WORK AND DIGITALISATION 21.11.2024 | Soňa Muzikárová

The next Silicon Valley?

In recent years, Central and Eastern European countries have emerged as vibrant innovation hubs. But a few things are still holding them back

While the world's attention remains focused on Ukraine's heroic stand against Russian aggression, a quieter revolution is reshaping Central and Eastern European (CEE) economies.

CEE countries have emerged as vibrant innovation hubs in recent years, generating a wave of new tech unicorns. Romania's UiPath, for example, has become an automation leader, enhancing workplace efficiency by freeing workers from repetitive tasks. Poland's Docplanner is revolutionising health-care access by leveraging artificial intelligence to connect millions of patients with doctors. And while Croatia's Infobip, with its AI-enhanced communication platform, facilitates seamless interactions between businesses, governments and citizens, Bulgaria's Payhawk is transforming corporate finance by streamlining expense management.

Together, these companies show that AI can be a powerful force for good, driving rapid advances in health care and finance and increasing workplace productivity. The next major tech innovation could well come from a startup incubator in Warsaw, a university lab in Bucharest or a co-working space in Kyiv — probably developed at a fraction of Western costs.

Complex challenges

Some might say that this wave of innovation is building despite the numerous challenges facing the region; others would say it is fuelled by them. As they strive to maintain their competitive edge in traditional sectors like auto manufacturing, CEE economies are also grappling with post-pandemic financial pressures, exacerbated by the European Union's revised budget rules. Meanwhile, the war in Ukraine has introduced a new set of threats, from relentless Russian cyberattacks targeting supply chains and vital infrastructure to AI-assisted disinformation campaigns.

AI has the potential to help CEE countries tackle these complex challenges, generating tremendous value across traditional public sectors such as health care and education while enabling governments to counter foreign interference and safeguard critical energy networks.

Encouragingly, CEE countries have a strong foundation upon which to build a thriving tech sector, with a critical mass of engineers and STEM (science, technology, engineering and math) graduates. Company valuations in the region increased more than sevenfold between 2017 and 2022. Moreover, the share of investment from outside the EU rose from nine per cent in 2022 to 21 per cent in 2023, highlighting these economies' growing global appeal.

The rise of populist parties threatens to undermine responsible macroeconomic management and deter partners and investors.

To be sure, significant challenges remain. Notably, recent research shows that CEE economies still lag behind their Western European counterparts in both infrastructure and investment. With a population of more than 150 million and a combined GDP of nearly €2.5 trillion ($2.7 trillion), the region has vast potential. Yet, total private-equity investment fell by 40 per cent in 2023, to €1.7 billion. Consequently, launching a startup in the region can feel like trying to build a spaceship with spare parts from a bicycle shop.

The rise of populist parties poses another serious challenge, threatening to undermine responsible macroeconomic management and deter partners and investors. Instead of addressing fiscal pressures through spending cuts, many CEE governments have opted to raise corporate and value-added taxes, prioritising short-term relief over long-term economic stability.

A more forward-looking strategy would embrace AI's transformative potential to drive economic growth and innovation across the region. To unlock this potential, CEE countries should take three key steps.

First, policymakers should focus on expanding STEM education and retaining top talent. The region's main obstacle to becoming the next Silicon Valley is a shortage of skilled professionals. While hundreds of promising biotech, finance and robotics startups have emerged in recent years, they cannot grow – let alone become unicorns – without a robust talent pool. And, although education is a public good, the sluggish pace of reform in CEE countries means that the private sector must also focus on human-capital development.

Governments must boost inward foreign investment.

Second, deeper European integration could fuel innovation by facilitating the cross-border exchange of ideas, talent and capital. With this in mind, the European Commission recently unveiled its AI Factories initiative, offering developers access to the computing power, data and other resources needed to train advanced AI models. Several CEE countries have also started exploring structured technological partnerships with other European governments to promote shared strategic priorities.

Lastly, governments must boost inward foreign investment. Despite the geopolitical turmoil of the past two years and subsequent decline in private-equity inflows, the region has demonstrated remarkable resilience. While CEE economies are poised to play a pivotal role in Ukraine's reconstruction, they must first address infrastructure gaps, funding shortfalls and regulatory uncertainty that could deter potential investors. Enhancing the region's appeal is essential not only for the tech sector but also for advancing digital infrastructure projects, including 5G networks, data centres and quantum computing facilities.

As CEE economies confront these challenges, it has become abundantly clear that they must act swiftly to harness AI's potential, or risk watching a generation of talent seek better opportunities elsewhere.

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Soňa Muzikárová

Soňa Muzikárová, a non-resident senior fellow at the Atlantic Council and a Mason Fellow at Harvard Kennedy School, is a former economist at the European Central Bank, a former diplomat at the OECD and a former senior adviser to the Deputy Minister of Foreign Affairs of the Slovak Republic.