



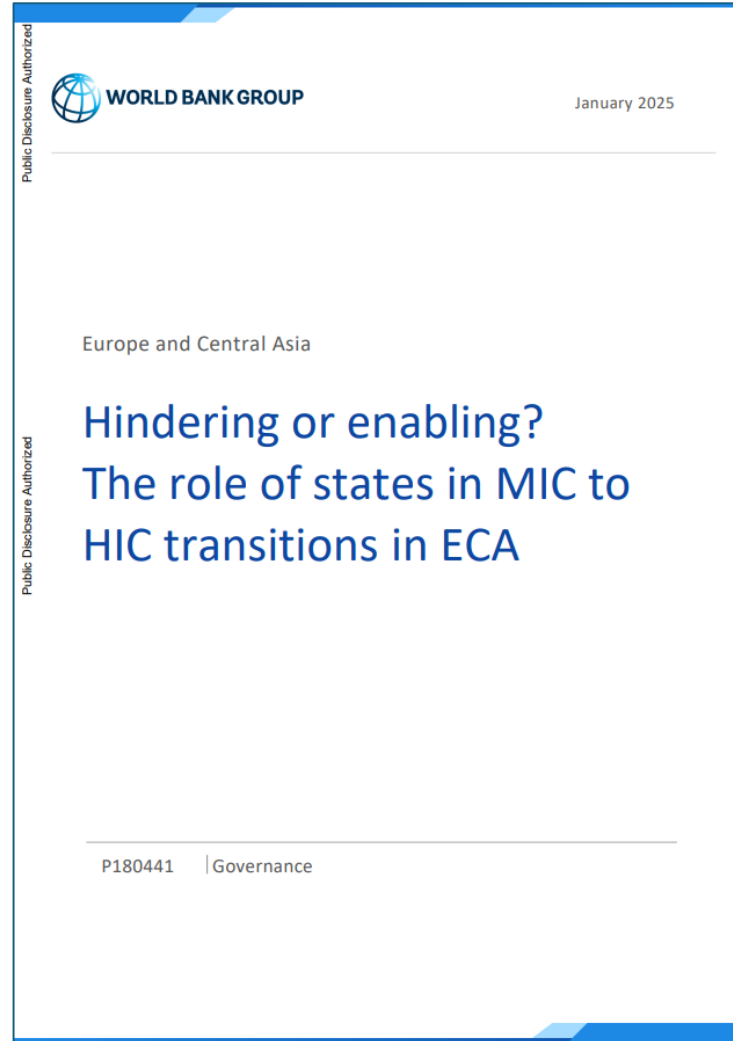
Hindering or enabling? The role of states in MIC to HIC transitions in ECA

Presentation to G&I Partners

January 28, 2026

[Link to the paper](#)

OVERCOMING THE MIDDLE-INCOME TRAP



What is the role of the state in the pursuit of middle-to high-income transitions in ECA ?

How different are HIC convergers from remaining MICs in ECA in institutional effectiveness, integrity, and state capture?

Are the region's states' large fiscal footprints a constraint, and how do converging and non-converging countries compare?

How did states in ECA pursue reforms during 'good' and 'bad' times?

How has the role of the states been recalibrated across different functions ?

Methodology and data limitations

Large set of economic and perception-based indicators on governance and institutions – both expert ratings and survey-based

The region combines EU members, Western Balkans, and Central Asia & many boundaries changed—data comparability issues are taken into account

Critical junctures and (historical) comparative cases are used to identify shifts in dynamics and how different factors impact these → not causation, but tracing pathways

The ideal role of the state –key approaches

Schumpeter's ideal state

- Fostering conditions for entrepreneurship, protecting intellectual property, and maintaining a supportive legal and economic framework to encourage innovation and economic growth.
- Implications for MICs: simplifying business regulations, providing access to capital, and offering tax incentives; invest in education and infrastructure

Other key approaches included

WDR 1997 – ‘The State in a Changing World’

Aghion's ideal state

EBRD Transition Report 2020 – ‘The State Strikes Back’

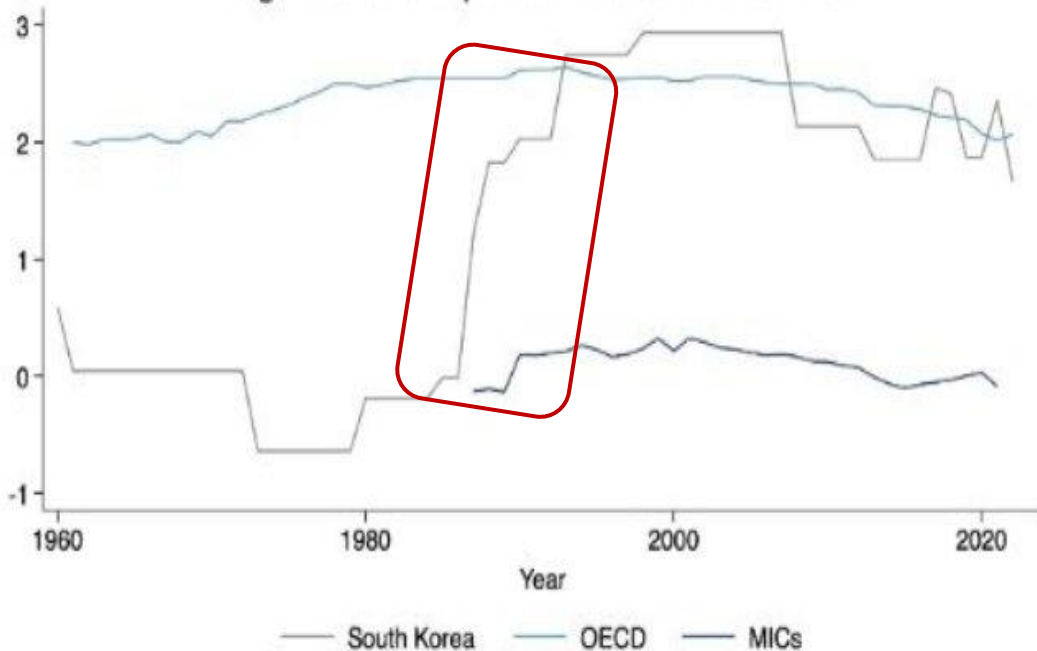
➤ *Compatibility of ‘ideal state’ with elite incentives is a key challenge*

