



Executive Alert



VOL. 16, NO. 4

ALL THAT'S NEW IN THE WORLD OF IDEAS

JULY/AUGUST 2002

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Benjamin Netanyahu, former Prime Minister of Israel, discusses his thoughts about the ongoing violence in his country with NCPA President John Goodman during a recent Summers Lecture. See page E-1.

Of Human Bondage

Contrary to conventional wisdom, slavery has not disappeared from the world. Sociologist Kevin Bales has found that it is “growing and evolving” in the 21st century.

- Based on reports from governments and nongovernmental organizations, there are an estimated 27 million slaves around the world.
- Slavery is not confined to parts of South Asia and North Africa where slavery never ended: according to the Central Intelligence Agency, 45,000 to 50,000 women and children are trafficked to the United States every year — and Europe has even more slave trafficking than America.

Some pay a fee to be smuggled to the

West, but then are sold to sweatshops, brothels or domestic service. Others are kidnapped and smuggled against their will.

Slavery persists because the weak rule of law and widespread corruption allows violence to be used with impunity.

There are an estimated 27 million slaves around the world.

Slavery may be called by different names, but still involves loss of free will backed up by violence. It also involves psychological manipulation. Slaves often know their enslavement is illegal, but accept their role and identify with their master. Constant physical bondage becomes unnecessary.

But where slaves in antebellum America were an expensive investment, today's slave is typically a cheap and disposable laborer.

- In 1850 an agricultural slave cost \$1,500 in Alabama (around \$30,000 in today's dollars), and it took 20 years of labor to repay his or her purchase price and maintenance costs.
- The equivalent laborer can be had for around \$100 today; and it takes two years for a bonded laborer in South Asia to repay the “loan” or smuggler's fee.
- This fall in price has made slaveholding more profitable — and while expensive slaves once were a protected investment, today's slaveholders have little incentive to care for them.

Source: Kevin Bales, “The Social Psychology of Modern Slavery,” Scientific American, April 2002.

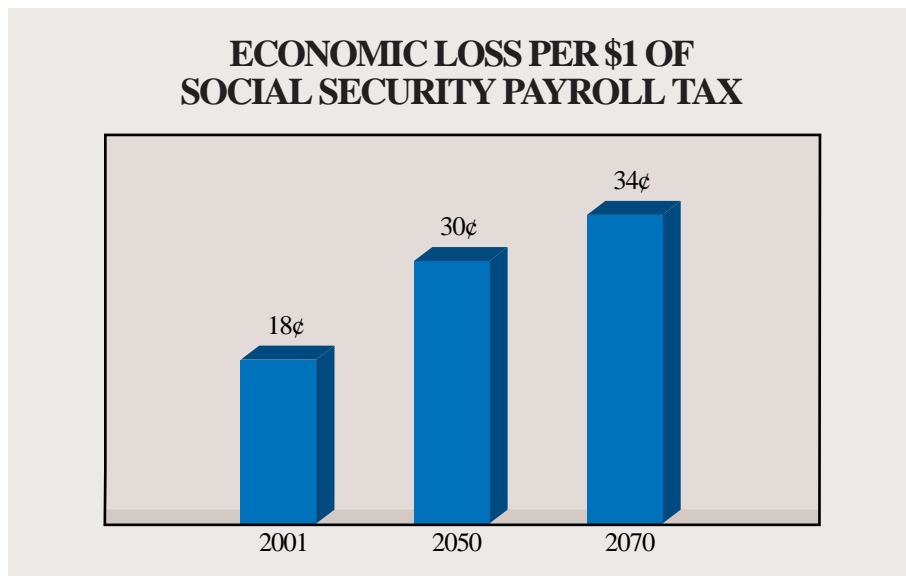
Economic Cost of the Payroll Tax

Any tax system imposes an extra burden on taxpayers over and above the tax revenue itself. Economists call these costs “welfare losses.” A payroll tax on labor income encourages people to work fewer hours and produce fewer goods and services, relative to an efficient tax system, because workers get to keep less of their earnings.

The payroll tax that funds Social Security, Medicare and Disability Insurance is already the largest tax most Americans pay. By the middle of the century, the tax will need to rise from its current level of 15.3 percent (combining the employer and employee shares) to more than 25 percent to pay benefits when today’s teenagers retire.

