

**PUBLIC OVERSIGHT HEARING ON
THE FISCAL YEAR 2007 AND 2008 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, Chair

**February 27, 2008
10:00 a.m.
Council Chamber, John A. Wilson Building**



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

Mr. Chairperson and members of the committee, I am Robert D. Ebel, Deputy Chief Financial Officer for Revenue Analysis and the Chief Economist for the District of Columbia Government. I am pleased to appear before you today to testify on the activities of the Office of Revenue Analysis (ORA).

Mission and Activities

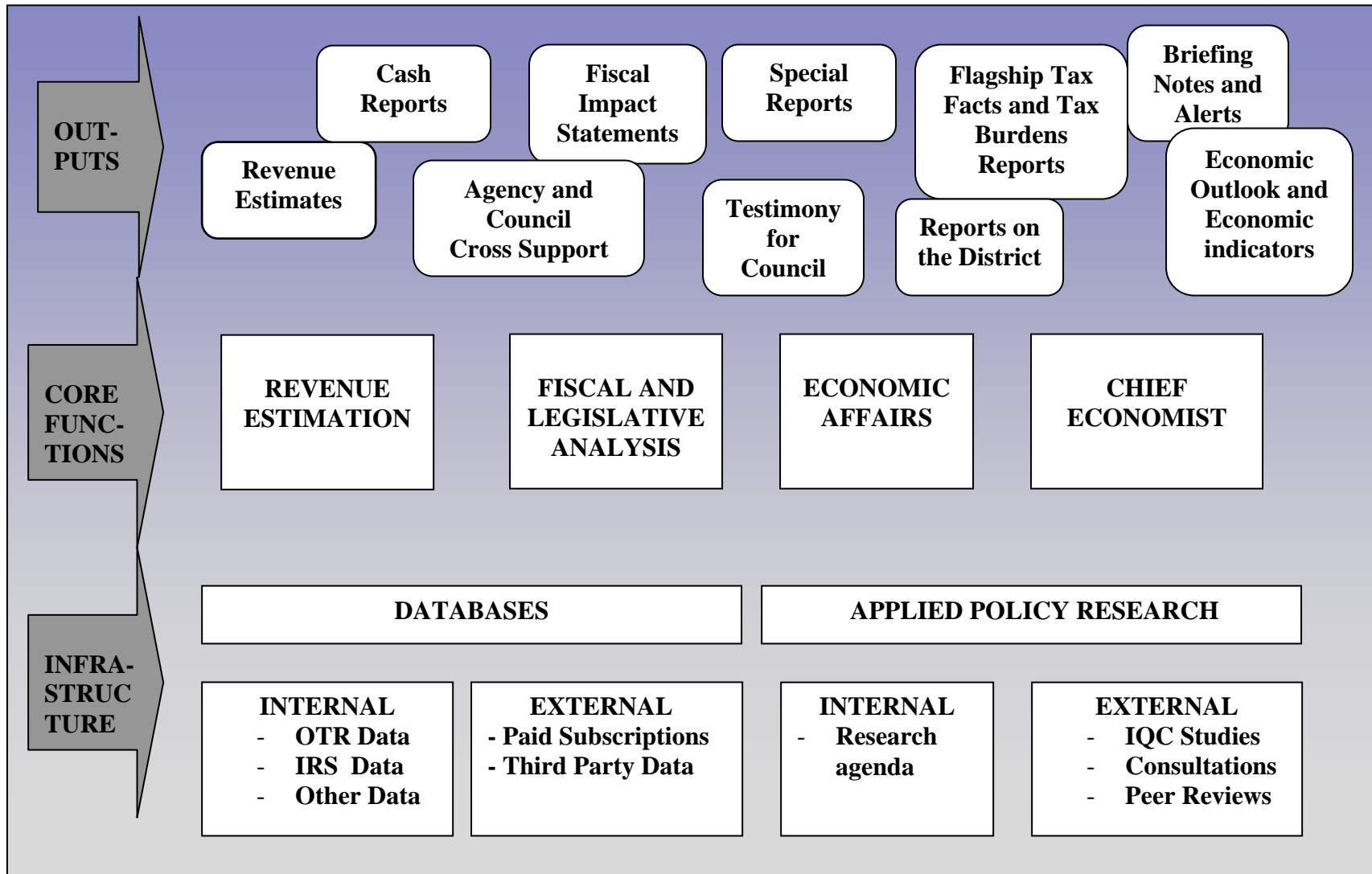
The mission of the Office of Revenue Analysis encompasses a wide range of fiscal and economic research as directed by the Chief Financial Officer (CFO). This includes responding, through the CFO, to requests by the Council of the District of Columbia and the Executive Office of the Mayor (EoM).

