



# Executive Alert



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ALL THAT'S NEW IN THE WORLD OF IDEAS

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## IN THIS ISSUE

- Medical Innovations ..... 2
- Stock Market Risk ..... 3
- Retiring Early ..... 3
- Trial Lawyers Threaten Affordable Housing ..... 4
- Importing Tort Cases ..... 4
- Wild Earth ..... 5
- Is the Oil Running Out? ..... 5
- Stifling the Internet ..... 6
- Higher CAFE Standards ..... 6
- Trade with Cuba? ..... 7
- European Pension Woes ..... 7
- Unqualified Teachers ..... 8
- Human Capital Contracts ..... 8



### VÁCLAV KLAUS ELECTED PRESIDENT OF CZECH REPUBLIC

Václav Klaus, NCPA distinguished leader, was elected president of the Czech Republic. President Klaus (left), pictured above with NCPA Senior Vice President Jeanette Goodman (center) and Presidential Office head Jiří Weigl (right) at a briefing introducing Klaus' budget book in Prague last December.

## Grading Schools

How much does a school *improve* students' test scores? Rather than how well a school's students do on tests, a first-of-its-kind study examined changes in the scores of specific students in Texas schools to discover how much students improved from year to year.

The results indicate a tendency for a school to do a good job with one group of students and a bad job with others. For example, in the Dallas area:

- Modrano and Moseley elementary schools do very well with high achievers, ranking No. 2 and No. 8 among 361 area schools, but for low achievers they rank No. 103 and No. 109, respectively.
- By contrast, Bushman and Bowie elementary schools are among the 10 worst for teaching high achievers, but they rank in the top quarter for teaching

low achievers.

There also are significant differences in how well a school does with different races or ethnic groups.

- Carpenter Elementary School and Commerce Middle School rank No. 1 and No. 2 for teaching Hispanic children but No. 89 and No. 117 for teaching African-American children.
- Field Elementary is the second-best school in the area for teaching black children but No. 49 for teaching Hispanic children.
- Lakewood Elementary is No. 10 for teaching white children but No. 141 for teaching black children.
- Gooch Elementary ranks No. 5 for teaching black children but No. 94 for teaching white children.

There are exceptions. Schools at the very top and the very bottom on the scale tend to be uniformly good or uniformly bad for all students. For example:

- Budd Elementary School and Kennedy-Curry Middle School are only a few bus stops apart and are both heavily minority.

■ However, Budd gets high marks for teaching the economically disadvantaged, Hispanics, African-Americans, low achievers and high achievers, while Kennedy-Curry does a uniformly poor job — at or near the bottom — regardless of who is sitting in the classroom.

One implication: if students could move to schools that have a comparative advantage in teaching children with their characteristics, test scores throughout the area would rise.

*Source: John C. Goodman and Matt Moore, "NCPA Texas Schools Report Card," forthcoming, National Center for Policy Analysis, 12655 N. Central Expressway, Suite 720, Dallas, Texas 75243, (972) 386-6272.*

## Innovations Increase Medical Spending

Technological innovations vastly improved health care in the last half of the 20th century, and accelerating innovation in the 21st century promises more prevention, effective treatment and cure of disease.

However, experts say that technological innovations are also the major source of increases in medical spending in the United States. One government agency attributes nearly all of the age- and price-adjusted growth in per capita medical spending in recent decades to such advances.

- Innovations such as magnetic resonance imaging, genetically engineered growth factors, and highly effective drugs for depression, gastroesophageal reflux, high blood cholesterol and HIV have greatly improved the detection and treatment of diseases.

- These innovations also have greatly improved the outcomes of complex procedures such as organ transplantation, coronary artery bypass surgery, and high-dose chemotherapy and bone marrow transplantation for leukemia and multiple myeloma.

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### *Medical innovations reduce the cost of desired outcomes, but increase spending per patient.*

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Such advances often have their greatest impact long after they are introduced, when patients who would have received an older, less-expensive treatment or no treatment receive more or more-expensive care.

- For example, middle-aged men with chronic stable angina pectoris were the first routine beneficiaries of coronary artery bypass grafts.

