PUBLIC OVERSIGHT ROUNDTABLE

ON

STRATEGIES FOR THE USE OF "AMERICAN RECOVERY AND REINVESTMENT ACT OF 2009" FUNDS

Before the
Committee of the Whole
Council of the District of Columbia

The Honorable Vincent C. Gray, Chairman

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Council Chambers

Testimony of
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Introduction

Good afternoon, Chairman Gray and members of the Committee of the Whole. I am Natwar M. Gandhi, Chief Financial Officer of the District of Columbia Government. I am pleased to appear before you today to provide our updated understanding and analysis of the impact on the District budget of the American Recovery and Reinvestment Act (ARRA) or "Stimulus bill" which was signed by President Obama on Tuesday, February 17, 2009. We have been tracking the Stimulus bill, with particular attention to the provisions that directly impact the District's budget and financial plan. In addition, we have begun to consider the potential indirect impact of the Stimulus on the District's economy and potential implementation challenges.

Background, Purpose, and Scope of the Federal Stimulus

As I discussed before the Council last month, the federal Stimulus proposal is a plan to boost economic growth through a combination of spending increases and tax cuts. The final package has a total cost of $787 billion over the next two years and will impact FY 2009 through FY 2011 of the District budget.

The Stimulus package includes several elements: tax cuts for both individuals and businesses, federal spending that flows through state and local governments, direct federal payments to individuals, direct federal spending, and tax credit programs to support municipal debt for capital projects. We have focused on the federal spending that flows through state and local governments, which is estimated to be roughly $320.4 billion of the total package.

Direct Budget Impact of the Stimulus Spending Provisions

At this point in the process the OCFO has certified that in FY 2009 – FY 2011, a minimum of $409.2 million of the stimulus package is available to balance the budget in the form of the State Fiscal Stabilization Fund and the Federal Medical Assistance Percentage (FMAP) increase which impacts Medicaid and foster care. In addition, there is potential budget relief depending upon how the estimated $188.2 million in operating grants are utilized. The utilization of the federal operating grants involves programmatic policy decisions that are beyond the purview of the OCFO, so I will leave those to Mr. Tangherlini to discuss.

As you can see from Attachment 1 to my testimony, we estimate that of the minimum $409.2 million in budget relief, $147 million is available in FY 2009, $185.9 million in FY 2010, and $76.3 million in FY 2011.

The recent dramatic slowdown in the economy has resulted in a deteriorating revenue outlook for the District. Compared to the estimates included in the June 2008 Budget and Financial Plan, the District's Local Source, General Fund estimate has been reduced by $393.5 million for FY 2009 and $802.1 million for FY 2010, as shown in Attachment 2.

The federal stimulus package will provide some needed assistance to the District to manage these revenue shortfalls. However, in its final form it is unlikely to address all of the District's fiscal challenges.

Impact of Stimulus Tax Provisions on the District

Due to the manner in which the District automatically conforms to the Federal Code (tax base) there are six Stimulus provisions that require DC Council attention.

The Earned Income Tax Credit (EITC). For tax years beginning 2009 and 2010 (thus the impact for the District is its FY 2010 and 2011) this provision increases the Federal EITC. A key provision of the Stimulus Plan is to increase the EITC from 40% to 45% of the first $12,750 of earned income (wages, not investment income) for families with 3 or more children. The District "piggybacks" on the Federal EITC by allowing the federal tax filer to take 40% of the Federal EITC as their DC EITC. If the District does not decouple from this provision, the cost to the District of Columbia is $3.5 million over FY 2010 and FY 2011 (estimated $1.8 million in FY 2010 and $1.7 million in FY 2011).

Sales tax deduction for new motor vehicle purchase. The second provision is a deduction for sales and excise tax on new motor vehicles up to $49,500 for new cars, light trucks, motorcycles, and mobile homes. This provision phases out for taxpayers with modified AGI in excess of $125,000 ($250,000 joint), and has a sunset date of 12/31/09. District law currently exempts motor vehicles from the general sales tax. However, the District does impose an excise tax on motor vehicles at rates of 6 to 8 percent of the value depending on the weight of the car. If the District does not decouple from this provision, it would reduce District revenue by an estimated $0.2 million in FY 2009 and $0.7 million in FY 2010.

