WORLD BANK GROUP

Jobs and Prosperity

Europe and Central Asia Economic Update

Office of the Chief Economist

Fall 2025

WORLD BANK **ECA ECONOMIC UPDATE** FALL 2025

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Abbreviations

AI	artificial intelligence
bps	basis points
CBT	Central Bank of Türkiye
ECA	Europe and Central Asia
EMDEs	emerging markets and developing economies
EU	European Union
FDI	foreign direct investment
GDP	gross domestic product
ICT	information and communication technology
KKM	foreign-exchange protected deposit scheme [Türkiye]
PMI	Purchasing Managers' Index
Q2	second quarter
R&D	research and development
SME	small and medium-size enterprise
SOE	state-owned enterprise

Country codes

Albania	ALB	Montenegro	MNE
Armenia	ARM	Poland	POL
Azerbaijan	AZE	Republic of North Macedonia	MKD
Belarus	BLR	Romania	ROU
Bosnia and Herzegovina	BIH	Russian Federation	RUS
Bulgaria	BGR	Serbia	SRB
Croatia	HRV	Tajikistan	TJK
Georgia	GEO	Türkiye	TUR
Kazakhstan	KAZ	Turkmenistan	TKM
Kosovo	XKX	Ukraine	UKR
Kyrgyz Republic	KGZ	Uzbekistan	UZB
Moldova	MDA		

Regional classification used in this report

This report covers the emerging markets and developing economies (EMDEs) in Europe and Central Asia (ECA). These are divided into the following groups: Central Asia, Central Europe, Eastern Europe, the Russian Federation, the South Caucasus, Türkiye, and the Western Balkans.

Central Asia: Kazakhstan, Kyrgyz Republic, Tajikistan, Turkmenistan, Uzbekistan

Central Europe: Bulgaria, Croatia, Poland, Romania

Eastern Europe: Belarus, Moldova, Ukraine

Russian Federation

South Caucasus: Armenia, Azerbaijan, Georgia

Türkiye

Western Balkans: Albania, Bosnia and Herzegovina, Kosovo, Montenegro, Republic of North Macedonia, Serbia

Executive summary

Economic growth in Europe and Central Asia (ECA) has slowed but the region has remained resilient amid continued global and regional challenges. Regional gross domestic product is likely to grow by 2.4 percent in real terms this year, down from 3.7 percent in 2024, because of a weaker pace of expansion in the Russian Federation. Excluding Russia, which accounts for about 40 percent of the region's output, growth is likely to remain little changed at about 3.3 percent this year and next. Growth in Türkiye and Poland is set to strengthen to 3.5 percent and 3.2 percent, respectively, supported by strong consumer demand and robust investment growth. The pace of economic expansion in Central Asia—ECA's fastest growing subregion for the third consecutive year—is projected to firm to 5.9 percent in 2025 from 5.7 percent last year, driven by higher oil output in Kazakhstan, stronger remittances, and higher public and private investment spending.

Private consumption remains the main driver of growth in ECA, although its pace is moderating as real wage gains ease and job creation slows. Strong credit growth—especially in Central Asia, the South Caucasus, the Western Balkans, and Türkiye—continues to sustain household demand. In many countries, investment has propped up growth, supported by public infrastructure and defense spending and increased inflows of foreign direct investment. Exports are recovering modestly, with global trade policy uncertainty affecting supply chains and weighing on auto suppliers in Central Europe and the Western Balkans.

Higher food prices have pushed up inflation. Median annual inflation rose to 4.9 percent by August from 3.8 percent a year ago. Hikes in administered prices also contributed. Fiscal consolidations across ECA have mostly been delayed. In more than half of the countries, fiscal deficits are set to rise this year due to higher public investment, interest costs, social spending, and defense outlays.

Growth in ECA is expected to pick up only modestly to 2.6 percent on average in 2026–27. In Russia, growth is likely to weaken further to 0.8 percent next year before picking up slightly to 1 percent in 2027. In contrast, economic expansion in Türkiye is expected to continue gaining momentum, with growth reaching 4.4 percent in 2027. Private consumption, supported by wages, remittances, and social transfers; continued infrastructure spending; and a gradual recovery in trade outside Russia are likely to sustain growth across the region. Nonetheless, there are substantial downside risks. Slow progress in advancing structural reforms has limited the scope for productivity growth to rebound and convergence to high income status to accelerate. Trade and geopolitical tensions and persistent inflation pressures have also heightened the region's vulnerabilities.

Weakening reform momentum and slowing productivity growth resulted in positive but modest job creation in the ECA region after the 2008 Global Financial Crisis. Developments since then have contrasted with the remarkable gains across the region in the late

1990s and early 2000s, reflecting the start of the transition from planned to market economies and deeper integration into the global economy. Since then, job creation in ECA has been faster than population growth but smaller than in other developing regions with much larger increases in population. The number of people employed in ECA grew by 12 percent between 2009 and 2024. That exceeded the 7 percent increase in the region's population, even with the substantial migration many countries experienced. Jobs growth has been driven largely by higher participation rates and a shift away from agriculture into services, which now account for over half of all jobs. Many of the new service jobs have been in low-skill occupations, even as employment in information technology and other global innovator services in the region also increased.

Rising labor force participation is a welcome development that has supported employment growth in many parts of ECA, especially Türkiye and the Western Balkans. Higher labor force participation—especially by women—accounted for just under one-half of gross job creation in ECA between 2010 and 2023. This is remarkable given that labor force participation rates in many ECA countries are already among the highest in the world. Nevertheless, significant underutilization persists among specific groups, with female and youth labor force participation rates in the region well below the levels observed in high-income European countries. A substantial portion of the region's underutilized labor resources could be mobilized to mitigate the effects of a declining working-age population.

Young and dynamic firms, together with very large firms, generate almost all the net job creation in ECA. Startups and young small and medium-sized enterprises account for 14 percent of total employment in ECA but almost 40 percent of gross jobs created. Large businesses also contribute substantially to net job creation. By contrast, mature small and medium-sized enterprises tend to eliminate more jobs than they create.

In contrast to high-income economies, despite substantial changes in the global and regional economic environment, job responsiveness to productivity growth in ECA has remained stable over the past decade. On average, a 1 percent increase in productivity translated into a 0.9 percent increase in employment in the region. Therefore, strong productivity growth is essential for job creation.

Unless resolved, structural impediments will limit the region's productivity growth and jobs potential. Several persistent obstacles exist: an abundance of small firms that rarely scale up; subdued competition; high barriers to entry and exit; underdeveloped credit; inefficient allocation of capital and talent; outdated education and training systems, resulting in skills mismatches; and underinvestment in lifelong learning. State-owned enterprises often distort the competition environment, and they create half as many jobs and eliminate twice as many jobs, compared to private firms.

Demographic headwinds—including aging and low fertility rates—also threaten labor market resilience. Fertility is below replacement in most of the region, and the working-age

population is projected to fall by about 17 million by 2050. Unlike the rest of the region, however, Central Asia and Türkiye will see significant increases in the working-age population, creating the need for more jobs.

Turning resilience into stronger growth in productivity and jobs requires bold reforms. Part II of this update is structured around three pillars of the jobs challenge that policy makers in the region need to consider to strengthen the link between economic growth and employment, reduce distortions, unlock the region's underutilized labor potential, and help manage complex labor market transitions.

First, they need to create the infrastructure foundations for jobs, including health care, education, skills training, transportation, and energy. These investments support inclusive labor market participation and productivity and are essential to mobilize underutilized labor, increase female and youth participation rates, and support the structural transformation needed for convergence to high-income status.

Second, strengthening governance and business-enabling policies is essential to ensure a predictable regulatory environment, simplify taxes, and deepen trade and competition. Reforms of state-owned enterprises should prioritize performance, governance, and a level playing field while supporting affected workers. Deeper trade integration will enable firms to join dynamic value chains and increase their returns on innovation.

Third, mobilizing private capital is critical for investments that can drive sustainable job creation. Countries stand to gain from promoting policies to support businesses through financing, equity investments, guarantees, and political risk insurance. These policies include co-investment programs, public-private partnerships, and support to local financial intermediaries. Such policies not only bring in much-needed private capital to strategic sectors but can also expand access to risk capital.

Sectoral priorities must complement structural reforms. To translate these pillars into tangible employment gains, countries should orient sectoral policy toward five priority areas. Agribusiness can support rural development and absorb informal labor. Value-added manufacturing can anchor tradable employment and raise productivity. Tourism offers opportunities to engage youth and catalyze service ecosystems. Health care expands higher-skilled employment. Energy and infrastructure underpin competitiveness and green growth.

The region's heterogeneity implies that countries cannot follow a single approach. For instance, compared to the rest of the region, the demographic pressures are different in Central Asia and Türkiye, where increasing the number of jobs employing the growing young population is an urgent priority. In the Western Balkans or Central Europe, in a context of a shrinking workforce, it will be crucial to upgrade jobs in terms of quality and productivity. Success will depend on country ownership, tailored approaches, and leveraging assets such as human talent and natural resources.

Central Asia's sectoral growth is likely to be driven by expanding agrifood and livestock processing. The region will also benefit from developing transport and logistics along Eurasian corridors, investing in renewable energy, and targeting specific manufacturing niches. In addition, the tourism industry can leverage Central Asia's exceptional heritage sites and rich cultural assets.

Across Central Europe, the most promising dynamic opportunities center on manufacturing and energy value chains, modern tradable services, and support for the aging population. These countries have strong potential in green manufacturing and energy, as well as a broad range of offshore business services, including software development, business process outsourcing, accounting, and architectural and engineering services.

Türkiye's biggest opportunities for growth and job creation lie in tradable services and logistics, upgrading global value chain–linked manufacturing, renewable energy, care services that increase female participation, and digital and information and communications technology–enabled services.

Ukraine's economy is undergoing a significant transformation, with the emergence of new sectors and productivity upgrades in existing industries likely to contribute to job creation. Information technology and digital industries, along with agriculture and agro-processing, have emerged as Ukraine's main comparative advantages. In addition, defense and associated industries have the potential to generate employment opportunities for skilled workers.

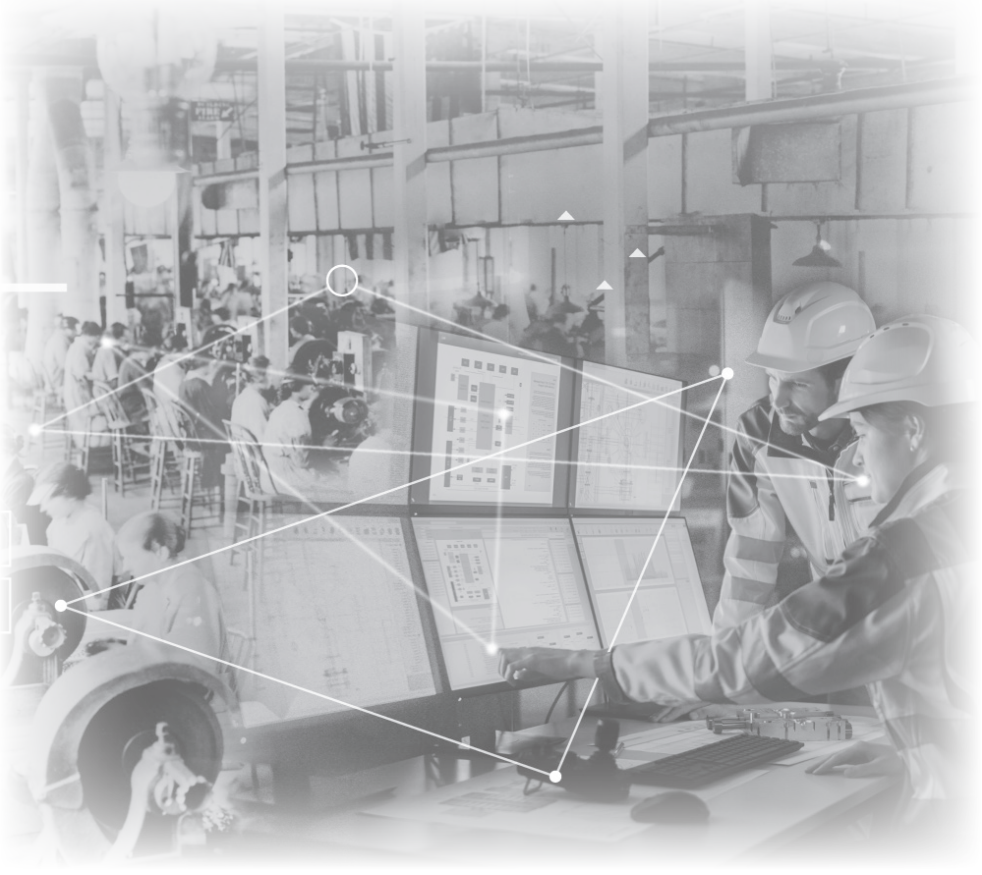
The Western Balkans presents robust opportunities for agribusiness and food processing, tourism diversification and upgrading, targeted light manufacturing (notably automotive parts), and care services.

The South Caucasus stands out for opportunities in renewable energy and exportable digital business services. The South Caucasus's position on the Middle Corridor also creates a platform for growth in regional transport and logistics services.

Across the remainder of ECA, sectoral growth is expected to be driven by deeper integration with the European Union, modernization of financial intermediation, advancement in high-value agriculture, and expansion of digital service offshoring.

PART

Recent Developments, Policies, and Outlook



Recent economic developments

Slowing economic growth

Growth in Europe and Central Asia (ECA) is projected to slow. Regional gross domestic product (GDP) is likely to grow by 2.4 percent this year and in 2026, down from 3.7 percent in 2024, because of a weaker pace of expansion in the Russian Federation. Excluding Russia, which accounts for about 40 percent of the region's output, growth is likely to remain little changed at about 3.3 percent this year and next (table 1.1).

Growth in Russia is projected to weaken to 0.9 percent this year from 4.3 percent in 2024, well below the 2000–24 average of 3.4 percent. Activity in non-defense sectors has been squeezed by high borrowing costs, shrinking consumer credit, and worker shortages. Growth is slower this year than in 2024 in more than 60 percent of the countries in the ECA region, including Eastern Europe, the South Caucasus, and the Western Balkans, contributing to the weaker regional momentum. However, since June, growth projections have been raised in over half of the countries, by an average of 0.9 percentage point. Growth is expected to be stronger in Central Asia, Poland, and Türkiye, leaving ECA's growth outside Russia broadly resilient (figure 1.1).

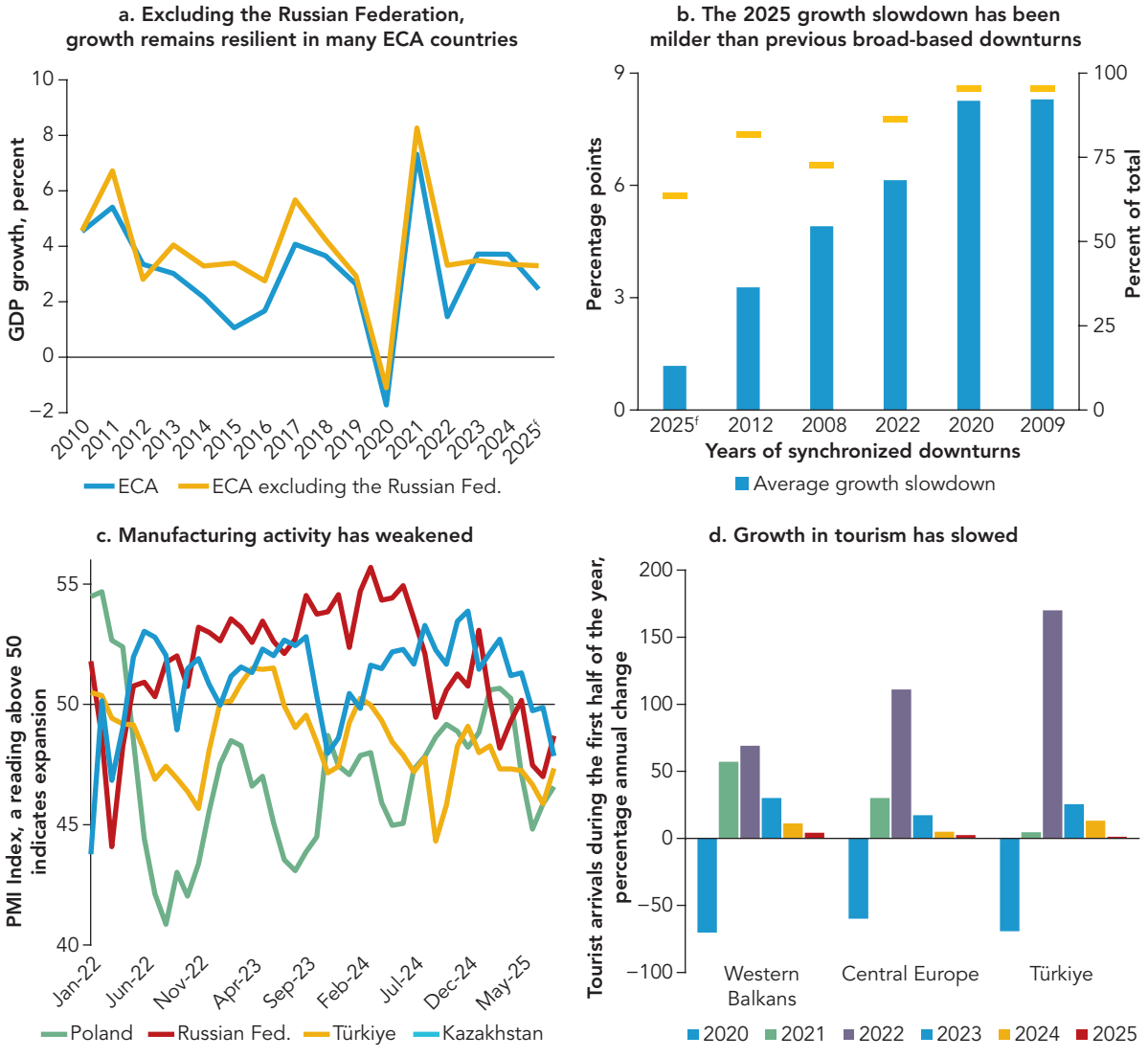
Domestic demand is the main source of ECA's resilience. Private consumption, in turn, is the main driver of domestic demand, but it is growing more slowly this year amid moderating wage growth and higher inflation. In contrast, investment is expanding more strongly. Among the sectors of the economy, services remain the key driver of activity and job growth across the region, underpinned by domestic demand. There are signs that momentum is beginning to ease in some service sectors. Notably, tourist-arrivals, having already surged to near-record, have less room for further large gains. In Central Asia and the South Caucasus, the earlier boost from trade is also fading.

TABLE 1.1. Europe and Central Asia Economic Growth Summary, 2022–27
(Real GDP growth at market prices in percent, unless indicated otherwise)[a]

	2022	2023	2024	2025f	2026f	2027f	Percentage point differences from June 2025 projections 2025f	2026f	2027f
ECA	**1.5**	**3.7**	**3.7**	**2.4**	**2.4**	**2.7**	**−0.1**	**−0.1**	**0.0**
ECA excl. the Russian Federation	3.3	3.5	3.4	3.3	3.3	3.7	0.2	−0.1	0.1
Central Europe	**5.0**	**1.0**	**2.4**	**2.5**	**2.6**	**2.7**	**−0.2**	**−0.1**	**−0.1**
Bulgaria	4.0	1.9	2.8	3.0	2.9	3.1	1.0	0.7	0.7
Croatia	7.3	3.3	3.9	3.1	2.9	2.7	0.0	−0.1	−0.1
Poland	5.3	0.1	2.9	3.2	3.0	2.9	0.0	0.0	0.0
Romania	4.0	2.4	0.8	0.4	1.3	1.9	−0.9	−0.6	−0.6
Eastern Europe	**−20.0**	**4.6**	**3.1**	**1.9**	**1.8**	**3.4**	**−0.1**	**−1.8**	**0.2**
Belarus	−4.7	3.9	4.0	1.9	1.3	0.8	−0.3	0.1	0.0
Moldova	−4.6	1.2	0.1	1.5	2.7	3.8	0.6	0.3	−0.6
Ukraine	−28.8	5.5	2.9	2.0	2.0	5.0	0.0	−3.2	0.5
Central Asia	**4.3**	**5.6**	**5.7**	**5.9**	**5.0**	**4.6**	**0.9**	**0.6**	**0.3**
Kazakhstan	3.2	5.1	5.0	5.5	4.5	3.9	1.0	0.9	0.4
Kyrgyz Republic	9.0	9.0	9.0	9.2	6.5	6.8	2.4	1.0	1.0
Tajikistan	8.0	8.3	8.4	7.6	5.2	4.7	0.6	0.3	0.0
Uzbekistan	6.0	6.3	6.6	6.2	6.0	5.9	0.3	0.1	0.1
South Caucasus	**7.3**	**3.8**	**5.7**	**3.7**	**3.3**	**3.1**	**0.1**	**−0.1**	**−0.3**
Armenia	12.6	8.3	5.9	5.2	4.9	4.7	1.2	0.7	0.2
Azerbaijan	4.6	1.1	4.1	1.9	1.8	1.7	−0.7	−0.6	−0.6
Georgia	11.0	7.8	9.4	7.0	5.5	5.0	1.5	0.5	0.0
Western Balkans	**3.5**	**3.5**	**3.6**	**3.0**	**3.1**	**3.6**	**−0.2**	**−0.4**	**−0.1**
Albania	4.8	4.0	4.0	3.7	3.5	3.5	0.5	0.4	0.4
Bosnia and Herzegovina[b]	4.2	2.0	3.0	2.6	3.0	3.2	−0.1	−0.1	−0.3
Kosovo	4.3	4.1	4.4	3.8	3.8	3.9	0.0	0.0	0.1
Montenegro	7.7	6.5	3.2	3.3	3.2	3.2	0.3	0.3	0.2
North Macedonia	2.8	2.1	2.8	3.1	3.0	3.0	0.5	0.3	0.2
Serbia	2.6	3.8	3.9	2.8	3.0	4.0	−0.7	−0.9	−0.2
Russian Federation	**−1.4**	**4.1**	**4.3**	**0.9**	**0.8**	**1.0**	**−0.5**	**−0.4**	**−0.2**
Türkiye	**5.4**	**5.0**	**3.3**	**3.5**	**3.7**	**4.4**	**0.4**	**0.1**	**0.2**

Source: World Bank.
Note: ECA = Europe and Central Asia; f = forecast; GDP = gross domestic product.
a. GDP is measured in average 2010–19 prices and market exchange rates.
b. GDP growth rate at constant prices is based on production approach.

FIGURE 1.1. Slower but resilient growth



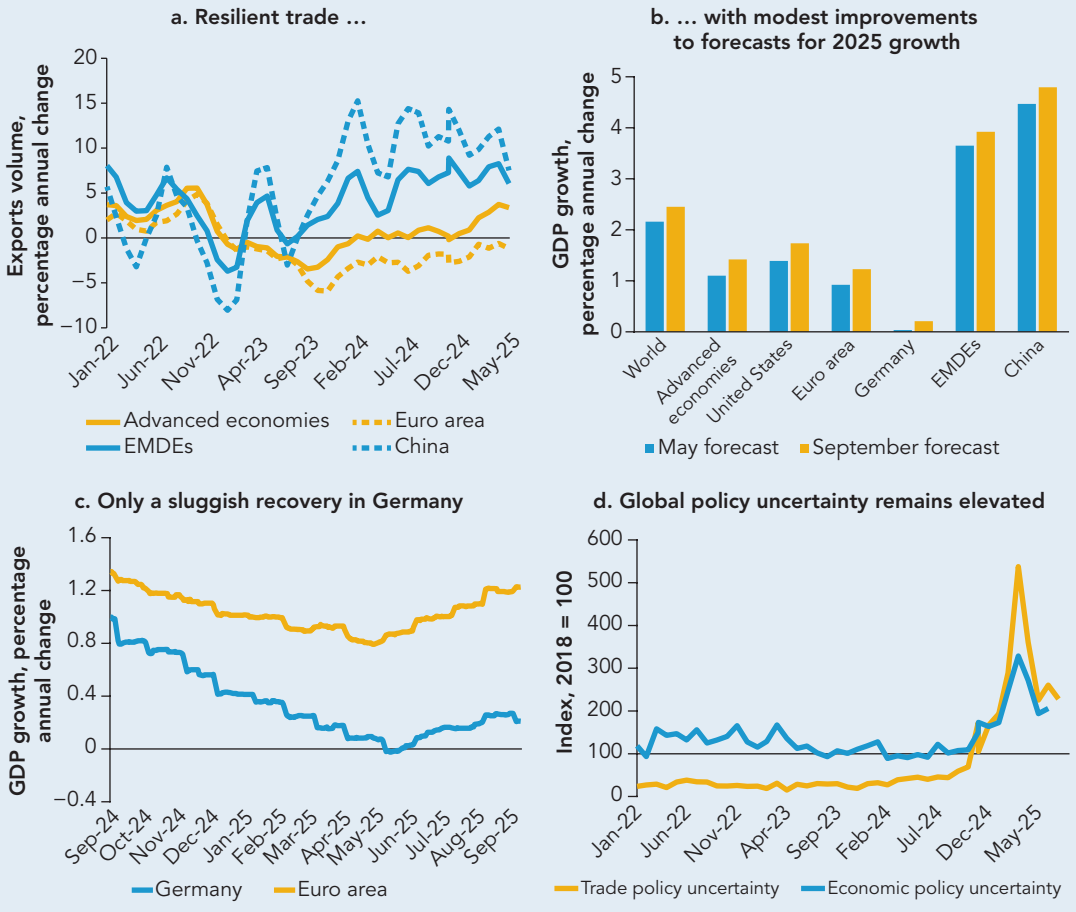
Source: Haver Analytics; Eurostat; national statistical offices; World Bank.
Note: ECA = Europe and Central Asia; GDP = gross domestic product; f = forecast; PMI = Purchasing Managers' Index.
a. GDP aggregates are measured in average 2010–19 prices and market exchange rates.
b. A synchronized downturn is defined as an episode when growth falls below the previous year's level in at least 60 percent of all countries.
c. The last observation is August 2025.
d. Aggregates are medians. The last observation is June 2025.

Unlike services, weakness lingers in ECA's export-dependent manufacturing. Goods exports are recovering slowly in many countries, weighed down by increased trade policy uncertainty; a slow rebound in the euro area, ECA's largest trading partner; and the steep growth slowdown in Russia (box 1.1). Manufacturing activity has remained in contraction across all major ECA economies since June—the first simultaneous downturn since the COVID-19 pandemic. Rising labor costs, which continue to increase at double-digit rates in

BOX 1.1 Resilient global growth, sluggish economic expansion in the euro area

Global growth and trade have been more resilient this year than was predicted earlier. Consensus global growth forecasts for 2025 rose to 2.5 percent in September from 2.2 percent in May (figure B1.1.1). The US economy's performance has been the single most important factor shaping positive global growth surprises in recent years. It appears that the near-term impact of trade tensions may be more limited than what economists had expected.

FIGURE B1.1.1. Resilient but sluggish global growth



Sources: Consensus Economics; https://www.policyuncertainty.com/; World Bank.
Note: EMDEs = emerging markets and developing economies; GDP = gross domestic product.
a. Three-month moving averages. The last observation is June 2025.
b., c. The last observation is September 2025.
d. The last observation is August 2025.

