

## Understanding the Economy 2001

### Wages and Crime

Decent pay reduces the crime rate

Imagine a young man with the possibility of making \$20 an hour in his first job. Now imagine another young man whose first job will likely pay \$6.25 an hour. The first makes about \$40,000 in a year, the second makes about \$14,000. Put yourself in the shoes of each of these young men, and then decide which position might cause you to think about making some extra cash by breaking the law.

That, more or less, is the heart of the economic model of crime. In a paper entitled, "Crime and Work: What we can learn from the low-wage market," Jared Bernstein and Ellen Houston of the Economic Policy Institute outline their study of how wages impact crime and vice versa.

Opportunities to make more money in a job lower the potential returns of criminal activity in relation to work. Initially, this statement is so obvious that it could go without saying. But despite this, the connection almost never enters into our public policy discussions regarding either crime or wages.

The predictions of the model are fairly straightforward. "All else equal, declining job opportunities (rising unemployment, falling wages) will increase crime rates," Bernstein and Houston wrote.

And in reverse, growing employment and rising wages will decrease crime rates.

Do these assertions stand up in real life? Figures beginning in 1992 and running to 1998 show that figures for both unemployment and crime rate dropped almost on parallel across the country for young men age 16-34 with a high school degree or less. This population typically has both the lowest rates of employment and the highest rates of incarceration.

What does this mean for issue campaigns around criminal justice or living wages? First, we should recognize that the two connect. The effects of classism mean that both the economic system and the judicial system exploit low-income people, and that a full solution must involve a reform of both.

Second, the minimum wage must be increased to a living wage if we want to provide equal opportunity to everyone in our society. People will do what they need to do to survive, and if they are exploited by work in the legitimate economy then they could join the criminal economy as an alternative.

Third, full employment must become a true goal of the Federal Reserve Bank, which can manipulate monetary policy so as to encourage the economy and keep more people working. In the past, the Fed has gone overboard in protecting against inflation, slowing the economy by deliberately changing interest rates, thus keeping unemployment higher than it otherwise could have been.

But most of all, and especially in Virginia, we must recognize that building new prisons and locking more people away may be less effective in controlling crime than simply paying people enough to live on. Individual choices always happen within a social context, and the choices we make as a society around wages will rebound upon us all, one way or another.

# Virginia: Phantom Revenues Allow Expensive Tax Cut to Occur This Year

by Bob Zahradnik

The 2001 legislative session in Virginia was marked by efforts to revise the Fiscal Year 2001 – 2002 budget in light of declining revenue growth and increasing expenditure needs. The difficulties of budget reform were exacerbated by political pressure to continue implementing an expensive reduction in car taxes, and the state was ultimately unable to enact mid-biennium adjustments to the budget.

A legislative analysis released prior to the 2001 session showed revenue growth falling below projections while the need for expenditures in Medicaid and other areas exceeded appropriations. These problems combined to create a budget gap that would ultimately amount to \$690 million. Virginia is also currently in the process of implementing a \$1.2 billion phased-in reduction of its car tax. The reduction includes a “trigger” provision that was designed to delay implementation if revenues grow slower than estimates. The report of slower revenue growth meant that the car tax cut might have to be delayed. In light of these issues, Governor James Gilmore released a revised FY 2001 – 2002 budget in December 2000.

In order to balance the budget, continue the car tax cut, and fund \$140 million in new spending, the governor's proposal included budget gimmicks, budget cuts, a plan to finance capital projects with debt instead of cash, and additional revenue sources.

The primary budget gimmick was designed to keep the car tax cut on track by including \$460 million in revenue from the proposed sale of the state's stream of future tobacco settlement receipts — a process called “securitization” — in the revenue estimate used to determine whether or not the phase-in of the car tax would continue. The governor's securitization plan was rejected by budget writers in both the House and Senate once the session began, but by that time the effect of including the securitization plan in the revenue estimate had already occurred; the next phase of the car tax cut was triggered on January 1, 2001.

