# PUBLIC OVERSIGHT ROUNDTABLE

**ON**

# PRIORITIES FOR THE USE OF POTENTIAL FUNDS FOR THE DISTRICT OF COLUMBIA FROM RECOVERY AND REINVESTMENT PROPOSALS CURRENTLY UNDER CONSIDERATION IN THE UNITED STATES HOUSE OF REPRESENTATIVES AND THE SENATE

**Before the**
**Committee of the Whole**
**Council of the District of Columbia**

**The Honorable Vincent C. Gray, Chairman**

**February 11, 2009, 10:00 a.m.**
**Council Chambers**

**Testimony of**
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**Introduction**

Good morning, Chairman Gray and members of the Committee of the Whole. I am Natwar M. Gandhi, Chief Financial Officer of the District of Columbia Government. I am pleased to appear before you today to provide our preliminary understanding and analysis of the impact on the District budget of the American Recovery and Reinvestment Act or "stimulus bill."

As you are aware, this has been a fast-moving and fluid process. The House passed a stimulus bill two weeks ago on January 28th and the Senate passed a bill yesterday. The House and Senate differences, which are significant, now need to be reconciled in conference. The goal appears to be to complete the conference of the House and Senate versions and have the final, revised bill on President Obama's desk no later than Monday, February 16th, which is President's Day.

We have been tracking the stimulus legislation, with particular attention to the provisions that directly impact the District's budget and financial plan. We have a detailed understanding of the House bill and are in the process of analyzing the newly passed Senate bill. At this point, we have a sense of the major differences between the two versions and I will discuss those in my testimony.

## Background, Purpose, and Scope of the Federal Stimulus

The federal stimulus proposal is a plan to boost economic growth through a combination of spending increases and tax cuts. The final plan reconciled by the House and Senate will likely cost in the neighborhood of $800 billion over the next two years and impact FY 2009 through FY 2011 of the District budget.

All of the plans moving through Congress share some similar features: tax cuts for both individuals and businesses, federal spending that flows through state and local governments, direct federal payments to individuals, and direct federal spending. This testimony is focused on the federal spending that flows through state and local governments, which some estimates indicate is roughly $365 billion of the total House-passed stimulus plan and about $288 billion of the total Senate-passed stimulus plan (see Attachments 1 and 2). Before discussing the stimulus plan, it is helpful to place the stimulus in the context of the District's economic and revenue outlook.

## Economic Considerations for District Budgets

The national recession, now having lasted over a year, is growing worse. Many economists believe it is likely to be longer than other recessions since World War II. There is no sign of recovery in the stock market or the credit markets. Real Gross Domestic Product is falling. In January the nation lost 598,000 jobs and the unemployment rate rose to 7.6 percent, the highest since 1992.

In some ways the District's economy is doing better than the nation as a whole, but there are signs of slowing. Job growth in the District has virtually come to a standstill. Unemployment jumped to 8.9 percent in the District in December, above the December U.S. level of 7.1 percent. This means that more than 29,000 District residents are without jobs. Commercial office vacancies rose to more than 7 percent in December, and because of the large amount of new construction due to come on line, vacancies are projected to hit more than 12 percent within two years.

The slowdown in the economy has resulted in a deteriorating revenue outlook for the District. Compared to the estimates included in the June 2008 Budget and Financial Plan, the District's Local Source, General Fund estimate has been reduced by $257.8 million for FY 2009 and $455.8 million for FY 2010, as shown in the tables below.

## September 2008 Revised Estimate

| **Local Source, General Fund Revenue Estimate ($ millions)** | **FY 2009** | **FY 2010** | **FY 2011** | **FY 2012** |
|---|---|---|---|---|
| **Local Fund revenue estimate of May 2008** (including tax policy changes) | **5,562.9** | **5,831.7** | **6,099.2** | **6,402.5** |
| Change from previous estimate | (130.7) | (151.9) | (148.5) | (162.3) |
| **September 2008 revised estimate** | **5,432.2** | **5,679.7** | **5,950.7** | **6,240.2** |
| *Percent growth over previous year* | *3.0%* | *4.6%* | *4.8%* | *4.9%* |

