A NEW FEDERAL CONTRIBUTION TO THE DISTRICT OF COLUMBIA? THE NEED, LIKELY IMPACT, AND SOME OPTIONS

By

Ed Lazere
Executive Director
DC Fiscal Policy Institute

And

David Garrison
Deputy Director
Brookings Greater Washington Research Program

November 2005

ACKNOWLEDGEMENTS

The Brookings Institution and the DC Fiscal Policy Institute express their appreciation to the Trellis Fund for its support of this report on the issues surrounding a possible new federal contribution to the District of Columbia.

The authors thank Congresswoman Eleanor Holmes Norton and Rosalyn Parker, her legislative assistant, for meeting to discuss Norton's proposed new federal contribution to the District. The authors thank the various congressional staff members who met with them from the House Government Reform Committee, the House DC Appropriations Subcommittee, the Senate Government Affairs Committee, and the Senate DC Appropriations Subcommittee. The authors are grateful for the assistance they received from city staff including Gregory McCarthy, assistant to the mayor for policy and legislative affairs, and Kevin Clinton, as well as a number of staff from the Office of the Chief Financial Officer. The authors also received invaluable comments and suggestions from Walter Smith, executive director of the DC Appleseed Center and Brookings Senior Fellow Alice Rivlin, director of the Brookings Greater Washington Research Program. The authors accept full responsibility for the final contents of this analysis.

EXECUTIVE SUMMARY

A 2003 report from the Government Accountability Office (GAO) found that the District of Columbia faces a large structural budget imbalance—that is, a persistent gap between its ability to raise revenues and the cost of providing basic services. DC's imbalance stems largely from its being a "city without a state" and from revenue limitations caused by the federal presence. The most logical solution to this problem would be an annual contribution from the federal government to help address the challenges that arise from DC's unique status as the nation's capital.

A bill introduced by DC Congresswoman Eleanor Holmes Norton and endorsed by the entire congressional delegation from the Washington region would provide the District with $800 million annually (adjusted each year for rising costs) to address a variety of infrastructure needs.

This paper assesses the proposal's likely impact. It finds that the bill would give DC leaders flexibility to make a serious dent in several of the city's major fiscal challenges. This paper also considers other options for designing and computing the size of a federal contribution.

Like other large cities, the District faces a number of factors that put upward pressure on its budget—such as a high cost of living and significant public safety and social service needs. The GAO found that the cost of providing basic services is far higher in DC than in any state. Yet the District is not embedded in a larger state that can help share this load. Sixty percent of the metropolitan area's homeless residents, for example, live in DC.

While its public service demands are high, DC's revenues are restricted by the federal prohibition against taxing the income earned by non-residents, who make up roughly two-thirds of those who work in the District. DC is also handicapped by the fact that 40 percent of its property is tax-exempt because it is owned by the federal government, other governments, or non-profits.

The GAO found that DC's structural imbalance is in the range of $470 million to $1.1 billion per year, depending on which assumptions are used. A review of these assumptions suggests that the most reasonable estimate is between $900 million and $1.1 billion. While the GAO noted that many states also face structural deficits, the gap in DC is the largest per capita.

One result of this fiscal imbalance is a long-term under-investment in the District's physical infrastructure. DC public schools, for example, are, on average, 65 years old. The most recent estimate of deferred capital needs is in the range of $5.2 billion over the next six years, and this was not a thorough assessment. Yet the District's debt is now far higher than any state's on a per capita basis, making it virtually impossible to address its infrastructure backlog.

Despite these challenges, the District has balanced its budget for eight years in a row, emerged from oversight by a federal control board, and enjoyed upgrades in its bond rating. This progress, however, has been built largely on an anomalous—and perhaps cyclical—upsurge in its real estate market, and it does not change the fundamental fact that the District faces substantial public service costs and a restricted tax base. Notably, the improvement in DC’s financial position has not helped its ability to address deferred infrastructure needs.