By contrast to the continuation of the car tax cut, a previously enacted phased-in reduction in the sales tax on food was halted because of the fiscal gap, despite the fact that it was far less expensive than the car tax cut and concentrated relatively more tax relief on lower-income taxpayers.

The Virginia House and Senate were ultimately unable to agree on a revised budget proposal. Differences centered around continuation of the car tax cut, with the House pushing for full implementation while the Senate argued to scale back the cut due to the economic slowdown. Both the regular legislative session and a special emergency session concluded without a budget agreement.

As a result, the state was forced to continue operating under the original budget containing the \$690 million budget gap, which consisted of a \$420 million revenue shortfall and \$270 million of projected overspending on mandatory programs. No additional discretionary spending, such as pay raises for state employees and teachers, was enacted.

The governor then released a budget-balancing plan that addressed only the \$420 million revenue shortfall; the plan did not include actions to address the \$270 million in overspending. The governor's plan included \$500 million in budget cuts (\$80 million more than needed), over half of which affect agencies that provide critical services in the areas of affordable housing, community development, the environment and public safety. The additional car tax cut, at a cost of \$300 million per year, was not changed. Because no new budget was enacted, the governor's plan was implemented.

A recent analysis indicates that Virginia's fiscal problems may not be confined to the current biennium. A study released by the business group Virginia Forward in 1999 projected annual budget deficits as high as \$3.5 billion by 2006. A recent update to the analysis raised that amount to \$4.3 billion.

Clearly, the fiscal challenges that were not met in 2001 may continue in Virginia for years to come.

**Many thanks to Bob and the Center for Budget and Public Policy. For more information, contact Bob at (202) 408-1080 or send e-mail to [zahradnik@center.cbpp.org](mailto:zahradnik@center.cbpp.org).**

# **Fiscal Virginia: The Tax Commission Report**

by Bob Zahradnick

This is Part III in a series examining Virginia's tax system, how it works, and how it doesn't. Created by the Virginia General Assembly, the Commission on Virginia's State and Local Tax Structure for the 21st Century was asked to look at the current tax structure supporting Virginia's state and local governments, and at the division of responsibility between the two levels of government for providing public services. It was charged with evaluating the adequacy of the current system to address Virginia's future needs, given current social and economic trends. Many thanks to Bob Zahradnick and the Center for Budget and Policy Priorities for their work on this series.

Virginia's state and local government fiscal system is both inadequate and unfair and requires a substantial overhaul, according to a report released last December by the Commission on Virginia's State and Local Tax Structure for the 21st Century.

The report found that Virginia's local governments have limited revenue-raising options, but face growing service needs. At the same time, the state government's long-term fiscal outlook indicates significant budget shortfalls if critical needs are to be met. On the other hand, Virginia is a low-tax state so other revenue options are still available for addressing the fiscal problems.

The Commission also found that Virginia's tax structure is unfair in that lower income residents pay a larger share of their income in taxes than wealthy residents.

## **Local Government Findings**

The Commission found that local governments in Virginia are faced with a shrinking revenue pie for several reasons. First, the local sales tax is declining as a local revenue source as Virginia's economy shifts from being a goods-based economy to a more service-oriented economy. In Virginia, as in many states, most services are exempt from the sales tax. Second, the elimination of the car tax has reduced the revenue-raising options of local governments. Third, the Commission found that state financial support for social services and education is inadequate and places an additional fiscal strain on local governments.

On the expenditure side, Virginia cities and counties face growing service needs that cannot be fully met with locally raised revenue or the current level of state aid. In addition, the study found significant income and poverty disparities across the state. As a result of these disparities, local government expenditures for health, welfare and public safety vary widely across the state. These geographic inequalities are further evidence of the need for additional state aid to support the areas of the state that have significant service needs, but do not have the revenue base to adequately provide needed services.

