

**STRUCTURAL IMBALANCE OF THE DISTRICT OF
COLUMBIA**

HEARING
BEFORE A
SUBCOMMITTEE OF THE
COMMITTEE ON APPROPRIATIONS
UNITED STATES SENATE
ONE HUNDRED EIGHTH CONGRESS

SECOND SESSION

SPECIAL HEARING
JUNE 22, 2004—WASHINGTON, DC

Printed for the use of the Committee on Appropriations



Available via the World Wide Web: <http://www.access.gpo.gov/congress/senate>

U.S. GOVERNMENT PRINTING OFFICE

96-426 PDF

WASHINGTON : 2005

For sale by the Superintendent of Documents, U.S. Government Printing Office
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STRUCTURAL IMBALANCE OF THE DISTRICT OF COLUMBIA

TUESDAY, JUNE 22, 2004

U.S. SENATE,
SUBCOMMITTEE ON THE DISTRICT OF COLUMBIA,
COMMITTEE ON APPROPRIATIONS,
Washington, DC.

The subcommittee met at 10:02 a.m., in room SD-138, Dirksen Senate Office Building, Hon. Mike DeWine (chairman) presiding.
Present: Senators DeWine and Landrieu.

OPENING STATEMENT OF SENATOR MIKE DE WINE

Senator DEWINE. I have a brief opening statement which I am going to go ahead and give. This hearing will come to order. Today we will hear testimony regarding the District of Columbia's long-term structural imbalance. This imbalance represents a gap between the District's ability to raise revenue at reasonable tax rates and its ability to provide services of reasonable quality to its residents.

I recognize that the structural imbalance is driven by expenditure requirements and revenue restrictions which are, frankly, mostly beyond the control of the District's leadership. Clearly the city's revenue capacity would be larger without Federal constraints on its taxing authority such as its inability to tax Federal property or the income of nonresidents.

I understand that the city faces a troubling problem in the long term. I want to help close the financial gap and help ensure the long-term economic health of our Nation's capital and the seat of our Federal Government. This is a Federal enclave established by the Constitution, and it must live by the constraints imposed on it by the Federal Government.

I believe that the Federal Government must recognize the costs it places on the city and the burden it places on the city's infrastructure, all the while limiting the ability of the city to raise revenue. Indeed, many of the problems facing the city result from it being the seat of the Federal Government.

At today's hearing we will begin a bicameral, bipartisan discussion about ways to address this structural imbalance. We have assembled today a very distinguished group of congressional leaders, city leaders, business leaders, to help determine ways to eliminate this structural imbalance. We certainly look forward to hearing their testimony. This marks the first step in what I hope will be a solution to the city's financial problems, but we know this will not be easy.

As chairman of this subcommittee, I intend to work to explore and develop ways to avoid a financial catastrophe for the District. It is our duty and our responsibility to make sure that this city is placed on solid financial ground.

The ranking member of this subcommittee, Senator Landrieu, is testifying right now before another committee and will join us shortly.

As usual, we would request that witnesses limit their testimony to 5 minutes for their oral remarks. We do have their written testimony in front of us. Copies of all written statements will be placed in the record in their entirety.

I might mention that the Senate is expected to have a series of votes at 10:45 and so we will try to complete, and we will complete, the first panel to respect the panel's time constraints. We will be done by 10:45 so that we do not carry anybody over for that.

Congressman Davis, welcome.

Mr. DAVIS. Thank you very much.

Senator DEWINE. Ms. Norton, thank you. You are a frequent visitor here and we welcome you back.

Mayor, thank you very much for being here. Mayor, why do we not start with you, and if we could have your testimony first, we would appreciate that very much. I understand you have to go to a funeral.

Mayor WILLIAMS. Yes. I am sure you understand that.

Ms. NORTON. So do I, Mr. Chairman, as well.

STATEMENT OF HON. ANTHONY A. WILLIAMS, MAYOR, DISTRICT OF COLUMBIA

Mayor WILLIAMS. In light of the fact that we have submitted written testimony for the record, I am just going to highlight in recognition of the time. Mr. Chairman, I am just going to highlight some of the salient points, also acknowledging that Congresswoman Norton is going to be taking a perspective on this as well as Congressman Davis. I want to take this opportunity to acknowledge both of them for their continued leadership on this issue, both of them before and through the District's fiscal crisis mid-decade, some years ago.

I want to focus, Mr. Chairman, not on the causes, because I think you are aware of the causes, and not on some of the general gross impacts in terms of overtaxing our citizens and in terms of overly indebting our citizens, but I really want to talk about how we are managing it on a day-to-day basis and what citizens in our city can see, touch and feel.

One is the schools. Our public schools on an operating basis can certainly operate more efficiently. I think there is a substantial record on that. But I think most analysts who have looked at this, most observers who have looked at our actual schools facilities agree that there is a dramatic need for investment in school capital and facilities. In fact, our public schools require an additional \$135 million a year over the next 6 years to fund a basic conservative modernization plan. There will also be approximately 10 new charter schools per year, which require funding. They have been very successful in our city. They deserve funding.

In transportation, we are facing deferred infrastructure needs in bridges, roads and other transportation improvements of \$240 million per year over the next 6 years. The Metro System has a total unfunded needed of \$1.4 billion, which will need to be shared among partner jurisdictions, and as I reported to the Appropriations Committee in our budget hearing, in relation to capital funding, the District has a particularly onerous burden when it comes to Metro because as the Federal Government has pulled back from Metro funding, States have stepped up, and we do not have the access to State tax base to meet those needs.

Neighborhood facilities such as fire stations, recreation centers, libraries and health clinics, require an additional \$70 million per year over the next 6 years.

In information technology, we require an additional \$100 million per year for the next 6 years to re-engineer and automate critical business practices, many of them critical to, for example, homeland security, which is critical to our role as the Nation's capital.

It has been a driving priority of my administration to improve efficiency of our government and reduce expenditures, and at the request of this committee we submitted a report in May that presented our work being performed across the government to enhance efficiency and effectiveness. The GAO report, looking at the different causes for an imbalance and possible remedies, concluded though that while these improvements were necessary, and in some cases overdue, only a small part of the solution to the imbalance could be found in greater government efficiencies of reducing services in the District. In fact, there are several alternative funding mechanisms that could be adopted by the Federal Government to provide this solution. In my mind, with a lot of experience on this issue, both as CFO of the city and now as Mayor, I believe the most promising vehicle is the District of Columbia Fair Federal Compensation Act of 2004, which was recently introduced by Congresswoman Norton along with Congressman Tom Davis, and I am happy to say, members of Congress from both Virginia and Maryland.

The bill would provide an \$800 million contribution on a formula basis, would settle this issue once and for all, put the District on its own solid, sound financial footing, and allow us to run our affairs, in a way that we have demonstrated over the last 10 years that we can, which is in a much efficient fiscally prudent manner, in a manner that is befitting of our Nation's capital.

PREPARED STATEMENT

I want to again thank you, Mr. Chairman, for this opportunity to testify, and I would be happy to answer any questions you have.
[The statement follows:]

PREPARED STATEMENT OF HON. ANTHONY A. WILLIAMS

Chairman DeWine, Ranking Member Landrieu, and other distinguished members of the committee, thank you for the opportunity to testify before you today on structural imbalance in the District of Columbia. Chairman DeWine, I appreciate your public support for a solution to the structural imbalance and your efforts to seek the city's input in the most appropriate and helpful solution. Senator Landrieu, I appreciate your long-standing efforts to resolve this issue, especially your role in requesting the General Accounting Office's expert analysis of the issue. I appreciate

your attention to this issue, and I think this hearing presents an excellent toward achieving a long-term solution to the District's fiscal structural imbalance.

THE STRUCTURAL IMBALANCE: WHAT DOES IT MEAN?

The District's structural challenges are not new. In some ways, the Federal Government has been deliberating the correct balance of Federal and local support for the Nation's capital for the last 200 years. An example of this ongoing effort is the 1997 Revitalization Act, which was one step (and a very helpful step, I may add) in this process towards a rational District-Federal fiscal relationship. Several reports that have explored this balance before and after the Revitalization Act have universally concluded that the District faces structural fiscal challenges. The esteemed authors of these studies include two former members of the Federal Reserve Board, Alice Rivlin and Andrew Brimmer, the McKinsey and Company consulting firm, and the U.S. General Accounting Office.

In its recent report to Congress, the GAO concurred with and re-emphasized the conclusions of the previous reports: the District has a structural imbalance, it is large, and fixing the imbalance is outside the control of local officials. The GAO concluded that the District of Columbia's structural imbalance is between \$470 million and \$1.1 billion per year.

And what is the source of this imbalance? It stems from various sources. Federal restrictions on taxation constrain our revenues below that of the States. A population that is younger, poorer, and sicker drives our expenditures to be higher than those of the States. Add to this the fact that we are the only major city in America that has no State to equalize and subsidize funding for our service to the region, and you have a "perfect storm," if you will, for undermining the solvency of a local city.

But despite these unique obstacles, this city government must function. It must provide services to our residents, welcome our visitors, support our businesses, and to balance our budgets. And we have been quite successful at doing so: our accomplishments include 7 consecutive years of balanced budgets, "A" ratings from all three rating agencies, and over \$250 million in cash reserves.

HOW IS THE DISTRICT MANAGING THE STRUCTURAL IMBALANCE?

Now to an outside observer this may seem like a paradox: How can the District achieve remarkable financial performance, yet still face a structural imbalance? The answer is twofold. First, we have a tax structure through which our residents pay some of the highest taxes in the Nation; and second, the District is deferring massive investments in critical services and infrastructure improvements. What is the magnitude of this deferral? Approximately \$2.5 billion of infrastructure has been deferred, including renovating crumbling schools, repairing the sewer overflow, fixing roads, and putting into place the needed security systems to keep District residents and visitors safe. More specifically, these needs include:

Schools.—The D.C. Public Schools have prepared a 10-year modernization program for all facilities in need of repair, and to execute it would cost \$250 million per year over the next 6 years. From its capital financing sources, the D.C. Government can probably finance only \$120 million per year. In addition, approximately 10 new charter schools are being established every year, and providing funding for these schools is proving to be increasingly difficult, especially in the current real estate market. While we are pursuing a strong effort to co-locate schools and find other efficiencies, these efforts can in no way address the full infrastructure needs of our traditional and charter schools.

The consequences of not doing so would be requiring children to attend inadequate schools without the necessary classroom space, labs, and athletic facilities needed for a quality education.

Transportation.—In the area of transportation, the District is facing major deferred infrastructure needs in bridges, roads, and public transportation networks. In the Metro system, aging infrastructure and a massive increase in rider needs now requires significant rehabilitation and renewal. The District's share of this expansion cost is estimated to be, on average \$140 million over the next 6 years. The District can finance approximately \$70 million of that amount, but no more.

In addition, it is important to note that within the Metro system, the District's structural imbalance becomes especially meaningful and problematic. Within the WMATA system, most partner jurisdictions share the cost of WMATA with their parent States. The District, with no parent State, bears the entire cost of WMATA itself. This burden is compounded by the high charges that WMATA's subsidy mechanism allocates to the District. The Federal Government is a primary beneficiary

but makes no contribution to its operating expenses, resulting in system-wide disinvestments.

Beyond Metro, the District's roads and bridges face similar deferred investment. If not repaired, the District's deteriorating transportation network will begin to have negative effects on our local economy, Federal workers, tourism, and other fundamental elements that ensure our viability as a city and the Nation's capital.

Neighborhood Facilities.—The District operates hundreds of facilities that serve residents and businesses across the city. Unfortunately, inadequate funding has left many such facilities in major need of repair. Every year we must consider a long list of fire stations, recreation centers, libraries, and health clinics that have major needs, but we can provide resources for only the most serious needs, and must defer the remainder. These facilities will require an additional \$70 million per year over the next 6 years to restore to an appropriate level of safety and functionality. Without these investments, residents and businesses in the District will see a continuing decline in the quality of public facilities, and this decline will adversely affect the population growth that we are so diligently working to bring about.

Information Technology.—Eight years ago, the District government found itself far behind average government operations in the use of personal computers, information databases, and Internet technology. Rotary telephones were not uncommon, for example, and the District Government's Web site consisted of 20 pages.

Having first stabilized the basic infrastructure and then developing data security and access, the District has the platform from which it has begun building integrated enterprise applications. In the next phase, the District must systematically reengineer and automate its mission critical business processes (from procurement, budget, and payroll to social services case management and regulatory enforcement). Although the development of these enterprise applications has begun, the District will require approximately \$130 million per year for the next 6 years. The District can only finance approximately \$30 million of this amount, however.

These systems are essential not only to basic government effectiveness, but to providing the information tools that will allow us to better track and serve school children, track and solve crime, and provide a much more cost efficient government systems in future years. Without additional funding, these goals cannot be fully met.

We have resorted to these harmful measures of deferring infrastructure investment because our options for addressing our structural imbalance are truly limited: we can either increase taxes or reduce expenditures. The District already charges some of the highest tax rates in the country. We have resorted to high rates in part because of restrictions on our tax base. A vast amount of Federal property in the District is not taxable and we cannot tax the income earned by the 70 percent of our workforce that lives outside the District. The other option for maintaining a balanced budget is to decrease our spending on public services. Our efforts to keep down public service costs not only limit services to District residents, but they hurt tourists, Federal workers, and visitors from your home States.

As we seek solutions to address the structural imbalance and our long-standing problems, it is clear that taxing our residents more or providing fewer services are not viable alternatives. Though the GAO report noted areas where the District can improve management, the report is quite clear that the structural deficit would exist under any management structure and even if operational efficiencies were improved even more. Even so, it has been a driving priority of my administration to improve the efficiency of our government. At the request of this committee, I submitted a report in February that presented work being performed across the government to enhance operational efficiency and effectiveness. These efforts cover the spectrum of administrative, financial, and service delivery operations. Through these efforts our government has made major strides in improving efficiency and effectiveness in many areas. As noted, however, these improvements provide only a small part of the solution to the structural imbalance, and therefore, I believe the District and Congress have no alternative but to make a fundamental change to the financing of District operations.

PROPOSED SOLUTIONS TO THE STRUCTURAL IMBALANCE

As the GAO considered solutions for the structural imbalance, it identified options of changing Federal policy to expand the District's tax base or providing additional financial support. There are several alternative funding mechanisms that could be adopted by the Federal Government to provide this support. In my report to this committee I highlighted one very promising vehicle and I would like to emphasize this same legislation here today, the "District of Columbia Fair Federal Compensation Act of 2004" which was recently introduced by Representative Eleanor Holmes Norton. This bill would provide the District with a dedicated Federal contribution

of \$800 million a year, which is indexed to inflation and may only be used to fund infrastructure investments.

This approach to redressing the District's structural imbalance provides what appears to be the best solution because it provides relief to the areas we need it most, it addresses the root of the structural imbalance problem, and it would allow the Federal Government to invest in infrastructure that benefits the Federal Government itself and the entire Washington metropolitan area, not just the District of Columbia. The Congresswoman is also to be commended for the broad regional and bi-partisan support she has garnered for her bill. The bill also has support from a broad spectrum of community leaders, including Our Nation's Capital, the business community, labor groups, environmentalists and health care advocates.

This bill is not the only viable approach, however. A second approach would be for the Federal Government to recognize that its charter and presence restrict the District's taxing authority and impose additional costs on the District. To offset these restrictions and costs, the Federal Government could reinstitute a formula-driven Federal payment. This Federal payment could be indexed to the taxation restrictions imposed by the Federal Government such as a payment in lieu of taxes for Federal property in the District or a payment in lieu of non-resident taxation authority that is linked to income earned in the District by non-residents.

A final approach could be for the Federal Government to recognize the extraordinary financial burdens placed on the District as a locality without a parent State. The District must incur infrastructure and operating costs for a wide range of programs that would normally be undertaken by or underwritten in whole or part by the State. Included are such activities as income tax administration, Department of Motor Vehicles, Alcohol Beverage Control, State University (University of the District of Columbia), regulatory commissions (public utilities, securities, insurance), and mental health facilities. Under this approach, the Federal Government could either assume responsibility for the operation of State type functions, as it has with the incarceration of felons, or reimburse the District for the operation of such functions.

Given the importance of this issue to the District and the Federal Government, I encourage you to move legislation that provides a structural imbalance solution quickly and urgently. Your public support for this issue is paramount for our upcoming efforts to request funding for the imbalance in the President's budget.

There was a time when you and your colleagues may have been reluctant to move forward on a structural imbalance solution because of a belief that the District was incapable of running itself. This premise is no longer valid. At a minimum, the District of Columbia merits the fundamental financial foundation that every other city's enjoy. In my view, the District of Columbia is the crown jewel of the Nation and our resources and financial standing should reflect the District's status as the Nation's capital.

Chairman DeWine, members of the committee, this concludes my remarks. Thank you for the opportunity to testify before you today. I look forward to answering any questions you may have.

Senator DEWINE. Mayor, we will have some questions in a minute.

Delegate Eleanor Holmes Norton is certainly no stranger to this subcommittee. She is here many times, and we appreciate always her comments, and we have worked with her on many issues, and we welcome her back. Thank you.

STATEMENT OF HON. ELEANOR HOLMES NORTON, U.S. REPRESENTATIVE FROM THE DISTRICT OF COLUMBIA

Ms. NORTON. Thank you very much, Mr. Chairman. I am pleased to see that my chairman is here, Tom Davis, with whom I work so closely on every issue facing the District. I thank him for that.

In the House we are very grateful to you, Mr. Chairman, for focusing the Senate on this matter, and to Ranking Member Landrieu for the time and the attention you have given to the details of the District economy, and of our finances. May I also say how much we respect the way you have respected home rule and self government.

Let me quickly try to make a few points that may not otherwise be made. I want to speak to you as a member of Congress who was here and saw the District go down, and to say to you that Congress did not capture the decline and fall of the District of Columbia until it crashed. It did not see it coming. The reason was not that they did not do extraordinary oversight. The hearings were amazing. The reason was the lack of transparency. There was very diligent and detailed oversight in both the House and the Senate, very tough, but there was no look at what you are doing here today, Mr. Chairman. There was no look at the long term.

Of course, it was easy to do what the States are doing today, to kind of pave over things, so that some of it was not seen as a crisis. I am particularly grateful that Ranking Member Landrieu joined with former D.C. Subcommittee Chair Connie Morella and me to produce what is regarded as a definitive document, the bipartisan 2003 GAO report. And my bill is based on that report.

I had a front seat at seeing the District go up and come down. And my only concern is that we not see that the District has 7 years of balanced budgets, see that somehow it is balancing its budget and do what was done for decades before it went down, because the reason the District is balancing its budget is that high taxes and high debt are in fact paying for the structural deficit, and the GAO report tells us that cannot go on much longer.

I do want to say to Mayor Williams and to our Council, that the progress the District has made is indisputable. Congress has complimented the city a lot on it. I think the city is right to say we need some help, and not only your very good words. Mayor Williams deserves very special credit because he served in two critical positions necessary for the resuscitation of the District, both as CFO and did such an outstanding job there the people actually did what you perhaps do not expect people to do, name the CFO as their Mayor.

But, Mr. Chairman, this could happen again, and when it happens again it will not happen suddenly. I will not be put in the position I was put in, where the District went down, investment bonds degraded, the District did not know quite what to do, was not a word from the District, and I had to go to the House, because if I did not do it, somebody else surely would do it, and say we need a control board. I had to do it because the District could not borrow money.

The homework has been done on my bill. It has been done three times. It was done by the Federal City Council. The Federal City Council is dominated by regional businesses. The McKinsey report that they commissioned found a structural deficit. At that point I asked the Bush Administration if they would see us so that we could get some help from them. They asked, well, have you not commissioned a GAO report? Meanwhile, the Brookings Institution, led by Alice Rivlin, the national expert on our economy, founding director of CBO, OMB director, found the same thing in its own report.

Finally the GAO report came out and my bill is based on its findings. It settled the basis question. There are three questions. How much? What is the responsibility? What are the options? They say between \$470 million and \$1.4 billion. Who is responsible? Un-

equivocally, they say generated by the Federal Government alone. No matter what the District of Columbia did, it could not overcome this Federal deficit. You know what I am talking about, services to the Federal Government, use of our most valuable land, continued payment for State functions. Third question they answered, what are your options? They say your options are not raising taxes. You have got the highest taxes of the United States because of the structural deficit. That is how you pay for it. Your options are not to cut services. You need to do just the opposite, to improve services. That is what the city is doing now. Having taken that off the table, they say in the report, the Federal Government would step up to the table in whatever way it decides to do so, enter the Fair Federal Contribution Act.

It is significant that every member of this region is signed on to the Act. It was done in total collaboration with the city. You have limited approaches. You could go at what the Congress already has done, State functions. I do need to inform you, since they took some State functions, well, why did that not do it? First of all, they left us with the majority of the State functions, the majority of the cost. The most important thing that Congress did when it passed the Revitalization Act, was to take the \$5 billion pension liability. It only took two State functions. That amounts to \$377 million, and at its minimum that is not what the GAO says that the structural payment costs us.

I think it would be a mistake to cobble together State functions and little by little pass them. This is why I think so. If we are to reduce the high taxes of District residents, if we are to have any hope of reducing this debt, we need to get at least enough money from the Federal Government so that the bond markets understand that something important has happened, and therefore, the conservative bill I put in, not \$1.1 billion, not \$470 million, but \$800 million, would go up, would go up every year by the CPI as the Federal payment did not, so that by the time the Federal payment that we used to have went out of existence—was not worth much anyway, which is one reason the District gave it up—we have finally aligned our bill in a way I think the Congress would want.

We say that this is to cover structural deficit. The funds would only be used for the structural deficit. Mayor Williams, as much as he needs money simply for various operating matters, could not use this money in this way. It could be used only for infrastructure and other structural matters, service on the debt to bring down the debt, bridges, tunnels. Ultimately the high taxes in the district would go down. The bond rating would go up. We would spend less money for interest. The most important reason for doing it all at once is in fact to get a hold of the District's ratings. We have the kind of rating they have in Virginia, where they do not have to pay millions and millions of dollars out in interest.

PREPARED STATEMENT

I hope that the Senate will ultimately see fit to join me in my bill, the Fair Federal Contribution Act, and again, I appreciate your work for us, Mr. Chairman.

[The statement follows:]

PREPARED STATEMENT OF HON. ELEANOR HOLMES NORTON

We greatly appreciate your initiative, Mr. Chairman, in initiating this hearing on the most serious financial problem facing the District. We are grateful as well for the continuing and beneficial attention of Ranking Member Mary Landrieu, and I want to express my great appreciation not only for the many ways that both of you have assisted the District but also for the principled way you have observed the Home Rule Act and respected the right of District of Columbia to self government.

H.R. 4269 (District of Columbia Fair Federal Compensation Act of 2004) ranks as one of the most important bills that I have introduced during my seven terms in Congress. The original co-sponsors are all regional House members who know the District best: Government Reform Committee Chair Tom Davis (R-VA), Appropriations Subcommittee Chair Frank Wolf (R-VA), Democratic Whip Steny Hoyer (D-MD), Congressional Black Caucus Chair Elijah Cummings (D-MD), and Representatives Jim Moran (D-VA), Albert Wynn (D-MD), and Chris Van Hollen (D-MD). I am deeply grateful for their support.

Without this bill, the long-term viability of the District of Columbia is again at risk. This risk arises from a structural imbalance caused by expenditures rising faster than revenues. Notwithstanding this dangerous situation, the District is able to balance its budget every year and avoid operating deficits by maintaining tax rates and debt that are among the highest in the Nation. District of Columbia Chief Financial Officer Natwar M. Gandhi has issued forecasts that show that in the out years, the structural deficit will overtake the city's diminished and inadequate tax base, not because of overspending by the D.C. government but because of the cost of Federal requirements and statutes imposed on the District.