The ORA serves a dual function: to carry out the task of the analysis of the revenue system of the District of Columbia (DC) government and to serve as the research center for the purpose of monitoring the economic base. These cross-cutting functions are critical to the creation and the enhancement of an economic and fiscal knowledge base for the use of DC citizens, policy makers, and fiscal practitioners alike.

Chart 1 provides a quick glance of the range of the ORA's operations. To summarize the key activities:

Preparing Fiscal Impact Statements. The District of Columbia Home Rule Act of 1973 (Pub. L no. 93-198) requires that all legislation submitted by the Council of the District of Columbia to the U.S. Congress for review prior to enactment into law be accompanied by a fiscal impact statement (FIS), which estimates the costs

Chart 1. ORA OPERATIONAL STRUCTURE



that will be incurred by the District of Columbia as a result of enactment of the Act in each of the first four (4) fiscal years for which the Act is in effect. These estimates are to be accompanied by a statement of the scope of the legislation and the methodology for making the estimate.

Per the *District of Columbia Financial Responsibility and Management Assistance Act of 1995* (Pub. L 104 I, Stat. 1995), one of the duties assigned to the newly created Office of the Chief Financial Officer was the preparation of fiscal impact statements. This mandate was reiterated and made permanent in the recently approved District of Columbia Omnibus Authorization Act (Pub.L.109-356, October 16, 2006).

During FY 2007, ORA analyzed and prepared fiscal impact statements on 255 bills in addition to a host of other documents, including contracts and regulations. For 2008 (and, we project, for FY 2009) the ORA FIS workload has been on the increase as the result of both the broadened mandate contained in the 2006 legislation (Pub. L 109-356) in combination with Mayoral and Council initiatives and an increase in legislative activity by the Council of the District of Columbia (Council). As part of this effort, substantial staff time has been devoted to public education reform (B17-01), small business tax relief, economic development projects, a wide range of revenue proposals, and specific expenditure programs that impact the District's Financial Plan and the District of Columbia economy (e.g., the recent analysis of the Paid Sick and Safe Leave Act of 2008). All fiscal impact statements prepared by the OCFO since May 2001 are retrievable on the OCFO Web site at www.cfo.dc.gov. Moreover, due to the establishment of a system of internal controls, all staff work related to the FIS are maintained in electronic files. In addition, the original signed copies of all FIS are delivered to

the Council. These files include not only the lists of cross-agency and OCFO contacts made relating to a given FIS, but also the detailed worksheets /spreadsheets and other background materials that were part of each FIS process.

Providing Monthly and Quarterly Reports on the Economic and Revenue Outlook with Accompanying Revenue Estimates. The OCFO is further responsible for forecasting the revenue for the District government. With respect to this activity, each February the OCFO issues the revenue estimate that is used to develop the Mayor's proposed budget for the next fiscal year (October 1 to September 30). This estimate is then revised quarterly thereafter.¹

Because of the high degree of attention given at this time to the outlook for the District's economy, as the FY 2009 budget is prepared, today's testimony provides below a more detailed review of the revenue and economic outlook.

Carrying out Special Studies. In addition to fiscal impact statement and economic and revenue outlook activities, the Office of Revenue Analysis provides to the citizens of the District of Columbia a series of technical reports, many of which are subject to an extensive internal and external peer-review process prior to release and publication. These include:

- *DC Economic Indicators* – Published monthly, these provide up to date detail on the performance of the District of Columbia with respect to the trends of the overall economy, revenues, and the sectors of labor, industry, office space and housing. ORA is currently developing a more detailed quarterly review of D.C. Economic and Revenue Trends.

¹ For a detailed discussion, see Fitzroy Lee, *Revenue Estimating Process*, Memorandum of the ORA/CFO, April 6, 2007.