## December 2008 Revised Estimate

| Local Source, General Fund Revenue Estimate ($ millions) | FY 2009 | FY 2010 | FY 2011 | FY 2012 | FY 2013 |
|---|---|---|---|---|---|
| **Revenue estimate of September 2008** | **5,432.2** | **5,679.7** | **5,950.7** | **6,240.2** | **6,216.9** |
| Change from previous estimate | (127.1) | (303.8) | (330.4) | (327.5) | - |
| **December 2008 revised estimate** | **5,305.1** | **5,375.9** | **5,620.3** | **5,912.7** | **6,216.9** |
| *Percent growth over previous year* | *-0.1%* | *1.3%* | *4.5%* | *5.2%* | *5.1%* |
| | | | | | |
| **Change in revenue estimate since June Budget and Financial Plan** | (257.8) | (455.8) | (478.9) | (489.8) | - |
| *As a percent of local fund revenue in FY 2009 Budget and Financial Plan* | *4.6%* | *7.8%* | *7.9%* | *7.7%* | |

The federal stimulus package will provide some needed assistance to the District to manage these revenue shortfalls. However, in its final form it is unlikely to address all of the District's fiscal challenges.

### Potential Impact on the District's Budget

The potential impact of the federal stimulus package on the District's budget will depend on the structure of the final legislation approved by Congress and signed by the President. At this point, our detailed analysis of the House bill and preliminary analysis of the Senate bill reveals some important differences regarding the flow of funds to state and local governments. These major differences include:

- The House bill includes a $79 billion State Fiscal Stabilization Fund designed to help states shore up funding for education and balance their budgets, including a competitive $15 billion Bonus Incentive Grant for public schools. The District's estimated three-year, non-competitive share of this fund is $118.2 million.

The Senate bill includes a $39 billion State Fiscal Stabilization Fund with $7.5 billion in Bonus Incentive Grants. State-by-state allocations of the Senate version are not yet available, but the District's three-year share could be roughly half of the allocation from the House bill (about $60 million).

- Within the federal capital grants, the House bill includes $14 billion for school modernization and $6 billion for higher education modernization, with the District's shares estimated to be $48 million and $22 million, respectively. The Senate bill eliminates those allocations.

- One important addition to the Senate bill for the District is the inclusion of a $125 million Federal payment to the District of Columbia Water and Sewer Authority to continue implementation of the Combined Sewer Overflow Long-Term Control Plan.

While the detailed allocations of the Senate and House bill differ substantially, there are similarities in the overall structure of the House bill and the Senate bill in terms of the funds flowing to state and local governments. Specifically, there are four general types of funds that will flow to the District and each is discussed in more detail below.

**State Fiscal Relief and Medicaid**

First, funds with the fewest strings attached are designed to help offset budget reductions and provide fiscal relief to states. This category includes two elements:

1) A temporary increase in the Federal Medical Assistance Percentage, or FMAP, which increases the Federal funds for Medicaid and correspondingly reduces the state funds required. These funds are available from the beginning of this fiscal year to December 31, 2010.

2) The State Fiscal Stabilization Fund, which provides an allocation to states based on school population to prevent cuts to K-12 education and higher education budgets and a second allocation based on overall population to support other state services. After the minimum threshold requirement of maintaining local funds at FY 2008 levels has been met, there is local discretion in the allocation of funds between K-12 education and higher education. These funds are available from July 1, 2009 to September 30, 2011 in the House bill. In the Senate bill the funds are available from the enactment of the bill through September 30, 2010 and are only for education services.

Based on the House bill, these funding sources are estimated to provide the District about $400 million from FY 2009 through FY 2011. As noted above, due in part to the reduction in the State Fiscal Stabilization Fund in the Senate bill, the total to the District would be about $360 million.

**Federal Operating Grants**

The second category of funds to state and local governments is federal operating grants. These funds have conditions which may prevent states and localities from realizing budget savings from these grants. For example, some grants would be competitive, for which the District would have to apply and compete for funding. There would be grants which include specific language that the funds must "supplement not supplant" existing funding. For example, this language applies to school modernization in the House bill. While the intent and practical application of this language will need to be clarified, this language presents a potential limitation on the use of these funds.

Some grants are for specific purposes in which current local appropriations may be limited, which would reduce the potential for realizing local savings. For example, the House bill includes $6.2 billion for home weatherization ($17.2 million is the estimated DC share for FY 2009). The degree to which the District's local fund spending on home weatherization is less than $17.2 million limits the potential local fund budget savings of this allocation.