Under the 1997 Revitalization Act, the federal government addressed some of the city’s greatest fiscal challenges by assuming responsibility for several court and corrections expenses, increasing the federal share of DC’s Medicaid expenses, and assuming responsibility for DC’s unfunded pension liability. This came with a cost, however—the elimination of an annual federal payment that had reached $666 million. Although the Revitalization Act appears to have provided a net fiscal gain to the District, it did not erase DC’s structural imbalance; GAO’s study on DC’s budget gap was conducted after the Revitalization Act was fully in effect.

Further federal efforts to address the DC’s structural imbalance are warranted. To be effective, a federal contribution must be stable and predictable, and it must allow the District to address its most pressing needs. As noted, an annual contribution of up to $1.1 billion is justified.

The bill introduced by Congresswoman Norton would devote the federal contribution to a dedicated fund that could be used for repayment of bonds, school construction, information technology, and transportation costs, including DC’s share of Metro system expenses. The bill’s contribution amount—$800 million—is roughly the mid-point of the range of DC’s imbalance as determined by GAO. This bill would help the District address deferred infrastructure needs without raising its debt. It also would allow the District to use these federal funds for certain operating expenses, such as debt payments, which could free up funds that the District could use to address high service costs in other areas, such as health care.

For example, an annual federal contribution of $800 million would enable the District, over the next decade, to address one-third of its major deferred capital maintenance needs, cut its high debt level in half, and address one-fourth of the burdens of state-level services it now provides.

Another way to set the size of a federal contribution would be to measure the services provided by the District that are funded at the state level elsewhere. Each year the District spends at least $1.2 billion on services that typically are funded entirely at the state level. This includes costly program areas, such as mental health and foster care.

Whichever method is used to compute the size of an annual federal contribution, it would make sense to permit the District to use this contribution to address high service delivery costs, as well as to make infrastructure investments. This would be an appropriate response to the problems resulting from DC’s structural imbalance as identified by GAO.

Federal compensation for DC’s structural imbalance would allow the city to make substantial progress on some its greatest challenges and become an even more welcoming place as the nation’s capital.

A New Federal Contribution to the District of Columbia?
The Need, Likely Impact, and Some Options

A 2003 study by the General Accountability Office confirmed something that DC leaders and a number of academic analysts have noted for years: the District of Columbia faces a large gap between its ability to raise revenues and the cost of providing basic services. The study found that the structural imbalance results directly from factors related to DC's unique status as the nation's capital.[1]

- **The costs of delivering services in the District are far higher than in any other state:** As a city not embedded in a state, DC bears high public service costs associated with urban areas—resulting from high rates of poverty and crime and a high cost of living— on its own. According to GAO, the amount the District must spend to provide an average level of basic services is higher than the cost of providing the same services in any state. In fact, DC's service costs are one-third higher than even the number two state—New York. Notably, the GAO analysis did not factor in any of the costs associated with being the nation's capital, such as public safety costs for national demonstrations. If such costs had been quantified, the gap between the District and other states would likely be even wider.

- **DC's revenue capacity is restricted significantly by the federal presence:** Federal law prohibits the District from taxing the income of people who work in the city but live outside it, which represents roughly two-thirds of those who work in DC. In the rest of the nation, standard taxing authority allows jurisdictions to tax all economic activity that occurs within their borders, including income earned by non-residents. The federal prohibition results in a revenue loss of roughly $1.4 billion every year. The District's revenue capacity also is limited by the fact that roughly 40 percent of its land is exempt from the property tax, including federal properties, embassies, and non-profits that locate in Washington as the seat of the federal government. The federal government also does not pay corporate income tax or sales tax.