Extension of "bonus depreciation." The Stimulus extends a temporary increase in a benefit (initially effective in 2008 and extended to 2009) that allows businesses to depreciate business equipment more quickly. The District of Columbia has already decoupled this provision.

Section 179. Under IRC Section 179, the IRS allows an expense method of depreciation and, the Stimulus package increases the amount of expense that may be taken from$133,000 to $250,000. DC has already de-coupled from Sec. 179.

Unemployment insurance benefits exclusion. The stimulus legislation includes an exclusion of up to $2,400 of unemployment insurance benefits from gross income for taxable year 2009. Since the District conforms to this part of the definition of Federal Income in calculating District Adjusted Gross Income, the District would sustain a tax loss of $1.0 million in FY 2009 and $4.1 million in FY 2010. The policy choice is to conform and sustain the tax loss or decouple from the federal provision.

Corporate income tax deferral of income from canceled or repurchased business debt. Under current law, firms recognize income when they cancel debt or repurchase debt for an amount less than the issue price. This provision allows firms to defer this type of income for the first four to five years and then recognize the income for tax purposes over the following five taxable years. If the District does not decouple from this provision, the estimated revenue reduction would be $5.7 million in FY 2009, $10.6 million in FY 2010, and $3.5 million in FY 2011.

These provisions are summarized in the table below:

	Stimulus Tax Provisions Potentially Impacting District Revenue		Revenue Reduction if District Does Not Decouple (Dollars in millions)		
	Provision	**Status of District Law**	FY 2009	FY 2010	FY 2011
1	Earned Income Tax Credit Expansion	The District EITC is 40% of the Federal EITC.	0.0	-1.8	-1.7
2	Sales Tax Deduction for New Motor Vehicle Purchases	DC exempts motor vehicles from general sales tax. District imposes an excise tax based on the weight of the vehicle.	-0.2	-0.7	0.0
3	Extention of "Bonus Depreciation"	District is decoupled	NA	NA	NA
4	Section 179 Expensing	District is decoupled	NA	NA	NA
5	Exclusion of up to $2,400 in Unemployment Compensation benefits from personal income tax	District is coupled to Federal definition of Adjusted Gross Income for the personal income tax.	-1.0	-4.1	0.0
6	Corporate income tax deferral of income from business debt associated with reacquisition of debt instrument	District is coupled to Federal definition of Adjusted Gross Income for the corporate income tax.	-5.7	-10.6	-3.5
		Total	-6.9	-17.2	-5.2

Impact of Stimulus Bond Provisions on the District

The Stimulus legislation includes federal tax credits for new and expanded municipal bonding authority. Proceeds from these bonds can be used to construct schools, public facilities, and infrastructure; to support economic development in distressed areas; and to finance energy conservation projects. It also increases authority for private activity bonds. The District's full allocation of these credits is not yet known.

These bond provisions may allow the District to realize debt service savings. Estimating the value of these savings at this time is very difficult. The savings to the District will depend upon:

- the value of these federal government tax credits to investors,

- the market conditions at the time of issuance, and,
- since these stimulus bonds would be issued as taxable bonds, the spread between tax-exempt and taxable interest rates.

The Office of Finance and Treasury will monitor the potential debt service savings to determine whether funding capital projects using these Stimulus package bonds would be beneficial toe the District. Any new debt that we issue must be within the confines of the District's debt cap.

The specific bond provisions include:

- The Qualified School Construction Bond program in which the federal government would pay 100% of the interest on District-issued bonds for school construction through a tax credit to bond purchasers.

- The Build America Bond program which is designed to expand credit markets to support traditional GO capital expenditures. Through the program, the jurisdiction issues taxable bonds and 35% of the interest is paid to the purchaser through a federal tax credit, or the District can elect to pay all of the interest and receive a direct payment from Federal government to the District.

- Recovery Zone Economic Development Bonds which are intended to promote development or other economic activity in a designated "recovery zone" including: capital expenditures, infrastructure, public facilities, job training. This program is structured like the Build America Bond program, but with a higher tax credit of 45%.

- An expansion of the Clean Renewable Energy and Qualified Energy Conservation Bond programs which provide a 70% credit for qualified renewable energy facilities and to initiatives that reduce green house gas emissions. This program could assist the District in efforts to become more energy efficient and facilitate a more "green-friendly" environment.

