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BY THE COMPTROLLER GENERAL

Report To The Congress

OF THE UNITED STATES

The Federal Payment To The District Of Columbia: - Experience Since Home Rule - Analysis Of Proposals For Change

About 21 percent, or \$300 million, of the District of Columbia's operating budget comes from a direct Federal payment. Since 1975, when a locally elected government first took office,

- the Federal payment has increased, but it has declined in relation to the total District budget and in purchasing power;
- local tax collections have increased by more than inflation, and the tax burden on moderate and upper income households is relatively higher than in surrounding jurisdictions and in other cities;
- the District tax base is strong and should continue to almost keep up with inflation without rate increases; and
- the Congress has used its power over the Federal payment and the District budget to make changes in programs and to seek improved financial management.

A new method for making the Federal payment and more consistent fiscal data could help District of Columbia officials manage the city better. Although a formula could be used to determine the payment, other approaches could yield the same benefits. Any change in the Federal payment must be a political decision because of the intricate relationship and divergent interests of the Federal and District Governments.



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To the President of the Senate and the
Speaker of the House of Representatives

This report discusses the role of the Federal payment in financing the budget of the District of Columbia government and evaluates proposals to establish the payment on a formula basis.

The amount of the Federal payment and the way the payment is made are issues which continue to generate interest in the Congress and in the District of Columbia government. We prepared this report to assist the Congress in deciding what, if any, changes should be made in the Federal payment or in the Federal-District relationship.

Copies of the report are being sent to the Director, Office of Management and Budget; and to the Mayor of the District of Columbia.

Milton J. Aroslaw

Acting Comptroller General
of the United States

COMPTROLLER GENERAL'S
REPORT TO THE CONGRESS

THE FEDERAL PAYMENT TO THE
DISTRICT OF COLUMBIA:
--EXPERIENCE SINCE HOME RULE
--ANALYSIS OF PROPOSALS FOR
CHANGE

D I G E S T

The amount of Federal payment to the District of Columbia and the process for determining such payment are central issues in the Federal-District relationship. In 1981, the Federal payment, which represents a significant portion of District revenues, is expected to amount to \$295.4 million, or about 21 percent of the District's expected \$1.4 billion general fund revenue.

Since 1978, the authorized Federal payment to the District, which sets the limit on the amount that can be appropriated, has been \$300 million. The President's 1982 budget recommended increasing the authorization to \$336.6 million. The Congress has not acted on Federal payment authorization legislation since 1973, when it passed the District Self-Government Act. (See p. 12.)

District officials would like to have the Federal payment determined by some formula, preferably a set percentage of District revenues. At the same time District officials would like to be totally responsible for local funds--in which case the Congress would not review the District budget except for the part pertaining to the Federal payment. (See p. 1.)

Because of the intricate relationship between the Federal Government and the District of Columbia, the decisions concerning changes in the Federal payment are essentially political. In this report, GAO provides a factual and analytical basis for discussing this issue.

EXPERIENCE SINCE HOME RULE

Since home rule, the Federal payment has declined as a percentage of total District revenue. The Federal payment share of total District general fund revenue increased in the years prior to home rule, reaching a peak of 27.3 percent in 1975 before starting its decline to 20.8 percent in 1981. Although the Federal payment increased

by \$69.2 million between 1975 and 1981, the purchasing power declined by about 16.8 percent during that period when discounted for inflation. (See pp. 11 and 12.)

District tax collections increased by more than the general rate of inflation during the period 1970-80. District tax burdens at most income levels were higher than in surrounding jurisdictions at the time of home rule and have remained so. Since home rule, District personal tax burdens increased slightly compared to those of other large cities. (See pp. 20 and 23.)

The District tax base shows evidence of becoming much stronger as a result of changes during the 1970s. Prior to home rule, increases in local tax rates were necessary in order to achieve an increase in revenues about equal to the national rate of inflation. In recent years, local tax collections taken as a whole have been increasing at rates much closer to national inflation without recourse to rate increases. However, Federal grants received by the District government have not increased nearly as much as prices since home rule, and this important source of program financing is expected to decline in 1981. (See pp. 20 and 25.)

DISTRICT GOVERNMENT'S PROJECTION
OF REVENUES AND EXPENSES

The Mayor is required by law to prepare and submit with the annual budget a financial plan for the future. The plan that was submitted with the 1982 budget was classified as a planning document and not necessarily a projection of future city spending levels that will actually be recommended in future budgets. This "hold the line" projection assumes

- no new taxes or changes in tax rates,
- no increase in the Federal payment from the current \$300 million authorization, and
- maintenance of existing levels of service and employment.

The 1982 plan projects a revenue shortfall for future years ranging from \$40 million in 1983 to \$173 million in 1986. The gap could be closed by reducing expenses, increasing the tax rate, enlarging the tax base, taxing non-residents, increasing the Federal payment, or any combination of these alternatives.

The economic assumptions which lie behind the plan's projections are not stated, which makes it impossible to tell how revenues and expenses compare with inflation. However, the projection appears to assume that the District of Columbia economy will grow at a rate of 3 percent each year, but how much of this increase is price and how much represents real growth is not stated. (See pp. 29 and 30.)

The plan does not provide information on past revenue collections or past expenditures. Also, the assumptions with respect to inflation, growth in the economy, demographic changes, service populations, expected wage and salary increases, number of employees, and availability of Federal grants are not stated. The plan does not show how the proposed budget and those estimated for future years compare to trends in past years in such areas as growth in District revenues compared to inflation. (See pp. 29 and 30.)

In addition to closing the gap between revenues and expenditures, a current problem is how to finance previous years' unfunded obligations, which totaled \$155 million in 1980. GAO's report, however, does not concentrate on the nature of the District's current deficit problems or the need for a bond issue to pay off the accumulated deficit. (See pp. 33 and 34.)

The District has not fully complied with provisions of the Self-Government Act which require the Mayor to prepare budgets reflecting expenditures for the immediately preceding 3 fiscal years. Data that was provided was not presented consistently and thus was not comparable over time. Also, data was not available which would allow comparison between general fund revenues, expenditures, and appropriations. This data is necessary if the District, the Congress, and the public are to effectively analyze the District's financial performance over time. (See p. 38.)

EVALUATION OF ARGUMENTS FOR A
FORMULA-BASED FEDERAL PAYMENT

One of the ways of increasing District revenues is by increasing the Federal payment. The increase could be provided through a lump sum appropriation as it is now or through a formula-based payment plan. GAO analyzed the different formulas in terms of seven issues associated with formula-based payments. The issues were

- preserving the Federal interest,
- amount of payment,
- predictability of the Federal payment authorization and appropriation,
- District government autonomy,
- incentives to increase efficiency,
- timeliness, and
- ease of administration.

Overall, a formula-based Federal payment should not be viewed as an end in itself but as a means to achieve the broader purpose of providing a more systematic basis for determining the Federal Government's share of the District government's expenses. Use of a formula, however, is not the only way to achieve this goal. For example, the Federal payment could be appropriated 1 or 2 years before the fiscal year begins so that the District would have a specific amount to include in the budget for planning purposes. Under any approach, the Congress could still direct changes to be made in specific budget items. (See pp. 41 and 57.)

CONCLUSIONS

How much the Federal payment should be in 1982 and subsequent years and whether changes should be made at this time in the way the Federal payment is provided to the District are essentially political questions that the Congress must decide. GAO did not attempt to answer these questions, but it did reach the following conclusions about formula-based Federal payments and about the relationship of changes in the payment mechanism to improvements in District financial management.

The arguments for and against a formula-based payment are complex, even when viewed strictly from the perspective of the Federal interest. It is not the case that all arguments for a formula favor the District as opposed to the Federal interest.

Issues associated with the desirability and nature of a Federal payment formula would be easier to resolve if

- there were an explicit effort by the Congress, OMB, and the District government to establish service goals for the District's population and service groups in an inflationary environment;
- the informative content and reliability of budget information provided by the District government to the City Council, the public, and the Congress were improved;
- the impacts of inflation and of economic and demographic changes on the District's revenues and expenses were better understood; and
- the District government made improvements in program and financial management.

If a formula-based approach were to be seriously considered:

- No one formula approach can be demonstrated to be theoretically superior, nor can the proper form of a formula be calculated free from judgments about what represents a fair Federal contribution to the government of the Nation's Capital.
- Formula-based Federal payments that would provide more funds to the District of Columbia than needed for efficient management of essential public services would not contribute to improved financial management. This situation could result if the formula was set on the basis of an abstract concept (such as revenue lost) or if a percentage of revenue was set too high.
- If a formula approach is to be used, formulas that utilize such items as past revenue collections, U.S. inflation in the previous year, or changes in District population as measured

by the Bureau of the Census are easier to administer than formulas based on future year estimates or on estimates of more intangible items, such as taxes lost, net financial burden, or tax comparability.

--A complex formula may be needed to take into account the various factors (inflation, population, efficiency, local tax effort, wage and salary increases) that would be involved in determining the initial level of the formula and its year-to-year change.

Some of the benefits associated with a formula approach can also be achieved by other changes in the way the Federal payment is authorized and appropriated and in the way the District budget is reviewed by the Congress.

The District government's ability to manage its revenue, employee compensation, and program management responsibilities would be improved if the District government had a clear idea about the amount of the Federal payment likely to be appropriated at the time it prepares its budget (18 months before the beginning of the fiscal year).

Annual congressional review of District financial affairs, including indepth investigation of certain matters and the ability to direct that certain things be done or not done, appears to be essential for maintaining the Federal interest on a continuing basis. It also provides a check and balance system for District finances. However, since the nature of the Federal interest would generally not be expected to change much from year to year, annual congressional review of District finances would not necessarily require line item review of the entire budget or appropriation of the entire District budget by the Congress.

Adoption of a formula-based Federal payment or other changes in how the Federal payment is provided to the District of Columbia are not required to achieve many important objectives for improved financial management in the District of Columbia. The budgets of most ongoing programs are largely unaffected by the uncertainties associated with the Federal payment process. A properly functioning accounting

and budgeting system is needed and should be established regardless of how the Federal payment is provided.

Any changes in the Federal payment mechanism that are adopted should be reviewed in 3 to 5 years to assess circumstances surrounding city finances and the degree to which Federal interest is being achieved.

RECOMMENDATIONS

GAO recommends that the Mayor take the following steps to enable the District's budget documents to serve as the basis for making more informed judgments about overall city financial policies:

- Comply with Self-Government Act provision to present consistent information for the current budget year, for the 3 previous fiscal years, and (on a projected basis) for the following 4 fiscal years.
- Present meaningful comparisons of past trends and assumptions about the future in areas such as the relationship of the budget to changes in the city's population and service groups and the impact of inflation and other changes in the economy on revenues and expenditures.
- Specifically show the relationship between each year's appropriations, each year's actual obligations, and each year's actual revenue and cash position.

AGENCY COMMENTS

District officials commented orally on GAO's report and recommendations. While they had no major problems with the report, they emphasized their concern about budget autonomy and administrative problems associated with the predictability of the Federal payment. They also felt that the report overemphasized data comparability problems because changes in basic accounting systems and fund categories have made it technically very difficult, if not impossible, to reconstruct past data on a strictly comparable basis.

In commenting on the recommendations, they recognized the value of accurate, consistent information but said that, in addition to changes in basic data systems that have occurred,

the burden of simultaneously preparing and processing budgets for 3 fiscal years and handling other ad hoc needs has precluded them from maintaining the best possible data. They acknowledged that data presentations have changed over the years but the changes were made necessary by such things as the change from cash-based budgeting to accrual-based budgeting. District officials expressed the view that most of the shifts in definitions, methods of measurement, and classifications have now been made, with the result that more consistent financial data should be available from the audited 1979 financial statements forward.

GAO recognizes that District officials handle many activities simultaneously, their budget process requires much time and attention, and from time to time changes will be necessary in accounting systems or data presentations. However, GAO believes that the collection and maintenance of good data are essential if the Congress and the City Council are to have an informed basis for determining overall fiscal needs. When changes are made in the data presentations, adequate documentation, such as footnoting the changes, should be included in the budget documents to make it possible to make reasonably accurate comparisons over time. GAO welcomes the commitment to provide consistent, reliable information in the future, and believes this will help the Congress and city officials to focus on overall issues of financial strategy. Once established, an adequate information system will help to lighten the load of preparing budget documents.

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CHAPTER 1

INTRODUCTION

The 97th Congress is faced with the issues of whether to increase the \$300 million now authorized for the annual Federal payment to the District of Columbia and whether to make other changes in the way the Federal payment is provided to the District government. An increase of \$36.6 million in the Federal payment authorization, an authorization that has remained constant since 1978, was included in the Reagan administration's 1982 budget. District of Columbia officials are also seeking a formula-based payment that could be made available each year without congressional line item review and appropriation of the entire District budget.

Seven years have elapsed since the Congress last enacted legislation dealing with the amount of Federal payment authorizations. Title V of the 1973 District of Columbia Self-Government and Governmental Reorganization Act (the home rule legislation that set up the elected government which first took office in 1975) increased the Federal payment authorization in four annual increments from the previously authorized \$190 million to \$300 million for 1978 and for each year thereafter. The period since prior congressional action includes the experience under the Self-Government Act, changes in the national economy, and changes in national trends in the financing of State and local governments.

The specific objectives of our study are discussed in detail below. In approaching each of these objectives, however, our overall purpose was to try to provide a factual and analytical basis for discussion of a topic that in the past has proved to be controversial.

In congressional testimony over the past 10 years, District officials and others have argued that formula-based payments would (1) provide a predictable amount for District planning purposes, (2) allow District officials to budget more effectively, and (3) allow the Congress to concentrate on national and international issues rather than on District needs. Others, however, have contended that a formula-based Federal payment plan could be open to abuse; would result in amounts that would not have any relation to needs of the city; and would remove the Congress from the budgetary process, which is a primary means of bringing about changes in the city.

OBJECTIVES, SCOPE, AND METHODOLOGY

This study was prepared because we believed information in several areas would be of use to the Congress in its deliberations about changes, if any, needed in the amount of the Federal payment, in the process used to determine the amount of the payment, or in the way the payment is made available to the District

and other management activities, provisions for financing past unfunded pension liabilities, or the overall level of financing needed to provide essential public services to the Nation's Capital.

One area discussed in the report, the impact of inflation on District revenues and expenses and the extent to which its effects on the District budget can be controlled by District government officials or the Congress, would benefit from additional work. Time did not permit us to undertake the detailed analysis of the components of the city budget that would be required. It was therefore necessary to rely on data in this important area that was not as firm as would have been desirable.

Following are brief explanations of what we did to pursue each of our objectives.

Characterization of the history of Federal-District financial relations

In this discussion, contained in chapter 2, we relied principally on previously published studies, on appropriation committee documents, and on the record of hearings and committee markup sessions on the 1973 Self-Government Act.

Summary of the history of the Federal payment and of the District budget since 1970

Our work under this objective involved trying to answer these questions:

- What has been the role of the Federal payment in District finances since home rule, and how has this compared with the pre-home rule period?
- How have the Federal payment, local taxes, and Federal grants changed compared to the general rate of inflation in the economy?
- How have District tax burdens changed since home rule compared to those of surrounding jurisdictions and of cities of comparable size?
- How have the Federal payment and other District revenues, discounted for inflation, changed in relation to changes in population, number of households, or other measures of service demand? (That is, have District revenues permitted financing of increasing, stable, or decreasing service levels?)
- How does the experience in the District of Columbia compare with trends in State and local finances throughout the United States?

Federal payment in the context of projections
of revenue and expenses through 1986

For this analysis, contained in chapter 4, we used District government projections prepared as a part of the 1982 budget submitted to the City Council in October 1980. The Self-Government Act budget provisions required that such projections be made, and we used this projection to allow "order of magnitude" comparisons with revenues generated by alternative Federal payment formulas. We are not, however, in a position to endorse the accuracy of this projection.

Analysis of Federal payment formulas

The discussion contained in chapter 5 does not rely on special data sources, and both the types of proposed formulas and issues of concern that we analyzed have been identified in other documents. We have, however, attempted to focus the discussion on specific matters of concern at the present time. We also identified changes not involving a formula-based payment that could provide benefits associated with formula-based payments.

Changes in the Federal payment process
that could contribute to efforts to
improve District financial management

In pursuing this objective we assessed information developed in each of the other objectives. We also brought to bear on the subject what we have learned from audits of District government activities and review of efforts to improve financial management in the District. We concentrated on trying to identify possible changes in the Federal payment process that would be consistent with and help contribute to efforts for improved financial management.

SELF-GOVERNMENT ACT'S FEDERAL PAYMENT AND
FINANCIAL MANAGEMENT PROVISIONS

The 1973 District of Columbia Self-Government Act provides for an elected mayor and city council and gives city officials greater responsibility over District affairs. However, the Congress retains the power to review the city's annual budget, to appropriate all funds (including those derived from city tax levies), to set the amount of the Federal payment, and to veto all locally enacted laws including revenue measures. 1/

The sections of the Self-Government Act that deal with budget and accounting matters are often quite detailed and encourage the development of sound financial management procedures. One such provision, section 447, stipulates that,

"The Mayor shall implement appropriate procedures to insure that budget, accounting, and personnel control systems and structures are synchronized for budgeting and control purposes on a continuing basis."

Title IV, part D, of the act assigns a number of budget and financial management responsibilities to the Mayor. They include preparation of a balanced annual budget, a multiyear financial plan, appropriation requirements, accounting and financial requirements, and other activities. The act also provides for District and GAO audit of the District government activities.

Title V of the act sets forth the duties of the Mayor, Council, and Office of Management and Budget with respect to the Federal payment. It requires the Mayor to prepare information on intercity tax comparisons and on the elements affecting the District budget that result from the "unusual role of the District as the Nation's Capital." It also states that the Federal payment should

"operate to encourage efforts on the part of the government of the District to maintain and increase its level of revenues and to seek such efficiencies and economies in the management of its programs as are possible."

Title V of the act is contained in appendix III. The act established Federal payment authorizations 4 years in advance and provided for the authorization to remain constant after 1978. The

1/With respect to Federal involvement in District fiscal matters, title VI of the act specifically states that there is to be no change in the role of the authorization and appropriation committees or of the Office of Management and Budget (which includes making changes in the District budget request and including the Federal payment in the U.S. budget). The act also prohibits the District government from taxing the wages of non-District residents.