- When all taxes on labor income are combined, the average American family already faces a 44 percent marginal tax rate on each additional dollar earned, and by 2050 will face a 53 percent marginal tax rate.

- The current cost to society as a whole in welfare losses from the Social Security payroll tax alone is between 11 cents and 18 cents for every dollar of tax revenue collected, or as much as \$804 for every



household in America.

- By the time today’s teenagers reach retirement age, the nation will be sacrificing as much as 30 cents for every dollar collected in payroll taxes, and by the time today’s newborns retire, the cost will be as much as 34 cents for every dollar collected.

The Bush administration and Congress have discussed a limited reform allowing workers to deposit two percentage points of their Social Security payroll tax in a personal retirement account. Over time, accumulations from these accounts would

partially replace Social Security benefits, leaving total benefits virtually unchanged. Even this limited reform would have a substantial payoff, reducing economic losses of the current system by almost one-third by mid-century and by more than half by the time today’s newborns reach retirement age.

Source: Liqun Liu and Andrew J. Rettenmaier, “The Economic Cost of the Social Security Payroll Tax,” NCPA Policy Report No. 252, June 2002, National Center for Policy Analysis, 12655 N. Central Expressway, Suite 720, Dallas, Texas 75243, (972) 386-6272.

The Real Social Security Problem

Public discussion about the financial health of Social Security usually focuses on the long-run solvency of the system, and is dominated by misleading and inaccurate portrayals of the Social Security Trust Fund.

In reality, the trust fund is an accounting measure, not an accumulation of real assets that can be used to pay future benefits. That means current discussion of Social Security “lock boxes,” or whether the Social Security “surplus” is being “raided,” are essentially irrelevant to the program’s future. The federal government lacks a mechanism that would allow it to save today against the future demographic and financial pressures that will make Social Security’s current structure unsustainable over the long term.

- Current projections of the Social Security actuaries indicate that Social Security payments will begin to exceed Social Security tax revenue around 2016.

- At that time, the trust fund is projected to hold about five trillion dollars in reserves.

- However, since those reserves hold no assets that can be used to pay the bills, the government must acquire additional resources from taxes or borrowing to cover the Social Security deficit.

The Social Security deficit is expected to grow in future decades. Under current policy, Social Security benefits alone will consume an increasing share of the nation’s resources. Expenditures on Medicare and Medicaid, two other large programs that serve the elderly, are expected to rise even faster.

- The Congressional Budget Office estimates that Social Security benefits will

increase from 4.2 percent of Gross Domestic Product this year to 6.5 percent in 2030.

- The CBO estimates that, taken together, Social Security, Medicare and Medicaid will increase from close to 8 percent of GDP this year to almost 15 percent in 2030 if current policies are unchanged.

Even if the federal government invested in private assets — an idea that itself is fraught with peril — there is no guarantee that the earnings would be dedicated to future Social Security liabilities. The only way to reliably prefund retirement benefits is through a system of individual accounts that are privately held and owned by the worker.

Source: June O’Neill, “The Trust Fund, the Surplus and the Real Social Security Problem,” SSP No. 26, Cato Project on Social Security Privatization, April 9, 2002, Cato Institute, 1000 Massachusetts Avenue, N.W., Washington, D.C. 20001, (202) 842-0200.

Lessons from Other Countries

The U.S. Social Security system is relatively healthy compared with other countries that have not yet reformed their systems. Yet it clearly is not sustainable in its current form.

Over the next 30 years, the proportion of the world's population over age 60 will nearly double. Some 20 countries in Latin America, Europe and the Asian-Pacific region have already made major structural reforms to their Social Security. At least another 10 countries are moving in that direction.

The reformed systems have many differences, but share certain characteristics. These include:

- A partial shift from a pay-as-you-go system to a funded system, with private management of the funds.
- A partial shift from defined benefit plans to defined contribution plans.
- Compulsory contributions to the private accounts; regulation of the investments; and integration with the public social security program.

There are several lessons that reformers in the United States can learn from the experiences of other countries around the world.

Lesson 1: Individual control over personal retirement accounts is more desirable and more profitable than a centrally controlled pension reserve.

The average privately managed pension fund in developed nations around the world earned a 4.1 percent average annual rate of return. By contrast, the average publicly managed pension fund lost an average of 8.4 percent per year. There are two reasons:

- Public managers are often required to invest in low-interest government securities — which is the case with the U.S. Social Security system — or are compelled to make politically motivated investments.
- The hidden and exclusive access to central public funds makes it easier for governments to run larger deficits or spend more wastefully than they could if they had to rely on a more accountable source of funds.