DC's Structural Imbalance Likely to be at Least $900 Million, Largest in the Nation

The GAO measured DC's structural budget imbalance by comparing the revenues that could be raised with an average tax system with the cost of providing an average level of services. In both cases, the averages were determined using data covering all states and localities. Using a variety of different assumptions, GAO found that DC's structural imbalance ranges from $470 million to $1.1 billion. A review of these methods suggests that the most reasonable assumptions place the budget gap at $900 million to $1.1 billion, making it the largest structural imbalance in the nation.

- GAO assessed the amount the District would need to spend to provide a typical set of services using both a "state" and "urban" basket of services. The cost of the urban basket—reflecting the mix of services that densely populated urban areas must provide—was $325

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[1] Government Accountability Office, 2003, "District of Columbia Structural Imbalance and Management Issues," GAO-03-666.

million higher than the cost of the state basket of services. Using the urban basket of services raises the structural gap to a minimum of $800 million.

- The GAO measured DC's capacity to raise revenue in two ways. The first relied primarily on income levels in DC and thus measured the city's general capacity to raise revenue. The second measure took into account the actual taxes that states and localities utilize and measured what the District would raise if it used those taxes and had average rates. The latter approach appears more reasonable because it takes the actual taxing experience of states and localities into account. The revenue capacity estimate under this approach is about $100 million lower than the income-based estimate.

Using the most reasonable assumptions about expenditure needs and revenue capacity, the DC structural budget imbalance would fall between $900 million to $1.1 billion.

The GAO found DC was not alone in facing structural budget gaps and that many states face such gaps although for different reasons. Nevertheless, the gap in DC is larger than in any other state, when measured on a per capita basis.[2]

It is worth noting that the GAO report found that the District's structural imbalance could not be resolved through improved efficiency. The gap would remain even if services such as police, fire, and schools were provided at average levels, given the city's high cost of living and demographics.

"Statelessness" Contributes substantially to the District's Imbalance

The District provides virtually all services that other states provide, but it has the profile of a city. Its urban profile, particularly its high poverty rate, is a major factor behind its structural imbalance.

- DC's poverty rate—17 percent in 2002–2003—ranks among the top five in the nation and is far higher than in neighboring Virginia and Maryland. The DC poverty rate is more than three times the poverty rate in the suburban jurisdictions of the Washington metro areas. This suburban-urban poverty gap is higher than in most U.S. major metro areas.

- The GAO study found that the District's statelessness results in high costs to provide public services for other reasons, as well. The GAO found that the cost of providing services in a densely populated urban area, including a greater need for public safety expenditures, adds $325 million to DC's annual operating costs.

DC bears a large share of costs for meeting social service and other needs for the Washington metropolitan area, without receiving the kind of state-level aid that other cities receive. For example:

[2] The GAO found that when measured as a percentage of own-source revenue, the structural imbalance ranged from sixth in the nation—based on a $470 million estimate—to the largest in the nation when using the $1.1 billion estimate.

- Some 25 percent of DC residents receive health coverage under Medicaid, a higher percentage than in any state. DC's higher-than average Medicaid enrollment stems entirely from its high poverty rate and demographic profile and does not reflect more generous eligibility rules, according to GAO.

- While the District represents just 10 percent of the population of the Washington metro areas, it accounts for roughly 60 percent of the metro area's homeless population. In 2002, some two-thirds of metro area families receiving Temporary Assistance for Needy Families welfare were DC residents.

District Infrastructure Needs Cannot Be Met Under Current Fiscal Constraints

Like many older cities, the District has substantial unmet infrastructure needs. Most of its school facilities are old. Road and bridge repair needs are tremendous.

These needs stem in part from significant under-investment and lack of maintenance through much of the past three decades. The limited ability to meet service needs created by the structural imbalance may have led to decisions to defer maintenance and upgrade outdated facilities.

The legacy of deferred maintenance has resulted in a seeming paradox today: the debt that the District has assumed to meet infrastructure needs is extremely high, yet the city is not able to support infrastructure investments at a level that would address its full needs.

- In fiscal year 2000 the District's debt per capita was higher than in any state, even when debt of local governments is included. The District's debt as a percentage of its revenue capacity also is higher than in any other state.

