced SOE dominance to increase the supply of investable assets. And fintech needs regulatory sandboxes that are broad enough to enable genuine innovation while maintaining financial stability. Across all these areas, the common requirement is a sustained commitment to reducing state dominance in financial intermediation and creating space for private capital to allocate resources more efficiently.

Key instruments for private capital mobilization

Guarantees are among the most capital-efficient instruments available to governments seeking to mobilize private investment. In ECA, guarantees have been deployed most successfully in energy and transport, where revenue uncertainty and regulatory risk are the primary deterrents to private entry. The World Bank's MIGA and IFC, the EBRD's trade finance program, and the EU's InvestEU guarantee facility have all provided coverage that catalyzed private lending in markets that would otherwise have remained closed. The leverage ratios can be substantial: a well-structured guarantee can mobilize four dollars or more of private capital for every dollar of public contingent liability. The key design challenge is pricing guarantees to reflect genuine risk transfer rather than creating a hidden subsidy that distorts investment decisions.

Blended finance structures combine concessional public resources with commercial capital to shift the risk-return profile of a project into the range that private investors require. The most common structure places MDBs or donor funding in a junior or subordinated position, absorbing disproportionate losses in adverse scenarios and thereby improving the expected return for senior private lenders or equity investors. In ECA, blended finance has found its strongest application in renewable energy (for example, in Uzbekistan). A limitation is that blended finance works best in markets that are almost commercially viable. In frontier markets, the required concessionality is so large that it risks crowding out the emergence of unsubsidized private finance altogether.

When well-structured, PPPs transfer construction, operational, and demand risk to private operators while preserving public control over the services delivered. ECA has a long PPP history, but outcomes have been highly uneven. Türkiye's city hospital program (the largest health infrastructure PPP program in the region) demonstrates that the model can work at scale when government commitment is sustained, transaction advisory capacity is strong, and contingent liabilities are transparently managed. At the other end of the spectrum, poorly structured concessions in transport across the Western Balkans have generated renegotiation, cost overruns, and fiscal stress.

Equity co-investment by development finance institutions (including the IFC) plays a distinct and underappreciated role in catalyzing private capital in markets where the absence of credible reference investors deters entry. By taking an equity stake alongside private investors, IFC, EBRD, or other institutions signal that the market has been subjected to professional due diligence and that a reputable institution has skin in the game. This certification effect can be decisive in ECA markets where regulatory unpredictability and governance concerns deter first movers. The limitation is that equity provided by development institutions is a scarce resource.

The full potential of these instruments requires complementary policies. Guarantees cannot de-risk regulatory uncertainty that governments have not credibly committed to

resolve. Blended finance cannot substitute for a tariff framework (for electric utilities, for example) that makes infrastructure commercially viable. PPPs cannot function where there is no institutional capacity to manage them. The instruments are necessary but not sufficient for private capital mobilization. They need to be deployed in conjunction with policy reforms, including credible regulation, competitive markets, fiscal transparency, and strong public investment management.

Policy implications

Public investment is a catalyst, not a substitute, for private investment. The countries in ECA need to pursue four priorities to help improve the efficiency of public investment and facilitate private investment mobilization:

- One, ensure adequate fiscal space for both public investment and maintenance. Reducing capital spending to meet fiscal targets is a short-sighted approach and should be avoided.
- Two, improve public investment efficiency by strengthening public investment management and integrating investment into credible fiscal frameworks and budgets.
- Three, strengthen the non-bank financial sector, reduce the role of the government in the economy to give space to private investors, and encourage prudent risk taking. Bank-dominant financial systems rarely help provide the financing for private capital countries need, especially as they move to high-income status.
- Four, open sectors that have been largely left to the government to invest in, such as education and health.

Improving the effectiveness of public investment in ECA also requires a regionally differentiated policy agenda. While the core objective is to “invest smarter, not just more,” the specific priorities vary across subregions:

- In Central Asia, managing quasi-fiscal investment and strengthening transparency are central challenges. Consolidating SOE activities into fiscal accounts, limiting off-budget operations, and improving oversight of large projects are critical steps to safeguard macroeconomic stability while maintaining high investment levels.
- In Central Europe, the key challenge is to shift from absorption-driven to efficiency-driven investment.
- In Eastern Europe, aligning external financing with domestic administrative capabilities is essential. Scaling up investment effectively will require targeted efforts to improve procurement, technical expertise, and coordination.
- In the South Caucasus, the priority is to enhance efficiency and embed investment decisions within robust fiscal frameworks. This includes reforming fiscal rules that may incentivize unrealistic capital plans, strengthening project appraisal and prioritization, and improving SOE governance.

- The Western Balkans need stronger institutional capacity. Reforms should focus on strengthening public investment management systems, integrating PPPs into fiscal frameworks, improving transparency around contingent liabilities, and limiting reliance on megaprojects that strain fiscal space and implementation capacity.

Investment by SOEs must be reformed to improve public investment outcomes and contain fiscal risks. Crucially, SOE investment must follow the same discipline as other public investment projects. This investment should align with national priorities, undergo rigorous appraisal, and be fully integrated into budget processes. Where countries have done this, they show that large-scale investment can be delivered without sacrificing efficiency or fiscal sustainability.

Conclusion

Public investment mobilizes private capital when it fills genuine market failures and infrastructure gaps and when it is used in economies with sound fiscal positions, strong governance, and credible institutions. Where institutions are weak and fiscal space is constrained, the mobilization effect is negligible. Crowding out is more likely when public budgets are stretched, when public spending displaces activity that the private sector would otherwise undertake, or when projects are poorly planned and executed.

These findings are relevant for ECA countries' efforts to boost economic growth and job creation by attracting more private capital. Public investment can shift the frontier for private opportunity. But private opportunity needs the appropriate business and financial environment to be scaled up. This is the key priority for governments in the region.

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Public Investment as a Catalyst: Crowding in Private Capital in Europe and Central Asia

Public investment can be a powerful catalyst for private capital in Europe and Central Asia (ECA). Evidence shows that raising public investment by 1 percent of GDP lifts private investment by up to 2.2 percent over five years, provided there is adequate fiscal space and credible institutions. Where these are weak, the effect vanishes. Strengthening public investment management and reforming state-owned enterprises can markedly improve the effectiveness of public spending and its power to mobilize private capital. Governments have a growing toolkit of guarantees, blended finance, and public-private partnerships, but use it well below its potential. With the right reforms, public investment can complement rather than crowd out private capital, helping ECA countries deliver stronger growth, productivity, and job creation.