H.R. 4269 is different from structural imbalance bills I have introduced in the past. This bill has as its predicate a May 2003 Government Accounting Office (GAO) report, which made three major findings—the first concerning the size of the imbalance, the second concerning its Federal origin, and the third regarding the unavailability of options internal to the D.C. government.

First, the GAO confirmed that the District has a structural imbalance which it found is between \$470,000,000 and \$1,100,000,000 annually, the first determination that is based on a precise methodology for valuing, documenting and calculating the imbalance. The congressional report confirms two prior privately commissioned reports that arrived at similar conclusions, a 2002 McKenzie study commissioned by the Federal City Council (an organization of regional and local business leaders) and a Brookings Institution study under the leadership of former Congressional Budget Office Director, Alice Rivlin, who also served as a chair of the former D.C. Control Board (Financial Management and Assistance Authority).

The GAO's second finding was that the District of Columbia's structural imbalance is caused by Federal mandates and is therefore beyond the reach of D.C. government officials and taxpayers. The Federal Government retains 42 percent of real property, the most valuable in the city, for its own use; requires the city alone to provide costly State services, such as special education, although the District is not a State and lacks a broad State tax base; requires the District to provide services to more than 200,000 Federal employees, who earn 66 percent of the income produced here; and prohibits taxation of Federal workers to help pay for these services. These costs to the city trace directly to the Federal Government and only the Federal Government.

The GAO's third finding is that the only two options available to the District government are raising taxes and cutting services, each of which the GAO said it could not recommend. Rather, the options are to "change Federal procedures and expand the District's tax base or provide additional financial support and a greater role by the Federal Government to help the District maintain fiscal balance," according to the GAO.

Our bill is based on these three GAO findings. The bill offsets part, though not all, of the annual structural imbalance, by providing for an annual Federal contribution of \$800 million. These funds are to be deposited into a D.C. Infrastructure Support Fund that cannot be used for operating expenses but only for the specifically stated infrastructure purposes.

The bill removes some of the harm to the District's investment bond rating and the resulting high interest payments by requiring that Federal contribution funds go only to the District Infrastructure Fund to be used exclusively for infrastructure and for debt service, most of which is debt from infrastructure costs. The focus on infrastructure is deliberate because such infrastructure costs are State costs and because much of the District's infrastructure is used by the entire region, where 80 percent of the vehicles originate and includes Metro, used overwhelmingly by regional residents. Regional complaints about the District's roads, bridges and tunnels

are justified, but there is no reasonable hope of repair and maintenance if the District's taxpayer-raised budget is the only source. The focus on debt service is calculated to reduce the District's debt, the highest per capita in the country. With some relief from the structural imbalance through a Federal contribution, the District will gradually be able not only to reduce its debt but also to lower the high tax rates that the imbalance forces on D.C. residents and businesses. This bill also takes into account past Federal contribution failures. H.R. 4269 does not allow the contribution to wither away by a failure to increase gradually with inflation but provides for annual increases tied to the Consumer Price Index.

In 1995 Congress began to come to grips with the reality that a city whose structure assumes it is a State although it lacks a broad tax base can no longer be responsible for the full set of costs shouldered by States. Congress relieved the District of the costs of some but not all State functions and left the unique Federal structural impediments described in the GAO report. The District has made remarkable progress by maintaining balanced budgets and surpluses every year despite adverse national economic conditions and by improving city services. It would be tragic for Congress to allow this progress to be retracted because of uncompensated Federal burdens. This bill allows the District to avoid great risks and to continue to build fiscal strength.

Senator DEWINE. Thank you very much.

Congressman Tom Davis has really been a leader in initiating reform for the District of Columbia.

Mr. Chairman, we thank you for being with us and we look forward to your testimony.

STATEMENT OF HON. TOM DAVIS, U.S. REPRESENTATIVE FROM VIRGINIA

Mr. DAVIS. Thank you for the opportunity to testify, Mr. Chairman, before your subcommittee today on the financial challenges facing the District of Columbia.

Ever since the D.C. Home Rule Act was signed into law in 1973, the District Government and the Congress have been unique partners with one of the most challenging aspects of the relationship being the role the Federal Government has set forth in Article I, Section 8, Clause 17 of the Constitution.

The District has the characteristics of both a city and a State. Congress quite frankly has never come to terms with how to treat the Nation's capital. The Founding Fathers created a Federal enclave to house the Federal Government, never envisioning the Nation's capital to grow to become one of the largest and most prosperous cities in the country.

This unique dynamic has caused Congress to continually reevaluate its relationship with the District, from establishing an appointed D.C. Council in 1967, the creation of an elected mayor and council in 1973, to the creation of a D.C. Financial Responsibility and Management Assistance Authority in 1995, and the passage of the Revitalization and Self-Government Improvement Act of 1997.

The Revitalization Act fundamentally transformed the relationship between the District and the Federal Government by transferring many of the State-like responsibilities placed on the District Government to the Federal Government. Through that legislation the Federal Government assumed responsibility for the District's pension system, criminal justice system and court system, all of which are considered State responsibilities that the Nation's capital, as a city, should not be expected to bear.

The transfer of financial responsibility in the Revitalization Act relieved the city of its most pressing exploding liabilities, but unfortunately, we were unable to capture all of the State-like functions

imposed on the District in the 1997 legislation. We think it is time to finish the job. By cosponsoring Mrs. Norton's legislation, I want to make clear my commitment to help her in leading that effort.

We are here today to discuss how to best finish what was started in 1997. Our message at that time was the Federal Government is, in effect, "the State" for the District of Columbia. Starting from this same premise would serve us well in considering any future reforms to the financial structure of the city.

One viable option would be the approach laid out in Mrs. Norton's legislation, which I cosponsored. Her legislation would authorize the creation of a narrowly-defined infrastructure fund that would direct Federal funds to where they are needed most, to roads, schools and information technology. The simplicity of this approach would provide much needed transparency by enabling the GAO to, at our request, scrutinize the administration of funds to ensure that the money is being spent effectively and properly.

While Ms. Norton's legislation has helped to focus discussion in Congress on how to best address the structural imbalance in the city, the Federal payment it authorizes is based on a ballpark estimate rather than hard numbers. Fortunately, however, the District, at your request, Senator, has come up with the informational foundation necessary to assist Congress in determining the amount of Federal investment to be required to cover the city's infrastructure investment needs.

The unfortunate reality of the District's current financial situation is that it forces the city to delay the type of infrastructure improvements that can only be delayed for so long. Road, schools, government office buildings are showing signs of serious disrepair. The city has been unable to make the type of IT investments that yield real financial and citizen service returns. With the exception of the city's tax office, the IT investment revolution that has occurred in local governments across the country has bypassed the District of Columbia and the city is missing out on the benefits of such an investment.

Given the financial situation that existed in the early 1990's in the District, some members may be skeptical about providing additional Federal assistance to the District, but let us be clear, with the help of the Control Board and the Revitalization Act, the District, under the leadership of Mayor Williams, has taken care of its financial house. It has balanced its balance now for 7 consecutive years. They have done a better job than we have in the Congress. They have done it without tricks or gimmicks, and it has a cash reserve that is the envy of most municipalities in the country. Whether it is Cleveland or New Orleans or Baltimore or Richmond, cities across the country generally get extra help from the States in funding formulas for schools, welfare and the like, and much of the city's tax base also in the city cannot be used because it is Federal property.

So to drive home the need for a Federal investment, we are not here discussing some random city, this is the Nation's capital. This is the gateway to the free world, and maintaining it, growing it and modernizing it is a national responsibility.

If we were making a decision not to provide financial assistance, local officials will continue to do what they are doing, balancing the

budget and borrowing responsible, but understand, they are doing this under extremely small margins if we decide not to partner with the local government and maintaining the infrastructure, the impact will be visible. It will not just be visible to the public school student that is stuck in a dilapidated building, but to the hundreds of thousands of Americans who visit here each year and foreigners who visit the Nation's capital each year.

PREPARED STATEMENT

In closing I want to commend your dedication to working with the city to finish the job we started in 1997, and look forward to working with you.

[The statement follows:]

PREPARED STATEMENT OF HON. TOM DAVIS

Mr. Chairman, thank you for the opportunity to testify before the subcommittee today on the financial challenges facing the District of Columbia. Ever since the D.C. Home Rule Act was signed into law in 1973, the District government and the Congress have been unique partners, with one of the most challenging aspects of the relationship being the role of the Federal Government as set forth in article 1, section 8, clause 17 of the United States Constitution.

The District of Columbia has the characteristics of both a city and a State. Congress, quite frankly, has never come to terms with how to treat the Nation's Capital. The Founding Fathers created a Federal enclave to house the Federal Government, not envisioning the Nation's Capital to grow to become one of the largest and most prosperous cities in the country.

This unique dynamic has caused Congress to continually re-evaluate its relationship with the District, from establishing an appointed D.C. Council in 1967 and the creation of an elected Mayor and Council in 1973, to the creation of a D.C. Financial Responsibility and Management Assistance Authority in 1995 and the passage of the National Capital Revitalization and Self-Government Improvement Act of 1997.

The Revitalization Act of 1997 fundamentally transformed the relationship between the District and the Federal Government by transferring many of the State-like responsibilities placed on the District government to the Federal Government. Through that legislation, the Federal Government assumed responsibility for the District's pension system, criminal justice system and court system, all of which are considered State responsibilities that the Nation's Capital, as a city, should not be expected to bear.

The transfer of financial responsibility in the Revitalization Act relieved the District of its most pressing, exploding liabilities. But unfortunately we were unable to capture all of the State-like functions imposed on the District in the 1997 legislation. It is now time to finish the job. By cosponsoring Congresswoman Norton's legislation, I wanted to make clear my commitment to help lead that effort.

We are here today to discuss how best to finish what was started in 1997. Our message at that time was that the Federal Government is, in effect, the "State" for the District of Columbia. Starting from this same premise would serve us well in considering any future reforms to the financial structure of the District.

One viable option would be the approach laid out in Ms. Norton's legislation, which I cosponsored. Her legislation would authorize the creation of a narrowly defined infrastructure fund that would direct Federal funds to where they're needed most—to roads, schools and information technology. The simplicity of this approach would provide much needed transparency by enabling GAO to, at our request, scrutinize the administration of funds to ensure that the money is being spent effectively and properly.

While Ms. Norton's legislation has helped to focus discussion in Congress on how best to address the structural imbalance in the District, the Federal payment it authorizes is based on ballpark estimates rather than hard numbers. Fortunately, however, the District, at Chairman DeWine's request, has come up with the informational foundation necessary to assist the Congress in determining the amount of Federal investment be required to cover the District's infrastructure investment needs.

The unfortunate reality of the District's current fiscal situation is that it forces the city to delay the type of infrastructure improvements that can only be delayed so long. Roads, schools and government office buildings are showing signs of serious

disrepair. The city has been unable to make the type of IT investments that yield real financial and citizen-service returns. With the exception of the District's Tax Office, the IT investment revolution that's occurred in local governments across the country has bypassed the District of Columbia, and the city is missing out on the benefits of such an investment.

Given the financial situation that existed in the early 1990's in the District, some members may be skeptical about providing additional Federal assistance to the District. But let me be clear: with the help of the Control Board and the Revitalization Act, the District has taken care of its financial house. It has balanced its budget for 7 consecutive years, without tricks or gimmicks, and it has a cash reserve that is the envy of every municipality in the Nation.

To further drive home the need for a Federal investment, we are not here discussing some random city. The District of Columbia is the Nation's Capital, and maintaining it, growing it and modernizing it—these are national responsibilities.

If Congress makes the policy decision not to provide financial assistance to the District, I am confident local officials will continue doing what they're doing: balancing the budget and borrowing responsibly. But understand that they're doing this with extremely small margins. If we decide not to partner with the local government in maintaining the infrastructure of the Nation's Capital, the impact will be visible. It won't just be visible to the public school student stuck in a dilapidated building, but to the hundreds of thousands Americans who visit here each year and expect a vibrant, safe and beautiful Nation's Capital.

In closing, Mr. Chairman, I would like to commend your dedication to working with the District to finish the job we started in 1997. I look forward to working with you, Congresswoman Norton, and the Mayor on a collaborative approach to solving this issue.

Senator DEWINE. Chairman Davis, Ms. Norton, let me first congratulate both of you for moving forward on this legislation. It is clear that we face a crisis. It is a long-term crisis, and we must move. So I thank you for your leadership.

Let me ask you both, and start with Chairman Davis, and you have touched on this a little bit, but I wonder if you could get into a little more detail about how you came up with the \$800 million figure.

Second, talk to me a little bit, Mr. Chairman, about the politics of this. Money is fungible. There are a lot of different ways. I know that you had to think about how you were going to approach this. You said very eloquently and very correctly that the best way to look at this is to look at what the real problem is, and that is that no one is acting as a State for the District of Columbia, and so the Federal Government really has to act as the State. We know that there are many pieces of legislation we could go back into, and basically put the Federal Government in the role of as the State, and that would be one way of changing formulas in legislation. That would be one way, or we could all sit here and think of four, five different ways.

Mr. DAVIS. Let me address the politics.

Senator DEWINE. You came up with this way, and it sounds like a good way to me, but how did you come up with it, I guess?

Mr. DAVIS. Let me have Ms. Norton address the \$800 million. She can talk to you a little bit. Let me talk to you about the politics of this. First of all, instead of putting this money into the government slop bucket, which is what Congress would consider a city budget where the politicians can spend the money freely on their pet programs, and this happens not just in the city, in fairness. It happens here and everywhere else in the country.

We are putting this in an infrastructure fund where you will be able to measure the results, you will be able to see the results in new schools, in new roads, maybe perhaps a new water system,

those kind of issues that everybody considers important and that need to be done, and that because of the District's low margins and in the past perhaps some failed leadership, money was not put into those funds.

That is politically viable. Getting it to the local politicians to spend is probably not going to be viable up here on Capitol Hill. But remember the infrastructure of this city is visible to all Americans, as in the Nation's capital, visiting a country. So we think the approach by putting it in the infrastructure, which is badly—indeed, it is important.

Secondly, let me just say the school system has been the hardest nut to crack of all of the city's problems. It is a failed school system by almost any standard, with the average school building being over 50 years of age, and that is an investment in the youth of this city. It is starting to turn around, but it is just a long haul, and that is a very needed investment.

I would just say prior to the closing of the Lorton Prison, there were literally high schools in this city that were sending more kids to Lorton as alumni than they were to college. That is starting to turn around a little bit, but that infrastructure is important for the safety of the city and for the future of this city as well, so that is why we put it into infrastructure.

Eleanor, I think can address the \$800 million.

Ms. NORTON. Just very quickly. I know Chairman Davis wants to work with me on the figure. He indicated that when he signed onto the bill. It is true it is not a scientifically based figure. The Federal payment never was, and there may be a more scientific way to go at it, and I would be very open to working on that.

On fungibility, that is a very important point, Mr. Chairman. All money is fungible. I hate to use that word that perhaps is discredited now, the Congress lockbox, but this is a lockbox I think would work, because the District of Columbia has to come here before the Appropriations Committee every single year, and in fact, this money will be looked at every single year. The bill is very explicit about where the money can go.

We have transparency now. We have a CFO. We have a Council that operates in the same way. I do not think this could be hidden. Let me say the \$800 million just to show you that this is not an elaborate figure.

When we gave up the Federal payment, it was almost \$700 million. I think it is rather conservative almost 10 years later to start with \$800 million and not with some larger figure, particularly given the GAO report. And finally, as a perfect example of what the Mayor was talking about, remember some of this money would go for capital costs and debt to capital costs, which would mean some capital costs in the schools.

What the District had to do—I guess it was a couple of years ago—is simply stop building schools. The Mayor had proceeded to build schools, but all the money had to be moved out of that because of the state of the economy, and they are lucky to even repair schools now, much less build them.

Thank you very much.

Senator DEWINE. I have been given a capital cities comparative analysis, and I am sure that someone could attack the figures here

and say we are comparing apples to oranges, but it is of interest. And percentage of total city budget from the national government, comparing some of the major capital cities in the world, London is 83 percent. Brasilia is 72 percent, Caracas 66 percent, Mexico City 39 percent, and then Washington, DC is 10 percent.

You all have a yellow sheet in front of you. It is of some interest.

Congressman Davis, tell us a little bit what a benefit payment like this would mean to the region.

Mr. DAVIS. To the region it would be significant. First of all, transportation, anybody who tries to get into the city on a non-crisis day without an accident, it is an ordeal. This could help the transportation infrastructure and therefore the efficiency of Government considerably. Moving people back and forth and sitting in cars is not a very effective utilization of some of the most highly trained and important people in the Government. Building a telecommunication system, right now, if you have ever tried to use a cell phone around here, all of these issues I think go to the efficiency of Government, which is really congressional oversight.

My theory has always been a lot of the city stuff they can deal with issues that affect the citizens of the city, but when it comes to the operation of Government, we have a decided responsibility to step in. A water system that works—and we have seen recently where the system is deteriorating again through lack of investment through the years. We talked about the school system prior to this.

But we have an infrastructure in this city that your statistics show it well. The city has been so stretched just to make its payments, just to get kids to school, get them on the buses and run the basic operations of government, that the overall maintenance of the infrastructure has suffered. It is going to catchup with us very, very quickly because there is no visible means for the city to step forward and do much else given its other obligation.

I just note one other thing. The city is short-changed in a number of the funding formulas, that if this were a city in any other State, the State formulas would make up for it. The Medicaid payments alone, I think the city, through an error that everybody acknowledges, is losing something like \$17 million a year.

Senator DEWINE. If I could just follow up, that was my point originally, that if you were trying to fix this, one way you could possibly fix it is to go into those different formulas, but maybe politically this is an easier way of doing it. That is what I was mentioning.

Ms. NORTON. Mr. Chairman, I just want to give you one example in response to your question and to Chairman Davis's explanation. Metro payment, we have the highest metro payment in the region. Of course this is the part of the region that is least able. Appreciate that this committee gave us \$3 million toward that. Our Metro payment is \$160 million. In Virginia I believe half of that is paid by the State. In Maryland all of it is paid by the State. So there is recognition that even our two neighbors, one of the richest counties in the United States, should not be paying for Metro payment by themselves, and yet the District is paying the entire payment of about \$160 million—the Mayor can correct me if I am wrong—all by itself, and it is one of the most urgent ways in which the infrastructure payment would be paid.

Senator DEWINE. My time is up. I am going to turn to Senator Landrieu for any statement she has to make and for any questions.

STATEMENT OF SENATOR MARY L. LANDRIEU

Senator LANDRIEU. Thank you, Mr. Chairman, and I will submit my full statement to the record, because as you know, I am extremely interested in finding a solution along with you and the members of our committee and the leadership of the city, and I really appreciate this leadership team's dogged determination to continue to pursue a remedy, because it is clear that we need, Mr. Chairman, to find a solution to what is now documented as a real structural imbalance. In other words, the GAO study that was completed, following several other studies in recent years that have continued to raise this issue, have gotten us to a point where I think it is clear to most that no matter how efficient the District is, no matter how competent the leadership of the city is—and I think we have very competent leadership—that there is still a difference between the capacity of the ability to raise taxes, which are some of the highest in the Nation. This is a city that is taxed one of the highest in the Nation, property tax, income tax, sales tax, fees and services. There is not a lot more taxing capacity out there. As the Mayor and the City Council and others, and the Congresswoman of course, have made efficiencies greater, what we are finding is there is still a structural imbalance.

Part of it, Mr. Chairman, is driven by the fact that the city is here, living, co-existing in a way with the Federal Government, which by its very nature drives up salaries, drives up—which is good. I mean we do not want to pay people little in the Federal Government so our salaries are fairly high with a fairly generous, or adequate to generous benefit structure. So it sort of drives the city of Washington to have to compete with those kind of salary structures in the metropolitan area, and as a result there is a real shortfall.

PREPARED STATEMENT

So whether we do a direct payment and how much that payment is, or whether there is another way that we can try to solve this structural gap, I am looking forward, Mr. Chairman, to working with you to explore the options that are before us for the benefits of the residents and the benefit of all of the citizens of our great country who look to this place as their special place as well.

I will submit the rest of my statement for the record.

[The statement follows:]

PREPARED STATEMENT OF SENATOR MARY L. LANDRIEU

The Senate Appropriations Subcommittee on the District of Columbia meets today to discuss an elusive problem in the financial system of the District. For many years discussion of an imbalance in the structure of the city's finances circulated on the edges of political and legislative work in Congress and the District. Recently, a clear focus on identifying the problem and recommending solutions has developed, particularly due to the leadership of many represented here today.

The elected leadership of the District, business leaders, and outside experts have all come to focus on the unique challenge faced by the city to provide services and maintain financial stability. We have learned that the unique structure of the District does not allow for the revenues and expenditures to meet under the current circumstances. The resulting financial structural imbalance is the subject of our

hearing today and I expect to discuss many ideas. I hope that with the commitment of my chairman, Senator DeWine, this subcommittee will contribute to action to address the imbalance.

The General Accounting Office (GAO) released a definitive report on the financial structural imbalance in the District of Columbia in June, 2003. GAO defined the imbalance as an inability to provide a representative array of public services by taxing at representative rates. The District is the only municipality in the country that must exercise responsibilities of a city, county, State, and school district. The District has the ability to tax all these levels of government, but the tax base is not sufficient to pay for the services it must provide.

The GAO found that the District's tax burden is among the highest of all other city/county systems in the country, between 33 percent and 18 percent higher than that of another locality. The high burden only yields revenue to support an average level of services. However, a solely urban area with a high concentration of poverty has a higher cost of delivering services. The same is true in my home city of New Orleans, however there are suburban and rural areas surrounding which contribute to evening out of the tax base.

The District has been criticized for having a much higher level of spending per capita, but without a similarly high level of service delivery. In fiscal year 2000 the District spends \$9,298 per capita compared to a national average of \$5,236. Many complain that it is due to management inefficiency that the city spends more than any other but still has average or below average services. The GAO study was able to put a more fine point on what has been the source of much deriding of the District—the high cost of delivering services in the city means that high spending will only achieve average services.

The imbalance cannot be closed only by delivering services more efficiently. The tax base in the District is just too small to sustain the level of services necessary for a typical city. Therefore, leaders in the District and in Congress must think creatively about how best to approach a gap which will not close itself. This committee has a responsibility to examine the challenges faces the District and contribute, however appropriate, to a resolution. As the State-like entity for the city, we must ensure the city's continued financial stability, and step in if necessary to address pressure.

In a May 5, 2004 report to the committee from the Mayor, three models were proposed to address the structural imbalance. The city has endorsed H.R. 4269, the Fair Federal Compensation Act, introduced by Congresswoman Eleanor Holmes Norton and Representative Tom Davis, here with us today. H.R. 4269 would create an \$800 million annual payment to the District for infrastructure investments. A second option is an unrestricted Federal payment to this city like the payment prior to 1997. The third option offered is for Congress to assume additional State-like functions with the Federal Government assuming program responsibility or reimbursing the city for operations.

I would like to offer an additional option to consider by the panelists, an approach which may be more feasible in the current fiscal outlook of the Federal and local budgets. If the Federal Government were to provide approximately one-third of the funds needed to meet the gap. The Congress may be more compelled to partner with the District with new funds if the city were to commit to one-third of new funding derived from management savings. Finally, the city and Congress could partner to increase Federal grants and formula funds to the District by one-third, such as the Medicaid match rate.

I would appreciate hearing from the witnesses today if an option such as the one I've described could be feasible. I would be interested to hear if there are concerns over the reliability of such funds on an annual basis. I believe this is the right time to revisit the current relationship between the District and Congress. The last major piece of legislation which affected that relationship was the National Capital Revitalization and Self-Government Improvement Act.