The experience of 'fast accelerators'

- South Korea and Finland both developed fast – building on institutional quality and targeted state actions - fostering innovation and leading to high income

- South Korea (US\$158 pc income in 1960):
 - Push for industrialization from the early 1960s
 - Started with low quality institutions, but greatly improved them during the middle-income stage
 - Became and remained a highly innovative economy (currently 4th on the GII)
- Finland (US\$1 192 pc income in 1960):
 - Made a rapid transition from middle to high-income status over a 20-year period
 - Enabled by three key factors: (i) heavy industries, (ii) institutional quality, and (iii) government-led investments in education and research with the private sector
 - Remains highly innovative (currently 7th on the GII)

Rigorous and Impartial Public Administration



Source: V-Dem

States in ECA: shifting from dominating to enabling

Communist Period

states in the ECA region took on a dominant rather than enabling role in economic and social development. No / Little focus on entrepreneurialism, but development of basic infrastructure and education.

Post 1990

ECA had some important pre-conditions for knowledge-based growth, but also had to grapple with profound transition disruptions.

2000s-2010s

Still large but changing states: Among the early convergers of ECA, the state has an especially large fiscal footprint.

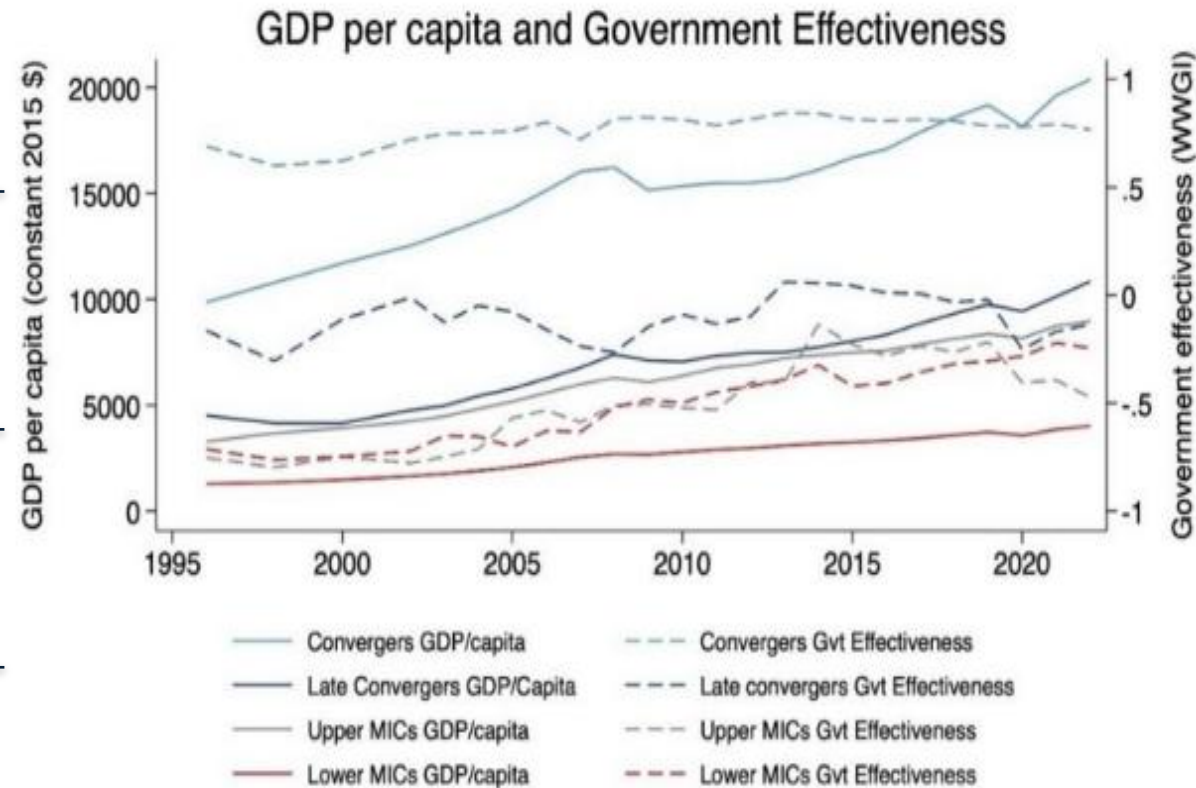
How has institutional performance differed between HIC convergers and others?

Strong institutions are rarely present from the outset in middle income countries seeking to move towards high income levels.

ECA countries had to reconfigure and rebuild institutions to promote growth. Some institutional improvements are more critical to enabling transitions to the high-income level.

Property rights were established across most countries but evolution differed.

Government effectiveness has been much higher in early convergers compared to MICs, and the latter only made limited gains over time.



Source: World Development Indicators and Worldwide Governance Indicators

Institutional quality shaped how quickly ECA transition countries shifted from state-led economies to private-sector-driven growth.

Early converging countries: rapid improvements—especially in SOE governance and competition policy.

Late convergers: also strengthened competition policy, at a slower pace.

Potential convergers / upper-MICs: weaker performance overall; policy progress picked up only after the mid-2000s.

Lower-income MICs: reforms stalled from the mid-1990s to mid-2000s, with little progress.