## **State Government Findings**

As cities and counties struggle to provide adequate services to residents, the state government is also faced with a potential fiscal shortfall. As evidence of this, the Commission cites an analysis that indicates that the state will need an additional \$3.5 billion in order to continue providing the current level of services and to address unmet needs in higher education, transportation and Medicaid.

This analysis may be overly optimistic because the conclusions were reached prior to the release of reports that the state's revenues were coming in lower than expected due to the slowing economy and the higher cost of the car tax cut. As further evidence of the need for additional resources, the Commission cites another report that estimates a \$40 billion shortfall in the funds available to meet the state's transportation needs over the next two decades.

While the state's long-term fiscal picture looks bleak, the Commission's report indicates that the state has the resources to address the service needs of the residents of the Commonwealth. Specifically, the Commission found that:

“If the citizenry and political leadership of the Commonwealth determine that there exists a necessity to increase investment in public services in Virginia, there appears to be latitude in the state's tax structure to accommodate that desire. Virginia's state taxes are low in relation to its five adjoining states and to the nation generally...(I)t appears to this Commission that Virginia could increase revenue collections to address the needs of its residents without placing the Commonwealth at a competitive disadvantage.”

Thus, the Commission's findings include evidence that there are needs that are not being met at both the state and local level, and that Virginia has the capacity to meet those needs if the political will exists.

The Commission's findings discussed thus far have focused on the inadequacy of Virginia's revenues to meet service needs. Another important aspect of a state's fiscal structure is whether or not it's fair. Fairness in this context refers to how the tax system impacts Virginia families across the income spectrum. On the issue of fairness, the Commission found that Virginia has a regressive tax structure whereby middle- and low-income families pay a greater share of their income in Virginia state and local taxes than do the wealthy.

Overall, the Commission's report found that Virginia has both an inadequate and an unfair revenue system. The report provided several recommendations for addressing these concerns, many of which have merit.

## **Recommendations**

To address the fiscal stress faced by Virginia localities, the report recommends several forms of increased state aid to localities. For example, the report recommends that the state increase substantially its support for both the operational and capital costs of the local school divisions. In addition, the report recommends that the state assume the full operational costs of state-mandated services including public health departments, local and regional jails and public welfare departments.

The report recommends dedicating at least 6 percent of annual income tax collections for return to localities — about \$500 million. This recommendation raises some concerns because dedicating or earmarking revenues reduces the flexibility of policy makers to address critical expenditure needs as they arise. However, this recommendation further highlights the Commission's view that the state needs to provide substantially more financial support to localities. All of these recommendations are intended to reflect a net increase in support to localities and are not intended to simply replace assistance currently provided to localities.

In order to raise sufficient revenues to provide adequate support to localities as well as address other needs, the Commission provides several reasonable recommendations for strengthening the sales tax as a revenue-raising tool by broadening the base. Specifically, the report recommends that Virginia should participate in the Streamlined Sales Tax Project that is intended to improve the ability of the state sales tax to capture revenue from sales conducted over the Internet. Next, the Commission recommends expanding the sales tax base by extending the sales tax to include personal services, amusements and repair services. A third recommendation that would broaden the sales tax base is to place a moratorium on sales tax exemptions and to critically review all existing exemptions for possible elimination.

In addition to strengthening the sales tax by broadening the base, the report indicates that if additional revenue is needed, the income tax is the best way to raise additional revenue. This recommendation makes sense because the income tax is the fairest or the most progressive of the major taxes.

The Commission report includes several recommendations for improving the fairness of the state income tax. Many of the income tax recommendations have merit, but one in particular deserves to be highlighted. The Commission recommends replacing the current low-income credit, which effectively eliminates state income taxes for families with incomes below the federal poverty line, with a refundable state Earned Income Tax Credit (EITC) equal to 20 percent of the federal credit. The federal EITC is a tax credit for low- and moderate-income workers, primarily those with children, designed to offset the burden of Social Security taxes, supplement earnings, and complement efforts to help families make the transition from welfare to work. The EITC has been widely praised for its success in supporting work and reducing poverty.

