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STATES WIN TOO WITH PROSPERITY DIVIDEND

Economic stimulus would boost sales tax revenue along with consumer spending

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U.S. economic growth has slowed to a crawl as manufacturing production continues to plunge and the bear market in stocks takes its toll on high-tech employment. Businesses and households have reined in spending, and retail sales have begun to decline.

Slower spending is leaving its mark on state revenues, prompting cutbacks in plans for spending on education and other state initiatives. The National Conference of State Legislatures, meeting recently in Washington, D.C., noted that 23 states may need to cut budgets or dip into rainy day funds. Some states that enacted tax cuts because they projected surpluses now face a shortfall and may have to cut programs. Given the difficulties of projecting revenues into the future, particularly when the economy may be turning down, it makes little sense to lock the nation into a huge tax cut that could create a national budget squeeze.

The economy, as Federal Reserve Chairman Alan Greenspan said in Senate testimony recently, has entered "a retrenchment that has yet to run its full course." Fed policy turned expansionary in January, but the Fed's interest rate cuts, though an important part of any solution to a potential economic slowdown, may be too slow to preserve full-employment prosperity. The economy needs a stimulus now to reduce the risk of a downturn. Undoing a recession will be a far more difficult task than averting one.

The Bush tax cut: too big, too small, too late

President Bush is promoting his tax cut—the same tax cut he endorsed last year while the economy was still growing rapidly—as insurance against a recession. Unfortunately, his tax cut doesn't do what he says it will do. It was not designed to be an economic stimulus, and it won't deliver the much-needed boost consumers, businesses, and state governments are waiting and hoping for. Even speeding up the tax cut and making it retroactive will not do much for consumers, state coffers, or the economy. According to the Administration's own estimate, the overall impact of the tax cut is only about $5.6 billion, or about $18 per person if shared evenly. This is hardly enough to "put money in the pockets of consumers in the short run," as the Republican chairman of the House Ways and Means Committee claims.

Another major shortcoming of the administration's tax cuts is that they are skewed to high-income households, which tend to save at much higher rates than other households. Many young families get little or nothing, despite the fact that a significant number pay federal taxes other than the income tax as well as federal excise taxes on items such as gasoline, state sales taxes, property taxes, and local wage taxes. According to researchers at the Center on Budget and Policy Priorities, the 50 million families with incomes below $26,000 would see their after-tax income rise by trivial amounts or not at all. Moreover, 34% of children live in families that won't benefit at all from the tax cut.

Rather than helping the economy now, the really big tax cuts in the president's plan—like the surpluses he is counting on using to pay for them—don't arrive until his current term is over. According to the administration's numbers, $4.2 trillion of the projected $5.6 trillion surplus won't materialize until 2006-11. In committing the economy now to a huge $1.6 trillion tax cut, the Bush administration is gambling that Congressional Budget Office forecasters will turn out to be right about the government's budget five years down the road. But neither CBO nor other forecasters were able to foresee the current surplus—as recently as 1997 they forecast deficits through most of this decade. There is no reason to expect their forecasts to be any more accurate in the future than in the past.

It is far too risky to bet the house on long-term economic forecasts. Should the projected budget surpluses fail to materialize, the Bush tax cuts would risk plunging the economy into deficit to meet the routine operating expenses of the federal government. This outcome would have a serious impact on the capacity of the federal government to invest in education, health care, and basic research and to maintain future Social Security and Medicare benefits.

A 'prosperity dividend': just right for consumers, businesses, and states

Fortunately, there is a sensible and prudent alternative to the president's tax plan that can stimulate the economy, put cash into the hands of strapped consumers, and provide a boost to state governments. The federal government should use this year's surplus to send a tax-free check now—a "prosperity dividend"—to every permanent resident of the United States—man, woman, and child. Because it is a one-time payment, this dividend check could be large enough to matter to households and to give the U.S. economy a boost, without tying the government's hands in the future or foreclosing on tax reform, spending priorities, or debt reduction in 2002 and subsequent years.

A stimulus this year to get the economy back on track will do no economic harm. Except for the volatile energy and food sectors, prices are flat or falling, and inflation is dormant. And with the economy slowing, consumer spending can increase without causing interest rates to rise.

A check from the federal government to everyone living in America that transfers the $125 billion non-Social Security surplus the country is generating this fiscal year from the government to the private sector could be as large as $440 per person. This amount, equal to 1.8% of consumer spending or 1.2 % of gross domestic product, is large enough to stimulate the country's $10 trillion economy substantially. Even if consumers spend 70% of their dividend checks in a short time period—about what they spend out of income tax refunds—consumer spending would increase by 1.2%, giving an immediate lift to GDP of 0.9%, a substantial stimulus this year.

And the prosperity dividend checks would be large enough to make a difference to households. A family of three, for example, would receive a check for $1,320 before October 1, 2001.

The $440-per-person figure is a reasonably sized number to give the U.S. economy a boost. But the amount is not etched in stone. The precise number will differ depending on the magnitude of the slowdown, the responsiveness of the economy to the current round of interest rate cuts, and other factors that affect the perceived need. The key point is that a check from the government to every American will have an immediate impact on consumers who have run out of consumer credit and will thus boost consumer confidence and spending just when such a boost is needed.