(continued next page)

BOX 1.1 (continued)

A modest recovery in the euro area. Consensus forecasts for the euro area suggest that growth is set to recover only gradually to 1.2 percent in 2025 from 0.9 percent in 2024, mainly reflecting persistent weakness in Germany. The euro area is the largest trading partner of the countries in Europe and Central Asia, and Germany is the predominant destination for exports from Central Europe and the Western Balkans through automotive and other value chains.

Downside risks prevail. Policy uncertainty, rising public debt, and growing protectionism continue to pose risks for private investment. Renewed inflationary pressures and softening labor markets could complicate monetary policy in the United States, raising the risk of asset repricing and increased financial volatility.

Central Europe and the Western Balkans, are also putting pressure on ECA's economies. Moreover, ECA's exporters are facing tougher competition from increased EU imports from East Asia (Boeckelmann et al. 2025). In contrast, manufacturing in many Central Asian economies has continued to grow, sustained by domestic demand and limited exposure to developed markets.

Growth in the biggest economies, other than Russia, is strengthening. Growth in Türkiye and Poland, the second and the third largest economies in ECA, is expected to firm to 3.5 percent and 3.2 percent, respectively, underpinned by resilient services, investment, and robust consumer demand. Growth in Central Asia is likely to strengthen to 5.9 percent in 2025 from 5.7 percent last year, supported by rising oil output in Kazakhstan, strong remittance inflows, and sustained public and private investment. In contrast, growth in the South Caucasus is projected to moderate to 3.7 percent in 2025 from 5.7 percent last year, reflecting declining hydrocarbon output in Azerbaijan, where oil output already fell by about 5 percent in the first half of 2025.

Growth in the Western Balkans is projected to ease to 3 percent in 2025 from 3.5 percent in 2024, amid political uncertainty in some countries. Construction—a key driver of recent expansions across the Western Balkans—is also losing steam after a prolonged boom, weighed down by labor shortages and rising costs.

Growth in Ukraine is projected to weaken. The economic expansion in Ukraine is likely to slow to 2 percent in 2025 from 2.9 percent in 2024 as Russia's prolonged invasion affects investment and business activity. Gas imports reached their highest level in nearly two years as infrastructure damage constrained domestic production. Weaker agricultural exports also slowed growth, reflecting unfavorable weather and the European Union's reintroduction of the pre-invasion trade regime, which tightened restrictions on key Ukrainian agri-food

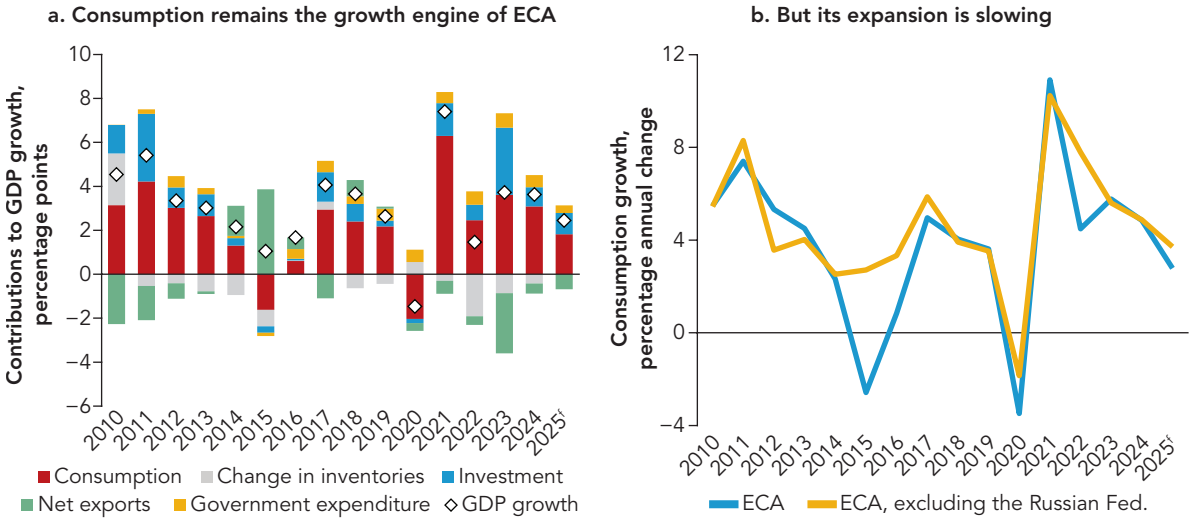
exports. During the first half of 2025, the value of exports dropped by almost 5 percent amid a contraction of exports to the European Union, the destination of almost 60 percent of Ukraine's shipments abroad.

Consumption growth in ECA has slowed

Consumer demand, the growth engine of ECA's recent expansion, has cooled because of smaller real wage gains and weaker job creation. With nominal wage growth slowing and inflation on the rise again, real wage increases have stalled (figure 1.2). As a result, the contribution of private consumption to overall growth is likely to drop to less than 2 percentage points this year from 3.1 percentage points in 2024 and 2.7 percentage points in 2000–24 on average.

Several countries are likely to see consumption growth slow sharply, held back by tighter policies and weak overall expansions. Romania's consumption growth is projected to slow to about 1.1 percent this year from 5 percent on average during 2000–24 as fiscal consolidation weighs on spending and inflation stays elevated. The volume of retail sales in Romania grew by just 3.1 percent in January-July this year, compared to nearly 9 percent in 2024. Reflecting weak consumer demand, new car registrations in Romania dropped 22 percent in the first half of the year, although delays in the government's car scrappage scheme weighed heavily on car demand as well (box 1.2). Consumption growth in Russia is likely to decline to just 1.2 percent this year, well below the 5.4 percent 2000–24 average.

FIGURE 1.2. Moderating consumption growth



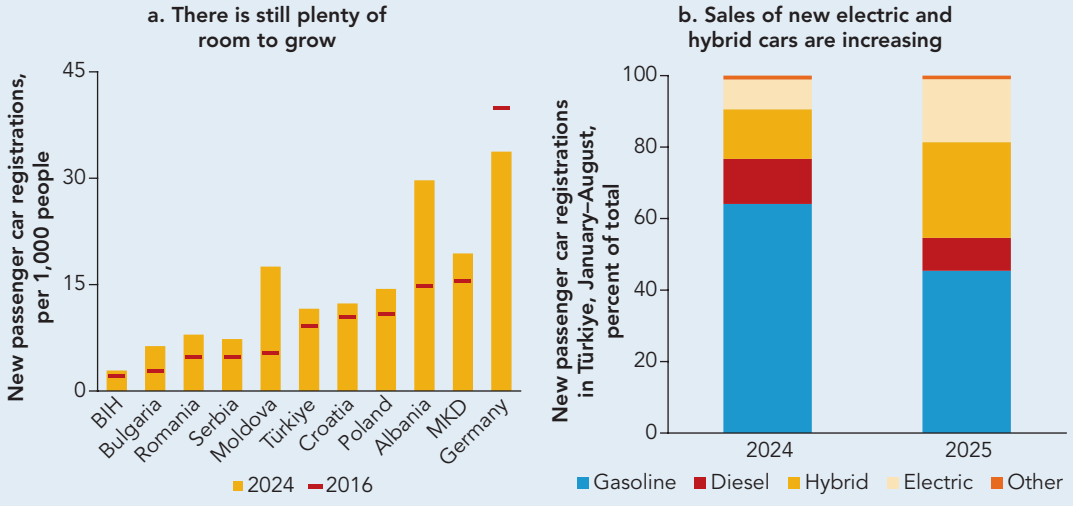
Source: World Bank.
Note: ECA = Europe and Central Asia; f = forecast; GDP = gross domestic product.
a. Aggregates are averages using GDP weights measured in average 2010–19 prices and market exchange rates. Investment denotes gross fixed capital formation.
b. Aggregate growth rates are weighted averages using real GDP weights.

BOX 1.2 Passenger car sales

New car registrations in Europe and Central Asia have surged in recent years, driven by resilient consumer demand and low rates of car ownership across the region. Between 2016 and 2024, registrations more than doubled in Bulgaria, tripled in Moldova, and rose over 30 percent elsewhere in the region, even as they fell by 11 percent in the European Union (figure B1.2.1). The strong momentum continued into 2025 in many countries, with registrations more than doubling in Albania in the first half of the year and rising 7 percent in Bulgaria and Croatia.

Registrations in Türkiye declined by more than 10 percent, however, reflecting higher car loan interest rates, sharp currency depreciation, and increased taxes. At the same time, the region is rapidly shifting toward cleaner vehicles. In Romania, for example, new registrations of hybrids and plug-in hybrids rose substantially despite a steep drop in overall registrations. In Türkiye, hybrid and electric vehicles now account for nearly 45 percent of all registrations, up from about 22 percent a year ago.

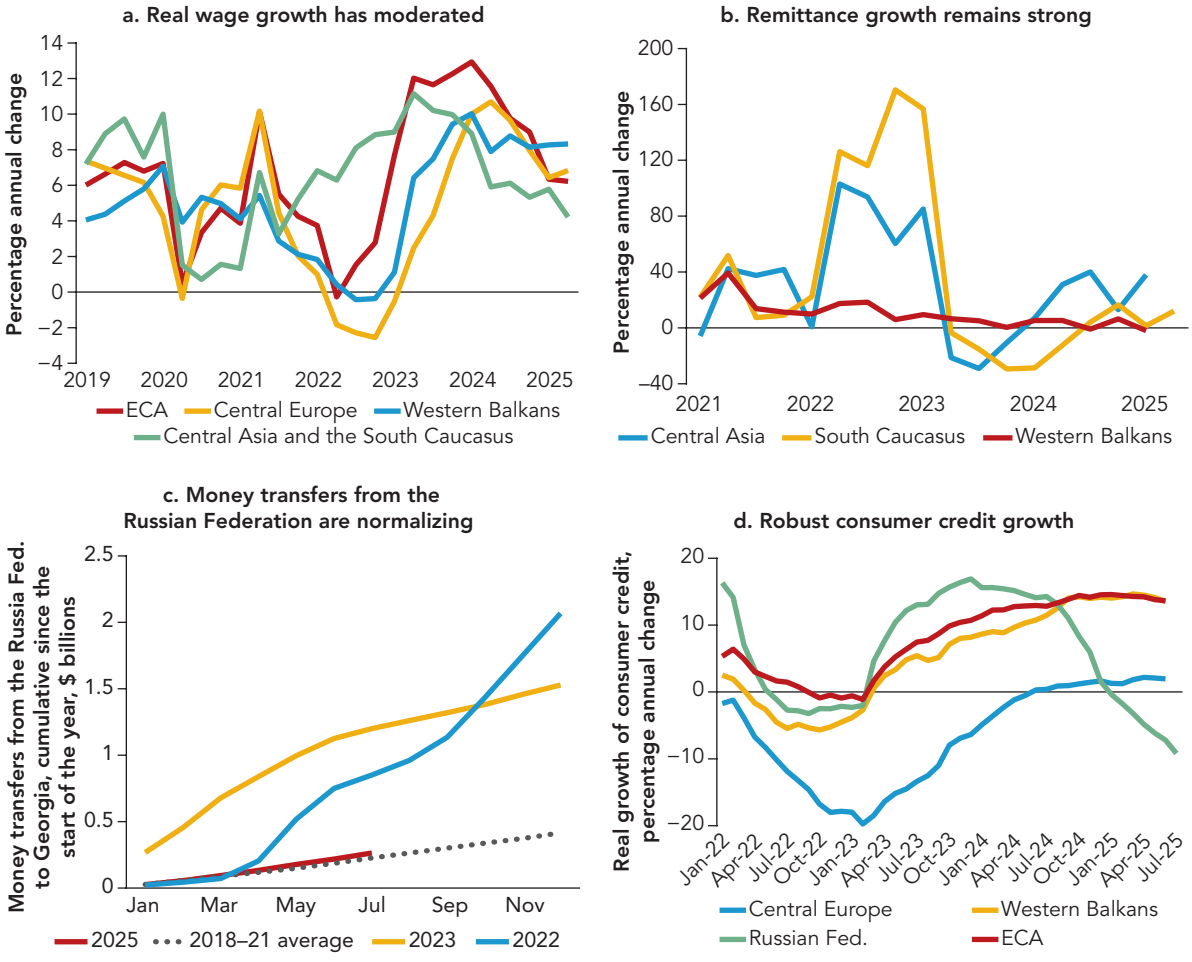
FIGURE B1.2.1. New car registrations are up in ECA



Sources: Eurostat; Turkish Statistical Institute; World Bank.
Note: ECA = Europea and Central Asia.
a. BIH = Bosnia and Herzegovina; MKD = North Macedonia. Data for Albania are from 2019.
b. The last observation is August 2025.

Elsewhere in ECA, consumption is still supported by rising wages, remittances, and social transfers. In Bulgaria, household demand has strengthened on the back of a higher minimum wage and rising pensions. In remittance-dependent economies, including those in Central Asia, the South Caucasus, and the Western Balkans, household consumption is also supported by larger inflows of personal transfers (figure 1.3). For example, remittance flows to Uzbekistan surged 27 percent year-on-year to $8.2 billion in the first half of 2025,

FIGURE 1.3. Drivers of consumer demand are pulling in different directions



Sources: International Monetary Fund; national central banks; World Bank.
Note: ECA = Europe and Central Asia.
a. Real wage growth is calculated as the difference between nominal wage growth and the headline inflation rate. The last observation is the second quarter (Q2) of 2025.
b. The last observation is Q2 2025. South Caucasus includes Armenia and Georgia.
c. The last observation is July 2025.
d. Real credit growth is calculated as the difference between nominal credit growth and the headline inflation rate. Aggregates are averages. ECA excludes Türkiye and the Russian Federation. The last observation is June 2025.

fueled largely by an increase in transfers from Russia, which accounted for nearly four-fifths of the total. In Tajikistan, where remittances amounted to almost 50 percent of GDP last year, personal transfers grew by more than 60 percent in the first quarter of 2025. Remittance growth in the South Caucasus remains resilient as well, even as money transfers from Russia are normalizing following the surge in 2022–23. Money transfers rose by 9.2 percent year-on-year during January-July in Armenia and 5 percent in Georgia, as a drop in transfers from Russia—down nearly 30 percent in Georgia's case—was offset by higher remittances from the European Union and the United States.

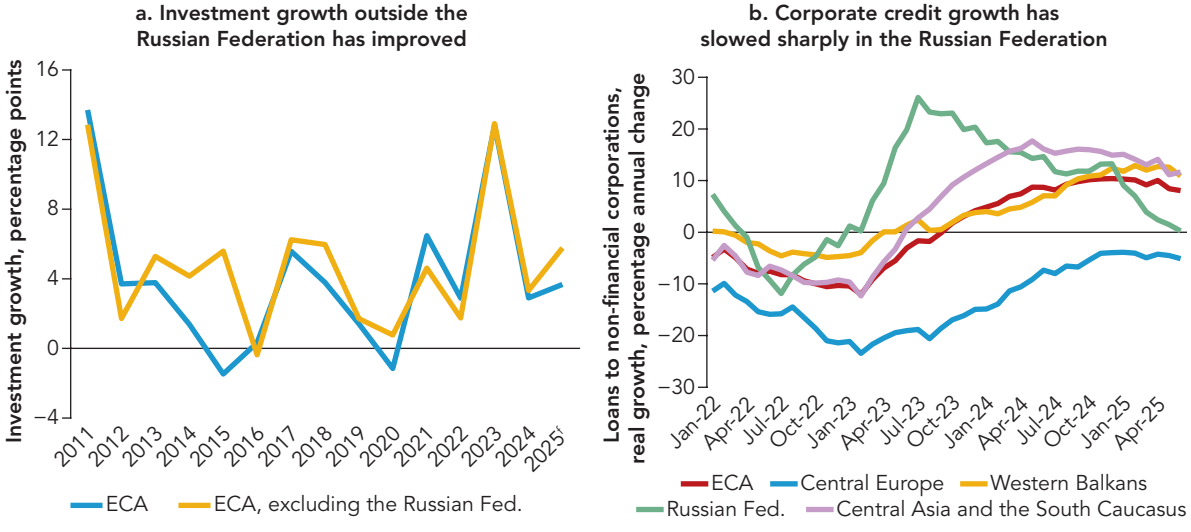
Strong increases in consumer credit have propped up private consumption. Credit growth has been particularly robust in Central Asia, the South Caucasus, and the Western Balkans, where lending to households continues to rise at double-digit rates. In Türkiye, consumer credit growth strengthened in real terms in recent months, increasing to 13 percent year-over-year in July, the highest since end-2023, as households' use of credit cards rose steeply. In contrast, in Russia, tighter monetary policy led to credit contracting by almost 9 percent in real terms year-on-year in July.

Investment growth has strengthened

Investment growth in ECA is likely to improve to 3.4 percent in 2025 from 2.6 percent in 2024, with about half the countries seeing faster expansions. Public investment spending, particularly on infrastructure and defense; increasing inflows of foreign direct investment (FDI); and robust private investments in construction are the key drivers of the continued resilience in investment spending.

The regional picture is uneven. Excluding Russia, investment growth is expected to strengthen to about 6 percent this year from 3.3 percent in 2024 (figure 1.4). Resilient growth and pro-market reforms have improved Central Asia's appeal to foreign investors, supporting some of the fastest investment growth rates across the region, averaging close to 8 percent in 2025. For example, inflows of FDI to Uzbekistan reached a record $11.9 billion in 2024. Strong growth continued this year as well, with external sources accounting for almost two-thirds of all investments. Urban infrastructure, transport, and renewable projects, backed

FIGURE 1.4. Investment growth is likely to strengthen



Source: Haver Analytics; national central banks; World Bank.
Note: ECA = Europe and Central Asia; f = forecast.
a. Aggregate growth rates are weighted averages using real gross domestic product weights.
b. Aggregates are averages. Real growth of corporate lending is calculated as the difference between the nominal growth rate and the headline inflation rate. The last observation is June 2025.

by public spending, are fueling strong investment momentum. Technology investment is also rising in Uzbekistan: an artificial intelligence–enabled and sustainable facility is being constructed at Tashkent's IT Park and another is planned in the Bukhara region, with total investment projected at $5 billion by 2030. Likewise, the Kyrgyz Republic is seeing sustained investment growth, fueled by FDI inflows, increasing corporate credit, and government spending on large infrastructure projects in transport and energy.

In Eastern Europe, investment growth is projected to average nearly 17 percent this year. EU-supported investments are an important driver, together with a recovery of construction in Moldova and an increase in Ukraine's infrastructure repair and defense–related spending.

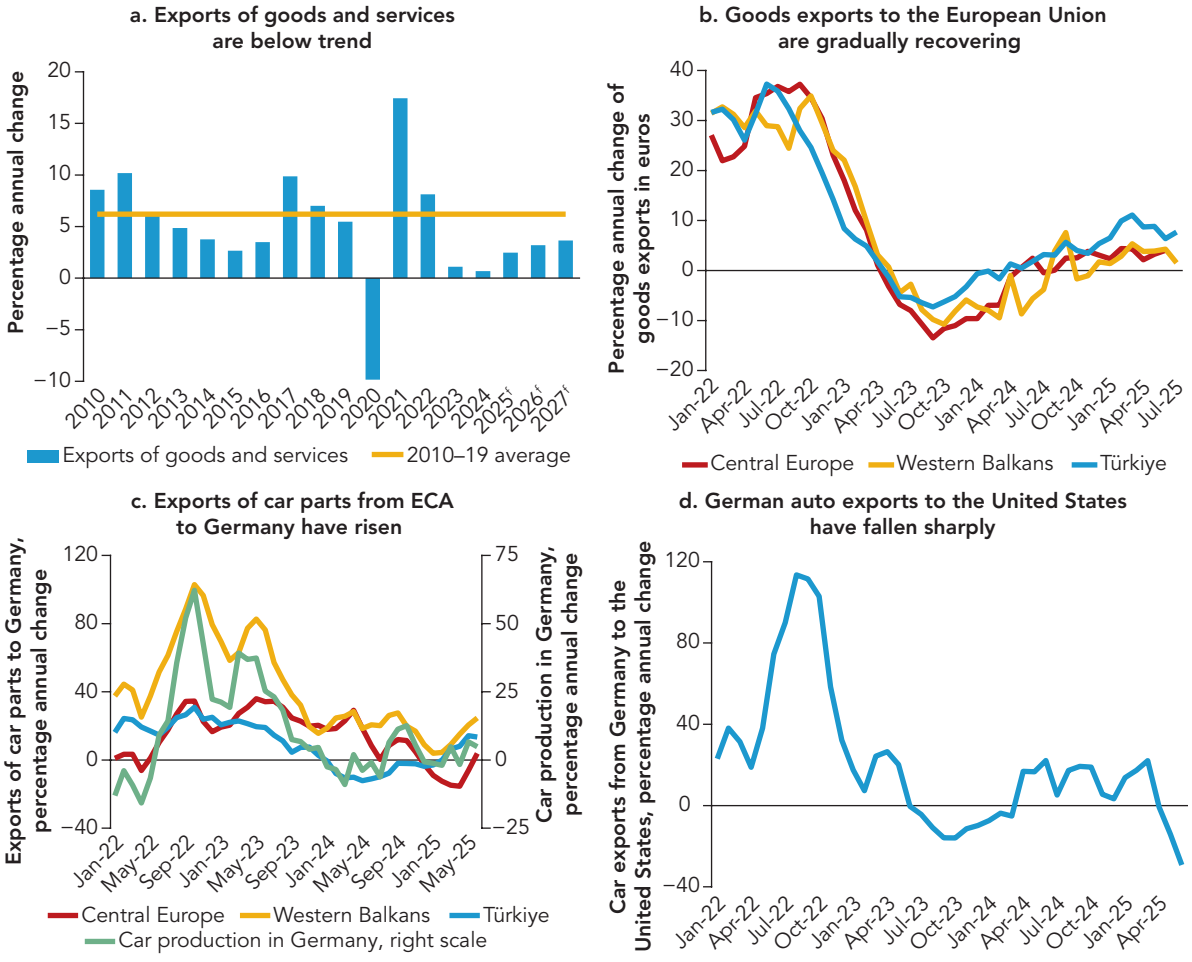
Investment growth in Central Europe is likely to recover to 5.4 percent on average this year from less than 2 percent in 2024. This is supported in part by EU-funded projects and lower borrowing costs. In contrast, momentum is softer in the South Caucasus and the Western Balkans, where investment growth is expected to moderate to 4.4 percent on average, although with important variations across countries. Investment growth in North Macedonia remains driven by large transport infrastructure projects. In Serbia, however, the completion of several large infrastructure projects last year, including key highways, and political uncertainty are expected to weigh heavily on activity in construction, with investment growth projected to slow to 3.1 percent in 2025 from 12.5 percent last year.

Investment is expected to decline slightly in Russia because of tighter policies, high borrowing costs, and the softening economic outlook. The growth of corporate credit has already moderated sharply, and mounting credit risks further constrain banks' profitability and capacity to extend new lending. The shares of overdue mortgages and consumer credit rose to 3.7 percent and 17 percent of the totals, respectively, from 1.4 percent and 10.6 percent at the start of this year. In Türkiye, investment growth is expected to recover moderately amid improving activity in construction, where growth is underpinned by public investment in reconstruction and urban renewal as well as resilient housing demand.

Stronger exports

Exports are projected to recover despite mounting uncertainty and rising headwinds. Growth of exports of goods and services in ECA, excluding Russia, is expected to increase to 2.5 percent this year from near stagnation in 2023–24 as the pace of economic recovery strengthens in the European Union. However, amid increased global uncertainty and still sluggish economic expansion in the European Union, ECA's exports are growing at a much slower pace than before the pandemic (figure 1.5). On the upside, buoyed by robust participation in automotive value chains and sustained competitiveness, exports to Germany—the largest trading partner for most countries in Central Europe and the Western Balkans—are recovering, with some countries performing especially well. In Serbia, for example, strong growth of the domestic automotive cluster, supported by surging exports of newly started

FIGURE 1.5. Modest recovery of exports



Sources: Eurostat; Federal Statistical Office, Germany; German Association of the Automotive Industry; World Bank.
Note: ECA = Europe and Central Asia; f = forecast.
a. Aggregate growth rates are weighted averages using real gross domestic product weights.
b. Three-month moving averages. Regional aggregates are medians. The last observation is July 2025.
c., d. Three-month moving averages. The last observation is June 2025.

production factories, is helping offset weakness elsewhere in the economy. Although a gradual recovery is underway, trade remains volatile as increased policy uncertainty and new trade barriers keep disrupting global supply chains. Indeed, headwinds are already intensifying for Europe's auto supply chains. Germany's car exports to the United States plunged by nearly 30 percent in the second quarter of 2025 because of the higher tariffs, a setback that is likely to impact ECA suppliers.

In ECA's oil exporting countries, trade flows have been hit by lower energy prices and lower global demand. Crude oil production continues to decline, reflecting the depletion of oil fields in Azerbaijan and the effects of sanctions and weak investments in Russia. In

contrast, crude oil production has grown strongly in Kazakhstan thanks to expanded output at major oil fields like Tengiz. The recent interruption of oil shipments through the Baku-Tbilisi-Ceyhan pipeline could dent exports in the coming months.

Weak global demand and the rising supply of crude oil are creating strong downward pressures on global oil prices. Prices have dropped by almost 15 percent since January and are expected to decline by almost 8 percent next year (World Bank 2025a). Energy exports represent 85 percent of total exports of goods in Azerbaijan and over 50 percent in Kazakhstan and Russia. Lower energy exports are already weighing on those countries' external balances.

Even excluding the energy producers, the current account deficit in the region is expected to weaken. This reflects continued strong demand for imports, underpinned by resilient consumption and stronger growth of domestic investment. For example, Türkiye's current account deficit, excluding gold, jumped by 75 percent year-on-year in the first half of 2025 to about 1 percent of projected full-year GDP, driven by rising imports of consumer goods and energy. For the full year, the deficit is expected to widen to 1.2 percent of GDP, up from 0.7 percent of GDP in 2024.