The success of the federal EITC has led a number of states to enact state Earned Income Tax Credits that supplement the federal credit. Altogether, 15 states — including Maryland and the District of Columbia — now offer state EITCs based on the federal credit. In addition, one local government — Montgomery County, Maryland — offers a local EITC. State EITCs have gained support across the political spectrum. EITCs have been enacted in states led by Republicans, states led by Democrats, and states with bipartisan leadership. Business groups as well as social service advocates support the credits.

An EITC would be an improvement over Virginia's low-income credit for three reasons. First, the benefits of an EITC phase-out gradually whereas the low-income credit ends abruptly at about the poverty line and results in high tax burdens on families as they work their way out of poverty. Second, eligibility for the EITC is broader than the low-income credit, up to about \$30,000 for a family of four compared to only about \$17,000 for the low-income credit. Third, the EITC recommended by the Commission would be refundable. Under a refundable credit, a family receives a refund check if the size of the credit exceeds its tax bill. Thus the EITC provides both tax relief and lifts families out of poverty by providing a wage supplement. Low-income working families frequently struggle with the additional costs associated with making the transition from welfare to work such as health care, transportation and childcare. A refundable EITC can provide an income supplement and assist in meeting these expenses.

## **Fiscal Virginia: Evaluating the System and Fixing the Problems**

Last November, Bob Zahradnik from the Center on Budget and Policy Priorities shed some light on Virginia's fiscal policy in a session organized by the Virginia Organizing Project and attended by people from around the state. In the last newsletter, Part One of this report focused on revenue (the money coming in) and expenditures (the money going out). Part Two focuses on our state's budget and tax policies and some of the problems in our system.

### **Evaluating Virginia's Budget and Tax Policies**

Many state legislatures and governors have agreed on five keys to a quality tax system. A state revenue system should:

- Provide appropriate and timely revenue (enough money, when and where it is needed).
- Distribute burdens equally (everyone pays their fair share).
- Promote economic efficiency and growth.
- Be easily administered (isn't needlessly complicated).
- Ensure accountability (transparent, public and honest).

### **How does Virginia's system measure up?**

1. Provide appropriate and timely revenue.

Tax systems should be stable, so that the state isn't thrown into crisis during hard economic times. They should also provide income that grows at the same rate as the economy.

Over time, states must spend more money to maintain a constant level of services. Growth in population, inflation, rising wages and other factors make government more expensive. Ideally, a state will match its new spending to the growth in the economy as a whole. Virginia's spending has remained flat over the last 20 years when compared to the growth in personal income. Across the board, we have been a low-tax state (45th in the nation compared to the other states). This means that for a long time, we have not taxed and spent the amount of money needed to maintain current services and fund long-term needs, like school construction and transportation.

Virginia Forward (a non-partisan business group concerned with education, transportation and infrastructure) says that Virginia is running a \$3.3 billion deficit in regard to unmet public needs this year, and that amount will grow to \$4.5 billion by 2008. In fact, Virginia cannot even fund the current level of services, with a \$1.2 billion deficit this year, growing to \$2 billion by 2008.

Like most states, Virginia maintains a Rainy Day Fund of reserves to be used during an economic slowdown. That fund currently contains \$361 million. The Center on Budget and Policy Priorities projects that during a three-year recession, Virginia could face a budget shortfall of \$804 million. As you can see, as a state we do not have enough saved up to provide for our rainy day. As the governor is currently demonstrating, resulting budget cuts will first hit those least able to bear it.

2. Distribute burdens equally.

There are different ways to measure this. Progressive tax systems embody the principle that people with a greater ability to pay should pay more. Regressive systems make people with less money pay more as a percentage of their income than those who have more.

