

CEE region growth model

1. Unsustainability of the current CEE region growth model

A public representative outlined that the Central and Eastern European (CEE) region has experienced strong and sustained growth since the 2004 EU enlargement, emerging as one of the most dynamic regions globally. There has been substantial convergence with Western Europe supported by EU funds, with the region's GDP rising from approximately 40% to 80% of the EU average and even surpassing 90% in the Czech Republic. However, despite accounting for 22% of the EU population, the region contributes only 12% of its GDP, highlighting the limitations of its current growth model. The region remains positioned in the lower stages of the EU value chain, with a continued focus on manufacturing. This reflects a broader European structural challenge described in Draghi's report as a "middle technology trap", a pattern of specialisation in mature, mid-tech sectors with limited innovation and upward mobility. Average wages remain below 50% of the EU average in the CEE region, and continued reliance on labour cost advantages is no longer viable. A shift towards a new development model, based on innovation and higher value-added activities, is therefore essential. The public representative noted that the strong entrepreneurial spirit that has contributed to the region's economic success and the modernised infrastructure of the region are assets on which to build.

Several panellists echoed the view that the growth model which has underpinned the CEE region's development over the past two decades — driven by export-led expansion, low labour costs despite a highly educated workforce, high energy intensity, and sustained capital inflows — is becoming increasingly unsustainable.

An official noted that the openness of CEE economies has made them major beneficiaries of foreign direct investment (FDI) and associated know-how transfers. However, like other advanced economies, the region is now facing structural challenges such as ageing populations and rising labour costs, which can only be mitigated through greater innovation and digitalisation.

An industry speaker observed that EU financial support has gradually declined as countries in the region have developed economically.

Another industry speaker stressed that these trends are evident in Poland notably, which has been one of the main drivers of European growth over the past two decades. While labour costs in Poland remain at 50% of the EU average, this advantage is now offset by relatively low productivity, contributing to a slowdown of the country's economy.

An official emphasised that it is becoming increasingly difficult to speak of a single growth model for the region. While CEE countries started from broadly similar positions in terms of demographics and level of education, differing

national policy responses and external factors, such as approaches to energy supply and pricing, have led to diverging development paths. In the Baltic region, for instance, the model based on low-cost labour and energy has long been phased out, with a gradual shift towards service exports already under way. This proactive transition has gained relevance in the current geopolitical context, shaped by Russia's war in Ukraine and wider global trade tensions. Moreover, prudent policy decisions in earlier years have helped build financial buffers, creating fiscal space for increased defence spending without undermining the stability of the region's economic model.

An industry speaker concluded that despite current political and economic headwinds, the CEE region continues to offer strong potential. This is underpinned by a well-educated and resilient workforce, a demonstrated capacity for innovation, evident in the significant number of start-ups and fintechs, and the region's close integration with Western Europe, which remains a key foundation for future growth.

2. Structural and geopolitical challenges faced by the CEE region

2.1 Structural challenges

An industry speaker explained that Poland, like the rest of the CEE region, is facing several interrelated structural challenges that are reshaping its competitiveness and growth prospects. These challenges span four key areas: energy, demographics, investment, and corporate structure. The sharp rise in wholesale electricity prices threatens the viability of energy-intensive industries, requiring a restructuring of the country's industrial base. Demographic trends also pose a serious concern. Over the past two decades, Poland's working-age population has declined by approximately 1.5 million, while employment has increased by 3.5 million, a net difference of five million. This gap was bridged by bringing 1 million economically inactive individuals into the workforce, reducing unemployment by 3 million, and attracting 1 million additional workers through immigration. However, the first two sources of labour growth have now been largely exhausted.

The industry speaker added that investment levels, particularly in Poland, are low and declining, unlike some other CEE countries such as the Czech Republic. Substantial investment is needed to transition away from a growth model reliant on cheap, high-quality labour, which is becoming increasingly scarce. New investment must prioritise productivity gains, addressing labour shortages, and enabling the adoption of new technologies. Without this shift, Poland's competitiveness cannot be sustained. Affordable electricity will also be critical to support this transformation. In terms of corporate structure, Poland's economy is characterised by a few large firms, either state-

owned or developed through foreign direct investment, and a vast number of small enterprises. Notably, 37% of Polish companies have fewer than 10 employees, compared to just 19% in Germany. The small size of the majority of firms hampers productivity growth, as they often lack the capacity to invest at the scale required for long-term transformation. Brunon Bartkiewicz also pointed to inflationary pressures. While price levels in Poland remain relatively favourable, they are rising much faster than in Western Europe, which poses a growing concern. Some other CEE countries have seen higher price increases. In Romania for instance, prices increase by a factor of 6.6 over the past 20 years.

Another industry speaker illustrated Poland's significant underperformance in terms of investment relative to its EU peers. The country's investment-to-GDP ratio is among the lowest in the EU, at just 70%, and its performance on innovation indicators is similarly weak.