Competitively managed private

pension plans are more likely to be diversified and are more likely to resist political manipulation.

Lesson 2: Individual accounts can be created in a way that minimizes administrative fees.

■ In Chile and most other Latin American countries, workers pay a front-loaded, one-time fee on new contributions rather than an annual fee based on assets; the fee has been criticized as too high, but amounts to less than 1 percent of assets per year for an average worker who contributes for 40 years.

■ Most countries in the Organization for Economic Cooperation and Development (OECD), like Switzerland, Australia, Denmark and the Netherlands, use group plans with an employer and/or union choosing the investment manager, which often produces lower administrative costs.

■ In Sweden, pension authorities established a maximum fee schedule for retirement account managers and records are kept centrally; workers may choose among a limited number of mutual funds and the money is moved only in large blocks.

Lesson 3: Individual accounts do not necessarily involve undue risk.

Reforming countries typically reduce risk by 1) encouraging diversification through restricting pension fund choices and ruling out highly volatile, concentrated portfolios, or 2) instituting a minimum benefit.

Lesson 4: Reformed systems can continue the redistribution of income.

In some cases, the reformed systems can redistribute income from high earners to low-income earners better than traditional pay-as-you-go programs, which are biased against people with shorter life expectancies.

Lesson 5: Reform involves transition costs.

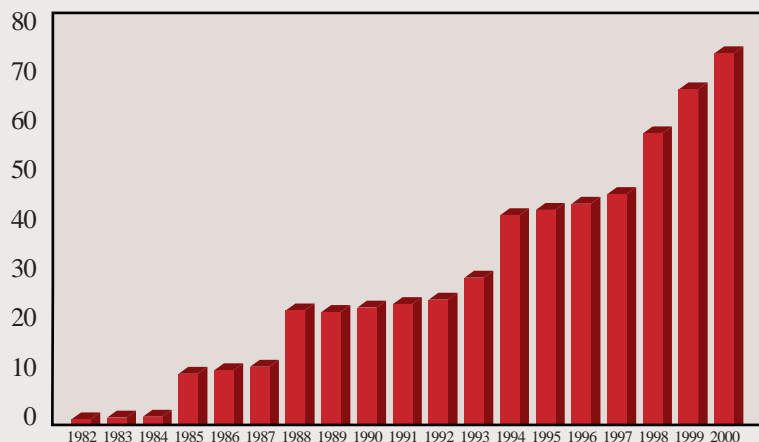
If a country with a pay-as-you-go system switches to a system that is partly prefunded, some of an individual's contribution to the pay-as-you-go system usually is shifted to the funded part (known as a "carve-out"). This creates a temporary financing gap between the remaining pay-as-you-go revenues and the revenues needed to cover the current obligations of the old system. Borrowing temporarily to finance transition to a funded system does not increase the size of a country's total public debt. Rather, this arrangement simply exchanges hidden implicit debt for more observable explicit debt.

All Latin American and Eastern European countries have used the carve-out approach. But in the course of reform, the total pension obligation of the government has actually been reduced in almost every country.

Source: Estelle James, "Social Security Reform Around the World: Lessons from Other Countries," NCPA Policy Report, forthcoming, National Center for Policy Analysis, 12655 N. Central Expressway, Suite 720, Dallas, Texas 75243, (972) 386-6272.

NUMBER OF PEOPLE COVERED BY A MANDATORY PRIVATE PLAN

(in millions)



Letting Prisoners Work

While the number of prisoners who work has increased over the years, only a modest share of state and federal prisoners work for pay.

- The Federal Prison Industries (an arm of the Federal Bureau of Prisons) employs about 23,000 of the 157,000 federal prisoners.

- About 65,000 inmates work in state prisons, but only 3,700 (in 36 states) are employed by private-sector companies.

Opposition from unions and businesses fearing competition from cheap prison labor has prevented more paid prison labor, in spite of the fact that it can provide convicts with work skills they could use on release. It could also help offset some of the cost of housing prisoners.

- A study by the New York State Department of Correctional Services found that 54 percent of prisoners who did not work during their incarceration eventually returned to prison, while only 34 percent of the group who worked were re-incarcerated.