EBRD Transition Indicator: Competition Policy

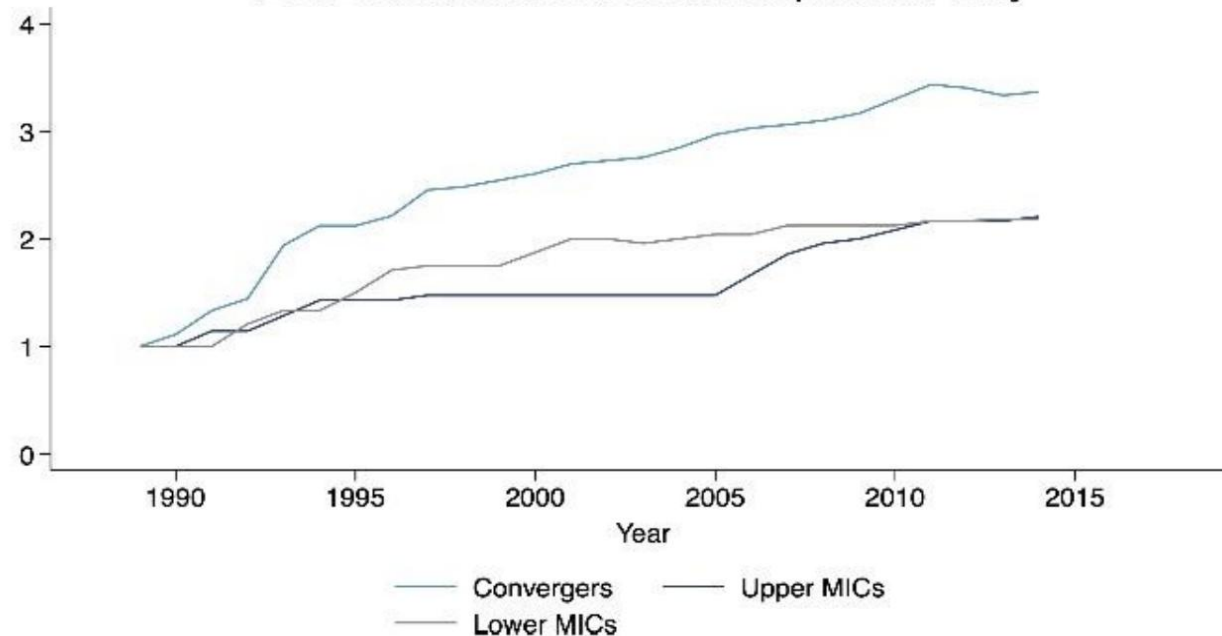
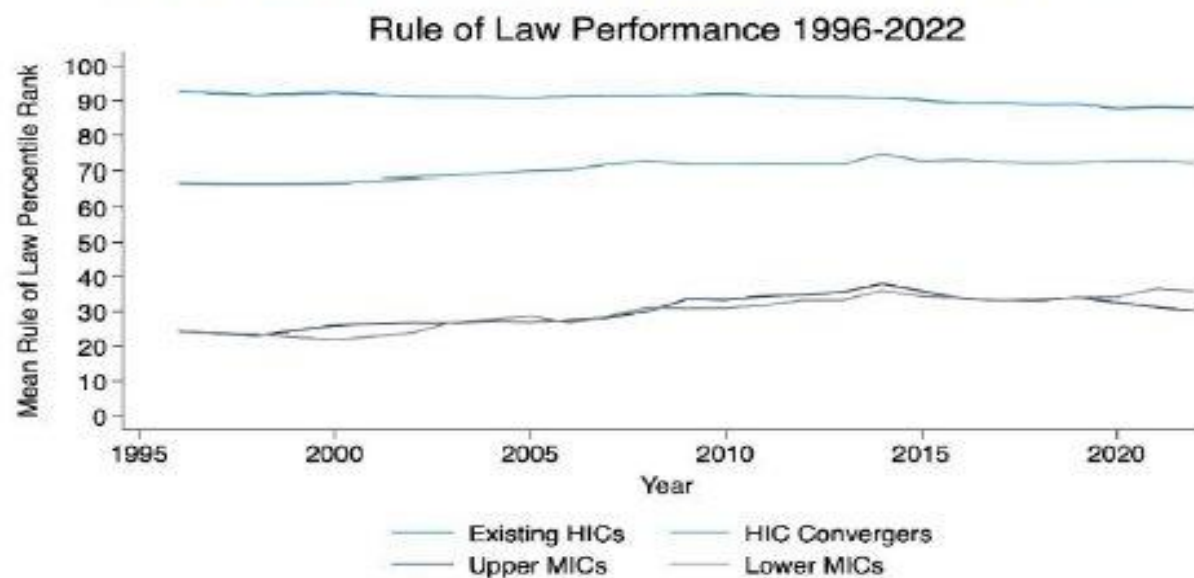


Figure 4: Rule of Law performance 1996 to 2022



Source: Worldwide Governance Indicators

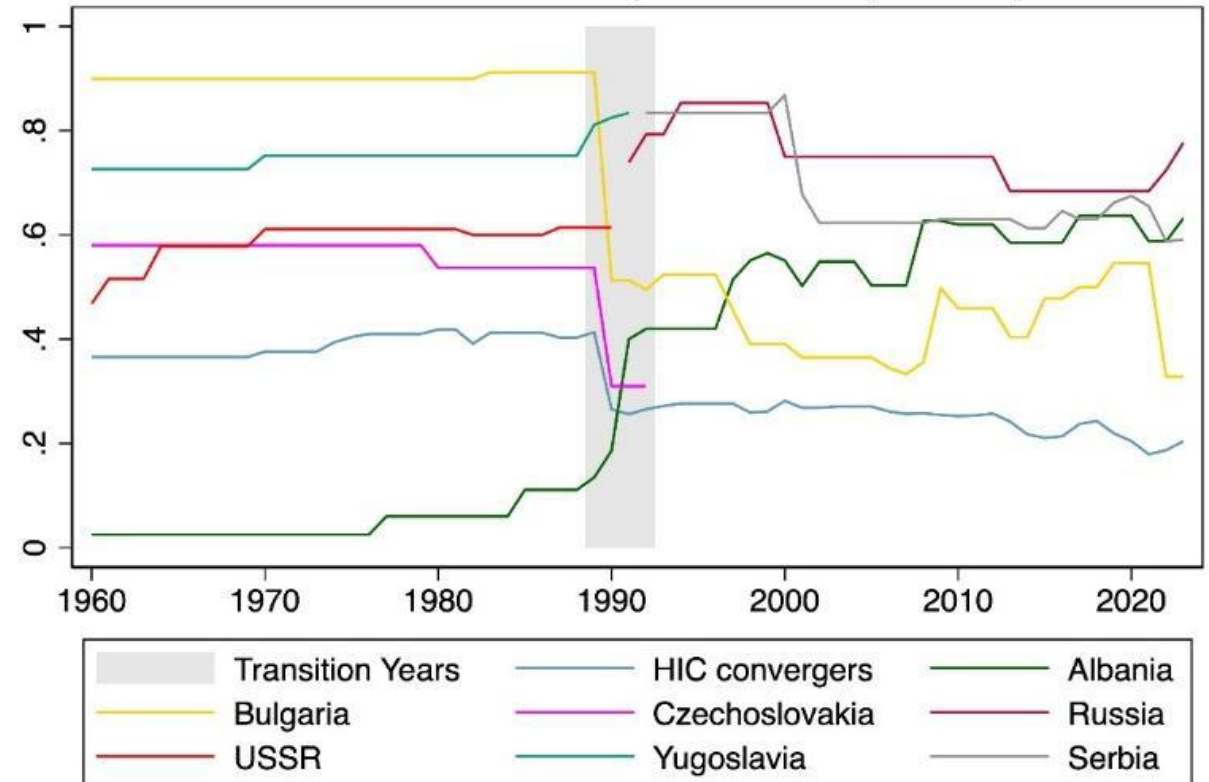
Early HIC convergers (grey blue):