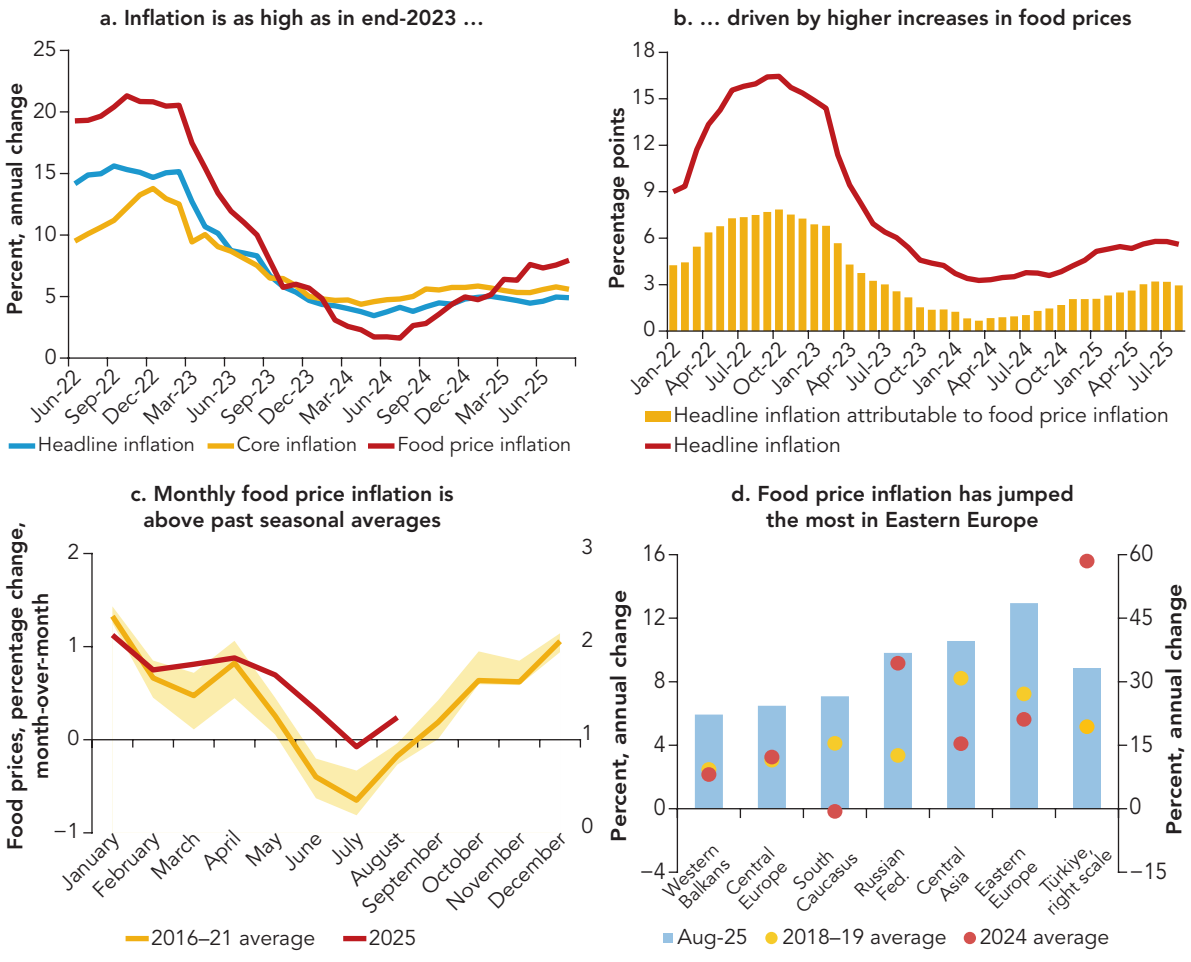
Soaring food prices push up inflation

Renewed increases in food prices caused median headline inflation to rise to 4.9 percent year-on-year by August, from 3.8 percent in August 2024. Increases in food prices now account for more than half of overall inflation (figure 1.6). Hikes in administered prices in several countries, including Kazakhstan and Romania, also added to price increases. Stable or stronger exchange rates in most ECA countries and falling global energy costs have acted in the opposite direction.

Average food price inflation jumped to nearly 10 percent year-on-year by August, the highest in almost two years. Monthly food price increases in the median ECA economy remain well above their historical range, with higher prices for meat, fruits, and vegetables, amid increased global food prices and the negative impacts of adverse weather on domestic agricultural yields.[1] Frosts in late April and early May reduced 2025 harvests of seasonal fruits across the region. In July, average annual inflation for fruits rose to more than 19 percent in Central Europe and the Western Balkans, which was four times higher than the 2024 average. The spike in food prices has been most pronounced in Moldova and Ukraine, where fresh fruit prices were nearly 50 percent higher than a year ago.

1. According to the Food and Agriculture Organization of the United Nations, the global food price index rose to its highest level in nearly 30 months by August, with the meat price index reaching an all-time high, making food imports more expensive for food importing countries. Weaker currencies in some of those countries added to inflationary pressures as well. For example, Kazakhstan sources roughly 60 percent of its imported food from Russia. Since the start of the year, the Kazakhstani tenge has depreciated by about a third against the Russian ruble, increasing the cost of these imports.

FIGURE 1.6. A resurgence of food prices is pushing up inflation



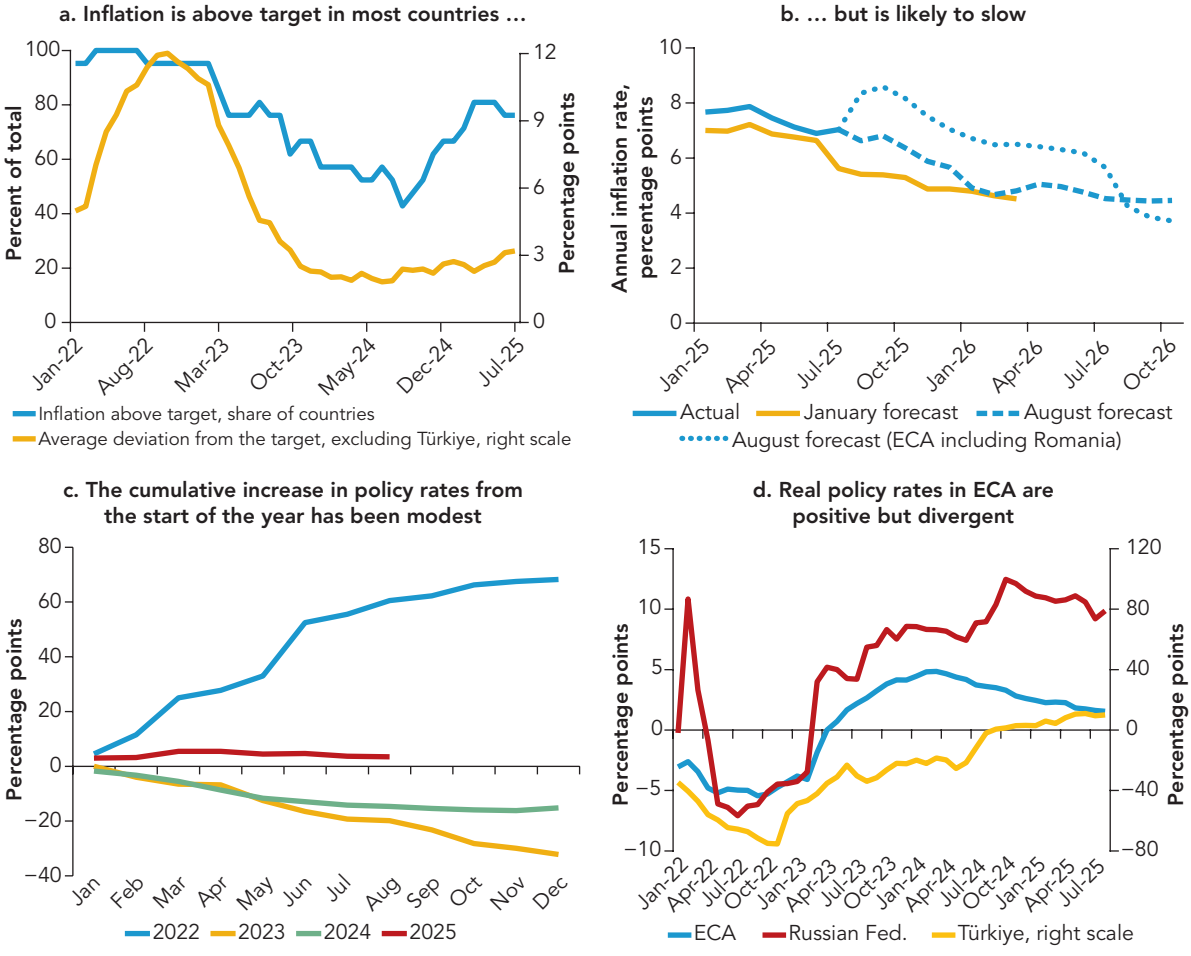
Sources: Haver Analytics; World Bank.
Note:
a. Aggregates are medians. The last observation is August 2025.
b. Averages for 13 economies in Europe and Central Asia. The last observation is August 2025.
c. Aggregates are medians. The last observation is August 2025.
d. Aggregates are averages. The last observation is August 2025.

Economic policies

Divergent monetary policy across ECA

Higher inflation has prompted some central banks to tighten monetary policy again. Indeed, in nearly eight in 10 countries in ECA, inflation exceeds the central bank inflation target by an average of more than 3 percentage points. Excluding Russia and Türkiye, policy rates have been hiked by a cumulative 320 basis points (bps) in 2025 following a nearly 5,000 bps reduction during 2023–24 (figure 1.7). Much of this increase came from just three countries, Kazakhstan, Moldova, and Ukraine.

FIGURE 1.7. Divergent central bank policy rates



Sources: Consensus Economics; Haver Analytics; World Bank.
Note: ECA = Europe and Central Asia.
a. The last observation is August 2025.
b. Aggregates are medians. The sample includes seven ECA countries (Bulgaria, Croatia, Poland, Romania, the Russian Federation, Türkiye, and Ukraine) for which monthly inflation forecasts are available.
c., d. Aggregates are averages. ECA excludes the Russian Federation and Türkiye. The sample includes 14 countries.
c. The last observation is August 2025.
d. Real policy rates are calculated as the difference between the nominal policy rate and the annual headline inflation rate. The last observation is August 2025.

In August, inflation was within the target range only in Albania, Armenia, Azerbaijan, Poland, and Tajikistan. Some of these countries have resumed a gradual easing of monetary policy through moderate rate cuts. For example, the central bank of Poland has cut interest rates three times since May, by a cumulative 100 bps. Policy rates have also been reduced in Russia, Türkiye, and Uzbekistan, where inflation is moderating but remains above target. Russia's central bank reduced its policy rate by 200 bps to 18 percent in July and by another 100 bps in September. In Türkiye, the policy rate, which was raised to 46 percent in April, was lowered to 40.5 percent by September—its lowest level in almost two years—as inflation had eased. With inflation set to remain above target for the coming years, Türkiye's

central bank is likely to maintain a restrictive policy stance to anchor inflation expectations (CBT 2025). Türkiye's central bank also continued to phase out unconventional policy measures by terminating the foreign-exchange protected deposit scheme (KKM) in September.[2]

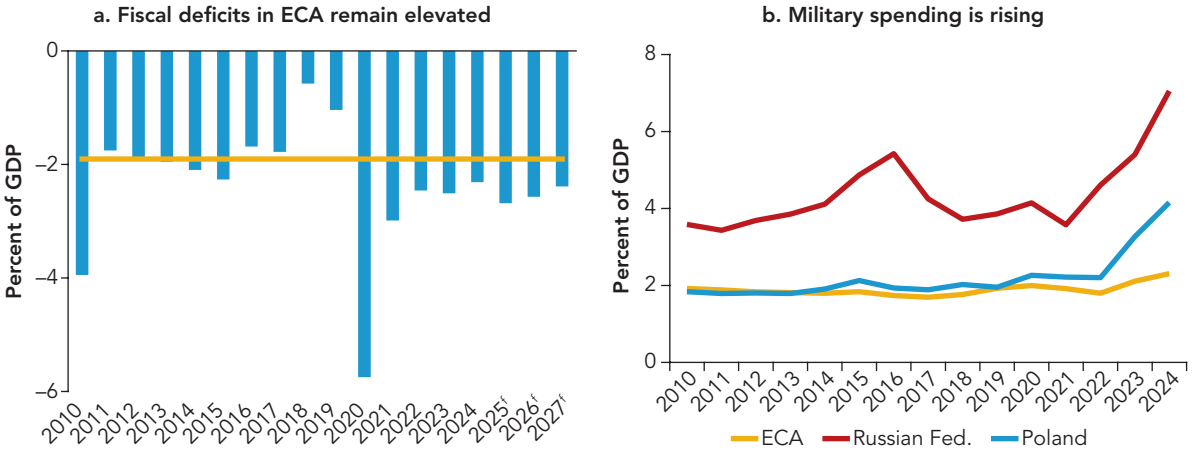
As a result of these policies, nominal policy interest rates in the region average about 8 percent, compared to an average inflation rate of 6.7 percent. Thus, real policy rates are almost twice as low as they were during 2018–19 on average, leaving monetary policy substantially less restrictive.

The Consensus Economics forecast is for a continued downtrend in inflation across ECA. One-off drivers behind the recent inflation increases, such as upward adjustments of administered prices, higher taxes, and volatility of food prices, are likely to fade. Even in Romania, where in August the central bank raised its year-end 2025 inflation forecast from 4.6 to 8.8 percent after a surge in domestic energy prices, inflation is expected to return to target by the end of next year.

Fiscal consolidation delayed again

Fiscal deficits across ECA are set to remain high. Over 60 percent of the ECA countries are likely to experience a deterioration in their fiscal positions by about 1 percent of GDP on average, driven by expanding public investment, higher interest expenses, the effects of earlier increases in social benefits and transfers, and rising defense outlays (figure 1.8). In a similar proportion of ECA countries, fiscal deficits are likely to be substantially higher than their 2010–19 averages.

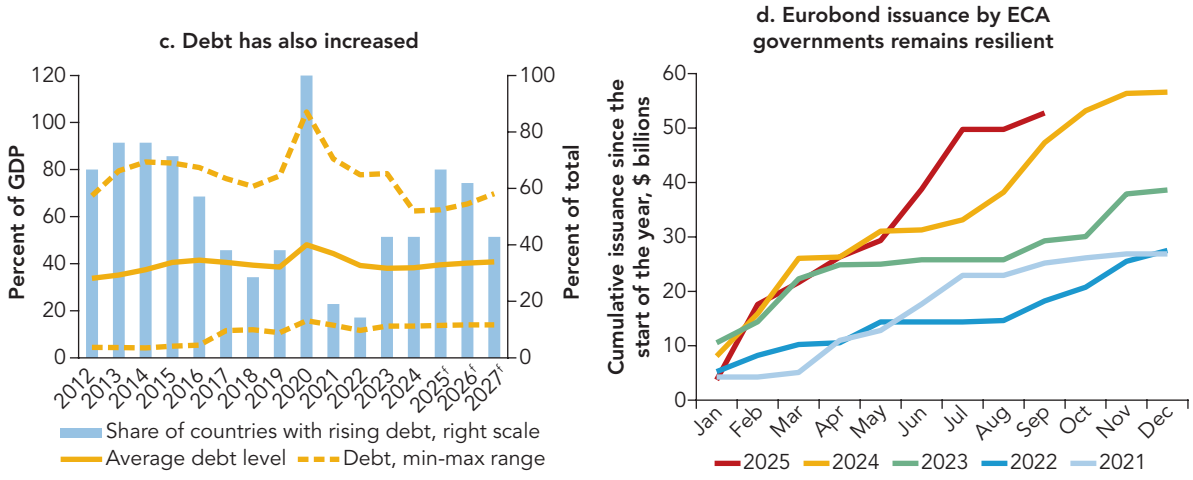
FIGURE 1.8. High fiscal deficits persist



(Continued next page)

2. The scheme was introduced in late 2021 to stabilize the exchange rate. KKM deposits reached about $140 billion at their peak in mid-2023 but have since declined, reaching $11 billion in August 2025, equivalent to about 2 percent of all deposits.

FIGURE 1.8 (continued)



Sources: Dealogic; Stockholm International Peace Research Institute; World Bank.
Note: ECA = Europe and Central Asia; f = forecast; GDP = gross domestic product.
a. The solid line indicates the 2010–19 average.
a., b., c. Aggregates are averages. ECA excludes Ukraine.
d. The last observation is September 2025.

Poland and Romania recorded the largest budget gaps in ECA in both 2024 and 2025. In Poland, the government recently raised this year's general budget deficit target to 6.9 percent of GDP. The fiscal deficit is projected to ease to 6.2 percent in 2026. Spending pressures remain elevated because of military outlays of about 5 percent of GDP, sustained increases in social transfers, and rising infrastructure and energy-related spending. Romania, with a fiscal deficit exceeding 9 percent of GDP last year, has introduced a fiscal consolidation package combining spending measures, such as public wage and pension freezes, with higher taxes. The fiscal deficit in Romania is expected to decline to below 6 percent of GDP by 2026.

Despite stronger revenue growth, Türkiye's fiscal deficit is set to remain above 4 percent of GDP in 2025, with elevated expenditure pressures due to high debt service costs. In the first half of 2025, interest payments more than doubled in nominal terms, rising to over 15 percent of central government spending. Russia ended the first half of this year with a federal budget deficit of 1.7 percent relative to its full-year GDP, compared to 0.7 percent a year ago, amid sustained increases in spending and a 17 percent collapse in oil revenues.

Reflecting persistently high fiscal deficits, government debt across ECA is on the rise. Excluding Ukraine, government debt is expected to edge up to 39.5 percent of GDP on average this year, with almost 70 percent of the region's countries seeing increases. Differences among the countries are substantial. On one side, government debt in Poland is projected to rise by more than 14 percent of GDP between 2024 and 2027, reaching nearly 70 percent of GDP. In contrast, in Croatia, government debt is projected to fall from a peak of 86 percent of GDP in 2020 to less than 55 percent of GDP by 2027. Government debt in Central Asia is projected to stay low, averaging around 30 percent of GDP, supported by strong growth, smaller deficits, and even surpluses in some countries (Kyrgyz Republic).

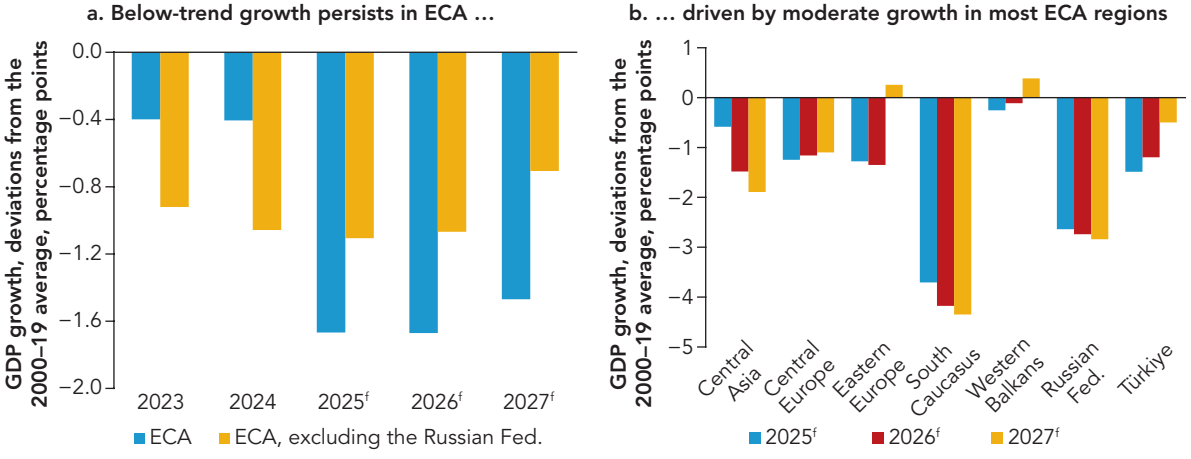
ECA's governments have accelerated foreign borrowing this year amid strong investor confidence. Between January and August, ECA countries raised nearly $53 billion through foreign bond issuance, equivalent to more than 93 percent of their total for 2024. This stands out against ongoing fiscal pressures and geopolitical risks, with almost 10 sovereign rating upgrades this year, including recent positive sovereign rating or outlook actions for Bulgaria, the Kyrgyz Republic, Türkiye, and Uzbekistan.

Continued favorable access to foreign borrowing notwithstanding, ECA's governments need to embark in earnest on ambitious yet growth-friendly fiscal consolidation. Although fiscal expansion was justified as a response to the overlapping crises earlier this decade, the economies in the region are growing broadly in line with potential. Yet, vulnerabilities are accumulating rapidly. Fiscal consolidation is needed as a cushion against future shocks and to make room for supporting aging populations, public investment, and investment in human capital.

Outlook: Moderate growth, rising risks

Amid resilient but modest global growth and heightened trade tensions, growth in ECA is likely to strengthen only modestly in 2026 and 2027. In Russia, growth is set to remain below 1 percent, constrained by tighter policies, waning fiscal support, weaker exports, and distortions from prolonged defense spending and a heavy reliance on state-led lending, which have fueled labor shortages and rising credit risks. Excluding Russia, growth in ECA is expected to pick up to 3.5 percent on average in 2026–27 (figure 1.9).

FIGURE 1.9 Growth improves modestly but remains below trend



Sources: World Bank.
Note: GDP aggregates are measured in average 2010–19 prices and market exchange rates. ECA = Europe and Central Asia; f = forecast; GDP = gross domestic product. Between 2000 and 2019, average GDP growth was 4.1 percent in ECA, and 4.3 percent when excluding the Russian Federation.

Growth is expected to recover in Türkiye. Growth is set to strengthen to 3.7 percent next year and 4.4 percent in 2027 as monetary policy loosens and inflation continues to moderate. With investment recovering alongside resilient consumption, the expansion in Türkiye is becoming more broad-based, signaling a shift toward a more durable and sustainable trajectory.

Central Asia continues to lead the region in headline numbers, not adjusting for the strong expansion of its population. Real GDP is likely to stay at 5 percent in 2026 before moderating to 4.6 percent in 2027, driven by strong momentum in the Kyrgyz Republic and Uzbekistan. Central Europe is expected to see steady growth near 2.6 percent on average in 2026–27, reflecting better outcomes in Bulgaria and Poland and a gradual pickup of growth in Romania.

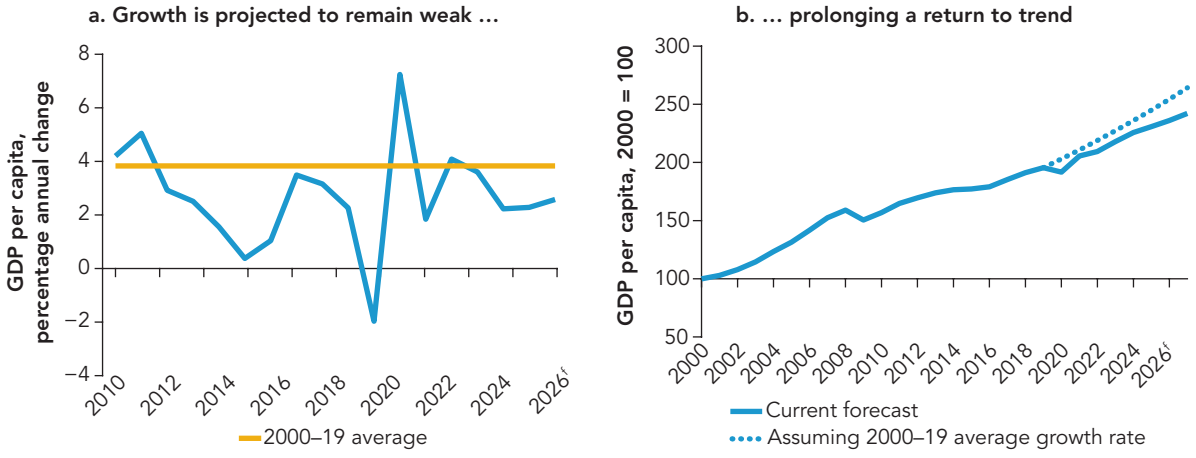
Growth in the Western Balkans is projected to improve modestly to 3.1 percent next year before strengthening to 3.6 percent in 2027. In the South Caucasus, growth is projected to slow to just above 3 percent, reflecting weaker expansion in Azerbaijan amid declining oil production, and a normalization of growth in Armenia and Georgia.

The outlook is subject to increasing headwinds. These include global and regional conflicts and geopolitical stress, rising policy uncertainty, further escalation of trade tensions, weaker than expected growth in major economies, and intensifying financial market volatility. Slower than expected growth in Germany and the European Union could further amplify the negative spillovers from increased trade barriers on ECA's exporters. Weaker than projected growth in Russia could curb remittance flows and weigh on exports in some countries, especially those in Central Asia and the South Caucasus.

Inflation also remains a key risk amid persistent price pressures, particularly from food and energy prices. Constrained fiscal space reduces governments' capacity to respond to shocks, leaving the region more vulnerable to both domestic and external disruptions. Delayed fiscal consolidation could erode investor confidence, deter private investment, and risk suspension of EU funds. A rise in domestic political uncertainty could delay reforms across the region, especially those needed to unlock EU funding in some countries. Broadly, the risk of reform backsliding in ECA remains significant, threatening to undermine investor confidence, curtail private sector dynamism, and deepen the ongoing productivity slowdown.

ECA is already grappling with a sharp decline in productivity. The slowdown in the region has become particularly steep since the global financial crisis. Weaker productivity growth translates into more sluggish growth in wage incomes and delayed convergence to high-income status. Indeed, GDP per capita growth in ECA is projected to average 2.5 percent in 2026–27, far below the 6.2 percent growth before the 2008–09 global financial crisis or the 3.8 percent in the decade prior to the pandemic (figure 1.10). In almost two-thirds of the ECA countries, average GDP per capita growth is projected to fall short of its 2000–19 average. If GDP per capita in ECA had continued to grow at the same pace as before 2020, incomes in the region would have been about 9 percent higher compared to the current projections.

FIGURE 1.10 Per capita growth has been sluggish



Sources: World Bank.
Note: GDP aggregates are measured in average 2010–19 prices and market exchange rates. ECA = Europe and Central Asia; f = forecast; GDP = gross domestic product.

ECA cannot afford to wait. Reforms have slowed or even reversed in some countries and the transition to a market economy has not been completed in several countries over the past three decades. Labor has flowed into low-skill, non-tradable services, while distorted markets and weak competition have kept capital and workers locked in low-productivity firms. Labor markets often struggle to support higher productivity growth because job growth is concentrated in low-quality employment and skill mismatches are widespread. The jobs challenge is central to the region's growth prospects. Part II of this ECA Economic Update examines this challenge in depth, highlighting the reforms needed to foster more productive employment.

