



Executive Alert



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ALL THAT'S NEW IN THE WORLD OF IDEAS

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Colorado Governor Bill Owens (standing), who was recently described by National Review magazine as the "Best Governor in America," speaks to a special meeting of NCPA Chairman's Club members. NCPA Board member James Cleo Thompson Jr. and his wife, Dorothy, look on.

Off Welfare, Better Off

Welfare rolls nationwide have fallen by more than 50 percent since welfare reform was enacted in 1996. The goal of reform was not simply to reduce the number of welfare cases, but to move families on welfare — the vast majority of which are headed by single women — from dependency to independence through work. How successful has reform been?

- Both national surveys and state data show that the women most at risk for long-term welfare receipt have left the welfare rolls at rates as fast as or faster than women who are much less at risk.
- In the states studied in depth, most of those leaving the welfare rolls have found employment, have increased their incomes relative to welfare recipients and are gradually moving up the income ladder; a majority of those who have left

say they are better off.

During the late 1990s, welfare reform critics claimed that the booming economy was primarily responsible for the fall in welfare rolls. They predicted that if the good times ended, welfare rolls would swell. But a national analysis of welfare leavers by economists June O'Neill and M. Anne Hill found that:

- The Temporary Assistance for Needy Families (TANF) program created in 1996 has accounted for more than half of the decline in welfare participation since then and for more than 60 percent of the rise in employment among single mothers.
- By contrast, the economic boom of the late 1990s contributed less than 20 percent to either change.

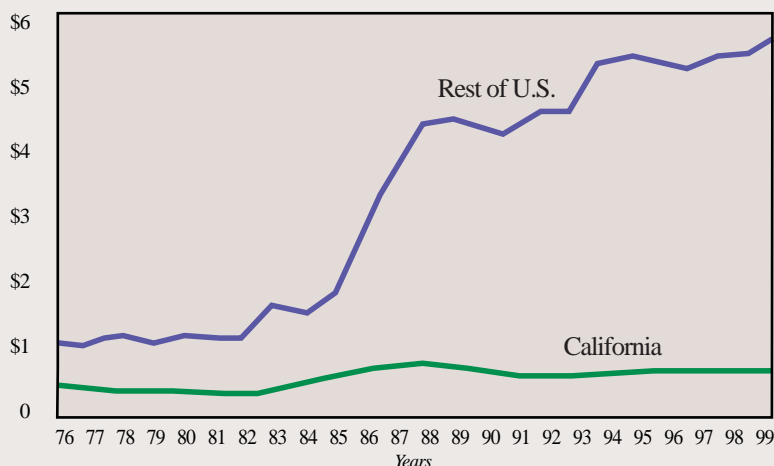
The most significant factor in caseload reduction is state policies. The

states that have been less successful have had ineffective sanctions, high benefit levels and other counterproductive policies. Two, New York and California, account for nearly a third of the remaining welfare caseload. Without any changes in federal law, the states that have failed to reduce their welfare rolls by as much as the average could adopt more effective policies. The impact would be significant:

- If the 23 less-than-average states had done as well as the average, more than 800,000 additional people would have left welfare.
- Instead of 59 percent fewer welfare recipients, the United States would have 66 percent fewer.

Source: Joe Barnett, "Better Off Welfare," Policy Report No. 255, October 2002, National Center for Policy Analysis, 12655 N. Central Expressway, Suite 720, Dallas, Texas 75243, (972) 386-6272.

MALPRACTICE PREMIUM GROWTH: CALIFORNIA VS. U.S. PREMIUMS (billions of dollars)



Source: National Association of Insurance Commissioners Profitability Study, 2000.

Malpractice Suits Raise Health Care Costs

Medical liability adds from \$60 billion to \$110 billion to the cost of private health care each year and another \$30 billion to \$60 billion to federal government payments for Medicare, Medicaid and other programs. A primary component of these rising costs is medical malpractice insurance. Excessive lawsuits and massive awards drive up the costs of insurance, which doctors must pass on in increased fees. However, most lawsuits are wasteful and benefit trial lawyers more than patients:

- Up to 70 percent of medical liability claims do not result in any payments to patients, but each of these cases costs almost \$25,000 on average to defend against.
- Lawyers' fees account for 40 percent or more of multimillion-dollar payouts.
- Less than 30 percent of all the money that doctors pay in liability insurance fees goes to patients.

Malpractice suits also raise medical costs in other ways. For

example, 79 percent of doctors surveyed admitted that they ordered more tests than were medically necessary in an effort to protect themselves against lawsuits.

Several states have put reasonable limits on noneconomic damages (e.g., \$250,000 to \$350,000). This has slowed the rise in insurance premiums in those states. States with no such limits are experiencing on-average rises of 44 percent in the cost of insurance, while states with limits are experiencing on-average increases of 12 percent.