A prosperity dividend would provide much-needed relief to state governments as well. States rely on sales tax

TABLE 1
Effect of a $440 per person prosperity dividend on state sales tax revenues

State	Resident population	Sales tax (%)	State revenue if... 100% spent	70% spent
Alabama	4,447,100	4%	$782,690	$547,883
Alaska	626,932	0	-	-
Arizona	5,130,632	5	1,128,739	790,117
Arkansas	2,673,400	5.13	602,852	421,996
California	33,871,648	7	10,432,468	7,302,727
Colorado	4,301,261	2.90	548,841	384,189
Connecticut	3,405,565	6	899,069	629,348
Delaware	783,600	0	-	-
District of Columbia	572,059	5.70	143,472	100,431
Florida	15,982,378	6	4,219,348	2,953,543
Georgia	8,186,453	4	1,440,816	1,008,571
Hawaii	1,211,537	4	213,231	149,261
Idaho	1,293,953	5	284,670	199,269
Illinois	12,419,293	6.25	3,415,306	2,390,714
Indiana	6,080,485	5	1,337,707	936,395
Iowa	2,926,324	5	643,791	450,654
Kansas	2,688,418	4.90	579,623	405,736
Kentucky	4,041,769	6	1,067,027	746,919
Louisiana	4,468,976	4	786,540	550,578
Maine	1,274,923	5	280,483	196,338
Maryland	5,296,486	5	1,165,227	815,659
Massachusetts	6,349,097	5	1,396,801	977,761
Michigan	9,938,444	6	2,623,749	1,836,624
Minnesota	4,919,479	6.50	1,406,971	984,880
Mississippi	2,844,658	7	876,155	613,308
Missouri	5,595,211	4.23	1,040,150	728,105
Montana	902,195	0	-	-
Nebraska	1,711,263	5	376,478	263,534
Nevada	1,998,257	6.50	571,502	400,051
New Hampshire	1,235,786	0	-	-
New Jersey	8,414,350	6	2,221,388	1,554,972
New Mexico	1,819,046	5	400,190	280,133
New York	18,976,457	4	3,339,856	2,337,900
North Carolina	8,049,313	4	1,416,679	991,675
North Dakota	642,200	5	141,284	98,899
Ohio	11,353,140	5	2,497,691	1,748,384
Oklahoma	3,450,654	4.50	683,229	478,261
Oregon	3,421,399	0	-	-
Pennsylvania	12,281,054	6	3,242,198	2,269,539
Rhode Island	1,048,319	7	322,882	226,018
South Carolina	4,012,012	5	882,643	617,850
South Dakota	754,844	4	132,853	92,997
Tennessee	5,689,283	6	1,501,971	1,051,380
Texas	20,851,820	6.25	5,734,250	4,013,975
Utah	2,233,169	4.75	466,732	326,713
Vermont	608,827	5	133,942	93,759
Virginia	7,078,515	4.50	1,401,546	981,082
Washington	5,894,121	6.50	1,685,719	1,180,003
West Virginia	1,808,344	6	477,403	334,182
Wisconsin	5,363,675	5	1,180,008	826,006
Wyoming	493,782	4	86,906	60,834
Total	**281,421,906**		**66,213,074**	**46,349,152**

Note: Consistent with the January 1999 U.S. Supreme Court ruling *(Department of Commerce v. House of Representatives,* 525 U.S. 316, 119 S. Ct. 765 (1999)), the resident population counts used in the apportionment population counts do not reflect the use of statistical sampling to correct for overcounting or undercounting.
Source: U.S. Department of Commerce, U.S. Census Bureau, December 28, 2000.

revenues to provide grants to school districts for public education, subsidize community college and university budgets, finance public hospitals, pay for Medicaid, police the highways, maintain prisons, help people get training and find jobs, and provide a range of services that people rely on, from maintaining state parks to administering driver's licenses. Yet state revenue growth has fallen off abruptly in many states.

The dividend would raise state sales tax revenues in line with consumer spending. **Table 1** illustrates the effects on state sales tax revenues if everyone living in America were to receive a check for $440 and spend it all (column 1) or 70% of it (column 2).

Conclusion

The Bush tax plan is fraught with risk, yet will do little to lift consumer spending now and reverse the current economic slowdown. It won't stimulate the economy this year, when the stimulus is most needed, and even next year, when the impact of the tax cut increases to $37 billion—representing just 0.3% of GDP and 0.5% of spending on consumption)—it will still be too little and too late to stimulate the large U.S. economy. Moreover, because the administration's tax cuts are skewed to the wealthy, who are more likely to save the money, consumer spending will increase by much less than the 0.5%. By contrast, a one-time prosperity dividend paid out of this year's surplus could stimulate the economy now without foreclosing on the future.

The current budget surplus is America's return on 10 years of good economic performance. Now, it offers the opportunity to help households meet their needs and enable state governments to provide services while, at the same time, getting the economy back on track. It's an opportunity the country can't afford to miss.

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