- The District's debt continues to grow. Since FY 2001, outstanding debt has increased from $2.6 billion to $3.6 billion. Under current plans, overall debt will rise by about $100 million per year, as the city will pay off roughly $200 million in current debt but issue $300 million in new bonds.

Nevertheless, the amount the city plans to borrow in the near future to support its capital improvement plan is limited by concerns that higher debt levels would affect the city's bond rating adversely. The full extent of the District's unmet capital needs is unknown because a thorough assessment has not been done. Yet there are several indications that planned capital spending will address only a share of the city's infrastructure needs.

- The cost of modernizing DC public schools is $1.7 billion to $2.9 billion, but planned capital expenditures for schools by the city over the next six years total roughly $740 million.[3]

[3]The DC Chief Financial Officer estimates modernizing costs at $2.8 billion. The 21st Century School fund, a nonprofit organization that studies District of Columbia Public Schools facility needs, estimates these costs at $1.7 billion to $2.8 billion.

- The GAO study identified $3.3 billion in deferred maintenance as of FY 2003.

- The DC Chief Financial Officer's list of deferred capital funding needs for the period from 2005 through 2010—projects that will not get funded due to limited capital funding—totals $3.5 billion (This figure includes deferred school renovation needs).[4] This figure is likely to be understated because a comprehensive assessment has not been done. For example, the CFO identifies total capital needs for basic government facilities (such as police stations and human services facilities) at roughly $500 million between 2005 and 2010. Yet the Office of Property Management (OPM) recently determined maintenance and replacement needs for these facilities to be $286 million per year—or $1.7 billion over six years. OPM also identified a backlog of $500 million in needed repairs. When these recent OPM figures are considered, the amount of unmet capital needs over the next six years rises to $5.2 billion.

Structural Gap Remains Despite Recent Financial Progress

Although the District faces a structural budget imbalance, it must balance its budget every year. The GAO study found that the District lives within its means by spending less than what is needed to provide an average level of services in an urban environment and by raising more taxes than average.

As a result of strong economic conditions, the District has had substantial budget surpluses in some recent years. For a variety of reasons, however, these surpluses are not a sign that the District no longer has a structural imbalance.

First, the budget surpluses stem in part from DC's somewhat unique circumstances as a city under federal control. The District must plan its budget well in advance of the fiscal year because it must be approved both locally and by Congress. This makes it difficult to project revenue collections accurately. If actual revenue collections in a given year are higher than expected, it is difficult to adopt a supplemental budget because this requires full federal review and approval.[5] Instead, additional revenues result in a budget surplus.

Second, the progress in recent years has been built largely on the back of a tremendously strong real estate market, which is not guaranteed to continue. Other revenue collections have not been this strong. For example, income tax collections fell $240 million between 2002 and 2003, and projected income tax collections in FY 2006 are 15 percent lower than FY 2002 collections, after adjusting for inflation. This suggests that the District's healthy finances in recent years are not necessarily an indication of long-term fiscal health.

A bill to issue a $1 billion bond for school modernization was introduced to the DC Council in 2005, but it has not been adopted as of this writing. One of the issues surrounding this bill is whether the District has the capacity to assume additional debt of this level, given its substantial existing debt.

[4] This figure does not include projects funded through the Highway Trust Fund or through enterprise funds of the District, such as the Water and Sewer Authority.

[5] The District can adopt tax reductions in the middle of the fiscal year without going through the extended review that a supplemental budget requires.

Third, and perhaps most important, the surpluses of recent years have not changed the fundamental factors behind the District's structural imbalance—namely that it is a city with well above average public service costs and a restricted tax base lacking support from a state. Notably, the improvement in DC's financial position has not improved its ability to address deferred infrastructure needs.

Where Do We Go From Here?