In 1997 the Congress and the District government struck a "new deal" on the share of services which would be paid for by the Federal Government. The annual Federal payment to the District was phased out in lieu of Federal oversight of the criminal justice functions and the responsibility for most public pensions. By doing so, the Congress also took oversight responsibility in addition to funding, of the criminal justice agencies in the District—the D.C. Courts and the Court Services and Offender Supervision Agency. Within these entities are the functions for representation of defendants, to incarceration and rehabilitation to supervision of offenders throughout the justice process. The District government works with these entities, but their funding and operations are solely overseen by Congress and this committee in particular.

Although this “new deal” relieved the city from the responsibility of two major functions typically done by States, there are still other functions which States, like my home of Louisiana, operate with State tax revenues. The functions which immediately come to mind are State education and transportation. In Louisiana, the State has its own board of education to oversee implementation of both Federal and State education standards in all of the elementary and secondary school districts, as well as the accompanying funding. In addition, the State oversees and funds operation of State colleges and universities. The Congress provides limited funding and even more limited oversight to the public education system in the District.

As a contribution to the State function of “university”, Congress provides annual funding to the Tuition Assistance Grant Program. The TAG program has been funded at \$17 million annually the last 4 years; however the cost of providing grants to every high school graduate in the District to attend a public or private school outside of the city is rising. The goal of this program was to make up the difference between in-State and out-of-State tuition for D.C. students to attend State universities elsewhere in the United States. It has been extraordinarily successful and is seen as a benefit to residents who would be paying high tuition because they maintained their residence in the District.

In order for the Congress to continue fully funding this program, I believe it will need to be considered as part of any restructuring of the financial relationship between the District and Congress. Post-secondary education is typically a State function. If Congress is to provide full funding, it may follow that Congress would want full oversight of the operation of a program which is currently local in nature.

I would like to explore with the panel the appropriate relationship between the District and Congress in providing oversight of Federal funds. If the amount of funds should represent the level of oversight, ours would be limited in the special appropriations provided to the District. The \$3 million provided in fiscal year 2004 by this subcommittee to subsidize the Metro operating payment is minuscule compared to the over \$260 million the District of Columbia must pay each year to Metro. Yet, this \$3 million was highly symbolic in recognizing that the Federal Government has a role and responsibility in these funds. In a time of constrained Federal and local spending and rising deficits, a prudent course would be to maximize every dollar.

I look forward to reviewing the current options for addressing the imbalance. I hope that this committee will partner with not only the leadership of the District and the House of Representatives, but also with the business and trade community in the city, and experts from all fields and pool our resources to make the capital city all that we know it can be.

Senator DEWINE. Let me just make one additional comment. I certainly want to agree with the comments made by all three of you and the comment made by Congressman Davis that this is the Nation’s capital, and we do have an obligation from a security point of view, and in just from the point of view of the people who come here and the people who live here, to deal with some of the basic things. You turn on your water, your water ought to be so you can drink it. Kids go to school, they ought to be decent schools. This is a target area for terrorists. We have to worry about this. We have to deal with the basic things of governance. Because this is the Nation’s capital, some of the things that we are doing cost more. There are security issues that exist here that simply do not exist in every other city in the country or most other cities in the country, and these are just costs.

The Federal Government, frankly, has made it very difficult for the District of Columbia to exist, and we just have to recognize that, in what we are doing just in working. I think the District Mayor is doing a good job, but we just have to give you some more assistance.

How we do it can be debated, and whether it is this bill, which I find to be a good bill and a very, very, very rational approach, or whether if other people find that it needs to be a different way,

I am open to that too, but we need to do something and we need to move forward.

Mayor.

Mayor WILLIAMS. If I could say something, Mr. Chairman, Chairman Davis mentioned this and Congresswoman Norton as well. The transportation infrastructure is of concern to the national government because we are the Nation's capital, as you mentioned, and because a huge part of your workforce is using this infrastructure. I think we have some 470,000 people come in here on a daily basis. I think we are the second or third largest in the country. This also has homeland security implications because as Congressman Davis has mentioned, you try to drive around in the morning or parts in the evening, and you are not driving, you are crawling. On top of this situation, we close Pennsylvania Avenue and we close E Street. We really have not done anything to address that, and that further intensified the congestion, and I think we have a real problem. We need to address it.

That is all I can say.

Senator LANDRIEU. I just want to make—

Senator DEWINE. Senator Landrieu.

Senator LANDRIEU. Thank you, Mr. Chairman. Just two comments on something you said, and what the Mayor has just said prompted me to. In addition, I think our strongest argument for coming up with some remedy, some significant remedy is that this city is the number one target for terrorists, and as the Commission has finished its work and moved to its work, we understand more of the details of what the original 9/11 thought was. We understand that not all 10 planes were headed to the District, but the District of Columbia was one of the No. 1 targets, along with several others around the Nation. So for the 500-plus residents that live in the District, I think the Nation has a special obligation towards their protection, and it needs to be on a fairly consistent and sustainable and pretty substantial basis.

So besides the Metro, which I think is also a very pressing and compelling argument, Mr. Chairman, because without a good transportation system the whole region is negatively affected and it is to the whole region's benefit, in addition to the residents that live here and the workers that work here, and those of us that are in and out temporarily representing our cities and our States here in Congress, having a—to lay the argument on top of what we have already laid down on the terrorism front.

The other point that I want to make, Mr. Mayor, and ask you and maybe the Congresswoman, if she wanted to make just a brief statement, about our ability to attract new residents to the city and what one or two strategies, without going into too much specific detail, but, Mr. Mayor, we have talked about this before. I think you have a couple of different strategies to attract new residents, therefore expanding the tax base. If you cannot tax the people that live here more, one other way to get more taxes is to attract more people to the city that could pay taxes. So it is a several-pronged approach. And what do you think maybe one or two of your most promising strategies would be for bringing people to the District? And Congresswoman or Congressman Davis, you might want to comment as well.

Mayor WILLIAMS. Senator, I have always believed that it is the three publics that draw people back to your city and expand your tax base in that way. One of the three publics is Public Works, and we have talked about transportation. I am going to be less likely to live in a city if I cannot get around. With the kind of infrastructure investment we are talking about, the city could invest, for example, in light rail. When we are investing in light rail we are minimizing to the extent feasible, investment in heavy rail. Heavy rail could cost you \$300 million a mile as opposed to light rail, which costs you substantially less. You also get the economic impact of light rail along that corridor. That is just one example.

Congressman Davis and Congresswoman Norton were mentioning technology. Technology has direct impact on policing and public safety because there are a number of different tools you can use in technology to improve your public safety presence in the neighborhoods. One that is being used around the country, for example, and there is some debate about this, but it has had substantial effects, for example, in cities like Chicago, in commercial areas, is the very judicious use of cameras and surveillance systems. This has had a significant reduction in crime in some of those areas. That is an example of a technology investment.

And last, and this is the hardest nut to crack, is in our public schools. The situation we are facing in our schools is actually that the overall number of children in the quote, unquote, public school system, is not diminishing, it is actually growing. Now, the distribution between the regular public schools and the charter schools is shifting. So we need to, between the regular public schools and the charter schools, see that these kids have the best facilities, and this kind of infrastructure investment that we are talking about here would allow our city to invest in a modernization plan that allowed our school facilities to improve as, hopefully—and I believe this will happen with the charter school movement and other efforts—our instructional program improves, and that is definitely the most important thing you can do to recruit and retain new residents.

Ms. NORTON. I would like to say one thing in response to this. Alice Rivlin, when she left the Control Board, said that the District, in order to remain viable, has got to have 100,000 new residents, and I think the Mayor has adopted that as a goal as well. She did not mean that you had to get that overnight because she is too smart to mean that. In fact, it is a very long-term goal.

When I was a kid growing up in this town, instead of almost 600,000, there were over 800,000 people, and you can imagine what it is going to take to get back the population. There are two strategies in place now. Give the Mayor and the City Council credit for the first one. The reputation of the District of Columbia had changed. There was a time when a lot of folks did not want to live here. They did not know a lot about this. But now the District itself looks like a better place to live because of our local elected officials.

The only other strategy we have in place, and it is one that has worked, is something that this body, as well as the House—in fact, the Senate was where I worked most closely, was the \$5,000 home buyer credit. The \$5,000 home buyer credit has—and studies have been done to show this—has the effect of, No. 1, keeping renters

who were the most inclined to move out here because they buy, goes way up the income line, it goes considerably up; and secondly, drawing new people to the District of Columbia. By the way, that has passed the House as a part of a larger bill, now passed the Senate as part of a larger bill. It will be retroactive, and it has been a very important stabilizing force in the District of Columbia.

Mr. DAVIS. If I could just take a second. The business base, obviously, is going to be critical because the old adage, as somebody who chaired the County Board in Fairfax, as a equivalent function there, the adage was, when residents move in it costs you money. Businesses come in, you make money on your businesses. The reason residents cost you is because it costs money to educate their kids, a lot, and the city pays more per student I think than Fairfax does. But the business base has really expanded here, and with the leadership of the Mayor, it has really helped. You look at downtown today compared to where it was, the MCI Center, the new Convention Center, the businesses and the cranes going up down there, and they are looking at other parts of the city too, and they are going to continue to look for us for help on the waterfront areas, around the Navy Yard, upper New York Avenue.

I look ahead at the possibilities for expansion, the business base in this city, and I think it is significant. We do not consider it a zero sum game where they are taking from the suburbs either. I think we have come to understand that we are all in this together. But there is room there, and the city has now produced an economic climate that I think makes it economic for businesses to come.

Ms. NORTON. The bill you have passed also has business tax credits which have been very instrumental. And, Mr. Chairman, the bill that you sponsored, I cosponsored and was sponsored and cosponsored in this Senate, has been very important. If you had a couple of kids and they were getting to be college old, this was the time to get out of Dodge and go to Maryland, Virginia. And the College Access Act now encourages people all over the District, it does the same thing.

Senator DEWINE. It is very important, absolutely.

Well, we thank you very much. You have been very, very helpful, and we look forward to working with you on your legislation.

Thank you very much.

Mayor WILLIAMS. Thank you too.

Senator DEWINE. Let me invite our second panel to come up, and I will introduce you as you come up. Senator Fred Thompson is President of the Federal City Council, a business supported non-profit, nonpartisan organization that works for the improvement of our Nation's capital. From November 1994 until January 2003, Senator Thompson, of course, served the people of Tennessee in this body, where he chaired the Committee on Government Affairs. His impressive career includes positions of counsel to the Senate Watergate Committee, the Senate Foreign Relations Committee and the Senate Intelligence Committee.

Dr. Alice Rivlin is a Senior Fellow in Economic Studies at the Brookings Institution, and Director of the Brookings Greater Washington Research Program. She is also a visiting professor in the Public Policy Institute at Georgetown University. She was Chair of

the District of Columbia Financial Management Assistance Authority from 1998 to 2001. She also chaired the Commission on the Finances of the District of Columbia from 1989 to 1990.

Ms. Patricia Dalton is a Director for Strategic Issues at the General Accounting Office. In this position she directs GAO's work related to Government management issues, particularly performance management and the Government Performance and Results Act, the organization, structure and design, inter-government relations and tools of Government.

Mr. Stephen Joel Trachtenberg has served as President of George Washington University since August 1988. He currently chairs the D.C. Chamber of Commerce Board of Directors and the Atlantic Ten Conference Presidents Council. He has been appointed by the Mayor to serve on the District of Columbia Tax Revision Commission, as well as the District of Columbia Committee to Promote Washington.

Mr. Ted Trabue is the Staff Director for Government Relations for the Greater Washington Board of Trade. He also serves as Pepco's Regional Vice President for the District of Columbia. A veteran of District Government and politics, he served as legislative analyst in the Office of the Mayor before being named Chief of Staff in the office of Council Member Linda Cropp.

We welcome all of you very much. Thank you for being here. Dr. Rivlin, we will start with you. Let me just indicate to you the last word we get from the floor, as we are going to have a vote in about 10 minutes, and we will just go as long as we can, and when we get a vote, I will just tell you all to stop and we will take off. Now the word is 10:15. Maybe we will make it through the testimony at least.

Dr. Rivlin, thank you very much.

**STATEMENT OF ALICE M. RIVLIN, SENIOR FELLOW AND DIRECTOR,
GREATER WASHINGTON RESEARCH PROGRAM, THE BROOKINGS
INSTITUTION**

Ms. RIVLIN. Thank you, Mr. Chairman. I am delighted to be here, Mr. Chairman, and Senator Landrieu. I am delighted that this subcommittee is holding a hearing on the District's structural imbalance.

I have been concerned for a very long time about this fundamental threat to the viability of the District. I think this is the first congressional hearing to explicitly address the structural imbalance, and I hope that this hearing is the beginning of a very serious debate in both chambers on the District's fiscal future and what the Congress can do about it.

What is a structural imbalance? As Mrs. Norton said earlier, it is different from the fiscal crisis that we had in the 1990's, which had various causes, including mismanagement of the government. But those critical problems are behind us. The District has balanced its budget for 7 years. It has cash in the till. It has a respectable bond rating and a far better managed government than it did a few years ago.

Now we need to face up to the fact that the status of the District as the Nation's capital, and the responsibilities it must undertake, combined with the narrowness of its tax base and the fact that it does not have a State to help it, creates a problem. The problem,

as has been documented by the GAO, is that the District simply does not have the tax base to provide even average services at average tax rates that prevail in States with their cities combined.

Two years ago now I co-authored a Brookings report that stressed all of these points, the special status of the capital city with its multiple responsibilities and the narrowing of the tax base in several ways, but particularly because of Congress prohibiting the taxation of nonresident income. The fact that central cities have high costs, but normally get State help, in the absence of a State means that the higher cost in the District cannot be spread over suburbs and industrial areas as they are in other States. And third, the legacy of the neglected infrastructure which imposes serious costs and makes it harder to deliver good services, especially education.

A more definitive analysis has been done by the GAO, an ingenious and in my opinion, well-executed study that estimate the range of the structural deficit at between about a half a billion and a billion dollars. It was followed by a study that I got a look at the other day by the American Economics Group, a consulting firm, applied a different methodology but came to approximately the same conclusion, a structural deficit at the high end of the GAO range. The city has recently done a report to this committee with some newer numbers and some documentation of the improved management, but basically the same story.

It seems to me that the basic facts are clear. Studies with different methodologies have come to the same conclusion and now we need to ask what to do about it. One option would be to revive the Federal payment, and if we go this route, I think it should be a permanent appropriation indexed to some indicator of the price or cost of producing services over time.

But another very attractive option I believe is embodied in Mrs. Norton's bill, the Fair Federal Compensation Act, that would create an annual Federal contribution of \$800 million to an infrastructure fund with allowable uses including construction, renovation, maintenance and debt service, especially for transportation and education, which clearly benefit the region as a whole.

PREPARED STATEMENT

I think this is the right moment to act on this kind of a bill. The District has survived its financial crisis, improved its management, and now we need to move on to the fundamental problem. Congress has the power to ensure that the District has the fiscal resources to provide the quality of public services that the Nation's capital ought to provide, and I believe ought to do so.

Thank you.

[The statement follows:]

PREPARED STATEMENT OF ALICE M. RIVLIN

Mr. Chairman and members of the committee, I am very pleased that the subcommittee has focused this hearing on the structural imbalance in the District of Columbia budget. I have been deeply concerned about this subject for a long time and am pleased to be invited to contribute to the subcommittee's deliberations.

We all want the Nation's capital to be a city that Americans can take pride in—a city that is a safe and attractive place to live and work and visit. That means a city that provides good quality services, including effective education, public safe-

ty, transportation, recreation and social services. Yet the special status of the District of Columbia creates a fundamental fiscal imbalance that prevents the city from being the great capital city we all want it to be. The District has the responsibility to provide both State and local services to residents, commuters and visitors, and has special duties associated with being the capital city. These responsibilities, combined with severe restrictions on the city's tax base, make it impossible for the District to finance the quality of services needed to fulfill the vision of a great capital city.

The problem of structural imbalance in the District is not a new discovery. Personally, I first focused on the problem in 1990 when I chaired the Commission on Budget and Financial Priorities of the District of Columbia. Our report detailed ways the District could improve the efficiency of its government and modernize its infrastructure. It also stressed the fundamental imbalance between its broad responsibilities and its limited tax base.

THE BROOKINGS STUDY

A dozen years later, in 2002, Carol O'Cleireacain and I worked together at the Brookings Institution to produce *A Sound Fiscal Footing for the Nation's Capital: A Federal Responsibility*. The study discussed three reasons for the District's fiscal imbalance and suggested various ways that increased Federal assistance to the District could fill the gap.

The first reason for imbalance grows out of the District's status as the Nation's capital. The Federal Government is the city's largest employer and generates, directly and indirectly, much of its economic activity. However, the city's major industry—as well as much of the activity it attracts—does not pay taxes, imposes costs on the city, and severely restricts the city's tax base. Federal and other exempt buildings require police, fire, emergency, and other services. Workers who commute to Federal and other tax-exempt buildings cause traffic congestion and wear out the city's infrastructure. During business hours about 70 percent of the vehicles on downtown streets come from outside the city. The visitors and tourists that flock to the capital also impose exceptional costs, including policing, emergency services, crowd control, and clean-up after parades, mass demonstrations, and major public events.

At the same time, the presence of the Federal Government restricts the District's tax base enormously. Fully 42 percent of the real and business property base is exempt from taxation, with the Federal Government alone accounting for 28 percent of the exemption. Sales and excise tax exemptions for diplomatic and military personnel also reduce the District's revenue, as does the inability of the District to tax the "commercial" activities of the Federal Government. But by far the most costly restriction the Federal Government imposes on the District is the prohibition against District taxation of income earned by non-residents. Non-residents—mostly commuters living in the Maryland and Virginia suburbs and working in the District—account for more than two-thirds of the income earned in the District. If the District were able to tax commuter incomes at its current rates, we estimated that it could raise almost \$1.4 billion in additional revenue annually. It would be able to spend substantially more to improve schools and other services and significantly reduce its tax rates at the same time. The Federal prohibition effectively transfers the bulk of the District's income tax base to the treasuries of Maryland and Virginia, leaving the District taxpayers with a commensurately higher burden.

The second argument for Federal assistance to the District follows from the fact that it is the only city in the Nation without a State. In the absence of a State, the District must provide public services normally provided by both State and local government. In recognition of this burden, Congress has authorized the District to levy "State-like" personal and business taxes, such as an income tax, not usually imposed by cities. However, States may tax all income generated within their borders, whether or not it is earned by residents. The District may tax only the one-third of that income that is earned by its residents (plus the comparatively tiny amount earned by District residents in Maryland and Virginia).

Moreover, State governments are able to collect revenue from diverse tax bases that include suburbs and industrial areas and redistribute those resources to local jurisdictions to equalize public services among localities of differing income and wealth. Central cities, which carry the heavy burden of costs associated with the concentration of inner city poverty, normally benefit from this redistribution. The Baltimore City school system, for example, gets more than half its budget from the State of Maryland. The District, however, has to carry these costs without State aid.

In the District of Columbia Revitalization Act of 1997 the Congress recognized the District's burden of State-like responsibilities and transferred some of them to the

Federal Government. It relieved the District of fiscal responsibility for custody of convicted felons and the cost of the local court system. It increased the Federal matching rate on Medicaid and transferred to the Federal Government the District's pension liability, created when the Federal Government ran the District's pension system, along with the corresponding assets of the system. However, other functions usually performed by States, such as higher education and mental health, remained the responsibility of the District. Moreover, the same Act phased out the Federal payment, by means of which, the Federal Government over the years had provided the District with compensation for its unusual fiscal burdens.

The third argument for Federal assistance to the District relates to the neglected state of the District's infrastructure and the high operating costs it imposes on the city. One result of the city's long history of fiscal stress is a legacy of aged and under-maintained school buildings, health facilities, and police stations; out-of-date and inadequate computer systems; and an aging sewer system that contributes to water pollution. I have recently been working with the District to improve its facilities planning and capital budget—a project that has made me acutely aware of urgent needs in the District for modernizing and improving schools and other buildings and infrastructure. In combination, these three fiscal problems seemed to us to constitute a strong case for Federal assistance to compensate the District for the fiscal limitations that prevent it from providing the quality of service a great capital city should provide. Various options were suggested in our paper.

THE GAO STUDY

More recently the General Accounting Office (GAO), at the request of the Congress, focussed its considerable analytical resources on the District's fiscal imbalance. GAO attempted to provide an answer to the question: Does the District have a "structural deficit" that undermines its ability to provide adequate services at reasonable tax rates and, if so, how big is it? The GAO defined structural balance as a situation in which the District would be able to deliver an average level of public services with average tax rates. By "average" they meant the average of the 50 States, including their local governments.

Comparing the District to the average of the States is a tricky proposition and GAO had to make this comparison with great care. The District is a unique jurisdiction, not comparable to any State. Quite a few States are primarily rural and have no large cities at all. Even those with big cities also contain suburbs, small and medium-sized towns and rural areas. No State is entirely urban, as the District is, and none is entirely composed of the central city of a large metropolitan area. Central cities face a higher level of costs due to higher rents and wages and the expenses of dealing with high concentrations of poor people, and must deliver a different range of services than States do (even when their local jurisdictions are included).

The GAO study reflects a thorough, sophisticated and ingenious effort to overcome these objections and produce useful comparisons. Not surprisingly, the GAO found that the District's per capita tax capacity (measured a couple of alternative ways) was higher than that of the average State; in fact, higher than any State. The difference reflects the higher incomes, sales and property values of a city, compared with States that include small towns and rural areas. However, GAO also found that the costs of delivering services in the District were higher than any State's, and were even higher when the set of services being measured were those associated with urban areas, instead of the average of State and local services. The higher costs are associated with wages, rents and concentration of poverty. Since the cost difference was bigger than the tax capacity difference, the GAO concluded that the District faced a structural imbalance: it could not deliver average services at average tax rates. GAO estimated the District's structural deficit at somewhere between \$470 million and \$1.1 billion a year, depending on specific assumptions. It made clear that the prohibition against taxing non-resident income is a major contributor to the District's structural problem.

The GAO also examined some of the District's management challenges and made helpful suggestions about enhancing efficiency—for example, by improving the process of seeking reimbursement of Medicaid expenditures and tightening the financial management of the school system. While greater efficiency would improve the level of District services, the GAO points out that "management improvements will not offset the underlying structural imbalance because it is caused by factors beyond the direct control of District officials." (p.15).

OTHER STUDIES

I recently had a look at the draft of another study, prepared by the American Economics Group, Inc. in connect with a legal challenge to the congressional prohibition

of non-resident income taxation by the District. This study uses different methodology than the GAO (including estimates of the uncompensated costs that commuters impose on the District), but comes to similar conclusions. The study estimates the District's structural imbalance at \$1.2 billion—just over the high end of the GAO range.

On May 5, 2004, the Mayor submitted a report requested by this subcommittee, *Issues and Approaches for Addressing the District of Columbia Structural Imbalance Between Public Service Needs and Public Financing Resources*. The report updates the estimates of where workers live and work and the flows of income across jurisdictional lines. It documents management progress made by the District and some of the reasons why the cost of providing services in the District remains high.

CONCLUSION

The facts are no longer in dispute. Well-documented studies, using different methodologies have concluded that the District faces a serious structural budget imbalance. The question is what to do about the problem. Perhaps the most straightforward option would be to restore the Federal payment in the form of an annual operating subsidy to the District government. To have maximum effect in improving District services, the Federal payment should be a permanent appropriation whose amount reflected increases in the cost of providing service.

A second option would be to restrict the Federal contribution to facilities and other needed infrastructure, so that the Congress could see clear physical evidence of the progress resulting from the Federal contribution. D.C. Delegate Eleanor Holmes Norton and an impressive list of co-sponsors from the surrounding region introduced the Fair Federal Compensation Act of 2004 in this session of Congress. The Act would establish an annual Federal payment to a dedicated infrastructure fund, which the District could use to improve transportation and information technology, pay for debt service, and finance building maintenance and capital improvement in the public schools, including charter schools. Given the District's severe infrastructure deficit and congressional desire for visible physical improvements this approach to the District's fiscal imbalance has a great deal of appeal.