CONGRESSIONAL EFFORTS TO IMPROVE
FINANCIAL MANAGEMENT IN THE DISTRICT
BEGAN BEFORE HOME RULE

The Congress has tried by various means to get the District to manage more effectively, operate more efficiently, and improve its accounting and financial management systems. The means used by the Congress have included increases and decreases in the city's budget; increases and decreases in the Federal payment; oral directions given during hearings; and written directions contained in committee reports, appropriation acts, and letters to District officials. Many of the sections of the Self-Government Act referred to above were also intended to facilitate good financial management.

The Congress established two commissions in the 1970s to help deal with management problems. The Commission on the Organization of the Government of the District of Columbia, established in 1970, studied the District organization and method of operation and made numerous recommendations for improvement in its 1972 report. The Temporary Commission on Financial Oversight of the District of Columbia, established in 1976, just a year after elected government took office, is presently working to improve several of the District's accounting and financial management systems.

On occasion, the Congress has specifically linked the Federal payment to efforts to improve accounting and financial management systems. In July 1980, the Congress increased the Federal payment \$6.5 million in the 1980 Supplemental Appropriations and Rescission Act (Public Law 96-304, approved July 8, 1980), to insure that the District could pay its share of the costs of the Temporary Commission on Financial Oversight of the District of Columbia. To cite another example, in a February 7, 1972, letter to the Mayor, the Chairman of the Senate Committee on Appropriations, Subcommittee on the District of Columbia, stated that

"* * * it is my present intention to recommend to the Committee and to the Senate that appropriation of the Federal payment to the District of Columbia for fiscal year 1973 be conditional upon the District implementing a system of accounting and record keeping that can meet both the Comptroller General's and your own standards of acceptability for the District's needs."

Such a contingent appropriation was not made and the District government's accounting system has yet to be approved by GAO. However, the District of Columbia is not unique in this respect. Despite the efforts associated with the Joint Financial Management Improvement Program, 36 percent of the accounting systems of Federal agencies have not yet been approved. Among cities, problems with financial management systems are by no means unique to the District of Columbia.

CHAPTER 3

THE FEDERAL PAYMENT AND DISTRICT REVENUES SINCE 1970

The District has now had 5 full years of self-government. The question of what financial changes have taken place in the District can be answered by economic trends before and after home rule. To make such comparisons for the period 1970 to 1982, we collected data which included financial, employment, tax burden, population, and other information.

Since home rule, the Federal payment has declined as a percentage of total District general fund revenue. The Federal payment as a percent of total general fund revenue increased in the years prior to home rule. As a result of the increased authorization for 1975 contained in the Self-Government Act, the percentage reached a peak of 27.3 percent in 1975, when elections took place and the new government took office. In 1981, the estimated percentage of total District general fund revenues represented by the Federal payment is expected to be 21 percent--1 percent below the percentage in 1970. Although the amount of the Federal payment increased by \$69.2 million between 1975 and 1981, the payment's purchasing power, when discounted for inflation as measured by the GNP deflator, has declined by approximately 17 percent during that period.

For the home rule period as a whole, District tax collections have increased by more than the general rate of inflation. District personal tax burdens at most income levels were higher than in surrounding jurisdictions at the time of home rule, and they still are. Since home rule, District personal tax burdens increased slightly compared to those of other large cities. The District tax base shows evidence of becoming much stronger as a result of changes that occurred during the 1970s.

Prior to home rule, increases in local tax rates were necessary in order to achieve an increase in revenues about equal to the national rate of inflation. For the most recent years, local tax collections taken as a whole have been increasing at rates much closer to national inflation without recourse to rate increases. However, Federal grants received by the District government have not increased nearly as much as prices since home rule, and this important source of program funding is expected to decline in 1981 and 1982. The District pattern of large increases in revenue in the early to mid-1970s due to tax rate increases, followed by a leveling-off since that time, is typical of the pattern in State and local finances throughout the country.

SINCE HOME RULE, THE FEDERAL PAYMENT HAS DECLINED IN RELATION TO OTHER REVENUES AND IN PURCHASING POWER

The Federal payment increased significantly during the period 1970 to 1975--just before the start of home rule. After

Table 3-1
Federal Payment Authorization and
Appropriation--1970-1982 (note a)

<u>Year</u>	<u>Authorization</u>	<u>Appropriation</u>
	----- (millions) -----	
1970	\$118.0	\$116.2
1971	131.0	131.0
1972	179.0	173.7
1973	190.0	181.5
1974	190.0	187.5
1975	230.0	226.2
1976	254.0	248.9
1977	280.0	276.7
1978	300.0	276.0
1979	300.0	<u>b</u> /250.0
1980	300.0	276.6
1981	300.0	295.4
1982 (note d)	300.0	<u>c</u> /300.0
1982 (pro- posed) (note e)	336.6	

a/See appendix I, table 5 for more detail.

b/Excludes \$2.565 million for farmers' demonstration which was for police, clean up, and other expenses.

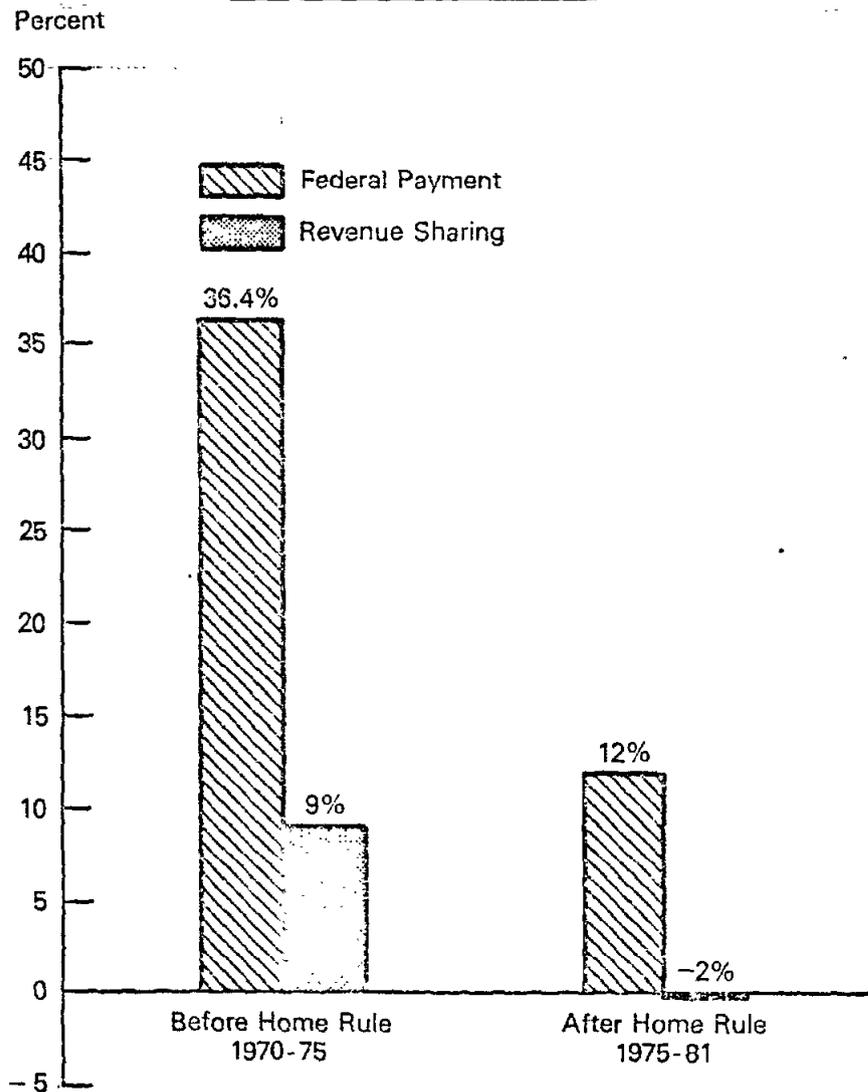
c/Estimated.

d/Present authorization.

e/Amount included in Reagan administration's budget.

From 1970 to 1975, the Federal payment and revenue sharing accounted for just over 45 percent of the increase in general fund revenue available to the District. In contrast, from 1975 to 1981, these Federal funds represented just over 11 percent of the increase (see fig. 3-2). In relation to District taxes, the share of increased expenses provided by District-raised funds increased from about 55 percent in the 5 years before home rule to 88 percent in the 6 years since home rule.

Figure 3-2
Percentage of Increase in Total District
General Fund Revenue Before and After
Home Rule Attributable to Federal Payment
and Revenue Sharing



Note: Calculations derived from data in appendix I, table 1. (Does not include pending authority.)

Figure 3-3
Percent Change in General Fund Revenues
and Prices Before and After Home Rule

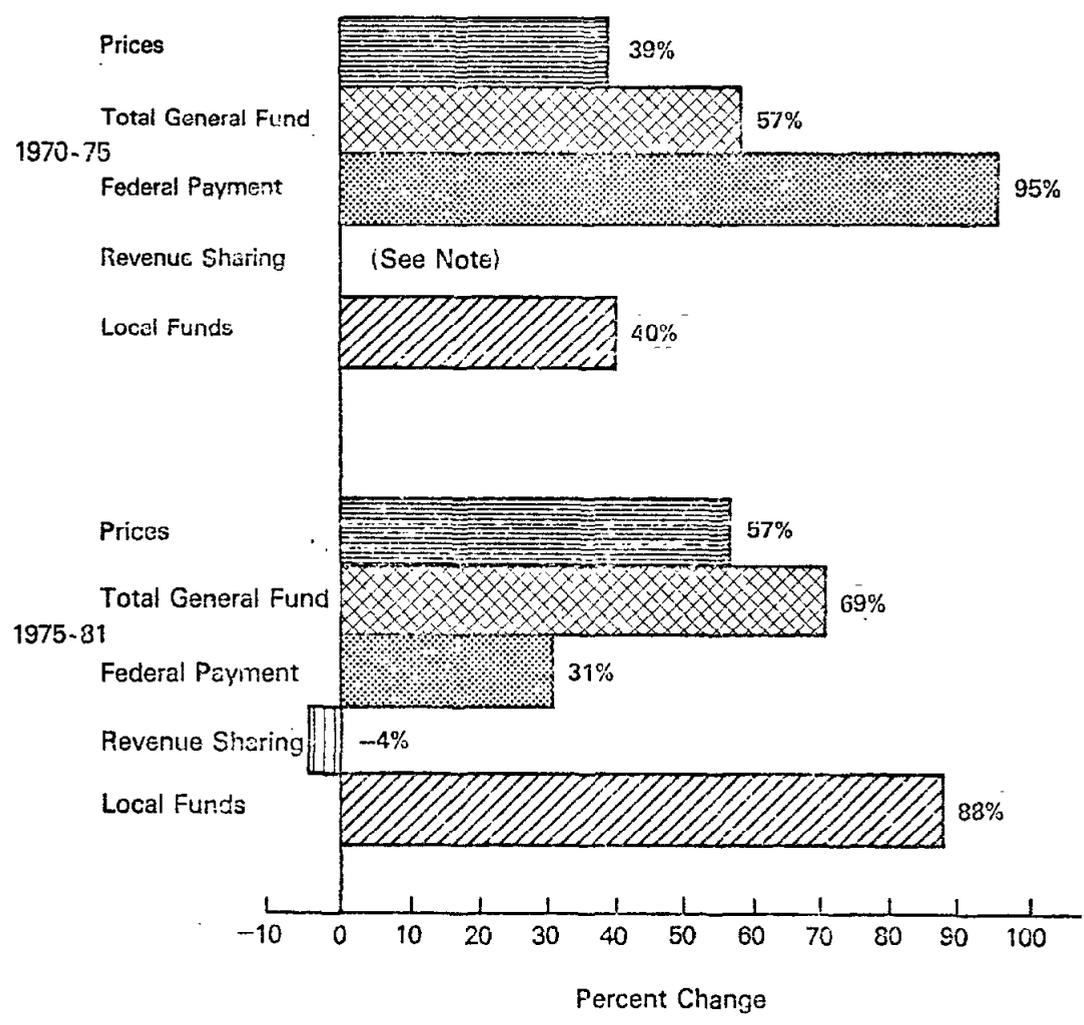


Table 3-2
Percent Change in General Fund Revenue
Available to the District Government

	<u>1970-75</u>	<u>1975-78</u>	<u>1978-81</u>	<u>1981-82</u>
Local funds	40.3	55.2	21.4	9.0
Revenue sharing	(a)	34.7	-28.4	-28.1
Federal payment	94.7	22.0	7.0	1.6
Total general fund revenue	57.6	45.5	16.6	6.7
Percent change in GNP deflator	39.2	19.6	31.3	8.8

a/Revenue sharing first received in 1973.

Note: Most of the 1981 and 1982 data estimated. See appendix I for supporting data. (Does not include pending authority.)

Table 3-3
Percent Change in District of Columbia
General Fund Revenues Discounted
by GNP Deflator

<u>Revenue Source</u>	<u>1970-75</u>	<u>1975-78</u>	<u>1978-81</u>	<u>1981-82</u>
Local	0.8	29.8	-7.5	0.1
Federal payment	39.9	2.0	-18.5	-6.7
Revenue sharing	(a)	12.6	-45.5	-34.0
Total general fund revenue	13.2	21.7	-11.2	-1.9

a/Revenue sharing first received in 1973.

Note: Most of the 1981 and 1982 data estimated. See appendix I for supporting data. (Does not include pending authority.)

tax base. 1/ The sales tax base would appear to be the biggest question mark among the major taxes. However, the District's own source revenues appear better able to keep up with inflation now than in the past.

Table 3-4
Percent Change in District Local Revenue
Sources, Selected Years

<u>Percent change in</u>	<u>1970-75</u>	<u>1975-78</u>	<u>1978-81</u>	<u>1981-82</u>
Property taxes	10.3	39.6	17.6	19.3
Income taxes	66.2	60.7	20.8	8.7
Sales and use taxes	48.8	57.8	20.3	4.4
Other (tax and nontax)	41.7	68.1	34.2	4.5
All local revenues	40.3	55.2	21.4	9.0
GNP deflator	39.2	19.6	31.3	8.8

Note: 1981 and 1982 data estimated by the District of Columbia government. See appendix I for supporting data. (Data does not include pending authority.)

1/It would be difficult for a rate of increase in property tax assessment twice as large as the rate of inflation to be sustained for a long period of time. If this in fact occurred, it might be appropriate to offset the increase by reducing the tax rates. High interest rates or other factors could depress property values at some point.

Table 3-5
Percent Change in District Personal Income
Total and Per Capita

<u>Percent change in</u>	<u>1970-75</u>	<u>1975-78</u>	<u>1978-80</u>
D.C. personal income, total	48.0	28.8	10.3
D.C. personal income, per capita	57.4	36.3	16.0
GNP deflator	39.2	19.6	18.9

Note: See appendix I for supporting data.

District personal tax burdens have
remained high at most income levels

The District of Columbia government regularly collects information on comparative tax burdens on households at different income levels residing in surrounding jurisdictions and in other cities. This data indicates that since home rule, the relative tax burden in the District has remained fairly high, especially in middle and upper income levels. For households with incomes above \$30,000, the tax burden in the District was the highest in the D.C. metropolitan area in 1975 and it still is. For the \$15,000 income or the \$15,000 income level and below, the District ranking in the D.C. area fell considerably since 1975. However, at this income level the differences between jurisdictions are relatively small and the D.C. tax burden is 89 percent of that of Prince Georges County, the highest in the area. The relative rankings for three income levels for which comparable data exists from 1975 are shown in tables 3-6 and 3-7.

Although District tax burdens overall have kept pace with local jurisdictions and many U.S. cities, it should be recognized that there are cities (Boston, New York, Philadelphia, Milwaukee, Baltimore, and Pittsburgh) whose combined State and local tax burdens are greater than the District's at most income levels. For a family of four earning \$30,000 per year, the estimated tax burden in Boston in 1978 was 88 percent higher, and Baltimore was 18 percent higher.

FEDERAL GRANTS SHOW A LEVELING
TREND AND MAY BE DROPPING

The District's share of Federal grant funds available to all State and local governments constitutes a major source for many District government activities, especially in the human resources, housing, and highway areas. The \$357 million which the District anticipates in grants for fiscal year 1981 exceeds the 1981 District Federal payment by 21 percent. Although this report concentrates on District general fund revenues not including grants, trends in grant fund availability can influence local funding decisions.

Before home rule, the District government included information on Federal grants in its budget submissions to the Congress, and the Self-Government Act took additional steps to include grants in District financial presentations. Because there is a question about the availability and consistency of grant data with other local budget information, in part due to timing of reimbursements and project grant awards, we were unable to obtain satisfactory time series information on grants.

Evidence on grant funds obtained from appropriation hearings suggests that, from 1970 to 1975, the estimated grant funds received by the District of Columbia more than doubled--far outpacing increases in the GNP deflator and also outpacing the relatively rapid increase in the Federal payment. Thus, in the years immediately before home rule the District experienced a sharp increase in Federal funds from three sources: the Federal payment, revenue sharing, and grants.

After home rule, however, Federal grants leveled off, a pattern similar to that experienced by the Federal payment and revenue sharing. Since home rule, the rate of increase appears to have been less than the rate of increase in inflation. From 1980 to 1981, a 13.5-percent drop in the absolute amount of grant funds was forecasted by the District government before proposals for reducing Federal spending were made by the Reagan Administration. 1/

REPORTED END-OF-YEAR EMPLOYMENT
HAS DECLINED SINCE 1979

To indicate changes in resource "inputs" available for delivering public services, we had hoped to be able to describe changes in District government employment before and after home

1/The 1982 District budget estimates Federal grant receipts of \$413.0 million in 1980 and \$357.4 million in 1981.

eliminates the effect of the decline in resources that occurred since 1978. If number of households rather than number of persons is used as an indicator of service demand, a different picture emerges because the number of households has not declined nearly as much as population due to decreasing household size.

Population and households, as the District properly points out, provide two measures of the demand for service, but there are others as well--school children, Aid to Families with Dependent Children (AFDC) recipients, senior citizens, etc. The school population dropped consistently through the 1970s, but since 1976 the District reports a 7-percent increase in AFDC cases, a 9-percent increase in the prison population, a 14-percent increase in police and fire pensioners, and a 27-percent increase in the general assistance caseload. The presence of diverse service groups makes it more difficult to evaluate the significance of changes in overall funding levels. In pointing out problems in placing too much weight on changes in per capita spending, the District government also notes that as a city's infrastructure ages, it becomes more costly to repair even if population has declined, and, moreover, the need for police and fire services does not decline in proportion to population.

