EXECUTIVE SUMMARY

Introduction

The idea of making Washington, D.C. a showplace for the rest of the world is not just a dream or vision detached from reality. In the summer of 1995, then Speaker of the House Newt Gingrich attended a community meeting at Washington D.C.'s Eastern High School organized by D.C.'s non-voting delegate, Congresswoman Eleanor Holmes Norton. The District had reached rock-bottom financially the year before, posting a $335 million deficit, and Congress had responded by asserting its authority over the city – creating the D.C. Financial Responsibility and Management Assistance Authority (the "Control Board") to help get the District back on track financially.[3] But this group, gathered just blocks from the Capitol, recognized that the District is a unique city with unique obligations to the American people, and that the Nation in turn has a special responsibility to the city. At the end of that meeting, Speaker Gingrich therefore announced an ambitious goal: to make Washington, D.C. "the best capital city in the world."[4]

Over the following two years, a bipartisan group, including Congresswoman Norton and others from Congress, members of President Clinton's Cabinet, and District officials worked together to enact the National Capital Revitalization and Self-Government Improvement Act of 1997 (the "Revitalization Act").[5] Together, the Control Board and the Revitalization Act set the District on a course back to fiscal well-being. As President Clinton stated in his remarks announcing this economic plan for the District, ***"[t]he city is every American's home, and it should be every American's pride. Our Capital City must reflect the best of who we are, what we hope to become, and where we are going."***[6]

Even at the time, however, it was understood that the Revitalization Act alone would not be enough to build the best capital city in the world. To achieve that goal, additional action would one day be needed. In fact, Congress explicitly recognized this by inserting a provision in the Revitalization Act that allowed the Federal Government to act again at an appropriate moment to expand its partnership with the local leaders of the Nation's capital city.

This report calls upon the Federal Government to join with the District once again to embrace this vision, and move Washington D.C. toward becoming the best capital city in the world. While it may be difficult to achieve universal agreement on a precise definition of what would make the District the best capital, this report defines what a *great* city looks like, and describes the very significant steps the District itself has taken toward that vision since the Revitalization Act. But the report also shows that without an expanded partnership with the Federal Government, the District will continue to struggle to become the great capital city that the Nation expects. And it shows that this is the kind of support that other Nations give to their capitals. Americans deserve no less.

In providing the rationale for an enhanced federal partnership, the authors of this report present the following case:

- D.C.'s unique financial situation and the revenue limitations Congress has placed on it create significant obstacles to the city's becoming a great capital city.

- Congress has long recognized its obligation to support the District in its role as the Nation's Capital.

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- The District has done its part by mounting a remarkable fiscal recovery, and has done so notwithstanding the unique revenue limitations it faces.

- The District's fiscal recovery masks the substantial deferral of needed investments in the city's infrastructure that impact services used by visitors, workers, and residents.

- Other Nations provide such support to their capitals; ours should do the same.

The District has made remarkable progress towards becoming a great city since its economic low-point in the mid-nineties. In particular, it has balanced its budget for eleven consecutive years.[7] But, despite the District's fiscal discipline, it does not have the revenue base to become a truly great city, given the unique economic burdens and revenue restrictions associated with being the Nation's Capital.

In regard to the fourth point above, the report notes that the District has had to impose strict fiscal discipline – suspending maintenance to aging infrastructure and, at times, foregoing investments in important services. Because it already has the highest debt per-capita rate in the country, the District has a very limited capacity to borrow more money to make the basic capital investments that have been deferred in the name of balanced budgets.[8] Even after ten years of increasingly strong performance in budget planning, budget management, and revenue growth, the District still does not have the fiscal capacity to support all of the key functions that are expected by the millions of people who live, work, and visit the capital city each year.

Congress' own investigative arm, the Government Accountability Office (GAO), has stated that, no matter how efficiently the District is run, and notwithstanding the progress it has made, it cannot provide the services and infrastructure of a great city because it simply does not have the revenues to do so.[9] The GAO Report called this a "structural deficit" and estimated that when compared to the average level of services that other urban areas provide, the District had a built-in shortfall of up to $1.1 billion per year.[10]

This report discusses three primary factors contributing to the structural deficit, and why, as a result, an enhanced Federal partnership is necessary in the Nation's Capital.

First, the District is expected to provide all of the services that states do without the broad revenue raising capacity that states have. Other large cities with the same problems as the District have the additional resources of a state government that can generate tax revenue in other parts of the state and redistribute those funds where the need is the greatest.