The parameters of DC's structural imbalance are now understood better than ever. The GAO study confirms that the District's problems stem from District's statelessness and from federal restrictions on its ability to raise revenue. Both of these factors call out for a federal solution. A new form of federal compensation to the District could help the city address some of the most pressing effects of its structural imbalance, while also making the nation's capital a top quality urban setting for both residents and visitors. A federal contribution could be used in a variety of ways, such as:

- Reducing its very high debt levels;
- Addressing unmet infrastructure needs; and
- Financing more of the state-level functions that still burden the District's budget.

Federal compensation also must be predictable and stable, so that the city can incorporate the funds into its regular budget process and conduct proper planning for the use of the additional resources.

It is worth noting that federal legislation enacted in 1997, the DC Revitalization Act, reflected an awareness of the federal responsibility to address the fiscal challenges DC faces as the nation's capital. Under that law:

- The federal government assumed responsibility for the unfunded portion of pension liability for DC government employees, which developed largely prior to the District's assumption of Home Rule in 1973. This can be viewed as a federal obligation rather than special assistance to the city.
- The federal government assumed responsibility for the District's court system as well as a number of corrections functions, most notably the District's felon population.
- The federal share of DC's Medicaid costs rose from 50 percent—the lowest possible federal match rate—to 70 percent, a level more in line with other states that have very large Medicaid-eligible populations. DC's Medicaid match rate is now one of the highest in the nation, though it remains lower than in some states.

The 1997 Revitalization Act also eliminated the annual payment the federal government had made to the District. The federal payment had exceeded $600 million throughout 1990s. Overall, the Revitalization Act appears to have provided at least a modest net fiscal benefit to the

District. In 1998, DC's local budget fell by more than $700 million as a result of the Revitalization Act. The federal payment, which had been $666 million in FY 1997, was phased out over two years.

Nevertheless, the Revitalization Act did not eliminate the city's structural imbalance. The 2003 GAO study that identified the District's fiscal imbalance fully took into account the Revitalization Act changes.

One option for addressing the structural imbalance is a bill introduced by Congresswoman Eleanor Holmes Norton. As described below, this bill would enable the District to address the major problems stemming from its imbalance. At the same time, other options for designing federal compensation to the District are worth considering.

The Norton Bill

On May 4, 2004, Mrs. Norton introduced a bill, H.R. 4269, entitled the "District of Columbia Fair Federal Compensation Act of 2004". The bill's stated purpose was to "establish an annual federal infrastructure support contribution" for the District. The bill was co-sponsored by all of the area's House delegation including Tom Davis (R-VA), chair of the House Government Reform Committee to which the bill was referred.[6] Sens. DeWine and Landrieu, the then chair and ranking minority members of the Senate Appropriations Subcommittee on the District, also expressed support for the bill. Norton has reintroduced the bill in the current session of Congress with the new bill number H.R. 1586.

H.R. 1586 would establish a "Dedicated Infrastructure Account" in the DC general fund. The federal contribution to the account would start at $800 million, and the amount would be adjusted each year by 4percent or the Consumer Price Index if it is higher than 4 percent. The federal funding would constitute mandatory spending, meaning that once the bill became a law, the annual contribution would be provided to the District without annual approval through the congressional appropriation process. All funds in the account would be available until expended and would not lapse if not used in the year provided. Interest could be earned on the funds in the account and be used for the same purposes as the principal.

The bill states that funds in this dedicated account could *only* be used for the following purposes:

- Transportation activities, including payment of the District's local share for the Washington Metropolitan Area Transit Authority (Metro) and for road and bridge construction and improvement projects;

- Information technology improvements in the District government;

- DC debt service payments; and

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[6] Also on board as original co-sponsors were Frank Wolf (R-VA), chair of one of the ten Appropriations subcommittees; Steny Hoyer (D-MD); House Democratic Whip Elijah Cummings (D-MD), chair of the Congressional Black Caucus; Jim Moran (D-VA); Albert Wynn (D-MD); and Chris Van Hollen (D-MD).