Virginia taxes are regressive, as are many state tax systems (see figure 1 below). The lowest fifth of families pays a little over 10 percent of their income in taxes on average, the middle fifth pays a little under 8 percent, and the highest fifth pays about 5 percent. Why? Our property tax, which provides about a third of our revenue, burdens low-income families because they spend a larger share of their income on housing. Second, our sales tax hits everyone equally, regardless of income. That means poor people spend more on sales tax as a percentage of their income. Finally, our income tax, which could balance out the other two, hasn't been adjusted since 1926. The income brackets are still set for 1926 dollars, not 2001 dollars, which means it is beginning to resemble a flat tax.

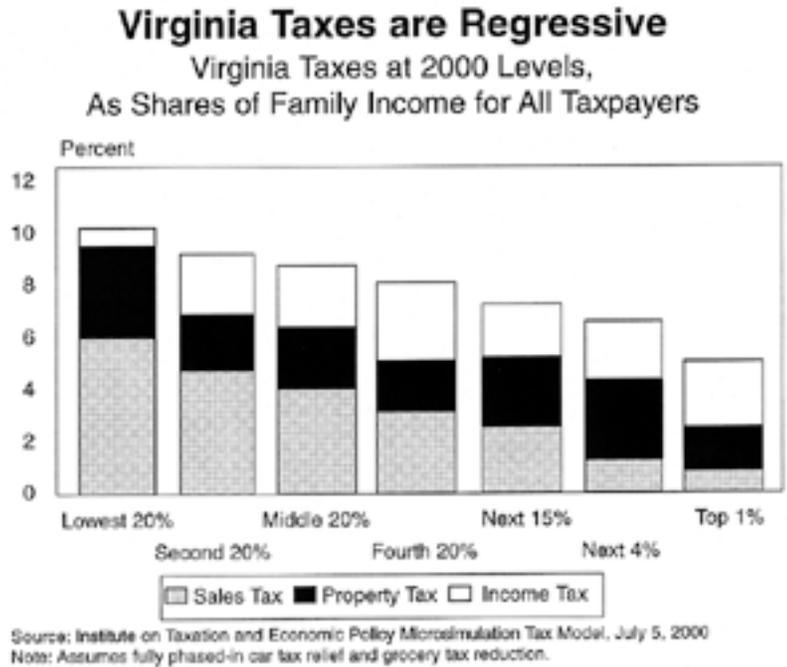


Figure 1

3. Promote economic efficiency and growth.

State tax systems should contribute to an economy which promotes economic well-being for the whole society, from individual citizens to businesses and everything in between.

In reality, taxes don't strongly influence a state's business climate. They usually represent less than two to three percent of business costs. Differences between states in business tax burdens are even smaller. Labor and transportation costs vary more than taxes when comparing states to one another. Many public services, such as education and transportation, mean much more to business than taxes. Surveys regarding business location decisions usually rank taxes low in importance in comparison to quality labor force, quality of life, good regulatory climate, good transportation systems, labor costs and real estate costs. So cutting taxes at the expense of public services may actually reduce economic growth by driving new businesses away.

What about tax breaks for economic development, or corporate welfare? They reduce revenue for the services described above which actually do attract business. They also discriminate against smaller or existing businesses which don't receive the same tax breaks. And they often don't really affect corporate behavior; most business start-ups or expansions would occur without the tax break, as many corporations have publicly admitted.

A good tax system that promotes economic growth pays for needed services. It is stable, not prone to big tax cuts followed by big tax increases. It doesn't give special breaks for certain businesses. Finally, it discourages activities with social costs (like polluting or exploiting workers) and encourages activities with social benefits.

4. Be easily administered and ensure accountability.

The state legislatures and governors who crafted these guidelines agreed that tax decisions should be explicit, with choices openly arrived at in full view of the electorate. Too often, these decisions are hidden in obscure features of state tax systems, never the object of genuine public debate.

To be transparent, these decisions cannot be rushed through a legislative process lasting only a month or two which does not allow adequate time for public review and input. There has to be a clear understanding of all the exemptions included in the system, who benefits from them, and how much they cost the public.