- Experienced a virtuous cycle between better institutions and greater private investments
- Had significantly better institutions from an early stage.
- This in turn enabled further improving public sector performance

For others:

- Gains have been slow and uneven
- Some have seen a longer-term reduction in integrity

Public Sector Corruption Index (V-Dem)

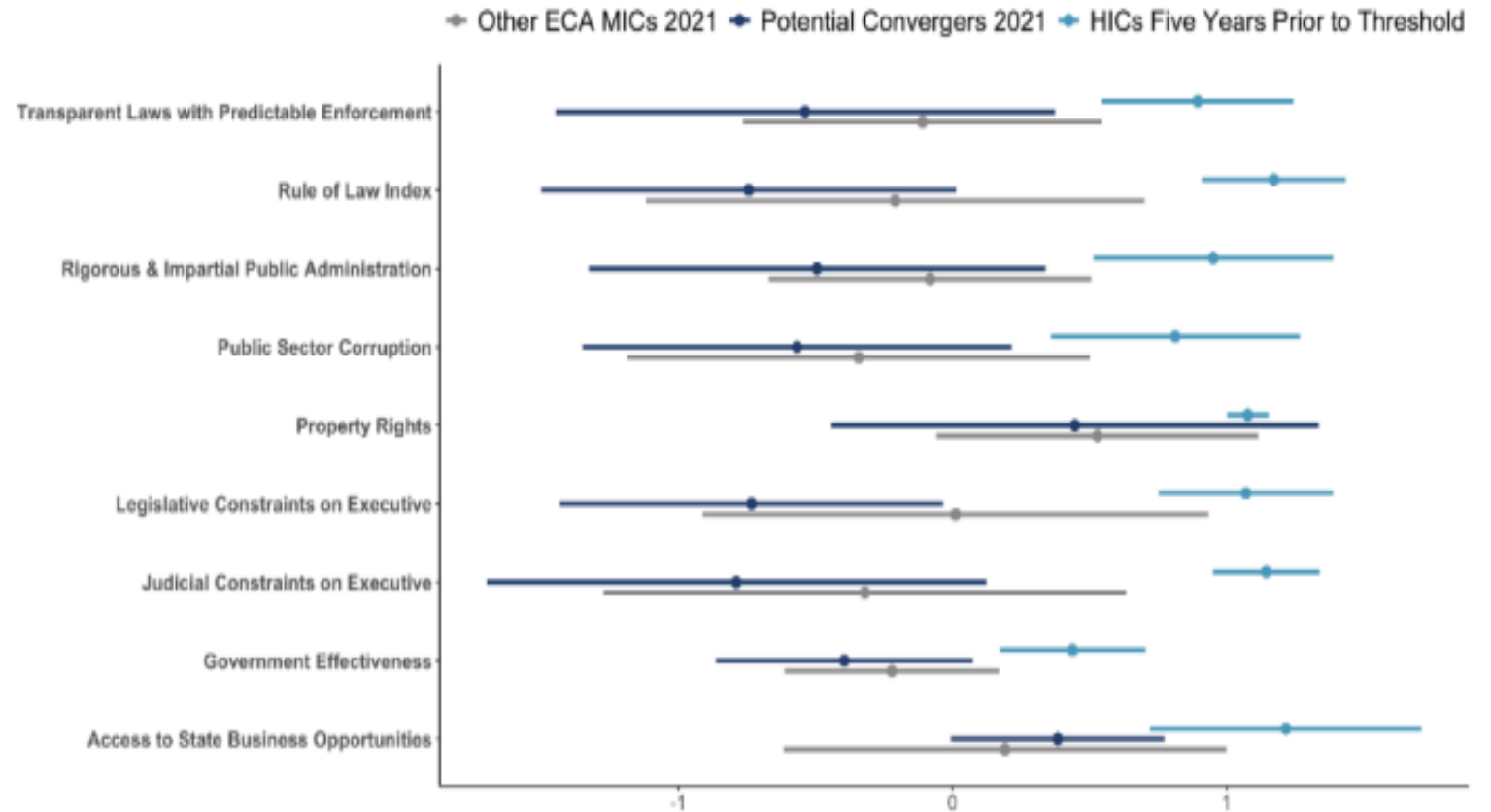


Five years prior to reaching HIC thresholds, ECA convergers had much better institutional quality than today's MICs

Across different dimensions of governance, converging countries showed significantly stronger institutional performance ahead of reaching the HIC threshold

Today's 'potential convergers' have not caught up in terms of institutional quality

On many dimensions, ECA countries further from the HIC frontier are performing better than those which are closer