Table 3-8
Per Capita and Per Household Changes in
General Fund Revenues Discounted for Inflation

<u>Percent change in</u>	<u>1970-75</u>	<u>1975-78</u>	<u>1978-81</u>	<u>1981-82</u>
General fund revenue discounted by GNP deflator	13.2	21.7	-10.3	- 3.0
General fund revenue discounted by GNP deflator and divided by D.C. population	20.3	28.8	- 4.7	- 1.0
General fund revenue discounted by GNP deflator and divided by the number of D.C. households	9.3	20.3	not available	not available

CONCLUSIONS

Prior to home rule, District local revenue sources increased at about the rate of inflation, but the total general fund revenue increases were considerably above inflation because of large increases in the Federal payment and the start of Federal revenue sharing. After home rule, particularly through 1978, District

CHAPTER 4

DISTRICT REVENUE AND EXPENDITURE OUTLOOK

THROUGH 1986

The District government projects a gap of \$173 million between revenues and expenditures in 1986 if neither the Federal payment nor local tax rates increase and if existing service levels are maintained. An increase in the Federal payment would help to close this gap, but expenditure reductions and local revenue increases could also help to balance each year's budget. Improvement in the District government's budget information would make it easier for the Congress, the City Council, and the public to assess overall financing strategies.

DISTRICT'S "HOLD THE LINE" FINANCIAL PLAN SHOWS A GAP BETWEEN REVENUES AND EXPENSES

The Self-Government Act requires the Mayor to submit a financial plan for at least the next following 4 fiscal years with the annual budget presented to the City Council. The financial plan through 1986, contained in the Mayor's proposed 1982 budget submitted to the City Council in October 1980, covers general fund operating and debt service expenses financed by local taxes, the Federal payment, and general revenue sharing. Federal grants, water and sewer expenses, and other special funds are not included. The plan assumes implementation of an accrual-based budgeting system as recommended by the Temporary Commission on Financial Oversight of the District of Columbia.

The plan provides a breakdown of major revenue and expenditure categories but there is little support to show what economic assumptions lie behind the projections. Insofar as we can determine, the plan assumes that from 1982 to 1986 there will be a 36 percent increase in the nominal value of the economy as the result of an average annual growth rate of about 8 percent each year. Assumptions regarding the division of this nominal change between prices and real growth are not given. The Carter Administration's 1982 U.S. budget assumed that the GNP deflator would increase about 32 percent between 1982 and 1986.

The plan provides for repayment of a \$215 million bond issue, ^{1/} the proceeds of which will be used to pay for accumulated obligations, and in 1983 for a gap of \$40 million between revenues and expenditures. By 1986, the gap is expected to increase to \$173 million (see table 4-1). It was difficult to analyze the expenditure forecast because the plan did not include specific information about population, households, or other service populations.

^{1/}At the current time a bill has been introduced in the Congress which provides for payment of a \$184 million bond issue rather than the \$215 million mentioned in the plan.

As required by the Self-Government Act, the 1982 budget, submitted to the City Council in October 1980, was balanced based on the currently authorized \$300 million Federal payment. In 1983, however, projected expenses exceed projected revenue by \$40 million, a gap that rises to \$173 million (about 9 percent of projected expenses) by 1986. The difference between projected revenues and expenditures is shown in table 4-1. Following a brief discussion of revenue and expenditure components, this chapter outlines alternatives for closing the gap.

Revenue projections

The percentage change in major sources of revenue compared to the nominal rate of change in the economy implicit in the District projection is shown in table 4-2. Taken as a whole, local revenues for the period 1982 to 1986, without rate increases, are forecast to increase by about 85 percent as much as the nominal rate of change in the economy. If this forecast is correct, this ability to almost keep up with price changes without tax rate increases represents a significant milestone for achieving a sound financial base for District government operations. Of the individual District revenue items, income and property taxes are expected to increase most rapidly. ^{1/} Sales taxes taken as a whole are expected to increase at a rate about two-thirds as fast as the rate of change in the economy; other taxes and non-tax revenues are projected to grow more slowly, except for pending authority. The items in pending authority consist of District requests to the City Council and/or the Congress for various revenue increases.

Expenditure projections

Table 4-3 indicates percentage changes in major expense categories compared to the nominal rate-of-change forecast for the economy. The budget presentation does not include specific information about population, households, or other service populations, so it is difficult to evaluate the forecast in terms of changing service needs. The projection does not explicitly state the rate of increase in wage and salary levels that is anticipated, but the increase would appear to be somewhat faster than the nominal growth in the economy, or about 9 percent each year.

^{1/}Net property tax collections resulting from assessment increases and rate modifications (if any) are expected to increase in line with the overall rate of change in the economy, and the progressive rate structure of the income tax system is expected to increase revenues by more than the comparable change in the District's personal income.

Table 4-3
Change in Expenditure Categories
Compared to Change in the Economy--1982-86

<u>Category</u>	<u>Expected change in level of expenditures</u>	<u>Percent change</u>
	----- (millions) -----	
Personal services	\$260.8	40.0
Goods and services	54.7	20.0
Entitlement programs and fixed costs	171.1	40.1
Debt service	40.3	28.3
Repayment of deficit (note a)	<u>10.0</u>	50.0
Total expenditures	<u>\$536.9</u>	35.5
Change in the economy	not applicable	36.0

a/ The District plans to borrow \$215 million 1/ to finance obligations currently due but incurred in 1980 and earlier. The loan plus a \$194 million amortization fund to offset non-current obligations would be paid at the rate of \$20 million the first year and \$30 million each year thereafter (\$10 million for the amortization fund and the rest for the bond issue). According to the District's 1982 executive budget, the bond issue will be paid up in 30 years and the amortization fund in 20 years.

FINANCING PRIOR YEAR OBLIGATIONS
AND OTHER SPECIAL ITEMS

Throughout the 1970s, the District budget was balanced on a cash basis, a practice which allowed obligations incurred in one fiscal year to be paid with revenues obtained in a subsequent year. As the decade progressed, the level of obligations carried over into the next fiscal year increased, with the most rapid increase occurring before home rule. In 1970, \$42.8 million in obligations incurred under the 1970 appropriation were carried over to be paid from 1971 revenue. As shown in table 4-4, the amount carried over at the end of the year had increased to \$103 million by 1975 and to \$155 million by 1980.

1/ Currently, the bond issue has been adjusted downward to \$184 million.

Compensating for declining Federal grant programs

The general fund projection excludes funds that the District receives under Federal grant programs, an amount estimated to be \$356 million in 1982. As discussed in the previous chapter, this source of funds reflects a 13.5-percent decline from 1980 to 1981--prior to consideration of the budget cuts proposed by the Reagan administration. A policy determination to provide District funding to mitigate the impact of diminished grant funds would require an increase in expenses over that contained in the financial projection.

Unfunded pension liability

The District has a large amount of unfunded accrued pension liabilities. The unfunded amount is projected to increase by 25.2 percent between 1982 and 1986. Although the unfunded liability is growing, the unfunded percentage of the liability is decreasing. For example, in 1982 the unfunded portion was 73.3 percent and the funded portion 26.7 percent of total pension liabilities. By 1986, the unfunded portion is projected to be 70.8 percent and the funded portion 29.2 percent of total liabilities. Any effort to reduce the unfunded liability further would obviously require an increase in expenses beyond that contained in the projection.

AN INCREASE IN THE FEDERAL PAYMENT IS ONE OF THE ALTERNATIVE WAYS THE GAP CAN BE FINANCED

Although the projected gap of from \$40 million in 1983 to \$173 million in 1986 may vary depending on District policy decisions, management efficiency, and economic conditions, the Self-Government Act requires District officials to present balanced budgets each year to the City Council and to the Congress. Several alternatives exist which would enable the District to close the gap between revenues and expenses when actual budgets are being prepared for consideration by the City Council and the Congress. The alternatives are reducing expenses, increasing tax rates, expanding the tax base, taxing non-District residents, increasing the Federal payment, or some combination of these alternatives.

Reducing expenses

Closing the gap through expenditure reduction would most likely have to focus on two of five major cost areas--personal services and goods and services. Personal services make up 43 percent of the 1982 operating budget and goods and services 18 percent, for a combined total of 61 percent. The other major cost categories are fixed costs, debt service, and repayment of deficit. Except for recipient benefit programs over which the

Taxing nonresidents

A potential source of income which could be readily available to the District if authorized by the Congress is a tax on non-District residents. The tax could take the form of a direct imposition of the District income tax (which is higher than the income taxes of surrounding jurisdictions at middle and upper income levels) or a flat percentage wage tax. The tax would be deductible from the nonresident's State or local income tax. Over time, imposition of such a tax could be a factor in expanding employment in suburban locations rather than in the District.

According to the U.S. Bureau of the Census, nonresident personal income averaged about \$7.3 billion for 1979. A 1-percent tax on gross earnings would have yielded \$73 million in added income for the District that year. The revenue raised by a 1/2-percent tax on nonresident wages would realize more than a 10-percent (\$30 million) increase in the Federal payment.

Increasing the Federal payment

Another way to finance the gap is by increasing the Federal payment to the District. The increase could be in the form of a lump sum increase (to be considered a year at a time) or a formula that builds in growth each year. The decision to increase the Federal payment and the form of payment is basically a political decision which must be decided ultimately by the Congress. A formula payment could easily be designed which would finance some or all of the gap in the District government's estimated "hold the line" budget. Types of formulas and issues raised by formula payments are discussed in chapter 5.

Combination of alternatives

Over the long term, a combination of factors could be considered as a logical means to balance the budgets. For example, combination of a 5-percent annual increase in the Federal payment, a 1/4 percent nonresident wage tax, reduction of expenditures, modest increases in the tax rate, and an enlarged tax base could fill the gap shown in table 4-1.

IMPROVEMENTS NEEDED IN THE BUDGET INFORMATION PROVIDED TO THE CITY COUNCIL, THE CONGRESS, AND CITIZENS

Needed improvements in the information provided to the City Council, the Congress, and citizens to evaluate District revenue and expenditure proposals extend beyond those associated with implementation of the financial management system that has been designed at the direction of the Temporary Commission on Financial Oversight of the District of Columbia. In addition to book-keeping accuracy, District budget presentations should provide a clearer understanding of the trends, assumptions, and policies which are implicit in financing proposals.

In addition to closing the gap, a current problem is how to finance the previous year's unfunded obligations. The District proposes to issue bonds and to use the proceeds to pay the unfunded obligations.

The District has not fully complied with provisions of the Self-Government Act which require the Mayor to prepare budgets reflecting approved budgets and expenditures for the immediately preceding 3 fiscal years. Data that was provided was not presented consistently and thus was not comparable over time. Also, data was not available which would allow comparison between general fund revenues, expenditures, and appropriations. This data is necessary if the District, the Congress, and the public are to effectively analyze the District's financial performance over time.

It was difficult to analyze the financial plan because there was little support to show what economic assumptions lie behind the projections. The section that projects revenues and expenditures contained no historical information on past expenditures or revenues and assumptions on expenditures, growth in the economy, or demographic changes, and other information needed to analyze the plan was not stated. This information is needed so that the District can focus clearly on its objectives and the City Council, the Congress, and the public can effectively analyze city operations.

RECOMMENDATIONS

The District of Columbia government, the Congress, and the public all need accurate, consistent information to be able to make informed assessments of the District's overall revenue and expenditure policies. The Self-Government Act, which stipulates that each year's budget must include data on the 3 previous and 4 subsequent fiscal years, creates a framework for providing the information if the District government closely adheres to the act's requirements.

We recommend that the Mayor take these steps to enable the District's budget documents to serve as the basis for making more informed judgments about overall city financial policies:

Comply with Self Government Act provisions to present consistent information for the budget year, for the 3 previous fiscal years, and (on a projected basis) for the following 4 fiscal years. All the information should be readily identifiable in the city's budget. Such information is needed for all revenues by major types, appropriations, and obligations (for personnel and other major categories of expense); annual full-time equivalent employment in positions actually filled; and grant and other data. If budget categories change, such as changing the the definition of the general fund, sufficient information should be provided to allow reasonably accurate comparisons to be made, as the Self-Government Act intended.

CHAPTER 5

ISSUES RELATING TO

FORMULA-BASED PAYMENTS

A formula-based Federal payment is not an end in itself but a means to achieve the broader purpose of providing a more systematic basis for determining the Federal Government's share of the District government's expenses. Use of a formula, however, is not the only way that the broader goal of providing a more systematic basis for Federal financial support to the District government can be achieved.

This chapter discusses proposals to provide the Federal payment to the District of Columbia on the basis of some type of formula. Different types of formula payments are analyzed in terms of these seven issues associated with formula-based payments

- preserving the Federal interest,
- amount of payment,
- predictability of the Federal payment authorization and appropriation,
- District government autonomy,
- incentives to increase efficiency,
- timeliness, and
- ease of administration.

The chapter also contains a discussion of ways other than formula payments that some of the benefits attributed to formulas can be achieved.

TYPES OF FORMULA PAYMENTS

Over the years, five types of formulas have been suggested as a basis for the Federal payment.

- Percentage of Local Revenue. Under this approach, the Federal payment would be calculated as a predetermined percentage of some or all local revenues. Under legislation considered by the House District Committee in 1980 the Federal payment for 1982 would have been set at 43 percent of 1980 District tax collections.
- Cost-of-Living Escalator. From a base considered to represent a fair Federal payment, the payment each year would

The legal basis for the Federal interest flows from the Constitution which gives the Congress exclusive jurisdiction over the District. As with all expenditures, the Federal Government has responsibility for assuring that funds appropriated to the District of Columbia are spent for authorized purposes and accounted for. The Federal Government has particular interest in public safety, transportation, and environmental services, since it is the city's largest employer. It owns about 40 percent of the land area in the District and is, moreover, the main reason that citizens from throughout the Nation visit the city each year. In a broader sense, however, a Federal interest arises in the District strictly as a result of its dominant economic role. Although the private sector has grown in recent years, the Federal Government is the largest employer, and many private sector activities are directly or indirectly dependent on the presence of the Federal Government.

As has been demonstrated in Pittsburgh, Detroit, and other cities, some redevelopment activities affecting the character of the city can only be taken by the dominant employer or employers in a city. These activities, such as the redevelopment of Pittsburgh's golden triangle, can be accomplished only if there is financial backing from major financial institutions and if major employers are committed to keeping employment in the affected area. In the District, this role, which involves a residual responsibility that is difficult to capture in a formula and which involves much more than a narrowly defined Federal enclave, can only be played by the Federal Government. 1/

The Federal interest, although difficult to quantify, would appear to be relatively stable in the sense that basic concerns continue from year to year. As a practical matter, this stability in the Federal interest could lend itself to establishment of a payment formula or other means that would provide a more systematic basis for providing the Federal Government's fair share of District expenses.

Enactment of a formula could serve the Federal interest if a formula plan promoted increased efficiency in the District government. For this in turn would mean better services to the Federal Government--a large user of District services. A Federal

1/An example of the need for special Federal initiatives that can arise from the Federal presence is the relatively small size of District banks compared to those in many other metropolitan areas of comparable size. This small size occurs because of the service nature of the District economy, because the Federal government is its own banker for the most part, and because branching across District lines is generally prohibited. As a result, the District traditionally has had less locally owned and controlled sources of capital than might be expected given the size and income of the city.

Almost any formula can be made to produce almost any desired amount of money in the initial year. Thus, for fiscal year 1982, three percentage-of-revenue proposals using different assumptions would have provided payment to the District in the amounts of \$332.8 million, \$409.0 million, and \$389.0 million. Setting the base year amount of a formula payment is thus much like changing the authorization under the present lump sum approach, except that it provides an explicit rationale for the amount of the payment that is also the basis for calculating the amount of the payment in subsequent years.

Examples of the amount of Federal payment that would be provided through 1986 under several alternative Federal payment formulas are shown in table 5-1. The formulas are based on revenue forecasts prepared by the District government in its fiscal year 1982 budget submission to the City Council in October 1980. These forecasts implicitly assume an increase in the local economy's size of about 8 percent each year. To maintain consistency with the projection that was based on a 1982 budget with a \$300 million Federal payment, the table assumes that initial changes in the Federal payment would take place in 1983. The Federal payment authorized under existing law is also included in the table.

Obviously any number of other formulas could have been calculated for inclusion in table 5-1. Some of these formulas could be quite complicated. For example, a formula could be devised that would take into account changes in population, assumed changes in productivity, a ceiling on the percentage growth in the payment that could occur in any year, and a ceiling on the percentage of the District general fund that can be financed by the Federal payment.

Since the initial level of a formula can be set at any amount, as a practical matter the establishment of a formula would no doubt have to take into account continuity with the recent history of the Federal payment and congressional judgments about the appropriateness of the overall level of District expenditures and of District own source revenue efforts. The fiscal situation which the District now faces is likely to be more conducive to a consensus judgment about the pattern of appropriate District total spending and revenue patterns than was the case at the time the Self-Government Act was passed. At that time there was real growth in the per capita level of city services financed by the District budget (with much of the increase financed by increases in the Federal payment).

With increases in the overall level of services discounted for inflation less likely to be an issue, it is more likely that a consensus can be reached on the appropriate amount of total Federal financing needed in a hold the line, inflationary setting. (Significant issues associated with the composition of services in an overall no-growth situation can, of course, be expected.) If national Federal grant programs (Medicaid, urban development, public sector employment) were to be cut back, however, the question of whether to increase locally financed services on a per capita basis could once again become a major issue, as it would in many other jurisdictions.

An issue that has been of continuing interest regarding District finances is whether the expenditures of the District are too high relative to the population. Although intercity comparisons are difficult to make, the District government seems generally to have more public employees per citizen than other jurisdictions. Some--and perhaps most--of the relatively high public employee ratio in the District of Columbia can be attributable to the totally urban character of the District, to the high percentage of commuters and tourists relative to the residential population that exists in the District, and to demographic characteristics. It is also possible that local taxpayers or the Congress desire (and are willing to pay for) a larger government sector than exists in other cities. For example, the Congress has supported a relatively large police force in the District compared to those of other large cities. Logically, a contributing factor to a larger public sector could also be that public services are provided more inefficiently in the District of Columbia than in other jurisdictions.

The comparable tax effort approach is different from the other approaches to the Federal payment in that the amount of the Federal payment in the base and in each subsequent year requires that an explicit judgment be made each year about the appropriate level of expenses that will be recognized for purposes of calculating the Federal payment. It also requires that a difficult judgment be made explicitly about the standard that should be used for tax rate comparability. Should the District be compared with the highest jurisdiction or with the weighted average of all jurisdictions? Should the District be at the top of the list for each tax or only for the average of all taxes? Should the District be at the top of the list for each income level or only for an "average" taxpayer?