In 1975, California placed a \$250,000 limit on noneconomic damages and required that any lawsuit be brought within three years after the alleged malpractice. Since then, provider insurance premiums in California have risen by 167 percent, compared to 506 percent in the rest of the country. This has saved Californians billions of dollars in health care costs and saved federal taxpayers billions in the Medicare and Medicaid programs.

Source: "Confronting the New Health Care Crisis: Improving Health Care Quality and Lowering Costs by Fixing Our Medical Liability System," July 24, 2002, Office of the Assistant Secretary for Planning and Evaluation, U.S. Department of Health and Human Services.

Advantages of Consumer-driven Health Care

Under traditional employer-sponsored health plans, consumers are given little choice or control over their medical purchases and little information on which to base their choices. For instance, about 40 percent of all employers and 92 percent of small ones offer employees only one health insurance plan. Giving consumers a choice — moving to consumer-driven health care — can improve quality, lower costs and increase patient satisfaction.

The consumer-driven approach can offer employees a wide range of plans they can purchase with the employer's contribution (adjusted for the individual employee's health status), their own money or both. In contrast to traditional managed care plans, consumer-driven health care would:

- Enable employees to customize their health benefits — for example, by allowing them to trade lower premiums for higher out-of-pocket maximums.
- Charge employees the actual cost of insurance — a 2000 study by the Kaiser Foundation found that for more than 60 percent of employees, the prices they saw were not the actual costs of premiums paid by the company.
- Let providers instead of insurers set prices for their services and reap the benefits of innovation.
- Offer employees comparative quality and cost information about both insurers and health care providers.

A few companies already have consumer-choice plans. For example:

- Medtronic credits \$2,000 to the personal care account of each employee and pays 100 percent of his or her preventive care.
- Employees can use the personal care accounts to cover out-of-pocket expenses for products and services, instead of unwanted insurance.
- One option with a \$3,000 deductible is only \$71 per month, saving nearly \$1,000 annually over most traditional managed-care options the company offers.

Source: Regina E. Herzlinger, "Big Picture: Let's Put Consumers in Charge of Health Care," *Harvard Business Review*, July 2002.

MSAs Beat Managed Care for Prescription Drugs

Evidence from South Africa, where Medical Savings Accounts (MSAs) have been available for almost a decade, strongly suggests that they can help control prescription drug costs — when they are designed and used in the right way.

A typical South African MSA plan has no deductible for drugs needed to treat a chronic condition, where skipping could lead to more expensive care later. But there is a deductible of about \$1,100 for discretionary health care, including other prescription drugs. Before reaching the deductible, the member pays for the drugs with MSA funds. Afterward, the insurer pays the drug claims. A comparison of the behavior of 76,072 enrollees before and after they reached their deductible found that per-member-per-month prescription drug costs rose 27.6 percent after members ceased spending from their MSAs and started spending insurance company money instead.

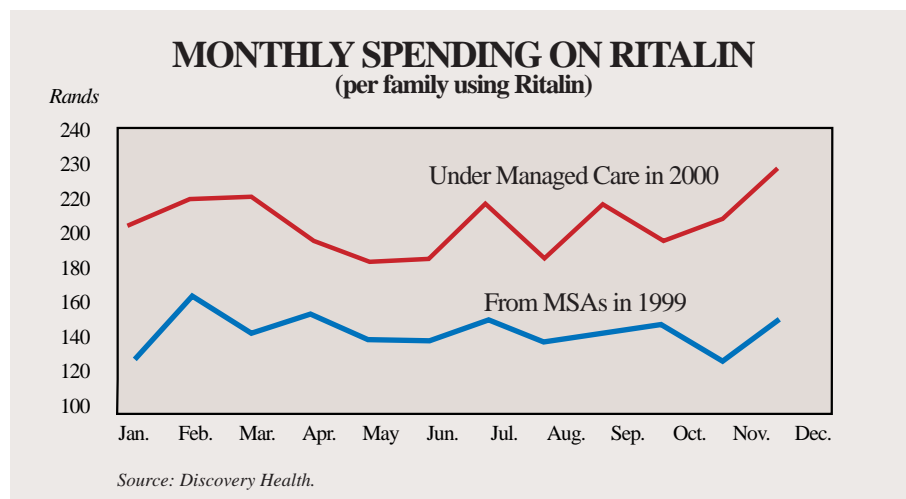
In the mental health field, patients often have considerable discretion in their drug purchases. For example:

- Patients spending from their own MSAs reduced spending on Ritalin (for children with attention deficit disorder) by almost 20 percent compared to their spending under a managed care arrangement, without any adverse health effects.

