	Government Spending as % of GDP, 2011	Debt-to-GDP Ratio, 2012 %	GDP per Capita on PPP Basis (Current International Dollars)	Maximum Individual Income Tax Rate, 2012
Bulgaria	35.2	16.7	13,980	10%
Czech Republic	43.4	43.9	24,190	15%
Estonia	38.2	6.6	21,270	21%
Hungary	48.7	79.0	20,380	16%
Latvia	39.1	44.6	17,820	25%
Lithuania	37.5	42.7	19,690	15%
Poland	43.6	56.1	20,450	32%
Romania	37.7	36.3	15,140	16%
Slovakia	38.2	46.4	22,610	19%
France	55.9	89.2	35,860	45%

Sources: EuroStat, World Bank, KPMG

Former Satellites Take on Europe

by Richard W. Rahn

FROM IRON CURTAIN TO ECONOMIC PROSPERITY

Prague, Czech Republic

Year by year, the current nine countries of Eastern and Central Europe that were controlled by the Soviets -- Bulgaria, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania and Slovakia -- become relatively more prosperous in comparison to the richer nations of Western Europe. As a result of the European debt crisis, this trend is likely to accelerate.

It has been more than two decades since these countries acquired their freedom. All have become multiparty, largely free-market democracies. What seems normal now was far from a foregone conclusion at the time of the dissolution of the old Soviet Union. In fact, most bets would have wagered that not all these nations would have made it. I was one of the economists who advised the reformers in Hungary and Estonia -- then later Russia and Ukraine -- and served as co-chairman of the transition team in Bulgaria. To say that at the time we were not all confident that the democratic and economic reforms would be successful would be an understatement.

Per capita incomes still lag somewhat behind those of the richer Western European countries, as can be seen in the accompanying table. But economic growth rates on average in the nine new countries, with plenty of ups and downs, have been much higher than the average of the European Union (EU). The improvement has been much greater than the official numbers indicate because the real level of well-being in the nine countries at the end of the Soviet period was greatly overstated. The Soviets exaggerated their success for obvious reasons, but many in Western intelligence agencies also accepted those phony higher numbers because it made the communist threat seem greater than it was, which led to higher defense and intelligence budgets. Many who leaned to the left in the media and academic establishments wanted to inflate socialism's success beyond actuality.

Why are the nine doing better than the rest of the EU? As can be seen in the table, all but Hungary have far lower levels of government debt as a percentage of gross domestic product than the EU average of 83.4 percent. They also have smaller government sectors than the EU average, and they have much lower marginal and flatter income tax rates than the rest of the EU.

France is included in the table to serve as a comparison. France is a large, rich country on its way to becoming poorer because it increasingly is less competitive in comparison with the reformed nine thanks to its high tax rates (the 75 percent tax on income over 1 million euros is pending), heavy labor and financial regulations, and an elevated level of government spending.

Why have the nine succeeded? First, their citizens saw socialism/communism up close, and they knew it did not work in practice or even in theory. They understand that government is more often the problem than the solution. Second, in most of the countries, there were those who had read and understood what F.A. Hayek and Milton Friedman had been saying, despite the difficulties in obtaining those economists' works. Many of these young economists became leaders in their respective nations -- notably, Leszek Balcerowicz, former deputy prime minister and minister of finance and former chairman of the National Bank of Poland, who initiated Poland's economic reforms in 1989; Mart Laar in Estonia, who was trained as a historian but had read Friedman and implemented many of his ideas when he served as the first real reformist prime minister in his country; and finally, Vaclav Klaus, president and former prime minister of the Czech Republic.

As a young economist, Mr. Klaus had the opportunity to spend limited time studying abroad. He quickly picked up the ideas of Hayek and Friedman, which got him in trouble in his home country. He was forced largely to keep out of politics until things began to change in the late 1980s in what is now the Czech Republic. It was during that time when I first met Mr. Klaus, and he was filled with enthusiasm and perhaps a bit of naivete about the task at hand. He went on to become finance minister and then prime minister, and finally for the past nine years he has been Czech president. In addition to his political success, he has continued to write serious economic policy books, including a highly regarded and widely distributed (in English) critique of global-warming hysterics.

Mr. Klaus, despite his official duties, has been an active participant in the Mont Pelerin Society (the global organization of classical liberty and free-market scholars and proponents formed by Hayek in 1947) which is holding its biannual general meeting in Prague this week. As one of the most free-market heads of state in the world, he is both hosting events at Prague Castle for the society and engaging in the debate over solutions for the global economic crisis.

France and many countries in Europe are headed in one direction. The Czech Republic and the other reform countries are headed in another direction. The question is, how long will it be before the Czechs overtake the French in per capita income? When that day comes, the Czech people should remember that a major reason for their success is that they were wise enough to elect Mr. Klaus as their leader rather than a typical European socialist.

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