**Federal Capital Grants**

The third type of funding is federal capital grants. Budget savings associated with federal capital grants are structurally limited to activities currently funded with PAYGO dollars or potential debt service savings associated with lower borrowing. In addition, the issue of "supplement and not supplant" is also relevant in the context of capital grants.

**Other Allocations**

The fourth type of funding is allocations to non-General Fund entities such as the DC Housing Authority, the Water and Sewer Authority (WASA) and the Washington Metropolitan Transit Authority (WMATA). These allocations, by definition, cannot provide budget relief to the District's general fund.

In sum, the portion of the potential federal stimulus package that most clearly could provide direct budget savings to the District includes the temporary increase in the FMAP and the State Fiscal Stabilization Fund (excluding the $15 billion "Bonus Incentive Grant" for public schools). Current estimates indicate the District share of these funds, based on the House bill, is about $400 million over three fiscal years. The other funding streams to state and local governments have various conditions that restrict the use of the funds and will limit the budget relief that they may provide.

**Tax Provisions Affecting the District**

As is true for the spending side of the budget, the scope and form of the tax adjustments are in flux, and we will not have firm information on these until the conference package is released.

The key question for the District of Columbia government is whether the federal changes will affect the federal income tax base (federal adjusted gross income, or AGI), which is the starting point for both the DC resident and business (corporate and non-corporate) taxpayer. If the Congress makes a change to the definition of this "starting point" federal tax base, District of Columbia law automatically "conforms" to the federal tax definitions unless it takes explicit action to "decouple" a specific provision.

Similarly, District income tax receipts (individual and business) are generally not affected by Congressional changes to credits taken against the federal income taxes unless the District makes an explicit case to link to the federal credit.

With respect to the House bill, every change to the federal definition of the tax base is either one from which DC has already decoupled or is not included in the "starting point" of computing the DC tax base. Thus, with one exception, the District need not take any legislative tax action with respect to the stimulus plan unless it wishes to reverse one of the earlier "de-coupling" provisions or newly conform in some manner to any new credits that will become allowable against the federal income tax.

The one exception in which the District is linked to a reduction in federal taxes pertains to the federal Earned Income Tax Credit, EITC. Both House and Senate versions would increase the benefits for families with three or more qualifying children for 2009 and 2010 and provide an increase for married couples. Because DC allows low income residents to "piggyback" on the federal EITC by electing to multiply the federal credit by 40 percent and subtract that amount as the District of Columbia EITC, the stimulus plan could lead to a reduction of local individual income tax revenues of $3.5 million over the FY 2010-FY 2011 period.

## Additional Considerations

I want to provide two general caveats to place the stimulus funds into context.

- First, these are temporary or "one-time" allocations, so care needs to be taken not to build new long-term commitments into the base budget through the use of these funds.
- Second, there will be some administrative costs associated with managing grant funded projects.

## Concluding Comments

In conclusion, Mr. Chairman, at this stage it is premature to estimate how much budget relief will be provided in the federal stimulus package. As noted earlier, the State Fiscal Stabilization Fund will likely provide significant budget relief. We will, of course, analyze the conference bill when it is available. We will then come back to you with CFO certification of funding for FY 2009 and FY 2010.

This concludes my remarks. I would be pleased to answer any questions you may have.

**ATTACHMENT 1**

House Passed Federal Stimulus Summary (Dollars in Millions)

| | Preliminary Estimate of Potential Impact of Federal Stimulus on the District | | | | DC Estimate (If available) by Fiscal Year | | |
|---|---|---|---|---|---|---|---|
| | Expenditure Areas | Total Amount | Percent of Total | DC Estimate (If available) Total | FY 2009 | FY 2010 | FY 2011 |
| 1 | State Fiscal Stabilization Fund (Includes Bonus Grants) | 79,000 | 22% | 118.2 | 13.1 | 52.5 | 52.5 |
| 2 | Medicaid FMAP Increase | 87,000 | 24% | 288.2 | 114.1 | 137.2 | 37.0 |
| 3 | Subtotal State Fiscal Stabilization Fund and Medicaid | 166,000.0 | 46% | 406.4 | 127.2 | 189.7 | 89.5 |
| 4 | Federal Operating Grants | 82,070.0 | 23% | 192.4 | 65.8 | 94.7 | 31.9 |
| 5 | Federal Capital Grants | 52,825.0 | 14% | 194.6 | 79.8 | 97.3 | 17.5 |
| 6 | Unemployment Trust Fund | 36,500.0 | 10% | 1.8 | 0.9 | 0.9 | - |
| 7 | Housing Authority, WASA, WMATA | 27,300.0 | 7% | 298.3 | 162.7 | 135.6 | - |
| 8 | Total Expenditure of Provisions | 364,695.0 | 100% | 1,093.5 | 436.4 | 518.2 | 138.9 |
| 9 | Tax Provisions | (22,676.0) | | (3.5) | (0.0) | (1.8) | (1.7) |
| 10 | Total with Tax Provisions | 342,019.0 | | 1,089.9 | 436.4 | 516.4 | 137.2 |