- DC Public School and public charter school building and facility maintenance, construction and capital improvement projects.

Table 1.

2005 Operating Budget	($ in 000s)
Debt service[7]	$ 347,700
WMATA share	164,163
Public Charter School facility allowance[8]	34,000
DC Public Schools maintenance	23,000
2005 Capital Budget	
Transportation (DDOT)	24,750
WMATA	42,800
Information Technology	40,324
DC Public Schools construction[9]	174,409
Total	$ 851,146

Table 1 identifies the amount that the District budgeted for these functions in fiscal year 2005. It shows that if the Norton bill were now in effect, DC would be able to utilize the federal funds fully for the intended purposes. The distribution of funding among the several functions listed in Table 1 varies significantly from year to year and thus is presented here only to illustrate the order of magnitude of support for these activities in a recent fiscal year.

The design of the Dedicated Infrastructure Account actually gives the District significant flexibility to address problems resulting from its structural imbalance. Perhaps most notable is the ability to use the federal funds for annual debt service costs. These are the interest and principal payments the District makes each year for bonds that have been issued to support its capital improvements program covering all infrastructure projects. Under the Norton bill, the District could issue additional general obligation bonds to support a variety of infrastructure projects—such as libraries and health centers—and use federal funds in the Infrastructure Account to pay off the added debt service costs that would be incurred.

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[7] The District's Office of the Chief Financial Officer estimates that a relatively small amount of the debt service costs in FY 2005 will be attributable to borrowing for capital activities covered by the table above. To that minor extent, there is some double counting in this table.

[8] Data on the rehabilitation and construction needs of public charter schools in the District, beyond what is covered under the public charter schools facility allowance, are not available.

[9] Since the table presents what the mayor and Council approved for the 2005 budget year, it also does not include the additional $125 million requested by the DC Public Schools as part of its long term capital plan but not approved by the mayor and Council.

Were the city to have available an annual federal infrastructure contribution starting at the $800 million level proposed in Congresswoman Norton's legislation, the mayor and Council might well decide to utilize the funds in one or a combination of ways. For example, the city could use the funds to:

- **Address unmet infrastructure needs in one or more targeted areas:** The city might decide, for example, to double the capital budget for school construction and rehabilitation from the $98 million projected for FY 2007 to $200 million.

- **Address other infrastructure needs:** As noted, the District could issue new bonds for a variety of capital projects such as libraries, and use federal funds to cover the higher debt service costs.

- **Reduce DC's high debt burdens:** The District could use the federal funds to pay directly for school and transportation projects, rather than supporting those projects with bonds. This would reduce the need for new general obligation borrowing. Over time, this would reduce the District's total debt as it paid off prior bonds while limiting the number of new bonds issued.

- **Relieve pressure from high costs of delivering basic services:** Funds currently devoted to debt service and the WMATA subsidy compete with funds for other operating costs (as opposed to infrastructure costs), such as public safety and health care services. The District could use federal funds in the infrastructure account to replace funds currently used for debt service and WMATA, and then use the freed up operating dollars to increase services elsewhere in the DC budget, including the many costly state-level functions the District must support; for example, the city might invest in improved primary health care delivery with these funds.

An Alternate Approach: Tying Federal Compensation To the Costs of State-like Services provided by the District

The legislation proposed by Congresswoman Norton is an important response to the District's substantial structural deficit as identified in the GAO report. Her approach would focus federal relief on a small number of specific programmatic functions. Another approach that may be worth considering is to look more broadly at the various major public programs and services that the District supports which in most of the 50 states are funded by the state level of government. This is the approach that was taken by the president and Congress in constructing the 1997 DC Revitalization Act. Under that Act, the federal government assumed the costs of the DC court and prison systems (except for the DC jail). It also increased the federal share of the District's Medicaid costs from 50 percent to 70 percent. These decisions were justified by the sponsors as appropriate on the grounds that the federal government was taking over state-like functions that in most cities are not funded with locally-raised revenue.