PREDICTABILITY OF THE FEDERAL PAYMENT
AUTHORIZATION AND APPROPRIATION

Predictability of the Federal payment encompasses several issues, including the amount of authorization and appropriation; yearly payment increases or decreases; and, in terms of a formula, whether current or past data is used to compute the payment. The authorized amount sets the stage for and actually determines the relevance of the other issues because the Federal payment is restricted to the limits of the authorization. Thus, the key to a predictable Federal payment is determined by the authorization first and the appropriation second. In cases where the appropriation amount is the same as the authorized amount, the Federal payment becomes totally predictable until the authorization is changed.

With respect to the predictability issue, separate consideration needs to be given both to the payment authorization and to its appropriation. The experience in the period 1978 to 1980, when the Federal payment was held level and then reduced despite higher authorization was unique in the history of the Federal payment in recent times. Before that experience, the Federal payment appropriation was much closer to the amount authorized. (See table 5-2.)

conduct effective financial planning. Although the Carter administration's proposed budget contained an increase in the Federal payment for 1982, the 1982 budget submitted to and approved by the City Council could not be based on use of the new funds because by law the District budget must be balanced against revenues already authorized.

The District government cites the sequence of events in fiscal year 1980 to demonstrate the problems of financial planning with an unpredictable Federal payment. The District began preparing the fiscal year 1980 budget in early spring 1978 and submitted the budget to the Council on October 1 on the basis of the authorized Federal payment of \$300 million. In June 1979, the House Subcommittee on Appropriations recommended a reduction of \$108.5 million in the Federal payment to \$191.5 million and commensurate decreases mostly in what the District considered to be nondiscretionary spending areas--e.g., retirement costs, pay raises, and public assistance. The Senate adopted a higher payment and the appropriations act was signed October 30, 1979. Additional funding for nondiscretionary items and pay raises was included in the 1980 supplemental appropriation financed in part by an increase of \$38.3 million in the Federal payment to a total of \$276.5 million.

There are possible advantages to the Federal Government of a Federal payment authorization (and perhaps appropriations) predictable in advance of final local action on the District budget for a given year. District officials will know that no more Federal aid can be expected and that they must raise local taxes if available revenue is insufficient for the desired spending program. A system in which the Federal payment is unpredictable can encourage "crisis type" budget presentations (and accompanying local political activity intended to elicit each year the largest possible Federal payment).

Since a major component of increased city expenses is wage and salary increases, there is an advantage in having city decisionmaking officials, employees, and the general public know well ahead of time the maximum Federal contribution that will be available. By the same token, it must be expected that the District will spend the full Federal payment, for it would be difficult to negotiate wage settlements if unused Federal funds lapsed back to the U.S. Treasury at the end of the fiscal year. This tendency for local expenditures to expand to whatever Federal payment can be predicted in advance suggests the importance of tailoring any formula that would be adopted to what the Federal Government believes the city needs to provide necessary services at reasonable cost.

DISTRICT GOVERNMENT AUTONOMY

Under the U.S. Constitution, complete autonomy for the District of Columbia is not possible, but the degree of autonomy that can be delegated is up to the Congress, as the Self-Government Act

The degree to which the Congress is willing to increase District budget autonomy may also be related to confidence in the quality of city services and in the quality of financial information that the District government provides to the City Council, the public, and the Congress itself. Implementation of efforts to improve financial management, adopting the recommendations contained in chapter 4 of this report, and demonstrating achievement in improving the efficiency would help to provide the necessary degree of confidence.

INCENTIVES TO INCREASE EFFICIENCY

Would formula-based payments increase or decrease incentives for achieving efficiency in the District government? The answer to this difficult question depends partly on the exact nature of the formula and how the payment would be made available to the city. It must also be borne in mind that both the need to balance the District budget each year and voter resistance to tax increases, as elsewhere, provide powerful incentives to limit the size of government in the District.

Clearly, increasing the amount of Federal funds made available by formula would not provide an incentive for the District government to become more efficient if the amount of funds so authorized were higher than needed to finance efficiently run essential services. A Federal payment indexed to a national inflation index could provide more funds than the rate of inflation actually experienced by the District government or could actually contribute to inflation of government expense by appearing to underwrite wage settlements tied directly to cost-of-living increases. (Sound public policy might suggest a payment that provides less than a full offset to measured inflation to encourage belt-tightening and improvement in efficiency.)

It is hard to assess the degree to which changes in the existing congressional involvement in the budget process would affect the overall efficiency of District government operations. At the present time, appropriation of the Federal payment and the entire city budget provides a built-in framework for annual congressional scrutiny of District affairs. Ad hoc oversight and legislative hearings on increases in the Federal payment, financial management, and other topics can also lead to improvements in government efficiency. The impact of this hearing and review process on District government efficiency, or the degree to which efficiency would suffer if the process were changed somewhat, cannot be quantified.

It is clear, however, that from time to time the Congress has found it necessary to use the leverage that the appropriation process provides to try to bring about improvements in District government efficiency. The (unsuccessful) 1973 efforts of the Senate Appropriations Subcommittee to bring about improvements in the accounting system and the use of the Federal payment appropriation to provide District funding for some of the work of the Temporary Commission on Financial Oversight to the District of

payment were automatically appropriated to the District, would the District have the same incentive to implement the recommendations? Is it worth risking slower implementation of these recommendations to achieve other benefits associated with a payment formula?

While there are reasons to associate direct congressional control with efforts to improve the efficiency of District government operations, there are also incentives leading to inefficiency built into the existing system. If the District reduces the budget for a particular item, local taxpayers may receive no benefit in that the entire saving can be accounted for by a reduced Federal payment rather than reduced taxes. If the District wants to drop one activity and fund a new one under existing tax rates, the Congress can accept the cut, deny the new activity, and reduce the Federal payment by the amount of the expenditure reduction. Also, under the present situation, the District government can raise a tax to finance a new program, but the Congress can deny funds for the new program while at the same time reducing the Federal payment by the amount of the tax increases the City Council agreed to in adopting the balanced budget presented to the Congress.

Uncertainty over the amount of the Federal payment also builds in an incentive for budget gamesmanship. When the exact amount of the Federal commitment is unknown, an incentive exists to include items in the budget which are not essential to provide a buffer for essential services.

It is the District government's opinion that factors other than congressional involvement in the budget process determine the efficiency of District programs. The District feels it is now operating under the same restrictions faced by other State and local governments. Officials point out that during the past 6 years of home rule the budget process has involved extensive citizen participation, and they are already organizing finances in response to potential bond market scrutiny.

TIMELINESS

From time to time complaints have been expressed about the long lead times involved in the District budget process. For example, the budget is presented to the City Council in October, a full year before the proposed budget would be in effect, and often before the budget for the previous year has been approved by the Congress. In 4 of the past 6 years the budget has not been appropriated before the start of the fiscal year. Part of the reason was that the Congress was late in passing the District appropriation, which was the case for fiscal year 1981, and part of the reason is that the District has submitted the budgets late to the Congress. For example, between 1973 and 1981 the District submitted the budget late to the Congress seven of nine times. The timing of the District's appropriations in relation to the start of the fiscal year is shown in table 5-3.

The payment-in-lieu-of-taxes formula would be relatively difficult to administer in that there are many judgment factors that enter into the calculation. A major problem would be assessing the value of Federal property (including the U.S. Capitol, White House, Mall, Monuments, Rock Creek Park, etc.) and updating that assessment each year.

A payment formula based on calculating the net costs and benefits of the Federal Government would require that quantified judgments be made in areas where there are many intangible factors to be considered. Should the Federal Government pay the District the full amount lost each year from congressionally imposed taxing restrictions? Should account be taken of indirect benefits of federally financed activities (such as the Metro subsidy or Pennsylvania Avenue development) that contribute to District sales and property tax increases?

A payment formula based on comparable tax effort would also be difficult to administer. This approach requires advance estimation of what the city budget should be, what other jurisdictions are likely to collect, and how much revenue the District is likely to collect under its tax provisions. Other difficulties with this approach were noted previously.

CHANGES NOT INVOLVING FORMULAS THAT
CAN ACHIEVE SOME OF THE ADVANTAGES
OF FORMULA-BASED PAYMENTS

Advantages of formula-based payments discussed above include more predictability in the Federal payment, delegation of greater budget autonomy to the District government, greater incentive to efficiency, and greater attention by District and Federal officials to overall fiscal concerns such as the per capita level of services which should be maintained in an inflationary environment. Adoption of a Federal payment formula is one, but not the only, way of achieving some of these advantages.

A Federal payment that will provide an incentive for increased efficiency must be based on estimates of the amount of Federal payment likely to be needed by an efficiently run government given a reasonable local tax effort. To the extent that the amount of Federal payment that would serve such a function can be estimated in advance, exact Federal payment amounts can be authorized several years ahead. This was essentially the approach taken in the 1973 Self-Government Act. The time horizon in such an approach can be as far ahead as the Congress desires, and future authorizations could also be amended at a later date. Data on such things as tax rates in surrounding jurisdictions and other large cities, estimated net burden of the Federal presence, and demographic changes can continue to be used to make the judgments about the Federal payment authorizations as informed as possible.

authority for the city, ^{1/} or changing the District fiscal year (or budget submission date) to reduce the time between budget formulation and execution.

CONCLUSIONS

How much the Federal payment should be in 1982 and subsequent years and whether changes should be made at this time in the way the Federal payment is provided to the District are essentially political questions that the Congress must decide. While we hope that this report will help the Congress in making judgments on these questions, we cannot answer them on the basis of work performed. Our analysis, however, does lead us to the following conclusions about formula-based Federal payments and about the relationship of changes in the payment mechanism to improvements in District financial management.

The arguments for and against a formula-based payment are complex, even when viewed strictly from the perspective of the Federal interest. It is not the case that all arguments for a formula favor the District as opposed to the Federal interest.

Issues associated with the desirability and nature of a Federal payment formula would be easier to resolve if:

- there were an explicit effort by the Congress, OMB, and the District government to establish service goals for the District's population and service groups in an inflationary environment;
- the informative content and reliability of budget information provided by the District government to the City Council, the public, and the Congress were improved;
- the impacts of inflation and of economic and demographic changes on the District's revenues and expenses were better understood; and
- the District government demonstrated improvements in program and financial management.

If a formula-based approach were to be seriously considered, we believe that:

- No one formula approach can be demonstrated to be theoretically superior, nor can the proper form of a formula be calculated free from judgments about the money that

^{1/} The Congress must approve all reprogramming requests for the shifts of appropriated authority between control centers in excess of \$50,000 or 10 percent.

associated with the Federal payment process. A properly functioning accounting and budgeting system is needed and should be established regardless of how the Federal payment is provided.

Any changes in the Federal payment mechanism that are adopted should be reviewed in 3 to 5 years to assess circumstances surrounding city finances and the degree to which Federal interest is being achieved.

Table 1
General Fund Revenue
District of Columbia
(note a)

	<u>1970</u>	<u>1971</u>	<u>1972</u>	<u>1973</u>	<u>1974</u>	<u>1975</u>	<u>1976</u>	<u>1977</u>	<u>1978</u>
	----- (thousands) -----								
General Fund Revenue: (note b)									
District Sources:									
Property tax	\$129,337	\$134,100	\$142,667	\$149,512	\$151,529	\$142,709	\$148,911	\$167,305	\$199,292
Sales tax	133,727	143,700	152,451	178,235	139,551	198,996	225,525	260,370	314,005
Income tax	103,351	136,600	137,465	149,948	164,159	172,655	205,197	251,107	277,399
Other	42,407	41,010	47,343	48,775	50,607	60,103	64,551	94,902	101,030
Total	<u>409,332</u>	<u>455,410</u>	<u>479,927</u>	<u>526,520</u>	<u>555,846</u>	<u>574,463</u>	<u>644,184</u>	<u>773,684</u>	<u>891,726</u>
Federal Sources:									
Federal payment	116,166	131,000	173,654	181,500	187,450	226,200	249,949	276,650	276,000
Revenue sharing	0	0	0	22,000	37,505	27,282	26,655	32,240	36,745
Total	<u>116,166</u>	<u>131,000</u>	<u>173,654</u>	<u>203,500</u>	<u>224,955</u>	<u>253,482</u>	<u>276,604</u>	<u>308,890</u>	<u>312,745</u>
Pending Authority (note c)									
Total general fund revenue	<u>\$525,498</u>	<u>\$586,410</u>	<u>\$653,581</u>	<u>\$730,020</u>	<u>\$780,801</u>	<u>\$827,945</u>	<u>\$920,787</u>	<u>\$1,082,574</u>	<u>\$1,204,471</u>
District Auditor Report:									
Total (note d)	not available	<u>\$534,119</u>	<u>\$654,637</u>	<u>\$731,024</u>	<u>\$792,069</u>	<u>\$833,326</u>	<u>\$927,479</u>	<u>\$1,089,876</u>	<u>\$1,215,103</u>

a/1970-73 cash basis of accounting. Data adjusted to be comparable to 1980 general fund definition by D.C. Department of Finance and Revenue. In 1930 the District of Columbia switched to an accrual basis of accounting; therefore, 1981-95 data may not be entirely comparable to earlier data. Data for 1976-80 adjusted for professional tax suit lost by the District. Excludes short-term borrowing and cash balance carryovers. Budget estimates used for 1971 because actual figures were not included in the budget.

b/General fund revenue as defined by the District in 1980.

c/Pending authority from the City Council and/or the Congress for additional taxing authority.

d/The District of Columbia Auditors 1980 Financial Report listed the 1971-73 data as cash basis of accounting and 1979-80 data as accrual basis of accounting.

Table 2
Relationship of Revenues, Expenditures
and Appropriations 1970-80

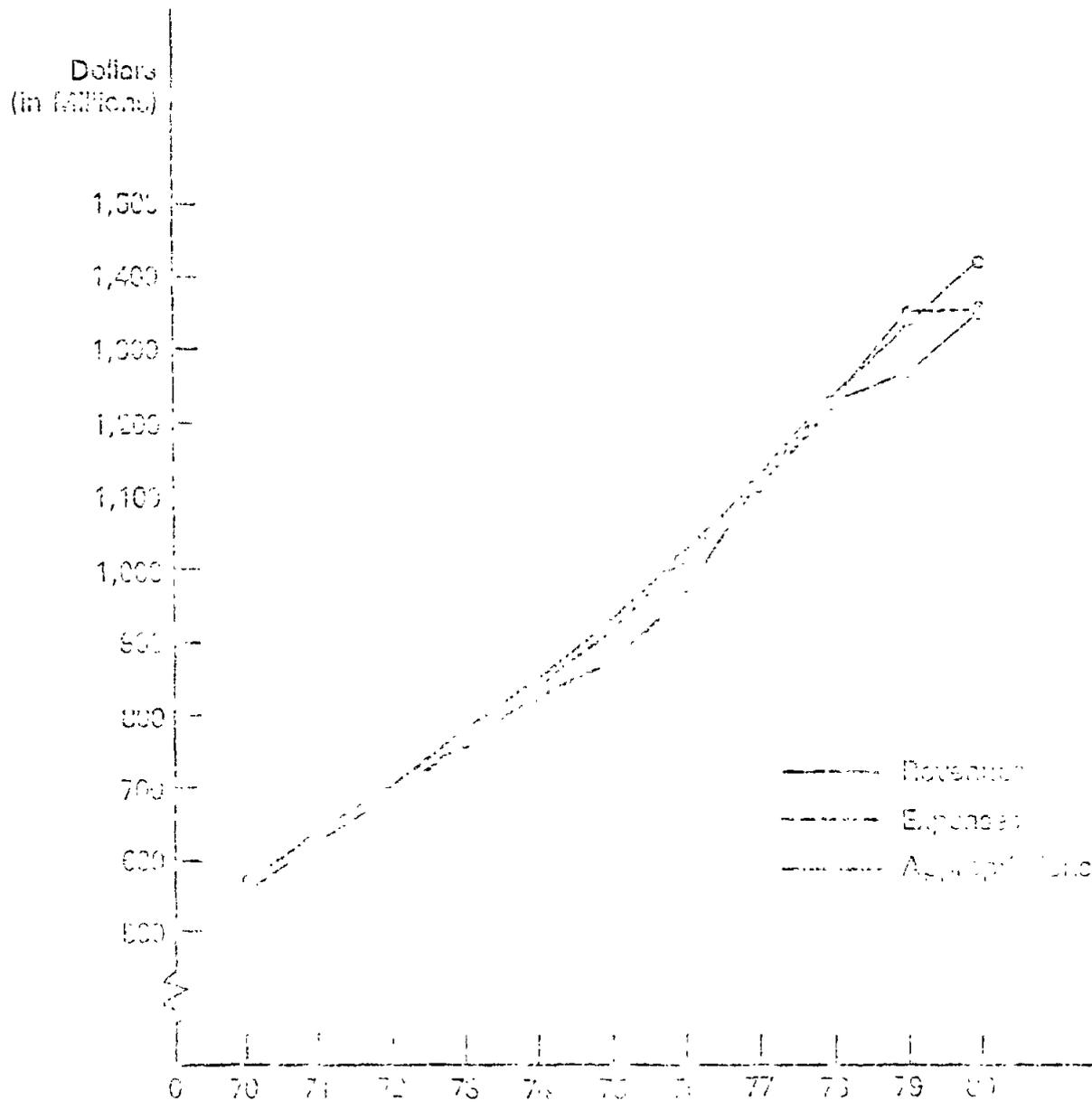
	1970	1971	1972	1973	1974	1975	1976
----- (thousands) -----							
Revenue Financing the Appropriation for Operating Expenses and Debt service: (note a)							
District sources	\$400,332	\$459,410	\$479,927	\$526,520	\$555,846	\$574,463	\$644,184
Federal sources (note b)	116,166	131,000	173,654	203,500	224,955	253,482	275,603
Other:							
Police and fire retirement	5,844	7,100	9,181	10,736	9,643	13,103	12,756
Water and sewer enterprise	<u>21,923</u>	<u>24,398</u>	<u>24,104</u>	<u>25,879</u>	<u>30,041</u>	<u>31,559</u>	<u>31,828</u>
Total Revenue	<u>\$553,265</u>	<u>\$620,908</u>	<u>\$685,866</u>	<u>\$766,635</u>	<u>\$820,485</u>	<u>\$872,607</u>	<u>\$964,371</u>
Operating expenditures	c/	c/	<u>\$684,959</u>	<u>\$770,806</u>	<u>\$829,104</u>	<u>\$909,694</u>	<u>\$1,020,414</u>
Operating appropriations	<u>\$71,713</u>	<u>\$636,872</u>	<u>\$693,669</u>	<u>\$782,058</u>	<u>\$841,371</u>	<u>\$919,933</u>	<u>\$1,042,143</u>

a/Cash basis of accounting 1970 to 1980. Revenue, expense, and appropriation data for the years 1970 to 1979 were adjusted to be comparable to operating appropriations as defined by the D.C. Office of Budget and Resource Development in 1980. The expenditures for years prior to 1976 and 1976 forward are not exactly comparable because prior to 1976 the District recorded as pension expense the amount of retirement payments made each year. In 1976, the District began recording the cost of retirement benefits earned by employees. Data for 1976-80 adjusted for professional tax suit lost by the District. Excludes short-term borrowing and cash balance carryovers. Budget estimate used for 1971 District revenue because actual figures were not included in the budgets. Budget estimate used for 1971 District revenue because actual figures were not included in the budgets.

b/Does not include grants.

c/Not available.