- Patients using their MSAs also were much more likely to purchase a generic equivalent that cost only 38 percent as much as Prozac (for depression); use of the brand-name drug jumped 45 percent when patients were spending insurance company money.

In both these examples, patients with MSAs controlled costs as well as or better than managed care — without the costs associated with managed care.

Some MSA critics contend that the introduction of deductibles might induce patients to forgo necessary care in order to save money. This contention is contradicted by the use of two drugs



Mental Health Care Is Different

Advocates of mental health parity want health plans to cover physical and mental health care in the same way and to the same extent. However, mental health care differs from other medical care in several ways:

- Mental health care relies largely on the patient's experience of illness, which is always subjective and often unreliable.

- The National Bureau of Economic Research has found that 38 percent of all mental health care patients — who make 28 percent of all treatment visits — are people who do not have a mental health disorder.

- Objective biological tests are unable to identify most mental disorders, even schizophrenia.

Further, few objective standards exist for either diagnosis or treatment.

- Numerous studies have found that patients on their own improve as much and as often as patients in therapy.

- Other studies have found that mental health professionals are no more effective than nonprofessionals such as school

(Fosamax and Trisequens) used primarily for the prevention and treatment of osteoporosis in postmenopausal women. Patients used some of their MSA funds to buy these drugs in 1999 but switched to managed care the following year so the insurer bore the entire cost of the drugs. Here, the results are quite different from the case of Ritalin. The amounts spent

counselors with minimal skills.

- A study conducted at the Stanford University School of Medicine found that patients in Alcoholics Anonymous and Narcotics Anonymous were significantly less likely to relapse into addiction than patients in professional programs that cost \$4,729 per patient per year.

The accounting firm Pricewaterhouse Coopers has estimated that mandating parity nationwide would increase insurance premiums by 10 percent, causing as many as 2 million people to drop health insurance.

Individuals and their families are the most efficient and effective monitors of most mental health care. For that reason, a better way to pay for care is through Medical Savings Accounts (MSAs), which allow patients and their families to manage their own health care dollars.

Sources: John C. Goodman and Wess Mitchell, "The Case against Mental Health Parity, Part I: Faulty Assumptions," "The Case against Mental Health Parity, Part II: Predictable Harms" and "The Case against Mental Health Parity, Part III: Does the Care Really Work?" Brief Analyses Nos. 410, 411 and 412, all August 9, 2002, National Center for Policy Analysis, 12655 N. Central Expressway, Suite 720, Dallas, Texas 75243, (972) 386-6272.

using MSAs were almost indistinguishable from those under managed care, providing convincing evidence that account holders were not forgoing necessary care.

Source: Shaun Matisonn, "Medical Savings Accounts and Prescription Drugs: Evidence from South Africa," Policy Report No. 254, August 2002, National Center for Policy Analysis, 12655 N. Central Expressway, Suite 720, Dallas, Texas 75243, (972) 386-6272.

School Choice Helps the Disabled

Opponents of school choice contend that it inevitably isolates children with special needs in separate schools for the learning disabled. However, a closer look at a variety of school choice programs worldwide shows that this is not the case. In many other countries with school choice, special education children are thriving far beyond American standards:

- In Denmark, where the government's commitment to fund private education dates back to 1899, more than 99 percent of learning-disabled children are educated side by side with mainstream children.

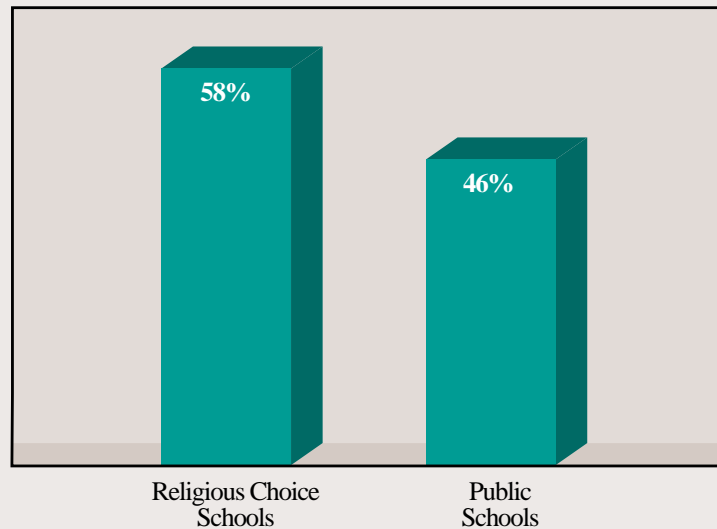
- The number of special school systems in the Netherlands has fallen from 14 to four since 1990, when the government began awarding educational stipends to parents of learning-disabled children to use at mainstream schools.

