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DC TOOK A BALANCED APPROACH TO ADDRESSING ITS LAST MAJOR DEFICIT: The Budget Shortfall in 2002 Was Addressed With Both Budget Savings and Revenue Increases

The District is facing a tremendous budget shortfall that has been caused by a weak economy and declining tax collections. DC's expected revenue collections for FY 2010 have fallen by nearly $800 million in recent months. While federal stimulus funds, DC reserves, and surplus funds from 2008 will help address this, the unresolved shortfall is more than $400 million.[1] This shortfall will have to be addressed when Mayor Fenty submits his proposed FY 2010 budget in mid-March.

Balancing the budget in the midst of a revenue shortfall can be accomplished by reducing spending — through better efficiencies or cuts in services — or by increasing revenues. The District already has adopted significant budget cuts this fiscal year in response to the shortfall, and further budget cuts seem likely. Revenues have been increased only modestly, however — through an increase in parking meter rates — covering a small share of the budget gap.

While raising taxes or fees is never popular or politically easy, addressing the remaining budget gap entirely on the expenditure side may require painful cuts in a number of services. As the District's leaders prepare to address the budget shortfall, it is instructive to review how the city handled its last major budget shortfall, which occurred in 2002 following a national recession and the economic aftershocks of the September 11 terrorist attacks. The plan developed then by Mayor Williams and the DC Council included a mixture of spending reductions and revenue increases. The package was not evenly split — spending cuts outweighed revenue increases two to one. Nevertheless, the revenue increases were notable, totaling $113 million — or $132 million in today's dollars. These included a mixture of permanent and temporary tax increases and a number of fee increases

The fact that the District raised revenues as part of its budget balancing effort during the last economic downturn, rather than relying on budget cuts alone, suggests that revenue increases can be a part of a balanced approach to deficit reduction that limits the impact on critical public services.

DC's Current Budget Shortfall Has Been Addressed Largely with Budget Cuts

The District of Columbia is facing its most serious budget deficit in a decade. In February 2009, the District's CFO released a revenue forecast showing that tax and fee collections are falling far short of the amounts expected when the FY 2009 budget was adopted. The revenue shortfall is nearly $400 million for FY 2009 and $800 million for FY 2010. DC's FY 2010 shortfall equals roughly 14 percent of the local budget — making it the largest fiscal crisis since the mid-1990s. The

[1] See DC Fiscal Policy Institute, *How Bad is DC's Budget Shortfall?*, March 2009

revenue shortfall for FY 2010 is larger than the combined local budgets for DC's fire department, libraries, parks, public works, human services, transportation, and motor vehicle departments.

Some steps have already been taken to address the revenue shortfall. In the fall of 2008, Mayor Fenty and the DC Council closed a budget gap following a September revenue forecast showing a $131 million drop in revenues in FY 2009 and a $152 million drop in FY 2010. The deficit reduction package relied almost entirely on spending reductions — and included no fee or tax increases. The cuts affected a range of services — including parks, public safety, and transportation— but many of the cuts were in services for low-income residents.[2] In December 2008, the Council adopted an increase in parking meter rates to reverse some of the budget cuts; the change in parking meter rates will generate roughly $9 million per year when fully implemented. The new revenues will thus address only a small share of DC's revenue shortfall.

In addition to these steps, the District has some resources to address the remaining shortfall. This includes budget reserves and surplus funds from FY 2008. In addition, the federal economic stimulus plan includes substantial funds for the District and other cities and states. At least $320 million of these funds will be available to close DC's budget gap in FY 2009 and FY 2010.

Nevertheless, the District faces tremendous budget challenges. Even with these resources, the District's shortfall through FY 2010 is more than $400 million. Moreover, the city's revenue collections could fall further as the economy continues to weaken. It is worth noting that there will be another new revenue forecasts before the FY 2010 budget is adopted in May.

Table 1: Funds Available to Address the District's Current Budget Shortfall

FY	2009 (in millions)	FY 2010 (in millions)	Total (in millions)
Budget Reserve Created by DC Council	$46	$46	$92
FY 2008 Surplus	$87	N/A	$87
Federal Stimulus Funds	$145	$178	$323
Total Funds Available	$278 $	224	$502
Current Budget Shortfall[1] (	$263)	($650)	($913)
Shortfall Remaining after Available Funds Used	(		$411)
% of Shortfall Covered by Available Funds	55		%

Sources: FY 2008 surplus from FY 2008 Comprehensive Annual Financial Report; federal stimulus funds estimates from DC Office of the Chief Financial Officer, "Revenue Estimates and Economic Outlook," February 25, 2009.
[1]Does not include the shortfall identified in September 2008 that the Council addressed in November.