- An expansion of our private activity bond authority in Recovery Zone Areas. Utilization of this program would not have a direct financial benefit to the District, but could have an indirect benefit in the form of allowing for increased development activity in the District from private borrowers that utilize the District's conduit revenue bond program (a program run by the Office of the Deputy Mayor for Economic Development).

All of these bonds must be issued before January 1, 2011.

Overview of methodology for estimating indirect impact of stimulus

One issue that has been raised during the process of analyzing the federal stimulus is the potential indirect benefits that may accrue to the District as the focal point of much of the Stimulus activity.

The first challenge in estimating the potential indirect effects is to identify funds: 1) that will be spent by entities located in the District, and 2) that have a reasonable likelihood of being spent in the District through the use of District-based firms or hiring District residents. The types of spending that may meet these conditions include: administrative expenses associated with implementing the grant programs, improvements to federal buildings, and contracting associated with managing all aspects of the stimulus package.

The stimulus legislation provides general allocations to Federal agencies for a number of activities such as buildings and facilities, technology improvements, and operations and maintenance. The potential economic impact of these funds on the District will depend greatly on how each agency allocates these funds. For example, Federal agencies with headquarters in the District and field offices located through the country could choose to focus the funds on central operations or distribute the funds to field offices or some combination of the two.

For example, the stimulus legislation includes $5.55 billion to be deposited in the Federal Buildings Fund, of which $750 million is for Federal buildings and courthouses, $300 million for border stations, and $4.5 billion to convert General Services Administration facilities to High-Performance Green Buildings. The GSA owns and leases over 8,600 buildings in more than 2,200 communities nationwide. While some of these building funds may be spent in the District, it will not be clear how much until GSA develops a plan for spending these funds.

As such, a thorough analysis of the potential indirect impact of the stimulus cannot be completed until there is a much clearer understanding of how the Federal agencies plan to spend the funds. This information should become available over the coming weeks.

After an estimate of the total potential spending is developed, the next step is to develop reasonable assumptions for what share of the funds will remain in the District economy through contracting with District-based vendors or hiring District-based workers. The District is part of a vibrant, open economy with a very competitive labor market and a wealth of government contractors located in neighboring jurisdictions. As such, it will be critical to construct a model that makes reasonable assumptions regarding the leakage of these funds to Maryland and Virginia.

The third step in this analytical process is to translate the potential Federal spending that remains connected to the District economy into potential jobs and income.

It is important to note that the extent to which the government spending could be considered "stimuli" or as activities that lead to a **net** increase in economic output is highly contested among experts. The estimates of the multiplier effect of government spending vary greatly, anywhere from 1.5 (that is, each public dollar spent increases private economic activity by $1.50) to less than 1 (that is, each dollar spent by the public sector means less than $1.00 in private expenditure – resulting in a smaller impact). The calculation of the secondary effects of the public spending in the District will depend heavily on the choice of this multiplier. At this time, we are working on determining a reasonable range for the multiplier to estimate a reasonable range of the economic impact.

Looking Ahead: Implementation Challenges

I would like to highlight two critical challenges we face as this Stimulus process moves towards implementation: 1) reporting requirements, and 2) internal controls and auditing. First, the American Recovery and Reinvestment Act includes language requiring quarterly reports on the use of the funds. The Office of Management and Budget (OMB) is responsible for issuing guidance on the form and content of the required reports. OMB issued preliminary guidance in February that noted in broad terms the types of information required in the reports such as: amount of recovery funds received; a list of projects for which recovery funds were obligated and expended; and number of jobs created or retained by the project. OMB anticipates releasing more detailed guidance in the next three to four weeks. Finally, OMB has indicated that the first quarterly report is due July 10, 2009.

The second implementation challenge is ensuring that there are robust internal controls so that these funds are spent to the letter and spirit of the law. The Government Accountability Office (GAO) has the responsibility to ensure accountability and transparency over the course of the implementation of the Stimulus plan. GAO will conduct bimonthly reviews of selected states' and localities uses of Recovery Act funds. GAO has selected a core group of 16 states and the District of Columbia to follow over the next few years to provide a trend analysis of the use of funds under the Recovery Act. We will work closely with the GAO to implement the best possible internal controls to meet this very unique challenge of spending these disparate funding sources both prudently and in a timely fashion. I am confident that working with the City Administrator and the GAO we can meet the challenge of providing the highest level of accountability and transparency required of this very important effort.

