

**HEARING ON BUDGET AUTONOMY
FOR THE DISTRICT OF COLUMBIA**

**Before the
U.S. House of Representatives
Committee on Government Reform
The Honorable Tom Davis, Chairman**

**June 13, 2003, 10:00 a.m.
Room 2154, Rayburn Building**



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

Good morning, Mr. Chairman and members of the Committee. My name is Natwar M. Gandhi, and I am the Chief Financial Officer for the Government of the District of Columbia. I am here today to testify on the issue of budget autonomy for the District of Columbia. At the outset, I want to express my view that, both as a citizen of the District of Columbia and the District's senior financial manager, I wholeheartedly endorse expanding the authority of the District to manage its own financial affairs.

In anticipation of this hearing, I re-read clauses 17 and 18 of Article I, Section 8 of the Constitution of the United States:

Clause 17. (The Congress shall have power) to exercise exclusive Legislation in all Cases whatsoever, over such District...as may by the Cession of particular States, and the Acceptance of the Congress, become the Seat of Government of the United States... and

Clause 18. (The Congress shall have power) to make all Laws which shall be necessary for carrying into Execution the foregoing Powers, and all other Powers vested by this Constitution in the Government of the United States, or in any Department or Officer thereof.

This language is unambiguous with respect to congressional authority over the legislative affairs of the District of Columbia. However, it gives the Congress wide latitude with respect to the execution of its constitutional mandate. With this in mind, let me speak to why I believe, from a financial management perspective, the District should have discretion with respect to the allocation of funds raised

from local sources and, further, how changes to current law would not affect Congress' constitutional role.

Under current law, all District of Columbia spending is authorized by the Congress through the federal appropriations process, irrespective of the source of revenue underwriting such spending. In the District's FY 2003 gross budget of \$5.573 billion, enacted by Congress on February 20, 2003, about \$3.813 billion, or 68 percent, was comprised of revenues raised through local taxes, fees, fines, and user charges (\$3.602 billion + \$211 million in private and other revenue). Of the remaining \$1.76 billion in federal funds, \$1.713 billion was comprised of federal transfer payments and grants. Only \$47 million was uniquely and especially appropriated from federal revenues for programs and projects peculiar to the District of Columbia.

I would argue that only the federal funds that are specifically and uniquely earmarked for District programs or projects must be appropriated by the Congress – for example, funds provided to support federal events such as the inauguration or funds for tuition assistance. In the case of local funds, the Congress rarely alters an allocation made by the District. Federal transfer and grant payments to the District have already been appropriated to the federal agency responsible for program administration, and are reflected in the District budget for the sole purpose of showing a complete accounting of planned District spending. Having already been appropriated to a federal transferring agency, these federal funds do not need to be “reappropriated” to the District.

Were the Congress to modify current law in the direction of reducing its role in the District's appropriation process, a range of possibilities would still remain to

exercise oversight over the District's budget and operations. These might include periodic audits, after-the-fact review of the District's locally enacted budget, or review of the District's locally enacted budget by the appropriate oversight group in the Congress. Federal funds directly appropriated to the District would remain within the federal appropriations process.

Benefits to the District

Faster enactment of budgets. Because the District currently receives all its authority to spend funds through the federal appropriations process, the District cannot enact the budget approved by its elected representatives until Congress passes and the President signs its appropriations bill. This situation guarantees a five-month lag between local approval and federal enactment. However, federal appropriations bills are often delayed beyond this period. There are adverse consequences for the District since it is tied to the federal appropriations cycle. Bond rating agencies take the uncertainties of the federal process into account in assessing the District's finances for a bond rating. In the case of new or expanded programs approved and financed locally, no action can be taken during the fiscal year until Congress passes its appropriations act. This unnecessarily delays the start of programs and virtually guarantees programs will not be executed as planned. Also, the more time that elapses between the formulation of a budget and its execution, the more likely the operating assumptions underlying that budget will not hold true.

Conformance to the Standard Local Government Fiscal Year. Further, the federal appropriations cycle runs on an October-September fiscal year, a fiscal cycle unsuited to local government. Were the District to have autonomy to appropriate its own funds like other local jurisdictions, my recommendation to the Mayor and

Council would be to revise the fiscal year to a July 1-June 30 fiscal year. This would have immediate advantages.

First, it would conform the fiscal year to the school year, greatly enhancing the ability of D.C. Public Schools (DCPS) and the University of the District of Columbia to manage their funds effectively. This is important because public education spending accounts for nearly 25% percent of District general fund expenditures. In the DCPS planning cycle, the July-September period is the largest spending quarter. Under current budget law, this period falls at the end of the fiscal year, after DCPS has had to deal with all the exigencies of the prior three quarters. In fact, in recent years, DCPS has had to rely on funds advanced from the upcoming year's expected appropriation to support start-up costs for the upcoming school year. Thus, it would clearly be better for DCPS management, and make greater budgetary sense, to fund school year start-up costs – purchase of books, start-up maintenance and the like – at the beginning of the year and with current fiscal year funds, and then cope with remaining issues as they occur.