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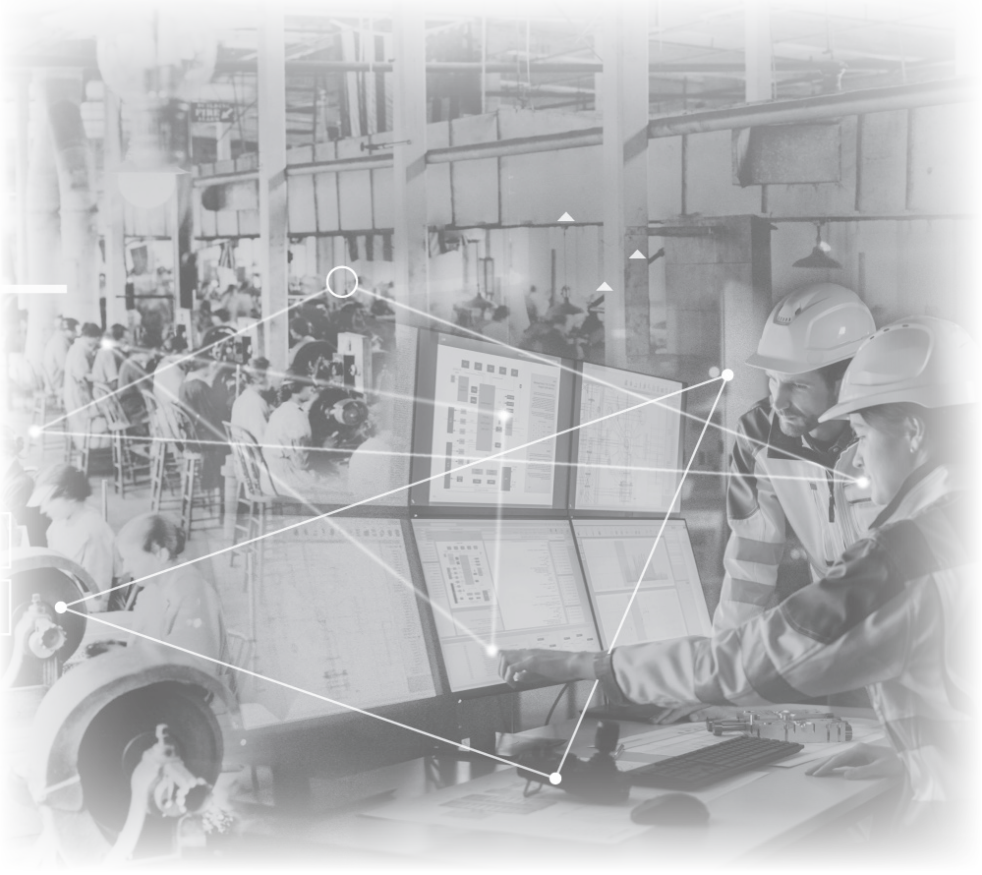
PART II

The Jobs Challenge



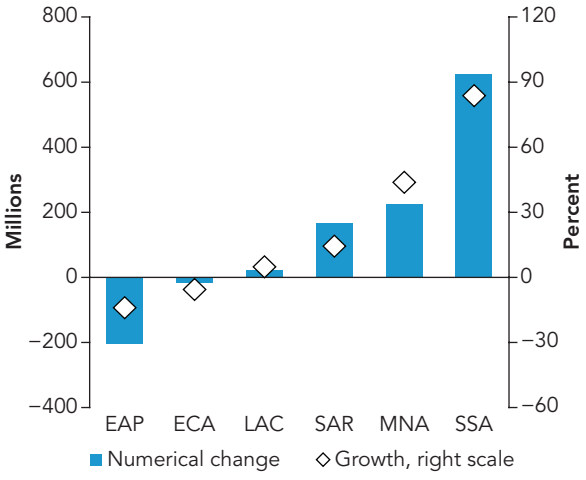
Context

The world is facing a jobs challenge of significant proportions. Creating jobs in the coming years may be harder than in the past. Job creation already slowed in many Emerging Markets and Developing Economies (EMDEs) even before the overlapping crises of the past five years. Structural changes, including shifting trading patterns, climate change and the energy transition, and the growing role of digital technologies, including artificial intelligence, add further uncertainty.

In many EMDEs, working-age population growth is stalling. The working-age population in Europe and Central Asia (ECA) is projected to fall by 17 million between now and 2050 (figure 2.1). Ten ECA countries will experience a working-age population decline of one-quarter or more. However, several countries will still experience significant increases. For example, Tajikistan is expected to add 3.6 million people to the working-age population, a 55 percent increase; Uzbekistan will add almost 10 million (42 percent). Therefore, policymakers in the region will have to manage diverging working-age population trends. The common denominator for policy challenges is the need to boost private sector development through a combination of foundational investments, a much improved business enabling environment, and mobilization of private capital.

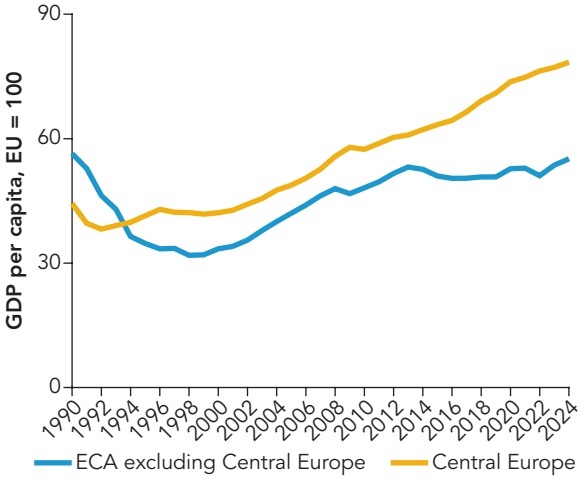
ECA's economic and jobs prospects over the next decades contrast with the remarkable gains across the region from the transition from planned to market economies and deeper integration into the global economy. This fueled rapid income growth, notably in Central Europe, and remarkable convergence with advanced economies.

FIGURE 2.1. ECA's working-age population is projected to decline from 2025 to 2050



Source: UNDESA (2024); World Bank (2025b).
Note: The figure shows the change in the working-age population, using the benchmark method over 2025–50 for regions of emerging markets and developing economies, in absolute magnitude and as a percentage change. EAP = East Asia and Pacific; ECA = Europe and Central Asia; LAC = Latin America and the Caribbean; MNA = Middle East, North Africa, Afghanistan and Pakistan; SAR = South Asia; SSA = Sub-Saharan Africa.

FIGURE 2.2. ECA: Income growth and convergence have stalled recently as productivity growth has slowed



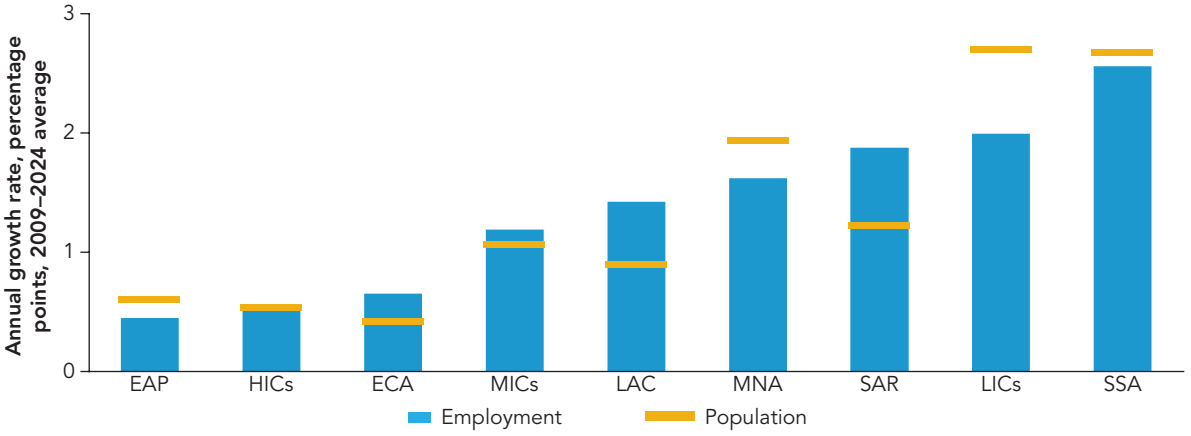
Source: World Bank (2025b).
Notes: GDP is measured in purchasing power parity, constant 2021 international dollars. Central Europe includes the four ECA clients that are members of the EU: Bulgaria, Croatia, Poland, and Romania. ECA = Europe and Central Asia; EU = European Union; GDP = gross domestic product.

Since the global financial crisis of 2008-09, that momentum has faltered as productivity growth has slowed sharply. The productivity slowdown in ECA has gone hand in hand with weakening reform progress (figure 2.2). Despite decades of market-oriented reforms, many ECA economies still show features of incomplete transition from plan to market. Large state-owned enterprises (SOEs), concentrated market structures, and restricted access to finance have dampened competition and hindered the reallocation of resources to more productive firms. In some countries, markets have become dominated by inefficient firms that survive and expand, while dynamic ones are held back, resulting in lower productivity growth. This environment also limits the creation of high-quality jobs—as productive firms struggle to grow, employment opportunities remain concentrated in low-skill, low-productivity sectors.

Declining reform momentum and slowing productivity growth resulted in positive but only modest job creation in the region. Job creation over the past 15 years in ECA has been faster than population growth but lower than in other developing regions. The number of people employed in ECA grew by 12 percent between 2009 and 2024. That exceeded the 7 percent increase in the region's population, even with the substantial migration many counties experienced (figure 2.3). Jobs growth in ECA was comparable to that observed in high-income economies and East Asia and the Pacific, but lower than in other developing regions.

In ECA, sustained economic growth is a necessary but not a sufficient driver of employment. The job intensity of growth in the region varies. Some of the differences

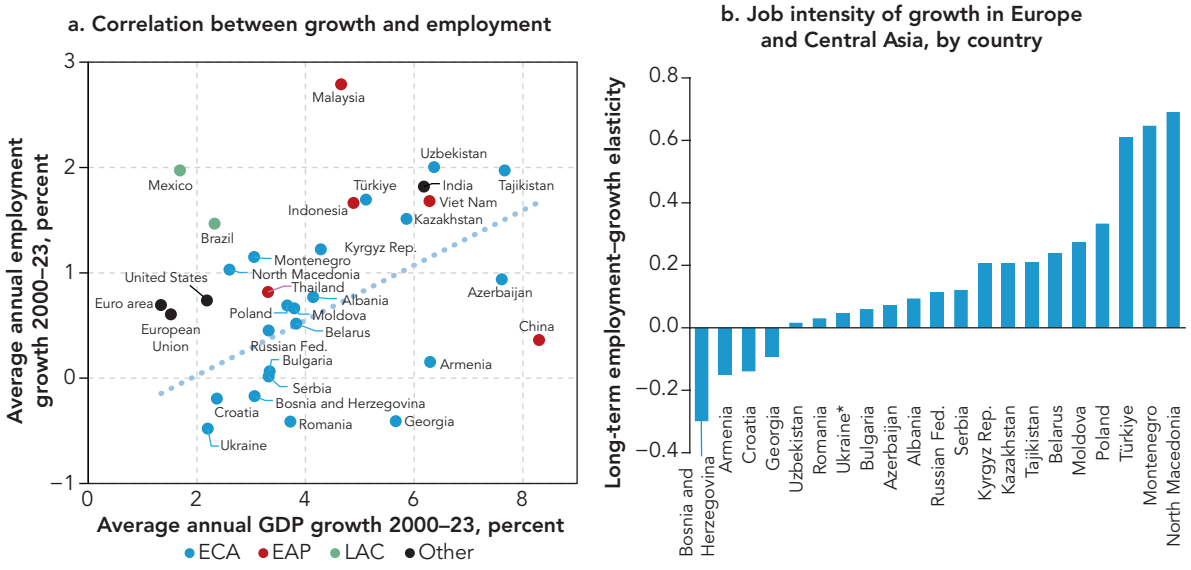
FIGURE 2.3. Employment growth in ECA exceeded population growth



Source: ILOSTAT (database); UNDESA (2024); World Bank (2025b).
Note: Bars and dashes show the average annual growth rates of the working-age population and 15+ employment, respectively. EAP = East Asia and Pacific; ECA = Europe and Central Asia; EMDE = emerging markets and developing economies; HICs = high-income countries; LAC = Latin America and the Caribbean; LICs = low-income countries; MICs = middle-income countries; MNA = Middle East, North Africa, Afghanistan and Pakistan; SAR = South Asia; SSA = Sub-Saharan Africa

still reflect the ongoing transition from plan to market and the reduction—or creation—of misallocations of labor and capital (figure 2.4). Some reflect restructuring of enterprises that are part of global value chains (GVCs). Structural reforms—such as enhancing labor and product market flexibility and reducing state involvement in the economy—can raise the

FIGURE 2.4. Economic growth is necessary for job creation



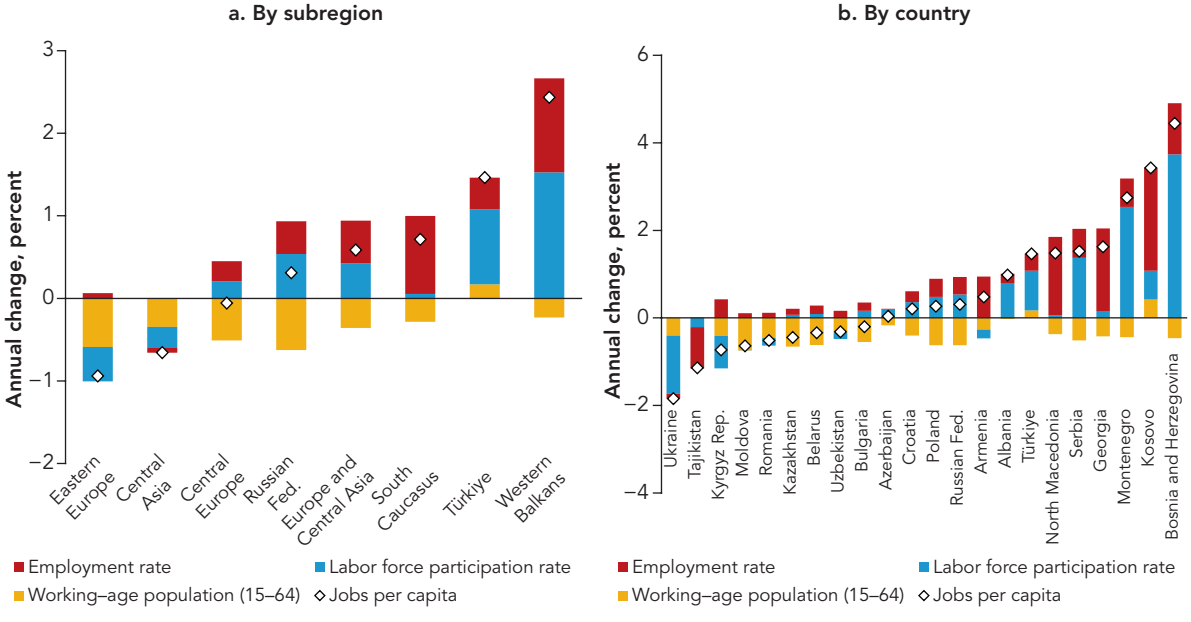
Source: Eurostat; International Labor Organization; national statistics offices; World Bank.
Notes: The sample covers 2000–23. Data for Ukraine end in 2021. In panel b, long-term employment-growth elasticities indicate the percentage increase in employment in response to a percentage increase in GDP growth. Elasticities are calculated as in Crivelli, Furceri, and Toujas-Bernaté (2012). ECA = Europe and Central Asia; EAP = East Asia and Pacific; GDP = gross domestic product; LAC = Latin America and the Caribbean.

employment elasticity of growth (Crivelli, Furceri, and Toujas-Bernaté 2012). Fully realizing such gains requires complementing these reforms with macroeconomic policies that provide broad macroeconomic stability and a predictable environment for investment and labor demand.

The pace of job creation has also been affected by acute demographic pressures in ECA, where fertility rates are below replacement levels in most countries and aging has accelerated. Per capita employment growth is driven by a combination of changes in the share of the working-age population, shifts in labor force participation, and variations in employment rates (figure 2.5). Changes in the labor force participation and employment rates explain all the average annual rate of per capita employment growth between 2010 and 2023. The decline in the relative size of the working-age population, a reflection of population aging, is becoming a constraint on employment growth, especially in Eastern Europe, Central Europe, and the Russian Federation.

Increased employment rates accounted for a bit over one-half of gross job creation, with variation across countries. The stronger impact in the South Caucasus and the Western Balkans reflects a combination of recent above-trend growth in the former and sustained job creation in services in the latter.

FIGURE 2.5. Increases in the labor force participation and employment rates explain the pace of job creation in Europe and Central Asia between 2010 and 2023

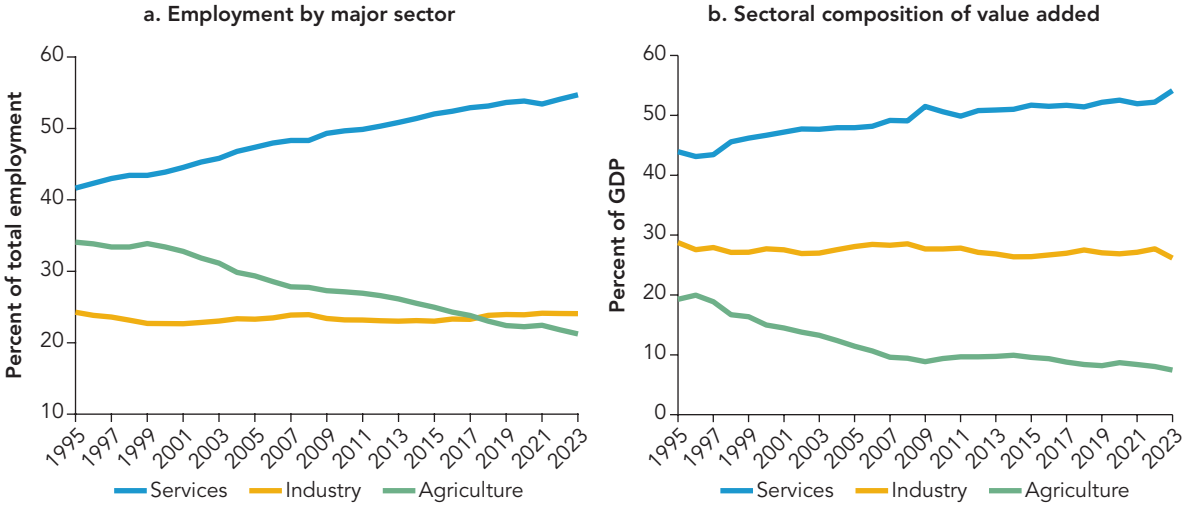


Source: International Labor Organization; United Nations; World Bank.
Note: Labor force participation and employment rates are for people 15–64. Sample covers 2010–23 or the latest data available. Data for Azerbaijan end in 2022; data for Belarus start in 2015; data for Kosovo start in 2013; data for Montenegro start in 2012; data for Ukraine end in 2021.

Rising labor force participation is a welcome development that has supported employment growth in many parts of ECA, especially Türkiye and the Western Balkans. Higher labor force participation—especially by women—accounted for just under one-half of gross job creation in ECA between 2010 and 2023. This is remarkable given that labor force participation rates in many ECA countries are already among the highest in the world. Nevertheless, significant underutilization persists among specific groups, with female and youth labor force participation rates in the region well below the levels observed in high-income European countries. A substantial portion of the region's underutilized labor resources could be mobilized to mitigate the effects of a declining working-age population.

Growth of the service sector has been the driving force behind ECA's structural transformation and job creation. As countries in ECA transitioned from planned to market economies, agricultural employment fell sharply, with the breakup of collective farms, land restitution and privatization, and rural restructuring. This decline was almost entirely offset by the rising share of jobs in the service sector, as the share of industry in total employment remained broadly stable. The service sector accounted for 54 percent of all jobs in ECA in 2023, up from about 42 percent in 1995. Between 1995 and 2023, agriculture's share of total employment shrank by almost 13 percentage points (figure 2.6, panel a). The average share of services in total output increased from 44 percent of gross domestic product (GDP) in 1995 to over 54 percent of GDP in 2023; the share of agriculture dropped to less than 7.5 percent of GDP in 2023, down from almost 20 percent in 1995 (figure 2.6, panel b). These shifts in sectoral output and employment reflect the broader structural transformation seen across emerging markets and developing economies over the past three decades (Nayyar and Davies 2023).

FIGURE 2.6. Services have led the structural transformation in Europe and Central Asia since the transition to market economies began in the early 1990s



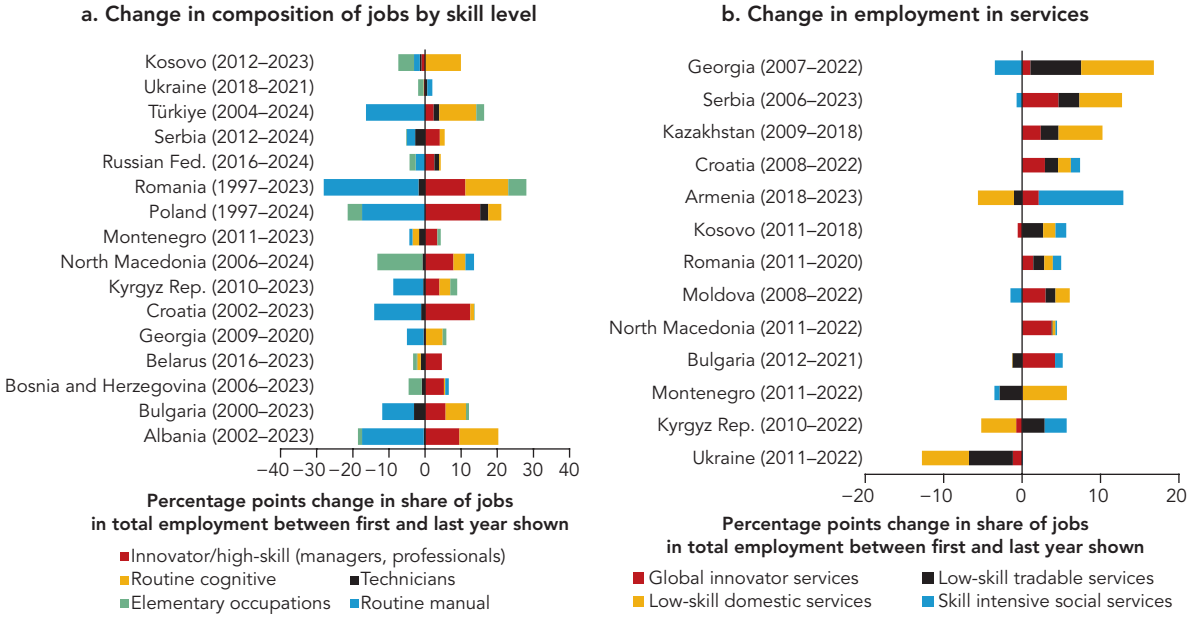
Source: Eurostat; International Labor Organization; national statistics offices; World Bank
Notes: Regional aggregates are averages. Eastern Europe excludes Ukraine. Data for Kosovo start in 2012 and for Montenegro in 2011.

Many of the jobs in services created in ECA, however, have been for low-skill workers, even as employment in global innovator services in the region also increased. The growth of the services sector was accompanied by an evolution of the occupational profile of jobs which saw an increase both in high-skilled occupations as well as routine cognitive ones, which are almost entirely in services (figure 2.7). As a result, much of employment remains concentrated in low-skill, low-productivity sectors—notably services, rather than high productivity tradable sectors, typically curbing both income growth and human capital development. Structural bottlenecks, including limited competition, persistent skills mismatches, and weak connectivity continue to weigh on the service sector. Policy and regulatory barriers—including the dominance of state-owned enterprises (SOEs)—restrict innovation and market entry.

Young and dynamic firms, together with very large firms, generate almost all net job creation in ECA; mature small and medium-size enterprises (SMEs) are net job destroyers. Although most employment is in mature and large firms, young businesses disproportionately contribute to job creation (figure 2.8). Startups and young SMEs account for 14 percent of total employment in ECA but almost 40 percent of gross jobs created. Large businesses also contribute substantially to net job creation. By contrast, mature SMEs tend to destroy more jobs than they create (Iacovone et al. 2025a).

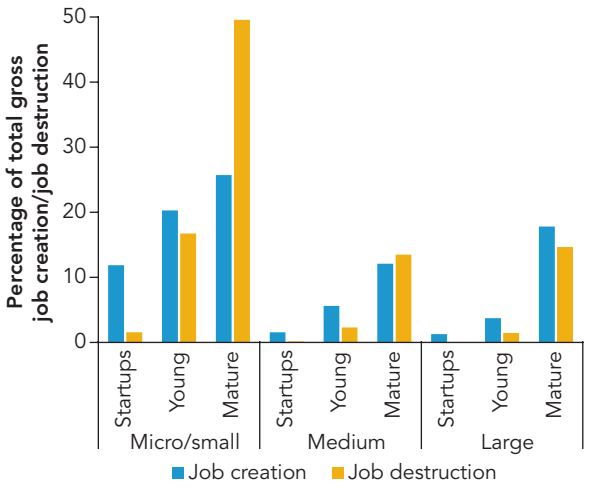
In contrast to high-income economies, despite substantial changes in global and regional economic environment, job responsiveness to productivity growth in ECA has remained stable over the past decade. On average, a 1 percent increase in productivity

FIGURE 2.7. The share of manual jobs in Europe and Central Asia dropped as workers moved from agriculture to services, though most new jobs were concentrated in low-skill occupations



Sources: Iacovone et al. (2025b); International Labor Organization; United Nations; World Bank.

FIGURE 2.8. Young firms, startups, and large firms create nearly half of the gross jobs and almost all net jobs in Europe and Central Asia



Source: Iacovone et al. (2025a).

translated into a 0.9 percent increase in employment in ECA (figure 2.9). Job responsiveness to productivity changes increases during crises, such as the COVID-19 pandemic, indicating that firms can adjust quickly to shocks by downsizing (Ilut, Kehrig, and Schenider 2017). However, it takes time for economies to bounce back during the recovery phase. Therefore, productivity increases during this phase do not necessarily translate into more jobs.

ECA's most productive sectors are better able to convert productivity gains into jobs than other sectors. Employment growth in the high-skill services sector (one of the region's most productive sectors) is about three times more sensitive to productivity shocks than is the manufacturing sector (one of the region's least productive sectors) (figure 2.10). Over time, employment responsiveness increased in the global innovator services and manufacturing sectors, while declining in the low-skill services sectors.