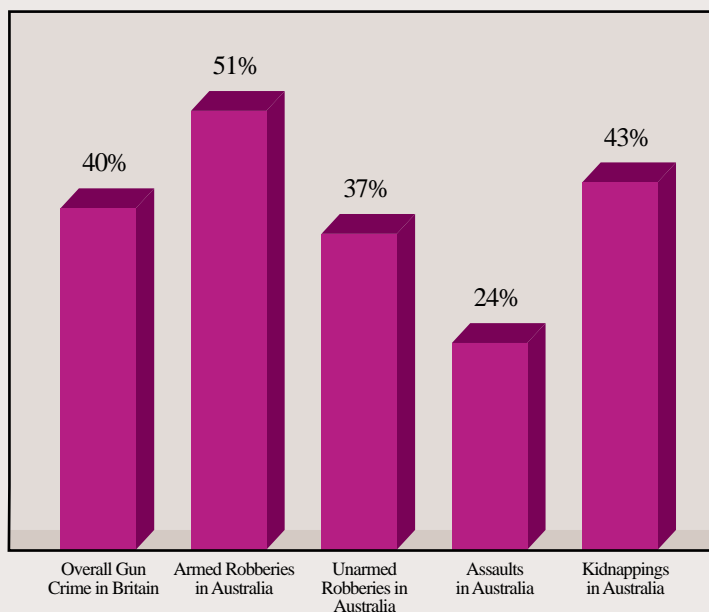
- If inmates were allowed to work in the private sector, their earnings could not only help pay for their food and housing — a \$40 billion annual cost — but also allow them to pay restitution and child support.

- Furthermore, allowing prisoners to be contracted in the private sector would increase the total economic output of society.

Employing idle prisoners would increase gross domestic product and create jobs in other sectors for any civilians displaced by lower-cost labor.

Source: Robert D. Atkinson, "Prison Labor: It's More Than Breaking Rocks," Policy Report, May 23, 2002, Progressive Policy Institute, 600 Pennsylvania Avenue, S.E., Suite 400, Washington, D.C. 20002, (202) 547-0001.

INCREASE IN CRIME AFTER GUN BANS (1996-2000)



Source: John Lott, Jr.

Guns Banned, Violent Crime up

Gun-control advocates conveniently ignore the fact that the countries with the highest homicide rates have gun bans. The three worst public shootings in the past year all occurred in Europe, which has enacted everything American gun-control proponents favor. Around the world, from Australia to England, countries that have recently strengthened gun-control laws with the promise of lowering crime have instead seen violent crime soar. For example:

- In the four years after the United Kingdom banned handguns in 1996, gun crime rose by an astounding 40 percent.

- Since Australia's 1996 laws

banning most guns and making it a crime to use a gun defensively, armed robberies have risen by 51 percent, unarmed robberies by 37 percent, assaults by 24 percent and kidnappings by 43 percent.

- While murders in Australia fell by 3 percent, manslaughter rose by 16 percent.

Not a single academic study shows that federal waiting periods, background checks, one-gun-a-month rules or safe-storage laws reduce violent crime. Some research even finds that these rules increase crime.

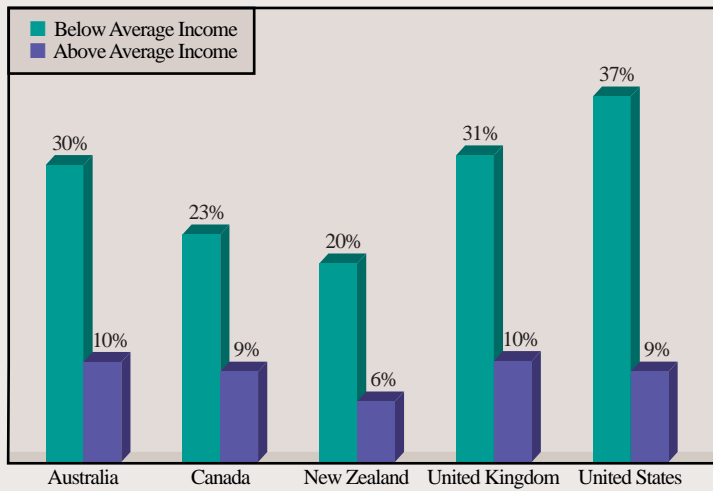
Source: John R. Lott Jr., "Gun Laws Don't Reduce Crime," USA Today, May 9, 2002.