Second, it would more closely conform the District's fiscal year to its revenue cycle. The annual income tax payments are due in April, and the first semiannual real property tax payment is due on March 31. Data on these payments is key to updated revenue projections for the upcoming fiscal year. Were the District to execute its fiscal year budget beginning in July, it would be proceeding on the most recently available, and therefore most accurate, revenue information.

Currently, budgets are based in large part on revenue estimates completed in February, some seven months before the start of the new fiscal year in October and a total of 19 months before the end of that fiscal year. The District does not get

actual data on how accurate these revenue estimates were, and whether budgeted expenditures were fully covered, until after the end of that fiscal year, perhaps 24 months after the original revenue estimates were made.

Finally, changing the fiscal year also could improve cash flow management and reduce some budgeting risks. Larger tax payments received in September, particularly the local half-year real property taxes due on September 15, essentially “back load” the cash stream toward the end of the fiscal year. Even as some \$5.6 billion in cash flows through our financial systems to pay for the budgeted \$5.6 billion in District expenditures, the District needs additional cash to negotiate the timing of expected tax receipts during the year. Changing the fiscal year mitigates this by reducing uncertainty about year-end revenue accounting, particularly for real estate payments received after September 30, and by reducing the impact of the distribution of this revenue between fiscal years.

Increased Local Financial Flexibility. Providing the District with the authority to direct the spending of its locally raised revenue would substantially increase the District’s ability to react to changing program and financial conditions. Under current law, the District must follow the federal supplemental appropriation process to appropriate additional revenues that become available during the course of the fiscal year or to make any significant realignment in resources among its appropriations. All program plans premised on supplemental appropriations are held in abeyance while Congress considers the request. The same problem is encountered on more mundane financial transactions, such as interappropriation transfers and reprogramming requests. For example, all reprogrammings from one object class of expense to another in excess of \$1 million require a congressional review period of one month before enactment. In addition, opportunities to

increase revenue arise occasionally, but require spending additional funds. Particularly in tight budget circumstances, it is difficult for the District to wait as long as 18 months for a new budget cycle to begin.

Mechanisms and Safeguards for Assuring Financial Integrity

The District of Columbia Financial Responsibility and Management Assistance Act of 1995 (the Act), coupled with the continuation of an independent Office of the Chief Financial Officer, provides the framework for assuring financial integrity without the need for imposing the federal appropriation process on local fund budgets. The Act provides for the reinstatement of a control board and other constraints should the District fail to meet major financial obligations. By itself, the Act has been a powerful motivator for our elected officials to maintain a balanced budget and strong financial controls at all times.

Further, under current law, the Office of the Chief Financial Officer provides an independent assessment of key financial data – annual comprehensive financial reports, revenue estimates, fiscal impact statements, and all other consequential financial data. I believe that a necessary corollary to increased local financial autonomy is the inclusion of the authorities and responsibilities of the Office of the Chief Financial Officer in organic law. Taken together, this legislative framework should be sufficient to ensure fiscal discipline without the added complexity of putting local spending plans through the federal appropriations process.

Were the District to be permitted local spending autonomy, my recommendation to the Mayor and Council would be that we adapt existing federal appropriations law for local use. The District is already accustomed to working within this framework – one that prescribes rules for the treatment of funds, realignment of funds and

other matters related to the formulation and execution of budgets. I should note in this regard that the District recently enacted a local anti-deficiency law to stipulate the responsibilities of management officials in the financial arena and provide sanctions for those that are not in compliance.

Fiscal Condition and Financial Improvements

I believe the District has the financial infrastructure to permit it to manage its local funds effectively. We have a strong accounting system linked to our budget oversight processes. Monthly closings and cash reconciliation are in place. Financial managers have a clear understanding of expectations. Unqualified opinions by the District's independent auditors have become routine and the number of management findings substantially reduced.

In the budget area, the District has enhanced its analytical capabilities, moving toward performance budgeting to link agency outputs to cost. Automated budget monitoring systems have been put in place to give program and financial managers the capability to review their financial posture daily.

Further, the District is well along on a project that will integrate all its significant administrative systems – personnel, payroll, procurement, budget, accounting, property management, and pension administration. This integration will substantially enhance both information on and controls over all transactions affecting expenditures and do so at lower cost.