Great nations take pride in great capital cities—and support them. Paris, London, Rome, and Tokyo each epitomize their countries, and each of their nations invests substantial resources in their wellbeing. Washington should enjoy the same prominence and support, but its peculiar status and treatment by the Federal Government undermines rather than enhancing its ability to provide high quality services and infrastructure. The Federal Government severely limits the District's revenue raising capacity, especially by prohibiting it from taxing non-resident income. To put the Nation's capital on a sound fiscal footing, the Federal Government should provide the District with financial compensation for the structural imbalance that it creates. Otherwise, despite a high tax burden on District residents, local officials will continue to be unable to provide adequate services for residents and visitors or finance and maintain the modern, efficient public infrastructure that a great capital city ought to have.

Thank you, Mr. Chairman and members of the subcommittee.

Senator DEWINE. Thank you very much.
Ms. Dalton.

STATEMENT OF PATRICIA A. DALTON, ASSOCIATE DIRECTOR, GENERAL ACCOUNTING OFFICE

Ms. DALTON. Thank you, Mr. Chairman, Senator Landrieu. I am pleased to be here today to discuss the report that we issued last year on the District's structural imbalance and other management issues. Today I would like to briefly discuss the methodology and analysis that led to our conclusion that the District, in fact, faces a structural imbalance. I will also discuss the District's management challenges, including infrastructure and debt issues.

The structural imbalance is not determined by simply projecting existing spending and taxation choices. This type of longitudinal analysis determines whether or not there is a current services imbalance. It looks at the government in isolation. In contrast, determining structural imbalance requires looking at the underlying cost drivers and revenue capacity of a government. We used a rep-

representative services definition of structural imbalance. It answers the question: If a jurisdiction were to provide a representative basket of public services with average efficiency, would it be able to generate sufficient revenues from its own taxable resources and Federal grants to fund those services at a representative tax burden? It looks at a government relative to other governments.

Specifically to assess structural imbalance, we benchmarked the District to the average level of services, resource capacity, and tax burdens for the District and all 50 State fiscal systems. State fiscal systems we defined by combining the State and all of its local government units.

Our quantitative analysis shows that the District's cost of delivering an average level of services per capita is the highest in the Nation due to factors such as high poverty, crime, high cost of living, and high wages in the District of Columbia. The District's total revenue capacity, on the other hand, which is defined as its own source revenue as well as Federal grants, is higher than all State fiscal systems. However, it is not enough to offset the higher cost that the District incurs. Our analysis did take into account the constraints that the District faces on its revenue-raising capacity.

There is a certain amount of imprecision in economic modeling, which is the technique that we were using. Therefore, we performed various sensitivity analyses. The consistency of our results over alternative assumptions led us to conclude that the District does, in fact, face a structural imbalance ranging from our lowest and most conservative estimate of \$470 million annually to over \$1.1 billion, and this is relative to other State fiscal systems.

To cope with the high cost conditions, the District uses its high revenue capacity to a greater extent than almost every other State fiscal system. Despite the high tax burden and large grant funding, our analysis showed the District can only provide an average level of services if it was providing them at average efficiency. Our analysis assumes that services are delivered at an average efficiency. We cannot really quantify what that efficiency is or inefficiency. However, for years, as you are well aware, GAO and other organizations have reported on significant management problems of the District, such as inadequate financial management, billing systems, and internal controls. These management inefficiencies waste scarce resources and hinder the District's ability to get its full share of Federal funding in programs such as Medicaid.

Clearly, progress has been made in correcting these management inefficiencies, but clearly, more needs to be done. To the extent that services are not provided with average efficiency, the District may actually be providing below-average service levels. It is important to note that addressing the management problems will only help address current budget shortfalls or allow the District to actually provide an average level of services. It is not going to offset the structural imbalance.

In addition, our work found that the District has often chosen to hold down its already high levels of debt, the highest per capita in the Nation, by deferring capital improvements. These are clearly symptoms of structural imbalance.

We did not in our report make specific recommendations to address the structural imbalance, but we did discuss various options.

The situation presents difficult policy decisions for both the District and the Congress. However, if Congress decides to provide the District with additional Federal assistance to address this imbalance, the District must achieve basic management practices and accountability standards and provide assurances to the Congress that Federal dollars would be spent effectively and efficiently.

PREPARED STATEMENT

For example, the District needs to follow sound capital planning and management principles and related practices such as those that we have outlined in an executive guide on capital decision-making.

Mr. Chairman, this concludes my remarks, and I will be happy to answer any questions.

[The statement follows:]

PREPARED STATEMENT OF PATRICIA A. DALTON

DISTRICT OF COLUMBIA: STRUCTURAL IMBALANCE AND MANAGEMENT ISSUES

WHY GAO DID THIS STUDY

District of Columbia officials have reported both a current services budget gap and a more permanent structural imbalance between costs and revenue-raising capacity. They maintain that the structural imbalance largely stems from the Federal Government's presence and restrictions on the District's tax base. Accordingly, at various times District officials have asked the Congress for additional funds and other measures to enhance revenues. In that context, the subcommittee has asked GAO to discuss its May 2003 report, District of Columbia: Structural Imbalance and Management Issues (GAO-03-666). This testimony addresses the key findings and concluding observations of the May 2003 report. Specifically, this testimony discusses: (1) whether, or to what extent, the District faces a structural imbalance between its revenue capacity and the cost of providing residents with average levels of public services by using a representative services approach; (2) any significant constraints on the District's revenue capacity; (3) cost conditions and management problems in key program areas; and (4) the effects of the District's fiscal situation on its ability to fund infrastructure projects and repay related debt.

WHAT GAO FOUND

GAO used a multifaceted approach to measure structural imbalance, which involves comparing a fiscal system's ability to fund an average level of public services with revenues that it could raise with an average level of taxation, plus the Federal aid it receives. This approach compared the District's circumstances to a benchmark based on the average spending and tax policies of the 50 State fiscal systems (each State and its local governments). GAO also reviewed key programs as well as infrastructure and outstanding debt. GAO found:

- The cost of delivering an average level of services per capita in the District far exceeds that of the average State fiscal system due to factors such as high poverty, crime, and a high cost of living.
- The District's per capita total revenue capacity is higher than all State fiscal systems but not to the same extent that its costs are higher. In addition, its revenue capacity would be larger without constraints on its taxing authority, such as its inability to tax Federal property or the income of nonresidents.
- The District faces a substantial structural deficit in that the cost of providing an average level of public services exceeds the amount of revenue it could raise by applying average tax rates. Data limitations and uncertainties surrounding key assumptions in our analysis made it difficult to determine the exact size of the District's structural deficit, though it likely exceeds \$470 million annually. Consequently, even though the District's tax burden is among the highest in the Nation, the resulting revenues plus Federal grants are only sufficient to fund an average level of public services, if those services were delivered with average efficiency.
- The District's significant, long-standing management problems in key programs waste resources and make it difficult to provide even an average level of serv-

ices. Examples include inadequate financial management, billing systems, and internal controls, resulting in tens of millions of dollars being wasted, and hindering its ability to receive Federal funding. Addressing management problems would not offset the District's underlying structural imbalance because this imbalance is determined by factors beyond the District's direct control. Addressing these management problems would help offset its current budget gap or increase service levels.

—The District continues to defer major infrastructure projects and capital investment because of its structural imbalance and its high debt level.

If this imbalance is to be addressed in the near term, it is a policy issue for the Congress to determine if it should change Federal policies to expand the District's tax base or provide additional support. However, given the existence of structural imbalances in other jurisdictions and the District's significant management problems and the Federal Government's own fiscal challenges, Federal policymakers face difficult choices regarding what changes, if any, they should make in their financial relationship with the District. If the District were to receive additional Federal support to compensate for its structural imbalance and enhance its ability to fund capital investments, it is important that the District follow sound practices to avoid the costly management inefficiencies it has experienced in the past. These practices include evaluating and selecting capital assets using an investment approach, integrating organizational goals into the capital decision-making process, and providing transparency and accountability over the use of Federal funds.

Mr. Chairman and members of the subcommittee, I am pleased to be here today to discuss our report, District of Columbia: Structural Imbalance and Management Issues.¹ Though our report was released a year ago, its focus on fundamental aspects of the District's financial structure continues to be relevant. In recent years, District of Columbia (District) officials have reported that a continuation of the District's current spending and taxing policies would result in ongoing current services budget imbalances. While District officials have demonstrated their resolve to maintain fiscal discipline by taking the steps needed to balance their budgets for fiscal years 2004 and 2005, those officials claim that the District faces a more permanent structural imbalance between its revenue-raising capacity and the cost of meeting its public service responsibilities that are the result of many factors, several stemming from the Federal Government's presence in the District and the restrictions on the District's tax base.

Although there is no uniform definition of structural imbalance, there are two concepts that can be used to measure it—current services and representative services imbalances. A current services imbalance answers the question: If a jurisdiction were to maintain its current level of services into the future, would it be able to raise the revenues necessary to maintain that level of service under its current taxing policies? This type of longitudinal analysis compares a jurisdiction's projected fiscal position with its current position and is independent of other similarly situated jurisdictions. In contrast, a representative services imbalance answers the question: If a jurisdiction were to provide a representative basket of public services with average efficiency, would it be able to generate sufficient revenues from its own taxable resources and Federal grants to fund the representative basket of services if its resources were taxed at representative rates? This type of analysis uses a basket of services and tax structure typical of other jurisdictions with similar public service responsibilities as a benchmark against which to compare imbalances between the cost of public services and revenue-raising capacity. The approach attempts to compare differences in jurisdictions' fiscal positions under a common set of policies regarding levels of services and taxation. The District has reported both a current services and a more permanent structural imbalance between its costs and revenue-raising capacity.

My statement today will discuss (1) whether, and to what extent, the District faces a structural imbalance between its revenue capacity and the cost of providing residents and visitors with average levels of public services by using a representative services approach; (2) any significant constraints on the District's revenue capacity; (3) cost conditions and management problems in key program areas; and (4) the effects of the District's fiscal situation on its ability to fund infrastructure projects and repay related debt.² We performed our work assessing the structural

¹ U.S. General Accounting Office, District of Columbia: Structural Imbalance and Management Issues, GAO-03-666 (Washington, D.C.: May 2003).

² Prior to our May 2003 report, we issued a preliminary report on these issues in September 2002. See U.S. General Accounting Office, District of Columbia: Fiscal Structural Balance Issues, GAO-02-1001 (Washington, D.C.: September 2002).

imbalance and management issues from August 2002 through May 2003 in accordance with generally accepted government auditing standards, and in June 2004 we obtained updated budget information.

GAO'S METHODOLOGY FOR ASSESSING STRUCTURAL IMBALANCE

We used a representative services analysis to conduct our work on whether and to what extent the District has a structural imbalance. This approach allows us to compare the District's fiscal circumstances against a benchmark based on services and taxation that is typical of jurisdictions with similar fiscal responsibilities, which is different from a current services approach, which would be based on the District's historical spending and tax choices.

When analyzing a representative service imbalance, the choice of a benchmark for a representative level of public services and taxation is a critical decision. In fact, the appropriate level of services and taxation is a matter of perennial debate in every jurisdiction in the Nation. For this reason, we used as a benchmark national average levels of spending and taxation because they are independent of individual jurisdictions' particular preferences, policy choices, and efficiency of service provision. National averages provide benchmarks that are "representative" of the level of services that a typical State fiscal system (the collections of a State, counties, cities, and a myriad of special purpose district governments) employs. A fiscal system is said to have a structural imbalance if it is unable to finance an average (or representative) level of services by taxing its funding capacity at average (or representative) rates. Because we defined structural imbalance in terms of comparisons to national averages, for any given time period a significant proportion of all fiscal systems will have structural deficits.

Determining empirically whether the District has a structural imbalance is a complex task that involves making judgments about: (1) the appropriate set of governments to use when developing benchmarks for the District's spending and revenue capacity; (2) the influence that various workload and cost factors, such as the number of school age children and number of vehicle miles traveled, have on the cost of public services; and (3) the best way to measure revenue capacity.

Using economic modeling, we were unable to provide a single, precise point estimate of structural imbalance, but provided a range instead. Given the lack of professional consensus and a limited empirical basis for many of the decisions underlying our methodology, which was vetted with key experts, we performed several sensitivity analyses to show how our estimates changed as we varied key assumptions. In addition, the precision of our estimates is adversely affected by data limitations for various cost and tax bases. Nevertheless, we believe that the consistency of our basic result over a broad range of alternative assumptions and approaches provides sufficient support for the conclusions offered in this report. Moreover, we supplemented our quantitative analysis with a programmatic review of the District's three highest cost program areas to provide additional insights into the level of services, costs, management, and financing.

For our cost analysis, we computed two separate sets of benchmarks: one based on a "State" services basket, the mix of services typically provided by State fiscal systems (each State and all of its local governments), and a second based on an "urban" services basket, the mix of services that are typically provided by governments in more densely populated areas. The scope of services included is the same for both baskets; what differs is the proportion of total spending that is allocated to each service. For example, the "urban" basket of services gives greater weight to public safety functions and less weight to higher education than does the State basket of services.

To estimate total revenue capacity of each State fiscal system, we combined estimates for the two principal sources from which those systems finance their expenditures: (1) revenues that could be raised from each system's own economic base (own-source revenue), and (2) the Federal grants that each system would receive if it provided an average basket of services. Two basic methodologies have been employed to estimate the own-source revenue capacity of States: (1) the total taxable resources (TTR), which uses income to measure the ability of governments to fund public services; and (2) the representative tax system (RTS), which measures the amount of revenue that could be raised in each State if an average set of tax rates were applied to a specified set of statutory tax bases "typically" used to fund public services. Because experts disagree as to which approach is superior, we computed separate results using both methodologies.

We estimated the size of the District's structural imbalance as the difference between its cost of providing an average level of services and its total revenue capac-

ity—the amount of revenue the District would have (including Federal grants) if it applied average tax rates to its taxable resources.

THE DISTRICT'S PUBLIC SERVICE COSTS ARE THE HIGHEST IN THE NATION

Using other State fiscal systems as a benchmark, our analysis indicated that the cost of delivering an average level of services per capita in the District exceeds that of the average State fiscal system by approximately 75 percent (or a total of \$2.3 billion more annually than if it faced average costs circumstances) and is over a third more than the second highest-cost State system, New York. If State fiscal systems were to provide a basket of services typically provided in more densely populated urban areas, we estimated that the District would have to spend over 85 percent more (or a total of \$2.6 billion more annually) than average to fund an average level of services.

The District faces high-cost circumstances, largely beyond its control, in key program areas including Medicaid, elementary and secondary education, and police and fire services that increase the fiscal burdens on the District's budget. For example, regarding Medicaid, we estimated that high-cost circumstances, such as its large low-income population, would require the District to spend well over twice the national average per capita. Consequently, to provide an average level of services the District would have to spend a total of \$437 million more than if it faced average cost circumstances. Similarly, we estimated that the District's per capita cost of elementary and secondary education is 18 percent above the average State fiscal system due to circumstances such as a disproportionately high percentage of low-income children. As a result, to provide an average level of services the District would have to spend a total of about \$136 million more than if it faced average cost circumstances. Likewise, for police and fire services, the District's per capita costs of providing an average level of services are well over twice the national average due to circumstances such as its relatively young population, especially high crime rates, and its dense living conditions. As a result, to provide an average level of services the District would have to spend about \$480 million more than if it faced average cost circumstances. Further, our cost estimates do not explicitly account for the various public safety demands and costs associated with the Federal Government's presence.

THE DISTRICT'S REVENUE CAPACITY IS AMONG THE HIGHEST IN THE NATION, DESPITE SOME CONSTRAINTS ON ITS TAXING AUTHORITY

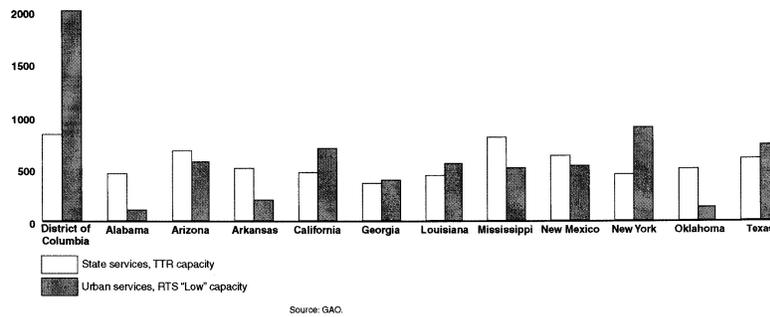
Our analysis indicated that the District's per capita total revenue and own-source revenue capacities are higher than those of all but a few State fiscal systems. Its capacity is high even though the District faces some significant constraints on its taxing authority, such as the inability to tax Federal property or the income of non-residents who work in the District.

The two estimation approaches we used to measure the District's revenue capacity yielded the same basic result: The District's own-source revenue capacity per capita ranked among the top five when compared to those of the 50 State fiscal systems. This high own-source revenue capacity, combined with the fact that its per capita Federal grant funding is over two and one-half times the national average, gives it a higher total revenue capacity than any other State fiscal system. Depending on which estimation approach we used, the District's total revenue capacity ranged from 47 percent above the national average (based on a conservative version of the RTS approach) to 60 percent above (based on the TTR approach).

THE DISTRICT FACES A STRUCTURAL DEFICIT

We concluded that the District does have a substantial structural deficit in the sense that the cost of providing an average level of public services exceeds the amount of revenue it could raise by applying average tax rates, although considerable uncertainty exists regarding its exact size. We obtained our lowest deficit estimate of about \$470 million per year by combining the lowest estimate of the District's costs (the one based on the State basket of services) with the highest estimate of the District's total revenue capacity (TTR). In contrast, we obtained the highest deficit estimate of over \$1.1 billion per year by combining the highest estimate of the District's costs (the one based on the urban basket of services) with the lowest estimate of the District's total revenue capacity (RTS). Among the contributing factors to the structural imbalance are high-cost conditions largely beyond the District's control, such as high poverty rates, large concentrations of low-income children and the elderly, and high crime rates. Figure 1 shows how the District's structural deficit per capita compares to the State fiscal systems with the largest structural deficits.

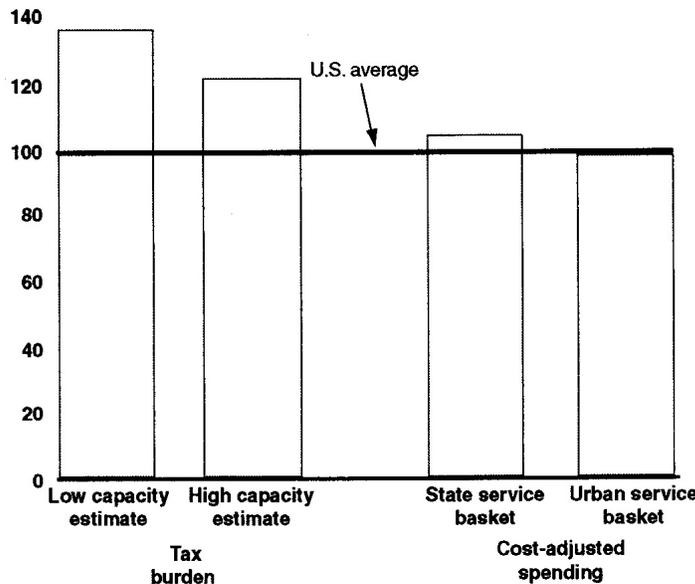
Figure 1: Fiscal Systems with the Largest Structural Deficits Per Capita
 2500 Deficit per capita (national average = 0)



DESPITE A HIGH TAX BURDEN, THE DISTRICT'S REVENUES ARE ONLY SUFFICIENT TO
 FUND AN AVERAGE LEVEL OF SERVICES

In addition to having high revenue capacity, the District also imposes above average tax rates; however, high taxes are only sufficient to fund an average level of services. Figure 2 shows the District's tax burden and cost-adjusted spending. Because of its high tax rates, actual revenues collected by the District exceeded our lower estimate of its own-source revenue capacity at an average tax burden by 33 percent and exceeded our higher estimate of that capacity by 18 percent (see the first two bars of fig. 2). However, the District's actual fiscal year 2000 spending was only equal to the cost of an average level of public services, based on the basket of services provided by the average State fiscal system. Using the basket of services typically provided by urban governments as a benchmark, the District's spending is 5 percent below that needed to fund an average level of services (see the last two bars of fig. 2). Our estimates of the cost of delivering an average level of services presume that they are provided with average efficiency. To the extent that the District does not deliver services with average efficiency, its actual level of services may be below average.

Figure 2: District's Tax Burden and Cost-adjusted Spending
160 Percentage of U.S. average



Source: GAO.

MANAGEMENT PROBLEMS RESULT IN UNNECESSARY SPENDING THAT COMPROMISES THE DISTRICT'S ABILITY TO PROVIDE AN AVERAGE LEVEL OF PUBLIC SERVICES

The District's long-standing management problems waste resources that it cannot afford to lose and draw resources away from providing even an average level of services. In three key program areas (Medicaid, elementary and secondary education, and police and fire services), our original report identified significant management problems, such as inadequate financial management, billing systems, and internal controls. While the District has taken some actions to correct management inefficiencies, more improvements are needed. In the case of Medicaid, in fiscal year 2001 the District wrote off over \$78 million for several years worth of unreimbursed claims for Federal Medicaid matching funds. The District was not able to claim this reimbursement because of late submission of reimbursement requests, incomplete documentation, inadequate computerized billing systems, providing services to individuals not eligible for Medicaid at the time of delivery, and billing for services not allowable under Medicaid. The independent auditor of the District's financial statements continued to report Medicaid accounting and claims processing as a material weakness in fiscal year 2003. The extent of these management problems suggests that the District continues to bear more of the burden of Medicaid costs than necessary.

In the case of education, in the recent past District public school officials were not able to track either the total number of employees or whether particular positions were still available or had been filled. For example, in March 2003, District officials announced that the school system had hired 640 more employees than its budget authorized, resulting in the District exceeding its personnel budget by a projected amount of \$31.5 million over the entire fiscal year. In another example, the District's lack of internal control for procurement practices in its public school system resulted in \$10 million in unauthorized purchases. While our cost analysis shows that the District is spending an amount that could provide an average level of services, the extent of these management problems suggests that the District provides less than the national average of education services.

In the case of police and fire services, the District historically has not adequately tracked the costs it incurs to support the Federal presence, in areas such as providing protection to Federal officials and key dignitaries and dealing with an array of special events and demonstrations. This hinders its ability to make a case for additional Federal reimbursement, requiring it to spend more of its own resources to support the Federal presence.

THE DISTRICT CONTINUES TO DEFER IMPROVEMENTS TO ITS INFRASTRUCTURE WHILE DEBT PRESSURES REMAIN

Although the District is making some attempts to address its backlog of infrastructure needs, it has nonetheless continued to defer significant amounts of infrastructure projects because of constraints in its operating budget. Most of the District's infrastructure and capital improvement projects are financed by using general obligation bonds. The interest and principal payments (debt service) on those bonds are paid from the District's operating budget. Although the District is not close to its legal debt limit, it cannot accommodate additional debt without cutting services or raising taxes that are already higher than those of other jurisdictions. Contributing to the District's difficulties is its legacy of deteriorated infrastructure and its 40 percent share of funding the metropolitan area's costly mass transit system. However, the District is attempting to address its backlog of infrastructure needs through increased capital expenditures (estimated at roughly \$371 million in fiscal year 2003). Nevertheless, the reality is that the District continues to defer major infrastructure and capital investment in part because of its structural imbalance.