Take a case study involving America Online (AOL) right here in Virginia. In early 1999, AOL announced they were considering building a new data center in either Northern Virginia or North Carolina. Virginia legislators crafted a bill which would provide sales tax exemptions for a company which exactly matched AOL's profile. The bill passed, even though most legislators did not know that it would only benefit one company. AOL will save an estimated \$18 million at startup and \$4 million a year after that.

This was a tax decision that was not accountable or transparent. North Carolina offered bigger tax breaks but AOL still located in Virginia, so it may have had little effect on their decision. No other companies received this tax break, so it created unfair competition backed by the state. And finally, it set a precedent: in the wake of the AOL tax break, eight major technology and telecommunications firms requested millions of dollars in state sales tax cuts.

## **Addressing the Problems with Virginia's System**

There are at least six areas in which Virginia could make significant and helpful changes in its tax system:

1. Adjust income tax burdens to shield the poor from state taxation.

This could be done in a number of ways. The most effective would be to adjust the income tax brackets so that they make sense based on current incomes. It would make our income tax progressive rather than flat and eliminate or dramatically decrease income tax on poor families.

Virginia could also adopt a refundable Earned Income Tax Credit (EITC), which would bring most working families out of poverty. Last year, Virginia adopted an income tax credit that effectively eliminates state income taxes for families with incomes below the federal poverty line. But it created a cliff in which a family whose income exceeds that poverty line by a small margin has to pay the full tax. Instead, Virginia should implement an EITC in which benefits gradually phase-out up to about \$30,000 of income. This would eliminate the cliff and provide tax relief to families as they leave poverty but continue to struggle to make ends meet.

2. Property tax relief for poor homeowners.

This would help low-income homeowners by exempting them from property taxes on their houses. Currently local governments in Virginia are authorized to give this exemption to elderly and disabled homeowners with income less than \$30,000. This exemption could be extended to all homeowners who fit the income guidelines.

Another option would be a renter's credit, in which tax relief would be set as a flat amount or as a percentage of rent paid. It could be targeted via income guidelines or applied to persons paying more than 30 percent of their income on rent. Though this exemption would be politically difficult to enact, it would benefit the population currently under the most economic pressure in Virginia, low-income renters.

3. Reduce sales tax on food.

Out of the 46 states that levy a general sales tax, 28 of them exempt most food purchased for home consumption. Beginning this year, Virginia is reducing the state general sales tax on food by 0.5 percent each year through 2003. The local rate of 1 percent will remain as an essential source of funding for local governments. However, the program requires that revenues exceed the forecast by 1 percent in order to trigger the next phase in reductions. As we have seen in this year's Car Tax debacle, that trigger is unlikely to be pulled in the short term.

4. Maintain adequate funding reserves in the Rainy Day fund.

At least twice in the last 10 years, the governor of Virginia has declared a hiring freeze at state institutions as a result of budget shortfalls. These extreme fluctuations in taxation (car tax cut) and expenditures (budgets slashed by 15 percent) are simply bad government. Virginia must reach some even keel in its fiscal policy, and a crucial ingredient will be sufficient reserves to weather an economic downturn or recession.

5. Increased accountability for tax expenditures.

Virginia must create some system for figuring out who is receiving tax breaks, how much, and what it costs our state in missing revenue. These tax breaks are costly, they usually benefit those least in need, and they are hidden in the tax code so that literally no one knows their impact. The system is open to corruption as a result.

Strategies for solving the problem include: increase scrutiny to establish the costs and determine who benefits; enact performance standards which require that tax breaks provide a clear public benefit; target tax breaks on those taxpayers who most need them; and create sunset clauses which force the legislature to renew tax breaks rather than assuming that they last forever.