Notes: Percent of total Federal dollars in each category in which there is a DC estimate:

| | | |
|---|---|---|
| a | State Fiscal Stabilization Fund and Medicaid | 91% |
| b | Federal Operating Grants | 66% |
| c | Federal Capital Grants | 95% |
| d | Unemployment Trust Fund | 1% |
| e | Housing Authority, WASA, WMATA | 77% |

Sources: FFIS, "Budget Brief 09-02: How Would the House Economic Stimulus Bill Affect States?" January 28, 2009.
DC Office of Revenue Analysis summary of House Committee on Approporiations, "Summary: American Recovery and Reinvestment ," Press Release, January 15, 2009.
Center on Budget and Policy Priorities, "Economic Recovery Packages: State-by-State Estimates of Key Provisions Affecting Low- and Moderate-Income Individuals," January 22, 2009.
Iris J. Lav, Edwin Park, Jason Levitis, and Matthew Broaddus, "Preliminary Analysis of Medicaid Assistance for States in the House Economic Recovery Package," Center on Budget and Policy Priorities, January 22, 2009.

**ATTACHMENT 2**

**Senate Passed Federal Stimulus Summary (Dollars in Millions)**

**Preliminary Estimate of Potential Impact of Federal Stimulus on the District**

| | Expenditure Areas | Total Amount | Percent of Total | DC Estimate (If available) Total | DC Estimate (If available) by Fiscal Year: FY 2009 | FY 2010 | FY 2011 |
|---|---|---|---|---|---|---|---|
| 1 | State Fiscal Stabilization Fund (Includes Bonus Grants) | 39,000.0 | 14% | 58.1 | 29.1 | 29.1 | - |
| 2 | Medicaid FMAP Increase | 87,000.0 | 30% | 299.7 | 125.9 | 137.1 | 36.8 |
| 3 | Subtotal State Fiscal Stabilization Fund and Medicaid | 126,000.0 | 44% | 357.8 | 154.9 | 166.2 | 36.8 |
| 4 | Federal Operating Grants | 63,432.0 | 22% | 120.0 | 59.1 | 56.9 | 4.0 |
| 5 | Federal Capital Grants | 39,560.0 | 14% | 132.4 | 66.2 | 66.2 | - |
| 6 | Unemployment Trust Fund | 36,260.0 | 13% | 1.5 | 0.8 | 0.8 | - |
| 7 | Housing Authority, WASA, WMATA | 23,025.0 | 8% | 313.9 | 152.4 | 152.4 | 9.1 |
| 8 | Total of Expenditure Provisions | 288,277.0 | 100% | 925.7 | 433.4 | 442.5 | 49.8 |
| 9 | Tax Provisions | (23,165.0) | | (3.5) | (0.0) | (1.8) | (1.7) |
| 10 | Total with Tax Provisions | 265,112.0 | | 922.2 | 433.4 | 440.7 | 48.1 |

Notes: Percent of total Federal dollars in each category in which there is a DC estimate:

| | | |
|---|---|---|
| a | State Fiscal Stabilization Fund | 94% |
| b | Federal Operating Grants | 67% |
| c | Federal Capital Grants | 68% |
| d | Unemployment Trust Fund | 1% |
| e | Housing Authority, WASA, WMATA | 85% |

Sources: FFIS, "Estimated State Allocations of Selected Proposed Senate Stimulus Funds" February 3, 2009.
FFIS, "Changes to Funding Levels for Major Programs in Senate Recovery Package." February 10, 2009.
DC Office of Revenue Analysis of summary of "American Recovery and Reinvestment Act," Senate passed.
Center on Budget and Policy Priorities, "Economic Recovery Packages: State-by-State Estimates of Key Provisions Affecting Low- and Moderate-Income Individuals," January 30, 2009.