- *Tax Rates and Tax Burdens: Washington Metropolitan Area* – Published annually, this report provides not only a comparison of the statutory rates of the District of Columbia *vis-à-vis* 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 and different income levels.
- *Tax Rates and Tax Burdens in the District of Columbia: A Nationwide Comparison* – Also an annual publication, the nationwide comparison report provides a compendium of statutory tax rate comparisons and estimates of the household burden of major taxes by income class of the District of Columbia *vis-à-vis* the largest city in each of the other 50 states. With respect to this report permit me to note that the Summary Tables are reprinted in the *Statistical Abstract of the United States*.²
- *The Economic Report of the District of Columbia: A Fiscal Perspective* –In 2007 ORA released its first Economic Report of the District of Columbia with information on the District economy and its revenue system, including a set of Special Analyses and supplemental economic and demographic data trends.³ This is a statistical abstract of the District of Columbia. Text and tables are provided on topics ranging from the macroeconomic indicators of the DC economy (e.g., trends in Gross State Product, Wage and Salary Employment, Commercial Space Inventory and sales, and the median price of housing) and to details on the expenditure side of the DC budget (e.g., per student public school system expenditures for DC and peer school systems, per pupil spending, number of residential dwelling units by ward) to an overview of revenue performance (e.g., the

² U.S. Department of Commerce, *Statistical Abstract of the United States: 2006*, “Estimated State and Local Taxes Paid by A Family for Selected Largest city In Each State (various years). Table 436.

³ Office of the Chief Financial Officer of the District of Columbia, *The Economic Report of the District of Columbia: A Fiscal Perspective*, 2007 (Kelly Dinkins, Ed.).

historical record on revenue collections, real property tax characteristics, business franchise profiles, and distribution of income tax filers by filer types) to what many may legitimately consider arcane (but, nonetheless still important) fiscal profiles (e.g., change in number of tax filers overtime, types of households receiving the District of Columbia Earned Income Tax Credit, trends in income tax withholding and non-withholding, and data on total income earned in DC vis-à-vis that earned by DC residents)

- *DC Tax Facts* – This important and widely used pocket-sized reference of District of Columbia tax collections provides descriptions of all the District of Columbia revenue (tax and non tax) sources, the history of major revenue changes since 1970, filing and payment dates, and the yield of each type of revenue utilized by the District of Columbia.
- *Cash Reports* – Each month ORA publishes a report of cash collections by the District of Columbia government. The tracking of these cash flows are particularly important in order to have an ongoing check on the quarterly revenue estimates. Then, at the end of the calendar year, as part of the process of preparing the Comprehensive Annual Financial Report (CAFR), ORA coordinates with the Office of Tax and Revenue to adjust the revenue numbers to reflect the net revenue accruals that then become the final numbers reported in the CAFR.
- *Revenue Chapter for the Annual Budget Document*. The ORA is also charged with the task of submitting to the Office of Budget and Planning (OBP) the Revenue Chapter (typically Chapter 4) that is included in the Mayor's initial budget submission to the Council and that is then further transmitted by the Council and the Mayor to the United States Congress. In its review of the *FY 2008 Proposed Budget and Financial Plan*, the

Government Finance Officers Association (GFOA) commented that the Revenue chapter was

“Outstanding. Obviously this is a very complex topic. [OBP] presented this information in a thorough and logical fashion. Needless to say it is a bit overwhelming, But [GFOA is] not sure how to simplify or lessen the amount of detail.”

- *Tax Expenditures* – The District of Columbia Code requires the CFO to prepare a tax expenditure budget for Fiscal Year 2003 and biennially thereafter. Tax expenditures are revenue losses that arise from the provisions of the tax laws that reduce the tax liability of individuals, groups of individuals and/or institutions. The next release is set for spring 2008.
- *Briefing Notes* – ORA has developed a series of short essays on a variety of economic and revenue topics. More than 50 briefing notes have been drafted and will be sent out for external peer review in early March.
- *Research agenda* – ORA had developed a research agenda including longer studies of key economic and revenue issues on topics that include: the District’s competitiveness, understanding the District visitor economy, and the District’s commercial property market.