- With experience and incremental clinical innovations, the same procedure now benefits heart attack patients and elderly patients for whom the procedure

## SURPRISE BLOCKBUSTER DRUGS (annual sales in excess of \$1 billion)

Drug	Indications	Initial Annual Sales Forecast
Tamoxifen	Breast Cancer	\$160,000
Captopril	Hypertension, heart failure	\$20 million
Cimetidine	Peptic ulcer	\$1.12 million
Fluoxetine	Depression	Not known
Atorvastatin	Hyperlipidemia	Not known

Note: Drugs with annual sales in excess of \$1 billion whose success was not anticipated.

Source: *British Medical Journal*, January 18, 2003.

initially was deemed unsuitable.

Many of these innovations have reduced the cost of achieving important health outcomes, but they have also raised per patient expenditures.

Health insurance is encouraging this trend. Insurance increases the demand for health care because insured consumers pay — directly — only a fraction of the cost. However, its most important effect on health care spending may be on the development of new forms of care.

Price is less important to U.S. consumers than convenience, safety and efficacy — that is, the quality of care. Thus we demand increased government and private investment in research on quality-improving innovations rather than on cost-reducing or productivity-enhancing ways to accomplish the same health outcomes as older interventions.

Source: Victor Fuchs and Alan M. Garber, "Medical Innovation: Promises & Pitfalls," *Brookings Review*, Winter 2003, Brookings Institution, 1775 Massachusetts Avenue, N.W., Washington, D.C. 20036, (202) 797-6000.

## Drug Approvals Dwindling

The number of new drug approvals in the United States and worldwide dropped to an alarming low in 2002. According to *Nature Reviews Drug Discovery*:

- The U.S. Food and Drug Administration approved only 15 new drugs last year.

- This was less than half the low average of 31 per year over the previous five years.

Selecting research targets for new drugs is strongly influenced by financial considerations, but forecasting potential sales of new drugs is difficult. Most so-called blockbuster drugs — those with worldwide sales of more than \$1 billion — were not forecast to be big sellers. For example, the initial annual sales forecast for the breast cancer drug tamoxifen was only \$160,000.

Source: "Guiding Drug Discovery through 2003"; and Jonathan Knowles and Gianni Giomo, "Target Selection in Drug Discovery," both in *Nature Reviews Drug Discovery*, vol. 2, January 2003.

## Social Security and Stock Market Risk

The major Social Security reform plans would allow younger workers to put some of their payroll taxes in personal accounts that would be invested in stocks and bonds. The accounts would earn a compounded rate of return over the worker's life and supply a portion of his or her retirement benefit.

While the market is volatile on a daily and even yearly basis, over longer periods the market has always trended upward. A worker saving for retirement will typically invest for more than 35 years.

- The average annual real rate of return over each of the 35-year periods ending between 1961 and 2002 was 7.3 percent after inflation.

- The lowest-earning 35-year period, which ended in 1982, generated an average rate of return of 3.6 percent per year.

- Every 35-year period showed gains, and each period outperformed what Social Security will pay in return for workers' payroll taxes.

Even if a worker retires during a sluggish market year, the compounded value of all the gains over the years will more than offset the losses. For example:

- The market declined by roughly 43 percent between January 1973 and September 1974.

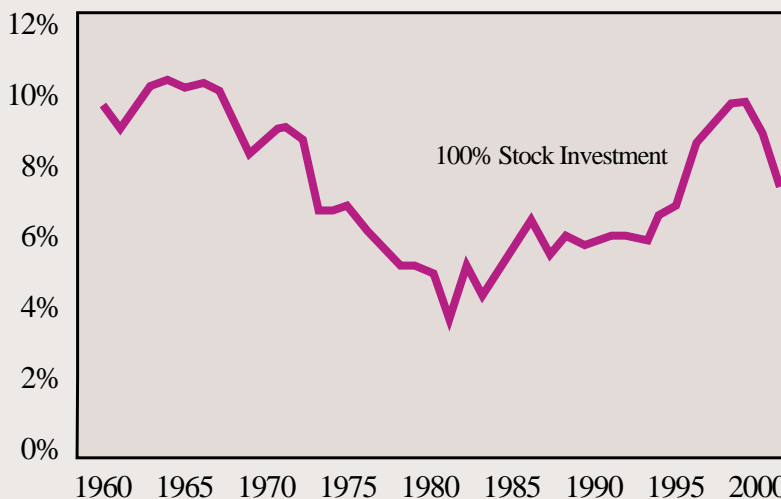
- Yet a worker who retired in 1974 after investing each year of a 35-year working life in a balanced, diversified portfolio would have averaged a 6.2 percent return each year.