- In Australia, a 1998 study found that intellectually and physically disabled children who studied in mainstream schools under the country's school choice program were acquiring literary and math skills equal to those of their peers.

The critical factor in determining whether inclusion works appears to be the willingness of legislators to extend freedom of choice to all parents, including parents of the learning disabled. In Britain, students are allowed to transfer between government-run schools on a space-available basis, but no funding follows a student to private (what the English call "public") or religious schools. The result has been the special education ghettos that opponents of choice say they are against. Popular schools in wealthy British communities have devised subtle ways to keep out expensive-to-educate students.

Source: Lewis M. Andrews, "More Choices for Disabled Kids: Lessons from Abroad," Public Policy Report, April 2, 2002, Yankee Institute for Public Policy, P.O. Box 260660, Hartford, Conn. 06126, (860) 297-4271.

RACIALLY INTEGRATED* MILWAUKEE SCHOOLS



* Less than 90 percent of pupils are of one race.
Source: American Education Reform Council.

Few Vouchers Available

Given the hullabaloo surrounding the recent victory of school choice in the Supreme Court, it's surprising to realize how few choices are actually being made.

- Cleveland offers educational vouchers to just over 3,700 of the city's 75,000 students.

- In Milwaukee, 10,739 students — about 10 percent of the city's schoolchildren — attend a school of their choice with public support.

- In Florida, which maintains the country's first and only statewide school choice program, only 50 students currently receive vouchers.

- All told, the nation's three publicly funded voucher programs offer educational options to about 0.0003 percent of American students.

If voucher laws saddle private schools with the same regulatory regime that now hampers the public education system, school choice will simply aggravate the nation's educational crisis.

Both the Cleveland and Milwaukee programs force participating schools to relinquish control of their admissions policies.

Admissions decisions must be made by lottery, ensuring nondiscriminatory access. These regulations, and concern about further state intervention in school administration, have already prompted some Milwaukee organizations to stay out of the voucher program. For example:

- The Milwaukee Archdiocese urged its 37 parochial schools not to participate in the program.

- The Wisconsin Evangelical Synod's 18 parish schools in Milwaukee are not, for the most part, accepting voucher children.

In this way, Milwaukee is representative of a larger trend.

- A 1998 report by the U.S. Department of Education found that 46 percent of religious schools in 22 urban areas nationwide would not participate in a school choice program that required a lottery system in admissions.

- Fully 86 percent of religious schools would refuse to participate in a program that required them to offer exemptions from religious activities.

Source: Steven Menashi, "The Church-State Tangle," Policy Review, August-September 2002, Hoover Institution.

Efficient Use of Carpool Lanes

Although the United States has spent billions of dollars adding carpool lanes to congested freeways, the 2000 census showed that carpooling declined from 13.4 percent of work trips in 1990 to 11.2 percent in 2000, with declines in 36 of the 40 largest metropolitan areas.

So what is the most efficient use of the carpool lanes? A UCLA Ph.D. dissertation by Eugene Kim estimates the comparative travel times from converting an existing high-occupancy vehicle (HOV) lane on a congested freeway to a general-purpose lane; a high-occupancy toll (HOT) lane, which imposes tolls on single drivers but allows carpools free access; or a toll lane. The conclusion: converting to a toll lane produces the greatest benefits.

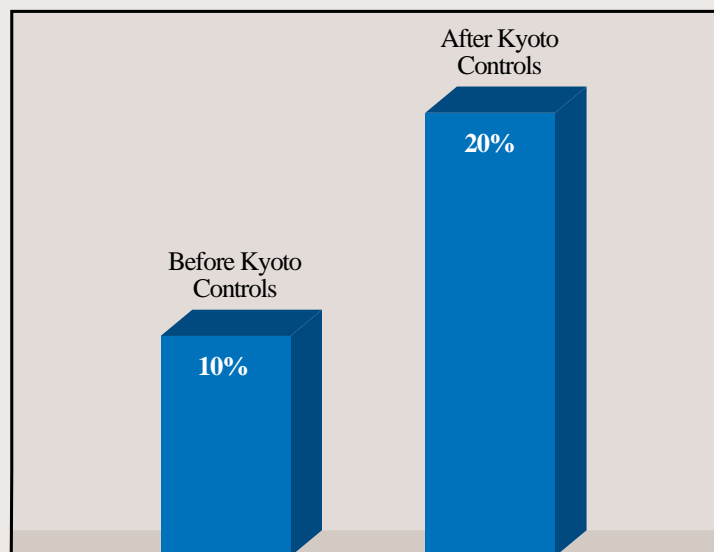
- Toll lanes can preserve free-flow conditions as traffic continues to grow and freeway congestion worsens.
- Toll lanes generate substantial revenues for the highway system.