Contributions by Working Texas Prisoners (1993 - 2001)

Room and Board	\$2.7 million
Crime Victims' Compensation Fund	\$1.6 million
Dependent Support	\$1.4 million
Personal Savings Accounts	\$1.3 million
Court-ordered Restitution	\$46,200

Source: Texas Department of Criminal Justice.

PERCENT OF ADULTS REPORTING FAIR OR POOR HEALTH



Source: The Commonwealth Fund.

Income and Health

The way a country pays for health care seems to make only a marginal difference in the health status of its population. A new survey in five English-speaking countries with different systems of financing health care found that in each lower-income people are much less healthy than those with higher incomes, usually by a factor of three.

Researchers from the Harvard School of Public Health and the Commonwealth Fund surveyed 1,400 adults each in the United Kingdom, Australia, New Zealand, Canada and the United States.

The U.K. has a National Health Service in which physicians are on the government payroll and hospitals are owned by the government. Canada uses private physicians and nonprofit hospitals, but provincial governments are the sole payer for virtually all essential health care except dental services and prescription drugs. The United States has government programs for the poor and elderly and voluntary private insurance for the rest of the population. New Zealand's system is similar to Britain but with a larger private sector. Australia has a national system supplemented with private financing.

Despite the different ways of financing, all five systems rely almost exclusively on a third party — the government, employers and/or insurance companies, but not the patient — to pay most of the cost.

Even in the United States, the portion of health care costs that people pay directly has fallen precipitously.

- In 1980 patients directly paid 28 percent of the cost, down from 56 percent in 1960.
- Today American patients directly pay only 15 percent of the cost.

However, Americans wait a far shorter time for hospital services than do people in other countries. Only 5 percent of U.S. patients reported waiting four months or more for surgery. This compares with 23 percent in Australia, 26 percent in New Zealand, 27 percent in Canada and 38 percent in the U.K.

Source: Greg Scandlen, "Health Care in Five Nations," Brief Analysis No. 397, June 17, 2002, National Center for Policy Analysis, 12655 N. Central Expressway, Suite 720, Dallas, Texas 75243, (972) 386-6272.

Patient-Directed Health Care

Eighty-eight percent of Americans with private health insurance coverage get it through employers, but both employers and employees are increasingly seeking change. Surveys show employees prefer to choose their own health care providers and want to be involved in treatment decisions. However, they do not want to spend more money or put themselves or their families at financial or clinical risk.

Evidence shows that costs are reduced and care is improved when patients are involved in their own treatment decisions. A number of companies are pioneering the idea of Patient-Directed Healthcare Benefits (PDHBs). PDHBs are usually offered as an option from among many employer-sponsored plans. In general they give employees and their families greater input in selecting the benefits they receive and in how they will pay for their health care:

- Employer and employee contributions are used to purchase major medical insurance.
- Preventive care is provided for all employees and is covered in full.
- The employer places separate funds in a Personal Health Account (PHA), from

which the employee is able to directly pay for discretionary medical expenses.

- The employee can use the PHA funds to pay for alternative health care services and other IRS-allowed health care expenses.
- Employees also can use employer-funded PHAs to directly purchase individual health insurance coverage.
- Employees can open a Flexible Spending Account (FSA) with their own pretax dollars to pay for additional health care services.

The knowledge that they can access care they need at the time they think they need it provides employees security. And spending their own health care dollars from a PHA gives them an incentive to spend wisely and to save money for future health care events. Funds not spent will accumulate and can be used to pay premiums for early retirement health insurance or to fund coverage for prescription drugs and Medicare supplemental coverage after age 65.

Source: Ronald E. Bachman, "Giving Patients More Control," Brief Analysis No. 399, June 17, 2002, National Center for Policy Analysis, 12655 N. Central Expressway, Suite 720, Dallas, Texas 75243, (972) 386-6272.

Why Africa Isn't the World's Breadbasket

Africa is the least likely place on earth to have a shortage of food, based on its natural endowments. Much of the land and climate are ideally suited for crops and livestock. But bad government and misguided foreign aid have prevented Africa from being the world's breadbasket.

Food aid to help countries through a temporary famine often drives farmers out of business. How can they sell their produce when wealthy western countries, often overflowing with subsidy-driven agricultural surpluses, are giving it away free? Thus most African nations have become dependent on food imports, even though they were food exporters not too many years ago.

Punitive domestic policies are to blame as well.