- The market has declined by about 40 percent since 1999.

- However, a worker who retired in 2002 after investing each year of a 35-year working life in a balanced, diversified portfolio would have averaged 7.3 percent return each year.

Source: Matt Moore, "Social Security and Stock Market Risk," Brief Analysis No. 429, January 16, 2003, National Center for Policy Analysis, 12655 N. Central Expressway, Suite 720, Dallas, Texas 75243, (972) 386-6272.

### RATE OF RETURN ON 35-YEAR INVESTMENT PERIODS ENDING IN YEAR INDICATED



Note: Graph denotes the average annual real rate of return of the stock market over the 35-year period ending each year from 1960 through 2002.

Source: Private Enterprise Research Center, based on data provided by the Center for Research in Security Prices.

## Retiring Early

There is a trend toward early retirement among workers in developed countries. This is creating increased fiscal pressures on those countries' social security systems due to the greater number of retirees and fewer workers.

The availability of retirement benefits affects the decision of workers to retire or keep working. The more generous the benefits for early retirees, the more likely they are to retire early. Since retiree benefits in most countries are funded by payroll taxes, the very generosity of the system aggravates the problem of pay-as-you-go financing.

Canada's Income Security (IS) programs for seniors, for example, not only provide early retirement benefits starting at age 60, but due to means-tested programs that

reduce retirement income as earnings and other income increase, provide disincentives to keep working. In response to these factors:

- The labor force participation of Canadian men ages 55 to 64 fell from 87 percent to 61 percent from 1960 through the end of the 1990s.

- For men over 65, it fell from 30 percent to under 10 percent.

- By age 64, Canadian males now face a net reduction in the present value of their retirement income of more than C\$4,400 if they work another year.

Source: Les Picker, "The Retirement Effects of Canada's Income Security Programs," *NBER Digest*, June 2002; based on Michael Baker, Jonathan Gruber and Kevin Milligan, "The Retirement Incentive Effects of Canada's Income Security Programs," *NBER Working Paper No. 8658*, December 2001, National Bureau of Economic Research, 1050 Massachusetts Avenue, Cambridge, Mass. 02138, (617) 868-3900.

## Importing Tort Cases

U.S. lawyers try to file tort suits in states known to have juries usually sympathetic to the interests of their clients — Mississippi, for example. In a new trend, European lawyers and their clients are using any pretext to have their cases heard in the United States, since punitive damages and class actions usually are not permitted in Europe.

- American citizens and non-citizens alike can have their overseas personal injury claims heard in U.S. courts — as long as Americans are involved and this nation has some interest in the litigation.

- The 1789 Alien Tort Claims Act gives federal courts wide jurisdiction over suits alleging human rights violations.

- Plaintiffs' lawyers argue that U.S. law allows anyone to be part of a class, including noncitizens.

- Thus a massive class action with a European company defending and with thousands of European plaintiffs and lawyers involved could wind up in U.S. courts — if a single American can be found as a plaintiff.

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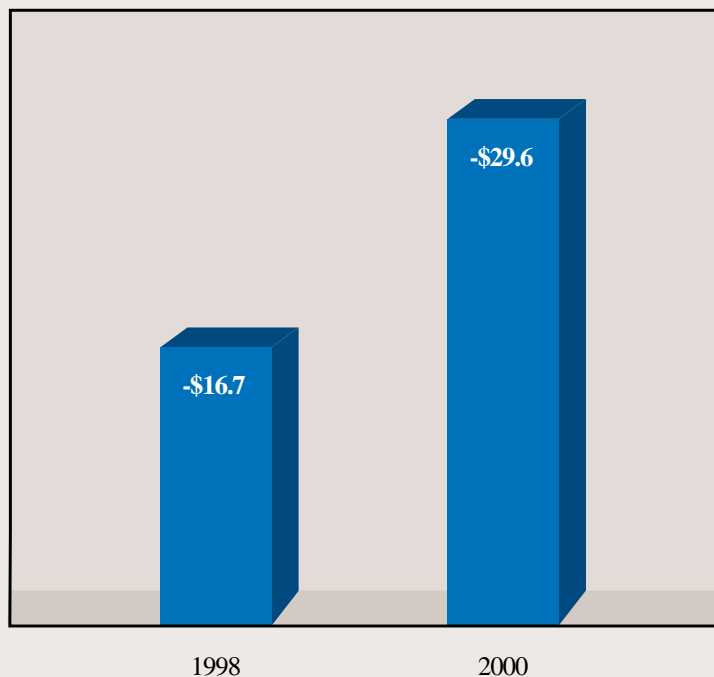
### *European countries usually do not allow punitive damages and class actions.*

