

civilians,” the private firms’ employees “tend to fall through the cracks of current legal codes.” The consequences for them can be dire, as three American employees of California Microwave Systems found when their plane crashed in rebel-held territory in Colombia in 2003. Unprotected by the Geneva Conventions, they’ve been held prisoner for the past two years, and both their corporate bosses and the U.S. government “seem to have washed their hands of the matter.”

Their murky legal status has also allowed private military contractors to escape prosecution for crimes in Iraq. The U.S. Army found that contractors were involved in more than a third of the incidents in the Abu Ghraib prisoner abuse case, but not one of the six employees identified as participants has been indicted.

The private military firms are, in effect, competing with the government, observes

Singer, a senior fellow at the Brookings Institution and the author of *Corporate Warriors* (2003). “Not only do they draw their employees from the military, they do so to play military roles, thus shrinking the military’s purview. [The firms] use public funds to offer soldiers higher pay, and then charge the government at an even higher rate.” And some were not even competent.

Yet military contractors of this type are here to stay. They’ve proliferated since the end of the Cold War, and many governments make use of their services. Singer argues that outsourcing can be beneficial where it will save money or improve quality, but the process needs to be made more open and accountable. More of the contracts should be awarded on a competitive basis (only 60 percent of the Pentagon’s currently are). And military functions critical to the success or failure of an operation should be kept within the military itself.

ECONOMICS, LABOR & BUSINESS

The Father of Free Trade

“David Ricardo: Theory of Free International Trade” by Robert L. Formaini, in *Economic Insights* (Vol. 9, No. 2), Public Affairs Dept., Federal Reserve Bank of Dallas, P.O. Box 655906, Dallas, Texas 75265-6906.

Competition from foreign goods and the “outsourcing” of jobs overseas have cost many Americans their jobs—or roused fear that they might. Yet most economists, rising in defense of free trade, say that the disruption is all for the best. Where in the world did they get that notion? From a brilliant 19th-century economic theorist named David Ricardo.

Born in London in 1772, Ricardo became a prosperous stockbroker before turning to political economy. He set down “what was to become a key idea in neoclassical economics: the so-called law of diminishing returns as it applied to labor and capital,” writes Formaini, a senior economist at the Dallas Federal Reserve Bank. Farming, for example, faced diminishing returns because the quantity of land is limited: More intensive cultivation would eventually lead to lower profits. As the price of home-grown corn rose, Ricardo argued in *On the Princi-*

ples of Political Economy and Taxation (1817), Britain would benefit by importing



David Ricardo (1772–1823), whose economic theories broke the hold of protectionist thinking, did not live to see his ideas triumph.

corn from countries able to produce it at lower cost. He was a leading opponent of England's Corn Laws of 1815, which barred food imports.

Ricardo also formulated the theory of comparative advantage, showing how two nations—each able, because of its particular natural advantages, to produce a different product at lower cost than the other—could increase their total output and lower their costs through specialization and trade. “It is this principle,” Ricardo wrote, “which determines that wine shall be made in France and Portugal, that corn shall be grown in America and Poland, and that hardware and other goods shall be manufactured in England.”

That was hardly the end of his contributions to economic thought. For exam-

ple, his doctrine of fiscal equivalence, now called Ricardian equivalence, held that the economic effects are the same whether government finances its activities through debt or taxes.

Ricardo didn't live to see his theories prevail. He died of an ear infection in 1823, leaving a fortune worth \$126 million in today's dollars. Twenty-three years after his death, the Corn Laws were repealed and his free-trade agenda was enshrined in British policy. “Britain became the ‘workshop of the world,’ importing most of its food and ‘outsourcing’ most of its agricultural employment.” As the 20th-century economist John Maynard Keynes put it, “Ricardo conquered England as completely as the Holy Inquisition conquered Spain.”

Tax Tales

“How Fair? Changes in Federal Income Taxation and the Distribution of Income, 1978 to 1998” by James Alm, Fitzroy Lee, and Sally Wallace, in *Journal of Policy Analysis and Management* (Winter 2005), Assn. for Public Policy Analysis and Management, P.O. Box 18766, Washington, D.C. 20036-8766.

The federal income tax has gone under the knife many times in recent decades, in some cases to promote economic growth, in others to make it fairer or more socially beneficial. The income tax that emerged from all the surgical nips and tucks between 1978 and 1998 was still progressive, but less so than it had been, report Alm, an economist at Georgia State University, and his colleagues. And that was before President George W. Bush's tax cuts in this decade.

The Suits Index measures how regressive or progressive a tax is on a scale from -1 (regressive) to +1 (progressive), with 0 repre-

senting a neutral tax. The more progressive a tax, the more redistributive its effect on income. Despite slight increases in 1995 and 1998, the index declined 16 percent over the whole 20-year period, falling from 0.273 to 0.229. It still remained in progressive territory.

Changes in the tax base have tended to make the system more progressive. These include subjecting some Social Security benefits to taxation (1983) and repealing the state and local sales tax deduction (1986). Changes in tax rates have had the opposite effect, producing a kinder and gentler tax system for those who have more.

EXCERPT

Google-opoly

In a few years you'll be driving your Google to the Google to buy some Google for your Google.

—EnsilZah, a poster on the online technology forum Slashdot.org (Jan. 31, 2005), quoted in *The New York Times*.