From 1995 to 2002, the District's outstanding general obligation debt changed little, totaling slightly over \$2.67 billion as of September 30, 2002, and debt per capita has remained fairly constant. The District's total outstanding general obligation debt as of September 30, 2003, was \$3.25 billion. As a percentage of local general fund revenues, debt service costs, which were 7.5 percent of revenue for fiscal year 2003, are expected to climb to approximately 10 percent by 2006. The District's projections assume that debt service costs will increase at a higher rate than local revenues. Furthermore, when compared to combined State and local debt across the 50 States, the District's debt, both per capita and as a percentage of own-source revenue, ranks among the highest in the Nation. Despite the challenges it faces, the District has been successful in having its bond rating upgraded by all the major rating agencies in part due to the improving economy and improved financial management.

CONCLUDING OBSERVATIONS

Due to a combination of its substantial structural deficit and significant management problems, the District is likely providing a below-average level of services even though its tax burden is among the highest in the Nation. By addressing its management problems, in the long term the District could reduce future budget shortfalls. However, management improvements will not offset the underlying structural imbalance because it is caused by factors beyond the direct control of District officials. As a consequence, District officials may face more difficult policy choices than most other jurisdictions in addressing a budget gap between spending and revenues based on current policies. Since the District may not be providing an average level of services, it would also be difficult to cut services further and the tax burden it imposes is among the highest in the Nation. An alternative option to raising taxes or cutting services would be for District officials to continue deferring improvements to its capital infrastructure. This strategy also is not viable in the long run in that deteriorating infrastructure would of necessity lead to further reductions in the levels and types of services provided and ultimately would necessitate either higher taxes or cuts in services.

Although it would be difficult, District officials could address a budget gap by taking actions such as cutting spending, raising taxes, and improving management inefficiencies. However, a structural imbalance is beyond the direct control of local officials. Without changes in the underlying factors driving expenses and revenue capacity, the structural imbalance will remain. If this imbalance is to be addressed, in the near term it may be necessary to change Federal policies to expand the District's tax base or to provide additional financial support. However, given the existence of structural imbalances in other jurisdictions and the District's significant management problems, Federal policymakers face difficult choices regarding what changes, if any, they should make in their financial relationship with the District. Further, another consideration for the Congress is that the Federal Government faces its own long-term fiscal challenges with the prospect of large, persistent deficits. Nevertheless, by virtue of the District being the Nation's capital, justification

may exist for a greater role by the Federal Government to help the District maintain fiscal balance. At the same time, the District must achieve basic management performance and accountability standards to ensure an efficient use of any resources.

Accordingly, if the District were to receive additional Federal assistance to compensate for its structural imbalance and enhance its ability to fund capital investments—as is proposed in the District of Columbia Fair Federal Compensation Act of 2004 (H.R. 4269)—it is important that the District follow sound practices in order to avoid the costly management inefficiencies it has experienced in the past. The Congress needs assurance that any Federal assistance to the District would be spent effectively and efficiently. It is critical to have clear, transparent reporting and accountability mechanisms in place to ensure the proper use of Federal funds. Also, the Congress might want to consider incentives to encourage the effective utilization of any Federal funds.

Specifically, we have issued detailed guidance—based on best practices of public and private entities—for the planning, budgeting, acquisition, and management of capital assets, including infrastructure projects and technology upgrades.³ Key elements of this guidance are to closely link any planned capital investments to a government or agency's strategic goals and objectives, ensure that effective information systems are in place to support sound decision making and management, and for city leaders to clearly communicate their vision and goals to project managers. In addition, our past work has shown that it is useful to make capital decisions based on the following five basic principles and to follow related practices.

- Integrate organizational goals into the capital decision-making process, such as conducting comprehensive assessments of needs in relation to the current inventory of assets, and evaluating alternative approaches to meeting needs.
- Evaluate and select capital assets using an investment approach, meaning that a clear project approval framework should be established, projects should be ranked based on established criteria, and long-term capital plans should be developed.
- Balance budgetary control and managerial flexibility when funding capital projects, which entails budgeting for the projects in segments and considering full, upfront funding.
- Use project management techniques to optimize project success, such as monitoring project performance, establishing incentives for accountability, and using cross-functional teams to manage the projects.
- Evaluate results to make sure goals and objectives are being met and incorporate lessons learned into the decision-making process, including occasional reappraisals of decision-making and management processes.

We have not examined the District's capital planning and management functions. District officials may already be following these principles and practices. Nevertheless, all of them are important to consider in order to maximize investment.

Mr. Chairman, this concludes my prepared statement. I would be pleased to answer any questions you or the other members of the subcommittee may have at this time.

Senator DEWINE. Thank you very much.
Senator Thompson.

STATEMENT OF HON. FRED THOMPSON, PRESIDENT, FEDERAL CITY COUNCIL

Senator THOMPSON. Thank you, Mr. Chairman, Senator Landrieu. I am here today in my capacity as President of the Federal City Council. The Council is a business-supported, nonprofit, non-partisan organization that works for the improvement of the Nation's capital. It is composed of and is financed by 200 of Washington's top business, professional, educational, and civic leaders.

I want to commend you, Mr. Chairman, for your willingness to focus attention on the long-term structural imbalance confronting the District. This is an issue that has greatly concerned the Federal City Council for many years. As far back as a decade ago, the Council engaged McKinsey and Company to look at the various

³U.S. General Accounting Office, Executive Guide: Leading Practices in Capital Decision-Making GAO/AIMD-99-32 (Washington, D.C.: December 1998).

problems, including the one we are talking about today. We have had, as a matter of fact, three interesting analyses for us: the McKinsey and Company study that we commissioned, most recently the Rivlin study, and, of course, the GAO study. They have come to the same conclusion; that is, there is indeed a structural imbalance, and as a result, the District cannot provide its citizens with an average level of public services with the revenue it could raise by applying average tax rates.

Mr. Chairman, it is obvious from listening to both your opening comments and Senator Landrieu's comments that you understand this, and there is no reason for me to belabor it. It seems to me, though, that a couple of things in the GAO report are worth highlighting and pointing out: that the deficit exceeds at a minimum \$470 million; that raising taxes, cutting spending, and even solving all of the managerial problems is insufficient to offset this structural deficit because they have to do with factors that are basically out of the control of the people that run the city.

If all of the inefficiencies were taken out, it would still require a substantially above average tax burden for just an average level of services. Therefore, I think that it bears focusing in on the most significant result of all this, and that is the deferral of infrastructure and capital investment throughout the city. As you know, it is financed by general obligation bonds and debt service from the operating budget, and it results in the disrepair of the streets and schools, which my understanding is they average about 60 years of age. And to quote from the GAO report, it says the results are badly deteriorated schools, health facilities, police stations, and sewer systems, and it points out that no peer governments that they have looked at—and they have looked at this thing, as you can see, from eight ways to Sunday, a very impressive report—no peer governments they have looked at had the same fiscal responsibilities and the same geographic and demographic characteristics as Washington, DC. Actually, spending with regard to these comparables is below average. And with the inefficiencies and structural deficit, it is also below average spending.

I think that all of the hardship caused by this has been pointed out, but there is another point, Mr. Chairman, that I think is very important to this issue, and it has to do with something that is intangible. This is the Nation's capital. We are the biggest salesmen in the world of the idea of liberty, freedom, and economic—we are for a market economy. We are taking responsibility for the things we have responsibility for, for prosperity, and we hold this out. And it is for our citizens who come to this city that we need to have a face in the Nation's capital that is consistent with these ideals that we have, whether it be with our folks who bring their kids in in the summertime or visitors that we had, for instance, for President Reagan's funeral coming from all over the world, we need to have a face that is consistent with that. And that is not consistent with dilapidated infrastructure and streets and the other difficulties, especially in light of the fact that a lot of these problems, as has been pointed out today, have to do with the Federal Government, caused by the Federal Government. The District obviously has some great benefits by the Government being here also, but these are things that have costs that there is no way out of. We

must take the responsibility. This really would be an investment. Every time we want to engage in spending, you know, we always call it investment. But it is usually just spending. But this really is investment, an investment not only for the District but for our Nation, where, of all places, we need the proper capital investment and infrastructure to take place.

PREPARED STATEMENT

So the Federal City Council is pleased with the progress the District is making. It is concerned with regard to the structural deficit we are talking about here today. We are delighted that we have this legislation as a starting point.

Thank you very much.
[The statement follows:]

PREPARED STATEMENT OF HON. FRED THOMPSON

Good morning, Senator DeWine, Senator Landrieu, and members of the subcommittee. My name is Fred Thompson and I am appearing before you today in my capacity as President of the Federal City Council. As you may know, the Council is a business-supported, nonprofit, nonpartisan organization that works for the improvement of the Nation's capital. Established in 1954, the Council is composed of and financed by 200 of the Washington area's top business, professional, educational, and civic leaders.

Mr. Chairman, I want to begin by commending you for your willingness to focus attention on the long-term structural imbalance confronting the District of Columbia. As Mayor Williams and Congresswoman Norton can attest, this is an issue that has greatly concerned the Federal City Council for many years. Nearly a decade ago, the Council engaged McKinsey & Company to look at the macro economic and demographic forces that were then exacerbating the city's financial difficulties. In 2002, we again retained McKinsey to assess the District's financial condition. The second McKinsey study concluded that notwithstanding the city's extraordinary economic turnaround since the late 1990's, unless major changes were undertaken, the District was facing a structural fiscal imbalance of at least \$500 million. McKinsey went on to say that this imbalance could not be fixed simply by belt tightening or improved management efficiency.

McKinsey's basic conclusions have since been reaffirmed by two additional independent studies, one carried out by Alice Rivlin and her colleagues at the Brookings Institution and a second undertaken by the General Accounting Office (GAO), at the behest of this subcommittee.

Particularly in view of its scope and comprehensiveness, we think the GAO's findings and conclusions are especially important. In its 2003 study entitled District of Columbia Structural Imbalance and Management Issues, the GAO found that the District's cost of delivering an average level of municipal services far exceeded that of the average State due to factors such as concentrated poverty, crime, and a high cost of living. The District's capacity to raise revenue is constrained by limitations on its taxing authority, such as the prohibition on taxing either Federal property or the income of nonresidents. Moreover, while the GAO stated that the District has significant—and widely noted—management problems, it went on to say that “addressing management problems would not offset the District's underlying structural imbalance because this imbalance is determined by factors beyond the District's direct control.”

As you are aware, the upshot of this structural imbalance is that the District cannot provide its citizens with an average level of public services with the revenue it could raise by applying average tax rates. This has led the District to set very high tax rates on both its residents and businesses, which clearly is not what the city should be doing if it wants to attract new residents and encourage businesses to relocate here.

Even when there has been a political consensus in favor of lowering tax rates—which we believe is the case today—it is very difficult for the District to do so given the array of services it must provide and the limitations on its revenue raising ability.

Apart from having to maintain very high tax rates, one of the other consequences of the structural imbalance is that the District continues to defer spending on major

infrastructure projects. Because of its unique status as a government with city, county, and State responsibilities, the District must respond to a far more extensive set of capital improvement needs than other major American cities. A partial list of its capital responsibilities includes elementary and secondary schools; a university; roads and bridges; mass transit; water and sewer lines; regional wastewater treatment; solid waste disposal; a jail; a mental hospital; nursing homes and shelters for the homeless; fire, police, and court buildings; administrative offices; and parks and recreation facilities.

On three occasions over the past 25 years, the Federal City Council has convened task forces to address issues related to the District's infrastructure spending. In part as a result of the Council's 1980 study, the District significantly expanded capital spending during the 1980's. Notwithstanding the increase in capital spending, the Council's 1988 study (updated in 1992) noted that the city was still spending significantly less on infrastructure projects than was necessary to bring its physical assets into a state of good repair. That continued to be the case in the 1990's and is still true today.

The city has estimated that the cumulative value of its infrastructure deferral is in the billions of dollars. Whatever the final number, it is clear that the cost of renovating or replacing antiquated schools (average age over 60 years), fixing the city's roads and bridges, replacing subway cars and facilities that are reaching their replacement age, adding to the capacity of the Metrorail system, and dealing with the problem of combined sewer overflows will be enormous.

In that connection, we were very pleased to see that all of the members of the House from the Washington metropolitan area have signed on as original co-sponsors of H.R. 4269, the proposed legislation that would provide an annual Federal infrastructure contribution to the District. We think it is particularly significant that the bill has been endorsed by representatives from both Maryland and Virginia and that the support is bi-partisan. Bringing the city's infrastructure up to modern standards and making the Nation's capital a city of which all Americans can be proud is in everyone's interest.

Mr. Chairman, we believe, as I think you do, that the Federal Government must recognize the costs it imposes on the District and the burden it places on the city's infrastructure, even as it limits the city's ability to raise revenue. We acknowledge that there may be other ways to assist the District of Columbia besides enactment of the District of Columbia Fair Federal Compensation Act of 2004. What we do know is that the problem of the District's structural imbalance is real and that it must be addressed. Nothing less than the long-term financial viability of the Nation's capital is at stake, and we urge you and your colleagues—and the administration—to craft a solution that deals with this problem once and for all.

That concludes my remarks and I would be pleased to respond to any questions that you or your colleagues might have.

Senator DEWINE. Senator, thank you very much.

Mr. Trachtenberg.

STATEMENT OF STEPHEN J. TRACHTENBERG, CHAIRMAN OF THE BOARD, DISTRICT OF COLUMBIA CHAMBER OF COMMERCE

Mr. TRACHTENBERG. Mr. Chairman, Senator Landrieu, I would just agree with everything that has been said, but everybody has not said it.

Senator DEWINE. We are waiting for you, though.

Mr. TRACHTENBERG. I am mindful of the time, so I am going to submit my testimony for the record. But I am here largely today on behalf of the District of Columbia Chamber of Commerce. This is an organization of 2,000 members, the largest Chamber in the greater Washington area. Many of our members are small business as well as the larger business community including restaurants, hotels, hospitals, universities, builders, law firms, banks, major corporations, and many, many small businesses. All of us are impacted by the financial imbalance in the city and largely because of the taxes that make it hard for us to compete. And this has been compounded since the tragic events of September 11 and their aftermath. I think Washington has been on a remarkable bounce-

back the city has made since September 11 in the economy, and the applications to George Washington University have risen after September 11, contrary to what you might ordinarily expect. But our students, our faculty, the moms and dads that come with them to the District are impacted by the fiscal imbalance, the quality of the infrastructure of the city, and it reflects on the university and on all of the businesses.

PREPARED STATEMENT

Even as we strive to make the economy of Washington stronger, we suffer with these problems, and I am most gratified by the comments made by both of you indicating that you are knowledgeable and sensitive to these issues, and I won't underscore these issues any more than they have been to date.

Thank you for the opportunity to be here today.
[The statement follows:]

PREPARED STATEMENT OF STEPHEN J. TRACHTENBERG

Good Morning, Senator DeWine and members of the Committee, for the record, I am Stephen J. Trachtenberg, President of the George Washington University and the Chairman of the Board of Directors of the District of Columbia Chamber of Commerce. I am here today to testify on behalf of the Chamber concerning the District's structural fiscal imbalance.

With over 2,000 members, the District of Columbia Chamber of Commerce is the largest Chamber in the region and our members come from all segments of the District's business community including restaurants, hotels, hospitals, universities, builders, law firms, banks, major corporations and many small businesses. As Chairman of the Board of an organization that is always working to improve the business and economic climate of the District, I truly believe that the success of our great City depends a lot on the ability of the Federal and local governments to work together to address the District's long-term structural financial imbalance.

Since the cataclysmic events of September 11 and their aftermath, the District has once again demonstrated both the vitality of the District's local business community and the high cost of serving as the Nation's capital city. While the Nation is focused on the war and other tragedies, the District of Columbia has shouldered the burden of wartime security measures that snarl traffic, shutdown commerce, discourage tourists and keep business travelers at home. The good news is that with intelligent fiscal management and cooperation between our local elected officials and the business community, the City's economy is growing stronger.

Wall Street has upgraded our bond rating. The City is in the midst of a development boom unparallel in our history. New commercial and housing projects are going up all over town. Downtown is being revitalized with more retail and restaurants and the tourists are back. The local elected officials have reduced spending, consistently balanced the City's budget, and improved service delivery. The local economy is growing stronger. Despite these positive signs of recovery, the District faces the significant challenge of maintaining its financial viability over the long term.

The District of Columbia is unique among municipal governments. As the Nation's capital, it does not have the benefit of a State to share the costs. It is the only City in the Nation that exercises the responsibilities of a city, State and a municipality. With home rule, the District inherited an infrastructure burden that is yet to be addressed. The Anacostia River has environmental problems, and the roads, bridges, and sewer systems are in dire need of infrastructure repairs. Almost 42 percent of all District property is not taxable. By Federal law the District cannot tax income at its source for 72 percent of the people who work here. Thousands of tourists and demonstrators visit the capital of the free world. All of these things put a definite strain on resources and limit the City's ability to efficiently provide the adequate level of essential services to our residents.

The General Accounting Office recognized that the District does not have the capacity to raise enough revenue under the current circumstances to provide adequate public services to residents. You will hear a great deal today about the GAO report and its conclusions. The key point that I will reiterate is this GAO statement:

“If this imbalance is to be addressed, in the near term, it may be necessary to change federal policies to expand the District’s tax base or to provide additional financial support.”

We are asking this committee to listen to GAO and to take appropriate steps to recognize the costs imposed on the District as the Nation’s capital. Help us find a solution to this fiscal imbalance.

The experts who studied this issue have reported that the structural deficit cannot be overcome by raising taxes. The District residents and businesses carry the highest tax burdens in the region. It hurts a City’s long-term financial viability when its businesses pay 61 percent more in retail taxes and 3 percent more in corporate franchise taxes than businesses in the surrounding jurisdictions. If the District is to remain competitive in the region, it must be in a position to lower taxes on residents and businesses. Clearly the costs of being the capital city outstrip our ability to raise revenues. The District suffers a substantial deficit that cannot be cured by improved efficiencies in the delivery of services, by increasing taxes on residents and businesses, or by management improvements. This imbalance is caused by conditions beyond of the District’s ability to raise revenues.

Congress has taken a piecemeal approach to addressing the imbalance issues. Congress historically subsidized District operations until the Federal payment was eliminated in 1997. The District of Columbia Revitalization Act of 1997 alleviated some of the financial burden by assuming responsibility for prisons, courts and the pension liabilities. Additional Federal resources are provided each year when the Congress earmarks money for a variety of special projects and provides resources for Federal entitlement programs. However, I am advocating for a more comprehensive sustained approach to this structural problem as outlined in the Mayor’s report to you. As you know, the report outlines three options and on behalf of the Chamber, I am asking you to consider them.

The D.C. Chamber strongly supports the Fair Federal Compensation Act of 2004 under which the Federal Government would provide an \$800 million infrastructure payment for transportation, technology upgrades, schools and debt service payments. The other options for addressing the fiscal imbalance include reinstating an unrestricted Federal payment and reimbursing or paying the costs usually paid by a parent State for the District’s State-level programs. The Federal Government must compensate the District for the constraints it imposes on the ability to tax income at its source, for the State related functions, and for the costs associated with being the Federal enclave. The District government and the Federal Government are partnered in the management of the Federal city and should be equitably partnered in bearing the costs. We need each other. The Congress has no fire department. The District has no State. We are only asking for fairness.

The imbalance between accessible revenues and imposed costs signal an approaching train wreck. How can we work with the Congress, the City leaders and the region to secure the future of the Nation’s capital? What would be the right thing to do in light of what the GAO called the District’s “substantial structural deficit?” We urge your close scrutiny to these reports and the options for solving this structural imbalance. The Chamber asks that the Federal Government take immediate steps to address these structural issues. The City, the region and the Nation can only benefit by a collaborative effort to solve this problem. The Federal Government must assume its share of this burden. Being the Nation’s capital is an honor and privilege, but an expensive one for the businesses and residents of the District of Columbia.

On behalf of the Chamber and its members, I thank you for the committee’s continued attention to this pressing issue, and for this opportunity to testify before you. The D.C. Chamber of Commerce stands ready to respond to any questions or requests to assist in this endeavor.

Senator DEWINE. Thank you very much.

Mr. Trabue, thank you for joining us.

STATEMENT OF TED TRABUE, GREATER WASHINGTON BOARD OF TRADE

Mr. TRABUE. Thank you, Mr. Chairman. For the record, my name is Ted Trabue, and I am here today representing the Greater Washington Board of Trade. The Board of Trade consists of 1,200 member companies which together employ about 40 percent of our region’s private sector workforce. I would like to thank the committee for this opportunity to testify on the District of Columbia’s

structural imbalance and applaud each of you for addressing this very important issue.

As a fourth generation Washingtonian, as regional vice president for Pepco, and as the chairman of the Board of Trade's D.C. Political Action Committee, I have witnessed the renaissance of the District of Columbia from a most unique vantage point. Indeed, the image of this great city has improved immeasurably in recent years. Much of this change in image—and change in actual conditions—has been made possible by the District's improved financial health and fiscal stability. The District has balanced its budget in each of the past 8 years. Under the leadership of Mayor Williams and with the support of the D.C. Council, the city has taken dramatic steps to improve the delivery of many public services, from vehicle registration to snow removal to street repairs.

However, the District cannot continue to meet its obligations without a major increase in Federal assistance. This is due to what the U.S. General Accounting Office defined as a "permanent imbalance between the District's revenue-raising capacity and the cost of meeting its public service responsibilities . . . based on structural conditions that are beyond their ability to control."

I have submitted my prepared testimony for the record, but I would like to comment about the schools. We are not getting the quality of students that we used to. The schools when I attended them back in the 1960's and 1970's—when I go into my daughter's school today, books are scarce. This is unacceptable in the Nation's capital.

PREPARED STATEMENT

A lot has been said today, and I have agreed with all of it. It is undeniable. The United States Government spends money trying to help governments. As a native Washingtonian like myself, I call this city home. And we believe this is critical to sustaining this District's impressive renaissance. Accordingly, we urge you to report this legislation favorably to the Senate and to support its prompt consumer and passage.

Thank you very much for your time and consideration of these comments.

[The statement follows:]

PREPARED STATEMENT OF TED TRABUE

Good morning. My name is Ted Trabue, and I am here today on behalf of the Greater Washington Board of Trade. The Board of Trade consists of 1,200 member companies which, together, employ about 40 percent of our region's private sector workforce. I would like to thank the Committee for this opportunity to testify on the District of Columbia's structural imbalance, and applaud each of you for addressing this very important issue.

As a fourth generation Washingtonian, as Regional Vice-President for Pepco, and as Chairman of the Board of Trade's D.C. Political Action Committee, I have witnessed the renaissance of the District of Columbia from a most unique vantage point. Indeed, the image of this great city has improved immeasurably in recent years. Much of this change in image—and change in actual conditions—has been made possible by the District's improved financial health and fiscal stability. The District has balanced its budget in each of the past 8 years. Under the leadership of Mayor Williams and with the support of the D.C. Council, the city has taken dramatic steps to improve the delivery of many public services—from vehicle registration to snow removal to street repairs.

However, the District cannot continue to meet its obligations without a major increase in Federal assistance. This is due to what the U.S. General Accounting Office defined as a “permanent imbalance between the District’s revenue-raising capacity and the cost of meeting its public service responsibilities . . . based on structural conditions that are beyond their ability to control.”

As you know, the GAO was asked to analyze the District’s finances and recently issued a report. It found a structural imbalance that ranges in magnitude from \$470 million to \$1.1 billion. The GAO cited three reasons for why this imbalance exists and why it is due to circumstances beyond the District’s control:

THE DISTRICT PROVIDES STATE SERVICES WITHOUT STATE INCOME

In addition to the customary responsibilities of a major U.S. city, the District of Columbia must be responsible for services traditionally provided by county and State governments. These include Medicaid services, public education, police and fire protection, mental health services, child support enforcement, and tax collection.

However, the District has no State government to help defray the cost of these State services. The District’s tax base is not sufficient, long term, to sustain the delivery of State functions without Federal assistance.