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At present, a suit stemming from a 1998 German train crash that killed 101 people is being heard in New York, even though only one American is listed among the plaintiffs. The lawyers selected her as lead plaintiff in the case.

Source: Michael Freedman, "Ich Bin Ein Tort Lawyer," *Forbes*, January 6, 2003.

## LOSSES OF CALIFORNIA BUILDERS' INSURERS (in millions of dollars)



Source: Steven Halaga, "Tort Turns Toxic," *City Journal*, Autumn 2002.

## Trial Lawyers Threaten Affordable Housing

Trial lawyers have driven medical malpractice insurance premiums to record levels. But that is just one part of the civil justice system crisis that has begun crippling various aspects of our national life. Now, spurious lawsuits against builders are hobbling construction firms and in some places have brought affordable home building to a halt.

The heart of this problem is a massive increase in "construction defect" litigation. During the 1980s, when middle-income condominium developments sprang up across the Sunbelt, some were poorly built, and owners and condo associations sued the contractors. Trial lawyers discovered that suits against multiunit complexes could be gold mines, since each case had so many potential litigants. By the mid-1990s, trial lawyers were actively soliciting condo associations across the

country, offering to represent them in suits against builders on flimsy or even nonexistent evidence of faulty construction.

- By 1998, California insurers were collecting \$19.3 million in premiums but paying out \$36 million in costs, a loss of \$16.7 million.

- Two years later, the loss widened to \$29.6 million — \$2.95 paid out for every \$1 in premiums collected.

Predictably, insurers are fleeing the market or ratcheting up their rates so that builders can no longer afford to construct multiunit housing. In California, for example:

- Multiunit housing construction has plummeted 85 percent since 1994, falling even during the years the Golden State's economy roared.

- One of California's biggest builders, Barnett America, no longer builds the affordable, multiunit housing it specialized in for 20 years.

Source: Steven Malanga, "Tort Turns Toxic," *City Journal*, Autumn 2002, Manhattan Institute, 52 Vanderbilt Avenue, 2nd Floor, New York, N.Y. 10017, (212) 599-7000.

## Are We Running Out of Oil?

Over the past 150 years, geologists and other scientists often have predicted that our oil reserves would run dry within a few years. The facts contradict these harbingers of doom:

- World oil production continued to increase through the end of the 20th century.
- Prices of gasoline and other petroleum products, adjusted for inflation, are lower than they have been for most of the last 150 years.
- Estimates of the world's total endowment of oil have increased faster than oil has been taken from the ground.