FIGURE 2.9. The elasticity of jobs to productivity change has been broadly stable in Europe and Central Asia

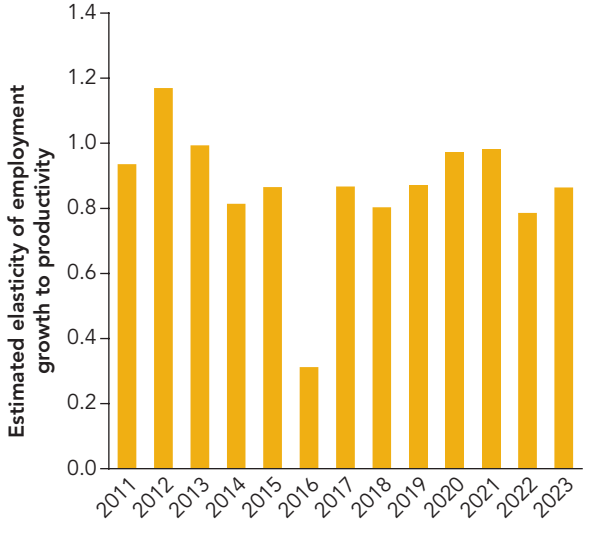
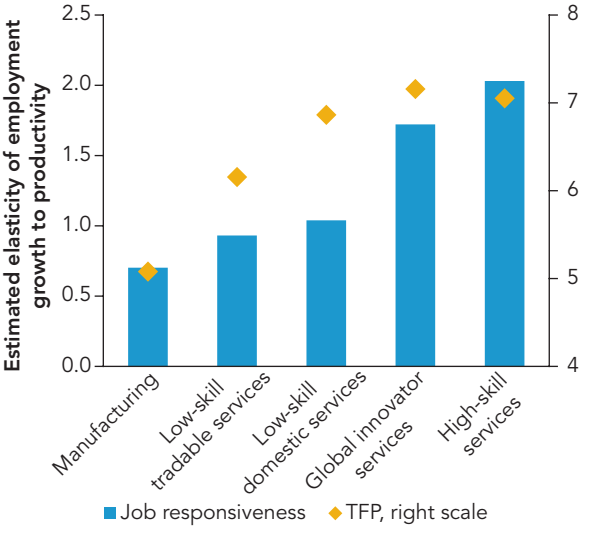


FIGURE 2.10. Employment is more responsive to productivity change in the most productive sectors

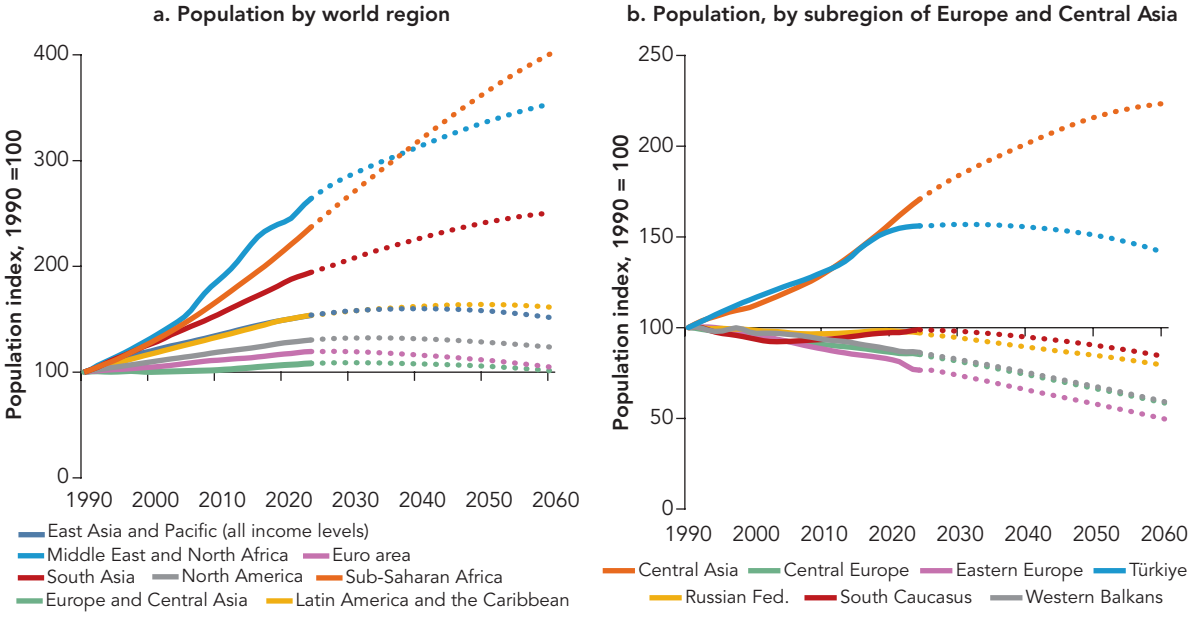


Source: Calculations based on data from Iacovone et al. (2025b).
Notes: The sample includes Armenia, Bulgaria, Croatia, Georgia, Kazakhstan, the Kyrgyz Republic, Kosovo, Moldova, Montenegro, North Macedonia, and Serbia. Results were obtained by estimating a specification of log employment growth on log TFP, controlling for interaction terms with distortions. TFP = Total Factor Productivity

Opportunities and challenges for jobs growth depend on population growth—but in most ECA countries, the population is projected to decline in the medium term. In 2025, the ECA population was estimated to be about 466 million, up from 433 million in 1990. It is projected to decline to 438 million by 2050 and to 287 million by the end of the century (UN 2024). The countries of Eastern and Central Europe and the Western Balkans are projected to shrink most, with the populations of Bulgaria and Ukraine expected to decline by more than 40 percent by the end of the century. These unprecedented demographic challenges in ECA will fundamentally alter labor markets, healthcare systems, pension schemes, and economic growth prospects. In contrast, the populations of the Central Asian countries are expected to continue growing into the second half of this century, albeit at a decreasing rate (figure 2.11). This poses a significant challenge for these economies to support sustained high levels of growth and job creation.

Age-dependency ratios are projected to soar in many ECA countries. Between 2023 and 2050, the share of people aged 65 years and older is projected to increase the most in Eastern Europe, where it is projected to rise from 17 to 28.2 percent. In the Western Balkans it is projected to increase from 17.5 to 30 percent, and in Central Europe from 21 to 32.1 percent. By 2050, the share of people aged 65 years and older will be the largest in Bosnia and Herzegovina (36.3 percent) and smallest in Tajikistan (8.6 percent). The total age-dependency ratio in ECA—the ratio of the number of people younger than age 14 and over age

FIGURE 2.11. The population of Europe and Central Asia is projected to shrink significantly over the next 35 years



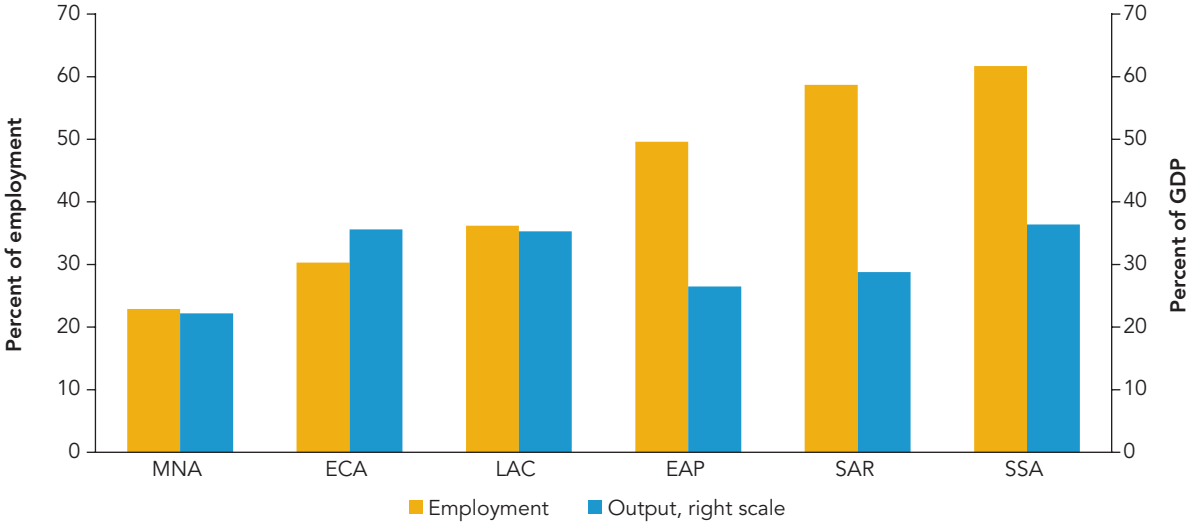
Source: Calculations based on demographic projections from UNDESA (2024)
Note: Dotted lines indicate projected values.

65 years to the working-age population—is projected to rise from 54.1 percent to almost 60 percent between 2023 and 2050. Every two workers in ECA will then be responsible for providing for three dependents (World Bank 2025b).

Emigration has contributed to the shrinking of the workforce. Net international migration rates are negative in almost all ECA countries. Russia is the main destination for migrants from Central Asian countries and the European Union is the primary destination for migrants from Central and Eastern Europe and the Western Balkans. More than 40 percent of people born in Albania, Bosnia and Herzegovina, and Moldova reside abroad. For Armenia, Bulgaria, Croatia, Georgia, and Kazakhstan, the figure exceeds 20 percent (Bossavie, Garrote Sánchez, and Makovec 2024). These sizable outward flows comprise primarily working-age individuals with above-average skill levels.

Informality also remains a challenge for labor market development, social protection, and income security across ECA. Progress in reducing informality has been uneven across the region, although is lower in ECA than in most EMDE regions (figure 2.12). The incidence of informality is markedly higher in the east than in the west of ECA, reflecting weaker institutions, less conducive business climates, larger agricultural sectors, and remittance-driven small businesses. Western ECA has reduced informality more rapidly, supported by stronger institutions, market liberalization, and lower corruption. Evidence suggests that easing tax burdens, strengthening enforcement, curbing corruption, and increasing labor market flexibility can reduce informality (Ohnsorge and Shu 2022).

FIGURE 2.12. Informality is lower in ECA than in most EMDE regions



Source: Ohnsorge and Shu 2022; World Bank.
Notes: DGE = dynamic general equilibrium model-based estimates in percent of official GDP; EAP = East Asia and Pacific; ECA = Europe and Central Asia; EMDEs = emerging market and developing economies; LAC = Latin America and the Caribbean; MNA = Middle East and North Africa (the source is from 2022, before the World Bank created a new region called MNAAP to include Afghanistan and Pakistan); SAR = South Asia; SSA = Sub-Saharan Africa. Blue bars show the average share of DGE-based informal output during 2010–18. Yellow bars show the simple average share of self-employment during 2010–18.

In summary, ECA countries confront a set of interlinked labor market challenges that limit the quantity, quality, and inclusiveness of job creation. Part II of this update is structured around three pillars of the jobs challenge that policymakers in the region need to consider strengthening the link between economic growth and employment, reduce distortions, unlock the region's underutilized labor potential, and help manage complex labor market transitions.

These three pillars are:

Pillar 1: Creating the infrastructure foundations for jobs. This includes both human infrastructure (health care, education, skills training), and physical infrastructure (transportation and energy). To promote women's labor force participation, policies can expand childcare and eldercare services, as well as promote flexible work arrangements. Social protection can support job transitions through unemployment insurance and reskilling programs. Active labor market policies that combine training with wage subsidies can help disadvantaged groups become more engaged in the labor market. Aging Central and Eastern European countries require flexible pension systems and measures to subsidize workplace adaptations for older workers, providing tax incentives for firms that retain workers beyond the standard retirement age. Well-managed migration through bilateral agreements have been used in some countries to help address skill shortages while benefiting countries of origin.

Better transportation infrastructure—such as efficient and integrated road networks, railways, and transit systems—connects workers to jobs and businesses to markets, reducing costs and expanding economic reach. Better physical connectivity can foster market integration and competition, while increasing allocative efficiency, and leveraging economies of scale. Developing inter- and intra-regional corridors in Europe and Central Asia is particularly important for improving productivity and competitiveness. Reliable, affordable, and sustainable energy infrastructure is also essential for job creation and economic transformation. Substantial investments in cost-effective energy infrastructure is required across Europe and Central Asia , with approaches tailored to natural resources endowment, national climate and development goals, and the evolving price landscape of emerging technologies. Given the scale of the challenge, policies and reforms to create an enabling environment for private sector participation will also be critical.

Pillar 2: Strengthening governance and supporting business-enabling policies and a predictable regulatory environment—so the private sector can operate and grow. This pillar also includes simplifying tax regimes, reducing compliance costs, and digitalizing administrative processes to lower firms' barriers to entry and growth. Liberalizing entry, removing exclusivity rights, and promoting competition can facilitate resource reallocation toward productive firms, boosting job creation. It is important that SOE reforms prioritize reducing the footprint of enterprises in competitive sectors and improve their governance, so that a level playing field for private businesses is created. Effective private sector growth can also

be supported through reforms that address ineffective bankruptcy laws, weak contract enforcement, corruption, and inadequate access to finance. Deeper trade integration enables firms to join dynamic value chains and increase their innovation returns. In addition, an investor-friendly framework that maximizes foreign direct investment spillovers through supplier development programs and research partnerships catalyzes private-led growth. And well-governed industrial policies can help build firm capabilities and capitalize on reindustrialization and nearshoring opportunities.

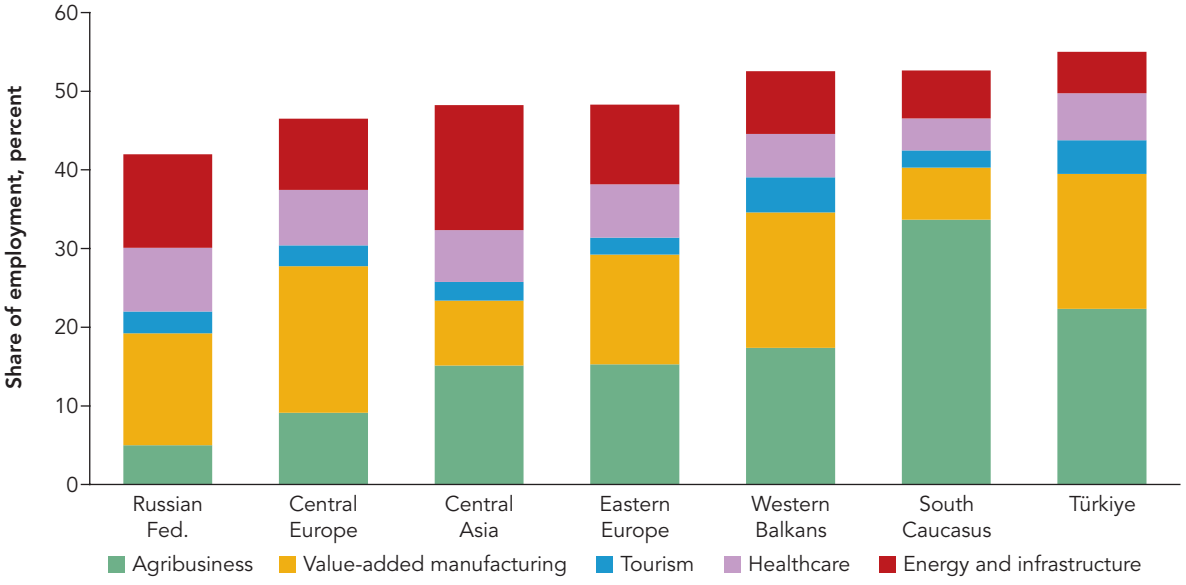
Pillar 3: Mobilizing private capital for the private sector to expand and create more and better jobs. Public budgets alone are insufficient to meet the scale of investment needed for job creation and economic transformation, so private capital will be critical through financing tools like equity, guarantees, and political risk insurance. These instruments help mitigate investor concerns and amplify the impact of development finance. Equity and quasi-equity tools—such as venture capital, convertible bonds, and subordinated debt—can support innovative, high-growth firms while preserving ownership incentives. Governments can further attract private investors through co-investment programs, equity guarantees, and demonstration investments that build market confidence and expand access to risk capital. Public-private partnerships (PPPs) are critical for leveraging private sector expertise and funding in infrastructure and public services. Additionally, supporting local financial intermediaries and expanding guarantees can improve credit access for underserved populations and strategic sectors like energy.

The heterogeneity of the region implies that countries cannot follow a single approach. The demographic pressures, for instance, are different in Central Asia and Türkiye than in the rest of the region. For the latter countries, increases in the number of jobs employing the growing young population are an urgent priority. In the Western Balkans or Central Europe, upgrading jobs in terms of quality and productivity is crucial in a context of a shrinking workforce.

Five sectors—agribusiness, value-added manufacturing, tourism, healthcare, and energy and infrastructure—have the potential to create good-quality jobs on a large scale in the ECA region. These sectors account for 47 percent of employment in the region, although the share varies across countries (figure 2.13). In agriculture, the employment share ranges from 5 percent in Russia to more than 33 percent in the South Caucasus. In manufacturing, the range is from almost 7 percent in the South Caucasus to 19 percent in Central Europe. In tourism, from around 2 percent in Eastern Europe to 4 percent in the Western Balkans. In healthcare, the share amounts to 4–7 percent, and in energy and infrastructure, about 5–16 percent.

Employment profiles vary by sector, creating different pre-conditions for future economic and jobs growth. Agribusiness employs older workers than tourism, which employs predominantly young people. More than 70 percent of healthcare workers are women;

FIGURE 2.13. Five sectors represent about half of employment in Europe and Central Asia



Source: National labor force surveys and ILOSTAT (database).
Note: Agribusiness corresponds to NACE rev.2 sector A (agriculture, forestry, and fishing). Value-added manufacturing corresponds to NACE rev.2 sector C (manufacturing). Tourism corresponds to NACE rev.2 sector I (accommodation and food service activities). Healthcare corresponds to NACE rev.2 sector Q (human health and social work activities). Energy and infrastructure correspond to NACE rev.2 sectors D (electricity, gas, steam, and air conditioning supply), E (water supply, sewerage, waste management, and remediation activities), and H (transportation and storage). The data corresponds to 2023 or the latest year available.

healthcare is also the sector with the most educated workers among the five strategic sectors (agricultural workers have the lowest levels of education). About 85 percent of workers in the energy and infrastructure sector are men. Thus, expanding job opportunities in these five sectors has the potential to improve the labor outcomes of almost every type of worker. Policy makers in the region stand to gain from addressing the jobs challenge with this sectoral focus in mind.

Central Asia's sectoral growth agenda cuts across agrifood and livestock processing, transport and logistics linked to Eurasian corridors, renewable energy, and selective manufacturing niches. As all countries in the region are landlocked, enhanced connectivity is central to its economic diversification. It is equally rich in natural resources and can grow its export potential for energy services. In addition, in Kazakhstan there are untapped agro-processing opportunities in wheat and livestock, constrained by very low wheat productivity, financially distressed incumbents (including SOEs) and politically exposed ownership structures that deter investment, and a narrow set of export markets. Addressing these bottlenecks—alongside reforms to unlock the logistics sector—would help diversify exports and enable higher-value processing.

The Kyrgyz Republic combines hydropower and emerging solar potential with tourism niches (soft adventure and winter), and a set of export-oriented services in finance, tourism, and information and communication technology (ICT). Realizing these opportunities requires public investments in network and utilities, combined with bankable frameworks to attract private capital in renewable energy investment; stronger destination development, higher-quality accommodation outside the capital, and better road, rail, and air connectivity; and resolution of costly operational, regulatory, and management constraints in aviation (including EU safety challenges and high airport costs). Given the country's small and hard-to-reach market, a deliberate focus on high-potential export services is central to diversifying growth and jobs.

Uzbekistan's priorities span chemicals manufacturing, ICT services, and horticulture. In the chemicals sector, competitiveness and energy efficiency gains depend on modernizing the industry and separating regulatory and control functions from commercial operations, while gradually removing subsidies, price ceilings, and export controls. ICT potential is limited by gaps in broadband coverage and affordability. Horticulture can scale exports by adopting global standards and certification, eliminating prepayment requirements for exports, and accelerating investment in modern irrigation and crop research and development (R&D).

For Tajikistan, opportunities lie in leveraging the country's enormous hydropower potential, improving corridor logistics and border processes, and expanding tourism. Across the country, the tourism industry could capitalize on its exceptional heritage sites and natural assets, but requires addressing upgrading hospitality infrastructure beyond major cities, improving international air connectivity and regional cooperation to promote cross country attractions, investing in skills local workforce development, along with better public-private partnerships and focusing on sustainable tourism practices, including community empowerment and environmental protection, which is essential for the long-term growth and resilience of the region's tourism industry.

Across Central Europe, the most dynamic opportunities center on manufacturing and energy value chains, modern tradable services, and support for aging. These countries have a strong potential in green manufacturing and energy, with exploratory scope in solar subcomponents—alongside a broad set of offshore business services including software development, business process outsourcing (BPO), accounting, and architectural and engineering services. In addition, countries with a large agriculture sector, such as Romania and Poland, there is scope for value addition if productivity and market access can be strengthened. Delivering on this potential requires several cross-cutting policy actions: deepening digital and technical skills and raising the quality of tertiary education to meet service sector's human capital demands; upgrading firm-level management and technology adoption; and enabling an agricultural transition through mechanization, improved access to finance, targeted human capital development, and measures that address fragmentation and limited economies of scale.

Türkiye's biggest opportunities for growth and job creation lie in tradable services and logistics. These include upgrading connectivity and manufacturing linked to global value chains, renewable energy, care services that lift female participation and digital and ICT-enabled services. Within tradable services, accommodation and food services, retail and wholesale trade, logistics, and professional an business services have historically been large net job creators. Tourism supports services jobs, and logistics continues to benefit from Türkiye's location and manufacturing base. In export-oriented manufacturing, automotive and parts, machinery, metals, and electronics and computers have posted strong employment growth among internationally linked firms; deepening GVC participation and upgrading can create additional jobs, especially in medium- and high-skill roles. Grid-scale renewables, energy efficiency in buildings and industry, and supporting green services—can yield new employment, with the country's net-zero 2053 ambition and expanding climate investments driving demand for "green" skills. Expanding childcare and eldercare can both generate jobs and raise female labor force participation, helping narrow persistent gender gaps. Digital and ICT-enabled services can create high-productivity employment and complement manufacturing and services via digitalization, logistics, and e-commerce. Realizing this potential will require addressing binding constraints: limited access to long-term finance that curbs investment, capacity expansion, and formal hiring; slowing productivity growth and a tilt toward lower-productivity services; and uneven industrial upgrading and subdued FDI. Further constraints include low female participation, skills mismatches, high rates of youth who are not in education, employment, or training (NEET) and unemployment, with many first-time jobseekers lacking work-relevant skills and networks. Labor market frictions—high informality that depresses job quality and productivity, and regulatory and cost burdens that impede firm upscaling—further weigh on outcomes. Moreover, the "demographic window" is closing around the mid-2020s, with rising old-age dependency and a likely population peak.

Ukraine's economy is in a process of transformation, with the emergence of new sectors and productivity upgrades in existing sectors likely to contribute to job growth. Among existing sectors, information technology (IT) and digital industries have proven resilient since February 2022 and are likely to contribute to future job growth. Agriculture and agri-processing have emerged as Ukraine's main comparative advantages since 2014, and productivity upgrading as well as moves up the value chain holds substantial potential for the creation of new jobs. Logistics, energy, and construction are likely to be major job and growth sectors during the reconstruction phase. Among newer sectors, defense and associated industries are likely to benefit from recent technological progress and sustained high demand, with the potential to create jobs for skilled workers.

The Western Balkans exhibits a robust opportunity set in agribusiness and food processing, tourism diversification and upgrading, targeted light manufacturing (notably auto-parts), and care services. Agribusiness prospects include horticulture, meat and hides/skins, processed fish, organics, and a broader base of value-added products—provided land

reforms move ahead, fragmentation is addressed; and irrigation, transport, and standards and certification systems are strengthened. Tourism can transition from concentrated, low-value beach segments toward a more diversified and sustainable portfolio—blue/coastal, mountain, cultural, and village tourism—with investment in marinas, boating and diving, nature-based offerings, and improved destination management. Policy action is needed across interconnecting regional infrastructure, trade coordination, regulatory quality, workforce skills, innovation and technology transfer, entrepreneurship support, access to finance, and better data for decision-making. The nascent automotive components industry in the smaller countries of the Western Balkans would benefit from a clear sector vision, an industry association, and investment in serviced industrial land and prebuilt factories alongside tailored vocational programs and the rollout of industry-standard training. Lastly, this subregion is facing an increasing demand for care services—both childcare and elderly care—which have been provided mostly informally and by women. Boosting the care economy can help deliver better services, generate jobs across the skills spectrum, and facilitate women's access to more productive and better remunerated jobs.

The South Caucasus stands out for opportunities in renewable energy, regional transport and logistics, and exportable digital business services. There is substantial potential in small and medium-sized hydropower and utility-scale solar, contingent on a credible and predictable regulatory and permitting framework, cost-reflective tariffs, and investments in transmission and regional interconnections. The South Caucasus' position on the Trans Caspian Trade Corridor creates a platform for growth in logistics services provided transport corridor bottlenecks around costs and transit times are addressed and required investments completed. Complementary opportunities lie in agro-logistics and downstream agribusiness investment, supported by farmer capability upgrades to meet standards. Digital businesses can scale internationally from a small domestic base with targeted support through accelerators and seed finance.

In the rest of ECA, sectoral growth lies in logistics integration with the EU and regional corridors, modernization of financial intermediation, high-value agriculture, and digital services offshoring. Transport and logistics are pivotal for competitiveness across tradables, yet the current system is constrained by poor road and rail quality, airport inefficiencies, and long export times at key border crossings. A coherent logistics investment roadmap, piloting of output- and performance-based road contracts, clear public service obligations for transport SOEs to catalyze investment in the hinterland, and renewed rail reform and unbundling are priority actions. Financial services need to deepen and broaden access for SMEs, addressing the sector's small size, limited sophistication, and unfinished reforms. On the agricultural side, high-value exports can be promoted through upgrading rural infrastructure (irrigation, post-harvest, energy, and roads); enabling productive aggregation and land consolidation; promoting adoption of modern technologies with better-targeted subsidies and access to finance; building standards, laboratories, and digital infrastructure; and advancing climate-smart agriculture via climate finance and risk products.

Promoting a more dynamic private sector and labor market

The presence of too many small firms that do not grow limits jobs opportunities

Although rates of business creation in ECA are comparable to those in upper middle income countries, the region still has too many small firms that do not create jobs compared to those in the United States and other advanced economies. The number of businesses per capita is high in ECA, but active enterprises generate fewer jobs than expected based on their income and far fewer than in high-income countries. ECA countries have an average of nearly 30 enterprises per 1,000 inhabitants, in line with comparable upper-middle-income countries, such as Brazil and Costa Rica (24 per 1,000 inhabitants) and more than the number in the United States (16 per 1,000 inhabitants). In the region's middle-income countries, these firms generate far less employment than they do in high-income countries. Employment density in ECA is lower than in countries with similar business density, because businesses do not expand enough (Iacovone et al. 2025a).

SMEs in the region have lower labor productivity than their EU counterparts. Across all size classes of enterprises, ECA businesses have significantly lower labor productivity than businesses in France, Germany, Italy, and the United Kingdom (Iacovone et al. 2025a). For instance, workers in microfirms (fewer than 10 employees) in ECA generate half the value added of workers compared to similar-sized German enterprise and even less than their counterparts in microfirms in France or the United Kingdom. Employees in small (10–49 employees) companies in ECA produce 30–80 percent of the value added of equivalent workers in small firms in Germany. This productivity gap is also evident in midsize firms. Inefficient firms are uncompetitive in international markets, impeding their integration into GVCs, and are less likely than efficient firms to access financial resources for upgrading technology and equipment.

New firms in ECA typically enter the market at less than half the size of their counterparts in the United States. This often reflects the prevalence of necessity-driven entrepreneurship and is highly correlated with limited growth. As these firms mature, their employment growth slows significantly, especially in less advanced ECA economies. Firms' employment growth trajectories are similar in ECA and the United States during their first 25 years but diverge thereafter. Most mature (over 25 years) US companies are substantially larger than US companies that are 6- to 25-years-old; the differential is much less pronounced in ECA countries, suggesting challenges in scaling operations and capturing market share.

SMEs, particularly high-growth firms have limited access to long-term finance, working capital, and trade finance. Credit markets are less developed in ECA than in the European Union, hindering firm growth. ECA countries rank below the global median in credit access distribution, with most at the bottom of the distribution (Belacin et al. 2025). Among the small number of firms that have access to long-term debt financing, the share of long-term debt

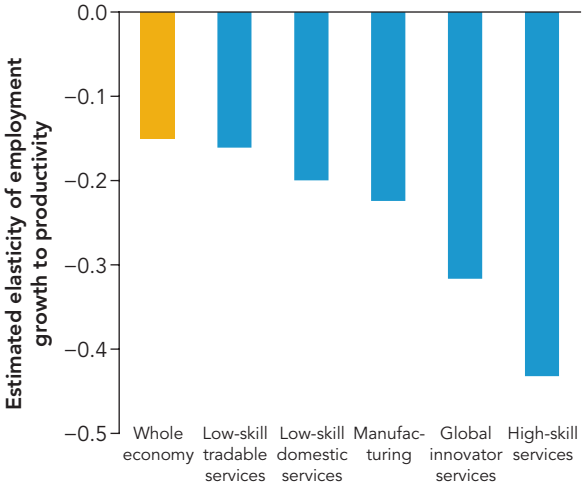
financing capital is small, suggesting the need to develop long-term credit markets. Absent long-term financing, firms need to rely on their own funds and short-term commercial bank credit. Per capita venture capital funding remains extremely low in ECA, both in absolute terms and compared to peers, particularly in middle-income countries (Didier and Cusolito 2024).