THE MAJORITY OF PROPERTY IN THE DISTRICT IS NOT TAXABLE

Approximately 60 percent of District property is owned by the Federal Government or other nonprofit institutions and is therefore not taxable. This inability to tax a majority of real property in Washington, DC—which has emerged as one of the strongest commercial property markets in the country—devastates our ability to serve our residents and meet our ongoing commitments.

THE DISTRICT IS UNABLE TO TAX INCOME AT ITS SOURCE

The District is prohibited by both congressional statute and the Constitution—as interpreted by Federal courts—to tax non-resident income. As this committee knows, it is routine for other cities, such as New York and Philadelphia, to tax the income of people who come into the city to work. Non-residents comprise approximately 70 percent of the vehicle traffic coming across District bridges and using District roads and other services. The District cannot use revenue from these commuters to offset the costs of providing these services.

The Board of Trade recognizes that the District of Columbia’s inability to levy a commuter tax impairs its revenue-raising authorities and that many cities have the power to levy such a tax. A commuter tax has strong opposition outside the District and if pursued, would likely prove to be regionally divisive.

To be sure, the analysis provided by the GAO identified what it labeled “significant management inefficiencies” in three key areas: Medicaid, elementary and secondary education, and public safety. The remaining challenges faced in each of these areas have been longstanding concerns for the Board of Trade, and have been well-documented over time. Importantly, however, the report also concluded that “even if the District’s services were managed efficiently, the District would have to impose above-average tax burdens just to provide an average level of services.”

The findings of the report are quite clear: there are clearly areas where the District government can, and should, be doing better. However, management efficiencies alone cannot remedy the structural imbalance between the District’s ability to raise revenues and its need to adequately provide essential public services.

We commend Congresswoman Eleanor Holmes Norton and Congressman Tom Davis of Virginia for their leadership in co-sponsoring legislation that would alleviate the structural imbalance. The District of Columbia Fair Federal Compensation Act of 2004 would authorize an \$800 million contribution to the District. This contribution would represent the median of the District’s estimated structural imbalance.

This contribution—coupled with efforts within the District government to operate in a more efficient and cost-effective manner—would enable the District to meet its core responsibilities without imposing an unacceptable burden on its citizens and businesses.

We believe this is critical to sustaining this District’s impressive renaissance. Accordingly, we urge you to report this legislation favorably to the Senate and to support its prompt consideration and passage. Thank you very much for your time and consideration of these comments.

Senator DEWINE. Well, thank you all very much.

Ms. Dalton, Dr. Rivlin, when you come up with the structural imbalance, how do you account or do you account for what this committee has seen as far as this horrible aging infrastructure in the District of Columbia? How does that get counted into that? Because if you were the Mayor or on this subcommittee and you tried to deal with the District's long-term problems, whether it is the water, whether it is the sewer, bridges, you are looking at the next 20 years. And if you really want to do what needs to be done, you have to figure, well, we have got to set aside x number of dollars every single year to catch up. It is just like a house, an old house that you have neglected for many, many years. You have got pay-back time now. How do you count that into this figure that you have come up with? Is it in there?

Ms. RIVLIN. Well, I will not speak for the GAO, but I think in our report we stressed that this was a very large number. It is hard to say exactly how much District costs are increased every year, but they are by the fact that maintaining even minimally a building which is old and has been badly maintained for a long time is very expensive. And, clearly, this infrastructure deficit which is very serious in roads and streets and schools and public health facilities—and you name it, it is decrepit—it is costing the District currently a substantial amount of money, and this will only escalate if we do not meet the problem.

Senator DEWINE. Ms. Dalton.

Ms. DALTON. There are two ways that you can look at it. One, which is really kind of the short-term way, is how much money is the District putting into infrastructure every year and how does it compare to other State systems. But probably the more important way to look at it is what kind of inventory infrastructure needs do they have, because infrastructure is a cumulative effect. And when you have years where you cannot put money into infrastructure, it just continues to build and probably costs more, which is why in our work we took a look at, you know, what was in that inventory of infrastructure needs. Even though we only received probably a partial list, it was very significant. And that is how we really kind of looked at the infrastructure issues to see was there a backlog, was there a need, and, yes, there was.

Senator DEWINE. So the figure that you have cited, that does take into consideration all this infrastructure that this subcommittee is looking at and the Mayor is looking at?

Ms. DALTON. No, it does not. What it looks at in terms of structural balance is just how much money on an annual basis is the District investing infrastructure. It has not looked at the cumulative need for infrastructure, and those build over time.

Senator DEWINE. So I would maintain that one could argue that that figure that you cited is understated.

Ms. DALTON. It is quite possible it is. As we were making our estimates, we tried to be as conservative as we could, which is one of the reasons why you see a range in terms of our estimation because there are a number of variables and assumptions that are built into those estimates, and we did take a conservative approach.

Senator DEWINE. And as Dr. Rivlin said, you know, we all know just from our own houses that the longer you wait, if you have an

old house—and we have an old house here in the District—the longer you wait, the more you are going to pay.

Ms. DALTON. Definitely.

Senator DEWINE. And you pay every year just to maintain it, and then when you finally get around to fixing it, it is just huge.

Ms. DALTON. The analogy would be in the private sector where you look at deferred maintenance.

Senator DEWINE. Right.

Ms. DALTON. And you want to manage that so it does not get out of control. The same applies to the Government. If you do not manage deferred maintenance, you have got trouble.

Senator DEWINE. Absolutely.

Senator THOMPSON, you chaired the Government Affairs Committee that would probably have this bill or a similar bill. Put your Senate hat back on and all your experience as a person who understands how things work in our Nation's capital and understands how things work in the Senate. How do we get something like this passed in Congress? We have got a tough—this is not an easy time. There are never easy times here in Congress. How do we persuade our colleagues?

Senator THOMPSON. That goes to the heart of the question, and I have thought about it. We now have at least three analyses of the city's infrastructure. I don't think there is much—I think what is going on, we have got a management problem. The city is making progress. I don't know how you institutionalize something in addition to what we already have. I think most everybody has confidence.

So I think we have to have—and I am really sincere where I say that this is a case of national investment. It doesn't look to me like we want to—the thing is we need to make investment in our Nation. We took a time-out where we all sat down together and we all thought about our common interests. I think in that same spirit we can come up with something we can be proud of. I think that with safeguards going in and understanding what is going to be needed is important.

Senator DEWINE. Good. Senator Landrieu.

Senator LANDRIEU. Thank you, Mr. Chairman. Just a couple of points and then a question or two, but I am assuming that you all are familiar with a report I guess submitted by the Mayor to us today. I would like to refer at least the staff and those that might have it to page 7 of this report, where it talks about the estimated wages and salaries earned in the District and by D.C. residents. It is quite very interesting, and actually somewhat jolting to see, Mr. Chairman, how much income is earned by non-District residents in the District as compared to the earnings of District residents in the District. Just for the record I would like to read that the total earnings in the District in billions—I am assuming this is annual earnings—is \$40 billion, and the amount of money earned in the District of Columbia by non-District residents is \$30.9 billion. And the amount earned by District residents in the District is \$9.1 billion for a total of \$40 billion.

What is very notable about this is that these earnings were not taxed earnings, but earnings earned in the city using city services, whether it is transportation, roads, sidewalks, fire, police, emer-

gency response teams, electricity, lights, and you can just go on and on, and it is earned but not able to be taxed. That is an awful lot of money that is basically not available to the District to support the city itself. That is point No. 1.

Point No. 2, I want to say before the hearing ends, which will be in a few moments, is that my comments about management efficiencies are really directed to the city generally itself, and not to the school system, and I want to make this very clear. I think that there are many opportunities still available for the school system to become more efficient, more responsive, more inclusive, stronger, within its current budget constraints. And I say that, having studied now—

Senator DEWINE. And I agree with that as well.

Senator LANDRIEU. Thank you. And the Chairman and I have studied this now for years and years, looked at it from every different angle, compared it to other cities that have the same demographics, same socioeconomic levels, to see that there is a better quality of education being provided for less dollars than is generally true of Washington, DC.

I would just say for the record that I want to be clear, that my comments about management are for the city generally, not the school system.

The third point is—and I appreciate, Senator Thompson, your comments about how we are going to get from where we are to where we need to be. But I think just sort of one unrestricted payment to the District for a variety of sort of menu choices will probably not meet the test of accountability or the way monies are invested these days at least, and perhaps a more structured help would make more sense along the lines that we have suggested, for transportation, which is obvious.

I am sitting here thinking, Mr. Chairman, of the contribution the State of Louisiana makes and other States towards their public school system that is not happening here, which we could potentially help in that direction.

Then to help with capital funding, at least from my limited experience in Louisiana, we had a capital outlay budget at the State level that helped all cities and all counties, parishes in our case, around the State, not to the extent that the parishes and cities ever wanted, but it was a pretty significant help in terms of general capital outlay, which of course does not exist here because there is no State.

So along those lines I think we could put something, could begin coming together and finding some form, but clearly, based on the earnings of people from outside of the District, in the District and our inability to tax, the high level of taxation for businesses and residents that is already in place for the 600,000-plus people that live here, something has got to be structured.

I will look forward to working with you all and would recommend the reading of this study.

The other interesting thing, is it would be interesting—I know people say why go back that far? The problem is 2004. But maybe understanding what happened back in the 1920's, because it is a huge falloff of direct Federal assistance.

The final point is maybe exploring making more generous the Federal match for this city's Federal programs would help. I fight very hard for more generous match for Louisiana, because I have a high percentage—Senator, you do also in Tennessee, Senator DeWine to some extent in Ohio—but my State is one of the poorest in the Nation, so I am constantly fighting, and I think on fairly substantial ground to get our Federal matches as generous as possible, claiming our people are less able to pay. The District could also in some ways make that claim and perhaps arguing for more generous Federal matches would indirectly, indirectly actually bring more dollars to the city.

So I guess I will conclude by saying there are many ways to skin this cat. I think we have gotten some good ideas this morning, and I would be for doing it for the city, not at this point for the school system. I am not saying I will not help the school system, but not a blank check to a system that is not, in my view, and in many views, not well managed, and when we do structure something, not have it just one big check for a selection of menus, but something that is transparent, accountable, so the taxpayers are sure that they are getting their money's worth.

ADDITIONAL COMMITTEE QUESTIONS

Senator DEWINE. That was the second bell for a vote. Let me thank you very much. I think your testimony has been very helpful, and I think really lends a lot of support for the changes that we need to make.

[The following questions were not asked at the hearing, but were submitted to the Department for response subsequent to the hearing:]

QUESTIONS SUBMITTED TO THE GENERAL ACCOUNTING OFFICE

QUESTIONS SUBMITTED BY SENATOR RICHARD J. DURBIN

MANAGEMENT CHALLENGES

Update on Management Challenges and Possible Improvements

Question. Can you provide us with any current insights about whether the District has taken steps to address these concerns, and whether those efforts have produced positive results?

What additional improvements would you like to see?

Answer. As I stated in my June 2004 testimony before your subcommittee, the District of Columbia has made progress in improving management and maintaining fiscal discipline. In fact, it appears the District has made some progress since we issued our comprehensive report—District of Columbia: Structural Imbalance and Management Issues—in May 2003 (upon which my June 2004 testimony was based).¹ For example, District officials have taken steps to balance their budgets for fiscal years 2004 and 2005. Also, the District's bond rating has been upgraded by all of the major rating agencies in part due to the region's improving economy and better financial management.

Further, our recent mandated review of the District's performance and accountability plan for fiscal year 2003 found that the District complied with statutory reporting requirements and that the report provided a comprehensive review of the District's performance.² We also found that the 2003 performance report provided an update on the following performance management programs.

¹GAO, District of Columbia: Structural Imbalance and Management Issues, GAO-03-666 (Washington, DC: May 22, 2003).

²GAO, District of Columbia: Fiscal Year 2003 Performance Report Shows Continued Improvements, GAO-04940R (Washington, DC: July 7, 2004).

- The District reported on the expansion of performance-based budgeting to 27 additional agencies. All 77 agencies are expected to be utilizing performance-based budgeting by 2006.
- The District also reported plans to expand its recommendations and court orders tracking system to begin tracking the costs of implementing recommendations and court orders. Originally this system was intended to only track the extent to which recommendations and court orders had been implemented throughout the District.
- In addition, the District reported plans to implement an online budgeting and performance program (Argus) to link agency budgeting and performance reporting. The District expected to implement the program in October 2004 in those agencies that are already using or implementing performance-based budgeting. This system will allow for monthly performance reporting and enhance oversight of agencies' data collection efforts. Through this system, agencies will prepare budget requests based on actual program costs. Further, the system will eliminate an agency's ability to modify performance targets or past performance without management approval.

The District's performance goals represent about 90 percent of its total expenditures. While the District has made steady progress in implementing a more results-oriented approach to management and accountability, actions have not been completed on our prior recommendations related to expanding coverage of goals and measures to all activities within the Mayor's authority, as well as the monitoring of court costs.

Despite the progress that has been made, challenges still remain, as evidenced by several studies and investigations that have been released since the issuance of our May 2003 report. For example, the independent auditor of the District's financial statements for fiscal year 2003 again reported District Medicaid provider accounting and financial reporting as a material weakness.³ We highlighted Medicaid management as a major challenge in our May 2003 report. According to the independent auditors' report, certain conditions have hindered the ability of the District of Columbia Public Schools (DCPS) and Department of Mental Health to accurately estimate and record amounts owed from the Federal Government for eligible services in a timely fashion. This means that the District continues to bear more of the burden of its high Medicaid costs with local funds than necessary and does not fully leverage the permanently enhanced Federal Medicaid match (70 percent) that Congress gave it in 1997. Addressing these problems in a timely manner has taken on greater significance because the District has proposed eliminating its Medicaid reserve fund in fiscal year 2005 (\$55 million in fiscal year 2004). This reserve was intended to serve as a cushion in the District's budget in the event of less-than-expected Federal reimbursement, which had been a significant problem in previous years.

In another example, in September 2003 the DC Appleseed Center for Law and Justice⁴ and Piper Rudnick LLP issued a study on special education problems in DCPS, which we also discussed in our May 2003 report.⁵ The District lacks appropriate special education programs and services, which frequently results in DCPS expending resources to subsidize private school placements and related transportation expenses, as well as the costs associated with due process hearings. According to the DC Appleseed Center for Law and Justice report, these problems are exacerbated by DCPS's inadequate dispute resolution process. The report concluded that DCPS's inability to promptly address parental inquiries and concerns about inadequate special education services and facilities results in anger and mistrust on the part of parents. Responding to parental concerns earlier and more effectively could minimize anger and mistrust, thereby reducing lawsuits, due process hearings, and their related legal costs. The report also laid out recommendations for improving DCPS's dispute resolution process.

Moreover, the District Office of the Inspector General reported in September 2003 that DCPS lost the use of approximately \$4.5 million in Federal homeland security funds because it was unable to identify a use for and obligate these funds in a time-

³ Government of the District of Columbia, Office of the Inspector General, District of Columbia: Independent Auditors' Report on Compliance and on Internal Control Over Financial Reporting (Washington, DC: Feb. 2004).

⁴ The DC Appleseed Center for Law and Justice is an organization that brings together volunteer teams of attorneys and other experts to conduct studies of serious local issues, research and analyze them, develop and publish recommendations for systemic reform, and advocate for solutions.

⁵ DC Appleseed Center for Law and Justice and Piper Rudnick LLP, *A Time for Action: The Need to Repair the System for Resolving Special Education Disputes in the District of Columbia* (Washington, DC: Sept. 2003).

ly fashion.⁷ Although DCPS lost out on the use of these funds, it nonetheless has identified a need for security enhancements totaling \$5.7 million.

As agreed with your staff, we did not conduct updated reviews of or new interviews with officials in District agencies in advance of my June 2004 testimony. Nonetheless, several GAO studies completed since the issuance of our report in May 2003 further describe the status of the District's management challenges. Several select examples of other more recent GAO work related to the District follow. In some cases, GAO has also recommended that certain actions be taken to address management challenges.

—*District-wide management and performance.*—In our July 2004 review of the District's performance and accountability report for fiscal year 2003 (described above), we identified certain gaps. Specifically, the 2003 performance report did not include 33 activities that represent 10 percent of the District's budget, including public charter schools (the most significant program activity that lacked goals). Previously, we recommended that the District establish goals for the charter schools and report on progress. District officials told us that goals have been established for the charter schools and will appear in the 2004 performance report. According to the report, most of the remaining program activities relate to particular funds (e.g., the disability compensation fund), and measures are not set for such funds.

—*Medicaid—mental health system.*—In March 2004 we issued a report on the status of reforms to the District's mental health system, which is managed by the Department of Mental Health (DMH), including its enrollment and billing system.⁷ DMH has developed and implemented a comprehensive enrollment and billing system designed to coordinate clinical, administrative, and financial processes. Under this system, a core services agency, which is a DMH-certified provider, enrolls eligible consumers in the District mental health system and develops treatment plans, provides and coordinates services, and bills DMH on a fee-for-service (FFS) basis. This system has two key attributes. First, it links payment directly to treatment planning and services provided. Second, it increases access to certain community-based mental health services, with a significant share of the costs reimbursable by Federal Medicaid funds for community-based mental health services. For fiscal year 2003, DMH received \$17.5 million in Federal Medicaid funds, and DMH expects further growth in Medicaid revenue. In transitioning to FFS, however, providers have faced challenges managing cash flow in a system that no longer guarantees revenue regardless of performance. In addition, because provider contracts were tied to the FFS billing projections, DMH could not pay claims in 2003 for providers that were delivering more services than had been projected until their contracts were changed. As a result, providers did not always receive claims payments on a timely basis in fiscal year 2003. By August 2003, DMH made the necessary contract changes to allow providers to be paid for the remainder of the fiscal year and, according to senior officials, had a plan in process for fiscal year 2004 to prevent this problem from recurring.

—*Medicaid—program and fiscal integrity.*—In July 2004, we issued a report on State and Federal efforts to prevent and detect improper Medicaid payments to providers.⁸ Fraudulent and abusive billing practices across the 50 States and the District include billing for services, drugs, equipment, or supplies not provided or not needed. States can generate cost savings by applying certain measures to providers determined to be at high risk for inappropriate billing and by generally strengthening their program controls for all providers. We identified a number of program control approaches and surveyed all of the States and the District on the extent to which they have implemented them. These include time-limited enrollment, on-site inspections, and criminal background checks, as well as increased use of information technology and prescription drug controls. According to our inventory, the District had implemented 9 of these 20 cost-saving approaches.

—*Public safety and justice—jail facilities.*—In August 2004 we issued a report that reviewed the status of health and safety conditions at the District of Columbia's Jail and Correctional Treatment Facility (CTF) along with its manage-

⁷ Government of the District of Columbia Office of the Inspector General, *Use of Homeland Security Funds at the District of Columbia Public Schools* (Washington, DC: Sept. 2003).

⁷ GAO, *District of Columbia: Status of Reforms to the District's Mental Health System*, GAO-04-387 (Washington, DC: Mar. 31, 2004).

⁸ GAO, *Medicaid Program Integrity: State and Federal Efforts to Prevent and Detect Improper Payments*, GAO-04-707 (July 16, 2004).

ment of capital improvement projects at the facility.⁹ We reported that District health inspectors consistently identified problems at the facility regarding air quality, vermin infestation, fire safety, and plumbing (among other things). However, we found that District health inspectors did not always document where deficiencies were identified or exact times and dates when they were identified—making it difficult for CTF officials to determine how prevalent health and safety deficiencies were, whether problems were occurring in the same locations, or whether they changed over time. Further, we found that the District lacked written policies and procedures concerning the management of jail-related capital improvement projects. We recommended that District health inspectors improve the specificity of their reports. We also recommended that the District strengthen management of capital improvement projects by establishing specific time frames for completing work and developing and implementing policies and procedures.

—*DCPS—special education.*—In September 2003, we issued a report on special education disputes and mediation strategies across the States (including the District).¹⁰ Officials told us that disagreements usually arose between parents and school districts over fundamental issues of identifying students' need for special education, developing and implementing their individualized education programs, and determining the appropriate education setting. We found that most due process hearings were concentrated in five States—California, Maryland, New Jersey, New York, and Pennsylvania—and the District of Columbia. We reported that 2,311 special education disputes occurred in these five States and the District in the year 2000—compared to 709 in all other States combined. Also, the District had 336 due process hearing per 10,000 students, compared with 24 per 10,000 in New York. We also found that dispute resolution activity was generally low relative to the number of students with disabilities.

The District has made and is making real and important progress in addressing its long-term and difficult management challenges. However, more work needs to be done. Sustained progress is needed to address the critical financial, program, and performance management challenges that the District faces across various agencies and program areas.

Link between Structural Imbalance and Management Challenges

Question. While you note that addressing these management issues could help reduce future budget shortfalls, such improvements will not offset the structural imbalance. I assume that conclusion is not in any way intended to signal that ignoring the management problems is acceptable, but can you please comment further on that?

Answer. Ignoring the management challenges that we and others have identified is not acceptable, nor did we mean to imply this in our report or my testimony. District officials agree that management issues need to be addressed. For example, in the District's formal response to our May 2003 report, the District Chief Financial Officer (CFO) concurred that improved program performance would permit the District to enhance the quality of the services it delivers and position the District to obtain a higher level of Federal reimbursement than it currently receives. The CFO also acknowledged that significant opportunities for efficiency improvements exist within District programs and noted that the District is taking some corrective actions.

Nonetheless, it is important to consider certain critical points regarding the District's management challenges and their relationship to the fiscal structural imbalance we confirmed in our report. The models we used to estimate the range of the District's fiscal structural imbalance presume that services are provided with average efficiency. To the extent that a jurisdiction does not deliver services with average efficiency, its actual level of services may actually be below average. Due to a combination of its significant management problems and its substantial structural deficit, the District is likely providing a below-average level of services even though its tax burden is among the highest in the Nation. Accordingly, the District's management problems waste resources that it cannot afford to lose and draw resources away from providing even an average level of services.

By addressing the management challenges that GAO and others have identified over the years, the District could free up local funds and possibly gain additional

⁹ GAO, District of Columbia Jail: Management Challenges Exist in Improving Facility Conditions, GAO-04-742 (Aug. 27, 2004).

¹⁰ GAO, Special Education: Numbers of Formal Disputes Are Generally Low and States Are Using Mediation and Other Strategies to Resolve Conflict, GAO-03-897 (Washington, DC: Sept. 9, 2003).

Federal funds for use in increasing the level of services to its residents and visitors. For example, improving Medicaid management could allow the District to obtain a greater level of Federal Medicaid funding and fully leverage its enhanced Medicaid match. However, management improvements will not offset the underlying structural imbalance because it is caused by factors beyond the direct control of District officials. As a consequence, District officials may face more difficult policy choices than most other jurisdictions in addressing a budget gap between spending and revenues based on current policies.

As we stated in our May 2003 report, by virtue of the District being the Nation's capital, justification may exist for a greater role by the Federal Government to help the District address its structural imbalance. However, this strategy is not without its own risks. For example, significant management problems in the District mean that the aid provided, if not used wisely, could result in more wasteful spending or in the District postponing management reforms. Given its management challenges, it is important that the District establish basic management, performance, and accountability standards to ensure the efficient and effective use of any Federal resources. Along these lines, it should continue planned management reforms, including the movement to performance-based budgeting. It should also address management problems and implement recommendations for improvements that have been highlighted by GAO and others.

LEGISLATIVE REMEDIES

Question. What guidance can GAO offer as Congress evaluates legislative measures to address the District's fiscal structural imbalance challenge?

What should be included in legislative language that would ensure adequate and appropriate transparency and accountability for the use of any Federal contributions that may be authorized to address the structural imbalance?

What safeguards would you recommend be considered as essential elements of any funding proposal?

Using H.R. 4269, the District of Columbia Fair Federal Compensation Act of 2004, as a baseline, what additions would improve that approach?