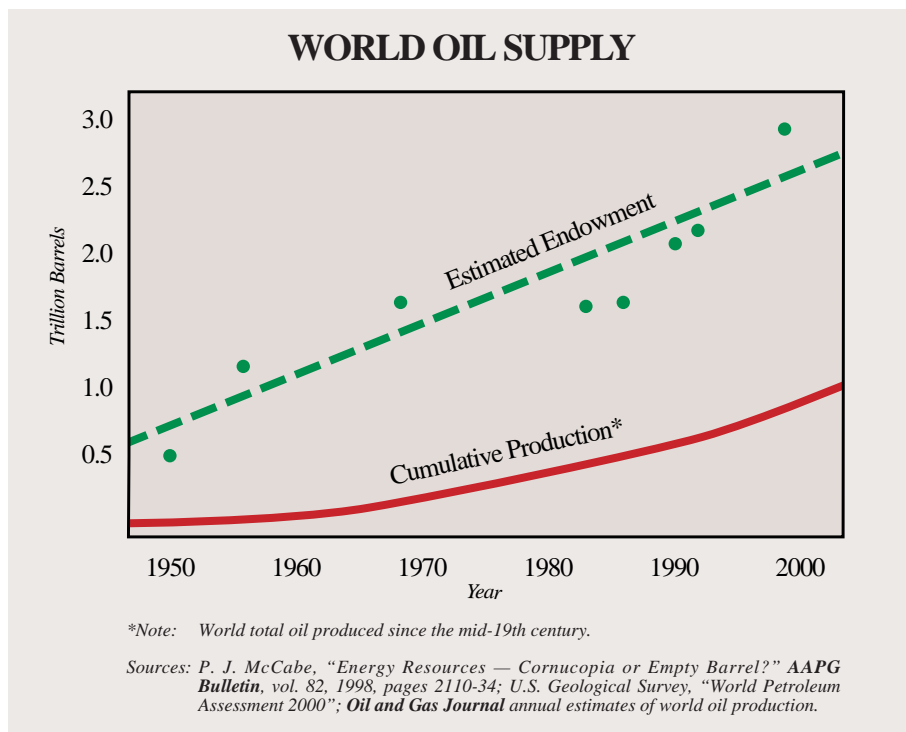
We have not run out of oil because new technologies increase the amount of recoverable oil, and market prices — which signal scarcity — encourage new exploration and development. Rather than ending, the Oil Age has barely begun.

Nonexperts persistently predict oil shortages because they misunderstand petroleum terminology. Oil geologists speak of both reserves and resources.

- *Reserves* are the portion of *identified* resources that can be economically extracted and exploited using current technology.
- *Resources* include all fuels, both identified and unknown, and constitute the world's endowment of fossil fuels.

Estimates of the total amount of oil resources in the world grew throughout the 20th century.

- By the year 2000, a total of 900 billion barrels of oil had been produced.
- Total world oil production in 2000 was 25 billion barrels.
- If world oil consumption continues to increase at an average rate of 1.4 percent a year, and no further resources are discovered, the world's oil supply will not be exhausted until the year 2056.
- Unconventional oil resources not included in the above estimates can extend supplies much further; oil-containing tar sands and oil shales in Canada, South America and the western



## Impact of Farming

Farming has a significant impact on the environment. More than half of the land in the United States is used for farming, and about 78 percent of endangered species in the United States rely on private lands for some or all of their habitat.

Government policies such as estate taxes and agricultural subsidies hinder the efforts of ecological entrepreneurs trying to correct the nation's past agricultural shortcomings.

- Farmers are 15 times more likely to be subject to estate taxes than other Americans.
- Oftentimes, in order to pay the taxes, they must sell items essential to the agricultural operation's survival (e.g.,

tractors, balers, corrals, barns and land).

Agricultural subsidies aggravate the environmental impact of farming by encouraging cultivation of unneeded marginal land. Subsidies also lead to increased use of chemical inputs that are released into the natural ecosystem.

- One study of six farming states found that eliminating subsidies would reduce fertilizer use by 29 percent.
- In the North Carolina coastal plain, researchers estimated that elimination of subsidies could reduce water pollution from nitrogen leaching out of fertilizer by 46 percent.

*Source: J. Bishop Grewell, "Farming for the Future: Agriculture's Next Generation," PERC Policy Series, Issue Number PS-26, October 2002, PERC - Center for Free Market Environmentalism, 502 S. 19th Avenue, Suite 211, Bozeman, Mont. 59718, (406) 587-9591.*

United States alone contain the equivalent of more than 2,100 billion barrels of oil.

Oil production in the United States is declining, but lower production does not necessarily indicate the looming exhaustion of U.S. oil resources. It shows instead that at current prices and with current technology, less of the remaining petroleum is economically recoverable.

We have only just entered the petroleum age. The world contains enough petroleum resources to last at least until the year 2100. This is so far in the future that it would be ludicrous for us to try to anticipate what energy sources our descendants will utilize.

*Source: David Deming, "Are We Running Out of Oil?" Policy Backgrounder No. 159, January 29, 2003, National Center for Policy Analysis, 12655 N. Central Expressway, Suite 720, Dallas, Texas 75243, (972) 386-6272.*

## Stifling the High-Speed Internet

The recent history of communications regulations prompts concerns that many promising new broadband and content-delivery technologies could be delayed or blocked in the United States by poorly crafted regulation.