The Continuing Role of the Federal Government in District Finances

Notwithstanding the clear advantages to the District of having local autonomy in the appropriation of locally raised revenue, there remains the question of the

federal government's role in assisting the District in attaining a structural balance between spending needs and its revenue raising capability. In its report on Structural Imbalance and Management Issues in the District of Columbia (GAO-03-666), the General Accounting Office (GAO) clearly demonstrates, using objective, quantifiable criteria, that the District of Columbia has a substantial gap between its spending needs and its local revenue resources. This gap is calculated to be between \$470 million and \$1.1 billion annually, based on FY 2000 information. In all likelihood, the gap is toward the upper end of this spectrum, which more closely represents the economic circumstances of a city like the District.

The report clarifies four fundamental features of the District's fiscal problems:

1. *The District's expenditure requirements for providing a standard group of services are far higher than any state fiscal system.* The District faces these high expenditure requirements because it provides public services in a market with high labor costs, it provides services to a large commuter population, and it has many residents with high service needs. The report identifies areas where the District has the potential to improve the efficiency of operations. Even so, the District's higher costs of providing average services are determined by factors beyond its control and far beyond possible savings from greater efficiencies, many of which are now in place, and more of which we intend to achieve.

2. *The District taxes itself very heavily.* The District's tax effort is much higher than that of the average state. Although the District's tax capacity is large – more than 47 percent above the national average – because of its large expenditure requirements, the District must compensate with a tax effort that is about 50 percent above that, among the highest, if not the highest, in the nation.

3. *Even with high taxes, the District cannot pay for average levels of service to residents, commuters, and visitors.* The District's additional tax capacity is not enough to compensate for the District's higher expenditure burden. The urban composition of the District's population, and the standard services needed by such a population, overwhelm even the District's high tax effort.

4. *The District has a serious infrastructure problem.* The District faces an accumulated infrastructure backlog of at least \$2.5 billion. The District has deferred capital investment to avert the operating costs associated with debt service. The problem is obvious when you consider that the District's general obligation debt service is about 10 percent of local revenues, and rising. Further, the problem is acute because our debt levels already are near the ceiling for maintaining credit-worthy debt ratings. Our capital borrowing analysis shows that only moderate additional borrowing would be acceptable to the agencies that rate the District's credit-worthiness. Whether expressed in per capita terms or in relation to revenue, the District's current outstanding debt is greater than any state fiscal system.

The report also recognizes that the federal presence imposes costs and limitations as well. To the extent that the federal government's property and purchases are off the tax rolls, or that non-resident income earned in the District cannot be taxed, these limitations are reflected in the tax base. Given these limitations, in order to try to pay for even an average level of service from the operating budget, District tax rates on the tax base available to it must be high. While the report does not quantify the actual costs of services provided to the federal government or incurred as a result of being the nation's capital, it puts these costs in perspective. When millions of dollars of expenditures related to being the nation's capital are

absorbed by the city, this diverts resources from ordinary services to residents, commuters, and visitors.

The District has made operating budget reductions of over \$190 million in FY 2003, in part to balance expenditures and revenues, but also as part of a larger effort to deliver services more efficiently. While significant opportunities for efficiency improvements exist within District programs, even with such improvements, the GAO report points out that the District would still face a structural deficit.

By law, the District must balance its budget each year, but making the spending or revenue adjustments needed to do this is not the same as solving a structural deficit. Due to this structural deficit, the District is forced to choose between tax levels that are even higher than the national average, service levels that are lower than the national average, or combinations of both in order to balance its budgets.

Although the GAO report makes no recommendations, it provides a strong case for federal action to assist the District of Columbia, the nation's capital. As noted, the structural imbalances in both the operating and capital areas result primarily from cost and workload factors that are beyond the District's control, and, in addition, the District must provide services to the federal government.

With tax and debt burdens higher than other jurisdictions, it is not feasible for the District to solve the problem through more taxes or borrowing. One option noted in the report is for the federal government to relax taxing restrictions on the District to compensate it for its special status as the capital city.

The GAO report indicates that providing federal assistance to the District may encourage state fiscal systems with structural deficits to request the same or similar treatment. However, a strong case can be made that the District of Columbia is unique among all local and state jurisdictions and that unique conditions dictate unique solutions. All states have federally tax-exempt property, but the District has more in terms of value relative to the size of the economy. All states may forego some tax activity due to federal commercial activity, but the District certainly loses much more in relation to the size of its economy. The District also is subject to revenue and other constraints that are not imposed by the federal government on any other jurisdiction. These factors have been many times documented and indicate that the District merits a unique fiscal relationship with the federal government that corresponds to its unique operational arrangement.

There is a wide range of options available to the federal government for assisting the District in overcoming its structural deficit and in providing a level of service quality that befits the nation's capital. In contemplating budget autonomy for the District, the Congress would be well served to also examine its financial relationship with the District. Unless a change is made, one can predict a gradual deterioration of services provided by the District to residents, commuters and visitors. This would be unfortunate in the extreme, especially in light of the major progress made in all aspects of District quality of life over the past eight years.

Mr. Chairman, this concludes my remarks. I would be pleased to answer any questions you might have.

###