Figure 1
Trend of Revenue, Expenses and
Appropriations for Operations and Debt Service



(Data for 1970-1979 are estimates; 1980 is preliminary)

Table 3 (cont.)
Price and Demographic Statistics for
Use in Analyzing District of Columbia Revenue

	<u>1979</u>	<u>1980</u>	<u>1981</u>	<u>1982</u>	<u>1983</u>	<u>1984</u>	<u>1985</u>	<u>1986</u>
GDP price deflator (note a)	154.4	180.8	199.6	217.2	235.0	252.6	269.5	285.1
D.C. households (note b)	656,000	639,000	632,000	625,000	619,000	613,000	607,000	601,000
D.C. households (note c)								

Table 4 (cont.)
Constant Dollars
Revenues Financing the Appropriations for
General Fund Operating Expenses and Debt Service
(1972 dollars)

	<u>1978</u>	<u>1979</u>	<u>1980</u>	<u>1981</u>	<u>1982</u>	<u>1983</u>	<u>1984</u>	<u>1985</u>
	----- (millions) -----							
General fund revenue D.C. sources	\$586,469	\$562,929	\$543,460	\$542,395	\$543,055	\$535,404	\$531,869	\$533,359
Federal Funds:								
Federal payment	181,519	152,039	153,001	147,996	133,122	127,660	118,765	111,317
Revenue sharing	24,166	17,196	15,615	13,176	8,702	8,043	7,482	7,013
Total general fund revenue	<u>\$792,154</u>	<u>\$732,193</u>	<u>\$712,079</u>	<u>\$703,557</u>	<u>\$689,873</u>	<u>\$671,106</u>	<u>\$659,116</u>	<u>\$651,689</u>

Table 6
Changes in District of Columbia
Local Revenue (note a)

	<u>1970</u>	<u>1971</u>	<u>1972</u>	<u>1973</u>	<u>1974</u>	
GDP price deflator	91.36	96.02	100.00	105.8	116.02	1
Amounts:	----- (thousands) -----					
Current Dollars:						
General property taxes	\$129,337	\$134,100	\$142,667	\$149,512	\$151,529	\$1
Sales taxes	133,727	143,700	152,451	178,295	189,551	1
Income taxes	103,851	136,630	137,466	149,948	164,159	1
Other (tax and nontax revenue)	42,407	44,010	47,343	48,775	50,607	
Constant Dollars:						
General property taxes	\$141,569	\$139,653	\$142,667	\$141,316	\$130,606	\$1
Sales taxes	146,374	149,656	152,451	168,511	163,378	1
Income taxes	113,693	142,262	137,466	141,728	141,492	1
Other (tax and nontax revenue)	46,417	45,834	47,343	46,101	43,619	
	<u>1970-75</u>	<u>1975-78</u>	<u>1978-81</u>	<u>1981-82</u>		
Percent Change:						
Current Dollars:						
General property taxes	10.3	39.6	17.6	19.3		
Sales taxes	48.9	57.8	20.3	4.4		
Income taxes	66.2	60.7	20.8	8.7		
Other (tax and nontax revenue)	41.7	63.1	34.2	4.5		
Constant Dollars:						
General property taxes	-20.7	16.8	-10.4	9.7		
Sales taxes	6.9	32.0	-8.4	-4.1		
Income taxes	19.4	34.4	-9.0	-0.1		
Other (tax and nontax revenue)	1.8	40.6	2.2	-4.0		

a/See footnotes in table 1 of this appendix for data limitations.

Note: 1971 District estimate used because actual data was not included in budget documents. Amounts for pending authority are not included in 1931 and 1932 data.

Table 7
Per Capita and Per Household Revenues in Current and
 Constant Dollars, Available to Finance the Appropriations
 for General Fund Operating Expenses and Debt Service (note a)

	<u>1970</u>	<u>1971</u>	<u>1972</u>	<u>1973</u>	<u>1974</u>	<u>1975</u>	<u>1976</u>	<u>1977</u>	<u>1978</u>
D.C. population (thousands)	755	751	745	737	723	710	700	683	671
D.C. households (thousands) (note b)	263		270	272	277	272	273	272	275
PER CAPITA:									
Current Dollars:									
District sources	\$542	\$610	\$644	\$714	\$ 769	\$ 809	\$ 920	\$1,133	\$1,329
Federal sources	154	174	233	276	311	357	394	452	466
Total general fund revenue	<u>\$696</u>	<u>\$785</u>	<u>\$877</u>	<u>\$991</u>	<u>\$1,080</u>	<u>\$1,166</u>	<u>\$1,314</u>	<u>\$1,585</u>	<u>\$1,795</u>
Constant Dollars:									
District sources	\$593	\$635	\$644	\$675	\$653	\$636	\$698	\$ 800	\$ 874
Federal sources	169	131	233	261	268	281	295	319	306
Total general fund revenue	<u>\$762</u>	<u>\$810</u>	<u>\$877</u>	<u>\$937</u>	<u>\$931</u>	<u>\$917</u>	<u>\$903</u>	<u>\$1,119</u>	<u>\$1,181</u>
PER HOUSEHOLD:									
Current Dollars:									
District sources	\$1,559		\$1,778	\$1,936	\$2,007	\$2,112	\$2,360	\$2,844	\$3,243
Federal sources	442		643	748	912	932	1,010	1,136	1,137
Total general fund revenue	<u>\$2,002</u>		<u>\$2,421</u>	<u>\$2,684</u>	<u>\$2,919</u>	<u>\$3,044</u>	<u>\$3,369</u>	<u>\$3,980</u>	<u>\$4,380</u>
Constant Dollars:									
District sources	\$1,707		\$1,778	\$1,830	\$1,730	\$1,661	\$1,765	\$2,007	\$2,133
Federal sources	484		643	707	700	733	755	802	748
Total general fund revenue	<u>\$2,191</u>		<u>\$2,421</u>	<u>\$2,537</u>	<u>\$2,430</u>	<u>\$2,394</u>	<u>\$2,520</u>	<u>\$2,809</u>	<u>\$2,881</u>

a/ See footnotes in table 1 of this appendix for data limitations.

b/ D.C. household defined as occupied dwelling unit. Number of D.C. households not available for years 1971, and 1979 through 1985.

Notes: Totals may not add due to rounding.

Table 3
Major Changes in Taxes and Estimated
 Revenue Effect First Full Year

Year enacted	Income		Property	
	Tax change	Amount (millions)	Tax change	Amount (millions)
1970	Change capital gains and sick pay	+\$ 1.5	3-percent rate increase real property	+\$ 3.6
	New rates and brackets (individual)	+ 25.0	4-percent increase personal property	+ .7
	\$25 minimum tax (business)	+ 2.5		
1971				
1972	Business rate increased to 8 percent	+\$ 6.0	3-percent rate increase	+\$ 3.9
1973			4-percent rate increase Phase out business inventory tax	+\$ 4.7 - 2.6
1974			Phase out business inventory tax	-\$ 5.3
1975			Phase out business inventory tax	-\$ 9.5
1976	Change in personal exemptions and child care	+\$ 1.5	18-percent increase personal property	+\$ 2.3
	New rates and brackets (individual)	+ 14.9		
	Professional tax and other	+ 30.2		
1977	Tax credit for elderly	-\$ 6.2	Assessed value reduced for selected property	-\$20.2
1978	Tax credit excess property 10-percent business surtax continued	-\$ 1.0 + 5.6	Increased homestead exemption	-\$ 3.0
1979				
1930	Professional tax suit lost	-\$36.9	Commercial rate increased Personal property increased Real estate transfer tax enacted	+\$15.8 + 2.2 + 11.0

Source: District of Columbia. District of Columbia Tax Facts, fiscal year 1930
 except that 1930 information was obtained from Department of Finance
 and Revenue.

APPENDIX II

	Aug.	Sep.	Oct.	Nov.	Dec.	1981 Jan.	Feb.	Mar.	Apr.	May.	Jun.
ew		(9/1) Final Mayor action; (9/5-10) call for President and Congress budgets	(10/1) D.C. adopts budget Agency response to calls President and Congress budget to printer	11/2 Submit budget to Congress			Congressional review of budget House action on Budget		Senate action on budget	Conference action on budget	President signs budget**
		Prelim. revenue estimates	Instruc- tions to agencies		(12/15) Agencies submit budget	(1/15) Prelim. budget distrib- uted	Public hearing— complete 3/15	Agencies update budgets	(4/26) Submit executive budget		(6/20) Budget adopted
		Prelim. revenue estimates	(10/1) Instruc- tions to agencies		Agencies submit budgets			(3/25) Prelim. budget to Board	(4/18) Final recom. by Board	(5/1) Final budget to Council	(6/10) Budget adopted
		Prelim. revenue estimates	Instruc- tions to agencies	Agencies submit budgets			(2/1) Executive approves budget	(3/1) Budget submitted to Council			Council must approve budget by 7/31
	(3/15)	(9/4) Prelim. revenue estimates	Instruc- tions to agencies	(11/15) Agencies submit budgets				(3/1) Budget submitted to Executive	(4/1) Submit budget to Council	(5/15) Council adopts budget	(6/15) Budget adopted
			Agencies submit budgets			Budget decisions presented to County Executive	(2/24) Budget submitted to Board			(5/1) Board adopts budget	

APPENDIX II

A Comparison of Fiscal Year 1982 Budget Calendars: District of Columbia and Selected Jurisdictions - Normalized to Fiscal Years Ending June 30, 1982 (note a)

Jurisdiction	1979		1980		Apr.	May.	Jun.	Jul.
	Nov.	Dec.	Jan.	Feb.				
District of Columbia			(1/23) Prelim. revenue estimate	(2/25) Prelim. budget to Mayor	(3/5) Instruc- tions to agencies (3/26) Agencies submit budgets	(5/7) Final marks to agencies	(6/15) Submit final budget to City Council	Council re- of budget
New York City								
Baltimore City								
San Diego								
Prince George's County								
Fairfax County								Prelim. revenue estimate Instruc- tion to agencies

a/The fiscal year ends on 9/30/82 for D.C. and 6/30/82 for the other jurisdictions. All events related to the District are shifted back 3 months to make the periods comparable.

b/This may not occur until well after the beginning of fiscal year 1982.

Source: District of Columbia, Office of Budget and Resource Development

Title V, Section 501
of Public Law 93-198

TITLE V—FEDERAL PAYMENT

DUTIES OF THE MAYOR, COUNCIL, AND FEDERAL OFFICE OF MANAGEMENT
AND BUDGET

Sec. 501. (a) It shall be the duty of the Mayor in preparing an annual budget for the government of the District to develop meaningful intercity expenditure and revenue comparisons based on data supplied by the Bureau of the Census, and to identify elements of cost and benefits to the District which result from the unusual role of the District as the Nation's Capital. The results of the studies conducted by the Mayor under this subsection shall be made available to the Council and to the Federal Office of Management and Budget for their use in reviewing and revising the Mayor's request with respect to the level of the appropriation for the annual Federal payment to the District. Such Federal payment should operate to encourage efforts on the part of the government of the District to maintain and increase its level of revenues and to seek such efficiencies and economies in the management of its programs as are possible.

(b) The Mayor, in studying and identifying the costs and benefits to the District brought about by its role as the Nation's Capital, should, to the extent feasible, among other elements, consider—

- (1) revenues unobtainable because of the relative lack of taxable commercial and industrial property;
- (2) revenues unobtainable because of the relative lack of taxable business income;
- (3) potential revenues that would be realized if exemptions from District taxes were eliminated;
- (4) net costs, if any, after considering other compensation for tax base deficiencies and direct and indirect taxes paid, of providing services to tax-exempt nonprofit organizations and corporate offices doing business only with the Federal Government;
- (5) recurring and nonrecurring costs of unreimbursed services to the Federal Government;
- (6) other expenditure requirements placed on the District by the Federal Government which are unique to the District;
- (7) benefits of Federal grants-in-aid relative to aid given other States and local governments;
- (8) recurring and nonrecurring costs of unreimbursed services rendered the District by the Federal Government; and
- (9) relative tax burden on District residents compared to that of residents in other jurisdictions in the Washington, District of Columbia, metropolitan area and in other cities of comparable size.

(c) The Mayor shall submit his request, with respect to the amount of an annual Federal payment, to the Council. The Council shall by act approve, disapprove, or modify the Mayor's request. After the action of the Council, the Mayor shall, by December 1 of each calendar year, in accordance with the provisions in the Budget and Accounting Act, 1921 (31 U.S.C. 2), submit such request to the President for submission to the Congress. Each request regarding an annual Federal payment shall be submitted to the President seven months prior to the beginning of the fiscal year for which such request is made and shall include a request for an annual Federal payment for the next following fiscal year.

AUTHORIZATION OF APPROPRIATIONS

Sec. 502. Notwithstanding any other provision of law, there is authorized to be appropriated as the annual Federal payment to the District of Columbia for the fiscal year ending June 30, 1975, the sum of \$250,000,000; for the fiscal year ending June 30, 1976, the sum of \$254,000,000; for the fiscal year ending June 30, 1977, the sum of \$280,000,000; for the fiscal year ending June 30, 1978, and for each fiscal year thereafter, the sum of \$300,000,000.

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Table 3 (cont.) -
Major Changes in Taxes and Estimated
Revenue Effect First Full Year

Year enacted	Sales		Other	
	Tax change	Amount (millions)	Tax change	Amount (millions)
1970	Various increases	+\$ 9.8	Motor vehicle regis- tration increase	+\$ 3.3
	Motor vehicle excise rate increase	+ 1.7		
	Cigarette rate increase	+ 1.1		
	Rate increase for liquor	+ 1.7		
1971				
1972	Rental of linen at 2 percent	+\$.1	Inheritance and estate rates increased	+\$ 2.8
	Gasoline rate increase	+ 2.4		
1973	1-percent rate increase public utilities	+\$ 3.0		
	General rate increase from 4 to 5 percent	+ 13.0		
	1-percent rate increase restaurant meals and other	+ 2.8		
	Motor vehicle excise rate increase	+ 1.9		
	Cigarette rate increase	+ 1.3		
1974				
1975				
1976	1-percent rate increase for public utilities	+\$ 4.3	Rate increase for deed recordation	+\$ 2.7
	2-percent rate increase on banks	+ 3.1	Motor vehicle regis- tration increase	+ 3.9
	Various rate changes (nat)	+ 7.3		
	Gasoline rate increase	+ 4.3		
	Motor vehicle excise rate increase	+ 2.4		
	Cigarette rate increase	+ 5.0		
1977			Motor vehicle regis- tration rates reduced	-\$ 3.9
1978	Rate reduced for spirits	-\$ 1.3	Hotel occupancy tax	+\$ 3.0
1979				
1980	General sales increased to 6 percent	+\$16.0		
	Hotel room sales increased to 10 percent	+ 3.7		
	Confectionary tax of 6 percent	+ .5		

Table 7 (cont.)
 Per Capita and Per Household Revenues in Current and
 Constant Dollars, Available to Finance the Appropriations
 for General Fund Operating Expenses and Debt Service (note a)

	<u>1979</u>	<u>1980</u>	<u>1981</u>	<u>1982</u>	<u>1983</u>	<u>1984</u>	<u>1985</u>	<u>1986</u>
D.C. population (thousands)	656	639	632	625	619	613	607	601
D.C. households (thousands) (note b)								
PER CAPITA:								
Current Dollars:								
District sources	\$1,411	\$1,540	\$1,714	\$1,836	\$2,033	\$2,192	\$2,368	\$2,556
Federal sources	424	478	509	510	515	520	525	531
Total general fund revenue	<u>\$1,835</u>	<u>\$2,018</u>	<u>\$2,247</u>	<u>\$2,422</u>	<u>\$2,580</u>	<u>\$2,747</u>	<u>\$2,926</u>	<u>\$3,126</u>
Constant Dollars:								
District sources	\$ 958	\$ 952	\$ 859	\$ 969	\$ 965	\$ 968	\$ 979	\$ 895
Federal sources	253	264	255	235	219	206	195	186
Total general fund revenue	<u>\$1,116</u>	<u>\$1,116</u>	<u>\$1,126</u>	<u>\$1,115</u>	<u>\$1,098</u>	<u>\$1,087</u>	<u>\$1,036</u>	<u>\$1,094</u>

Table 6 (cont.)
Changes in District of Columbia
Local Revenue (note a)

	<u>1976</u>	<u>1977</u>	<u>1978</u>	<u>1979</u>	<u>1980</u>	<u>1981</u>	<u>1982</u>
1982 price deflator	133.71	141.7	152.05	164.4	180.8	199.6	217.2
Amounts:	----- (thousands) -----						
Current Dollars:							
General property taxes	\$148,911	\$167,305	\$199,292	\$215,216	\$219,395	\$234,300	\$279,626
Sales taxes	225,525	260,370	314,005	305,446	322,359	377,700	394,195
Income taxes	295,197	251,107	277,399	301,173	337,041	335,090	364,027
Other (tax and nontax revenue)	64,551	94,902	101,030	103,620	103,781	135,600	141,667
Constant Dollars:							
General property taxes	\$111,359	\$118,070	\$131,070	\$130,910	\$121,347	\$117,395	\$123,741
Sales taxes	168,567	193,747	206,514	195,794	179,296	189,228	181,499
Income taxes	153,454	177,210	182,439	183,195	185,416	167,836	167,600
Other (tax and nontax revenue)	49,277	66,974	66,445	63,029	57,401	67,936	65,224

Table 5
Federal Payment as Percentage
of General Fund Revenues

	<u>Federal</u> <u>payment</u> <u>appropriation</u> <u>-----</u> <u>(millions)</u>	<u>District sources</u> <u>general</u> <u>fund</u> <u>revenue</u>	<u>Total</u> <u>general</u> <u>fund</u> <u>revenue (note a)</u>	<u>Federal payment</u> <u>as percent</u> <u>District source</u> <u>revenue</u>	<u>Federal payment</u> <u>as percent</u> <u>total general</u> <u>fund revenue</u>
1970	\$ 115.2	\$ 409.3	\$ 525.5	28.4	22.1
1971	131.0	458.4	599.4	23.6	22.2
1972	173.7	479.9	653.5	36.2	26.6
1973	181.5	526.5	730.0	34.5	24.9
1974	187.5	555.8	730.3	33.7	24.0
1975	225.2	574.5	827.9	39.4	27.3
1976	243.9	644.2	919.3	38.6	27.1
1977	276.7	773.7	1,032.6	35.3	25.6
1978	276.0	891.7	1,204.5	31.0	22.9
1979	<u>b/250.0</u>	925.5	1,203.7	27.0	20.8
1980	276.6	982.6	1,287.4	23.1	21.5
<u>c/1981</u>	205.4	1,032.6	1,419.0	27.3	20.3
<u>d/1982</u>	300.0	1,179.5	1,514.3	25.4	19.3

a/Includes revenue sharing funds received beginning in 1973.

b/Excludes expenses for farmers demonstration.

c/Estimated except Federal payment amount is actual.

d/Estimated.