Staffing and Budget

For FY 2008 ORA’s authorized staffing of 25 FTEs has not changed from FY 2007. The FY 2008 budget for ORA is \$3.28 million, of which approximately 23

percent is allocated to the Economic Development Finance (EDF) function.⁴ Total operating expenses for the entire ORA plus EDF through February 13, 2008, total \$1.42 million, or 43 percent of our budget. This expenditure pace reflects a front-loaded requirement to annually purchase a wide range of data base, regional modeling, statistical and other software licenses. ORA's organization chart (excluding EDF) is provided as an attachment to this testimony (Attachment 1).

Discussion of the Economic and Revenue Outlook

Revenues and Revenue Estimates

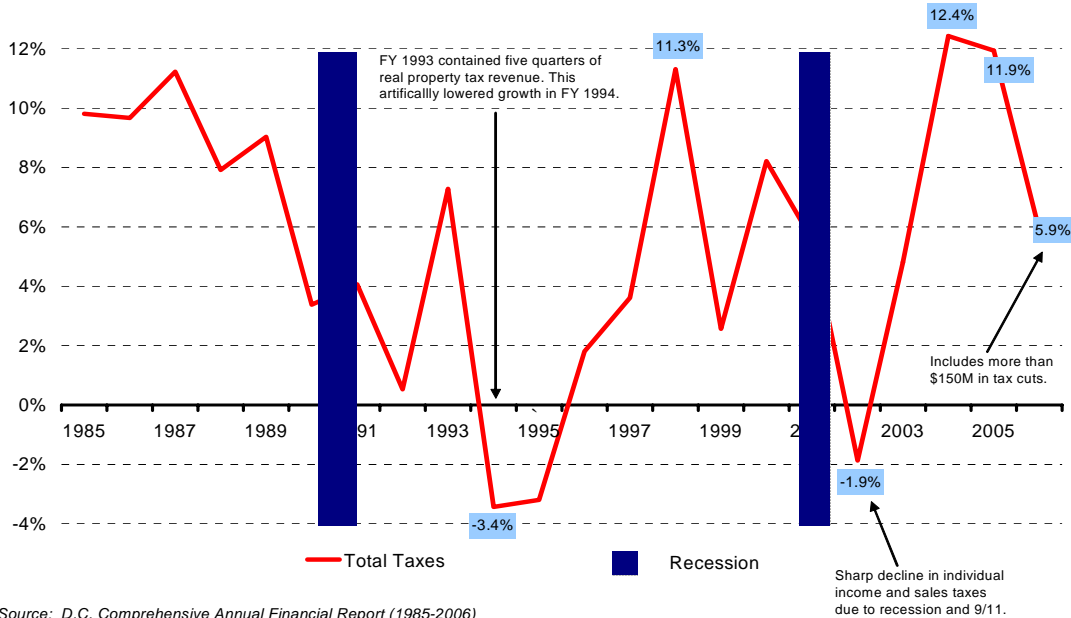
As noted, a key function of the ORA is to provide timely and accurate reports on the District's economic and revenue outlook and, with that, estimates of the present and projected performance of the revenue system (with reports issued quarterly). In the time between the May official binding estimate on which the budget is based, and the end of the forthcoming fiscal year, any number of changes can happen to the economy and the revenue stream – changes that are often exogenous to this revenue system. The chart below shows that the annual change in tax revenue can range widely. One challenge is to find what is “normal” in this growth and plan for a budget supported by normality – and subject to large swings. “Normal” or average growth in the last five years is about 6.8 percent, and in the last 3 years the percentage is about 10.1 percent.

⁴ The ORA FTE count includes six FTEs attached to the otherwise independent (of the ORA) Office of Economic Development Finance. The key functions of Economic Development Finance are (i) conduct research supporting the financing of special economic development projects; (ii) conduct analyses of the special finance projects, and (iii) represent the CFO in economic development-related board commitments and provide research and analytical staff-work related to those commitments. The 26% does not reflect special grant funds for fiscal studies that the EDF manages that supplement its staffing operations.

Yet actual tax revenue did not grow by either of these specific percentages in any one of the last six fiscal years, bouncing from -1.9 percent to 12.4 percent.

