

**PUBLIC OVERSIGHT HEARING ON
THE FISCAL YEAR 2011 SPENDING AND
PERFORMANCE BY THE OFFICE OF REVENUE
ANALYSIS (ORA) OF THE OFFICE OF THE CHIEF
FINANCIAL OFFICER (OCFO)**

**Before the
Committee on Finance and Revenue
Council of the District of Columbia**

The Honorable Jack Evans, Chairman

**February 27, 2012
10:00 a.m.
Council Chamber, John A. Wilson Building**



**Testimony of
Fitzroy Lee
Deputy Chief Financial Officer
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**Natwar M. Gandhi
Chief Financial Officer
Government of the District of Columbia**

Good morning Chairman Evans and members of the Committee on Finance and Revenue. I am Fitzroy Lee, Deputy Chief Financial Officer for the Office of Revenue Analysis and Chief Economist. I am pleased to appear before you today to testify on the performance of the Office of Revenue Analysis (ORA) over the past fiscal year.

Mission of the Office of Revenue Analysis

ORA's mission is threefold: (1) to provide quarterly revenue estimates that form the hard budget constraint for the District of Columbia's four-year budget and financial plan; (2) to provide policymakers with the information to maintain budget balance by estimating the fiscal impact of legislation drafted by the Mayor and Council; and (3) to conduct a wide range of fiscal and economic research and analyses on an ongoing basis and at the request of the Mayor and Council, or as directed by the Chief Financial Officer (CFO).

Revenues and Revenue Estimates

After two successive years of falling revenues, the District's economy and its revenue began to show signs of recovery after the first quarter of fiscal year 2011. From February to September of last year, we added almost \$200 million to the estimated revenue for FY 2011. At the end of the fiscal year, local fund revenue exceeded the estimate used for the FY 2011 budget by \$187 million. Of the \$187 million local fund revenue surplus, \$149 million was from taxes and \$38 million from non-tax source, and of the \$149 million, \$130 million came from individual income, estate, and real estate transactions taxes. The stock market staged a remarkable turnaround in the last quarter of calendar year 2010, *after* the Mayor and the Council had already completed the fiscal year 2011 budget. The higher capital gains and the strengthening of the economy generated \$81 million in individual

income tax surplus and were largely responsible for a \$34 million estate tax revenue windfall. The thawing of the credit markets, starting in late 2010 and continuing into 2011, fueled a strong recovery in the District's commercial real estate sector. This generated a surplus of nearly \$18 million in real estate transaction taxes revenue. It is not a surprise that the most volatile components of the revenue system contributed the most to the higher than expected tax revenue; we estimate these conservatively because of their tendency to big swings during economic turning points.

Economic turning points are notoriously hard to anticipate, which is why most state and local governments, not just the District, ended last fiscal year with an unexpected revenue surplus. In Maryland, general fund revenue exceeded the estimate by \$314 million (2.4 percent of total revenue) in fiscal year 2011, \$304 million of which was from unanticipated individual income tax revenue. In Virginia, general fund revenue came in at \$322 million (or 2.2 percent of total revenue) above the estimate. Again, unanticipated individual income tax revenue accounted for the bulk of the excess revenue (\$198 million). According to the National Association of State Budget Officers, revenues exceeded the estimate in 32 states in fiscal year 2011, whereas nine states were on target and nine states were below the estimate. Given the difficulty of anticipating economic turnarounds, whether upward or downward, fiscal prudence requires that we adopt a conservative approach to revenue estimation.

We should not forget that the same financial and economic forces that generated the surplus in fiscal year 2011 brought severe fiscal distress to the District two and a half years ago when the economy turned downward. You will recall that in September 2008, just before the start of fiscal year 2009, and three months after the Mayor and the Council completed the budget, Lehman Brothers went bankrupt, the

stock market collapsed, and credit markets froze. The collapse of the stock market, and with it capital gains income, led to 15 percent lower income tax revenue (just over \$200 million less) than the previous year. The non-withholding portion, that is, the portion tied to capital gains, fell by over 70 percent. The credit freeze immediately choked off activity in the commercial real estate market and revenue from real estate transactions taxes fell 42 percent (or about \$135 million). That year we revised the revenue estimate downward four times and revenue for the fiscal year fell short of the original estimate by almost \$400 million. The following fiscal year, fiscal year 2010, as the national and local economies struggled to recover from the longest and deepest recession since the Great Depression of the 1930s, revenue again fell short of the estimate by \$137 million, the bulk of it coming from lower than expected individual income tax collections.

Throughout this period, our practice of revising the revenue estimate four times a year kept the Mayor and the Council informed of the rapidly deteriorating economic and revenue outlook. Policymakers were thus able to use a combination of spending cuts, revenue increases, rainy day funds, and federal stimulus dollars to offset the revenue shortfall and avoid a budget deficit. If our practice had been to build the revenue boom of the previous years into our revenue forecasts, the revenue shortfall could easily have run over a billion dollars, thereby becoming unmanageable and significantly increasing the risk of ending the fiscal year in a deficit. We recognize that revenue surpluses are an unavoidable consequence of conservative revenue estimation during economic booms. This is where regular revisions of the revenue estimates come in. Regular revisions of the revenue estimate enable policymakers to adjust the budget during the fiscal year in response to changing economic circumstances.