Table 4
Constant Dollars
Revenues Financing the Appropriations for
General Fund Operating Expenses and Debt Service
 (1972 dollars)

	<u>1970</u>	<u>1971</u>	<u>1972</u>	<u>1973</u>	<u>1974</u>	<u>1975</u>	<u>1976</u>	<u>1977</u>
	------(millions)-----							
General fund revenue D.C. sources	\$448,043	\$477,411	\$479,927	\$497,656	\$479,095	\$451,799	\$481,777	\$546,001
Federal funds:								
Federal payment	127,152	136,430	173,654	171,550	161,567	177,900	186,185	195,236
Revenue sharing	<u>0</u>	<u>0</u>	<u>0</u>	<u>20,794</u>	<u>32,326</u>	<u>21,457</u>	<u>19,935</u>	<u>22,752</u>
Total general fund revenue	<u>\$575,195</u>	<u>\$613,841</u>	<u>\$653,581</u>	<u>\$690,000</u>	<u>\$672,988</u>	<u>\$651,156</u>	<u>\$687,897</u>	<u>\$763,989</u>

Table 3
Price and Demographic Statistics for
Use in Analyzing District of Columbia Revenue

	<u>1970</u>	<u>1971</u>	<u>1972</u>	<u>1973</u>	<u>1974</u>	<u>1975</u>	<u>1976</u>	<u>1977</u>	<u>1978</u>
GDP price deflator (note a)	91.36	96.02	100.00	105.80	116.02	127.15	133.71	141.70	152.05
D. C. population (note b)	755,000	751,000	745,000	737,000	723,000	710,000	700,000	683,000	671,000
D. C. households (note c)	262,538	(d)	270,000	272,000	277,000	272,000	273,000	272,000	275,000

a/Source: 1970-78 Economic Report of the President, January 1980, table B-3, p. 206; 1979-86 Budget of the United States Government, fiscal year 1982, pp. 3 and 5. For years 1970-78, the index is the average for the calendar years; for 1979-86 the index represents change from fourth quarter to fourth quarter.

b Source: 1970-80 U.S. Bureau of the Census. For the period 1981-86 GAO assumed District population would decrease by 1 percent each year.

c/Source: U.S. Bureau of the Census. D.C. household defined as occupied dwelling unit. Household data not available for 1971, and 1979 through 1986.

d/ Not available

Table 2 (cont.)
Relationship of Revenues, Expenditures
and Appropriations 1970-80

	<u>1977</u>	<u>1978</u>	<u>1979</u>	<u>1980</u>
	(thousands)			
including the Appropriation of Expenses and Debt (note a)				
sources (note b)	\$773,634	\$991,726	\$925,455	\$982,576
	306,890	312,745	279,270	304,863
total fire retirement and sewer enterprise	14,675	16,760	18,940	11,108
	47,987	76,337	53,458	62,505
total revenue	\$1,145,236	\$1,297,568	\$1,276,123	\$1,361,052
expenditures	\$1,113,111	\$1,247,608	\$1,339,719	\$1,370,835
appropriations	\$1,131,013	\$1,260,791	\$1,335,746	\$1,426,093

Table 1 (cont.)
General Fund Revenue
District of Columbia
 (note a)

	<u>1979</u>	<u>1980</u>	<u>1981</u>	<u>1982</u>	<u>1983</u>	<u>1984</u>	<u>1985</u>	<u>1986</u>
	----- (thousands) -----							
General Fund Revenue: (note b)								
District sources:								
Property tax	\$215,216	\$219,335	\$234,300	\$279,626	\$302,465	\$326,200	\$351,916	\$379,500
Sales tax	395,446	322,359	377,700	394,195	396,900	430,600	431,732	493,800
Income tax	301,173	337,011	335,000	364,027	395,905	430,900	469,644	507,400
Other	103,620	103,781	135,600	141,667	172,930	147,800	185,108	154,600
Total	<u>925,455</u>	<u>932,576</u>	<u>1,032,600</u>	<u>1,179,515</u>	<u>1,259,200</u>	<u>1,343,500</u>	<u>1,437,400</u>	<u>1,535,300</u>
Federal sources:								
Federal payment	250,000	276,631	295,400	300,000	300,000	300,000	300,000	300,000
Revenue sharing	28,270	28,242	26,300	18,900	18,900	18,900	18,900	18,900
Total	<u>278,270</u>	<u>304,873</u>	<u>321,700</u>	<u>318,900</u>	<u>318,900</u>	<u>318,900</u>	<u>318,900</u>	<u>318,900</u>
Granting Authority (note c)			14,651	15,900	20,000	21,400	20,000	23,600
Total general fund revenue	<u>\$1,203,725</u>	<u>\$1,287,449</u>	<u>\$1,418,951</u>	<u>\$1,514,315</u>	<u>\$1,597,100</u>	<u>\$1,683,800</u>	<u>\$1,776,300</u>	<u>\$1,877,800</u>
District Auditor Report:								
Total	<u>\$1,180,869</u>	<u>\$1,361,859</u>						

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DATA USED IN THIS REPORT

We used figures in this appendix as the basic data to analyze financial trends of the District government for the period 1970 to 1980. It was extremely difficult to obtain comparable data because over time the District has defined and presented financial accounts differently. For example, general fund revenues have been the measure used by the District to reflect local revenue experience. However, during some of the years, gasoline taxes were recorded separately from the general fund, and during other years it was part of the general fund. Other accounts were treated similarly so that the trend of the general fund revenue is significantly distorted unless it is defined and the data adjusted accordingly. We did this to reconstruct general fund revenue data for the period 1970 to 1980 on the basis of a 1980 general fund revenue presentation provided by a District official. We could not do the same with general fund appropriations or general fund expenditures; however, we were able to obtain total operating expenditures and appropriations.

To determine whether general fund revenue was reliable for trend purposes, we adjusted it to be comparable to total operating expenditures and operating appropriations. The data is shown in table 2 of this appendix. We then charted the data, as shown in figure 1, to determine whether the trend lines were reasonably close. The trend lines for the three sets of data are extremely close, meaning that revenue data should be reliable for trend purposes. Consequently, we believe that general fund revenue data presented in chapter 3 reasonably tells the story of what happened financially in the District. We also compared our general fund revenue data with figures published in the 1980 District of Columbia Financial Report. The amounts are reasonably close, as shown in table 1.

represents a fair Federal contribution to the government of the Nation's Capital.

- Formula-based Federal payments that would provide more funds to the District of Columbia than needed for efficient management of essential public services would not contribute to improved program or financial management of the District of Columbia. This situation could result if the formula was set on the basis of an abstract concept (such as revenue lost) or if a percentage of revenue was set too high.
- If a formula approach is to be used, formulas that utilize such items as past revenue collections, U.S. inflation in the previous year, or changes in District population as measured by the Bureau of the Census would be easier to administer than formulas based on future year estimates or on estimates of more intangible items such as taxes lost, net financial burden, or tax comparability.
- A complex formula may be needed to take into account the various factors (inflation, population, efficiency, local tax effort, wage and salary increases) that would be involved in determining the initial level of the formula and its year-to-year change.

Some of the benefits associated with a formula approach can also be achieved by other changes in the way the Federal payment is authorized and appropriated and in the way the District budget is reviewed by the Congress.

The District government's ability to manage its revenue, employee compensation, and program management responsibilities would be improved if the District government had a clear idea about the amount of the Federal payment likely to be appropriated at the time it prepares its budget (18 months before the beginning of the fiscal year).

Annual congressional review of District financial affairs, including investigation of certain matters in depth, and the ability to direct that certain things be done or not done, appears to be essential for maintaining the Federal interest on a continuing basis. Such review also provides a check-and-balance system for District finances. However, since the nature of the Federal interest would generally not be expected to change much from year

If fully carried out, those provisions of the Self-Government Act requiring the Mayor to present to the City Council a budget which shows, on a comparable basis, funds made available for the past 3 years as well as estimates for the forthcoming 4 years could encourage the Congress to set, and if necessary revise, advance authorizations. (For additional discussion see chapter 4 and its recommendations.)

The Self-Government Act requires the District of Columbia's annual request for a Federal payment to include amounts for the year ahead of the budget year as well as for the budget year. Although the District of Columbia government made such a request in 1981, no action was taken. Authorization and appropriation committees and OMB could use this advance request to provide explicit guidance to the District on the amount of the Federal payment likely to be available for the forthcoming year.

If authorization and appropriation committees and OMB could articulate goals for the District with respect to financing services for the city's population in an inflationary environment, the range of uncertainty associated with annual authorization or appropriation of the Federal payment would probably be significantly reduced. Although a consensus about what approach to follow may not be achieved, debate about the payment would at least be focused on overall financing policy. Combined with advance authorization, this process of setting goals would provide a more predictable basis for the Federal payment without requiring formal changes in District budget autonomy. Decisions by committees to reduce the extent of the line item review of the District budget could also shift debate to general matters of fiscal policy without requiring formal changes in budget procedures. Improvements in accounting and financial management procedures and in reporting by District officials of the type recommended in chapter 4 would also assist in focusing budget discussion on overall fiscal strategy.

Formal changes in procedures that the Congress could adopt would also encourage the achievement of some of the advantages associated with formula-based Federal payments. One of these is changing the appropriation process so that only the Federal payment is appropriated, leaving final approval of the budget to the City Council subject to such specific directive, veto, or limitation provisions as the Congress wished to adopt either when it appropriated the Federal payment or at a later time.

Table 5-3
Date District Appropriation Act Passed
and Time Elapsed of Fiscal Year
Selected Years

<u>Fiscal year</u>	<u>Date act passed</u>	<u>Months elapsed of fiscal year</u>
1976	6/30/76	a/12
1977	10/1/76	0
1978	6/5/78	8
1979	9/18/78	0
1980	10/30/79	1
1981	12/15/80	2.5

a/The fiscal year started on July 1, 1975 and the District budget was transmitted to the Congress on November 5, 1975.

Although longer than the process used in many other jurisdictions, the District process is very similar to that applicable to all Federal agencies which must make a full submission to OMB for the fiscal year to start a year later. (See app. II for a chart which shows that the District budget process is considerably longer than that of New York, Baltimore, San Diego, Prince Georges County, and Fairfax County.) Formal reprogramming and budget amendments must be used to enable the District to respond to major changes in circumstance.

Adoption of a formula approach to the Federal payment need have no effect on the timing of the District budget process. If a formula were to be authorized and appropriation review were simplified, the amount of time District officials had to spend in hearings would be reduced. But the only changes that would reduce the time between City Council review and the beginning of the fiscal year would be (1) later submission of the request to the Congress or (2) earlier action by the Congress combined with an earlier District fiscal year. A formula-based Federal payment or appropriation of the payment a year ahead of time, although it would not reduce the calendar time involved in the budget process, would reduce the uncertainty that now exists about Federal intentions when the City Council acts on the budget in the fall of each year.

EASE OF ADMINISTRATION

Columbia were cited in chapter 2. In 1977, to cite another example, the Senate Appropriations Subcommittee reduced the Federal payment \$2 million while admonishing District officials to increase collections of parking fines. In response to the action, the District recovered \$13 million within 2 years.

More recently, Arthur Andersen and Company and Lucas, Tucker and Company, the city's independent auditors, submitted a memorandum of comments and suggestions to the District government for making management improvements. 1/ While noting that much progress had been made, the auditors identified the need to proceed with these key tasks:

- Key positions at many agencies urgently need to be filled and must be given a high priority.
- The financial internal audit function of the District must be planned and staffed, and personnel must be formally trained.
- The financial discipline, supervision, and monitoring which District personnel have experienced during the past year must be reinforced with short- and long-term training in financial management and accounting.
- Financial management and accounting procedures must be clarified and documented so that they can be effectively used and procedures must be monitored.
- Financial management system documentation of manual and data processing control techniques must be expanded. Overall documentation must be indexed and/or reorganized to facilitate understanding and use of the financial management system.
- Additional key financial reports must be developed (now underway) and personnel trained in their use.
- Regular financial reporting and management review of monthly operating data must begin as soon as possible in 1981. Certain financial management system reports, such as error listings, should be reviewed and errors cleared promptly.
- Significant continued effort is necessary to sustain improvements in the SHARP Computer Center operations

clearly indicates. Changes in the Federal payment and budget process could increase the degree of local autonomy. But no matter what changes are made, from time to time special congressional interest in specific program areas (such as Metro financing, highway construction, the size of the University of the District of Columbia, or the police force) can be expected to result in hearings, legislation, or appropriation directives or limitations. Eliminating congressional line item review of the District budget would, however, require the Congress to make its concerns explicit in other ways because making changes through the budget markup process would no longer be possible.

The possibility of changing the Federal payment mechanism to provide for greater autonomy is related to the amount of funds authorized. If city employment is judged to be too high or city-granted pay raises too great, it is unrealistic to expect the Congress to lock itself into a formula that can be viewed as subsidizing excessive employment expenses. In arguing for changes in the Federal payment mechanism to increase local autonomy, the District essentially is trying to persuade the Congress that over the long term even if mistakes are made the city will be better run if locally elected officials have the authority to deal with local problems without detailed review and approval by the Congress. District officials believe that they are subject to the same discipline as other municipal governments, such as taxpayer resistance to rate changes and scrutiny of audited financial statements. Therefore, they believe they should also experience the degree of control over their own budget that officials have in other cities.

The issue of autonomy cannot be completely separated from the unique nature of the District of Columbia government. If virtual total autonomy were to be delegated to the District, 14 individuals (the Mayor and 13 members of the City Council) would have more power and authority than State or local officials in other jurisdictions in the United States. The District of Columbia government has all the legislative power of a State (with a few exceptions, such as commuter tax prohibition, prosecution of felonies, and building height limitations, which are spelled out in the Self-Government Act), and it administers the entire range of public services. In all other jurisdictions, legislative and administrative authority is split between a variety of State and local officials, and local jurisdictions must often seek State aid for significant parts of their budget.

Table 5-2
Unappropriated Federal Payment Authorizations

<u>Year</u>	<u>Authorized but unappropriated</u>	<u>Unappropriated as percent of authorized</u>
	--(millions)--	
1970	\$1.8	1.5
1971	0	0
1972	5.3	3.0
1973	3.5	4.5
1974	2.5	1.3
1975	3.8	1.7
1976	5.1	2.0
1977	3.3	1.2
1978	24.0	8.0
1979	50.0	16.7
1980	23.4	7.8
1981	4.6	1.5

At its current authorization of \$300 million, the Federal payment appropriation is almost totally predictable at close to \$300 million, but this predictability is achieved at the price of eliminating payment increases. A totally predictable Federal payment that did not increase from year to year is unlikely to be acceptable to the District government. The District often talks about a predictable Federal payment in relation to a formula, in which case the increases would be predictable as well as the total Federal payment.

A Federal payment formula that relies on data from a past year will be more predictable than one that must rely on current year estimates or calculations. The most predictable future payment authorization is, of course, one that sets exact dollar amounts in forthcoming years (the approach used in the 1973 Self-Government Act).

The issue of predictability is often closely associated with the District's desire for more autonomy. The nature of the present appropriation process necessarily introduces an element of unpredictability into the budget process, although changes imposed by the Congress on the Federal payment or on the total size of the budget are usually quite small in relation to the total and

Although it is clear that almost any formula could be made to produce any amount, each formula approach is not equally flexible with respect to either the initial amount of the payment or its year-to-year change. A percentage of revenue formula which represents a straightforward pragmatic approach to providing a Federal payment to the District is the most flexible. The proper percentage can be debated, different percentages can be set for different years, and changes in the percentage can be made in the percentage in the future.

A cost-of-living escalator approach also gives complete flexibility in setting the initial level, but this approach provides less flexibility with respect to subsequent changes. A general inflation index--such as the U.S. GNP deflator--is unlikely to reflect exactly the inflation actually experienced by the District government. (It specifically should be noted that wage adjustments, a major component of inflation, are set by the Government itself and hence there is an element of control in the degree of inflation experienced by the Government. State and local governments, just like the Federal Government, often increase wages at rates less than the rate of inflation measured by general inflation indices.) Once having adopted an indexed approach, however, if the Federal Government paid less than 100 percent of an inflation index, the Government would look like it was changing its policy arbitrarily.

A formula based on payment-in-lieu-of-taxes is more difficult conceptually to target to a particular amount of money unless a special tax rate is to be applied to the estimated base used to calculate the payment. The Congress could, however, legislate the rates to be applied to the value of Federal property or imputed income. Since this formula depends on changes in the tax base for growth, it is better insulated from pressure to increase or decrease the payment than the percentage of local revenue approach. If the Federal "tax base" is increased by a rate of inflation, the result is the same as indexing. If the base is increased by percentage changes in comparable District government magnitudes, it becomes like a percentage-of-revenue approach.