- Cellular service could have been operational at least 10 years earlier except for delays imposed by the extended regulatory process — costing the U.S. economy and consumers \$86 billion by one accounting and giving European and Asian companies the competitive lead in cellular technology.

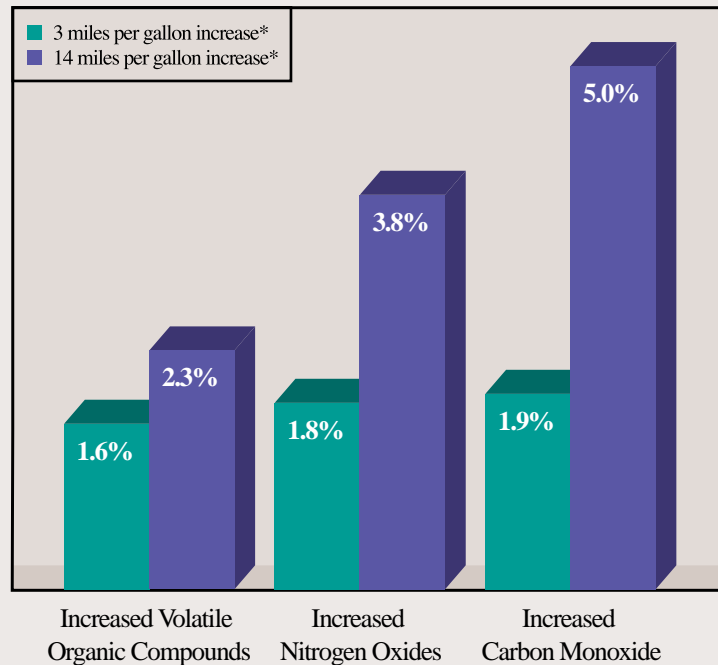
- Time Domain, a leading provider of Ultra-Wideband for use in automobile radar, location finding and imaging functions, spent 13 years getting approval to provide limited services.

- Wi-Fi (wireless fidelity) and Bluetooth, two new high-speed technologies for Internet access, have already been threatened with delays by regulatory action.

The Federal Communications Commission has been the major culprit, but Congress is often asked and sometimes prevailed upon by various interest groups to pass communications laws that have harmful effects.

*Source: Richard D. Hearst, "Beware Preempting the Cyberspace Revolution: Lessons from History for Broadband Policy," in Sonia Avison, ed., **Telecrisis: How Regulation Stifles High-Speed Internet Access** (San Francisco: Pacific Research Institute for Public Policy, 2003).*

## ESTIMATED EFFECT ON AIR POLLUTION OF PROPOSED HIGHER FUEL ECONOMY



*\*Note: Three mpg increase proposed by Vice President Dick Cheney's energy task force; 50 percent increase (13.75 mpg for cars) proposed by Sen. John Kerry (D-Mass.).*

*Source: Regulation, Fall 2002.*

## Higher CAFE Standards Not the Answer

Proponents of stricter Corporate Average Fuel Economy (CAFE) standards, including the authors of a recent National Research Council report, claim that reduced fuel consumption would offset the cost of increasing CAFE standards. In fact, higher CAFE standards would reduce consumer welfare and motorist safety, harm the environment and increase the profits of foreign firms. Worst of all, higher fuel economy standards would do very little to save gasoline.

- Because pollution from a car is a direct function of the number of miles it is driven and people in more fuel-efficient vehicles drive more, the net result of an increase in CAFE standards

is an increase in automobile pollutants.

- Compliance with stricter standards means that automakers lighten their cars, and lighter, smaller cars mean more fatalities from automobile accidents.

- Increasing the standards by just three miles per gallon would cause U.S. automakers to lose about \$1.24 billion, while foreign automakers would increase their profits by \$260 million.

A more effective approach to reducing energy consumption would be to increase the gasoline tax instead. However, raising and extending CAFE standards is a politically attractive policy to reduce gasoline consumption's external costs. Because of that attractiveness, the real energy consumption issues largely are ignored.