Intuitively, one might expect that a HOT lane would work better because free access should encourage carpooling. But Kim's model shows that conversion to toll produces the largest benefits in reducing congestion regardless of whether the number of carpooling vehicles increases or decreases.

Kim also concludes that a toll lane produces the largest reduction in emissions, and that an HOV lane produces more emissions than either general-purpose or toll lanes.

Source: Robert W. Poole Jr., "New Research on HOT Lanes," August 6, 2002, Reason Public Policy Institute, 3415 S. Sepulveda Boulevard, Suite 400, Los Angeles, Calif. 90034, (310) 291-2245.

PERCENT OF INCOME SPENT ON ENERGY BY THE POOREST U.S. HOUSEHOLDS*



* Bottom 10 percent of the income distribution.
Sources: Energy Information Administration, Office of Energy Markets and End Use, 1997, and U.S. Census Bureau, 2000.

Kyoto Would Hurt Poor Most

The Kyoto Protocol on Global Climate Change requires participating nations to cut carbon dioxide emissions an average of 5 percent below 1990 levels between 2008 and 2012. It would harm economies worldwide while only minimally — if at all — reducing global warming. The costs would be borne disproportionately by the world's poor due to rising energy costs, lower economic growth, job cuts and indirect effects on developing nations.

Reducing carbon emissions would increase the cost of housing, heating and cooling, electricity, transportation and consumer products. Specifically, according to the Heritage Foundation:

- Direct energy price hikes alone could cost the average U.S. household an extra \$1,000 per year.
- Aggregating the effects on all consumer prices, energy costs could reduce average U.S. household income by \$1,620 per year.
- Cumulatively, by 2020, the protocol could cost the average U.S. household \$30,000 — equivalent to an income tax

increase of 14.5 percent.

The portion of income consumed by energy costs could increase 10 percentage points for the poorest 10 percent of Americans. Families with annual incomes of less than \$10,000 average spending nearly \$1,000 each year on energy. Kyoto could double this cost to 20 percent of disposable income, or almost \$2,000 per year.

Furthermore, Kyoto could cost the U.S. between \$330.2 billion and \$467.8 billion in gross domestic product, or \$1,105 to \$1,565 per person, in 2010.

Nor would the poor in the United States be the only victims. The protocol would deny the poor in developing countries, which are not required to reduce emissions, a chance to raise their living standards. By shrinking the economies and energy markets of signatory nations, the protocol would sharply curtail trade between industrialized and developing countries. Thus even nonparticipating nations would face GDP losses up to 3 percent.

Source: Christopher L. Dodson, "Kyoto Misses Targets — Hits Poor Instead," Brief Analysis No. 407, July 24, 2002, National Center for Policy Analysis, 12655 N. Central Expressway, Suite 720, Dallas, Texas 75243, (972) 386-6272.