Market competition and selection mechanisms are weak, allowing inefficient firms to survive, impeding integration into GVCs and reducing overall productivity. In well-functioning competitive markets, selection mechanisms coupled with learning make survivor firms increasingly productive, as less productive firms are forced to exit. In highly competitive sectors, businesses innovate and upgrade to outperform the competition. In ECA, the average productivity of older cohorts of firms tends to decline more rapidly in less advanced economies than in more advanced ones (Iacovone et al. 2025b). This suggests that incumbent firms have problems growing and boosting their productivity as they mature, especially in less advanced economies.

Stronger competition means stronger job creation from productivity gains. In the sectors with the highest level of firm concentration, a 1 percent increase in productivity translates into a 0.5 percent increase in jobs. In sectors in which concentration is lowest and markets are more competitive, a similar increase in productivity leads to almost a 2.5 percent increase in jobs.

Market and policy-induced inefficiencies weaken job creation, imposing a heavy burden on the most productive firms

FIGURE 2.14. Distortions in revenues and factor prices reduce the elasticity of jobs to productivity in the region



Source: Calculations based on Europe and Central Asia firm level database.
Note: Estimated values were obtained by regressing log employment growth on log productivity; interacting log productivity with sales and relative factor taxes; and controlling for distortions, country-time, and sector-time fixed effects.

Two types of policy-induced inefficiencies—often known as *wedges*—affect how firms convert productivity gains into new jobs. The first type is revenue-reducing regulatory burdens (taxes, tariffs, fees, and rules that reduce revenues). The second are policies that increase labor and capital costs (such as taxes and regulations). Both sources of inefficiency make firms less likely to expand labor demand when productivity rises (Cusolito et al. 2024).

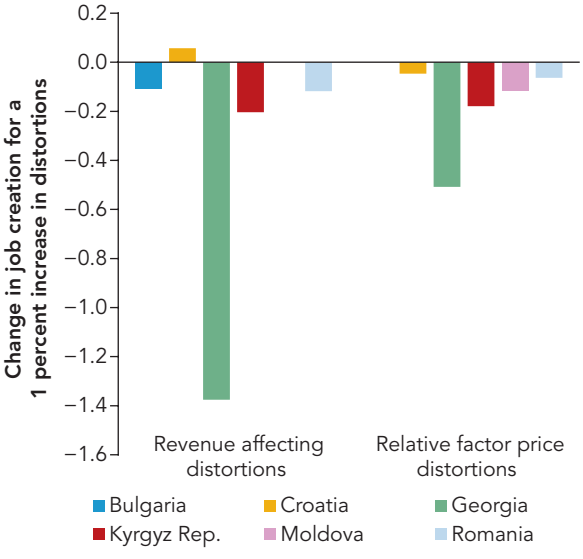
Policy-created wedges in the region reduce the elasticity of jobs to productivity growth by 15 percent a year on average (figure 2.14). The most dynamic sectors experience the largest reductions in job responsiveness to productivity increases, with average annual rates of decline of 43 percent for high-skill services and 32 percent for global innovators.

Job creation is affected equally by policy restrictions that affect firms' revenues and those that increase production costs. In a sample of six ECA countries for which data are available, the estimated elasticities of job creation to revenue-affecting policies range from close to zero in Croatia to 1.37 in Georgia (figure 2.15). Thus, in the case of Georgia, a 1 percentage point increase in the revenue distortion rate decreases jobs by 1.37 percent. The estimated elasticities of job creation to relative factor wedges measured as the ratio of capital wedge to labor wedge range from nil in Bulgaria to 0.50 percent in Georgia.

Policy-induced inefficiencies also change who benefits from productivity gains, shifting gains away from workers towards management. Revenue and factor wedges reduce the pass-through of productivity gains to wages by roughly 20 percent in ECA and increase markups by the same amount (figure 2.16). During crisis periods, the incomplete pass-through is exacerbated. For example, during the COVID-19 pandemic, the reduction in the transfer of productivity gains to wages increased by up to 30 percent (the pass-through to markups did not change).

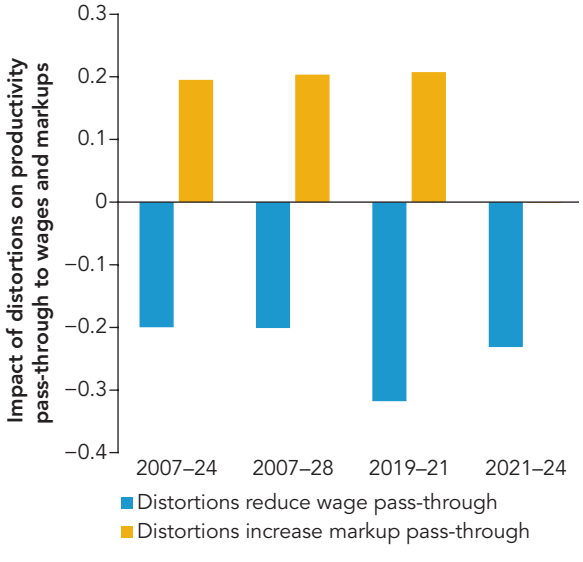
Buyers' market power limits the impact of productivity on wages. Markdowns—a wedge between the marginal cost and the marginal value of labor, which indicates the presence of monopsony or oligopsony in the labor market—reduce average wages in ECA. The estimated elasticity of wages to markdowns ranges from –1.32 percent in the most advanced

FIGURE 2.15. The effect of distortions on job creation varies widely across ECA



Source: Authors, based on ECA firm level database.
Note: The figure shows estimated responses of job creation to revenue distortions (1-distortion rate) and factor wedges (capital tax/labor tax).

FIGURE 2.16. Distortions reduce productivity pass-through to wages and increase pass-through to markups



Source: Calculations based on Europe and Central Asia firm level database.
Note: The figure presents the aggregated estimated effect of distortions on the pass-through of productivity gains to wages and markups in percentage terms

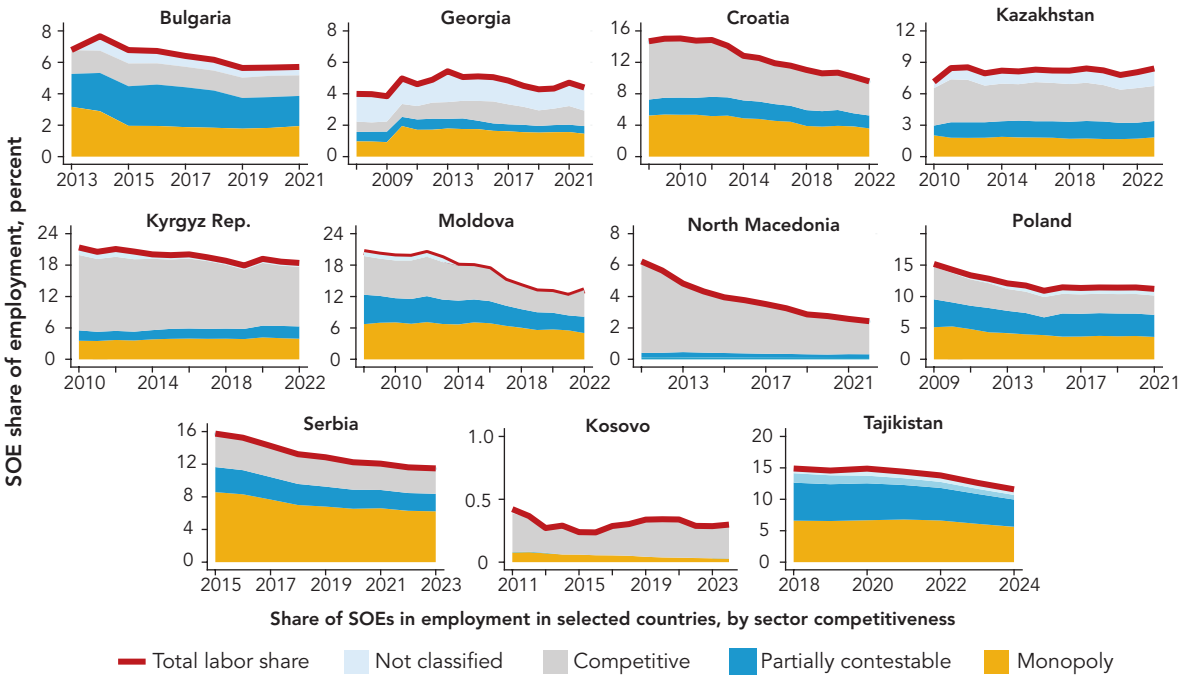
economies in ECA to –4.25 percent in Central Asia. Larger markdowns are also associated with lower labor productivity, reinforcing the drag on wages and performance as a response to weak incentives.

Policy-induced inefficiencies that raise labor costs increase the pass-through of markdowns to wages. Policies that raise the cost of hiring can amplify markdowns by reducing workers' mobility across firms, which strengthens employers' wage-setting power and lowers wages (Berger et al. 2022). Cutting revenue-reducing wedges is associated with lower markdowns. Overall, less interventionism is associated with more efficient market functioning, more jobs, and higher wages.

SOEs hinder job creation and trap many workers in low-productivity jobs

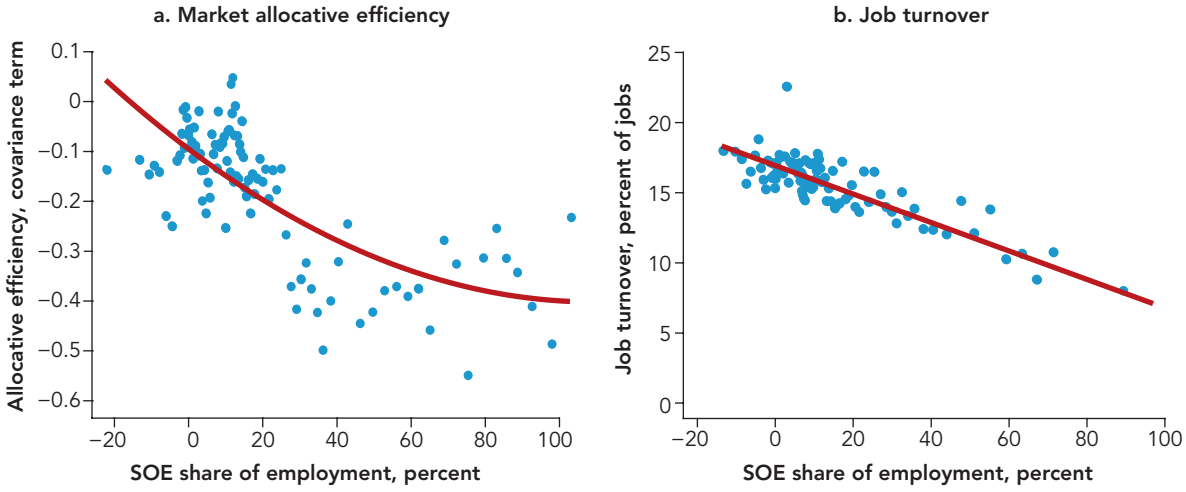
There are other mechanisms through which government intervention can result in inefficient labor market dynamics. The still large footprint of SOEs in many ECA countries is one of them, SOEs employ from 0.5 percent of all workers in Kosovo to 24 percent in the Kyrgyz Republic (figure 2.17). The sectors with the largest SOE presence (by employment) are (a) electricity, gas, steam, and air conditioning provision; (b) water provision and waste management; (c) air and land transportation; and (d) postal services.

FIGURE 2.17. SOEs are present across most sectors in the region, especially in more concentrated markets



Source: Iacovone et al. (2025b), based on firm-level data from national statistical offices; Orbis Bureau Van Dijk; Business of State dataset (World Bank 2023).
Note: SOEs = state-owned enterprises.

FIGURE 2.18. The presence of SOEs is associated with lower market dynamism



Source: Iacovone et al. (2025b), based on firm-level data from national statistical offices, Orbis Bureau Van Dijk, and the Business of State dataset (World Bank 2023).
Notes: Market allocative efficiency is the covariance term of the Olley-Pakes static decomposition (difference between the weighted and unweighted value added per worker). Job turnover is job creation and job destruction (sector-country-year combination) as a share of total employment. The unit of analysis is the sector (three-digit of NACE Rev. 2) at the country and year level. The specification controls for country-year fixed effects. Negative SOE exposure is due to the algorithm computing residuals after including control variables, although the underlying SOE exposure data are positive. The figure considers only sectors with at least 10 firms and positive exposure of sectors to SOEs. Georgia, Kazakhstan, and Moldova were excluded from panel b because panel data are required. SOEs = state-owned enterprises.

Most SOEs in ECA provide less business dynamism to the economy than private firms do. An increase in government shareholding is associated with a decrease in the cost of labor and capital. A 10-percentage-point increase in government ownership is associated with a subsidy of production costs of 0.7 percent via financial channels and a 0.5 percent subsidy via real channels (Cusolito et al. 2024). The largest subsidies are observed in construction (0.49 percent reduction in cost for a one percent increase in government shareholding), manufacturing (0.29 percent), ICT (0.27 percent), and finance (0.26 percent) (Cusolito et al. 2024).

The presence of SOEs is associated with lower efficiency and lower job turnover. The greater the presence of SOEs in a sector, the lower is the market allocative efficiency (figure 2.18, panel a) and the lower the job turnover (figure 2.18, panel b). This suggests that there is long-term crowding out of resources for privately owned firms.

Employment growth in SOE–dominated sectors is also less responsive to changes in productivity than in sectors dominated by private firms. A 10 percent increase in firm productivity is associated with a 9 percent increase in firm employment. This figure declines to 0.35 percent in sectors with intermediate levels of exposure to SOEs and becomes negative (–0.4) in sectors with strong SOE presence.[1]

1. Results were obtained by regressing log employment growth on log productivity and lagged log employment growth, controlling for country-time and sector-time fixed effects. Sectors with intermediate SOE exposure are those in which the share of SOE sales in total sales lies between the 50th and 75th percentiles (0.0026].

SOEs' labor demand does not respond to changes in revenue-reducing policies, such as taxes and tariffs. The private sector is highly responsive to these changes. The effect is greater in sectors dominated by private firms, among which an increase in revenue distortions reduces the elasticity of employment growth to productivity shocks by 0.16 point. In sectors with intermediate exposure, the figure is just 0.07 point. The effect is statistically insignificant in sectors with strong state participation.

Policy recommendations

The analysis in this section suggests several policy recommendations:

- **Remove policy-induced inefficiencies.** Such inefficiencies, specifically those that decrease firms' revenues (for example, taxes and tariffs) instead of labor costs (for example, taxes and social contributions), affect job creation, reduce jobs responsiveness to productivity shocks in the most dynamic sectors, and alter the distribution of productivity gains to wages in favor of managers instead of workers. Larger, mature, unproductive enterprises get subsidized access to labor, while high-growth firms—start-ups and young enterprises—are the ones with the highest job potential based on their relative productivity performance.

- **Revisit labor policies**. Traditional policies that incentivized high-paid jobs need to be revisited and revised, shifting government efforts toward more effective mechanisms to support job creation. Governments have often relied on the flexibilization of labor market regulations to foster formalization and job creation. Typical policies have included flexibilization of the type of contract and the minimum number of hours for which a firm needs to provide to hire a worker, lower mandated benefits, and decreased the time and cost to dismiss workers. However, removing revenue-reducing policy restrictions like sales taxes and tariffs may be more effective in fostering job creation. Simplifying the tax regime and facilitating tax filing can also complement these efforts. Given that jobwise it takes time for economies to bounce back during recovery phases and translate productivity gains into jobs gains, governments are advised to redouble efforts to remove inefficiencies, especially during these periods.

- **Facilitate efficient market functioning.** Market dynamism is key to growth of output, productivity, and jobs. Product market competition can be fostered by liberalizing market entry, removing exclusivity rights to operate, and eliminating rules that facilitate collusion and those that grant preferential treatment to specific firms to protect vested interests. These policies can create a more competitive, agile, and responsive environment (World Bank 2023).

- **Reduce the state footprint in the economy**. The findings also show that state-owned firms add less business dynamism to the economy compared to privately-owned firms, and state-owned firms crowd-out resources for more productive private companies. Com-

pared to private sector firms, SOEs create and destroy fewer jobs. SOEs need to be reformed to allow for a more efficient allocation of labor across firms, while paying attention to their distributional impact when workers need to move from the public to the private sector. Fostering competition by removing entry bans, auctioning licenses to operate in the market, offering contracts for differences to derisk private investments in upstream sectors, and guaranteeing competitive neutrality can level the playing field and foster private sector participation in SOE-dominated sectors. These reforms should be complemented by measures that remove other types of policy-induced inefficiencies as well as corporate governance reforms that can not only improve the performance of SOEs while they remain active in the market but also guarantee a more equitable distribution of productivity gains between managers and workers when they shift to the private sector.

- **Deepen trade integration with the world through enhanced infrastructure, trade, and FDI**. Reconnecting firms to dynamic GVCs is key to creating new jobs. Expanding and improving the transport network, reducing tariffs, and eliminating nontariff and logistics barriers can significantly lower export costs and unlock trade potential for small exporters. Streamlining customs procedures and adopting digital-trade agreements would enhance competitiveness in knowledge-intensive services. Maximizing the impact of FDI requires a robust, investor-friendly policy framework and targeted supplier-development programs that equip local firms to absorb foreign know-how. Redirecting tax incentives toward R&D partnerships and labor mobility schemes can amplify spillovers, embedding frontier practices into the domestic economy and igniting long-term productivity growth.

- **Facilitate firm upgrading**. The creation of high-growth firms for highly-paid jobs is essential. Policies that can help to do so include reducing the number of procedures, cost, and time of getting a license to operate. This can be achieved through online business registration, interoperability of public services, and direct firm incorporation. Decreasing paid-in minimum capital requirements and facilitating access to finance are also key to creating a dynamic entrepreneurial ecosystem.

- **Increase access to equity financing to support innovative entrepreneurial activity**. Recent World Bank research has shown that firms' capital structure matters for aggregate productivity and therefore labor demand, at least in part because of the value of equity financing for innovative firms (Didier and Cusolito 2024). Yet, venture capital financing is skewed toward a narrow set of high-tech sectors, suggesting that equity financing might play a limited role in advancing technological change in developing countries. This tech-centric focus of finance, justified by the sector's dynamism, is somehow prohibiting the allocation of finance, specifically equity, towards potential high-growth firms in other sectors. Misallocation of finance, at the regional and country level, is partly explained by the presence of frictions and market failures. Removing these is crucial to catalyze and mobilize private finance for development. While two-thirds of the productivity and jobs gains from fixing financial markets come from facilitating access to finance, either debt or equity, the rest depends on providing companies with the optimal capital structure to sup-

port their investments. In this context, de-risking equity investments is of paramount importance to mobilize private capital and re-orient it towards more efficient and innovative activities and firms. Investment readiness programs can also help identify and build high-quality pipeline for equity investments (Cusolito et al., 2023 and Cusolito et al., 2021).

- **Remove uncertainty, decrease sovereign risks, and create a more predictable and investment-friendly business environment**. Reforms in this space include removing entry barriers to FDI such as liberalizing the service sector, eliminating obstacles in specific sectors, removing exclusivity rights to operate that only favor domestic and/or public-owned firms, increasing pre-approval thresholds, expediting--through digitalization and interoperability--registration and incorporation, reducing minimum capital requirements, and creating a foreseeable regulatory environment for the private sector. It is important that reforms be complemented with the flexibilization of the labor market. Some of the reforms need to include elimination of restrictions on the type of contract and the minimum number of hours needed for a firm to hire a worker, allowing dismissal based on redundancy, need to adapt to shocks and trends, or support organizational restructuring.

Building a more skilled and adaptable labor force

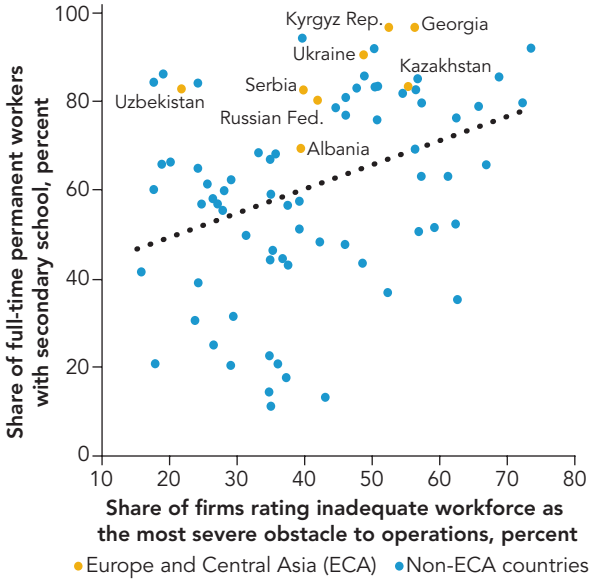
Workforce skills are an important driver of economic expansion, innovation, and productivity growth. Differences in the quantity and the use of skills account for about a third of the variation in GDP per capita across countries (Hsieh and Klenow 2010) and a comparable portion of the productivity discrepancies among firms (Criscuolo et al. 2021). Gains in learning and skills account for half of all global economic growth observed since 1980 (Gethin 2025).

Across ECA, firms consistently report a shortage of skills as one of the main constraints to their growth. This holds across firm sizes and countries and is perceived as a structural barrier to expansion, innovation, and productivity gains (figure 2.19). This finding is puzzling because educational attainment has increased considerably in ECA over the past three decades, with steady gains in secondary and tertiary education enrollment and completion. Labor force survey data show an increase in the share of the workforce that has completed tertiary education, from around 10 percent in 1997 to more than 30 percent in 2022, suggesting a more educated population than previous generations.[2]

Despite increases in educational attainment measured by the number of years of schooling, skill levels are significantly lower than in high-income countries. Although a subset of individuals in ECA perform comparably to German survey adults on literacy, most adults in the ECA countries studied performed below the German median—and far below the German mean—on international literacy assessments (Iacovone et al. 2025b).

2. Izvorski et al. 2024.

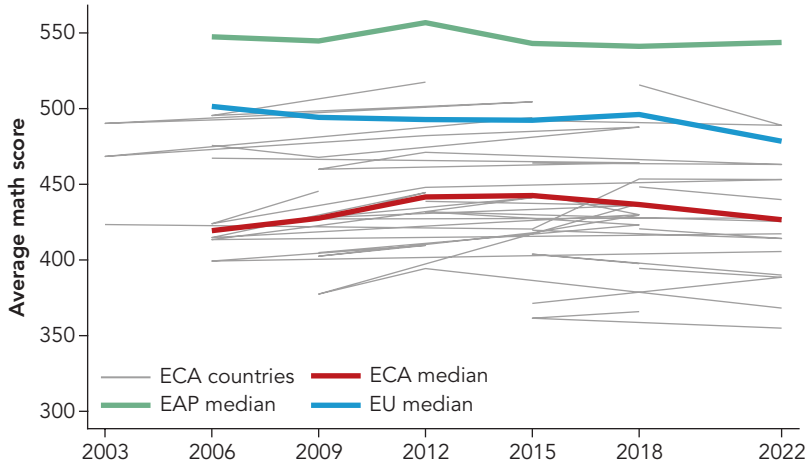
FIGURE 2.19. Lack of workforce skills remains an obstacle to firm growth



Source: Honorati, Santos, and Gomez Tamayo (2024), based on data from World Bank Enterprise Surveys.
Notes: Only the latest survey in each country is included. The surveys cover 78 countries from 2010 to 2019 and include subjective assessments of the degree to which each element of the business environment is an obstacle to the firm's operations. The surveys include only formal firms with five or more employees in all manufacturing sectors and selected services. ECA = Europe and Central Asia.

With some exceptions, the quality of education in ECA has declined over the past decade despite the increases in attainment. The region's median reading score on the Progress in International Reading Literacy Study (PIRLS), which is given to fourth graders, decreased from 547 points in 2006 to 518 points in 2021 in the ECA countries in which it is administered (Azerbaijan, Bulgaria, North Macedonia, Poland, Russia, and Türkiye). This decline is slightly larger than the decline in EU countries, where the average fell from 542 to 526 points over the same period. The median math score on the Programme for International Student Assessment (PISA), which is administered to 15-year-olds decreased from 441 to 427 points in ECA between 2012 and 2022. This decline is comparable to that in EU countries, where average PISA scores fell from 490 to 475 points (figure 2.20). The education quality gap in math PISA scores between ECA and the best

FIGURE 2.20. PISA math scores have declined in most countries in Europe and Central Asia



Source: OECD (2024).
Note: The figure plots the average score in math on the PISA among 15 years old students in ECA countries (thin grey lines), the ECA median (based on eight countries: Albania, Bulgaria, Croatia, Kazakhstan, Montenegro, Poland, Romania, and Türkiye) (red line), the median of the European Union (blue line), and the EAP median (based on the best performers in East Asia: Hong Kong SAR, China; the Republic of Korea; Japan; Macao SAR, China; Singapore; and Taiwan, China (green line). EAP = East Asia and the Pacific; ECA = Europe and Central Asia; EU = European Union; PISA = Programme for International Student Assessment.

performers in East Asia widened slightly, from 114 points in 2012 to 117 points in 2022—a difference of about four and a half years of schooling. Student performance in ECA declined markedly after the COVID-19 pandemic, even among the region's top performers.

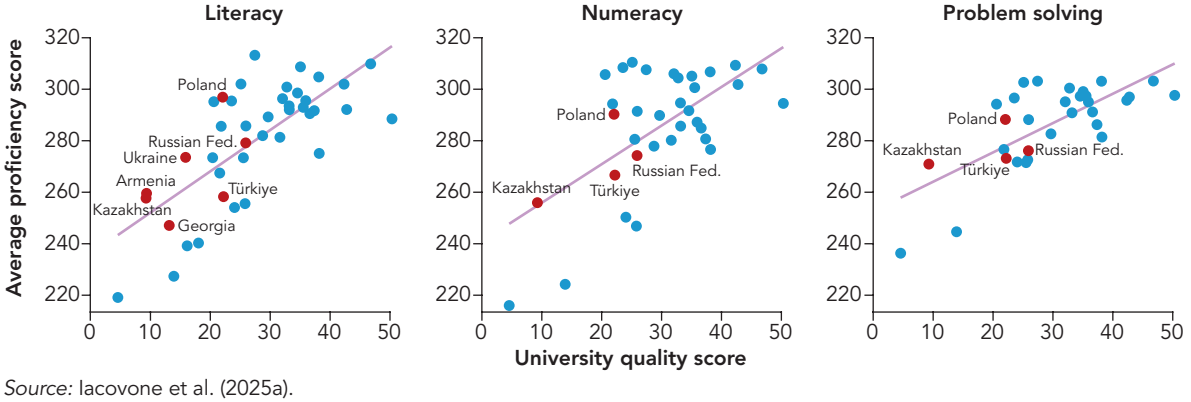
Students enrolled in vocational education, who represent almost half of the student population in upper secondary and who come overwhelmingly from disadvantaged backgrounds, perform poorly in basic subjects such as reading and math. The labor market advantage that vocational education graduates have at the beginning of their professional lives quickly dissipates, as the professional skills these students acquire become obsolete because of technological change (Dalvit et al. 2023; Hanushek et al. 2017).