- Throughout Africa, farmers are forced to sell to marketing boards, which pay far less than the world price.
- This de facto tax allows the government to reap most of the profit; to avoid it, farmers produce only for themselves, smuggle their output elsewhere or simply cease farming altogether.

- Insecure property rights also discourage farming, as in Zimbabwe, where the government has confiscated white farmers' land.

- Moreover, rather than distributing this land to the landless, governments often give it to friends of the ruling party for their personal enrichment.

A recent World Bank study found that full elimination of import tariffs in Europe, Canada, Japan and the U.S. would raise African exports by \$2.5 billion per year. This would lead to a major increase in growth for Africa. Although most African goods enter the U.S. with low or no tariffs, some of Africa's best exports, such as ground nuts and tobacco, face heavily protected U.S. markets.

Additionally, Africa could encourage trade within itself by lowering its own tariff barriers. Almost all African countries have import tariffs far above those in the West.

Source: Bruce Bartlett, senior fellow, National Center for Policy Analysis, June 3, 2002; and Elena Ianchovichina, Aaditya Mattoo and Marcelo Olarreaga, "Unrestricted Market Access for Sub-Saharan Africa: How Much Is It Worth and Who Pays?" World Bank Working Paper 2595, April 2001, World Bank, 1818 H Street, N.W., Washington, D.C. 20433, (202) 473-1000.

Globalization and Economic Inequality

The world economy has become more unequal over the last two centuries. That inequality is characterized by a widening income gap among nations, but not necessarily within them. The world economy also became more integrated, leading some economists to suggest a relationship between global economic integration and inequality. However, research indicates that the actual impact has been quite different.

- The evidence indicates that increasing globalization has probably mitigated the effects of inequality between nations that participate in global markets.

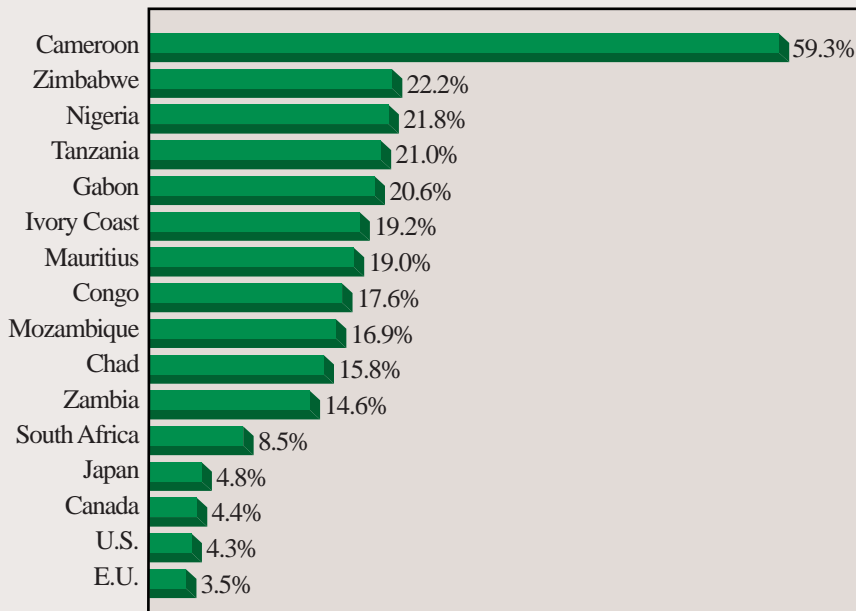
- The nations that gained the most are poor countries that changed their policies to exploit global markets, while the ones that gained the least did not, or were too isolated to effectively change economic and political policy.

In analyzing economic data from 1820 to the present, researchers have found that the dramatic widening of income gaps between nations probably has been reduced by globalization of commodity and factor markets, at least for countries that integrated into the world economy. All effects considered, more globalization has meant less world inequality.

World incomes would still be unequal with complete global integration, just as they are in any large integrated national economy, such as the United States or Japan. But with only negligible barriers to trade, migration and capital movements, incomes would be less unequal than today's barrier-filled, partly globalized world economy. In a globalized world, poor government and a lack of democracy are more likely to be the source of inequality than globalization itself.

Source: Les Picker, "Does Globalization Make the World More Unequal?" NBER Digest, September 2001; and Peter Lindert and Jeffrey Williamson, "Does Globalization Make the World More Unequal?" NBER Working Paper No. 8228, April 2001, National Bureau of Economic Research, 1050 Massachusetts Avenue, Cambridge, Mass. 02138, (617) 868-3900.

