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# EPI Issue Brief

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Issue Brief #150

Economic Policy Institute

February 9, 2001

## DECLARE A PROSPERITY DIVIDEND

### *A stimulating idea for the U.S. economy*

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Recent economic news suggests that the risk of recession has become acute. Economic growth, which registered a strong 5.6% in the second quarter of 2000, slowed to 1.4% in the final quarter and is currently close to zero. At the same time, unemployment has now begun to rise.

It is ironic, perhaps, that the first slowdown in the New Economy looks so much like those of the past. Manufacturing has contracted for the last four months, and layoffs are rising. In fact, employment in this sector has shrunk by 600,000 jobs since its 1998 peak. Layoffs extend to the temporary help industry (whose workers provide a buffer for permanent employees), which lost 500,000 jobs in the last four months. This is a huge drop in an industry that employs only four million workers. Furthermore, new data suggest that the service sector now hovers on the brink of recession. One widely followed index shows a decline in non-manufacturing activity to a record low of 50.1 in January.

The chances of the economy turning itself around without some help are not promising. Slower wage growth, a deluge of pink slips, and the fall in the stock market have eroded consumer confidence. The consequences of last year's interest rate increases are still working their way through the economy, and the benefits of January's rate cuts won't be felt for a while yet. Not surprisingly, consumption growth – which was the driver of the 1990s boom – has slowed. Spending on consumer durables such as appliances has declined, and consumption of nondurables, such as clothing and food, has been nearly flat. In fact, consumption is now growing more slowly than at any time in the last five years.

All of which points to one conclusion: the economy needs a stimulus. Policy makers are right to look for a quick way to stimulate the economy and lessen the risk of a recession. Business and consumer debt levels are high relative to income, and the country has accumulated a large foreign debt. A recession, if it develops, could turn nasty. Preemptive action can make a difference, and a short-term stimulus could be the insurance policy needed against the increasing risk of recession.

### **No stimulus in the Bush tax plan**

President Bush argues that, by making the tax savings in the first year of his tax plan retroactive, his proposed tax cuts will stimulate the economy. Unfortunately, the first year's tax savings in the Bush plan are too small to have

much of an effect on the economy, arrive too late to avert a recession, and are skewed toward the wealthy, who are more likely to save the extra money than spend it. As a stimulus, the president's tax plan is a weak response to an increasingly serious problem.

Even if the Bush tax plan were enacted this year, most of the effects would not be felt until April 15, 2002. In addition, the plan is backloaded. First-year tax savings amount to \$20-30 billion. Even if households spent all of their tax cut, consumer spending would increase by less than 0.5% – not enough to be much of a stimulus. Finally, Citizens for Tax Justice estimates that the richest 1% of households receive 43% of the tax savings in the Bush plan (much more than the 21% share of income and payroll taxes this group actually pays), and the top fifth gets 71% of the savings.

The Bush tax cut leaves a lot of people behind. Most families earning less than \$30,000 will get little or nothing in the way of tax relief, despite the fact that they have paid payroll taxes. Other middle-income households that pay a lot more in payroll than income taxes will see only small cuts in their income taxes, especially in the first year, which is the very time these tax cuts are supposed to act as a stimulus to the economy.

A single mom with two kids earning \$21,000 a year would get nothing in the Bush tax plan, despite having paid more than \$1,600 in payroll taxes. A recent study by Deloitte and Touche analyzed the effects of the Bush proposal on families that pay income tax. The accounting firm found that a single wage earner with no children earning \$62,000 would get just \$160 in tax savings in the first year of the Bush plan. A two-earner family with no children earning \$38,000 would get \$144. A two-earner family with two children earning \$70,000 would get \$410.

Because these kinds of tax cuts don't add up, the Bush tax plan simply does not work as a stimulus. Moreover, adopting the Bush plan ties the hands of policy makers for the future without reducing the risk of rising unemployment later this year.

### **Stimulating the economy with a “prosperity dividend”**

On all counts, revising the tax code is the wrong way to try to stimulate the economy. A tax cut enacted this year won't have much effect until next. Not only is the Bush tax cut too small in the first year to be of much help to the economy, it's likely to arrive too late. Moreover, the tax code is too important to be tampered with in haste, as the consequences of any changes will be felt for years.