2.2 Geopolitical challenges

A public representative observed that discussions about transitioning to a more innovation-driven economy are overshadowed by the ongoing war in Ukraine nowadays. For many CEE countries, rearmament has become an existential priority. Poland, for example, is allocating around 5% of its GDP to defence, which is a major change. This new reality requires the CEE region to reconcile the need for innovation-led growth with defence imperatives, in the context of a new geopolitical landscape.

The public representative added that EU enlargement must be realistically accounted for in future policy planning. Although the next EU multiannual financial framework does not envisage any new accessions before 2030 or even 2034, enlargement remains a critical issue. There are currently 10 candidate countries for EU membership, including Ukraine. Ukraine, the first country to be granted candidate status during an active war, presents a particularly complex case. Despite a declining population, it remains more populated than all the other candidate countries combined, and it is also ageing. Its potential impact on EU agriculture and the Union's budget must also be carefully considered.

An official remarked that geopolitical risks and the resulting trend towards global fragmentation pose structural threats to open economies such as those in the CEE region. These risks must be taken into account in shaping future policy responses.

An industry speaker added that, in the current geopolitical context, maintaining a robust domestic defence industry is essential to support ongoing rearmament efforts.

3. Priorities for enhancing the CEE region's growth model

3.1 Developing capital markets to boost investment and innovation

An industry speaker stated that sustaining long-term growth in the CEE region requires improving productivity through increased investment and innovation. This

depends on broader access to affordable, long-term financing, which is best supported by well-developed capital markets. Poland currently has the most developed capital market in Central Europe. However, its market capitalisation amounts to only 25% of GDP and has declined over the past decade, failing to keep pace with economic growth. By contrast, countries like Sweden have capital markets exceeding 170% of GDP, illustrating the current disparity across the EU. Sweden also offers a strong example of how capital markets can be effectively developed in a European context. Its success, built on solid domestic capital sources provided by pension fund investments and the widespread use of retail investment accounts (40% of Swedes hold ISK accounts), is supported by high levels of financial literacy and a well-developed financial ecosystem. Adopting similar reforms in the CEE region could help lower the cost of capital, attract more corporate listings, and foster innovation through deeper and more dynamic markets.

The industry speaker noted that the EU's Savings and Investments Union (SIU) initiative, aimed at developing capital market funding and channelling household savings into productive investment, could support these goals. However, its effectiveness depends on recognising the specific characteristics of smaller markets. A fully unified EU capital market with centralised infrastructure could negatively impact the CEE region, where SMEs form the backbone of the economy, reducing their visibility to investors and limiting their access to funding. Rather than top-down solutions, initiatives are needed to support the development of national and regional capital markets. In this regard, the EBRD-led effort to connect seven regional exchanges through voluntary, bottom-up cooperation offers a more suitable model. Previous attempts at harmonisation, such as MiFID's best execution and research unbundling rules, have weakened local brokerages and undermined competitiveness rather than strengthening the ecosystem. Future reforms must avoid repeating these mistakes. Crucially, member states also need to recognise the strategic importance of developing their own capital markets.

Another industry speaker noted that a further challenge to capital market development in the CEE region is the risk-averse mentality and low level of trust in financial markets among households. Although household savings in CEE, notably in Poland, are relatively high, more than half are held in cash or bank deposits. This stands in sharp contrast to countries like Sweden, where a much larger share of household wealth is actively invested. Overcoming this barrier requires both improved financial education and a stable, well-regulated environment to build confidence among individual savers and unlock the potential of domestic savings for capital market investment.

An official emphasised that improving the productivity of SMEs and their integration into global value chains is essential for the CEE region to remain competitive as labour costs rise. Supporting this transformation requires expanding access to equity financing to support innovation, moving beyond traditional bank lending. Facilitating SME access to capital markets is therefore critical and should be accompanied by targeted efforts to strengthen financial literacy among SME managers. Stock exchanges have an important role to play, not only by simplifying listing

procedures but also by offering educational initiatives tailored to the needs of smaller companies, helping them grow and innovate.

An industry speaker suggested that deeper EU integration of the financial sector, along with an expansion of the euro area, could help stimulate investment in the CEE region. For instance, the issuance of joint EU bonds for defence could attract additional investment and strengthen economic resilience. As small, open economies, CEE countries have already benefited significantly from the EU single market and stand to gain even more from further integration. Beyond finance, additional areas where deeper EU cooperation would be beneficial include infrastructure, such as energy and rail systems, and research networks.

3.2 Implementing structural reforms and enhancing digitalisation

In response to a question from the chair about the lessons that structural reforms in the Baltic States may offer the broader CEE region, an official noted that the pressure for economic restructuring has existed for some time. Growth strategies should focus on core foundations such as education and labour market structures. Sustained competitive pressure, particularly through a well-functioning single market, is also critical. Although such structural reforms are politically and economically demanding, they are essential to drive continued transformation in both the private sector and public policymaking.