6. Improve budget transparency.

Lawmakers and outside advocates need high quality budget and tax information to analyze proposals and make thoughtful decisions. This information would include:

- Budget estimates for revenues and expenditures at current service □levels
- Multi-year expenditure and revenue projections for both current □service levels and the governor's proposed budget
- Detailed reporting on tax breaks
- A tax incidence report that shows how the tax burden is distributed among income groups.

In the final analysis, the Virginia tax system is inadequate, unstable and inequitable. As a state we can do better.

## **Fiscal Virginia: Where the Money Comes From and Where It Goes**

Mysterious, confusing, dirty. Hidden behind committee room doors, buried in stacks of bills and papers. Virginia's state budget draws little notice by the population at large, but within it lies the core of everything we call "government" in Virginia. In this article, we will "follow the money" in our state government and try to make sense of how it works.

In late November, Bob Zahradnik from the Center on Budget and Policy Priorities shed some light on Virginia's fiscal policy in a session organized by the Virginia Organizing Project and attended by representatives of organizations from around the state. In a two-part series, we will summarize his insights and comments. Part One will focus on revenue (the money coming in) and expenditures (the money going out). Part Two, in the April 2001 edition of *virginia.organizing*, will focus on our state's budget and tax policies and discuss some of the problems in our system.

### **Taxes: Where the Money Comes From**

Most of Virginia's revenue comes from taxes, 58.9 percent. Referring to Figure 1 below, other revenue sources include federal aid (13.6 percent), miscellaneous general revenue (10.7 percent) and current charges for services (16.9 percent.) There are a number of tax categories used in our state:

1. Sales Tax.

Nationwide, sales taxes provide 36 percent of state and local revenue. In Virginia, it provides only 31 percent. There are two main types: general and selective. General sales taxes apply across the board, while selective sales taxes target specific products like cigarettes, gasoline or meals bought in restaurants

Virginia's state general sales tax rate is 3.5 percent, meaning that it is three and a half percent of the price of what is being purchased. (The local sales tax is 1 percent.) The U.S. median rate is 5 percent, so we are significantly less than most states. Our state taxes food at a lower rate than other goods, only 3 percent, but over half of the states have no sales tax on food purchases.

Virginia also has selective sales taxes. They apply to gasoline (17.5 cents/gallon), cigarettes (2.5 cents/pack), wine (\$1.51/gallon) and beer (26 cents/gallon.) Our cigarette tax is the lowest in the nation, courtesy of a strong tobacco industry.

2. Personal Income Tax.

Virginia, like most states, taxes personal income based on a graduated rate system. Those who make less pay a lower rate and those who make more pay a higher one. Unfortunately, Virginia's tax brackets have not been adjusted for many, many years, so that in effect the rates have collapsed, or flattened.

Income	Rate
Under \$3,000	2.00%
\$3,000 to \$5,000	3.00%
\$5,000 to \$17,000	5.00%
Over \$17,000	5.75%

Since many workers make over \$17,000, the rate system has become almost meaningless

3. Property Tax.

There are two types, tax on real estate and personal property tax (cars, business equipment, boats, etc.) This revenue source provides 51 percent of the income for local governments in Virginia. Thus, when Governor Gilmore cuts the car tax, the state has to reimburse localities for the income they lose.

4. Corporate Income Tax.

The corporate income tax rate is 6 percent, though the median for all the states is 7.5 percent. Otherwise, Virginia has a fairly typical corporate income tax structure.

5. Lottery Proceeds.

The Virginia State Lottery was created on December 1, 1987, after being approved in a statewide referendum. Ticket sales generate the income. The proceeds are divided as follows: 50-55 percent go to players as prizes, 5 percent goes to retailers who sell tickets, 7-10 percent is for operating expenses and 35 percent is left to fund other programs (now designated for education.)

**Figure 2** shows the type of tax listed above and who levies it, being either state or local government. It should be no surprise that most of the tax burden falls on individuals via income and property taxes, while corporate income tax provides the least government revenue.