Volatile Tax Revenues

Annual Percent Change in Tax Revenue: FY 1985 - 2006



Since FY 2000, the District has had to twice grapple with this volatility. First, in FY 2002 income tax revenue fell abruptly and precipitously due to the events associated with September 11, 2001: a subsequent recession accompanied by stock market decline. When these revenue implications were identified in the summer 2002, the challenge for the Council and the Mayor was to create a balanced budget using revenue enhancements and expenditure reductions. Adjustments were made in both FY 2002 and 2003, and the District of Columbia closed out both FY 2002 and FY 2003 with small, but positive, budget surpluses. In FY 2003 the opposite swing began with transactions in both residential and commercial real property. Arising out of a year of no change in FY 2002, by the end of FY 2004 the annual value of transactions had more than doubled. Moreover, due to in part to the deed tax rate changes that had been enacted to deal with the prior revenue shortfall, deed tax revenues also more than doubled

between 2002 and 2004 (*DC Tax Facts*, various issues). Now we are entering a period where revenues are slowing.

Final Comments on the Outlook for FY 2008 and FY 2009.

As the Committee is aware, the U.S. economy is slowing and financial markets are experiencing significant difficulties. In January, national employment declined for the first time in over four years and the growth in real GDP in the 4th quarter of 2007 was the slowest in over four years (except for the first quarter of 2007 which was also 0.6 percent). On the last day of January the stock market (and measured by the S& P 500) was 6.5 percent lower than a month earlier. The February 10th *Blue Chip Economic Indicators* report, summarizing the forecasts of about 50 private sector economists for the period through 2009, noted:

“Reflecting mounting concern about the economy, the consensus now puts the odds of a recession at almost 50%.... The majority of our panelists, however, continue to say a recession will be avoided.”⁵

In the past, when the U.S. economy slowed the District’s economy usually did as well. This happened in the early 1990’s and again before the 2001 recession. In both instances D.C. revenues were adversely affected. As has been noted, the bursting of the stock market bubble in 2001 was the most significant reason for the decline in D.C. revenues in FY 2003.

Based on this context, our estimating assumptions for FY 2008 and FY 2009 include, respectively

- job growth of 1.1 percent and 0.6 percent
- growth of 0.7 percent and 0.1 percent each year in total resident employment

⁵Blue Chip Economic Indicators, Aspen Publishers, February 10, 2008, Summary, p.1.
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- 4.5 percent and 4.5 percent increases in the personal income of District residents, and
- (low) inflation of 3.0 and 2.2 percent, respectively.

Private sector service industries, especially professional and business services, will be the drivers of most of the increases in jobs and wages in the District.

As I have already noted, recent developments point to a number of possible risks. For example, much of the future performance of the U.S. economy depends upon continued gains in consumer spending. Consumers are heavily indebted, with net saving rates close to zero. Were consumers to cut back on spending, a slowing U.S. economy would eventually impact the District's economy, primarily through its dampening effect on tourism receipts, other retail sales, and corporate profits. District revenues are also vulnerable to a sharp rise in interest rates or declines in the stock market, because these affect the real property market, corporate income, and the non-wage component of the individual income tax.

Another source of risk is the pattern of federal expenditures. Government spending is a significant economic underpinning of the entire Washington D.C. Metropolitan area, including spending by the District of Columbia itself. Security concerns arising out of 9/11 and the Iraq war have resulted in large increases in government spending that benefited the Washington D.C., area. However, federal government employment is not growing and there is some evidence that procurement dollars spent in D.C. are not increasing. Efforts to reduce government spending over the next few years to bring greater balance to federal fiscal policy could further dampen growth in the District of Columbia. Uncertainties about when the D.C. housing market will return to better health and

when tourism will rebound also add the uncertainties in revenues in the months ahead.

With all of the risks present in the current environment, it is necessary to be aware of them not only in the abstract but also the impact they could have on District of Columbia revenues. As an example, we analyzed the possible impact on District of Columbia revenues of a national recession, including if the stock market continues to fall, if D.C. employment growth stagnates, and if the unemployment rate increases. Suffice it to say, we are actively monitoring trends in the economy and in revenue collections and are committed to bringing to the attention of the Mayor and Council any changes that could have a material affect on the District's finances.

Thank you for the opportunity to testify before you today. I am pleased to respond to any questions that you may have.

Attachment 1

For OCFO Use Only
January 15, 2008

OFFICE OF THE CHIEF FINANCIAL OFFICER Office of Revenue Analysis

Organization Chart