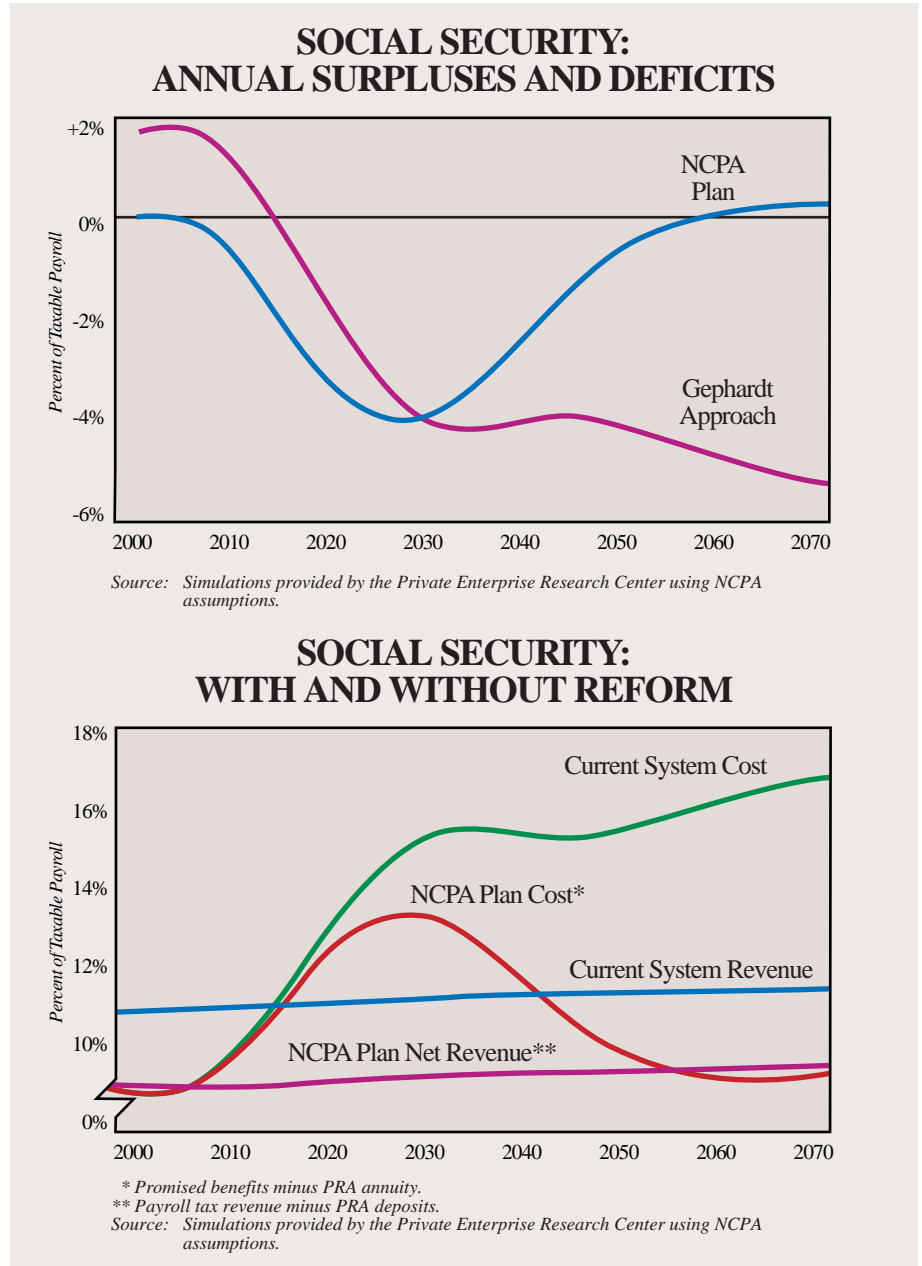
A Plan to Save Social Security

In just 15 years, Social Security will begin paying out more than it collects in taxes. In each following year, the deficit will grow larger. Over the next 75 years, Social Security faces a total debt of \$25 trillion (measured in current dollars). If the program is not reformed, Social Security benefits for baby boomer retirees and all subsequent generations will have to be cut because current law requires that benefits be limited to the program's income. That means that beginning in 2041 — when all the Treasury IOUs in the trust fund have been reclaimed — benefits will have to be cut to match payroll tax revenues. The National Center for Policy Analysis has developed a plan that would strengthen Social Security by combining features of proposals made over time by both Republicans and Democrats. The NCPA plan would allow younger workers to voluntarily deposit two percentage points of their current 10.7 percent payroll tax in a personal retirement account (PRA) they would own and control. The NCPA plan's advantages:

- **No benefit cuts.** Social Security would be able to pay promised benefits with the current tax rate even at the time today's teenagers retire.
- **No tax increases.** Taxes would equal benefit payments by 2058, and Social Security would run annual surpluses thereafter.
- **No long-term deficits.** Short-term borrowing would be necessary to pay full benefits between 2008 and 2058, but Social Security would run surpluses thereafter.
- **No downside risks.** The government would "top up" the accounts of retirees to bring everyone's monthly Social Security benefit to the level promised under current law.

By contrast, using the Social Security surplus to pay down the publicly held debt and borrowing the money back once deficits appear, as House Minority Leader Dick Gephardt has proposed, would vastly increase the national debt.

Source: John C. Goodman and Matt Moore, "How to Save Social Security," Brief Analysis No. 417, September 9, 2002, National Center for Policy Analysis, 12655 N. Central Expressway, Suite 720, Dallas, Texas 75243, (972) 386-6272.



The Cost of Dying

Senior citizens nearing death typically generate more than \$50,000 in medical, funeral and burial costs. The government picks up about 65 percent of the total through subsidized programs such as Medicare and Medicaid.

- Medicare averages spending \$28,616 on medical bills for seniors in the last two years of life.
- Medical costs paid by Medicaid and private insurance average \$4,006 and \$3,720, respectively.
- The deceased and their families face average out-of-pocket medical expenses

of \$5,723.

- Funeral and burial expenses average another \$8,000.

Roughly speaking, individuals in the last two years of life account for one-third of all Medicare spending annually, although they constitute fewer than 10 percent of all Medicare beneficiaries. Nevertheless, the cost of dying does not appear to have risen faster than overall Medicare spending and does not appear to be fueling Medicare's spending growth.

Source: Andrew J. Rettenmaier, NCPA senior fellow, and Zijun Wang, "Explaining the Growth of Medicare: Part II," Brief Analysis No. 408, August 6, 2002, National Center for Policy Analysis, 12655 N. Central Expressway, Suite 720, Dallas, Texas 75243, (972) 386-6272.

