Greater Washington Research Center

Policy Brief

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April 2000

# Potential Problems in the District's 2001 Budget

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The District's financial recovery is at a critical stage and will be threatened unless sound budget decisions are made over the next several weeks. While these decisions must be made by the Mayor and the District Council, they also will need public support and understanding. This policy brief is intended to draw attention to the problems related to balancing the 2001 budget.

Although the city had an accumulated surplus in excess of $200 million at the end of fiscal year 1999 and will add modestly to that surplus in fiscal year 2000, the surplus should not be a reason for complacency when considering the 2001 budget. In fact, **there is no room in the 2001 budget for either a tax reduction or discretionary increases in program expenditures, unless dollar for dollar reductions in spending are made in other parts of the budget.**

**Budgeting Rules**

Under the ground rules established by Congress for the District, current revenues must equal or exceed current expenditures to have a balanced budget. Failure to achieve budget balance will result in continued control board oversight, despite the presence of an accumulated surplus. Although contrary to budgetary rules followed by other state and local governments, the congressional ground rules for the District's budget say accumulated sur-

**Changes in District's Budget 1998-2001**

| | Actual 1998 | Prelim. Unaudited 1999 | Budget 2000 | Proposed 2001 |
|---|---|---|---|---|
| **Local Revenues** | $3,048.1 | $3,090.6 | $3,211.9 | $3,196.0 |
| Percent Change | 10.0% | 1.4% | 3.9% | -0.5% |
| **Expenditures** | $2,725.8 | $2,964.0 | $3,133.9 | $3,195.5 |
| Percent Change | N.A.* | 8.7% | 5.7% | 2.0% |
| **Revenue over Expenditures** | **$322.3**** | **$126.6**** | **$78.0** | **$0.5** |

*Not comparable because of shift in responsibilitites to federal government in 1998.
**Does not include $198 million federal contribution in 1998 and audit adjustments in 1998 and 1999.

plus may not be used to balance annual budgets. Moreover, to insure that unanticipated expenses will be covered, Congress requires the District to include a $150 million reserve in each year's budget. The reserve can be spent only for emergency one-time purposes. Therefore, all necessary spending for 2001 must be budgeted without consideration of the accumulated surpluses or the reserve.

**Development of a Budget Problem**

In fiscal year 1998, the District had a banner year with revenues increasing over 10 percent and the federal government making a contribution of $198 million. The result was a whopping excess of revenues over expenditures for the year. The optimism generated by this good year had two potentially problematic consequences. First, expenditures in 1999 were increased 8.7 percent over 1998. Second, a $286 million five year tax reduction package was enacted beginning in fiscal year 2000. The tax reduction for 2000 was relatively small and left sufficient revenue to support an expenditure increase of 5.7 percent over the 1999 expenditure level.

In 2001, however, the tax reduction package reduces revenues by about $134 million and leaves the District with 0.5 percent less revenues compared to 2000. To live within those revenues, the budgeted expenditures can increase only 2 percent over the budgeted 2000 expenditures. In the meantime, several District agencies are having trouble staying within the 2000 budget. Actual 2001 spending, therefore, may not be able to increase at all over the actual 2000 spending. In addition, cost estimates for increases in pay, foster care, fire fighting staff, and other 2001 spending commitments already exceed available revenues in 2001.

**The Mayor's Proposal**

In the 2001 budget presented to the Council, the Mayor proposes to provide additional funding for education and other programs by making $62 million worth of reductions from unspecified activities in agency budgets. Without knowing which agencies or programs are to be cut, it is impossible to judge whether reductions of $62 million are possible. The 2001 budget also seems to include an underbudgeting of Medicaid and some other required expenditures in order to fund budget increases. It is hard to determine the exact amounts by which some activities may be underbudgeted. Further, the Mayor proposes to use $107 million of the mandated $150 million reserve to meet some vital city needs, such as $35 million for increased charter school enrollments. This proposed use of the reserve does not seem to fit the Congressional guidelines for its use. For all these reasons, the Mayor's proposed budget appears not to meet the balanced budget test required under the District's budgetary rules.

**Mayor's Alternatives**

In response to objections raised by the Council and others, the Mayor has suggested alternatives to his original budget proposal. The following possibilities presented by the Mayor are described and evaluated:

- Proceed with the original $62 million reductions in unspecified agencies and add additional cost savings of $73 million. While there is undoubtedly excess District spending, finding and targeting it at this late stage in the budget process will be very difficult to do. The magnitude of even the $62 million reduction will require targeting public safety, education, and health care budgets. Reductions in these programs can be expected to result in strong objections from the public.

- Postpone or eliminate tax cuts scheduled for 2001. This alternative is a simple but clearly controversial answer that would provide about $64.4 million in additional revenue.

- Eliminate the $150 million reserve requirement rule and require only that the District maintain at least a $250 million accumulated surplus for emergencies. This change would bring the District into conformity with the Generally Accepted Accounting Principles that are followed by most state and local governments. Since the District is likely to have over $250 million in accumulated surplus at the end of its 2000 fiscal year, there would be no requirement for budgeting $150 million reserve in 2001. At the same time, however, the requirement for a balanced budget would remain in effect to encourage conservative budgeting. Such a change in policy would have to be approved by Congress and is unlikely to happen soon enough to resolve the 2001 budget problem.

- Use tobacco settlement funds to achieve a $73 million debt service reduction in 2001. The original budget had proposed to use the $42 million of 2001 and left over 2000 tobacco funds for new health, education, and youth initiatives in 2001. By using most of this tobacco revenue and that of future year's revenues through 2014 to support revenue bonds, a $73 million reduction in general obligation debt service could be achieved in 2001. If used to balance the 2001 budget, it would eliminate the prior proposed use of tobacco funds for new initiatives that have been committed.