Moreover, the quality of higher education in ECA is particularly worrisome. ECA countries appear to have a lower quality of higher education than warranted by the quality of their primary and secondary education, indicating that higher education in the region is underperforming relative to global trends (Iacovone et al. 2025a). Academic capture—with universities prioritizing political or business interests over academic excellence—inadequate funding, outdated curricula, a lack of modern infrastructure, and the proliferation of tertiary institutions, are among the leading causes of the poor quality of tertiary education.

The low quality of higher education is mirrored by the relatively poor performance on tests of cognitive skills among adults with tertiary degrees. Where higher education is of low quality, adults with a tertiary degree perform worse on literacy, numeracy, and problem-solving than they do in countries with better institutions of higher learning (figure 2.21).

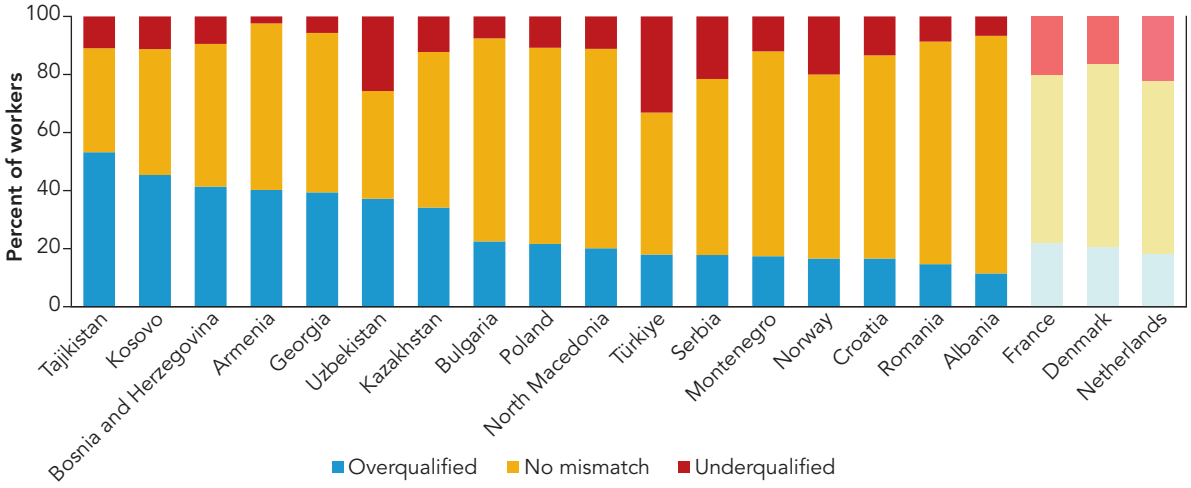
Poor quality of education can lead not only to productivity losses but also to skill misallocation. Overqualification is prevalent in many ECA countries. About 39–53 percent of the workforce in ECA countries has an educational degree that is above that required for their job. This figure is far higher than the 20 percent in high-income EU countries (figure 2.22). In all but one ECA country, the skills mismatch is more prevalent among tertiary-educated workers than lower-skilled workers (Bossavie and Torre 2025).

FIGURE 2.21. A worse quality of higher education is associated with a worse proficiency in cognitive skills among adults



Source: Iacovone et al. (2025a).
Note: This figure plots the country-level average skills proficiency scores for tertiary graduates (vertical axis) against the country-level quality of higher education (horizontal axis). The quality of higher education is proxied by the aggregate university quality score used in Demirgüç-Kunt and Torre (2022). Red points indicate Europe and Central Asia countries.

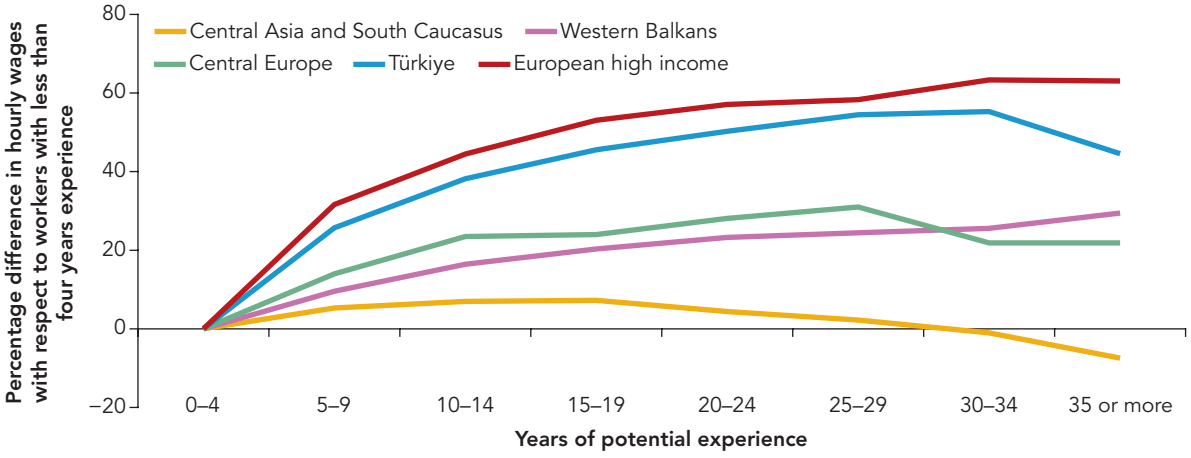
FIGURE 2.22. Large shares of workers in some countries in the region are overqualified for their jobs



Source: Bossavie and Torre (2025), based on data from national labor force surveys.
Note: Lighter colors indicate high-income EU countries. The figure includes only wage employees. Mismatch is based on whether the skill or education requirements of a job match the actual skills or education qualifications of the individuals in the jobs. The data are for 2023 or the latest year available.

Returns to experience—an indicator of skill development at work—are moderate at best in ECA. In Western Europe, wages tend to rise sharply and consistently with experience; workers with 35 or more years of experience can expect to earn 70–80 percent more than those just starting their careers (figure 2.23). In contrast, in Central Europe and the Western Balkans, wages rise more gradually, leveling off at 20–30 percent above entry-level wages by the time workers reach the highest experience bracket. In Central Asia and the South Caucasus, profiles are even flatter, with negligible returns to experience.

FIGURE 2.23. Returns to experience in Europe and Central Asia are modest at best, except in Türkiye

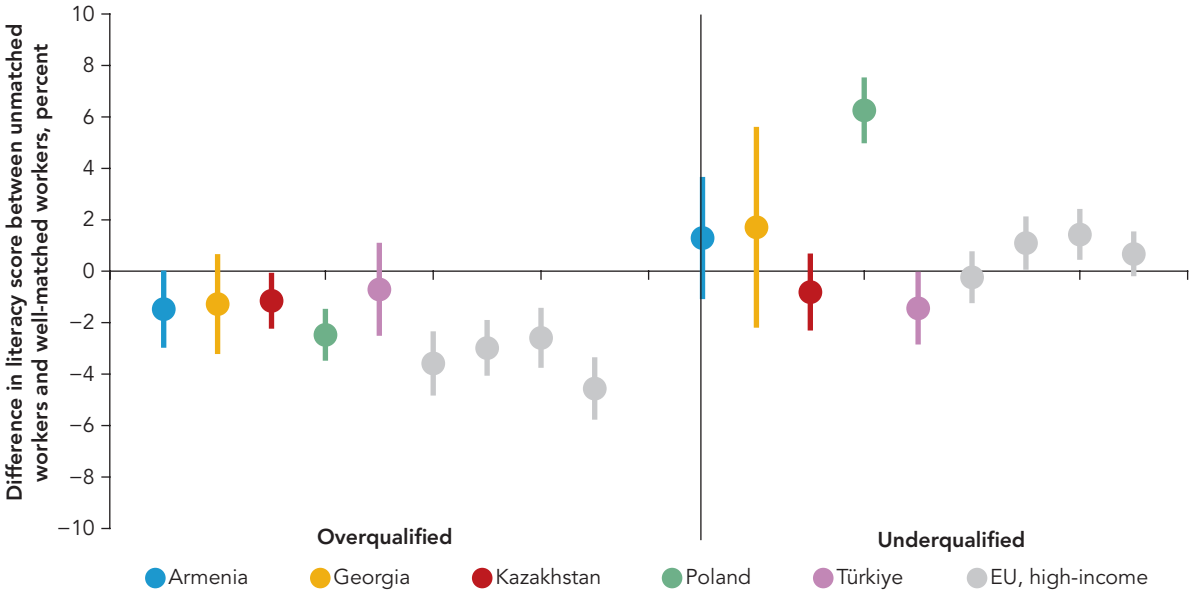


Source: Bossavie, de Hoyos, and Torre (2025), based on data from national labor force surveys and the OECD Program for the International Assessment of Adult Competencies.
Note: The figure includes only wage employees. The data are for 2010–23 (different periods across countries).

Skill misallocation is not only a reflection of poor skill proficiency. Skill mismatch does not appear to be exclusively the result of underlying differences in skill proficiency—at least for the subset of countries with more granular skills data. No ECA country with data except Poland shows a significant difference in cognitive skill proficiency between unmatched and well-matched workers (figure 2.24). This contrasts with advanced European economies, where vertical mismatch is associated with differences in foundational skills—particularly for overqualified workers. The pattern in ECA is particularly worrying from a productivity perspective because it suggests that skilled workers may be in jobs that are not objectively aligned with their skill level. This means that individuals in advanced European economies who appear overqualified may be underskilled, with their occupation matching their actual skill level.

The nature of labor demand can drive skill misallocation. The low accumulation of human capital in the workplace across ECA, as proxied by returns to experience, is lowest in low-skill services and manufacturing; it is slightly higher in global innovator services, particularly in skill-intensive social services. These sectoral differences are positively correlated with total factor productivity, suggesting that not only poor foundational skills but also weak labor demand may explain the limited human capital accumulation at work (Iacovone et al. 2025b; World Bank 2025a). Also, the East-West divide in the levels of returns to experience as shown in figure 2.23 could potentially indicate that integration with the European Union and

FIGURE 2.24. In most countries in Europe and Central Asia, proficiency in cognitive skills does not differ between unmatched and well-matched workers



Source: Calculations based on data from cycle 1 of the Organisation for Economic Co-operation and Development's Programme for the International Assessment of Adult Competencies (PIAAC) (Kazakhstan, Poland, Türkiye, and the EU high-income countries) and the World Bank's Skills Toward Employment and Productivity initiative(STEP) (Armenia and Georgia).
Note: Bars indicate 95 percent confidence intervals. European high-income countries are Belgium, Denmark, France, and the Netherlands. Estimated differences control for workers' education level. The data corresponds to 2012 for PIAAC cycle 1 (except for Kazakhstan, which corresponds to 2018), to 2023 for PIAAC cycle 2, and to 2013 for STEP.

global markets more broadly—with the corresponding trade and foreign investment flows—might also be shaping the demand for skills. This could partly explain the misallocation of skills in the region.

Skill misallocation could be the result of frictions stemming from institutional and structural features of the labor market. Even when workers possess the right skills and firms can utilize them and compensate them at the right prices, frictions may still prevent a successful match. Institutional features of the labor market—such as the minimum wage and the strictness of employment protection—are a potential source of friction, although, with some exceptions, they do not appear to be a binding constraint for job matching in ECA (Iacovone et al. 2025b). Limited labor mobility does not appear to be statistically associated with higher rates of skill misallocation. In contrast, the extent of informality—a structural feature of many of ECA's labor markets—is positively correlated with overqualification and low returns to experience. The scale of informality in some economies suggests that even workers currently in formal jobs may have alternated between formal and informal jobs throughout their professional lives, with negative consequences for their human capital accumulation. In economies with large informal sectors, job opportunities for highly skilled workers may be limited.

The overall size and composition of the labor force can affect skill allocation. Workers with the right skills—particularly women and the youth—may not participate in the labor market for reasons unrelated to their actual skill proficiency, thus constraining the effective supply of skills. This can be a constraint for job growth, particularly in regions where the workforce is shrinking.

Persistently low labor force participation rates among women are a feature of some ECA countries. Female labor force participation rates are as low as half those of men in Kosovo and Türkiye, and they are less than two-thirds of men's rates in most of Central Asia. These low participation rates reduce the potential labor supply of ECA countries. Cultural and societal expectations, combined with a lack of childcare support and gender-biased hiring practices, contribute to keeping female labor force participation rates low. Women are also more likely to be employed in informal and lower-paid sectors, exacerbating income inequality.

Many young people are excluded from the labor force. Youth employment rates are critically low throughout the region. Some of the youth are enrolled in education or training, but the share of youth who are NEET is substantial, especially in the Western Balkans. NEET rates among youth exceed 30 percent in Kosovo and 20 percent in Albania and Montenegro. Many young people are employed in precarious, informal, or temporary positions, where they lack job stability, benefits, and opportunities for career advancement. The problem reflects structural weaknesses, limited job opportunities, and the lack of alignment between education systems and labor market needs.

Advances in the medical field and promotion of healthy living have increased healthy life expectancy and are allowing older individuals to stay in the labor force longer or return to work from retirement. However, existing policies seem to have exhausted the potential of increasing the labor force participation of older workers in ECA countries. Recent growth in the labor force participation of older workers is attributed mainly to changes in the social security and tax systems. A possible approach for redesigning labor market policies is to lower the costs of hiring and retaining older employees and make post-retirement work more attractive to older workers. On the demand side, strict employment protection increases the costs of hiring and retaining older workers. On the supply side, work flexibility is one of the main factors that determines whether older workers continue working after retirement. It is important that labor market legislation support employees seeking more flexible work arrangements, including work hours, extended vacation time, and the ability to work remotely or in a hybrid fashion. Practices such as "returnships"—internship-type periods during which retirees can temporarily return to assist on a particular task or project or to mentor younger workers—could increase the attractiveness of work for retirees. Labor regulations can also make it easier for older workers to work for themselves. Deemphasizing formal educational requirements and prioritizing skills, competencies, and years of relevant experience could improve the labor-market prospects of many older workers. Skill-based hiring could help overcome the challenges that older workers face, stemming from a lack of traditional education or difficulty changing careers.

Migration to some ECA countries that were traditionally considered sending countries has increased in recent years, providing temporary relief to the decline in the workforce size. This is the case, for instance, of Croatia, Poland, and Türkiye, partly buoyed by the large number of refugees coming from the Arab Republic of Syria (for Türkiye) and Ukraine (for Croatia and especially Poland) but also by economic migrants from other regions of the world. Countries in the region can adapt successful models from high-immigration countries to their specific conditions and needs. They can proactively develop strategies aligned with labor market demands to attract qualified migrants, particularly to high-skill sectors that drive innovations and in care sectors supporting aging populations. Such policies can be supplemented by programs to facilitate integration, language acquisition, certification, and credential recognition, as well as the social inclusion of migrants and their families (Bossavie et al. 2024).

Policy recommendations

- **Improve the quality of education, particularly for foundational and socioemotional skills**. It is important that education reforms help ensure that all students acquire essential competencies, such as literacy and numeracy, at an early stage. Such skills are especially critical given the rise in automation and the increasing complexity of tasks.

- **Enhance higher education quality and efficiency.** Consolidating universities (merging two or more institutions into a single entity) could address the decline in student enrollment and the need for improved educational quality. Consolidation can achieve significant cost savings by eliminating duplicate administrative structures and optimizing infrastructure. It also makes it easier to streamline curricula, focusing resources on high-quality, in-demand courses. Universities also need to improve their management and increase their autonomy.

- **Improve youth employment outcomes by reforming vocational training, investing in apprenticeships, and providing career guidance**. The vocational education and training systems in ECA deserve deep reform. Delaying vocational school tracking to the end of lower-secondary education would help reduce talent misallocation, and it would help to develop strong foundational skills among vocational education students. It is key for the private sector to be involved in providing work-based learning and apprenticeships.

- **Modernize skills development by reforming credentialing systems and expanding workplace learning opportunities**. First, shifting away from excessive reliance on formal degrees toward modular, competency-based certification frameworks would ensure that credentials more accurately reflect actual competencies and support lifelong learning. Second, enhancing workplace learning by increasing access to high-quality training opportunities is essential, especially in settings where on-the-job training is limited but has been shown to boost productivity significantly. Governments can play a pivotal role by supporting cost-sharing initiatives for training, promoting skill diagnostic assessments to tailor programs to workers' needs, and ensuring that foundational skill gaps are addressed before investing in advanced technical training.

- **Improve the tools for addressing the mismatch between worker skills and job requirements.** Enhancing labor market observatories that monitor skill demand and wage returns, as well as modern, data-driven public and private employment services, can help job seekers, especially young people, make more informed decisions about training and employment opportunities. Implementing more effective matching mechanisms is crucial for reducing both the prevalence and persistence of skill mismatches and overqualification.

- **Promote female labor force participation, through support for childcare, elder care, flexible work, and norms-focused interventions.** Access to public and private daycare and elder care significantly increases female labor force participation, including for older workers. Expanding support for family care may not be enough, however, if gender norms at home or in the workplace prevent women from participating in the labor market.

- **Support disadvantaged groups with targeted active labor market policies.** Active labor market policies (ALMPs) are crucial tools for improving employment opportunities and earnings among disadvantaged groups. Evidence suggests that supply-side interventions, such as vocational and soft skills training, can have a significant impact on labor market outcomes, particularly when programs incorporate practical experience and job

referrals. Tailoring ALMPs to local contexts and combining multiple intervention types increases the likelihood of positive outcomes for disadvantaged groups.

- **Provide adequate social protection to help job transitions**. An adaptable workforce requires enhanced protection both during employment and especially during transitions between jobs**.** Unemployment insurance with activation requirements improves the quality of job matching, while ALMPs that combine income support with vocational training could be beneficial in the long run. For displaced workers, portable benefits and targeted adjustment assistance could be implemented. Social protection can also play a key role in making technological transitions inclusive and protecting vulnerable groups. Localized policies are essential for stabilizing incomes and protecting workers and communities, ensuring a just transition.

- **Encourage healthy and active aging, to extend working lives.** Key recommendations for doing so include investing in healthcare systems to improve health outcomes for older adults, supporting lifelong learning and skills development to keep older workers engaged and adaptable, and reforming labor market policies so they can better accommodate and leverage the experience of aging workers. Encouraging behavioral changes and creating age-friendly workplaces can also help older individuals remain productive, reduce dependency ratios, and contribute to sustained economic growth.

- **Develop policies to retain talent, attract return migration, facilitate regional labor mobility, and mitigate the negative impacts on the domestic labor supply**. Origin countries can do little about pull factors, but they can try to diminish the strength of push factors, by, for example, increasing the competitiveness of wages in critical high-skilled occupations. Smaller countries could focus on developing niche sectors, such as personal and health services for tourists, which may become strong enough to retain qualified workers when these sectors reach critical mass. Bilateral migration agreements could also help.

Looking forward for job creation—cross-cutting and sectoral opportunities

Looking ahead, countries across ECA can create more and better jobs by harnessing a set of cross-cutting opportunities. AI and broader digital technologies have the potential to catalyze innovation and firm creation, lift productivity, and open new forms of work. These can happen provided countries invest in the complementary capabilities that make technology productive, including digital infrastructure, workforce reskilling and on-the-job training, modern management and organizational change, and agile labor regulations. There is also the opportunity to reignite manufacturing through deeper trade and value-chain integration by supporting firm upgrading, easing customs and logistics, embracing digital trade, and reorienting incentives toward innovation and R&D. Removing frictions and market failures in

financial markets is critical to catalyze private finance for development. Reigniting the manufacturing sector to tap into new sources of comparative advantages and fostering upgrading in the service sector will require significant equity-backed investments. De-risking these investments is key to mobilizing private capital.

At the same time, country- and sector-specific pathways are as diverse as the region itself. Central Asia will continue to benefit from positive albeit slowing population growth. The countries also have abundant opportunities to create jobs by scaling up production and exports related to agrifood and livestock processing, tourism, logistics, renewable energy, and precious metals and rare earth mining. The countries in Central Europe can deepen their participation in manufacturing and energy value chains, and bolster their share in tradable services, including medical services and services to support the rapidly aging population in the European Union. Türkiye can further leverage its strategic location for advanced manufacturing including the automotive industry, expand renewable energy production, and scale its tradeable and digitally enabled services sectors. Rebuilding its economy after the war, Ukraine will have opportunities to create jobs by investing in the resilient IT and digital service sector, modernizing agriculture and expanding food processing capabilities, restoring and improving the energy and logistics infrastructure, and rebuilding and upgrading manufacturing sectors to integrate into European supply chains. The countries in the Western Balkans can accelerate agribusiness and food processing, upgrade and diversify tourism, target light manufacturing, and further develop tradable digital services. The other countries in the region can integrate more tightly into the EU and regional logistics, scale high-value and climate-smart horticulture, and grow offshoring digital services.

AI and other digital technologies have the potential to boost productivity and employment growth—if the right policies are in place

AI is rapidly transforming the global economy, offering unprecedented opportunities to boost productivity, spark innovation, and improve living standards. By automating both routine and even some non-routine tasks, optimizing business operations, and enabling new forms of work, such as virtual migration, AI is helping firms and workers achieve greater efficiency and extend productive working lives. These benefits are especially promising for ECA, where aging populations and slowing growth call for new engines of economic dynamism. With the right investments and policies, AI can be a powerful catalyst for inclusive and sustained development across the region.

The full impact of AI on productivity has yet to materialize at the macro level, because time is needed to build complementary capabilities. Skilled labor, modern management systems, and organizational restructuring will help integrate AI into firms' operations (Cirera et al. 2024; Bergeaud et al. 2025). In ECA, where digital infrastructure and firm-level innovation are still far from the European frontier, these foundational investments are crucial. Many countries in the region are making strides in digital adoption and internet access, laying the groundwork for broader AI–driven gains. Still, AI adoption is in its early stages across the region.

The labor market effects of AI vary significantly across demographics and skill levels. Unlike earlier waves of automation, which displaced middle-skilled jobs, AI is now reshaping roles that require advanced cognitive and analytical skills. High-income economies—where up to 60 percent of jobs are exposed to AI—face the greatest disruption (IMF 2024). In ECA, where exposure levels are much lower, countries may have more time to adapt. Younger workers are facing increased competition in fields such as software development and customer service; older workers may benefit from experience-based skills that are less susceptible to automation (Brynjolfsson et al. 2025). These shifts highlight the importance of proactive labor market policies.

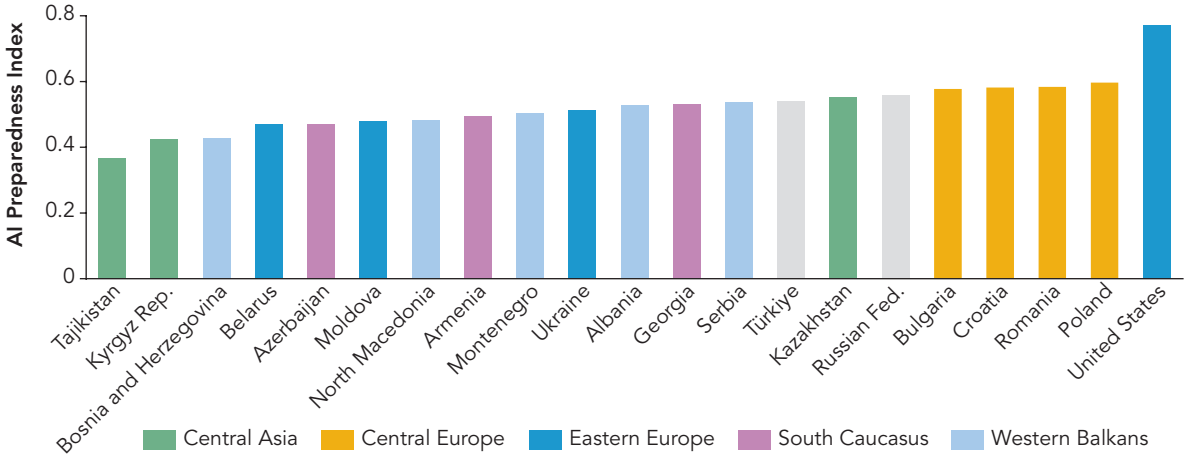
Access to digital technologies is almost universal in ECA, but differences between the firms' use of basic digital technologies in most of ECA and advanced economies are stark. Between 2016 and 2023, all ECA countries reported improvements in the share of firms using the internet, computers, cloud services, and e-commerce. However, in most countries, the gap with the global technological frontier in each of these areas also widened. The divide seems to be driven by SMEs (Iacovone et al. 2025b).

Firms in ECA struggle to move from initial adoption to more frequent and productive use of advanced technologies. Access to basic digital enablers is nearly universal in the ECA countries included in the World Bank's Firm-Level Adoption of Technology survey, but there is a wide gap between adoption and intensive use (Iacovone et al. 2025b). Many firms in ECA have begun to use sophisticated digital technologies, but they are not yet employing them intensively in their business operations. To reap the productivity gains of digitalization, firms could use these technologies intensively, especially for administration, production planning, and marketing. This pattern of higher rates of adoption and lower rates of intensive use is also observed in high-income economies, although the differences between adoption and intensive use are smaller than in ECA.

ECA countries lag in AI preparedness. ECA countries significantly lag the United States in AI preparedness, according to the International Monterary Fund's AI Preparedness Index (AIPI), a measure of macro-structural indicators relevant to AI adoption (Cazzaniga et al. 2024). The United States scores 0.771 on the AIPI (figure 2.25). The average for ECA countries is 0.511. Tajikistan (0.367), the Kyrgyz Republic (0.426), and Bosnia and Herzegovina (0.428) have the lowest AIPIs in the region; Poland (0.598), Romania (0.584), Croatia (0.582), and Bulgaria (0.577) the highest in the region. Countries with higher AIPI scores are more closely integrated with the European Union and adhere to EU standards and best practices.

Lack of AI preparedness partly reflects deficiencies in digital infrastructure. The availability of AI infrastructure is crucial to AI preparedness, because it represents a country's capacity to develop, train, and deploy advanced AI systems. Countries with higher server densities possess the hardware backbone necessary to compete in AI innovation, support AI startups, and implement AI solutions across various sectors, including healthcare, transportation, and public services (Maslej et al. 2025). Server density is relatively low in the

FIGURE 2.25. Countries in Europe and Central Asia lag the United States in preparedness for AI

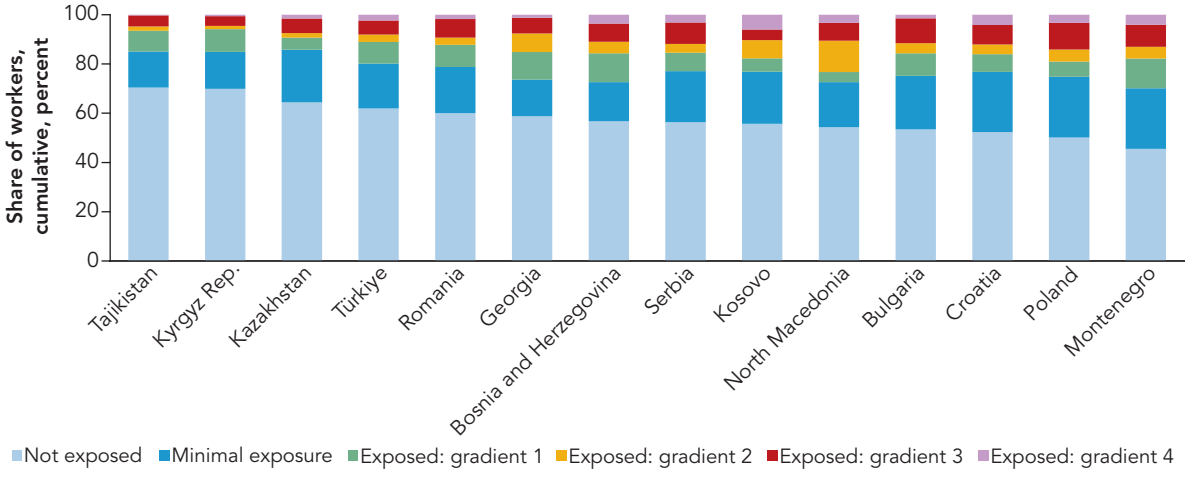


Sources: IMF (2024) and WIPO (2024).

countries of Central Asia, Armenia, Albania, Montenegro, and North Macedonia, averaging fewer than 3,000 servers per million people. The number of servers is especially low in Tajikistan (120 per million people), Turkmenistan (140), and Azerbaijan (550). Even countries with the highest server density in the region— Bulgaria (54,100 per million people), Poland (37,300), and Croatia (29,400)—lag the United States indicating significant room for expansion.