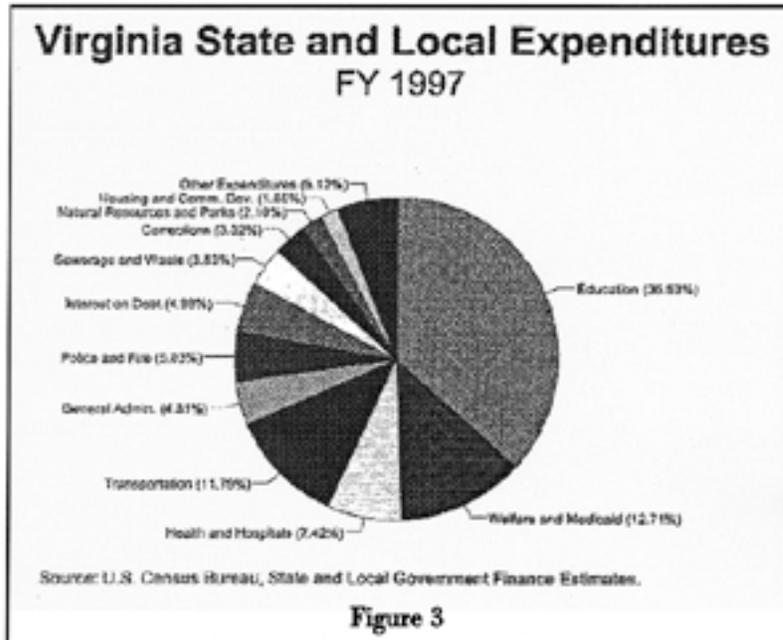
## Income Inequality Increasing

Looking at the average numbers, Virginia looks good compared to the country and the region in terms of our citizens' economic indicators. State median income from 1997-99 was \$44,884, tenth highest in the nation. Our poverty rate was 9.8 percent, thirty-seventh out of fifty states. Those without health insurance made up 13.6 percent of our population, twenty-ninth nationally. And our unemployment rate in 1999 was 2.8 percent, forty-seventh nationally.

However, income inequality has greatly increased in Virginia since the 1970's. Adjusted for inflation, the poorest fifth of our citizens lost 3 percent of their income comparing the late 1980's to the late 1990's. The middle fifth lost 1 percent of their income, but the income of the richest fifth rose 13 percent during that same period. In fact, from the late 1980's to the late 1990's, the bottom 80 percent of Virginians lost income while only the top 20 percent gained.

## Expenditures: Where the Money Goes

In light of this income inequality, how does Virginia spend its money? Figure 3 below shows the various categories of state and local government expenditures: 36 percent goes to education, welfare and Medicaid receive 12 percent, transportation gets 11 percent and health and hospitals receive over 7 percent.



Overall, we are a low spending state, the second lowest in our region. We rank at the bottom regionally in our spending on welfare, significantly behind such states as Alabama, Tennessee and South Carolina. That said, our spending on welfare has increased over 13 percent between 1989 and 1997, so we have gone from awful to merely bad.

Looking at our figures for 1997, we spend less than the region on health, with only Maryland behind us. On housing, we rank fourth in our region and below the U.S. average. We spend more than the national average on higher education, but less than most states in our region. We are below average in our spending on elementary and secondary education. Our per pupil spending on education is almost \$1,000 below the U.S. average, but average for our region. State and local per pupil education spending declined in Virginia between 1989 and 1997.

Finally, one cannot talk about expenditures without also mentioning debt. Governments, like individuals and businesses, must borrow money at times. For many years, Virginia has had a pay-as-you-go policy toward debt. The Debt Capacity Advisory Committee has set our ratio of tax-supported debt as a percent of revenue at 5 percent. The legislature and the governor have authorized a little over half of that as a ceiling. On the positive side, that means our state government will not have a high debt burden to trouble us in a slow economy. On the negative side, many needs around the state go unfunded, even in good economic times, because the government will not borrow money to finance them.