The current budget surplus is America's return on 10 years of good economic performance, to which all of us have contributed. Now we have the opportunity to share the country's prosperity with every household and, at the same time, get the economy back on track.

To this end, the government should declare a prosperity dividend. It should send a check for \$500 to every man, woman, and child who is a permanent resident of the United States.

Such a prosperity dividend could provide a real stimulus to the economy. The dividend could be issued quickly, and it would put money in the hands of people who would spend it. And at \$500 per person, for most families it would be big enough to make a difference, dwarfing the first-year savings offered under the Bush plan (see **Table 1**).

Thus, a prosperity dividend this year would give a quick lift to the economy, spur consumer spending, and help fight off a potentially deep recession.

A tax-free \$500 check to every permanent resident would transfer roughly \$140 billion from the government to the private sector. If households spent all of the money, consumption spending could be increased by about 2%. A tax-free check for \$300 would transfer about \$90 billion to households—enough to raise consumption spending by 1.3%.

These are big enough numbers to matter in a \$10 trillion economy. By comparison, research on the wealth effect shows that the run-up in the stock market between 1997 and 1999 led to a significant increase in consump-

tion. A mid-point estimate of this increase was 1.7%.

A stimulus is most effective when it is targeted to people who need it. The prosperity dividend would be distributed equally to everyone living permanently in the United States (see box for eligibility guidelines). But it would mean the most to low- and middle-income families with young children. These families would be likely to spend all or most of the dividend on goods and services, allowing them to increase consumption without going further into debt. Families in financial distress could use the dividend check to pay down credit card debts and secure their ability to consume in the future.

A prosperity dividend check to every person in America is the best way to stimulate the economy and prevent a major recession – which is

supposed to be the goal of the Bush Administration and Congress. It is a fair and efficient way to use part of the surplus to stimulate the economy without tying the government’s hands for the future. After sidestepping the downturn, we can reassess the fiscal surplus and carefully decide the best way to restructure the nation’s fiscal stance so that it is fair and creates incentives for all Americans, from the least advantaged to the most.

**TABLE 1**  
**Which is more stimulating?**  
*Bush tax cut vs. prosperity dividend, sample scenarios*

Taxpayer	Annual gross income	Bush tax plan (1st year savings)	Prosperity dividend
<b>Singles</b>			
<i>2 children</i>	\$21,000	\$0	\$1,500
<i>1 child</i>	68,000	254	1,000
<b>Married couples</b>			
<i>3 children, 1 in college (single earner)</i>	\$32,000	\$299	\$2,500
<i>No children (2 earners: 30,000 &amp; 8,000)</i>	38,000	144	1,000
<i>2 children (2 earners: 40,000 &amp; 30,000)</i>	70,000	410	2,000
<i>1 child (2 earners: 86,000 &amp; 130,000)*</i>	216,000	1,459	1,500

\* “Breakeven” point.  
Source: Deloitte and Touche, *USA Today*, February 4, 2001.

### How the prosperity dividend works

Eligibility requirements for the prosperity dividend are modeled on Alaska’s Permanent Fund Dividend. To qualify for the prosperity dividend, a resident of the U.S. would have to be able to answer yes to all of the following statements.

- I was a resident of the U.S. during all of calendar year 2000.
- On the date I applied for the prosperity dividend, I had the intent to remain a resident of the U.S. indefinitely.
- I have not claimed residency in any other country at any time since December 31, 1999.
- If absent from the U.S. for more than 180 days, I was absent on an allowable absence (attending college, serving in the U.S. Armed Forces, receiving medical treatment, employed on a vessel of the U.S. Merchant Marine, required by employer, etc.).
- I was physically present in the U.S. for at least 72 consecutive hours at some time during 1999 or 2000.

Applying for the prosperity dividend would be easy and the application form would be very short. Residents would provide their name, address, telephone number, date of birth, Social Security number, and signature. They would also provide the names, addresses, and telephone numbers of two adult residents of the U.S. who can verify residency, and a statement that they understand that if they deliberately misrepresent or recklessly disregard a fact, they are liable for civil penalties and a fine of up to \$5,000.

If we send the prosperity dividend to anyone currently living in the U.S. who worked or resided here last year, then we could have an even simpler procedure. Most people who are working or retired would receive their prosperity dividend check from the government automatically.