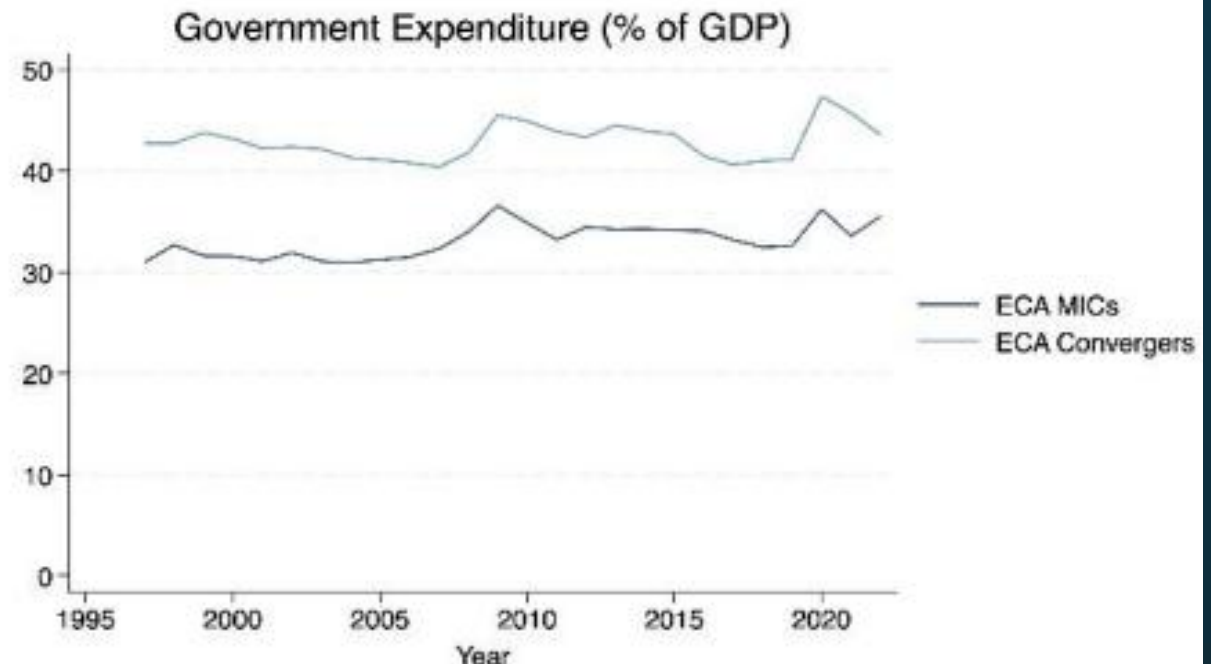
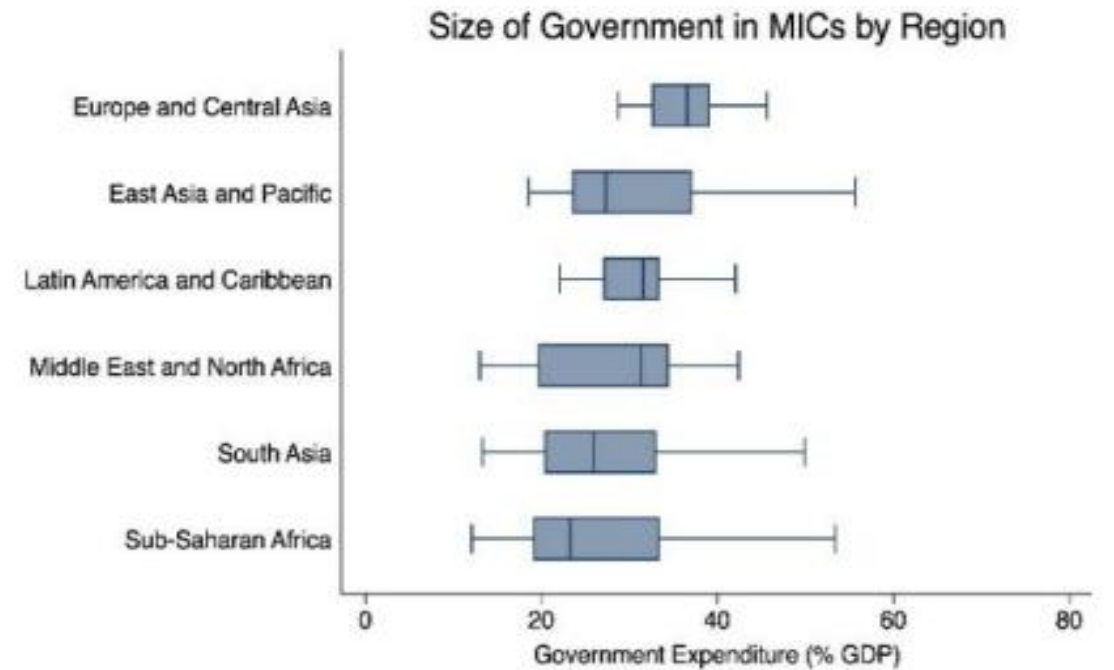


Potential Convergers (at least \$4,900 GNI per capita in 2012): Belarus, Bosnia and Herzegovina, Kazakhstan, Montenegro, Russian Federation, Serbia, Turkey, and Turkmenistan. Other MICs: Albania, Armenia, Azerbaijan, Georgia, Kosovo, Kyrgyz Republic, Moldova, North Macedonia, Tajikistan, Ukraine, and Uzbekistan. Source: V-Dem, Worldwide Governance Indicators, World Development Indicators.

HIC convergers have especially large fiscal footprints – but better quality & efficiency of spending than MICs

Key Drivers of Large Fiscal Footprints in ECA:

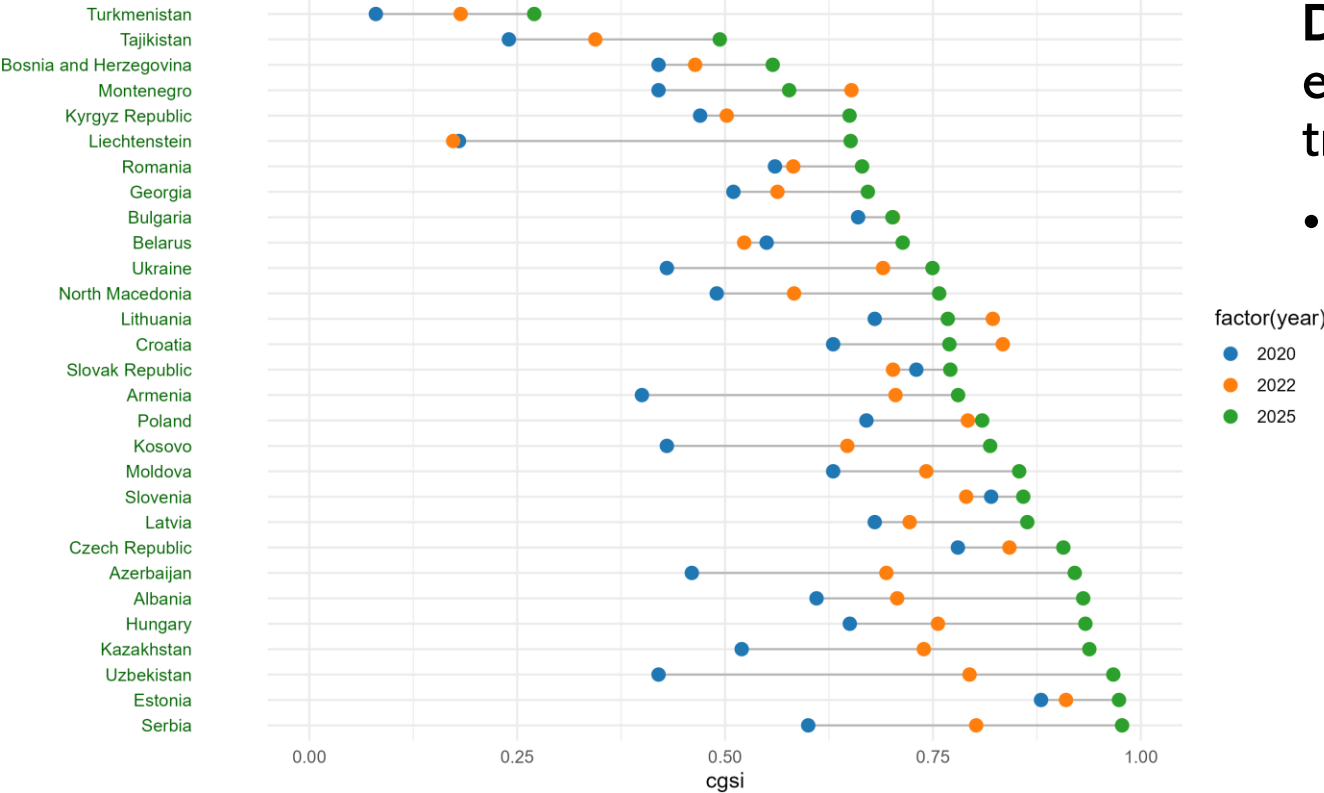
- HICs and MICs in ECA allocates a larger share of GDP to social programs.
 - Stronger institutions **improve spending efficiency** and make high fiscal footprints **sustainable**.
 - High tax burdens can be mitigated when public services are well-managed, but in cases of weak institutions, taxation becomes a burden due to corruption, inefficiencies, and wasteful spending.
 - Weak procurement, SOE mismanagement and resulting need for bailouts, and bureaucratic burden lead to wasteful spending.



Source: International Monetary Fund

The Role of Digitalization in Addressing Inefficiencies

CGSI scores for ECA economies
Green if 2025 ≥ 2020, red if 2025 < 2020



Digitalization offers one way of achieving efficiency improvements – reducing effort of transactions, and increased transparency

- **Progress in Digitalization:**
 - **Estonia:** Digital public services increased efficiency & citizen trust – global leader
 - **Poland & Czechia:** E-government reforms reduced administrative costs.
 - **ECA MICs:** Many are improving; some LMICs still very low

Avoiding capture: ensuring that markets and opportunities remain competitive



Distorts Competition & Growth:

- Public resources and opportunities go to connected firms, undermining competition and innovation.

Hampers innovation:

- Rent-seeking crowds out genuine private-sector investment.

Reduces Innovation:

- While some technology infusion may still occur, excessive rent-seeking becomes a major barrier to private-sector investments in innovation.


Creates social tensions:

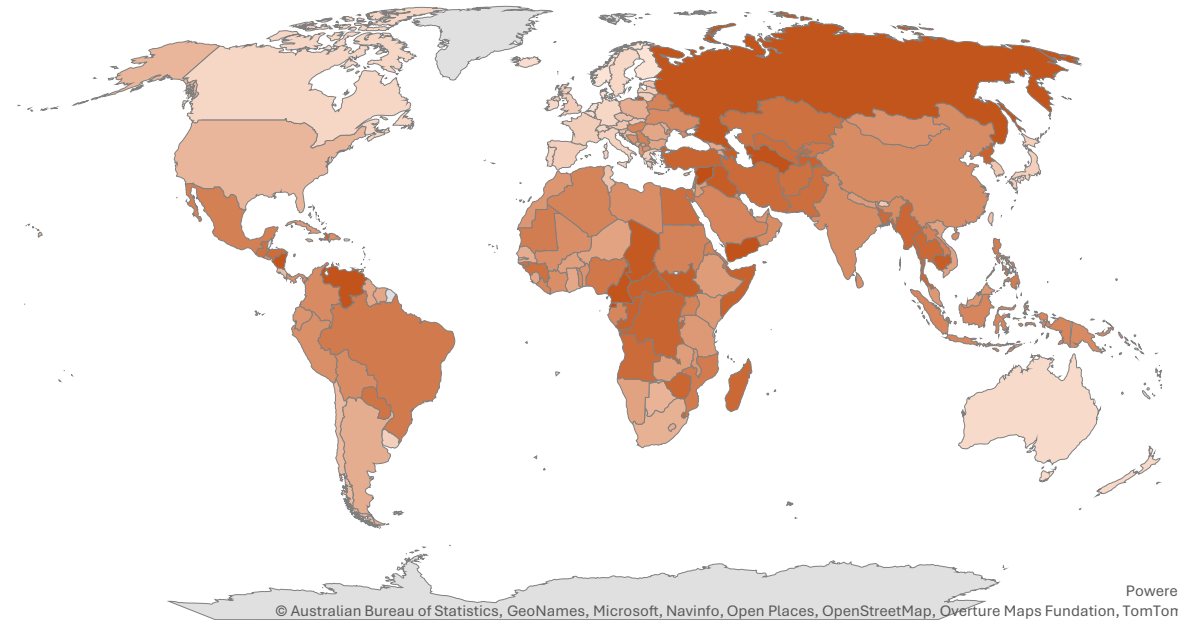
- Unfair access to opportunities fuels resentment among firms and citizens.