AVERAGE TARIFF RATES IN AFRICAN AND INDUSTRIALIZED COUNTRIES



Source: World Bank.

More Drug Research Exits Europe

Another pharmaceutical research company is fleeing Europe because of regulations and price controls that have made it unprofitable to remain there. Among those that have moved to the United States:

- Switzerland's Novartis, which recently announced it would shift its center for global research to Cambridge, Mass.
- French-German drug maker Aventis, which brought its research center to New Jersey in 1999.
- Formerly Swedish Pharmacia, which moved its base of operations from London to New Jersey after merging with Upjohn in 1995.

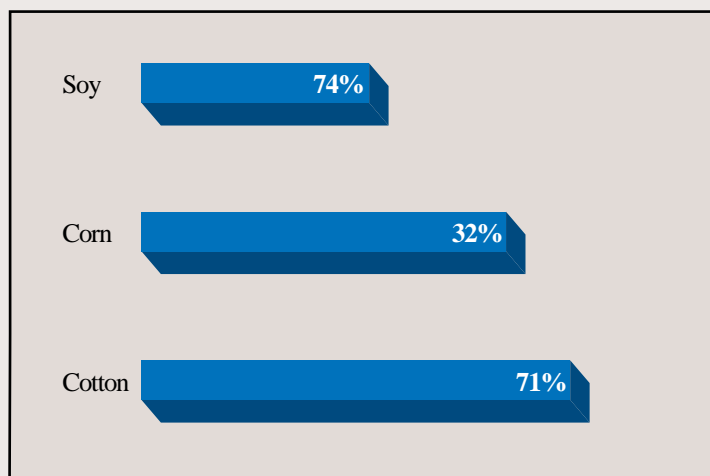
In 1990, the United States had only 70 percent of the investment in pharmaceutical research that Europe did, but by the year 2000, those numbers had reversed.

Europe's government-run health-care systems are monopoly purchasers of pharmaceuticals, and they push drug prices down to 40 percent to 60 percent of U.S. levels. However, patients are also often denied access to approved drugs for years while discount prices are negotiated. And, lest consumers start demanding expensive drugs, the same governments also ban direct-to-consumer advertising.

Communities of research excellence like the one Novartis wants to use in Cambridge tend to spring up in the environments likely to reward innovation. And for pharmaceuticals, the United States, with its strong patent protection and comparatively free medical market, is that environment.

Source: Editorial, "The Novartis Warning," *Wall Street Journal*, May 8, 2002.

BIOTECH PLANTINGS AS A PERCENTAGE OF ALL U.S. PLANTINGS THIS YEAR



Source: Michael Fumento, *Washington Times*.

Biotech Foods Can Be a Boon

Despite opposition in some quarters to genetically engineered farming, crops developed through biotechnology are resulting in more food production in the United States at lower costs and with less reliance on pesticides.

- A new study found that six crops developed through biotechnology and currently in the marketplace — soybeans, corn, cotton, papaya, squash and canola — produce an additional 4 billion pounds of food and fiber on the same acreage, improve farm income by \$1.5 billion and reduce pesticide volume by 46 million pounds.
- If biotech versions of an additional 21 crops are eventually planted, the study estimated it would help Americans reap an additional 14 billion pounds of food and improve farm income \$2.5 billion while using 163 million fewer pounds of pesticide.

Biotech products are an increasing share of America's agricultural output. For example:

- About 74 percent of this year's soy crop will be genetically engineered,

compared with 68 percent last year and 54 percent in 2000.