Answer. Due in part to its substantial structural deficit, the District is likely providing a below average level of services even though its tax burden is among the highest in the Nation. As a consequence, District officials may face more difficult policy choices than other jurisdictions in addressing a budget gap between spending and revenues based on current policies. For example, given its existing high tax burdens, further raising taxes would likely worsen its competitive advantage in attracting new businesses and residents to the city rather than surrounding jurisdictions. It would also be difficult to cut services further.

If raising taxes or cutting services is to be avoided, an alternative option District officials might exercise would be to continue deferring improvements to its capital infrastructure. However, this strategy also is not viable in the long run, in that deteriorating infrastructure would of necessity lead to further reductions in the levels and types of services provided and ultimately would necessitate either higher taxes or cuts in services.

Federal policymakers are faced with difficult choices regarding what role they should play, if any, in addressing the District's structural imbalance. Federal policymakers could choose not to address the District's structural imbalance and require local officials to deal with the difficult choices it faces to meet its obligations. This approach recognizes that other jurisdictions also face substantial structural deficits, and District officials are in the best position to decide for themselves the most effective means of balancing trade-offs between high tax burdens and reduced levels of public services for local residents and visitors to the Nation's capital.

Alternatively, additional Federal assistance for the District could compensate for its structural imbalance. However, this assistance might suggest that some other States, also with sizable structural imbalances, would have an equally sound claim on additional Federal assistance. Nevertheless, by virtue of the District being the Nation's capital, and the restrictions placed upon it, justification may exist for a greater role by the Federal Government to help the District maintain fiscal balance. As previously noted, this strategy is not without its own risks. For example, management problems that plague the District mean that the aid provided, if not used wisely, could result in the District simply postponing many management reforms necessary to avoid the wasteful expenditure of much needed resources and would assist in closing current budget gaps. Given its management challenges, the District must achieve basic management performance and accountability standards to ensure an efficient use of any resources.

In the end, it is up to Congress to decide whether or in what form to provide the District with additional Federal assistance to compensate for its structural imbalance. As the Mayor of the District of Columbia discussed in his May 2004 report to the Senate Committee on Appropriations, there are various forms that enhanced Federal assistance could take. The Mayor outlined three forms: an unrestricted Federal payment, assumption of State-like functions by the Federal Government, and Federal funding that would be targeted for specific purposes as laid out in the District of Columbia Fair Federal Compensation Act of 2004.

No matter what form this assistance might take, it is important for Congress to have assurances that the funds would be spent efficiently and effectively and be used for any intended purposes. These safeguards should be written into any legislation. Specifically, District officials should be required to report to Congress on how they plan to spend the Federal assistance and regularly report on how it is being spent. For instance, Congress could require District officials to submit a master plan to Congress on how they intend to spend the Federal assistance—before any funds are obligated—and update this plan as circumstances or priorities change. Further, any reports and financial statements should be required to undergo periodic review by independent auditors. In addition, Congress may consider further specifying the types of projects for which Federal funds could be used. Congress may also consider a matching requirement to ensure that some local funds continue to be used for infrastructure and capital projects.

Finally, as I discussed in my testimony before your subcommittee, it is of critical importance to have an effective and transparent capital decision-making and management system in place for all District agencies. In my response to the third set of questions that follow, I discuss principles and practices that should be followed to ensure efficient and effective capital decision making and management.

PLANNING AND OVERSIGHT

Question. What types of preliminary evaluations should be conducted and what management controls should be in place as a prerequisite for addressing the District's infrastructure needs?

In your oral testimony, you referred to an inventory of infrastructure and noted that what GAO was provided as part of its work was an "incomplete" array. Can you elaborate further and describe any impediments GAO encountered in getting complete information?

What do you suggest would help ensure that the District compiles and maintains an accurate and full inventory of its infrastructure needs and estimates, as well as having in place a fully functional system for tracking investments made and projected future costs?

Answer. If the District were to receive additional Federal assistance to compensate for its structural imbalance and enhance its ability to fund capital investments—as is proposed in the District of Columbia Fair Federal Compensation Act of 2004 (H.R. 4269)—it is important that the District follow sound practices in order to avoid the costly management inefficiencies it has experienced in the past. Congress needs assurance that any Federal assistance to the District would be spent effectively and efficiently. It is critical to have clear, transparent reporting and accountability mechanisms in place to ensure the proper use of Federal funds. One option for Congress would be to require the District to develop and submit for review a set of capital planning and management policies and procedures that would be reliably followed by all District agencies.

Regarding my comments about the District's infrastructure inventory, we had some difficulties obtaining complete and timely information on infrastructure projects that were not recommended for financing due to funding constraints. This emphasizes the importance of the District having systems in place to track information related to all infrastructure projects, including proposed projects not approved for funding.

A key way to ensure that Federal capital funds are spent effectively and efficiently is to have a clear capital decision-making and management system in place. Along these lines, GAO has developed an executive guide that identifies organizational attributes that are important to the capital decision-making process as a whole, as well as capital decision-making principles and practices used by leading State and local governments and private sector organizations.¹¹ These principles and practices could be applied to any District agency or the District as a whole. Key elements of this guidance are to closely link any planned capital investments to a

¹¹GAO, Executive Guide: Leading Practices in Capital Decision-making, GAO/AIMD-99-32 (Washington, DC: December 1998).

government's or organization's strategic goals and objectives, ensure that effective information systems are in place to support sound decision making and management, and ensure that city leaders to clearly communicate their vision and goals to project managers. Specifically, we have identified five basic principles of effective capital decision making and linked certain practices that leading public and private entities use to carry out each principle.

We did not examine the District's capital planning and management functions in advance of my June 2004 testimony, and District officials may already be following some of these principles and practices in certain program areas. Nevertheless, the District should consider these principles and practices in ensuring the implementation of an effective, transparent, and reliable system for making capital decisions and managing them from start to finish. Our executive guide contains additional detail on each of these practices along with numerous examples from the leading organizations that we studied.

Principle I: Integrate organizational goals into the capital decision-making process.

Conduct comprehensive assessments of needs to meet mission and results-oriented goals and objectives.—Conducting a comprehensive needs assessment or analysis of program requirements is an important first step in an organization's capital decision-making process. A comprehensive assessment of capital needs considers an organization's overall mission and identifies the resources needed to fulfill both immediate requirements and anticipated future needs based on the results-oriented goals and objectives that flow from the organization's mission.

Identify current capabilities, including the use of an inventory of assets and their conditions, and determine if there is a gap between current and needed capabilities.—Leading organizations gather and track information that helps them identify the gap between what they have and what they need to fulfill their goals and objectives. To help assess current capabilities and establish a baseline, such organizations maintain automated systems that track the use and performance of existing assets and facilities. Current and accurate information is essential. Some functions performed by asset inventory and tracking systems include (1) identifying asset and facility location and status, (2) tracking and reporting asset and facility condition and deferred maintenance needs, and (3) tracking user satisfaction. Routinely assessing the condition of assets and facilities allows managers and other decision makers to evaluate the capabilities of current assets, plan for future asset replacements, and calculate the costs of deferred maintenance.

Decide how best to meet the gap by identifying and evaluating alternative approaches (including noncapital approaches).—Leading organizations consider a wide range of alternatives to satisfy their needs, including noncapital alternatives, before choosing to purchase or construct a capital asset or facility. Managers carefully consider options such as contracting out or divesting the activity the asset would support. When they determine that capital is needed, managers also consider repair and renovation of existing assets. When evaluating alternatives, prudent decision makers also consider the various funding options available to them. They weigh the different impacts of debt financing, engaging in joint-venture projects, or using current-year appropriations. Leading organizations examine their needs and seriously consider whether capital is needed to fulfill their requirements. They look at two primary issues to evaluate options available to them: (1) whether the function is essential to fulfilling the organization's core responsibilities and (2) whether the organization has the specific expertise to perform the function well and cost effectively.

Principle II: Evaluate and select capital assets using an investment approach.

Establish a review and approval framework supported by analyses.—We found that establishing a decision-making framework that encourages the appropriate levels of management review and approval, supported by the proper financial, technical, and risk analyses, is a critical factor in making sound capital investment decisions. A well-thought-out review and approval framework can mean capital investment decisions are made more efficiently and supported by better information. Some leading organizations have review processes in place that determine the level of analysis and review that will be conducted based on the size, complexity, and cost of the project. As part of the capital review and approval process, leading organizations develop a decision or investment package to justify capital project requests. Common categories of information in the packages include links to organizational objectives; solutions to organizational needs; project resource estimates and schedules; and project costs, benefits, and risks. These packages provide decision makers with a valuable tool for analysis and planning at the time the project is being considered. Decision packages are supported by a range of materials. Types of materials

include detailed economic and financial analyses, such as cost-benefit analyses and analysis of return on investment.

Rank and select projects based on established criteria.—Leading organizations have defined processes for ranking and selecting projects. The selection of capital projects is based on preestablished criteria and a relative ranking of investment proposals. Leading organizations determine the right mix of projects by viewing all proposed investments and existing capital assets as a portfolio. Organizations generally find it beneficial to rank projects because the number of requested projects usually exceeds available funding. Sound criteria help link potential investments to program priorities and desired results.

Develop a long-term capital plan that defines capital asset decisions.—Once projects are ranked, they should be put into a long-term capital plan. Leading organizations develop long-term capital plans to guide implementation of organizational goals and objectives and help decision makers establish priorities over the long term. While a plan must respond to changing requirements, it is based on the long-range vision for the organization embodied in its overall strategic plan. Therefore, any year-to-year changes to the capital plan should be driven by strategic decisions. Leading organizations prepare long-term capital plans to document specific planned projects, plan for resource use over the long term, and establish priorities for implementation. These plans usually cover a 5-, 6-, or 10-year period and are updated either annually or biennially. Long-term planning requires that decision makers rank capital needs and promotes making informed choices about managing the organization's resources and debt. Some leading organizations also prepare long-term asset and facility maintenance plans that are incorporated into their long-term capital plans. This helps decision makers determine whether and when to purchase a new capital asset or continue to maintain an existing one.

Principle III: Balance budgetary control and managerial flexibility when funding capital projects.

Budget for projects in useful segments.—One strategy that has been proven to be useful to organizations in dealing with problems posed by full funding in a capped environment is to budget for projects in useful segments. This means that when a decision has been made to undertake a specific capital project, funding sufficient to complete a useful segment of the project is provided in advance. The U.S. Office of Management and Budget has defined a useful segment as a component that either (1) provides information that allows the agency to plan the capital project, develop the design, and assess the costs, benefits, and risks before proceeding to full acquisition (or canceling the acquisition) or (2) results in a useful asset for which the benefits exceed the costs even if no further funding is appropriated. For full up-front funding and the funding of useful segments to be effective, organizations must be able to develop good, firm cost estimates of the full cost of either the project or the segments early in the life of the project. To develop these estimates, the organization must have good information and data systems in place. Some organizations fund capital projects in useful or meaningful phases by breaking up their capital planning and budgeting cycles into segments, such as predesign, design, and construction. Funding is provided for one of these segments at a time and generally is not guaranteed from one phase to the next.

Consider innovative approaches to full up-front funding.—Alternative strategies used by some leading organizations and Federal agencies to accommodate full funding of capital projects in a constrained budget environment include contracting out for capital-intensive services, using an investment component that is similar to a savings account, and developing public/private partnerships. These strategies enhance an organization's flexibility to finance the full costs of projects without compromising management's ability to make decisions based on full costs.

Principle IV: Use project management techniques to optimize project success.

Monitor project performance and establish incentives for accountability.—Successful implementation of a capital investment project is determined primarily by whether the project was completed on schedule, came in within budget, and provided the benefits intended. However, the first step is to provide decision makers with good information about costs, risks, and scope of a planned project before committing substantial resources to it. This, in combination with full upfront funding, can help to prevent cost overruns, project cancellations, and projects that fail to meet completion schedules. By monitoring project performance against cost, schedule, and performance goals—as well as establishing incentives to meet those goals—organizations can increase the likelihood that projects will be successfully completed. Typically, a good project plan is used to manage and control project implementation and includes performance measurement baselines for schedule and cost,

major milestones, and target dates and risks associated with the project. Regular review of the status of cost, schedule, and performance goals by individuals outside the project team allows for an independent assessment of the project. Leading organizations also establish incentives to encourage teams to meet project goals. Leading organizations generally hold managers accountable for meeting goals. Further, leading organizations use a number of built-in incentives for managers and teams to meet project goals. Among them are reporting project status to individuals or groups in positions of authority outside the project and using the project manager's overall performance in determining the assignment to future projects.

Use cross-functional teams to plan for and manage projects.—Leading organizations use multidisciplinary teams, consisting of individuals from different functional areas led by a project manager, to plan and manage capital projects. Teams typically consist of people from the user community and from the organization's budget, accounting, engineering, procurement, and other functions. A core project team is established early in the life cycle of a project and additional individuals with particular technical or operational expertise are incorporated during appropriate phases of the project. Moreover, successful teams have spirit, trust, and enthusiasm and a sense of ownership over the project.

Principle V: Evaluate results and incorporate lessons learned into the decision-making process.

Evaluate results to determine if organization-wide goals have been met.—One way of determining if a capital investment achieved the benefits that were intended is to evaluate its performance using measures that reflect a variety of outcomes and perspectives. By looking at a mixture of hard and soft measures, for example, financial improvement and customer satisfaction, managers are able to assess performance based on a comprehensive view of the needs and objectives of the organization. To implement this balanced approach to performance measurement, leading organizations developed financial and nonfinancial criteria for success that link to the organization's overall goals and objectives. Another way to determine if a capital investment is contributing to the success of an organization's goals and objectives is to conduct an audit after the project is completed. The primary focus is not to evaluate the technical aspects of the project, but rather to evaluate the process and whether the end users are satisfied. The lessons learned from the audit can be incorporated into the design and construction of the next project.

Evaluate the decision-making process: reappraise and update to ensure that goals are met.—Although some organizations evaluate their capital decision-making process on an ongoing basis, this is not the norm. Leading organizations seemed generally to revise the processes in response to an internal crisis, such as severe budget constraints, or to a perception of changing needs, a changing environment, or both. In such situations, organizations felt that they had to conduct self-assessments and undergo major changes in their capital decision-making practices in order to continue successful operations.

We are also sending this report to the Honorable Mary Landrieu, Ranking Minority Member of your subcommittee; the Honorable Richard Durbin, United States Senate; the Honorable Eleanor Holmes Norton, House of Representatives; and the Subcommittee on the District of Columbia, Committee on Appropriations, House of Representatives. This report is also available to other interested parties at <http://www.gao.gov>.

ADDITIONAL SUBMITTED STATEMENTS

[CLERK'S NOTE.—The subcommittee received the following additional statements to be included for the record. The statements follow:]

PREPARED STATEMENT OF NATWAR M. GANDHI, CHIEF FINANCIAL OFFICER, DISTRICT OF COLUMBIA

I am Natwar M. Gandhi, Chief Financial Officer for the District of Columbia. Thank you, Mr. Chairman and members of the subcommittee, for including my testimony in the record for the Senate District of Columbia Appropriations Subcommittee hearing on the fiscal structural imbalance facing this great city. First, let me thank you for holding this hearing and providing an opportunity to discuss and comment on the long-term fiscal health of the District. And let me also thank Senator Landrieu and Congresswoman Norton, along with former Congresswoman Connie Morella, for requesting the study that is the basis of the hearing. Finally,

I must thank the General Accounting Office for their thoughtful and thorough analysis of the fundamental fiscal circumstances facing the District of Columbia.

The District has come a long way since the Control Period began, with 7 consecutive balanced budgets for fiscal year 1997-fiscal year 2003, probably the largest cash reserves of any city in the United States, and substantially improved bond ratings. In fiscal year 2003, revenues grew by 6.3 percent and they continue to grow more rapidly in fiscal year 2004. These are wonderful achievements and should be duly celebrated. Even so, the District cannot put financial concerns aside. The report GAO-03-666, "DISTRICT OF COLUMBIA, Structural Imbalance and Management Issues," of May 2003, verifies what we have long argued—that there is a large, long-term imbalance between the cost of services needed by District residents and guests and the revenue the District can raise at reasonable rates to cover these costs. The size of the gap in fiscal year 2000 was between \$470 million and \$1.16 billion. (In current year dollars this climbs to \$500 million to \$1.2 billion.) This report and its implications are the subject of this hearing.

The purposes of my comments are threefold:

- First, to explain how the District of Columbia's finances can appear to be doing so well while at the same time things are seriously wrong,
- Second, to identify the harm done by the Structural Imbalance, and
- Third, to build upon Congresswoman Norton's very fine proposal in H.R. 4269, the District of Columbia Fair Federal Compensation Act of 2004. If lawmakers so choose, the Infrastructure Fund created by the Bill could be used to cover debt service payments that are \$350 million or more annually. This \$350 million, therefore, helps to close the annual structural gap of \$470 million to \$1.16 billion. The remaining \$450 million yearly can be applied to the \$4.2 billion of unfunded capital needs in fiscal year 2005–2010 to address items such as the District's deteriorated infrastructure in Transportation, Public Schools, and Information Technology. (Attached is a table delineating the District's funded and unfunded capital needs.)

To set the framework, let me make it clear that the District's elected leadership will continue to achieve balanced budgets, making the best use of the limited resources available to the District. The Mayor and Council fully support this goal and have consistently accomplished it over the last 7 years. Nonetheless, the structural imbalance will be eating away at the financial foundation of the city because:

- The District has an ongoing inability to provide the quality and quantity of services that are needed,
- In addition to the annual financial gap, the District has billions of dollars in deferred infrastructure needs that it has no way to finance, and
- The chronic erosion presents a heightened risk of financial crisis. Reserves and boom years can and do cushion an immediate shock and avoid an immediate crisis. But intermittent remedies will not repair the chronic erosion any more than relying only upon emergency room treatment will give a patient long-term robust health. Reliable, consistent fixes are also needed.

This is a great city and we are all thrilled at the turnaround since the mid-1990's. The vitality of the city is evident wherever you go. In turning to the Federal Government for financial support in the past, we were often told to first "get our financial house in order." We now have our financial house in order, and this wise counsel is part of the reason that the District's economy is doing so well today. But its future is by no means secure unless the structural issues are addressed—issues that Congress must consider because the District cannot resolve them on its own.

WHAT IS A STRUCTURAL DEFICIT?

In the GAO analysis a structural deficit means that, over the long run, the District does not have sufficient tax base to pay for an adequate ("average") level of services at reasonable (or "average") tax rates. This is primarily because the District has severe needs and a high cost environment but a limited tax base. There are several dimensions to this, which require assessing both revenue and cost considerations.

On the revenue side, the District's tax base consists of the property, sales, income, and other taxes typical of States and local jurisdictions taken as a whole. The District is unusual in that, as one jurisdiction, it uses all of these sources of revenue. The District also is unusual in the severe limitations on the District's tax base, notably the inability to tax non-resident earnings, the large percentage of tax-exempt property, and the inability to tax the city's largest employer, the Federal Government. Nonetheless, the District's tax base features high per capita income, good residential and commercial property values, and a vigorous hospitality industry. The

District's per capita tax base is well above the national average for State and local governments combined, according to the GAO findings.

GAO found that the positive features of the District's revenue are outweighed by the cost of providing services in the District. Despite having high per capita revenue, providing an adequate level of public services requires an even higher level of per capita costs. The cost of delivering an average level of services is 75 percent to 85 percent higher in District of Columbia than the average State system.

There are three reasons costs are so high in the District:

- The District of Columbia is entirely an urban jurisdiction with dense population, dense land use, and high land values,
- The District of Columbia has service needs, principally related to the incidence of poverty, that place a great burden on services, and
- The District of Columbia operates in a very expensive urban labor market. Wages and benefits account for more than 30 percent of the D.C. Government budget, with salaries alone representing \$1.5 billion in fiscal year 2004. In hiring, the District competes against a salary structure dominated by the Federal Government and high-salary private sector services. The unavoidably high cost of doing business also appears in all the contracting services acquired by the District such as medical care and construction.

Some additional considerations add to the problem in the District and are not in the GAO report. Collectively, these argue a structural imbalance much closer to the top of the GAO range, at about \$1.2 billion, than to the bottom at about \$500 million.

- The District of Columbia's benchmark, practically speaking, for the quality and cost of public services is the Washington Metropolitan Area (rather than "average" quality across jurisdictions nationwide). Both quality and cost are well above average in this Metropolitan Area.
 - The District of Columbia has special service considerations related to terrorism and other costs to protect the Nation's capital.
 - Throughout its history, national leaders have identified a special role for the District of Columbia as the capital city of this great Nation. Because the GAO report is a technical comparison across various jurisdictions, it includes nothing about the special circumstances of the District of Columbia as the Nation's capital.
 - As the District of Columbia moves away from the Federal personnel and retirement programs last used for employees hired in 1987, we face growing demands in retirement and health care costs for retirees first hired post-1987. The District's current payment to the Retirement Board for retirement programs of Police, Firefighters, and Teachers hired post-1987 is about \$60 million; this will grow to about \$103 million in fiscal year 2009. Retiree health care costs for all post-1987 employees are currently quite modest, at about \$1 million in fiscal year 2004. These will reach \$96 million for the year in fiscal year 2009 due to a change in accounting requirements and to aging of the current workforce.
- Arguably, each of these additional features adds to the annual structural deficit already identified by the GAO.

WHAT HARM IS DONE BY THE STRUCTURAL IMBALANCE?

Given that the District of Columbia has nearly \$900 million in fund balance, 7 years of balanced budgets with surpluses every year, and inefficient service delivery in some areas, why should anyone believe that a structural imbalance actually has an impact on the District?

Harm No. 1: Needed Infrastructure.—The Mayor and Chairman Cropp have spoken about the state of disrepair of infrastructure due to the inability to fund capital borrowing. This inability may be partially attributed to the District not having the money to repay borrowing and partly to the District not having the population to borrow the money. As you know, Wall Street closely monitors debt-per-capita as a key variable in bond ratings and the District of Columbia's current debt-per-capita of \$5,887, the highest for a U.S. city, roughly 9 percent above the second highest city, New York City. This high debt-per-capita limits the District's credit-worthiness. Because the District is the capitol city, and not a State, it must borrow to meet capital needs for a city, a county, a State, and a school district. Other cities borrow only for their own needs and therefore maintain a lower debt-per-capita. For example, Baltimore has debt-per-capita of \$805 and Detroit stands at \$925.

Attached to my testimony is an analysis of capital spending incorporated in the funded Capital Improvement Program along with additional new unfunded capital needs through fiscal year 2010. Projects that lack funding include the forensics laboratory, mental health hospital, a new headquarters for Metropolitan Police Depart-

ment/Department of Motor Vehicles, major capital projects for the Washington Metropolitan Area Transit Authority, public school maintenance and construction, neighborhood service facilities, information technology, and local road and Federal highway construction/repair. If the District is to begin to recover from many years of capital infrastructure erosion, it must find funding for currently unfunded capital requirements in excess of \$4 billion over the next 6 years. Unfortunately, we do not have access to the funds.

The accumulated unfunded needs of the past and present show up as “real” problems for residents and visitors in the form of:

- crowded Metro cars, stalled trains, and unreliable escalators,
- potholes in the streets,
- crumbling swimming pools, libraries, and school buildings (the average age of the District of Columbia’s school buildings is more than 60 years),
- concerns about potable water, and
- numerous other outcomes.

These matters will only get worse without intervention. Intervention to rebuild in the short-term will not prevent another infrastructure meltdown in the future unless maintenance funding becomes available.

Harm No. 2: High Tax Rates and Tax Burdens.—A second harm is that the District of Columbia’s tax burdens are unusually high, as the District stretches to generate the funds to cover service costs. District of Columbia’s tax burdens, as measured by the GAO, are 18 to 33 percent above what national average rates would yield if applied to the District of Columbia’s tax base. Citizens who live here and businesses that locate here must want to be here badly enough to accept a very high tax burden in return.