Transforming the Postal Service

The U.S. Postal Service recently published a 450-page “Transformation Plan” for eliminating its current and projected deficits. The plan focuses on freeing the Postal Service to, for instance, set its own postal rates and expand into new product lines that would compete with private business, while preserving its privileges as a government enterprise. The Postal Service also wants to keep its monopoly on nonurgent letter delivery and on mailboxes, its tax-exempt status and its access to credit at low interest rates.

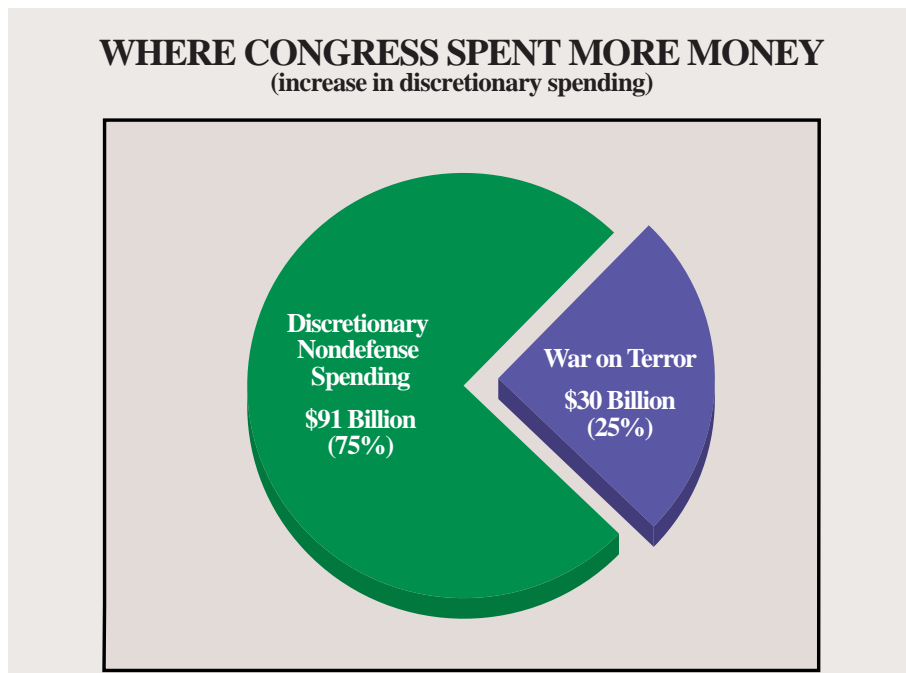
However, economists suggest that short of privatization, an option it rejects, the Postal Service can best alleviate its financial woes not by expanding but by improving its cost management. Some essential changes, such as revamping the laws that determine employee wage increases, would require congressional approval.

- Labor costs, which make up about three-fourths of total operating costs, are seriously out of line with those of private sector businesses.

- Postal service employees’ wages were 28 percent higher than those of comparable private sector employees in the mid-1990s, 34 percent higher after adjusting for skills and working conditions and, with fringe benefits, 42 percent higher.

The Postal Service wants to move into markets already served by private sector companies, maintaining that expansion would enable it to generate more revenue and thus reverse its losses. However, evidence suggests that expansion might make its plight even worse.

- The Postal Service went from a \$1.6 billion profit in 1996 to a \$1.7 billion loss in 2001 because, while its



Note: Estimate for Fiscal Year 2001.
Source: *Fortune*.

War on Terrorism Not Fueling Budget Growth

Budget experts report that federal spending is skyrocketing — but that only about one-third of the growth can be attributed to America’s war on terrorism. Expenditures started to zoom soon after then-President Bill Clinton declared, “The era of big government is over” in 1996. Spending is now rising so briskly that, for the first time since the late 1960s, annually appropriated programs are growing faster than entitlement programs.

- Of the programs that the president and Congress control directly, spending is up 13.9 percent this year.

- While only about \$30 billion has

revenues increased every year, its costs grew even faster.

- The Postal Service acknowledges that if it were a private sector firm, it would already be among the three dozen largest companies in the world.

been spent on homeland security and national defense programs directly related to the antiterror campaign, \$91 billion has been appropriated this fiscal year for matters that range from highway construction to medical research.

- Farm subsidies have doubled, unemployment compensation and health programs other than Medicare and Medicaid have jumped 50 percent, and education outlays have risen by a third.

Just over one year ago, President Bush was confidently predicting \$5.6 trillion in budget surpluses over the next decade. But in fiscal 2002, the U.S. government likely will post a deficit near \$165 billion.

Source: Jeffrey H. Birnbaum, “The Return of Big Government,” *Fortune*, September 16, 2002.

