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Highlights

Highlights of GAO-04-908T, testimony before the Subcommittee on the District of Columbia, Committee on Appropriations, U. S. Senate

June 2004

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.

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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 services. 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.