Economic and Fiscal Outlook

Despite the brightening economic and fiscal prospects over the past year, a high degree of uncertainty clouds the future course of both the national and local economies. The District's economy, in particular, is now caught between slowing growth in the federal sector and modest growth in the private sector. The threat of federal cutbacks now poses the greatest risk to the District's economic and fiscal outlook. The federal sequestration, if implemented in its current form, could have a severe impact on the District's economy and finances. Yet the possibility of federal government cutbacks is not the only threat to the District's economy. Financial ripple effects from the ongoing European debt crisis, disruptions to oil supplies from the Middle East, and a downturn in the still fragile national economy could all derail the nascent District economic recovery.

Fiscal Impact Statements (FIS)

During fiscal year 2011 the FIS team produced 359 fiscal impact statements (for 269 individual bills and two Budget Support Acts, as well as 90 draft bills). Additionally, the FIS team worked with the Economic Development Finance unit in developing the Economic Development Budget report—they compiled a list all of abatements and exemptions approved by the Council and the Mayor, and estimated the cost of these tax exemptions through 2020.

In fiscal 2011 the FIS team also worked on several special projects:

- In education, the FIS team looked at the funding of public schools, and the funding practices of states that have multiple higher education institutions. The FIS team also analyzed the cost of extended school days.

- In human services, they analyzed the FMAP and Poverty rates, comparing DCs FMAP rate with other states and counties, controlling for the poverty rates. They also worked with the Department of Health Care Finance to build a model that could be used for projecting Medicaid caseloads.
- In tax and revenue, the FIS team analyzed the impact of the federal government's decision to purchase the property known as "Columbia Plaza."
- In government services, they employed an actuary to provide an analysis of pension reductions on the District's long-term fiscal position.

Fiscal impact statements are important tools in maintaining budget balance—these analyses ensure that no new legislation is put in place without the necessary funding. In this difficult budget environment, correctly determining the potential cost of proposed legislation is crucial to protecting the city from additional financial risks. The FIS team will continue to carefully research all legislative proposals and scrutinize all input from all agencies of the DC government. They will also continue to work very closely with District government agencies and the Council staff. The FIS team is now organized to be more closely aligned to the committee structure in the Council, and we actively monitor the legislative timeline to ensure we have sufficient time to conduct thorough analyses of proposed bills.

Research and Analyses

In addition to the revenue estimates and fiscal impact statements, ORA provides District stakeholders with a number of fiscal and economic reports, all of which are subject to an extensive internal and external peer-review process prior to release and publication. These include:

- *DC Economic Indicators* is published monthly and provides a two-page "at a glance" overview of four key sectors of the DC economy: (i) "labor and

industry” which includes information on District employment trends, along with the composition of resident employment by industry; (ii) “revenue” collections by major tax types; (iii) “DC and US economic information,” including DC personal income, inflation, and unemployment rate trends; and (iv), “real estate” that provides information on home sales volume and prices and commercial office vacancy rates and inventory.

- *A Review of District of Columbia Economic and Revenue Trends* is published monthly and provides a wealth of information on all aspects of the DC economy, including employment, wages, housing, commercial office space, and hospitality and retail industry.
- *Tax Rates and Tax Burdens: Washington Metropolitan Area* is published annually and provides not only a comparison of the District’s statutory rates with its five neighboring jurisdictions (Alexandria and the counties of Montgomery, Prince George’s, Arlington and Fairfax), but also comparative measures of household tax burden by type of tax for different income levels.
- *Tax Rates and Tax Burdens in the District of Columbia: A Nationwide Comparison* is an annual publication that provides a compendium of statutory tax rates and estimates of the household burden of major taxes by income class in the District compared with the largest city in each of the 50 states. The summary table from this report is reproduced in the annual *Statistical Abstract of the United States*.
- *The Economic Report of the District of Columbia (Data Book)* is an annual publication that provides detailed data on the District’s economy and its revenue system.
- *DC Tax Facts* is an important and widely used pocket-sized reference of District tax collections and describes all District’s revenue (tax and non-tax)

sources, the history of major revenue changes since 1970, filing and payment dates, and the yield of each revenue source utilized by the District.

- ORA also publishes a monthly table of *Cash Collections*, as well as a *Cash Collections Narrative Report* that tracks cash collections by source. This report is critical in monitoring the performance of District revenue collections relative to the revenue estimate.
- *Tax Expenditures* is a biennial report that catalogues and quantifies revenue losses from federal and District tax provisions that grant special relief designed to encourage certain kinds of taxpayer behavior or to aid taxpayers in special circumstances.

The next edition of the tax expenditure budget will be released along with the Mayor’s budget next month. I am pleased to note that the Center on Budget and Policy Priorities described the most recent tax expenditure budget, the one issued in April 2010, as “drastically improved” and “a model for other states.”

- Each year the ORA is responsible for the preparation of the Revenue chapter that is included in both the Mayor’s *Proposed Budget and Financial Plan*, and then, with Council revisions, the Executive Summary of the *Budget and Financial Plan* that is submitted to Congress (June). The Revenue chapter begins with a comprehensive review of the US and District’s economic outlook and then proceeds to present in great detail information on the revenue flows by revenue source over the financial plan period. The revenue presentations include detailed as well as summary tables of the baseline revenue estimate and policy proposals included in the budget.

Conclusion

Finally, I want to thank the entire ORA team for their hard work and professionalism during what has been a very challenging year for the District. I would especially like to thank the ORA directors, Farhad Niami, Norton Francis, and Yesim Yilmaz for the leadership and teamwork they displayed, not only within ORA, but also in working with other agencies within the Office of the Chief Financial Officer as well as with Mayor and Council staff. This concludes my testimony. I would like to thank you for the opportunity to testify before you today. I am pleased to respond to any questions that you may have.

Chart 1