*Source: Andrew N. Kleit, "CAFE Changes, by the Numbers," Regulation, Fall 2002, Cato Institute, 1000 Massachusetts Avenue, N.W., Washington, D.C. 20001, (202) 842-0200.*

## Should We Trade with Cuba?

Opponents of ending the U.S. embargo on Cuba are concerned that increased trade would strengthen the regime of Fidel Castro. But increased trade has fostered democratic development in other countries, including other Communist regimes. China, for example, has become the United States' fourth-largest trading partner. As the Center for Trade Policy points out:

- In 1978 international trade was 10 percent of China's gross domestic product, but by the late 1990s it was 36 percent.
- Due to China's reforms, 100 million people no longer live below the poverty line, and both rural and city dwellers have better access to health care and education.

Trade also has encouraged China to develop enforceable contracts and property rights laws, which can act as anchors for the process of democratization.

Like China, Mexico has benefited greatly from embracing trade liberalization:

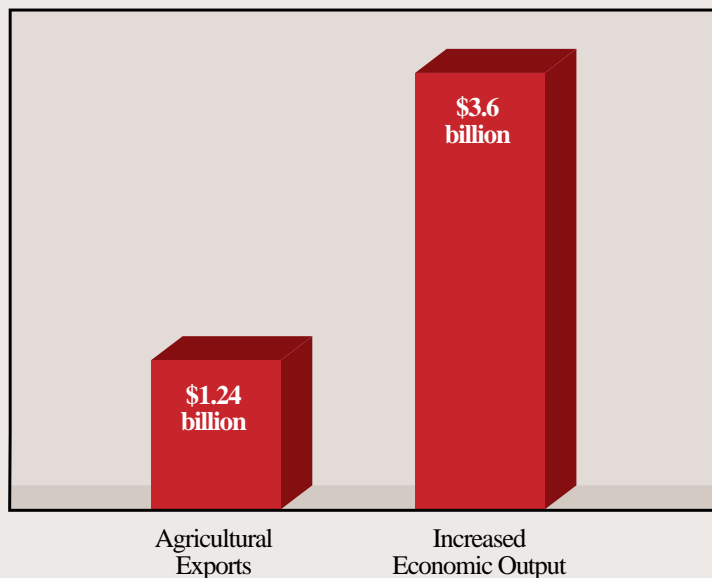
- Since the North American Free Trade Agreement (NAFTA) was enacted in 1994, foreign direct investment (FDI) in Mexico has grown to over \$115 billion.
- Employment in FDI firms has grown more than twice as fast as the economy as a whole, and these firms offer salaries that are 48 percent higher than average.
- Between 1993 and 1999, Mexico rose from 26th to eighth among the world's exporting countries and became the United States' second-largest trading partner.

Increased democratization was evinced in Mexico's case by the election of President Vicente Fox in 2000, which ended seven decades of single-party rule.

Cuba now imports about \$1 billion a year in goods from U.S. allies. A recent Texas A&M study commissioned by the Cuba Policy Foundation shows that the embargo costs U.S. farmers \$1.24 billion a year.

*Source: Amy Maness, "Should We Trade With Cuba?" Brief Analysis No. 427, January 14, 2003, National Center for Policy Analysis, 12655 N. Central Expressway, Suite 720, Dallas, Texas 75243, (972) 386-6272.*

## POTENTIAL ANNUAL U.S. SALES AND INCREASED OUTPUT FROM TRADE WITH CUBA



*Source: C. Parr Rosson III and Flynn J. Adcock, "Economic Impacts of U.S. Agricultural Exports to Cuba," Texas A&M University and Cuba Policy Foundation, January 28, 2002.*

## European Pension Problems

Over the next decade, Europe's baby-boom generation of the 1950s and early 1960s will reach retirement age, increasing the pressure on the public finances of the 15 countries in the European Union. Although pensions are the responsibility of individual governments, a recent E.U. report urges them to speed up radical economic reforms to defuse a "pension time bomb" in the next few decades.

- In most European countries, pension expenditures are expected to rise significantly from about 2015 onward, giving rise to concern about the capacity of future pensions to ensure decent living standards for the retired.

- Due to longer life expectancy and

low birthrates, by 2050 only two people will be working for each person over 65 — half the current ratio.

- As a result, E.U. governments' expenditures on pensions are set to rise by about a third, to more than 13 percent of gross domestic product, within the next four decades.

The problem is likely to be more acute in countries such as France, where most pensions are funded by the state. Other countries, including Germany, Spain and Italy, also will have to speed up reforms to prevent a collapse of their pension systems. By contrast, in the United Kingdom, where nearly half of pension incomes have been privatized, the funding of pensions is not a concern.