The District Addressed the Last Major Budget Gap with New Revenues in Addition to Budget Cuts

The District's last major budget shock occurred in the fall of 2002. Just three months after enactment of the annual budget that year, a new $323 million budget hole was identified — a result of falling revenue collections and a weak economy.

[2] DC Fiscal Policy Institute, *Budget Cuts Adopted by the DC Council Fall Disproportionately On Programs for Low-Income Residents*, November 2008 (http://dcfpi.org/?p=267)

That budget gap was closed through a mixture of budget cuts and revenue increases. The budget cuts totaled roughly $200 million, and revenue increases totaled $113 million.[3] (The District did not use its "rainy day" fund to address the shortfall.)

While the deficit reduction relied heavily on budget cuts, it also included notable revenue increases. When adjusted for inflation to today's dollars, the revenue increases equaled $132 million. The revenue increases, which helped prevent the budget cuts from being even more severe, included the following:

- Suspension of a scheduled cut in the corporate income tax rate. This suspension, which saved $17.5 million, later was made permanent. (See Table 2.)

- A temporary increase in deed recordation and transfer taxes that apply to real estate sales, which raised $24 million. The increase in the rates for these taxes — from 1.1 percent of the sales price to 1.5 percent — was reversed in FY 2005.[4]

- A temporary increase in taxes on utilities — from 10 percent to 11 percent. This tax increase also was later reversed.[5]

- $13 million in increases in cigarette, alcohol, and vacant property taxes; and

- $43 million in increases in fees for licenses, permits, and other District services. For example, the fee for residential parking permits was increased from $10 to $15 per year. Many of these changes reflected adjustments for inflation in fees that have not been raised for several years. The fee increases also included $11 million from greater utilization of speeding cameras and nearly $3 million in fees charged by the fire department for emergency medical services and fire code violations.

Conclusion

This review shows that the last time the District faced a major budget shortfall, it addressed the deficit with a mixture of budget cuts and revenue increases, rather than relying on budget cuts alone. This combined approach helped the District limit reductions to services. It also suggests that careful consideration of revenue increases also can be a part of efforts to address the current budget shortfall.

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[3] DC Fiscal Policy Institute, *Dealing with the Deficit: Eliminating DC's $323 Million Budget Shortfall for 2003 Has Meant Substantial Spending Cuts, Notable Revenue Increases*, February 2003

[4] In FY 2007 the Council adopted a permanent increase in deed recordation and transfer taxes — to 1.45 percent — to fund housing and other programs.

[5] In a subsequent year, the utility tax was raised back to 11 percent for commercial properties to help fund construction of the baseball stadium

Table 2: Revenue Initiatives Used To Address DC's Budget Deficit in FY 2003 ($ in millions)	
Revenue Source	**Total**
SALES	
Increase retail alcoholic beverage tax from 8% to 9%	$1.4
Increase Cigarette tax from $0.65 to $1.00/pack	$5.8
PROPERTY	
Tax vacant and abandoned property at 5% of Market Value	$5.8
DEED (Temporary*)	
Increase Deed Tax rate	$24.0
Recordation rate from 1.1% to 1.5% (homes over $250,000)	
Transfer rate from 1.1% to 3.0%	
Economic Interest rate from 2.2% to 3.0%	
FRANCHISE TAX	
Defer Corporate Franchise Tax Cut	$17.5
GROSS RECEIPTS (Temporary*)	
Increase Public Utilities tax rate from 10% to 11%	$10.4
Increase Toll Telecommunications tax rate from 10% to 11%	$4.9
NON-TAX REVENUES	
Increase all User Fees & Charges	$7.9
Increase Licenses & Permits	$9.9
AGENCY FEES	
Fire & EMS	$2.9
Police	$10.3
Public Works and Motor Vehicles	$2.7
Increase in Various Fees	$9.5
TOTAL REVENUE INITIATIVES	**$113**