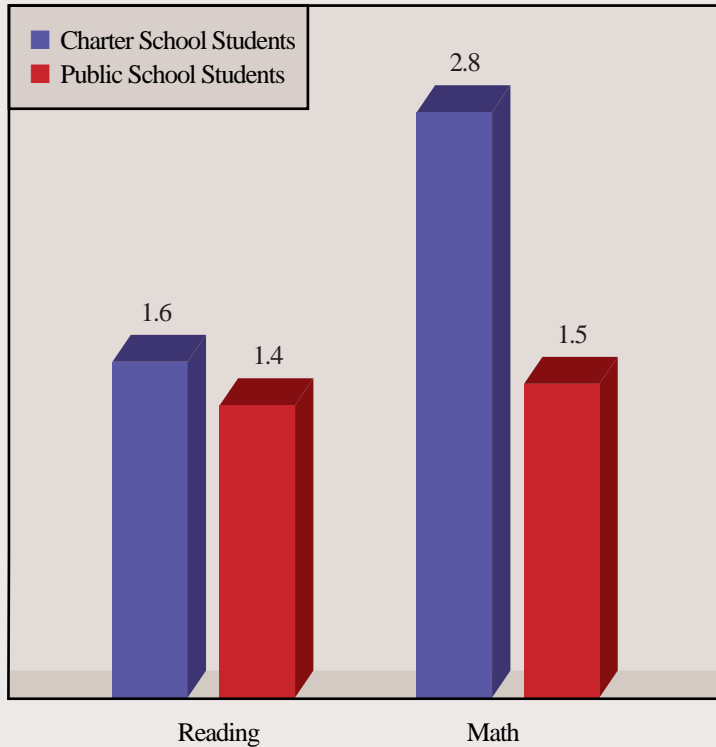
- Some 32 percent of the corn crop will be of biotech varieties, compared with 26 percent in 2001 and 25 percent in 2000.
- About 71 percent the cotton crop will be bioengineered, up from 69 percent in 2001.

Even with the world population expected to stop growing by 2050, the world will still need farm outputs 2.5 to 3 times greater than current harvests to provide quality diets to the world population.

While organic farming is often held up as the agricultural ideal, the United States has only about one-third of the organic nitrogen needed to support current U.S. farm output — and countries such as India and China have even less.

Source: Leonard P. Gianessi et al., "Plant Biotechnology: Current and Potential Impact for Improving Pest Management in U.S. Agriculture: An Analysis of 40 Case Studies," June 2002, National Center for Food & Agricultural Policy, 1616 P Street, N.W., first floor, Washington, D.C. 20036, (202) 328-5048; and Michael Fumento, "Beating the 'Frankenfood' Rap," *Washington Times*, May 9, 2002.

IMPROVEMENT IN STUDENTS' LEARNING INDEX SCORES AFTER TWO YEARS



Source: Texas Public Policy Foundation.

How Texas Charter Schools Measure Up

Texas has more charter schools than any other state except Arizona and California. Each charter school is different by design, and the number of charter school students has grown rapidly since the first one opened in 1996. Thus it is difficult to make meaningful comparisons with traditional public schools. However, the available data do permit some limited evaluations.

- Students entering charter schools generally experience a first-year drop in scores on the Texas Assessment of Academic Skills (TAAS) test (0.7 percentage points in 2000).
- However, students remaining in charter schools for two or more consecutive years have strong academic gains: 6.9 percentage points in reading and 9.1 percentage points in math from 1999 to 2000.
- The performance of the students remaining in charter schools for two or more consecutive years also improved at a rate greater than that of traditional public school students.

Source: Matt Moore, policy analyst, "Texas Charter Schools: Do They Measure Up?" forthcoming Brief Analysis, National Center for Policy Analysis, 12655 N. Central Expressway, Suite 720, Dallas, Texas 75243, (972) 386-6272.

Vouchers Raise Black Students' Scores

A three-year evaluation of privately funded voucher programs in three cities establishes that inner city black children in the programs consistently score higher than their peers in public schools. Researchers analyzed data from voucher programs in New York City, Washington, D.C., and Dayton, Ohio. Among their findings:

- Overall, black children in voucher programs had test scores 3 percentile points higher in the first year, 6 percentile points higher in the second year and 6 percentile points higher in the third year, compared with peers in public schools.
- Black students in New York City's privately funded voucher program had test scores more than 9 percentile points higher than public school students.
- In Washington, black students in

voucher programs had scores 9 percentile points higher after two years, but no significant difference from public school peers after three years.

Researchers suggested that the reason for this fading effect could have been caused by the presence of a large-scale use in Washington of publicly funded but academically innovative charter schools, which are advancing many public school students. The effect was not observed in New York City, which has very few charter schools.

The scores of non-black students in public and private schools in the three cities did not differ significantly from one another.

Source: William G. Howell and Paul E. Peterson, The Education Gap: Vouchers and Urban Schools (Washington, D.C.: Brookings Institution Press, 2002).

Executive Alert®

Publisher John C. Goodman
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 Editor Joe Barnett
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