*Source: Francesco Guerrera, "E.U. Governments Warned on Pensions," Financial Times, December 18, 2002.*

## Human Capital Contracts

With the cost of higher education increasing every year, more students are looking for financial aid. Some education experts suggest an alternative to traditional student loans: private financing of higher education through human capital contracts. These are agreements between students and lenders who would invest in the students in exchange for receiving a portion of their future income for a fixed period.

Human capital contracts could be attractive to both students and investors.

- They would relieve the student of uncertainty about being able to make fixed loan payments.
- They would virtually eliminate default due to financial distress.
- They would require lower payments for those who pursue careers that pay less during the repayment period.

However, policy-makers must take certain steps to make human capital contracts a viable alternative to traditional student loans:

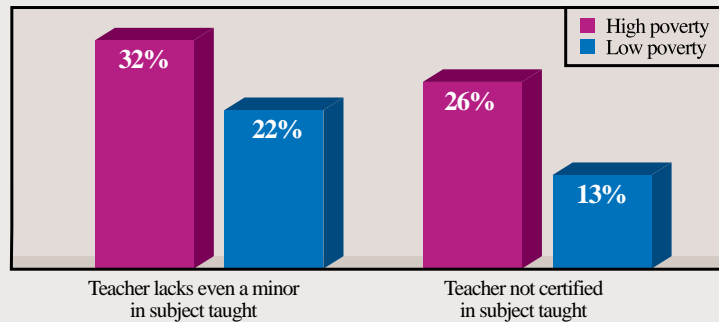
- Investors must receive protection similar to that given student loan lenders today — such as recognition of the validity of the loan contract and denial to students of the right to renege on their obligation if they file for bankruptcy.
- Contracts must be acknowledged as securities so that investment funds can hold them.

- Tax treatment of these instruments should be similar to that of other student financing so they can compete on an even plane with student loans.

Once these concerns are met, some analysts say students will benefit through better financing conditions, lower overall costs and increased competition for student loans.

*Source: Miguel Palacios, "Human Capital Contracts: 'Equity-like' Instruments for Financing Higher Education," Policy Analysis No. 462, December 16, 2002, Cato Institute, 1000 Massachusetts Avenue, N.W., Washington, D.C. 20001, (202) 842-0200.*

## UNQUALIFIED TEACHERS IN HIGH-POVERTY AND LOW-POVERTY SECONDARY SCHOOLS



*Source: Education Week, January 9, 2003.*

## Poor Children Get Least-Qualified Teachers

On average, public schools with a high proportion of minority students or students from poor families have fewer qualified teachers than other schools. States and schools districts are taking steps to recruit and retain competent teachers, but these efforts generally are not aimed at finding teachers for high-poverty, high-minority and low-achieving schools. Instead, state incentives are geared toward increasing the teacher supply overall or in specific subjects or regions. When states do target programs, they rarely keep track of whether their incentives work and where recipients end up.

An *Education Week* survey of the 50 states and the District of Columbia finds:

- Only about half of secondary students in high-poverty schools have teachers who majored in and are certified to teach their subjects, compared with about 70 percent of secondary students in low-poverty schools.
- In high-poverty secondary schools, 32 percent of students take a class with a teacher who lacks even a minor in the subject taught — about a third more than the proportion (22 percent) in low-poverty schools.
- Secondary students in high-poverty schools are twice as likely as those in low-poverty schools (26 percent vs. 13 percent) to have a teacher who is not

certified in the subject taught.

The faculties of high-poverty, high-minority schools also are less experienced. At the elementary level, 13 percent of teachers in high-poverty schools have less than three years' experience, compared with 9 percent of teachers in low-poverty schools.

The federal "No Child Left Behind" Act of 2001 requires states to ensure that all teachers of the core academic subjects are "highly qualified" in every subject they teach by the end of the 2005-06 school year. Newly hired teachers in schools receiving Title I money must have satisfied those requirements this school year. The survey indicates that much remains to be done if states are to meet the challenge of the new law.

*Source: "To Close the Gap, Quality Counts," Editorial Projects in Education, Education Week, January 9, 2003.*

## Executive Alert®

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