A number of recent studies have sought to identify the range of the state-like functions supported by the city.[10] It should be noted that sorting out such functions among state, county and municipal systems in this country requires some judgment calls since across the 50 states there are usually exceptions to every rule. As Philip Dearborn and Carol Meyers pointed out in their 1997 study of District service costs[11]:

> "(T)here is no clear definition of what are local services and what are state services, nor is there any clear division as to which government finances those services. Each state makes its own decisions about the appropriate division. The best we can do is to list those services that most often are financed by state governments, those that are most often financed locally, and those that are generally financed by both."

With the above caveat, however, it does seem clear that there are still a number of functions currently financed and managed by the District government that are normally funded in whole or in large part by states in our federal system. To the extent to which the federal government assumed the financial burden for some or all of these costs, such relief would permit the District to address directly the structural deficit identified in the GAO report. Because many of these functions are ones that the federal government does not directly administer at the national level, it would be best to view such an approach as one where the federal government is financing these functions as if it were the state for the District but where the District would be expected to carry out these functions as an agent of the "state." This corresponds with the way counties often act as agents for their state governments in carrying out various health and social service programs.

Table 2.

Program Function	2005 Local Funds (Operating) ($ in millions)
Medicaid (remaining 30% share not paid by federal gov't)	$ 362
Mental Health	153
Child and Family Services	143
Human Services	259
UDC subsidy	50
Motor Vehicle registration and inspection	41
WMATA operating subsidy	164
Total	$1,172

[10] Philip Dearborn and Carol Meyers, "The Necessity and Costs of District of Columbia Services." as provided to the District of Columbia Financial Responsibility and Management Assistance Authority, Brookings Greater Washington Research Program, 1997.
District of Columbia, 2004, "Report to the Senate Committee on Appropriations: Issues and Approaches for Addressing the District of Columbia Structural Imbalance Between Public Service Needs and Public Financing Resources," (the "DeWine Report").

[11] Dearborn and Meyers, pp. 15–16.

There are many other functions which are typically shared broadly between states and their local governments, one of the largest categories of which is elementary and secondary education. We chose not to include any of these functions in this analysis because there is not a predominant practice upon which to base a formulation for the District. As a result, the $1.1 billion total in the table above is a conservative representation of the actual level of city funds currently devoted to the full range of state-like functions.

It would be impractical to design a federal contribution around an ever changing array of operating levels for certain identified District government functions. Instead, a more workable approach might be to follow the structure of the Norton bill by setting a starting amount for this contribution that is tied to the total for these functions. Annual increases thereafter would be needed using a standard formula such as growth in the CPI but not less than a minimum amount (the minimum level in the Norton bill is 4 percent growth). It also would be sensible to provide for some periodic revisiting of this base calculation (such as every five years) in such a way that the base could be recalculated to account for significant changes in funding levels for the aggregate of these various functions that may occur over time.

The GAO finding that the upper end of the structural deficit facing the city each year is about $1.1 billion (in 2003 dollars), coupled with the calculation above that shows current state-like functions costing the District nearly $1.2 billion, confirms that it is supportable to peg the size of a federal contribution at or above the $800 million level proposed by Congresswoman Norton in her bill.

A Combined Approach May Work Best

The Norton bill is designed to address the infrastructure problems resulting from the District's structural imbalance. Tying federal compensation to the state-level functions currently funded by the District would partly address the GAO finding that service delivery costs in DC are higher than in any state, and it would be consistent with the step taken in the 1997 Revitalization Act to increase the federal share of DC Medicaid costs.

Both approaches are legitimate, and thus a combined approach may make sense. Federal funds to compensate for the District's structural budget imbalance could be used either for infrastructure investments or to address high service delivery costs. While this approach is broad —and may go against congressional interests in defining narrowly how federal funds are used by the District— it would be an appropriate response to the problems resulting from DC's structural imbalance as identified by GAO.