A formula based on the net financial burden of the Federal Government is also difficult to target to a predetermined amount of revenue. Either numbers associated with benefits or costs have to be juggled, or what appears to be an arbitrary percentage factor would have to be used to increase or decrease the net benefit to

Table 5-1
Estimated Amount of Federal Payment to the District
Government Under Alternative
Payment Formulas (note a)

Type of formula or payment	Actual		Estimated				
	1980	1981	1982	1983	1984	1985	1986
	------(millions)-----						
Existing or projected appropriation	\$277	\$295	\$300	\$300	\$300	\$300	\$300
30 percent of local D.C. general fund revenues for previous year assuming no in- crease in tax rates			300	354	377	403	431
30 percent of local D.C. general fund revenues of previous year assuming local tax rate increases bring in 3 percent more revenue per year			300	365	389	415	444
40 percent of local D.C. gen- eral fund revenues for previous year assuming no increase in tax rates			300	472	503	538	575
Cost of living escalator (3% per year)			300	324	350	378	408
Amount of Federal payment required to pay 100 percent of projected gap between revenues and expenses			300	340	383	429	473

a/The 1982 payment is not based on our calculations. It is from the District's 1982 budget submitted to the City Council in October 1980.

For comparative purposes, the 36-percent increase in the

payment and budget process that is easier to administer than the current budget process would result in the Congress spending less time on District affairs and more on national and international issues.

The history of the relationship between the Federal and District Governments since home rule indicates that there will be times when budget decisions made by the District government will be different than those that the Congress feels serve the overall Federal interest. The size of the police force and the size and location of the campus of the University of the District of Columbia are two recent cases where there has been substantial difference of opinion between the Congress and the District of Columbia government. In the case of funding for police officers, the Congress has made changes in the Federal payment and in the overall District budget in order to fund the number of police positions felt necessary. The conference report on the 1981 District appropriation, dated November 21, 1980, states:

"The conference action provides \$113,013,200 instead of \$113,522,100 as proposed by the House and \$112,013,200 as proposed by the Senate. This allowance includes an increase of \$6 million above the proposed police budget for fiscal year 1981. The conferees are concerned with the low level of staffing of the uniformed police force and direct that no further reductions be made in the number of sworn officers below the current level. The conferees further direct District officials to move aggressively toward a hiring and training program that will bring the employment level of the Metropolitan Police Department above the level of 3,800 filled sworn police officer positions immediately."

The \$6 million increase was financed by a \$6 million increase in the Federal payment appropriation over what otherwise would have been appropriated.

The reluctance of the city to fill police department vacancies in the absence of continuing congressional scrutiny has been a matter of concern as recently as March 13, 1981--the date of a House appropriations subcommittee hearing. This history suggests that the Congress may require a vehicle for annually making determinations about the nature of specific budget items in order to be able to serve the Federal interest.

be increased by a cost-of-living index, such as the GNP deflator or the Consumer Price Index.

- Payment-in-Lieu-of-Taxes. The Federal Government would pay an amount equal to the property and income taxes that it would pay if it were a private sector employee.
- Compensation for the Net Financial Burden that the Federal Presence Imposes on the District Government. The expenses of services provided by the Federal Government to District residents (e.g. zoo, parks) would be subtracted from the sum of revenue lost by the District government (prohibition of commuter tax, building height limitation, exempt property) and expenses incurred (demonstrations, police and fire protection) as a result of the Federal presence. An allowance could also be included for revenue that the District received indirectly from higher property values as a result of Federal financing for Metro, Pennsylvania Avenue development, etc.
- Comparable Tax Burden. Under this approach, District taxes would be set (or assumed to be set) at rates comparable to those prevailing in surrounding jurisdictions and in cities of comparable size. The Federal payment would represent the difference between the revenues collected by these tax rates and the amount needed to pay the District government's expenses.

Conceptually, each approach can be supported as a valid basis for the Federal payment. Rather than debating the merits of each possible approach in the abstract, however, the discussion which follows concentrates on the characteristics of each approach in terms of the seven highlighted issues (amount of revenue, predictability, autonomy, etc.). 1/

PRESERVING THE FEDERAL INTEREST

The Federal Government has an interest in keeping the Federal payment to the District as low as possible, but this is not the sole interest. The Capital City requires an adequate level of well-managed public services, and it does not serve the Federal interest to have District tax rates so high that it drives people and businesses from the city.

--Present meaningful comparisons of past trends and assumptions about the future in areas such as the relationship of the budget to changes in the city's population and service groups and the impact of inflation and other changes in the economy on revenues and expenditures.

--Specifically, show the relationship between each year's appropriations, each year's actual obligations, and each year's revenue and cash position.

AGENCY COMMENTS

District officials commented orally on the report and the recommendations. While they had no major problems with the report, they emphasized their concern about budget autonomy and administrative problems associated with the predictability of the Federal payment. They also felt that the report overemphasized data comparability problems because changes in basic accounting systems and fund categories have made it technically very difficult, if not impossible, to reconstruct past data on a strictly comparable basis.

In commenting on our recommendations, they recognized the value of accurate, consistent information but said that, in addition to changes in basic data systems that have occurred, the burden of simultaneously preparing and processing budgets for 3 fiscal years and handling other ad hoc needs has precluded them from maintaining the best possible data. They acknowledged that data presentations have changed over the years but the changes were made necessary by such things as the change from cash-based budgeting to accrual-based budgeting. District officials expressed the view that most of the shifts in definitions, methods of measurement, and classifications have now been made, with the result that more consistent financial data should be available from the audited 1979 financial statements forward.

We recognize that District officials handle many activities simultaneously, their budget process requires much time and attention, and from time to time changes will be necessary in accounting systems or data presentations. However, GAO believes that the collection and maintenance of good data are essential if the Congress and the City Council are to have an informed basis for determining overall fiscal needs. When changes are made in the data presentations, adequate documentation, such as footnoting the changes, should be included in the budget documents to make it

The Self-Government Act stipulates the information that should be included in the budget to facilitate analysis of trends and overall financing issues. Section 442(a) (1) and (2) provide for the Mayor to prepare budgets which reflect the actual financial condition of the District government and information on the approved budgets and expenditures for the immediately preceding 3 fiscal years. Although the District provided some data in the budget, it was not available for the preceding 3 fiscal years. Data that was presented, such as grants, employment, and general fund revenue, was not presented consistently from year to year. Although we recognize that there have been changes in accounting and data systems, to comply with this section of the act we believe that the District should have made a good faith effort to provide the best possible comparable data over time in such areas as total revenues, expenditures, appropriations, employment, and grant funds.

The act also states that, in each budget the Mayor shall report budget estimates for the next 4 succeeding years. Although some of this information is contained in the 1982 budget submitted to the City Council (such as the projection of revenues and expenses discussed in this chapter), there is still much room for improvement in implementing those provisions. The section that projects revenues and expenditures from 1982 to 1986 contains no historical information on past expenditures or revenues, and the general fund definition used there apparently is not used consistently throughout the budget documents. Also, the assumptions with respect to inflation, growth in the economy, demographic changes, service populations, expected wage and salary increases, number of employees, and availability of Federal grants are not stated in the projection. Comparisons are not developed to show how the proposed budget and those estimated for future years compare to trends in past years in such areas as growth in District revenues compared to inflation.

CONCLUSIONS

The District's financial plan for the period 1982 to 1986, which assumes no new taxes or rate changes, no increase in the Federal payment, and maintenance of existing levels of service and city employment, projects a gap between revenue and expenditures starting in 1983. If the revenue projections are accurate, revenue will almost keep up with price changes without tax rate increases. To do so will represent a significant milestone for

city can exercise some discretion, these other items cannot be easily reduced in a short period of time.

Major reductions in amounts projected for personal services would have to involve some combination of reductions in the number of full-time equivalent employees, reduction in average grade, and reduction in the wage and salary increases granted each year to city employees. Unfortunately, the budget projection does not include figures on the estimated number of employees, nor does it explicitly state the assumptions used about pay increases to be granted to employees. Since the 40-percent increase in personal expenses exceeds the 36-percent projected nominal growth in the economy, closer scrutiny of the personnel and pay policies applicable to a "hold the line" budget would appear to be in order.

Increasing the tax rate

The extent to which taxes can be increased depends on the reaction of voters, economic conditions, and the political climate in the District. At the present time, the tax burden for a family of four in the District is at the top in comparison with other local jurisdictions for income groups at the \$20,000 income level and up. A tax increase which would widen the tax burden between the District and other local jurisdictions would provide additional incentives for businesses and households to flee to the suburbs in search of lower taxes, thereby making it difficult or impossible to achieve anticipated revenue gains.

Enlarging the tax base

Enlarging the tax base is another way of helping to obtain additional revenues, particularly in the long term. Instituting a lottery is an example of a way to enlarge the tax base by creating a new revenue source. Enlarging the tax base for existing property, income, and sales taxes by a substantial amount takes time because of the long lead time needed to establish profitable businesses, attract higher income households, or increase retail sales.

Tax policies can affect the size of the tax base. For example, the recent increase in the gasoline tax made it economical for consumers to leave the District to obtain gasoline. The Mayor rescinded the increase within a short time because the adverse economic impact on gasoline sales would have decreased

Table 4-4
District Obligations Carried Over
to Subsequent Fiscal Year

	<u>1970</u>	<u>1975</u>	<u>1978</u>	<u>1980</u>
	----- (millions) -----			
Amount of obligations carried over to sub- sequent year	\$42.8	\$103.0	\$141.5	\$155.0
Increase from previous year shown		\$ 60.2	\$ 38.5	\$ 13.5

The audit of District finances for fiscal year 1980 showed that, on an accrual basis, operations resulted in a \$388 million general fund deficit. Subsequently, the District government estimated that \$184 million of this deficit represents a need for cash if the 1982 budget is to be appropriated and financed on an accrual basis. 1 We have not made a detailed review of this estimate of cash needs, but the major component appears to be represented by the \$155 million in 1980 obligations to be carried over to 1981 under the 1981 budget that was appropriated on a cash basis. (If the level of unfunded obligations does not increase in 1981--as the District government originally said, there would then be \$155 million in 1981 obligations that would either have to be paid from 1982 revenues or from some other revenue source.)

Without cutting approximately \$155 million from the pending 1982 budget, the District cannot switch to the accrual budgeting system unless special provision is made to fund the 1981 obligations that were expected to be paid from 1982 revenues. The District's financial projection through 1986 assumes that these carryover obligations will be paid from a special general obligation bond issue. The funds to pay off the bond are included in the estimated expenditure needs. If the bond issue is not authorized, revenue increases beyond those projected by the District could be needed if the carryover obligations are to be liquidated rapidly as part of a switch to an accrual-based budgeting system.

Table 4-2
Change in Taxes and Other General Fund Revenue
Compared to Change in the Economy--1982-86

<u>Source</u>	<u>Expected increase in level of receipts</u>	<u>Percentage increase</u>
	----(millions)----	
Local Sources:		
Property	\$ 99.9	35.7
Income	143.4	39.4
Sales	99.6	25.3
Other taxes	5.4	15.0
Pending authority (note a)	7.7	48.4
Other D.C. revenue	<u>7.5</u>	7.1
Total	<u>\$363.5</u>	30.4
Federal Sources:		
Revenue sharing	0	0
Federal payment	<u>0</u>	0
Total	<u>0</u>	0
Total all sources	<u>\$363.5</u>	24.0
Change in the economy	not applicable	<u>b/36.0</u>

a/Mayor's requests to the City Council and/or the Congress for changes in various taxes or fees such as estate taxes, license fees, or other taxes and fees.

b/The 36-percent change from 1982 to 1986 that appears to be implicit in the District projection is equivalent to an 8 percent annual net increase in the nominal value of the economy over the 4-year period. Assumptions regarding the division of this net change between price changes and real growth are not given.

The plan does not discuss specifically how to close the gap or propose alternative ways to pay the accumulated obligations although alternatives are available to take care of both.

The financial plan prepared by the District government is a financial planning document and not necessarily a projection of future city spending levels that will actually be recommended in future budgets. The plan can be characterized as a "hold the line" projection since it assumes

- no new taxes or changes in tax rates,
- no increase in the Federal payment from the current \$300 million authorization, and
- maintenance of existing levels of service and of city government employment.

Economic assumptions which lie behind the plan's projections are not stated, which makes it impossible to tell how revenues and expenses compare with inflation. However, the projection appears to assume that the District of Columbia economy would grow at a rate of 8 percent each year, ^{1/} but how much of this increase is price increase and how much represents real growth is not stated.

Table 4-1
Difference Between District of Columbia
Revenues and Expenditures

	<u>1982</u>	<u>1983</u>	<u>1984</u>	<u>1985</u>	<u>1986</u>
	------(millions)-----				
Revenue	\$1,514.3	\$1,597.1	\$1,683.8	\$1,776.3	\$1,877.8
Expenditures	<u>1,514.3</u>	<u>1,637.1</u>	<u>1,766.8</u>	<u>1,905.6</u>	<u>2,051.2</u>
Gap	<u>\$ 0</u>	<u>\$ (40.0)</u>	<u>\$ (83.0)</u>	<u>\$ (129.3)</u>	<u>\$ (173.4)</u>
Gap as a per- cent of:					
Revenue	0	2.5	4.9	7.3	9.2
Expenditures	0	2.4	4.7	6.8	8.5

^{1/}The 8-percent rate is referred to as the nominal rate of change in the economy.

local revenue and revenue sharing 1/ increased significantly, while the Federal payment increases became more moderate. Since 1978, revenue sharing decreased by a large percent, the Federal payment continued its leveling trend, and local revenue increases were less than inflation. When discounted by the GNP deflator, the percentage declines in local revenue, the Federal payment, and revenue sharing were 7.5 percent, 18.5 percent, and 45.5 percent respectively between 1978 and 1981.

Overall, District tax collections increased significantly since home rule and as of 1979 the tax burden remained high for most income levels when compared with other jurisdictions in the metropolitan area. The latest figures available (1978) show that the District's tax burden is above average when compared with other large cities. For 1982, the District of Columbia anticipated that local revenues would increase at the same rate as the GNP deflator without the need for tax rate increases. Available data shows that Federal grants may be leveling off and dropping.

Demographic data can provide some indication of a city's needs for future revenue, providing that the data is available and is comparable over time. We were not able to provide a complete analysis of District demographic trends in relation to District finances because some information was not available and some was not comparable over time. We believe the District could better articulate its needs through the use of demographic trends. We discuss data needs in more detail in chapter 4 and recommend that the District provide better data in its budget documents.

1/The increase in revenue sharing was due primarily to counter-cyclical funds.

rule. 1/ However, we were unable to obtain a consistent time series on filled full-time equivalent positions.

In line with what would be expected with decline in inflation-adjusted revenues since 1978, the District government reports end-of-year employment will show a significant decline from 1979 to 1981. End-of-year employment from all funding sources, including grants, is projected to drop from 45,126 in 1979 to 39,965 in 1981. Employment in D.C. funded positions is projected to drop from 37,329 in 1979 to 33,579 in 1981--a 10-percent reduction in end-of-year employment. This reduction in D.C. funded employment compares to a 2.9-percent reduction in inflation-adjusted general revenues (excluding grants) expected to be available to the city over the same period. For the same period, the District government expects end-of-year employment on Federal grants to decline 18 percent by 1981, but inflation-adjusted grant funds are expected to decrease by only about 4 percent. From 1981 to 1982, however, the District government expects end-of-year employment to decline by less than 1 percent while inflation-adjusted grant funds decline by more than 10 percent. The relationship between changes in employment and changes in funding is a matter which would appear to warrant further investigation in order to understand how changes in funding affect actual service levels in an inflationary environment.

ON A PER CAPITA BASIS REVENUES
DISCOUNTED FOR INFLATION HAVE
REMAINED ABOUT CONSTANT SINCE 1978

To provide an indication of trends with respect to the level of services which the District has been able to finance from general fund revenues, we discounted these revenues for inflation (using the GNP deflator) and divided these amounts by the number of people and households in the District. This information is shown in table 3-8. 2/ District population declined by 15 percent between 1970 and 1980.

Viewing the change in spending discounted for inflation on a per capita basis accentuates the increase in spending that occurred before and immediately after home rule and virtually

1/We had hoped to compare this experience with projections of employment through 1986 that were consistent with the funding projection discussed in chapter 4 but could not because such data was not available.

2/Once again, the problems of using the GNP deflator as an exact measure of inflation for District government expenditures should be noted; the measure probably overstates the impact of inflation since neither the wage and salaries of government employees nor payments to public program recipients have increased by as much as the GNP deflator.

Table 3-6
Change in Metropolitan Area Tax Burden Rankings
Since Home Rule, by Income Category

<u>Jurisdiction</u>	<u>\$15,000</u>		<u>\$30,000</u>		<u>\$40,000</u>	
	<u>1975</u>	<u>1979</u>	<u>1975</u>	<u>1979</u>	<u>1975</u>	<u>1979</u>
District	1	9	1	1	1	1
Montgomery County	4	4	3	3	3	3
Prince Georges Co.	3	1	2	2	2	2
Charles County	6	10	5	7	5	8(tie)
Alexandria	2	3	4	5	4	5
Arlington County	8	7	8	3	8	7
Fairfax County	7	5	7	6	7	6
Fairfax City	5	6	6	10	6	3(tie)
Loudoun County	9	3	9	9	9	10
Prince Wm. County	10	2	10	4	10	4

Note: 1 represents the highest tax burden.

Source: District of Columbia publications, Comparison of Major State and Local Tax Burdens in Selected Washington Metropolitan Area Jurisdictions, 1975 and 1979.

Table 3-7
Change in Major City Tax Burden Rankings
Since Home Rule, by Income Category

	<u>\$15,000</u>		<u>\$30,000</u>		<u>\$40,000</u>	
	<u>1975</u>	<u>1978</u>	<u>1975</u>	<u>1978</u>	<u>1975</u>	<u>1978</u>
D.C. rank out of 30 cities ranked	12	9	3	7	9	6

Note: 1 represents the highest tax burden.

Source: District of Columbia publications, Tax Burdens in Washington D.C. Compared with Those in the Nation's Thirty Largest Cities, 1975 and 1978.

The assessed value of real property (adjusted for comparable definition of assessed value) increased by only 6.7 percent from 1970 to 1975 but by 74 percent from 1975 to 1980. 1/ From 1980 to 1982, the expected increase in assessed value exceeds the expected overall national rate of inflation. Assessment increases of 21.4 percent have been made for fiscal year 1982.