Second, Congress, by banning an income tax on non-residents, created a revenue-generating challenge that exists only in the District. Two-thirds of the income earned here is earned by non-residents, so the District's ability to generate revenue from those non-residents is severely limited, while the obligation to provide services to them is not.

And third, the District's biggest industry – the Federal Government – does not pay taxes, creating an additional, unique burden for the District. While the Federal Government provides other jurisdictions with payments in lieu of taxes for tax-exempt federal land, the District is excluded from these payments despite the fact that the Federal Government holds 42

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percent of property in the District.[11] There are also a large number of other tax-exempt organizations located in the District because of the federal presence: embassies and consulates; international organizations like the World Bank, International Monetary Fund, and the Organization of American States; nonprofit entities, including several major universities; religious institutions; and hospitals. The tax-exemption for these organizations further exacerbates the District’s lost revenue opportunities.

The report also explains why the new President and the next Congress should embrace the vision of making the District of Columbia the world’s best capital city now.

First, for more than a decade, the District has achieved a remarkable financial turnaround. It has also installed the modern budgetary and fiscal processes necessary to manage the infrastructure projects that it must undertake to become a great city.

Second, the cost of beginning to move toward a great capital city – which our report shows is around $1 billion annually – would be relatively small in the context of the Federal Government’s budget. It would represent only three tenths of one percent of the federal expenditures for FY2009.[12]

Third, Congress is considering spending billions of dollars on infrastructure modernization in order to stimulate the economy now and increase productivity and energy conservation in the long-run. Certainly there is no better place to start investing in the Nation’s infrastructure than in our Nation’s Capital where roads and bridges, public transportation, water and sewer systems, and schools are in serious disrepair.

Fourth and finally, as the United States commits itself to promoting democracy and alleviating poverty around the globe, its capital city should serve as a model for the rest of the world. Our Nation’s Capital should showcase what is best about our country to dignitaries and visitors from around the globe. It should also be a city of which the whole Nation can be proud. And the Federal Government should support the District at least as well as other Nations support their capitals.

We have not attempted to precisely calculate the amount of additional funds required to create the “best capital city in the world.” However, we do quantify the revenue losses suffered by the District under its current revenue limitations and discuss some of the additional expenditures that are almost certainly required if the District is to move to the level of becoming a great city. At a minimum, the District needs around $1 billion in additional annual operating budget to address its most basic infrastructure needs. This amount is also a very conservative estimate of the amount the District loses each year as a result of the restrictions placed on it by Congress and costs associated with the Federal presence. Specifically, we know that: (1) the District loses at least $1 billion annually from the non-resident tax prohibition;[13] (2)

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it faces a minimum of $1 billion annually in expenditures for state-like services it must provide, but for which it does not have state revenue-raising authority;[14] and (3) the size of the District's "structural deficit" resulting from these circumstances is approximately $1 billion per year.[15]

We urge the new President and Congress to embrace this vision of America's capital becoming a model city around the world. Turning this vision into a reality will require the Federal Government to renew its partnership with the District. There are a variety of ways this could be done, and we do not in this report attempt to lay out the details of the appropriate next steps. The point of this report is to show why the new President and Congress need to fashion those steps now.

President Clinton helped move the city forward through the Revitalization Act. President Bush helped the city through his agreement to transfer federal land to the District for use in its economic development. The next President has an opportunity to build on this work and to make part of his legacy the building of the best capital city in the world.

The Sections of the Report

This report features three chapters and two appendices. The chapters show that federal support is essential if the District is to become a great capital city, and that the current level of support falls short of that which other Nations provide to their capitals.

In **Chapter One**, Alice Rivlin, Director of Greater Washington Research and senior fellow at the Brookings Institution, founding Director of the Congressional Budget Office, former Director of the Federal Office of Management and Budget, and Chair of the D.C. Control Board, describes the unique fiscal burdens and limitations associated with being the Nation's Capital. First, the District's spending needs cannot be compared to those of any other city in the country because it must perform the functions of both a state and a city without the financial support of a state. States have a larger base to draw revenues from and can distribute revenue from other, more affluent areas to cities with greater needs. Second, the District does not have the full taxing powers of a state, including the ability to tax non-resident income, which results in a loss of at least $1 billion annually. Third, the District's main industry–the Federal Government and embassies, international institutions, and nonprofit groups that locate here due to the federal presence–does not pay property tax. As Dr. Rivlin points out, "[t]hose federal installations require city services, but do not add to the tax base."[16] Finally, the District was forced to neglect its infrastructure in order to balance budgets, resulting in a number of costly capital needs. Dr. Rivlin explains that, "even with a revived economy, improved leadership, and higher revenues in the current decade, the District still faces the daunting task of repairing, modernizing, and replacing an aging and outmoded infrastructure."[17] She argues that, given these financial restraints, the District simply cannot become a great city without additional resources from the Federal Government.