Source: Michael Schuyler and Stephen J. Entin, “Postal Service’s ‘Transformation Plan’: One Good Idea for Reducing Losses and Two Bad Ones,” IRET Congressional Advisory No. 129, May 20, 2002, Institute for Research on the Economics of Taxation, 1730 K Street, N.W., Suite 910, Washington, D.C. 20006, (202) 463-1400.

A Critique of U.S. Tax Policy

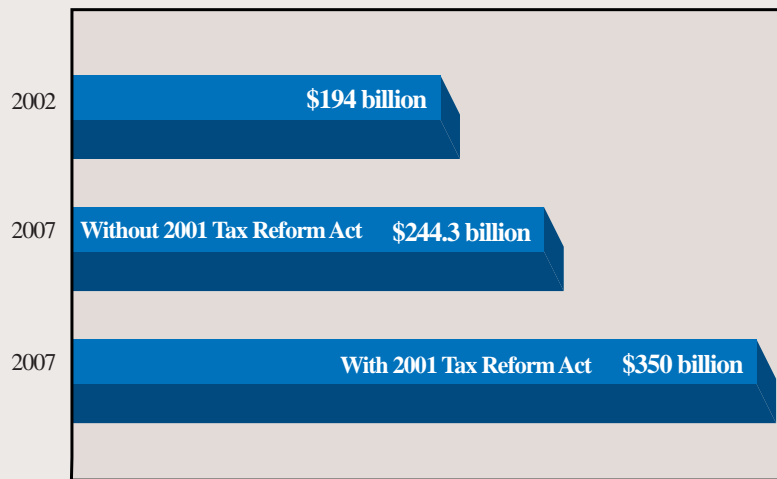
A recent study for the Organization for Economic Cooperation and Development (OECD) concludes that the U.S. tax system is unnecessarily inefficient and complicated. The study recommends that the United States reduce its heavy tax burden on capital income, praises major elements of the 2001 tax act for cutting high marginal tax rates and deprecates the alternative minimum tax and many income-based phase-outs. Given the OECD's generally pro-tax attitude, these findings are especially noteworthy.

In "Increasing Efficiency and Reducing Complexity in the Tax System in the United States" and a follow-up article, OECD economists Richard Herd and Chiara Bronchi are critical mainly of the income tax, especially the treatment of saving and investment. They say:

- The U.S. system discourages saving by taxing both the amounts saved and the returns to the saving.
- Replacing the income tax with a consumption tax would eliminate many of the biases against saving of the current system.
- If this is too big a change, another approach could be reducing corporate tax rates, integrating the taxation of corporations and individuals and cutting the capital gains tax rate.
- Efficiency gains might also flow from lowering the top marginal tax rates on income and extending the scope of saving schemes that allow tax-free accumulation of income until the money is spent.

Source: Michael Schuyler, "Even the OECD Criticizes the U.S. Tax System's Inefficiency," IRET Congressional Advisory No. 128, May 3, 2002, Institute for Research on the Economics of Taxation, 1730 K Street, N.W., Suite 910, Washington, D.C. 20006, (202) 463-1400.

ESTIMATED COST OF TAX LAW COMPLIANCE (Individuals, Businesses and Nonprofits)



Source: Tax Foundation estimates.

Cost of Tax Compliance

In addition to the amount Americans pay in income tax, the amount it costs us to comply with tax laws and regulations is growing dramatically. This is due not only to the inherent difficulty of defining income to be taxed, but also to the growing noneconomic demands placed on the tax code. The latter include determining who has the ability to pay and providing incentives for socially beneficial activities.

- In 2002, individuals, businesses and nonprofits will spend an estimated 5.8 billion hours complying with the federal tax code, with an estimated compliance cost of more than \$194 billion.
- This amounts to imposing a 20.4 cent tax compliance surcharge for every dollar the tax system collects.
- By 2007, the compliance cost is conservatively estimated to reach \$244.3 billion; when the Economic Growth and Tax Reform Reconciliation Act of 2001 (EGTRRA) is taken into account, that figure could go as high as \$350.2 billion.

Complying with tax laws represents a fixed and highly regressive cost for many individuals. For example:

- Taxpayers with adjusted gross incomes (AGIs) of less than \$20,000 pay a compliance cost of more than 4.53 percent of their AGI, but the compliance cost drops to 0.29 for taxpayers with an AGI of more than \$200,000.
- Corporations with less than \$1 million in assets spend about 27 times more than the largest corporations on compliance costs as a percentage of assets.

Source: Scott Moody, "The Cost of Tax Compliance," February 2002, Tax Foundation, 1250 H Street, N.W., Suite 750, Washington, D.C. 20005, (202) 783-2760.

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