The exposure of jobs to AI is heterogeneous both within and across countries in ECA. On average, around 30 percent of ECA's workforce has some degree of exposure to automation through generative AI (figure 2.26). Exposure is highest in the Western Balkans and

FIGURE 2.26. About 20–30 percent of workers in Europe and Central Asia are exposed to generative AI



Source: National labor force surveys.
Note: Estimates of exposure based on Gmyrek et al. (2025). Minimal exposure means only a few tasks are at risk of automation by generative artificial intelligence (AI). Gradient 4 refers to jobs with the highest share of tasks at risk of AI-driven automation.

lowest in Central Asia. It is highly correlated with educational level: Exposure to AI affects less than 7 percent of workers with lower-secondary education, 23 percent of workers with upper-secondary education, and almost 33 percent of workers with tertiary education. Women tend to be more affected by AI–driven automation risks than men, because women are more likely to work in jobs where a larger share of tasks are at risk of being automated. Differences across age groups tend to be small, with the 25–34 cohort most exposed.

Exposure does not necessarily mean displacement; it can also mean augmentation. In many jobs, particularly where exposure is concentrated in a few tasks, AI–enhanced automation may free workers to spend more time on tasks that cannot be automated, leading to higher productivity.

To harness AI's full potential, ECA countries are advised to invest in reskilling and on-the-job training, update labor regulations, and support innovation that complements human capabilities. Targeted policies to close skill gaps, foster competition, and incentivize digital adoption will be essential. With thoughtful and inclusive strategies, AI can become an important driver of productivity growth and job creation in ECA.

ECA can strengthen its manufacturing base

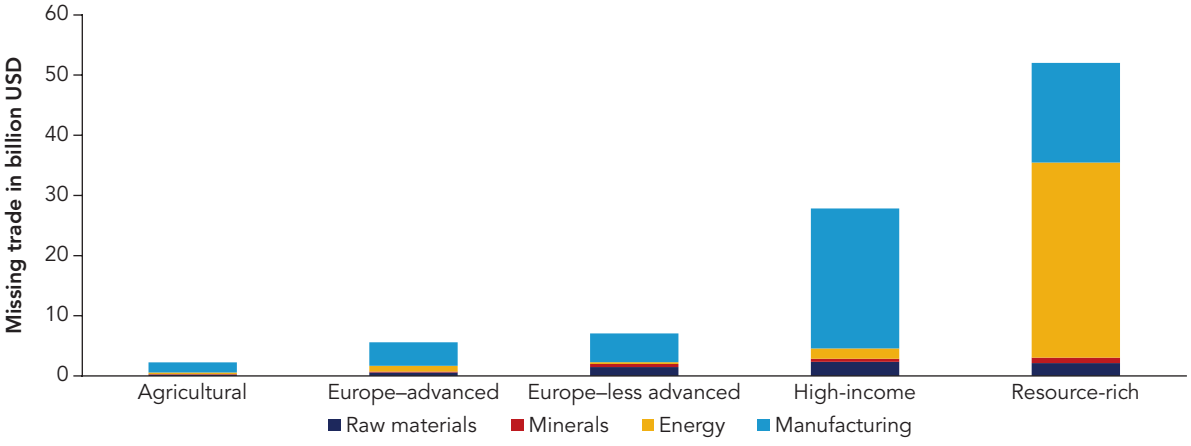
The region's recent productivity slowdown is linked to a decline in the manufacturing sector and a shift toward lower-skill activities. Reversing this trend by reallocating resources toward modern manufacturing can reignite productivity growth and broaden opportunities for higher-quality jobs. Evidence from within the region shows both capacity and precedent: parts of the Western Balkans have reached industrialization peaks comparable to or higher than those in some advanced European economies. Integration into automotive value chains in Central Europe demonstrates how manufacturing can anchor technology transfer and upgrading. In short, there is room for re-industrialization that boosts aggregate productivity—provided countries lean into policies that support firm upgrading and integration into markets beyond their small domestic bases.

Trade integration with the European Union, where it has occurred, has mitigated deindustrialization. Several developing countries outside ECA have seen a pattern of deindustrialization that can be attributed to import competition from China and other countries, and to broader globalization (Sposi et al., 2021). In this sense, the trade links of many ECA countries to the European Union—particularly those in the western part of ECA—may have partially shielded the region from faster deindustrialization, which would have otherwise occurred given the extent of distortions in the economy. However, this inward protection has not created the right incentives for upgrading and diversification, which are needed to export to high-income countries.

Therefore, there is clear, untapped growth potential in manufacturing across ECA. A large share of the region's "missing trade" is in manufactured goods and is concentrated in OECD markets especially the United States and Japan—indicating sizeable, unexploited

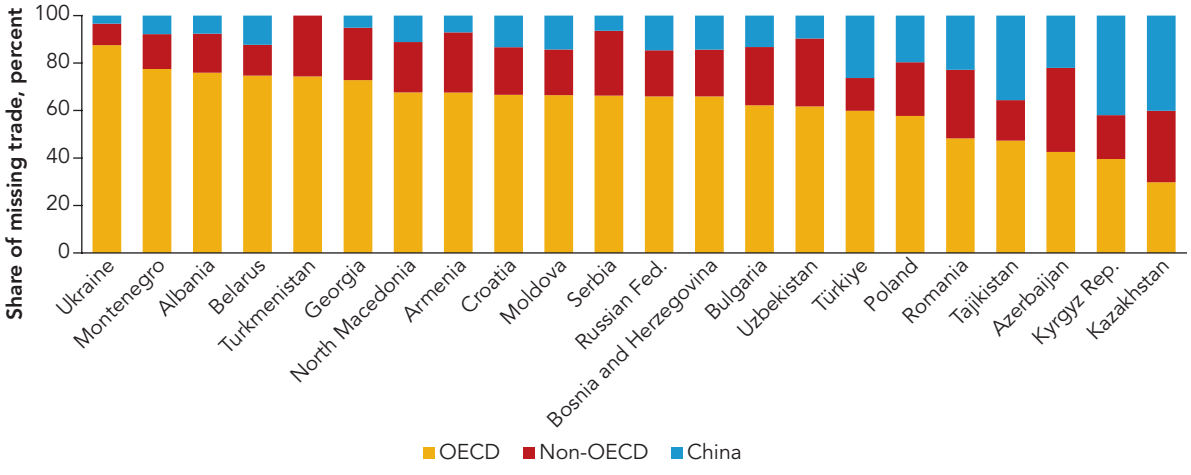
export opportunities beyond the European Union, where ECA already trades intensively (figures 2.27 and 2.28). At the same time, supply-chain realignments (nearshoring and friend-shoring) create openings for higher-value production close to Western Europe, building on the demonstrated strengths of several ECA countries in industries like vehicles and machinery and on the upgrading of local supplier networks around foreign assemblers. Although

FIGURE 2.27. A large share of missing trade in Europe and Central Asia is in manufacturing, 2020–2022 average



Sources: Iacovone et al. (2025b) based on data from Comtrade.
Note: The estimates were obtained from a gravity model and correspond to country averages for 2020-2022. The following countries are included in each group: Agriculture (Kyrgyz Republic, Tajikistan, and Uzbekistan); Europe advanced (Belarus, Bosnia and Herzegovina, Bulgaria, Georgia, Montenegro, North Macedonia, and Serbia); Europe less advanced (Albania, Armenia, Moldova, and Ukraine); High-income (Croatia, Poland, Romania, and Türkiye); and resource-rich (Azerbaijan, Kazakhstan, the Russian Federation, and Turkmenistan).

FIGURE 2.28. Most of the missing trade in Europe and Central Asia is with high-income countries, 2020–2022 average



Sources: Iacovone et al. (2025b) based on data from Comtrade.
Note: The estimates were obtained from a gravity model and correspond to country averages for 2020-2022. OECD = Organisation for Economic Co-operation and Development.

intra-regional trade has partly cushioned some economies from import competition, it has not driven sufficient diversification or upgrading. Deeper participation in GVCs—with more sophisticated products, broader market reach, and learning by exporting and importing—remains the key lever to unlock this potential (Iacovone et al. 2025b).

New jobs can be created to protect the environment

Among the most important structural changes that ECA will face in the next decades is the shift towards a less energy intensive economy. This entails massive investments in technology and infrastructure and innovation in production models, and will also imply strong changes in the labor market as new jobs will emerge, while others will be adjusted or replaced (ILO 2016). This transition has the potential to create new and better jobs while protecting the environment (Ruppert Bulmer and Rutkowski 2021; ILO 2016; 2018; World Bank 2021). At the same time, it will affect employment in some areas, mainly in fossil fuel and particularly the coal mining sector (ILO 2016). According to the International Labour Organization (2018), adjustments in the production and consumption of energy could eliminate around 6 million jobs but create about 24 million new ones, including indirect jobs.

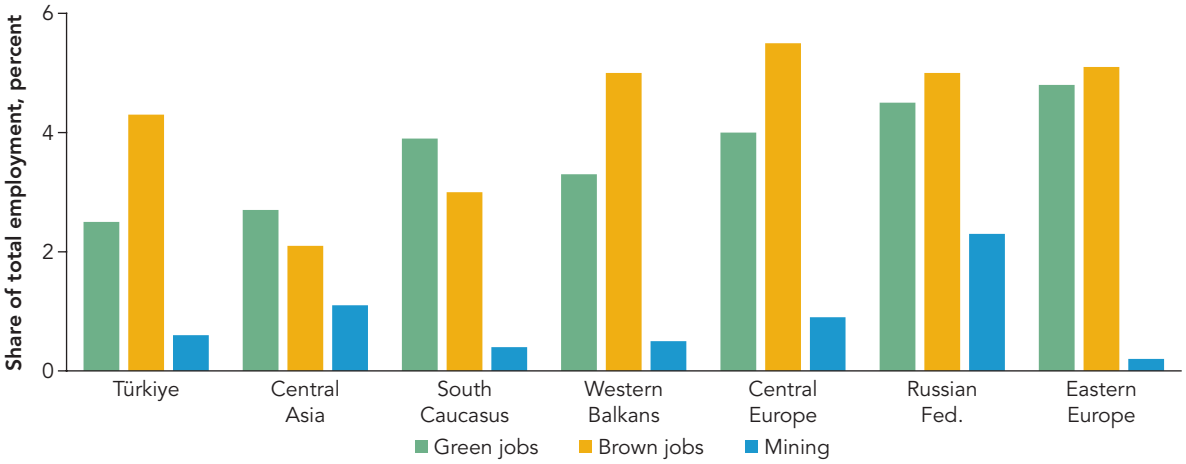
Many countries in Central and Eastern Europe are still heavily reliant on coal, both for power and jobs. The region, on the other hand, has significant renewable energy sources and large deposits of gas and other natural resources. For example, Turkmenistan has the sixth-largest gas deposits globally and is the world's eighth most intensive energy consumer. Both Kazakhstan and Turkmenistan are the region's two leading producers and consumers of fossil fuels (European Parliament 2019).

In this transition, ECA countries will be impacted differently. In ECA, around 4 percent of the tasks carried out in an average job can be classified as "green." The lowest shares of green tasks in jobs are seen in Türkiye (2.5 percent), Central Asia (2.7 percent), and the Western Balkans (3.3 percent) (figure 2.29). In terms of brown jobs, at least as defined by the emissions of the industries where they take place, the highest shares in employment in ECA are observed in Central Europe at an average of 5.5 percent. Other subregions where the share of brown jobs is higher than the ECA average are Russia, Türkiye, and the Western Balkans (figure 2.29).

The mining sector has already been undergoing a process of downsizing in several countries in the region. While, on average, only 0.8 percent of the ECA workforce is employed in mining; however, this figure is particularly higher in countries such as Kazakhstan (3 percent) and Russia (2.3 percent).

A particular characteristic of the ECA region, especially Central Asia, is that the companies that contribute roughly half of the aggregate carbon footprint of any economy—in sectors like energy and transport—are owned by the state. In addition, these SOEs do not work efficiently and have subsidized access to both financial and real resources,

FIGURE 2.29. There are more brown jobs than green jobs across most of Europe and Central Asia



Sources: The shares of green and brown jobs were calculated following the methodology in World Bank (2022). The share of mining jobs was calculated based on data from labor force surveys.
Notes: This graph plots the subregional country average (population weighted) of the share of green tasks in jobs among the employed population (green bar), the share of brown jobs among the employed population (orange bar) and the share of employment in mining (NACE code B) among the employed population (blue bar). Eastern Europe includes Belarus and Moldova. The South Caucasus includes only Armenia and Georgia.

crowding out labor and capital for more productive and greener firms. Yet, subsidized prices put a lot of fiscal pressure on governments. Therefore, the region needs to pave the road for private sector participation in the renewable sector. De-risking investments is key, as intermittence and lack of storability coupled with uncertainty about weather conditions make investments in renewables highly risky and uncertain. Contracts for differences can help derisk them and mobilize capital to achieve climate plans like Nationally Determined Contributions.

The proximity of ECA to EU markets, characterized by stringent environmental regulations and a skilled workforce, creates favorable conditions for adopting renewable technologies in ECA countries. Countries in Eastern Europe are well-positioned to capture manufacturing opportunities, creating new jobs in the production of electric vehicles, renewable energy equipment, and batteries. Job-creating opportunities in Central Asia could be centered on renewable energy production and mining the rare minerals that are essential for renewable technologies. New and better jobs in Central Asia could be fueled by growing domestic energy demands, the region's strategic location between the European and Asian markets, and the abundance of land for solar and wind renewable energy projects. The Western Balkans and the South Caucasus can leverage their strategic positions to become green energy corridors, transforming these countries into renewable energy exporters while creating jobs in construction, operations, and maintenance. The development of trans-regional green energy infrastructure would generate employment across the value chain—from project development to grid management.

Policy recommendations

- **Invest in digital infrastructure, especially in lagging regions.** Broader adoption of AI will require significant upgrading of the region's digital infrastructure, including expansion of broadband access and server capacity. PPPs will help accelerate the development of digital infrastructure.
- **Shift support for digital technology from simple subsidies to comprehensive adoption strategies.** Many firms in the region struggle to incorporate digital technology into their daily operations. Public support needs to go beyond providing incentives to acquire technology, to incentivize the integration of these technologies into business processes.
- **Reduce the digitalization gap with frontier economies through targeted investments in education and skills.** A key barrier to firm-level digital transformation is the shortage of workers with expertise to deploy and manage advanced technologies. Enhancing specialized digital training—through short training programs and on-the-job learning—can significantly improve firms' capacity to adopt and benefit from digital tools. By aligning workforce capabilities with technological advancements, governments can accelerate private sector digitalization and boost productivity.
- **Strengthen logistics and corridor competitiveness by coupling physical investments with complementary reforms**. Streamlining nonphysical barriers such as border processes and standards, providing broader trade facilitation, and reforming SOEs in the sector are fundamental elements of a growth agenda for transportation and logistics.
- **Advance regulatory reforms to expand the energy sector.** Energy transition opportunities depend on predictable renewable energy frameworks, cost-reflective pricing, and grid and transmission upgrades that de-risk private investment.
- **Develop high-quality infrastructure for standards and certification to facilitate agrifood upgrading and export diversification.** By ensuring reliable quality, safety, and traceability, this can lower transaction costs, reduce border rejections, and build buyer confidence, enabling entry into higher-value segments and new destinations.
- **Foster a reform-minded investment climate to crowd in private capital at scale across the ECA region**. This implies separating regulatory from commercial roles in government intervention, dialing back distortive subsidies and controls, and deploying credible PPP frameworks.

Summarizing the policy priorities to address the jobs challenge

Building on the ongoing transition from planned to market economies and with an ambition to grow to high-income status, the countries in ECA can tackle the jobs challenge. Government priorities can be summarized around the three key pillars:

Pillar 1: Creating the infrastructure foundations for jobs. This includes developing the physical infrastructure and the human infrastructure.

Modernizing skills development beyond formal degrees is important. Competency-based, modular certifications that recognize both formal and informal learning expand pathways for workers to upgrade skills over time. Diagnostics that tailor training to individual needs, along with co-financing arrangements that align worker and firm incentives and credible certification systems, can scale workplace learning—particularly where on-the-job training has been limited. To widen participation, it is recommended that policies expand childcare and eldercare, encourage flexible work, and address norms that dampen women's employment. Targeted active labor market policies, combining practical training with selective demand-side instruments such as wage subsidies, can improve outcomes for disadvantaged groups when tailored to the context. Throughout, social protection can support job transitions by pairing unemployment insurance and portable benefits with activation and re-skilling, recognizing that technological and structural change will create and destroy jobs in tandem. Embedding inclusion and resilience in these transitions is fundamental.

Activating older workers in aging societies is critical. The aging countries of Central and Eastern Europe can implement a range of policies to extend productive working lives. This requires introducing flexible pension systems that allow for partial retirement with partial work. Governments may wish to investigate the possibility of implementing laws against age discrimination, subsidizing workplace adaptations for older workers, and providing tax incentives for firms that retain workers beyond the standard retirement age. Public employment services could offer retraining programs that focus on re-skilling for workers aged 50 and above, coupled with wage subsidies for employers hiring older workers. These policies could help retain and reintegrate many experienced workers into the labor market, partially offsetting demographic decline while addressing existing skill shortages in priority sectors.

Managed well, migration can help alleviate labor shortages and expand opportunities. Developing bilateral migration agreements in which destination countries fund education and training programs in origin countries can also support a more efficient allocation of talent across borders. This would help ensure that destination countries can address the skill shortages they face, while also improving the skills of the origin countries' workforce. Returning migrants and diaspora communities could be considered as key agents for creating productive connections to global sources of knowledge, capital, and goods.

To seize the opportunity of digitally-enhanced job creation, several foundational investments are needed. Accelerating digital and AI readiness entails investing in digital infrastructure, including broadband and server capacity in lagging regions, and shifting from narrow acquisition subsidies toward comprehensive adoption strategies that embed digital tools in business processes. Closing the digital skills gap requires a mix of education reforms, short-cycle programs, and on-the-job learning aligned with evolving firm needs, enabling continuous upgrading as technologies diffuse.

Healthcare and environmental quality are critical preconditions for successful job creation. Countries can consider investing in primary and preventive care programs, strengthening public health systems, improving access to essential medicines, and building healthcare infrastructure that can respond to emergencies while maintaining routine services. Clean air and water infrastructure have a direct impact on worker health and productivity. Investments in water treatment facilities, sanitation systems, and air quality monitoring and control reduce the disease burden and improve the quality of life, thereby attracting investment and skilled workers.

Transportation infrastructure connects workers to jobs and businesses to markets. Modern road networks, efficient public transit systems, railways, and logistics hubs reduce transportation time and costs, expanding the effective labor market and enabling businesses to access wider customer bases and supply chains. The expansion of service-based economies and emphasis on private sector development demand transportation systems that can support both traditional manufacturing and modern tradable services. The development of intra- and inter-regional corridors to connect the European and Central Asian markets is especially needed for addressing the fragmentation of labor markets and business competitiveness across the region. Efficient transit systems in urban centers and agglomerations across the region can improve labor mobility, thus expanding labor market catchment areas and facilitating workers' access to higher-productivity jobs beyond their immediate localities. Investments in multimodal transportation hubs and the modernization of railways could be crucial for the landlocked countries of Central Asia and the South Caucasus, promoting their integration into global value chains.

Affordable, accessible energy infrastructure is the foundation of job creation and economic transformation. Affordable and reliable energy is essential for productive employment opportunities in ECA to materialize. ECA's energy transition is unlike that of any other region because countries in the region face distinct challenges. Demographic divergence, geographical location, natural endowments, political situation, and initial conditions all require country-specific approaches. In Central and Eastern Europe, the shift away from coal requires support for transitioning workers and investments in renewable infrastructure that can generate new employment opportunities. Expanding populations in Central Asia require increased access to energy, leveraging hydropower potential and solar resources, with natural gas playing a transitional role in Kazakhstan and Turkmenistan. The South Caucasus

can become an energy corridor, with Georgia's hydropower, Azerbaijan's transition to renewable energy, and Armenia's solar potential driving regional economic growth and job creation. Nuclear energy can in some countries complement other sources. This differentiated approach will ensure that energy investments translate directly into productive employment.

Pillar 2: Strengthening governance and supporting business-enabling policies and a predictable regulatory environment—so the private sector can operate and grow. This pillar also includes simplifying tax regimes, reducing compliance costs, and digitalizing administrative processes to lower firms' barriers to entry and growth.

Good governance is necessary to allow the private sector to operate and grow. This includes transparent and accountable institutions, the rule of law, protection of property rights, and efficient public administration. Ineffective bankruptcy laws, weak contract enforcement, corruption, and a lack of access to finance hold back private sector development. Targeted reforms that address these bottlenecks are essential to allow the private sector to thrive.

Connecting better to global markets is also critical. Deepened trade integration can help firms become part of dynamic value chains and raise the returns to innovation and upgrading. A clear, investor-friendly framework that maximizes spillovers from FDI, including targeted supplier-development programs and partnerships for research and mobility, can further catalyze private-led growth. Improving the connection with global markets requires governments to strengthen some regulatory roles. Quality infrastructure for standards, certification, and traceability will support agrifood upgrading and export diversification, reducing rejection risks and unlocking higher-value markets.

Access to finance remains a binding constraint for many high-growth firms, particularly SMEs. Reducing procedures, time, and cost to start and operate, lowering paid-in capital requirements, and expanding instruments for SME and scale-up finance will enable investment and hiring. Finally, where latent advantages exist, smart, well-governed industrial policies—targeted, competitively allocated, time-bound, and transparently executed and monitored—can help build firm capabilities and seize opportunities in reindustrialization and nearshoring, provided they are disciplined by clear metrics and sunset clauses.

Countries are advised to separate regulatory and commercial roles in government intervention. They need to unwind distortive subsidies and price controls that deter entry and innovation and deploy credible public–private partnership frameworks that mobilize private capital—recognizing that public resources alone will not deliver the level of investment required for vibrant job creation.

Sectoral pathways could be tailored to factor endowments and demographic profiles: agribusiness can provide upgrading opportunities in rural areas; value-added manufacturing can anchor tradable employment and productivity; tourism can absorb youth and catalyze

services ecosystems; healthcare can expand higher-skilled, often female, employment; and energy and infrastructure can underpin competitiveness and green growth.

Eastern and Central European countries have the opportunity to become an integral part of EU green value chains, relying on their mature industrial capabilities and proximity to EU markets. Central Asian countries could use their comparative advantage in the production of renewable energy and rare earth minerals, while improving their infrastructure and developing the regulations necessary for the management of renewable resources. The Western Balkans and South Caucasus can bridge these approaches, serving as green energy corridors while developing niche manufacturing and service capabilities.

Pillar 3: Mobilizing private capital for the private sector to expand and create more and better jobs.

The scale of investment required to create sufficient jobs and drive economic transformation far exceeds the capacity of public budgets. There is an opportunity for countries to promote policies to mobilize private capital by supporting businesses through financing, equity investments, guarantees, and political risk insurance. These instruments can help attract private investors who might otherwise be deterred by perceived risks, thereby multiplying the impact of development finance.

Using equity interventions can help support innovative and high-growth firms where financing gaps tend to be most acute. Policy makers can combine equity (especially early-stage financing such as venture capital) and quasi-equity instruments (such as convertible bonds, mezzanine, and subordinated debt) to provide risk capital while mitigating entrepreneurs' reluctance to dilute ownership. Governments can also mobilize private investors via co-investment programs, equity guarantees and other risk-sharing arrangements, and demonstration investments, all of which help create markets, build investor confidence, enable scalable solutions, and expand access to risk capital.

Public-private partnerships (PPPs) are a core mechanism for mobilizing private capital. PPPs leverage private sector expertise, innovation, and financing, particularly in infrastructure – but, growingly, also in other public services such as health and education. These instruments need to be well structured to be successful, and the payment structure -be it government-pay or user-pay- will depend on the specific context. Hybrid PPPs - special PPP structures in which concessional financing is used to partially or fully cover a project's government support requirements - can be an opportunity to mobilize private capital in contexts where fiscal resources are limited.

The expansion of guarantees can encourage foreign private investment in strategic sectors. Guarantees can be particularly helpful to promote private loans to sub-sovereigns and other eligible public borrowers in key strategic areas and in the implementation of high impact projects. A wider use of guarantees can provide an enhancement to credit, especially in the energy sector.

Financial support to local financial intermediaries can serve as a catalyst for increased credit access. Providing support to local commercial banks, microfinance institutions, and leasing companies, can help address the unmet credit needs of small businesses and underserved populations. This can be complemented by risk-sharing facilities, which reduce the risk for local banks and encourage them to lend to riskier segments. Capacity building for local financial intermediaries, including technical assistance on risk management and advisory support on broader financial infrastructure, can also help to expand credit access to new market segments.

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Jobs and Prosperity

Economic growth in Europe and Central Asia is likely to slow to 2.4 percent in 2025, reflecting a sharp slowdown in the Russian Federation. Outside Russia, growth momentum remains broadly resilient, supported by private consumption, infrastructure spending, and a gradual recovery in trade. Although a modest pickup is expected in 2026–27, ECA's growth is likely to remain well below the 2000–19 average. In this slow-growth environment, downside risks dominate, with the potential for setbacks in reforms posing a significant threat to investor confidence, private sector dynamism, and job creation.

The region's labor market shows signs of resilience but faces deep-rooted structural challenges. Since the start of the transition from planned to market economies in the early 1990s, employment has grown faster than the region's population, driven by rising labor force participation and a shift out of agriculture. Yet most new jobs are in low-productivity services. Although productivity growth results in strong job creation, it has stalled in ECA. Structural bottlenecks, including weak competition, limited access to finance, and outdated skills systems, constrain firm growth and innovation. Demographic pressures—aging, shrinking workforces, and emigration—add to the strain.

The update calls for a three-pillar reform agenda: investing in foundational infrastructure for jobs, strengthening the business environment, and mobilizing private capital. Targeting five priority sectors—manufacturing, agribusiness, tourism, health care, and energy—can help translate stronger economic growth into more and better jobs and shared prosperity.

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