In **Chapter Two**, Brooke DeRenzis and David Garrison of the Brookings Institution describe the typical characteristics of a great city, and discuss the types of investment in infrastructure and capital projects the District must make to achieve those characteristics. They explain that our Nation's Capital falls short on many of the measures of a great city because much of the District's infrastructure is in demonstrably poor shape. In order to balance budgets, the District deferred massive amounts of spending on important infrastructure improvements, including basic maintenance to schools, upgrades to fire stations, and repairs for bridges and roads. Ms DeRenzis and Mr. Garrison acknowledge that "[t]the District of Columbia is not unique in many of the infrastructure problems that confront it–older cities face similar challenges. However, as the Nation's Capital, Washington is the only city in the country that does not belong to a state, and as such, must fund infrastructure improvements typically covered wholly or partially by states." Deferring these improvements prevents the District from becoming the great capital city that it should be, and affects not only District residents and non-resident workers, but also the experience of visitors. It is difficult to put a price tag on these needed investments, but it is a financial undertaking that is out of the District's reach acting on its own.

Finally, in **Chapter Three**, Garry Young, Associate Director of the George Washington Institute of Public Policy at The George Washington University, offers a comparison between the Federal support that Washington, D.C. receives and the support that 14 other countries give to their capital cities. He shows that these other countries recognize and compensate their capitals cities for the challenges that result from hosting the national government in ways that the United States does not. Indeed, comparable national capital cities do not have the same local budgetary obstacles placed upon them, or if they do, they receive considerably more support from their national government in order to provide the services expected by their citizens and visitors. Mr. Young concludes that relative to the United States, all of "these 14 Nations do more to compensate their cities for the fiscal stresses created by the capital presence."

The report's two appendices present the strong historical case for a strengthened partnership between the District and the Federal Government by reviewing the Revitalization Act and the District's past decade of fiscal accomplishments. The first appendix shows that the Congress agreed to reconsider its commitment to the District once it got is financial house in order while the second appendix shows that the District has in fact done that.

In **Appendix One**, Jon Bouker, former Chief Counsel and Legislative Director to Congresswoman Eleanor Holmes Norton and currently a partner at Arent Fox LLP, and others from his firm describe the work that Congress did in the 1990s to examine the District's fiscal problems and provide some of the resources needed to move the District towards becoming a great city. This includes establishment of the Control Board and passage of the Revitalization Act. As explained in more detail by Mr. Bouker, the Revitalization Act ended the annual mandatory Federal Payment to the District and provided for the Federal Government to assume some of the District's state-like functions. However, Mr. Bouker makes clear that the Revitalization Act "was (and remains today) an incomplete remedy because it alleviates only some of the expenditures that the District must bear uniquely as the National Capital, but it ignores the crippling federally imposed limitations on local revenue." In fact, Congress was explicitly told at the time of the Act that ending the Federal Payment–while continuing to require the District to finance a number of state-like functions without addressing its revenue limitations–would mean that the

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District would never become a great city. Mr. Bouker demonstrates that at the time of the Revitalization Act's passage, Congress and the President knew that the solutions they put in place were neither sufficient nor final, and the Federal Government would one day need to reexamine the District's condition.

In **Appendix Two**, Dr. Julia Friedman, former Deputy Chief Financial Officer of the District and professor at The George Washington University, details the remarkable financial turnaround the District accomplished over the last ten years – moving from massive budget deficits to eleven years of balanced budgets and surpluses. She describes a government in such disarray in the early 1990s that "tax payments [were] characterized (only partly tongue-in-cheek) as gifts from civic minded citizens and businesses." But between 1994 and 1997, the District went from a $335 million budget deficit to a $186 million surplus. And since then, the District has recorded eleven consecutive balanced budgets. As a result of the District government's hard work, the three major bond rating agencies have increased the city's rating from near junk status to approaching the highest rating available – showing Wall Street's optimism for the District's economy and allowing the District to access long-term capital at more favorable interest rates. In short, she shows that the District has made remarkable progress toward becoming a great city, particularly given its current fiscal constraints. Nevertheless, Dr. Friedman makes clear that under current circumstances the District, no matter how well-run, faces enormous challenges to becoming a great capital city because of the congressionally-imposed revenue limitations.