This concludes my remarks. I would be pleased to answer any questions you may have.

Attachment 1

	Conference Agreement Federal Stimulus Summary (Dollars in Millions)						
	Preliminary Estimate of Potential Impact of Federal Stimulus on the District				DC Estimate (If available) by Fiscal Year		
	Expenditure Areas	**U.S. Total Amount**	**Percent of U.S. Total**	**DC Estimate (If available) Total**	**FY 2009**	**FY 2010**	**FY 2011**
1	State Fiscal Stabilization Fund	53,278.0	16.6%	89.4	17.9	35.8	35.8
2	Medicaid FMAP Increase	86,600.0	27.0%	314.3	126.7	147.7	39.9
3	Foster care\Adoption Assistance - Title IV-E	843.0	0.3%	5.5	2.4	2.4	0.6
4	Subtotal State Fiscal Stabilization Fund, Medicaid, Title IV-E	140,721.0	43.9%	409.2	147.0	185.9	76.3
5	Federal Operating Grants	72,394.0	22.6%	188.2	55.8	90.4	42.1
6	Federal Capital Grants	34,007.0	10.6%	123.5	61.8	61.8	0.0
7	Non-General Fund: Unemployment Trust Fund	43,660.0	13.6%	3.2	1.6	1.6	0.0
8	Non-General Fund: Housing Authority, WASA, WMATA	29,650.0	9.3%	231.7	104.5	104.5	22.6
9	Total of Expenditure Provisions	320,432.0	100.0%	955.8	370.7	444.1	141.0
10	Tax Provisions	-72,247.0		-29.4	-6.9	-17.2	-5.2
11	Total with Tax Provisions	248,185.0		926.4	363.8	426.9	135.8

Notes: Percent of total Federal dollars in each category in which there is a DC estimate:

a	State Fiscal Stabilization Fund	96%
b	Federal Operating Grants	73%
c	Federal Capital Grants	81%
d	Unemployment Trust Fund	2%
e	Housing Authority, WASA, WMATA	60%

Note: Totals may not add due to rounding.

Sources: FFIS, "Budget Brief 09-04: The American Recovery and Reinvestment Act Becomes Law" February 23, 2009.
DC Office of Revenue Analysis summary of "American Recovery and Reinvestment Act," Conference report.
Center on Budget and Policy Priorities, "American Recovery and Reinvestment Act of 2009: State by State Estimates of Key Provisions Affecting Low- and Moderate-Income Individuals," February 13, 2009.
PattonF Boggs, LLP. "No Small Change: The Stimulus Package and Its Impact," February 17, 2009.
Grant estimates from Federal agencies including: Department of Education, Department of Housing and Urban Development, Department of Justice, Department of Labor, Environmental Protection Agency, Department of Energy.

Attachment 2

Revenue Estimates: Original and Revised

	Local Source, General Fund Revenue Estimate ($ millions)	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013
1	**Revenue estimate included in June budget (Original)**	**5,562.9**	**5,831.7**	**6,099.2**	**6,402.5**	
2	Change in the estimate (September 2008)	(130.7)	(151.9)	(148.5)	(162.3)	
3	**Revenue estimate of September 2008**	**5,432.2**	**5,679.7**	**5,950.7**	**6,240.2**	
4	Change in the estimate December 2008)	(127.1)	(303.8)	(330.4)	(327.5)	
5	**Revenue estimate of December 2008**	**5,305.1**	**5,375.9**	**5,620.3**	**5,912.7**	**6,216.9**
6	Change in the estimate (February 2009)	(135.7)	(346.3)	(488.3)	(613.8)	(676.9)
7	**Revenue estimate of February 2009**	**5,169.4**	**5,029.5**	**5,132.0**	**5,298.8**	**5,540.0**
8	Dollar Change in General Fund revenues compared to prior year		-139.9	102.4	166.9	241.2
9	Percent Change in General Fund revenue compared to prior year		-2.7%	2.0%	3.3%	4.6%
10	Change in the estimate since June budget	(393.5)	(802.1)	(967.3)	(1,103.7)	n/a
11	Loss sustained compared to June budget	-7.1%	-13.8%	-15.9%	-17.2%	n/a