It is impossible to determine exactly how the District would use federal funds under such circumstances, but it is likely that they would be used in at least three ways: addressing unmet capital needs, reducing the District's high debt, and addressing costs of state-like functions.

For illustration purposes, it is worth exploring the impact of dividing the federal funds among these purposes equally. The $800 million fund would support nearly $270 million for each of these functions if divided equally, which would have the following effects:

- **Addressing Unmet Capital Needs:** As noted, deferred infrastructure projects now total roughly $5.3 billion over the next six years. Devoting an additional $270 million in federal funds to these projects would enable the District to address roughly one-third of its deferred maintenance projects.

- **Reducing DC's Substantial Debt:** Outstanding general obligation debt now totals $3.6 billion and is growing at a rate of about $100 million per year. Using $270 million in federal funds to finance currently planned projects—using "paygo" financing—would reduce the city's need to borrow by this amount. Over 10 years, this would reduce the District's outstanding debt from $3.6 billion to $2.1 billion. Without this level of paygo capital financing, outstanding debt would rise to roughly $4.4 billion during this period.[12] In other words, using federal funds in this way would reduce the District's debt by more than half from current projected levels**.** *Because DC's debt per capita has been far higher than the debt per capita in every state, a reduction of this magnitude is likely to still leave the city's debt at an above-average level***.[13]**

- **Offsetting High Costs of State-Level Services:** $270 million would cover roughly one-fourth of the state-level functions identified above.

Conclusion

The purpose of this paper has been to revisit briefly the rationale for the view that the District suffers from a structural imbalance and then to consider several ways in which legislation might be crafted to help close the city's funding gap. We have noted two such approaches, the most promising of which may well be the federal infrastructure contribution advanced by Congresswoman Norton in her pending bill, H.R. 1586. The Norton bill is an especially attractive option given the breadth of support for the concept from the all important congressional delegation representing the area's suburban communities in Maryland and Northern Virginia. We have also suggested that consideration could be given in the alternative to an approach which pegs a federal contribution to some percentage of remaining state-like functions still borne by the District. A combination of these two approaches might work with the federal contribution being based partly on a continued effort to further relieve the District of the burden of financing various state-like functions and partly on a desire to assist the city in improving its many badly outdated public facilities.

[12] These figures are based on the District's current plan to issue $300 million in new bonds per year. It assumes that by using $270 million in federal funds for paygo capital financing, new bond issuances would be limited to $30 million per year. Outstanding debt would be reduced as the District made debt service payments on existing bonds (an average of $180 million in principal payments per year over the next 10 years) while only issuing $30 million in new bonds.

[13] In 2000, according to GAO, DC's debt per capita was more than three times the state and local debt per capita in the median state. If DC's debt were reduced by half, its debt per capita could still be above that of the typical state.

If a federal contribution to the District is provided in stable, predictable amounts over time, we would expect the District would consider taking advantage of this flow of critical additional resources to gradually reduce its currently quite high per capita borrowing burden on its citizens and similarly to adjust the overall tax burden on its taxpayers to bring those rates more in line with the average levels in this metropolitan area.

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For More Information:

Ed Lazere
Executive Director
DC Fiscal Policy Institute
lazere@dcfpi.org

David Garrison
Senior Fellow and Deputy Director
Brookings Greater Washington Research Program
dgarrison@brookings.edu
202-797-6289

DC Fiscal Policy Institute
An Affiliate of the Center on Budget and Policy Priorities
820 First Street, NE, #610, Washington, DC 20002
(202) 408-1080 · Fax (202) 408-8173
www.dcfpi.org

THE BROOKINGS INSTITUTION
WASHINGTON, DC
Greater Washington Research Program
The Brookings Institution, 1775 Massachusetts Ave., NW, Washington, DC 20036
(202) 797-6000 · Fax (202) 797-2963
www.brookings.edu/washington