The increase in the personal income tax base is accounted for both by growth of taxable income and the effect of increased income pushing taxpayers into higher rate brackets. In total, District personal income as measured by the Department of Commerce and per capita personal income increased at a rate faster than inflation from 1970 to 1978. 2/ In the years 1978 through 1980, during which real per capita personal income nationally did not increase, the rate of change in District personal and per capita income increased at a rate which was less than the GNP price deflator. (See table 3-5.)

The sales tax base also seems to have gotten stronger relative to inflation during the period since home rule. Although some components (gasoline, alcoholic beverages, tobacco) are either not increasing or declining, overall sales tax revenues in the future are expected to increase at rates about two-thirds as fast as the inflation rate without the need for rate increases or base broadening. 3/ Before 1978, collection increases approximating the rate of inflation in the economy were achieved only by a major rate or other changes.

1/The extent to which changes in assessment practices, rather than underlying economic value, account for the rapid increase is beyond the scope of this report.

2/Compared to total U.S. personal income, total District personal income has increased at a rate less than the U.S. average (reflecting declining population and loss of higher income households to other jurisdictions), but per capita personal income increased at about the same rate as the U.S. average.

3/See table 4-2, p. 32.

DISTRICT TAXES HAVE INCREASED AND THE TAX BURDEN REMAINS HIGH, ALTHOUGH INCREASES IN THE TAX BASE ARE NOW ABOUT KEEPING UP WITH INFLATION

Local revenue, consisting mostly of taxes, has increased significantly both before and after home rule. Before home rule the increases paralleled price increases, but for 3 years after, the increases were more than double the rate of inflation. However, since 1978, the revenue increase has been moderate. The tax burden remains high at most income levels when compared with other local jurisdictions, and the District ranked above average in 1978 when compared with 30 other U.S. cities.

The percentage increase in each major tax category and the national inflation rate for selected periods before and after home rule are shown in table 3-4. Major rates or other tax changes that occurred before and after home rule are summarized in appendix I, table 8.

In the 5 years prior to home rule, tax collections from income and sales taxes increased more rapidly than inflation, but property tax yields did not. The net effect noted in the preceding discussion was that overall tax collections increased in line with inflation over the 1970 to 1975 period.

From 1975 to 1978, the increase in property tax revenues was twice as great as the change in the price level, and other local revenue sources increased even faster as overall revenue increased by 55 percent compared to a 20-percent change in the GNP deflator.

From 1978 to 1981, when tax rate changes were almost exclusively associated with offsetting the effects of the illegal tax on professionals, most revenue sources have lagged behind changes in the GNP deflator. The percentage increase in local revenue during this period is expected to be about 68 percent as much as the percentage change in the GNP deflator.

For 1982, the District of Columbia expects that local taxes, without rate increases, will increase at the same rate as the change in the GNP deflator estimated in the Carter administration's 1982 U.S. budget submission to the Congress. This is expected to occur because of a projected very large increase in assessed value and a projected increase in income tax collections about proportional to inflation. According to District estimates, the tax bases for major sources of revenue apparently are moving to a position where, taken together, they are expected to about keep up with inflation without major changes in rates or in revenue sources. There is, of course, no way of anticipating all of the changes that could affect the city's economy and its

Changes since 1978

The preceding discussion has considered the home rule period from 1975 to 1981 as a whole, but the 1978 to 1981 period seems markedly different from that of the preceding 3 years. The percentage increase in District and Federal funds for the periods 1975 to 1978 and 1978 to 1981 are shown in table 3-2. In the 1975 to 1978 period, total general fund resources increased at a rate about twice as fast as the increase in national inflation due to the very rapid increase in local tax collections and to percentage increases in the Federal payment about equal to the inflation rate. From 1978 to 1981, recorded local collections fell somewhat behind the rate of inflation, revenue sharing decreased in absolute amount, and the increase in the Federal payment was far below the national inflation rate. During the period, the only significant tax rate increases were associated with offsetting lost revenue and refunding prior collections from the tax on professionals that was declared to be a tax on non-District resident income in violation of the Self-Government Act.

The District's experience since 1978 parallels that of other State and local governments. According to the Advisory Commission on Intergovernmental Relations, the increase in national State and local spending has slowed substantially in recent years. From the late 1940s to the late 1970s, the State-local sector was one of the fastest growing in the economy. Since 1977, however, State and local expenditures have been growing at a slower pace than both the economy and the price level.

Of potentially great significance is the District government estimate that local revenues for 1982 will increase at a rate about equal to the national rate of inflation with only minor changes in tax rates. Increases in local tax collections at close to the rate of change in the economy are also contained in the outlook through 1986 discussed in the next chapter. These increases suggest that substantial improvements in the economic base of the District of Columbia have occurred during the 1970s and early 1980s.

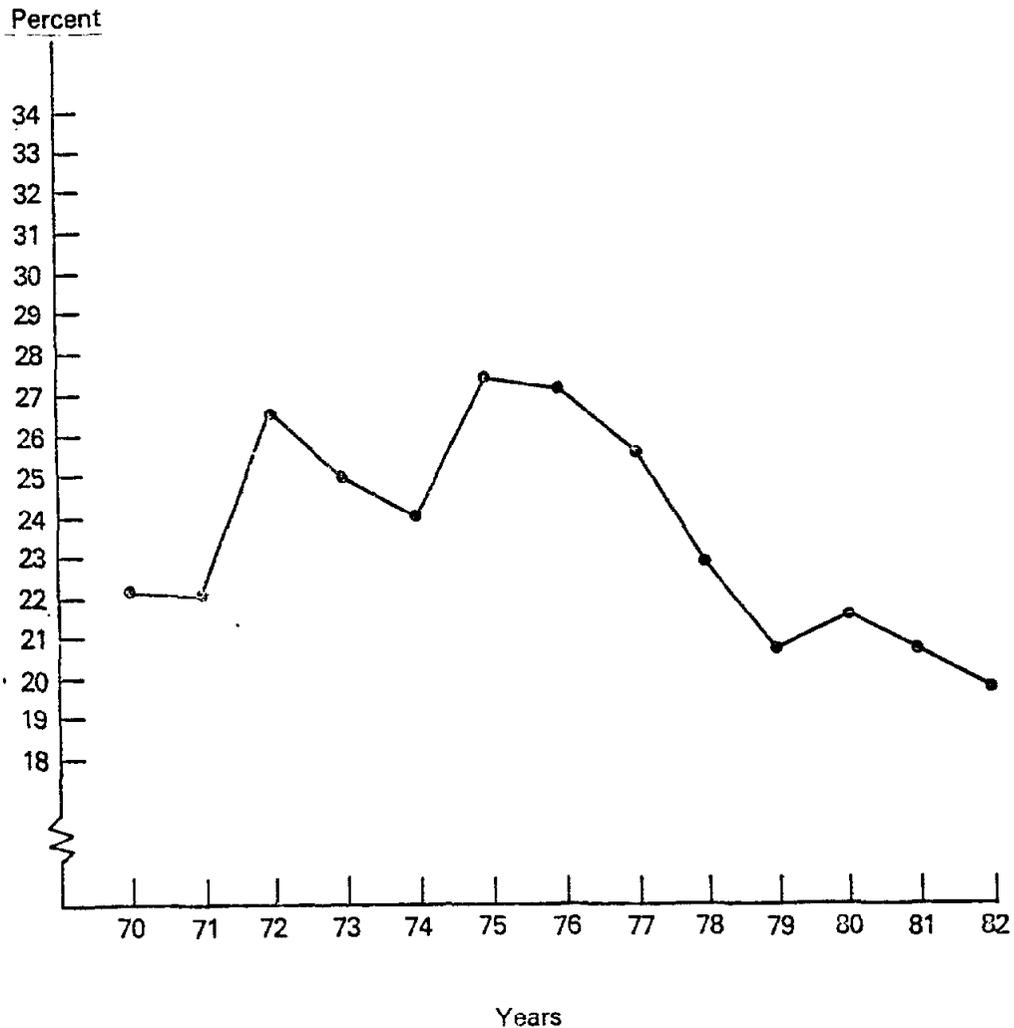
Changes in District and Federal contributions to the general fund discounted for inflation, as measured by the GNP deflator for the United States economy as a whole, are estimated in table 3-3. The sharp drop in the value of the Federal payment discounted for inflation during the 1978 to 1981 period is evident. As emphasized in chapter 1, however, this comparison can only be taken to illustrate general trends, since there is no true index of inflation for the District government, and since policies of the District government influence wage and salary increases and benefit levels which are major components of inflation in State and local governments.

Changes in the Federal payment and local resources compared to inflation

In the 5 years prior to home rule, funds from District sources increased at a rate approximately equal to inflation. The increases in total general fund revenues, however, substantially exceeded inflation, primarily because the increase in the Federal payment was over twice as great as the overall rate of inflation in the economy. Since home rule, local revenue sources increased at a rate faster than the rate of U.S. inflation, but Federal funds did not. Overall, for the 1975 to 1981 period the increases in District revenues have kept ahead of the national rate of inflation. Total District general fund revenues before and after home rule in relation to the general rate of inflation in the U.S. economy is shown in figure 3-3.

As indicated in figure 3-1, the Federal payment as a percent of total District general fund revenue increased to a high of 27.3 percent in 1975, the last year before home rule, and then began a gradual decrease to a current projected low of 19.8 percent in 1982. Thus, since 1975 the Federal payment has declined in relative importance to total District general fund revenue.

Figure 3-1
Federal Payment as Percent of Total
District General Fund Revenue



Note: Estimates used to calculate the percentages in 1981 and 1982. See appendix I, table 5, for data used to derive the percentages.

1975, the payment increases were not as great, resulting in a significant decline in importance of the Federal payment when viewed as a percent of total District general fund revenue. Discounted for inflation, the Federal payment declined in purchasing power during the 1975 to 1981 period.

The Federal payment authorization and appropriation for the years 1970 through 1982 (estimated) are shown in table 3-1. In 1981 the estimated \$295.4 million Federal payment appropriation was 2-1/2 times the appropriation for 1970. Sixty-one percent of this increased appropriation occurred by 1975, the last year before home rule became fully effective.

Prior to enactment of the Self-Government Act, the Congress authorized several increases in the Federal payment. The most notable one was for 1972, when the payment jumped from \$131 million to \$179 million. The 1973 Self-Government Act increased the authorization over 4 years from the previously authorized \$190 million to the \$300 million authorized for 1978 that still remains in effect. Since home rule, the Congress has not enacted Federal payment legislation. An increase to \$336.6 million was included in the Reagan administration's 1982 budget.

The use of congressional authority over the District budget to attempt to accomplish improved financial management objectives is an example of a larger issue involved in any reconsideration of the Federal payment mechanism. This larger issue, the extent to which existing authorization and appropriation processes are essential for protecting the Federal interest and improving efficiency, is an important part of the discussion in chapter 5.

CONCLUSIONS

The views of the Congress on the amount of funds which should be provided to the District as payment for the Federal presence have changed significantly over time. As the views changed, the Federal payment became firmly established as part of the District's annual budget, and new issues emerged. Issues concerning how best to determine the Federal payment and what form the Federal-District relationship should take were discussed during passage of the 1973 Self-Government Act, and these issues are still being discussed today.

amount increased from \$230 million in 1975 to \$300 million in 1978.

IN PASSING THE SELF-GOVERNMENT ACT THE
CONGRESS APPARENTLY EXPECTED THE FEDERAL
PAYMENT TO PLAY A LARGER ROLE IN FINANCING
THE DISTRICT GOVERNMENT

During Self-Government Act deliberations there was much discussion in the Congress about the amount of the Federal payment and the way it should be provided to the locally elected government. The Senate passed a bill basing the Federal payment on a percentage of District revenue that was higher than the percentage prevailing at the time the act was passed. (In 1973 the percentage was about 35 percent.) The Senate plan provided for a Federal payment based on 37-1/2 percent of District revenue for fiscal year 1974 and 40 percent for each year thereafter. It was estimated that for 1975 such Federal payment would represent Federal financing of 26.4 percent of the total District general fund budget. The Senate committee report indicated that District revenues were expected to increase from 1974 through 1978 at an average rate of about 5 percent each year, and the Federal payment resulting from the payment authorization was expected to rise to \$264 million in 1978.

In adopting home rule legislation the House rejected a payment formula and provided instead for specific dollar authorizations for fiscal year 1975 and later years. The amount of the Federal payment authorized in the final legislation was greater than the Federal payment which the Senate had estimated would have resulted from its 40-percent-of-District-revenue formula. Thus, the Self-Government Act authorized \$300 million for 1978 rather than the estimated \$264 million which would have resulted from the Senate bill.

The sponsor of one of the House Federal payment provisions, Representative Thomas M. Rees, indicated that a 40 percent formula probably would mean that the District would get less money than if the District had no formula, because the 40 percent authorization ceiling would tend to be permanent rather than going up when needed to meet government expenses. Mr. Rees also indicated that a provision stipulating that the Federal payment could not be reduced would not be needed because it was not possible to conceive of the Federal payment going down. 1/

1/Mr. Rees was chairman of the House District Subcommittee on Finance and Revenue. For the discussion and other information related to the Federal payment, see background and legislative history of H.R. 9056, H.R. 9682, and related bills, Committee Print, Home Rule for the District of Columbia, 1973-1974, December 31, 1974, pp. 1101-1119, especially p. 1104.

CHAPTER 2

A BRIEF HISTORY OF THE FEDERAL-DISTRICT

FINANCIAL RELATIONSHIP

Through the years significant changes have taken place in the percentage of District expenses paid by the Federal Government in this unique financial link between the two governments. In passing the Self-Government Act, the Congress apparently expected the federally financed percentage to rise somewhat, but the Congress did not change the longstanding system of congressional appropriation of the Federal payment and of the District's budget. Congressional efforts to improve financial management in the District began before home rule and have continued since that time.

THE PERCENTAGE OF DISTRICT EXPENSES PAID BY THE FEDERAL GOVERNMENT HAS VARIED

In the early years of the Nation, the Congress did not expect to pay anything to the local government for building or maintaining the city. This view changed as the Congress realized that the Federal Government would have to share some of the local costs on a regular basis if the city was to be built and maintained as the Nation's Capital.

The Congress used several different methods for determining the amount of the Federal payment over the years. In the 19th century, the Congress appropriated money intermittently for specific projects, such as building streets and installing water systems. In 1871, the Congress approved territorial status for the District. This gave local officials control of the city, including fiscal responsibility, without direct congressional involvement in the raising and use of city revenue. During the period 1871 to 1874, the city became heavily indebted, and the Congress restored direct congressional control (which included reviewing the District's budget and appropriating funds annually for District use). This system of detailed annual congressional review and control of the District budget remains in effect today.

Between 1879 and 1920 the annual Federal payment amounted to 50 percent of the congressional appropriation for District operating and capital expenses. From 1921 through 1924 the Congress reduced the Federal proportion to 40 percent of expenses, partly on the basis of evidence that the District tax rates were substantially lower than other cities. Since 1925, the Federal payment has been set annually by the Congress to finance a percentage of operating expenses that has varied between 9 and 29 percent. In 1980, the percentage was 21.5 percent.

To answer these questions, we collected financial, tax burden, population, and other information which would make it possible to compare pre- and post-home rule experience. Most of this information (contained in ch. 3) was obtained from District and congressional documents dealing with the District budget. We also met with District officials to develop time series data that was consistent with data contained in the backup material used in the 1990 audit prepared for the District government. We were not able to obtain consistent time series for grant funds received, District Government employment, and actual general fund obligations and expenditures. One problem in assembling a consistent set of data is that District accounting procedures and fund categories have changed, especially in the last several years. Problems in assembling a consistent set of data over the period are discussed in appendix I, which also contains the basic data used in the analysis presented in chapters 3 and 4. We believe that the information contained in these chapters is sufficiently accurate to discuss trends.

In comparing how District revenues and budgets have changed in relation to inflation, we selected the U.S. gross national product (GNP) deflator ¹/ _{as the most applicable general purpose index of inflation. However, the reader should exercise caution in interpreting the information about inflation contained in the report. Using the GNP deflator can provide a general indication of how District resources have changed when discounted for price level changes, but there is no implication that District revenues must increase at the same rate as the GNP deflator in order to maintain a constant level of service. This is because the mix of District government expenses may be different from that included in the GNP deflator and because major components in District government inflation--wages and salaries of employees and payment levels to program clients and beneficiaries--are somewhat under the control of the government itself.}

Our comparison of experience in the District of Columbia with national trends for State and local finances is based largely on reports and articles prepared by the staff of the Advisory Commission on Intergovernmental Relations. Our purpose in comparing pre- and post-home rule experience was only to describe what happened. We did not attempt to infer the intentions of city or congressional officials to determine why things happened as they did, nor did we attempt to judge the appropriateness of the level of Federal payment now or at any time in the past.

¹/The GNP deflator, used extensively by economists as a general measure of inflation, takes account of price changes for all goods and services produced in the economy.

of Columbia. Specifically, this report seeks to accomplish these objectives:

- Characterize the history of Federal-District financial relationships.
- Summarize the history of the Federal payment and the District budget since 1970, a period that permits comparison of experience before and after the advent of home rule.
- Discuss the need for possible increases in the Federal payment in the context of projections of District revenues and expenses through 1986.
- Analyze arguments for using different types of formulas to provide a more systematic basis for determining the annual Federal payment.
- Identify changes in the Federal payment process that are consistent with and could make a positive contribution to efforts to improve District financial management.

The issues discussed in this report ultimately involve questions about the size of the public sector in the District of Columbia and about the nature of the responsibilities delegated by the Congress to the District of Columbia Government. We did not attempt to develop recommendations in either of these areas, which are basic matters for determination by the political process associated with District of Columbia affairs.

In preparing the report, we discussed the issues with officials of the District government, Federal Office of Management and Budget, Advisory Commission on Intergovernmental Relations, and several congressional offices, all of which provided insight into current views, problems, and suggested solutions. We also made extensive use of legislative history files, the Congressional Record, District budget documents, and other published information on formula-based payments and District statistical data.

We did not conduct an audit of District government finances, although this report makes use of information resulting from the recent audit of the District's 1980 budget prepared by Arthur Andersen and Company and Lucas, Tucker and Company. This report includes information on the accumulation of financial liabilities that the District proposes paying from the proceeds of a special bond issue, but extensive discussion of this subject was outside our scope of work. Analysis of the present cash flow position of the District government or of the unexpected deficit that appears to have arisen during implementation of the fiscal year 1981 budget are also outside the scope of this study. Similarly, we were not able to address such important topics as progress being made by the District government in improving financial

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ABBREVIATIONS

GAO	General Accounting Office
OMB	Office of Management and Budget