Taken together, these three chapters and two appendices show (1) that D.C.'s unique fiscal situation creates significant obstacles to its becoming a great capital city; (2) Congress recognized its obligation to support the District in that effort and recognized further the need to revisit the issue once the District succeeded in getting its financial house in order; (3) the District has done that job; (4) the District lacks the local resources to make the infrastructure and capital investments needed for it to become a great capital city; (5) the District receives less support from the Federal Government than do capital cities of other democratic Nations; and (6) now is the moment for the Federal Government to address these circumstances and enhance its partnership with the Nation's Capital.

Creating a great capital city comes with a price tag. The chapters in this report all suggest that the needed investment to move towards a great Nation's Capital is around $1 billion per year. This is the amount that the District spends on state-like functions for which other cities are not responsible; it is the amount that the District loses through the congressional ban on a non-resident income tax; and it is the amount that the GAO estimates as the District's "structural deficit."

Conclusion

The District should be proud of its recent economic success. But despite this success, under the current circumstances the District cannot alone make the needed investments to become a great world capital. In order to achieve the balanced budgets that

Congress and sound fiscal policy demand, the District has had to forego spending on needed capital investments and other services. These decisions impact not only District residents, but also millions of visitors to the Nation's Capital who are precluded from seeing a truly great city and millions of commuters who suffer from subpar services. And all Americans are denied a great capital that should serve as a symbol of democracy for the world.

The new President and Congress have an historic opportunity to partner with the District to create a capital city of which we can all be proud. Congress laid the groundwork more than ten years ago with the first Revitalization Act, and it is time for Federal leaders to take the next step. The District's performance over the last ten years shows that it can manage its budget effectively. But, as Alice Rivlin notes regarding the shortfall in infrastructure investment, "This small central city simply cannot carry that burden alone given its truncated tax powers, narrow tax base, and heavy state and local responsibilities." In fact, the report shows that it will, conservatively, take a minimum of $1 billion annually just to compensate the District for the unique burdens it faces as the Nation's Capital. The Federal Government recognized its share of the burden at the lowest point in the District's financial collapse. Now, at the highest point in the District's financial recovery, it is time for the Federal Government to renew its partnership with the District, and help make it the best capital city in the world. The country deserves such a capital. Moving the city toward that vision should be a matter of pride for both political parties and all Americans.

ENDNOTES

3. The District of Columbia Financial Responsibility and Management Assistance Act of 1995, Pub. L. No. 104-8 (1995).
4. Robert Pear, *The Nation; Washington: Not Just Another Big City,* N.Y.TIMES, Aug. 6, 1995.
5. Pub L. No. 105-33 (1997).
6. Clinton, William J., Remarks Announcing the Economic Plan for the District of Columbia, (March 11, 1997).
7. The General fund is a fund into which general revenues are deposited and from which monies are appropriated to pay the general expense of the jurisdiction.
8. U.S. GEN. ACCOUNTING OFFICE, GAO-03-666, DISTRICT OF COLUMBIA STRUCTURAL IMBALANCE AND MANAGEMENT ISSUES 42 (2003) ("GAO Report").
9. *Id.* at 40, 71. As the GAO report points out, the District already has such a high debt level and such high taxes, it could not effectively raise its debt or tax levels without endangering its borrowing capacity and driving residents away – thereby decreasing its tax revenue.
10. *Id at 8.*
11. *Id at 9.*
12. http://www.whitehouse.gov/omb/budget/fy2009/pdf/budget/tables.pdf.
13. A recent report from the office of the District's Chief Financial office has estimated that the ban on a non-resident income tax costs the District as much as $2.2 billion in tax revenue. *See* Yesim Yilmaz, Senior Economist, D.C. Office of Revenue Analysis, Calculating the Impact of Federal Preemptions on the District's Tax Revenue 4 (DRAFT Mar. 5, 2008).
14. *See infra* Chp. 1.
15. *See supra note 8.*
16. *See infra Chp. 1.*
17. *Id.*
18. *See infra Chp. 2.*
19. *See infra Chp. 3.*
20. *See infra App. 1.*
21. *See infra App. 2.*
22. *See infra Chp. 1.*