Another official highlighted that digitalisation is a key enabler of productivity and innovation, and a powerful tool for reducing administrative and regulatory burdens, a shared priority for both governments and businesses. Beyond financing, the financial sector can contribute significantly by creating a supportive ecosystem that helps SMEs navigate the twin transitions of digitalisation and sustainability. Its expertise should be mobilised to guide SMEs through this shift. In Hungary, several banks have established innovation centres to foster closer cooperation with corporate clients and promote public-private collaboration. Additionally, the Hungarian Investment Promotion Agency (HIPA) facilitates partnerships between investors, local firms, and universities to enhance skills and support innovation-driven growth.

An industry speaker stressed that energy supply remains a central issue for the CEE region's economic transformation, as it is a critical factor for competitiveness. With demand continuing to rise, swift action is needed to reduce energy costs and adapt to a rapidly evolving energy landscape. This requires a rapid shift towards a more diversified energy mix, along with the deployment of solutions such as smart grids and effective storage systems to stabilise supply and strengthen industrial resilience.

4. The role of banks in the CEE region's economic growth

An industry speaker explained that the banking sector in the CEE region underwent significant rationalisation following the 2008 financial crisis. Before the crisis, the

entry of numerous Western European banks in the region had created an overbanked and fragmented market, where many institutions lacked the scale and market share needed for efficient operations. A post-crisis wave of consolidation alleviated these inefficiencies, leading to stronger capital bases, operational improvements and cost synergies. Larger, consolidated banks became better positioned to offer cost-effective services, while smaller institutions continued to struggle with limited capital and structural constraints. Today, strong regional banking groups play an increasingly important role in promoting economic integration across the CEE region through cross-border activity. Their regional focus and greater familiarity with local markets and the risks they pose enable them to serve businesses and consumers more effectively, though this potential is still not fully realised.

To enhance banks' ability to support economic transformation in the CEE region, the industry speaker suggested that targeted policy actions should be pursued. These include simplifying and tailoring capital requirements in a risk-sensitive manner and providing incentives for lending to priority sectors such as green finance and defence. Currently, these areas are often seen as unattractive by banks due to complex compliance obligations and limited profitability. Regulatory and supervisory frameworks need to be adjusted to improve the viability of lending to these sectors. In parallel, it is important to promote a more positive narrative around the role of banking and finance as essential components of a well-functioning society.

A second industry speaker noted that, while governments and EU institutions are leading efforts to reduce energy costs, financial institutions can also play a role in supporting mid-sized companies operating within energy supply chains. In Poland, banks currently face no significant barriers to financing projects in the energy or defence sectors, however regulatory frameworks must remain stable, given the long-term nature of such investments.

A third industry speaker highlighted that the banking sector in the CEE region is generally resilient, well-capitalised, and maintains strong liquidity coverage. In Poland, for example, banks display solid fundamentals, with a total capital ratio of 20%, a liquidity coverage ratio above 200%, a 14% return on equity, and low levels of non-performing loans. However, regulatory frameworks must evolve to support greater risk-taking and a shift towards more growth-oriented assets, enabling banks to act as drivers of economic transformation and play a more active role in capital market development. Current rules in Poland favour conservative investment strategies, encouraging banks to hold government bonds rather than expand lending, a trend driven by tax burdens, banking levies, and legal uncertainty around consumer rights. As a result, banks maintain a risk-averse stance that limits their ability to finance private sector growth.

5. Wrap up

The chair observed a broad consensus among the panellists that the current growth model of the CEE region

has reached its limits and must be reoriented. Over the past two decades, the region has achieved substantial growth by leveraging low labour costs, foreign direct investment, and EU single market integration. However, it now faces a dual constraint: the mid-tech economy trap, as highlighted in the Draghi report, and the middle-income trap. Further development is increasingly difficult due to skill shortages, labour force constraints and the small scale of businesses. Additional structural challenges, such as energy supply issues, and heightened security concerns with the war in Ukraine also weigh on the region's growth prospects.

Despite the diversity of situations in the region, from the Baltics to the Balkans, the chair noted a shared set of priorities for the future. These include strengthening domestic capital markets to support investment and innovation, better integrating SMEs into global value

chains, and improving financial literacy to mobilise household savings. Panellists emphasised the importance of structural reforms in labour markets and education, simplifying regulatory and administrative burdens, and ensuring stable, long-term policy frameworks, particularly for sectors like energy and defence. There was also support for deepening EU integration, including progress on the SIU, provided that the specific characteristics and needs of the region are taken into account. Finally, the discussion underlined the importance of balancing top-down EU policies with bottom-up regional initiatives and ensuring proportionality in regulatory approaches.