Strengthens authoritarian tendencies:

- Incumbents may use state capture to weaken opponents and consolidate power.

State Capture Index

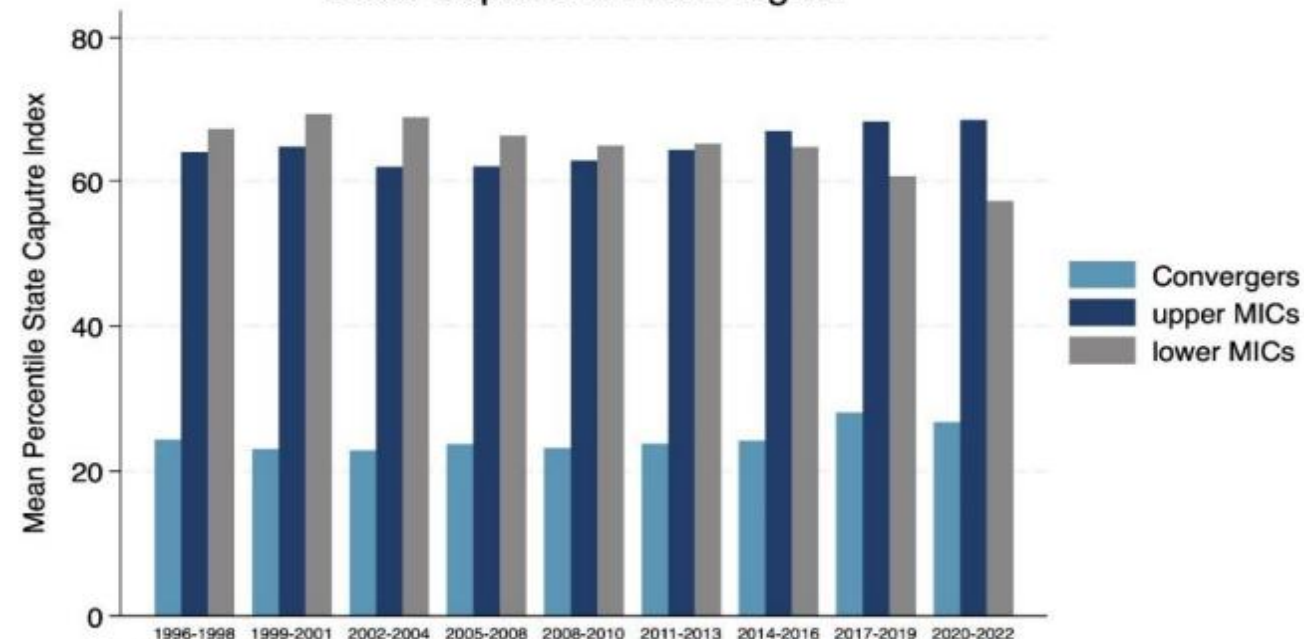
2020-22  2.7 93.7



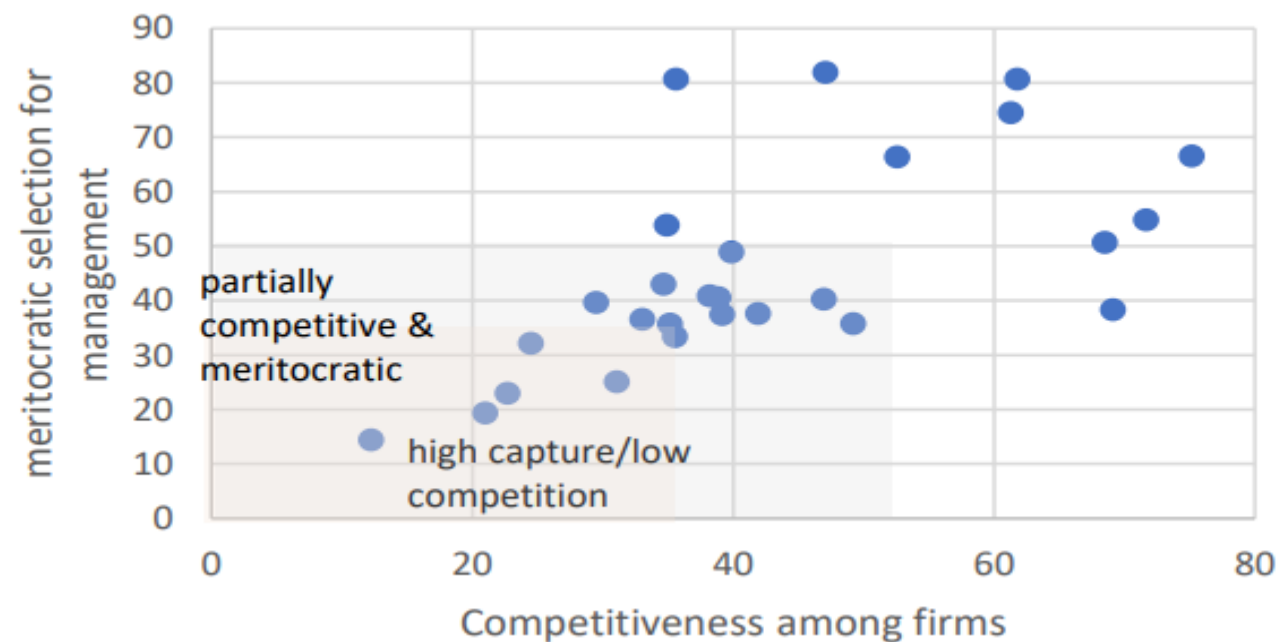
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- Convergents performed far better than both upper and lower ECA MICs since the start of the series
- While initially state capture was higher in lower than in upper MICs, the gap started closing from the late 2000s, and reversed since the late 2010s, as more lower than upper MICs sought to constrain capture tendencies
- Competitiveness among firms and the meritocratic selection of management of SOEs can offer one way of observing potential state capture (WEF data)
- Some Convergents have seen subsequent increases in state capture – becoming a break on their further growth

State Capture in ECA Region



Source: Kaufmann (2024)



The role of the state varies across functions and evolves over time

As Schumpeterian economic thinking has highlighted, the role of states is a combination of **'getting out of the way'**, setting a framework for private enterprise and investments, and taking action to provide certain goods and services.