A family of 4 living in the District with income of \$50,000 to \$150,000, pays about 40 percent more in sales and use, income, and automobile taxes than the average for cities around the Nation that levy such taxes. This same family pays 24 to 38 percent more than one living in the Virginia suburbs and 9 percent more at \$150,000 income than one living in the Maryland suburbs.

The District has high tax rates and low thresholds of income against which the rates are applied. The District of Columbia’s lowest individual income tax rate is 5 percent, assessed on the first \$10,000 of net taxable income (NTI), with a middle rate of 7.5 percent on NTI between \$10,000 and \$30,000, and a highest rate of 9.3 percent assessed on NTI over \$30,000. The 5 percent lowest rate in the District of Columbia is greater than or equals the highest income tax rate in 15 States (including 7 that have no income tax). The District of Columbia’s middle rate of 7.5 percent exceeds the highest rate in 34 States, and the highest rate equals or exceeds the highest rate in 48 States. Compared to the two States with a higher top rate, the District’s estimated income tax liability on the family of four is higher because our highest rate takes effect at a comparatively low level of \$30,000 NTI. This compares to \$76,200 (more than two and one-half times as high) in Montana and \$297,350 (nearly 10 times as high) in Rhode Island. None of these circumstances or findings will change under the 9.0 percent top rate scheduled to take effect for District taxpayers on January 1, 2005.¹

Harm No. 3: The District of Columbia Needs Better-than-Average Services.—Schools are an example of the District of Columbia’s need for better than average services. Our immediate neighbors include some of the very best jurisdictions anywhere in the United States in terms of quality of the public schools. If the District of Columbia schools offer “average” services, many parents with choices will move to a suburb in order to enroll their children in a “world-class” public school. This drives up the proportion of students in the District’s Public Schools who are without such choices, and, inevitably, the per-student costs and challenges of even average services become very high. It appears as though this cost spiral will not end until only those students that are least able to leave the District’s public schools remain.

The need for better-than-average services extends to multiple areas. Our neighboring jurisdictions maintain a very high standard for public safety, public works, and other service areas. This competing level of service, combined with the District’s struggling public school system, make it difficult for the District of Columbia to attract residents who place high value on these services.

¹ Oregon, with a 9 percent top rate, is the only State added to the District of Columbia’s “comparison” group. The District’s tax burdens on the hypothetical family of four are very similar to those in Oregon.

THE DISTRICT'S STRUCTURAL IMBALANCE IS QUITE LARGE

While many jurisdictions have a structural imbalance according to GAO, the District of Columbia's is very large, ranging from \$821 to \$2,032 per resident in fiscal year 2000, or 14.4 to 40.3 percent of local revenue. At \$821, the low end of the GAO scale, the District would rank among the worst States for structural imbalance. At \$2,032, the high end of the GAO scale, the District's structural imbalance would rate about 2.3 times as high as New York, the worst-off State. GAO's own perspective is that the District's problem is probably on the higher end of the range.

The District of Columbia provides a high level of services per recipient because of the high level of need of our population. In 2000, 20.3 percent of the District's population was disabled and 12.2 percent was over the age of 65. The cost of caring for the aging and disabled population has increased at a rate much faster than inflation because of price increases in prescription medications, nursing home services, and labor costs, driven by a nationwide shortage of nurses and by new staffing requirements. As the population continues to age, these costs can be expected to increase even further.

Twenty-five percent of the District of Columbia's residents are Medicaid eligible as compared to 12 percent in Maryland and 9 percent in Virginia. The District spends, on average, \$7,242 per enrollee, compared to \$5,509 in Maryland and \$5,177 in Virginia. (Recall that, unlike Maryland and Virginia, the District has no rural areas with lower costs to help offset the much higher cost of care in urban areas.) The cost per District of Columbia resident to provide Medicaid services is \$1,776, compared to \$649 in Maryland and \$445 in Virginia. The extra per capita burden of Medicaid costs in the District of Columbia is quite high. Even if it were realistic for the District of Columbia to improve efficiency by 25 percent, the District's cost per capita would still remain twice as high as Maryland's and three times that of Virginia.

WITH ALL THE FINANCIAL CHALLENGES, HOW CAN THE DISTRICT CONTINUE TO HAVE A BALANCED BUDGET?

Let me first acknowledge the enormous effort and dedication of our elected leadership. We have balanced budgets because they are determined to have it so. Clearly there are sacrifices involved, but we learned during the now-dormant control period that enormous sacrifices also are attached to an unbalanced budget and budget deficits. We expect always to have balanced budgets and see this outcome as a key to holding on to the basic freedoms of Home Rule. A return to a control period would mean the loss of certain democratic rights entrusted to our citizens.² There is risk, however—if the roads and other infrastructure get too bad and the schools too ineffective and children's services too weak to make a difference, then the District of Columbia could once again see a generalized drain on its population, prosperity, and general vitality. In this scenario, the rising need for public services could clash with a waning revenue capacity, leaving the District, once more, in deep financial crisis.

CAN THERE BE A FAIR AND SUSTAINABLE FINANCIAL RELATIONSHIP BETWEEN THE DISTRICT AND THE FEDERAL GOVERNMENT?

Financial distress is a pattern going back to the earliest days when the District of Columbia was created to be the host city for the Federal Government. George Washington chose the site for Washington City. Thomas Jefferson worked with Pierre Charles L'Enfant to guide the survey work and coordinate the design process.³ With canals to be built for transportation, flooding and sewage and the Tiber Creek to be managed, and road paving needed to save the Federal halls from the ravages of muddy streets, a great deal of investment capital was needed. Many financing approaches were used, including Federal funding, private subscriptions, and public funding by local residents. Debts were high and delays in major projects were common. In 1870 the furniture of the Mayor of Washington, Sayles J. Bowen, was reportedly seized to help pay the city's debts.⁴

In 1878, Congress passed the Organic Act establishing a 3-commissioner system of local government that lasted until 1967. In that Act, Congress held that the District should receive 50 percent of its operating budget from the Federal Government, to insure sufficient services would be available for support of the city and the Federal Government. In 1916 a Joint Congressional Committee recommended that cap-

²For example, in a Control Year certain legislation passed by the council and signed by the Mayor can be overturned by the Financial Authority.

³Iris Miller, *WASHINGTON IN MAPS, 1606–2000*, Rizzoli International Publications, 2002, p. 48.

⁴Cited in "DC ALMANAC" at <http://prorev.com/dcfactshist1.htm>.

ital funding should also be subject to the 50 percent allotment. The 1916 Committee Report ends as follows: “Our unanimous conclusion is that the rate of taxation in the District should be fixed and certain; that the Congress should pursue a definite policy of regular and liberal appropriations, having in view not only the permanent moral and physical advancement of the city, but also its preeminent beauty and grandeur as the municipal expression of the Nation’s home and its peoples’ pride.”⁵

This discussion, more than a century long, suggests that the longer-term financial problems of the District of Columbia have never been fully addressed. The District has had many forms of government since the turn of the 19th century—elected and appointed mayors teamed with elected councils, a governor and house of delegates were in place for a few years, appointed commissioners have served the District of Columbia, and currently we enjoy the privileges of Home Rule. Throughout, however, I believe we have not had complete resolution of the financial aspects of the Nation’s home city.

H.R. 4269, THE DISTRICT OF COLUMBIA FAIR FEDERAL COMPENSATION ACT OF 2004

H.R. 4269, the District of Columbia Fair Federal Compensation Act of 2004, introduced by Congresswoman Norton provides an excellent solution both for the District and for the Federal Government. That Bill establishes a Dedicated Infrastructure Account within the general fund of the District. The fund would receive \$800 million annually in Federal monies, with growth adjustments over time. These monies could be used only for transportation including streets, information technology, and DCPS infrastructure developments and to support debt service payments on bonds, notes and other obligations of the District. Funds would remain available until expended.

By supporting debt service payments, the infrastructure fund would remove some operational burdens from the District government and close part of the structural gap. While varying over time, debt service will generally be in the \$350 to \$400 million range each year until fiscal year 2009. The remaining \$400 to \$450 million could be used to meet the \$650 million of needed infrastructure projects that meet purposes permitted by the Bill and that cannot be funded under the District of Columbia’s current budget and borrowing constraints. In the 5 years between fiscal year 2005 and fiscal year 2009, about 85 percent of these projects could be financed.

While it will take the District some time to work through our current infrastructure crisis, this bill makes it possible to plan and move forward with the most urgent priorities immediately. And it fulfills the goal of long ago members of this august body that, in addition to locally raised taxes, Federal support of the District of Columbia “should always be in such sum as will not only continue the city of Washington and the District of Columbia in every respect as the splendid and beautiful central residence of this great Nation, but also cause it to become and be forever maintained as a model for all the cities of the world.”⁶

There are many ways that funding for the Infrastructure Fund might be accomplished. One is a straight payment of \$800 million into the fund from an appropriation, adjusted annually by either the CPI or 4 percent—whichever is greater—as proposed in H.R. 4269. Another could be the model of the territories whereby, under IRC 933, income earned by a resident of the territory from a source in the territory is not subject to Federal taxation. If applied to the District, this latter approach would yield an estimated \$1.8 billion in tax savings to the District of Columbia residents for Tax Year 1999 (the tax year most closely corresponding to the GAO benchmark year of fiscal year 2000).

Allow me to suggest yet another alternative that may be simple, cost effective, and reliable for all parties. Funding would be determined as 30 percent of all Federal personal income tax paid by District residents. Upon collecting revenue from the District of Columbia residents, the U.S. Treasury would simply allocate to the D.C. Infrastructure Fund \$30 from every \$100 paid. This formula would yield about \$803 million based on IRS data for Tax Year 2001, and the amount would automatically adjust up or down as revenue changes over time.

⁵“Report of Joint Select Committee Appointed Pursuant to the Act of Congress Approved March 3, 1915 to Determine the Fiscal Relations Between the United States and the District of Columbia,” Sixty-Fourth Congress, First Session, House of Representatives Document No. 495, p. xxiii. Unfortunately, by 1920, Congress had moved in the opposite direction and eliminated the District’s 50 percent funding by the Federal Government. Reportedly District residents resented paying 50 percent of the costs for acquisition of Rock Creek Park, the Smithsonian, and other projects that, once paid for, were listed as Federal assets. Federal officials of the time felt the District got more than half the benefit and should pay more. By 1930, Federal funding fell to about 25 percent. www.dccwatch.com/richards/0106.htm.

⁶Ibid. p. xvi.

DISTRICT OF COLUMBIA FEDERAL INCOME TAX LIABILITY

Tax Year	Number of Returns	Adjusted Gross Income	Tax Liability	30 Percent of Federal Liability
2000	216,082	\$16,270,673,000	\$2,838,570,000	\$851,571,000
2001	214,404	\$15,913,850,000	\$2,677,002,000	\$803,100,600

Under the 30 percent approach, the annual amount of support is predictable and consistent over time for both the District of Columbia and the Federal Government. The funding varies with the economic cycle, becoming smaller when the economy is lagging and higher when it is booming. This precludes any counter-cyclical funding burden on the Federal Government. The formula would be transparent and simple to understand and virtually without cost to monitor.

These features are critical to the District in many ways. Wall Street is very alert to changes in the Federal-city relationship, fearing that neither the District nor bondholders can rely on Federal commitments over the long-term; the 30 percent approach creates stability. At the staff level in the District Government, we spend many hours and dollars responding to inquiries and requirements presented by Federal officials; the 30 percent approach requires comparatively little of this kind of effort. In the budget process, the District of Columbia cannot count on promised Federal money that is not matched by funding or clear legislative language—sometimes this promise simply disappears; the 30 percent approach would be secure for each budget cycle. And each dollar that is consistently and reliably provided will buy more service than a dollar occasionally given.

Mr. Chairman, I am so pleased to have reached the point where we can have such an in-depth dialogue on this matter. The efforts of many people—working over two centuries—were required to bring us to this point. The District's current elected leadership is as capable, conscientious, and dedicated to sound finances as any leadership could possibly be. The GAO has shed much light on the nature and duration of our financial problems. And you have provided this opportunity for meaningful and candid discussions of the issues raised by that report. It has been my pleasure to provide this testimony.

GOVERNMENT OF THE DISTRICT OF COLUMBIA: CAPITAL IMPROVEMENTS PROGRAM—20-YEAR PROJECTED CAPITAL NEEDS

Capital Description	Fiscal Year 2005	Fiscal Year 2006	Fiscal Year 2007	Fiscal Year 2008	Fiscal Year 2009	Fiscal Year 2010	Fiscal Year 2005-2010	Fiscal Year 2011-2024	20 Year Total
Capital—Funded Needs:									
Forensic Lab	\$3,800						\$3,800		\$3,800
Mental Health Hospital									
MPD/DMW Headquarters									
WMATA	42,800	\$60,600	\$77,000	\$87,700	\$83,800	\$84,400	436,300		436,300
Government Centers Facilities	52,612	40,375	13,500	1,500	1,500		109,487		109,487
Schools	174,909	147,123	98,299	98,300	98,300	98,832	715,763		715,763
Information Technology	114,361	33,760	7,179	6,849	3,750	4,750	170,649		170,649
Neighborhood Services facilities	71,198	70,618	29,281	13,972	13,972	13,972	213,013		213,013
Transportation Infrastructure	244,454	277,385	264,087	252,741	207,522	207,536	1,453,825	\$2,906,909	4,360,734
WASA—CSO	23,477	39,252	51,634	42,859	25,151	25,746	208,119		208,119
Economic Development	19,725	5,120	5,100	1,000	1,000		31,945		31,945
Capital Funded Needs Total	747,336	674,233	546,080	504,921	434,995	435,336	3,342,901	2,906,909	6,249,810
Capital—Unfunded Needs:									
Forensic Lab	15,000	37,500	27,500				80,000		80,000
Mental Health Hospital	13,000	37,500	19,500				70,000		70,000
MPD/DMW Headquarters	20,000	50,000	30,000				100,000		100,000
WMATA 1	16,700	91,500	119,500	61,500	48,200	56,300	393,700	995,214	1,388,914
Government Centers Facilities 2	15,000	27,237	54,112	66,112	66,112	67,612	296,185	1,195,176	1,491,361
Schools 3	125,361	129,953	115,611	186,244	126,849	126,082	810,100	2,386,998	3,197,098
Information Technology 4	40,000	76,240	115,821	124,151	133,250	141,250	630,712	2,496,874	3,127,586
Neighborhood Services facilities 5	25,000	32,380	77,732	95,299	98,577	101,953	430,940	1,802,223	2,233,164
Transportation Infrastructure 6	190,650	204,030	249,212	258,278	242,228	281,908	1,426,306	5,176,158	6,602,464

GOVERNMENT OF THE DISTRICT OF COLUMBIA: CAPITAL IMPROVEMENTS PROGRAM—20-YEAR PROJECTED CAPITAL NEEDS—Continued

Capital Description	Fiscal Year 2005	Fiscal Year 2006	Fiscal Year 2007	Fiscal Year 2008	Fiscal Year 2009	Fiscal Year 2010	Fiscal Year 2005–2010	Fiscal Year 2011–2024	20 Year Total
WASA—CS0 ⁷	30,000	30,000	30,000	30,000	30,000	30,000	180,000	2,185,170	2,365,170
Capital Unfunded Needs Total	490,711	716,340	838,988	821,584	745,216	805,105	4,237,943	14,052,645	18,290,588
Total Capital Needs	1,238,047	1,390,573	1,385,068	1,326,505	1,180,211	1,240,441	7,580,844	16,959,554	24,540,398

¹WMATA Unfunded Needs includes the District's share of the \$1.4 billion unfunded portion of the Infrastructure Renewal Program, rail and bus replacement program and necessary security improvements.

²The Office of Property Management (OPM) is responsible for managing 334 municipal buildings, approximately 14 million square feet of space. The age of these facilities vary from 6 years to over 60 years. A significant portion of this space is for Government Center Facilities include Government office buildings and equipment staging areas. The total cost of renovating all government center facilities is estimated to be over \$1.5 billion over the next 20 years.

³The D.C. Public School System currently operates 146 active schools. Of the 146 active schools, 91 or 62 percent are over 45 years old and only eight have ever had total renovations. The total renovation cost is estimated to be \$3.5 billion over the next 10 years, at an average cost of \$350 per square foot. In addition, ongoing component replacement and capital maintenance will average approximately \$35 million a year.

⁴In order to meet the needs of the 21st century, and continue to improve service delivery to residents and business of the District, an additional investment of \$630 million for the next 6 years. An annual replacement cost of \$10 million per year thereafter. In addition, future projections include funding of \$100 million annually to keep up with next generation technologies.

⁵The Office of Property Management (OPM) is responsible for managing 334 municipal buildings, approximately 14 million square feet of space. The age of these facilities vary from 6 years to over 60 years. A significant portion of this space is for Neighborhood Services which includes Parks and Recreation Centers, D.C. Public Libraries, Fire Houses, Police Stations, Wellness Centers, Human Service centers, Correctional Treatment Facilities. The total cost of renovating all Neighborhood Service facilities is estimated to be over \$2.4 billion over the next 20 years.

⁶The inventory of streets and highways under the District's jurisdiction extends approximately 1,421 centerline-miles of urban roads. Approximately 400 (or 39.2 percent) miles of streets and highways are eligible for Federal Aid Match, as are most bridges. The remaining streets are funded solely with local funds including ROW fees and GO bonds.

⁷D.C. Water and Sewer Authority (WASA) has an estimated need of \$2.6 billion to fund the Combined Sewer System Long Term Control Plan (LTCP) which will address the violation of the Clean Water Act, due to the dumping of garbage and raw sewage into Class A waters.

LETTER FROM THE LEAGUE OF WOMEN VOTERS OF THE NATIONAL CAPITAL AREA

JUNE 23, 2004.

Senator MIKE DEWINE,
Chair, Appropriations Subcommittee on the District of Columbia.

DEAR SENATOR DEWINE: The League of Women Voters of the National Capital Area (NCA) thanks you for holding a hearing on the District of Columbia's structural deficit.

In 2000, our national League at its 44th annual convention—recognizing that the District does not have the capacity to raise the revenue required to provide the necessary services for the residents of the District, the Federal Government, and the many visitors to our Nation's capital—adopted a position calling for the restoration of the Federal payment. This position was adopted at the request of our NCA League, and I've asked Elinor Hart, who chairs our D.C. Finances Committee, to send you the material we presented to League delegates throughout the country when we asked them to support restoration of the Federal payment.

We look forward to supporting your efforts to address the District's structural deficit.

Sincerely,

BARBARA SHERRILL,
President.

PREPARED STATEMENT OF LEONARD SULLIVAN, JR., PRESIDENT, NATIONAL ASSOCIATION TO RESTORE PRIDE IN AMERICA'S CAPITAL (NARPAC, INC.)

Thank you, Mr. Chairman, for including my organization's views in the record. NARPAC was founded to address the embarrassing public image of our Nation's capital city held by many Americans, and by other countries as well (murders, drug use, teen moms, et al). For 8 years, we have analyzed the District of Columbia's problems and offered solutions (largely unheeded) on our educational web site (see last page). We do not lobby and we do not promote unchallenged conventional wisdom.

We agree that our capital city could benefit from additional revenues, Federal, regional or local, for capital investment or debt relief, but not for the District of Columbia's inefficiently delivered operating costs.

Our rationale is simple: America's capital city should be the best possible symbol of what this country stands for, but not for what it doesn't stand for. We are adamant that our city should not lobby or beg for hand-outs based on faulty inputs (viz., Iraq!). We reject using mythical conspiracies and false financial threats to build a misleading case for making our capital city the world's best.

Let me first highlight the faulty inputs and then offer remedies other than Federal cash subsidies. For impact, I will be blunt and oversimplify the issues. Better explanations are provided on our web site.

The GAO report, so widely endorsed by advocates of hand-outs, contains serious analytical flaws. It should have been subjected to a separate challenge. It applies a dubious methodology that seeks to identify average operating expenditures, based on average bureaucratic performance, adjusted for unique local conditions. It was developed to rationalize the distribution of Federal grants.

Did you note this same approach justifies equivalent (often much larger) hand-outs to 28 other States just to become "average", and that the District of Columbia has one of the highest revenue-generating capacities?

The District of Columbia's \$700 million higher incremental "worst case" imbalance (\$1.16 billion) stems primarily from what the District of Columbia can "afford to pay" in taxes and, we believe, was miscalculated.

Recalculation by NARPAC indicates a \$480 million arithmetic error based on GAO application of an unfamiliar methodology. If living and working within 5 miles of the Nation's Capitol dome can justify "box seat" taxes 10 percent higher than the national norm, the imbalance declines \$500 million more.

The low estimate of \$470 million is far too high based on more substantive analytical errors in "should spend" estimates for city police and firefighters (while school spending is judged about right!).

The imbalance can be shifted from -\$470 million to +\$700 million if: (a) police force levels are assumed to be dictated by violent crime rates, not murder rates; (b) wages are kept to the BLS average for cities rather than arbitrarily increased; and (c) urban workload factors are used vice national factors.

Unfunded capital investment needs are badly exaggerated by using unchallenged estimates of DCPS facility requirements based on poor enrollment projections, school and land utilization.

Extrapolating current school enrollment, and applying national urban average school size can cut this 6-year backlog (\$1.2 billion) by perhaps \$300 million: selling surplus properties yields over \$500 million more.

On the other hand, capital investment in the city's transportation infrastructure, also unchallenged, (defined broadly to include parking, trash, RRoWs, etc.) is probably underestimated by \$3 billion–5 billion.

Did you know there are no plans to extend Metrorail trackage inside the District of Columbia in the next 10–20 years?

The District of Columbia's operating costs are abnormal because the District of Columbia has perhaps four times its share of the region's poor.

Does the Federal Government really want the Nation's capital city to be its regional poorhouse?

Finally, NARPAC has tried (harder than District of Columbia's CFO!) to quantify the net costs of the Federal presence. We conclude they are trivial compared to the benefits of hosting the Nation's capital.

How can the District of Columbia claim it is "denied (almost \$200 million in) property taxes" from Federal parklands?

NARPAC concludes the District of Columbia should be making far greater capital investments in its infrastructure, from roads and rails, to sewers and sidewalks, while spending less on the perennial consequences of poverty. We also conclude that the District of Columbia's "missing State" status is overblown, and can be offset by a "willing metro area". Congress, then, can best assure the District of Columbia's financial future via policy changes to:

- Eliminate arbitrary constraints (Fed or local) on the District of Columbia's own revenue-producing potential by:
 - Removing any Federal objections or statutes prohibiting the development of much taller, denser buildings near the District of Columbia's boundaries with its neighboring "edge cities" (outside L'Enfant's Bowl);
 - Requiring the District of Columbia to provide high-density zoning around all existing/future transportation nodes paid for all or in part by Federal funds (defeat local NIMBYs);
- Motivating the District of Columbia to sell off its surplus school properties, by offering to also:
 - Cede to the District of Columbia surplus Federal properties for high-density development, using the ongoing BRAC Round to realign/close outmoded military bases (doubling the District of Columbia's high-revenue commercial acreage);
 - Eliminating bans on inter-jurisdictional taxes rooted in Congressional conflicts of interest;
- Impose regional burdensharing by making only regional grants (equitably allocated) for:
 - first-class regional transportation infrastructure;
 - affordable/subsidized housing combined with employment, adult education/skill training;
 - unique (broadly defined) health and learning disability problems, etc.

Thank you for your attention. Feel free to visit our web site at www.narpac.org.

CONCLUSION OF HEARING

Senator DEWINE. So thank you all very much. The subcommittee will stand in recess.

[Whereupon, at 11:28 a.m., Tuesday, June 22, the hearing was concluded, and the subcommittee was recessed, to reconvene subject to the call of the Chair.]