General education

The state remains the main provider across the region

Higher education

Some public universities remain key knowledge hubs in the region; some private institutions are new centers of excellence with less government interference, while others are 'degree mills'

Energy sector

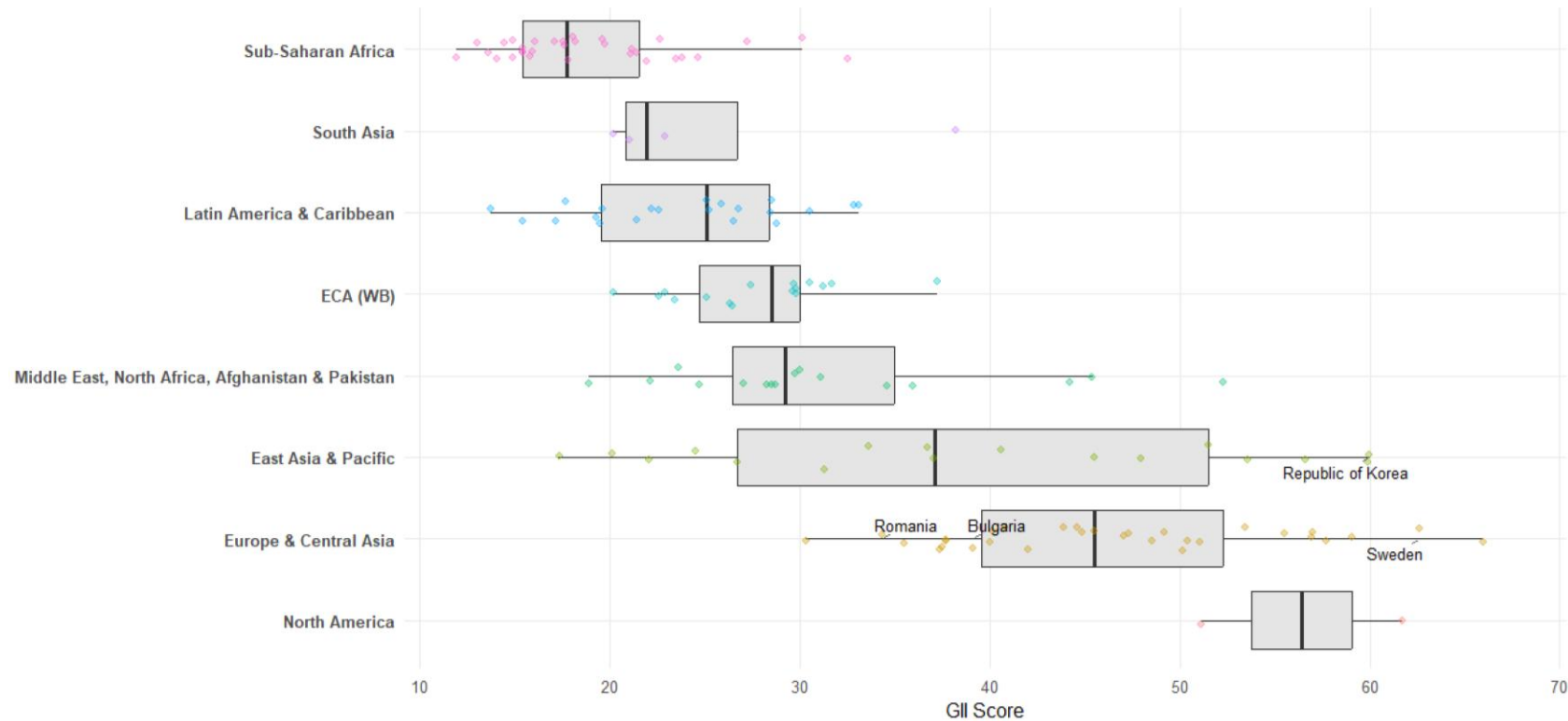
The role of states is currently facing a major re-configuration: energy transition is demanding and requires government orchestration to succeed

State's Role in Innovation

- Historically, states in ECA funded R&D and higher education
- Some countries maintained strong public R&D funding and selected good institutions, but lack a quality business and investment environment
- Lack of strong collaboration between universities, businesses, and the state
- Overregulation in/control of tertiary education leads to low flexibility & innovation-driven learning.

Key Factors Behind Successful Innovation Models: Estonia, Czechia, Poland, Baltics

Strong business-university partnerships
Incentives for the private sector to innovate
Favorable policies for entrepreneurship



Labels shown for Republic of Korea, Sweden, Romania, and Bulgaria

The Role of the State in MIC to HIC Transitions

- States and institutions play a crucial role in shaping markets and fostering innovation.
- Some ECA states effectively enable growth with efficient fiscal resource use.
- Others are reforming institutions to create open and supportive business environments.

Policy Implications

Improving institutional quality matters for the transition from MIC to HIC

‘Upscaling’ institutions requires social and political consensus, with a mandate and political will → EU accession processes can help to reinforce these, but not generate where they are absent

Large states – by fiscal, staffing or SOE footprints – have not been a hindrance for MIC to HIC transitions, but only as long as institutional quality ensures that these resources are used well enough

State capture continues to pose a risk in several MICs as well as in some HICs in ECA and can stifle competitive and dynamic markets at different stages

To regain higher growth performance, ECA states need to manage risks and pursue reforms both in good and in bad times

The role of the state needs to be calibrated across different functions, responding to policy challenges and objectives arising at different points in time.

The region’s most innovative economies also have some of the highest levels of institutional performance → improving institutions matters beyond reaching high income status

Thank you, G&I Partners!



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