

Shifting Landscape:

**A Brief History of the Fiscal Relationship
Between the District of Columbia
and the Federal Government**



October 2021

**★ Statehood
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About this Report

This report was prepared and produced by the D.C. Policy Center for SRDC. The D.C. Policy Center is an independent nonprofit think tank committed to advancing policies for a strong and vibrant economy in the District of Columbia.



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Executive Summary

It is a common myth that the District has always been dependent on a steady stream of reliable federal funding. This myth clouds the DC statehood debate.

The truth is that, going back to the 1790s, federal fiscal supports to the District are better characterized as erratic, unpredictable, and declining over time. Nor have these fiscal arrangements incorporated much feedback from city leaders, and as a result, the funding allocations rarely reflected the city's needs. Over the course of the city's history, the District and the federal government were never able to arrive at a fiscal relationship that both worked well for the city and was continuously supported by the federal government.

Today, the District's own fiscal standing, independent of the federal government, has never been stronger. The most stable and successful stewardship of the city's finances has occurred since the federal payment was eliminated 25 years ago—which was also a period when the city earned meaningful levels of budget autonomy. Predictable budgeting and maximum local control have resulted in city finances that are the envy of states and municipalities across the country.

Based on the strong fiscal management of the past decade, the city has proved that it has the discipline and wherewithal to manage its finances under statehood. Indeed, it can be argued that the city's fiscal position strengthened as its fiscal autonomy increased.

DC's Relationship With the Federal Government Went Through Three Distinct Periods Before Home Rule

These three periods include an *ad hoc* period between 1790 and 1878 when there were no fixed payments from the federal government (or even a requirement for any payments); a period between 1879 and 1923 when the federal government paid for a certain share of District's expenditures; and a period of lump-sum payments that lasted between 1924 and 1973, when Congress passed the city's home rule charter. Throughout these years, the level of federal support varied greatly and declined over time, especially as the District's expenditures increased.

1790 to 1878: Unstructured fiscal relationship

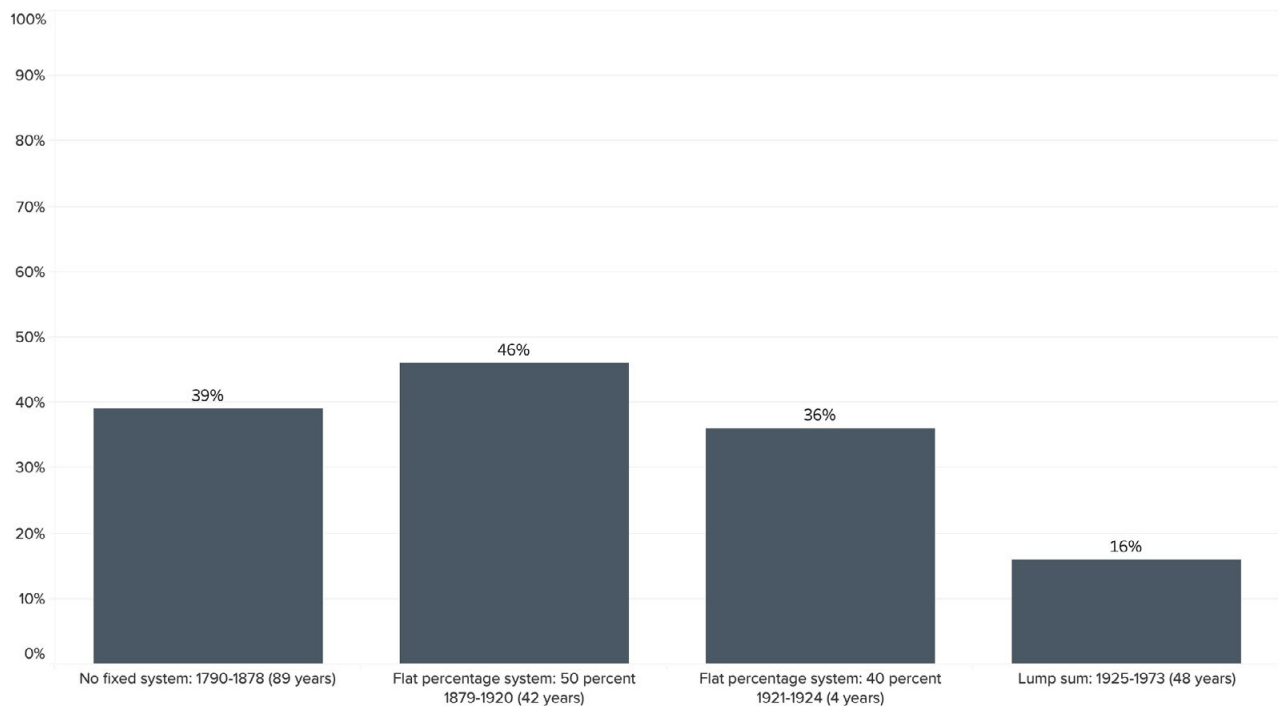
Between 1790 and 1878, the fiscal arrangement between DC and the federal government was unstructured, with the city and federal government paying for expenditures without any defined system.^{1,2} Expenditures were sometimes paid for by the city (which, at the time, comprised of the local governments of Georgetown and Washington, and a municipal government that covered the unincorporated parts of the federal territory) and were sometimes paid for by the federal government. Lack of reliable accounting records makes it difficult to know precisely how much the municipal District government and the local governments of the cities of Washington and Georgetown spent during these periods, but information from congressional hearings from the

early 1900s suggests that federal payments totaled approximately 39 percent of all expenditures.³

Frustrated by the lack of a definite plan and inadequate infrastructure investments, DC residents made repeated appeals for relief to Congress between 1800 and 1871. They argued that the national capital was being developed on a scale beyond the means of an average locality, and therefore, the federal government should share the cost of the city's operation and maintenance with its residents. These demands were borne out of residents' concerns and conditions in the city, including unpaved roads, which looked like "dust bins in dry weather, and sloppy mudholes when it rained,"⁴ inadequate water supplies, and the terrible state of sanitation with some waterways serving as open sewers. Basic services suffered, sometimes because of a lack of money, and sometimes because of the ongoing argument between the local governments about who was ultimately responsible.

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Figure 1.
Federal contributions toward D.C. expenditures prior to Home Rule, as a share of total expenditures



Sources: United States Seventy Sixth Congress "Annual Payment of the United States Awards Expanded to the Government of the District of Columbia Hearing before a Subcommittee of the Committee of the District of Columbia"

Notes: Per the source report, the share of federal supports averaged 21 percent between 1925 and 1936. The data for the 1925-1973 period includes information gleaned from later testimony submitted to the Congress which identifies the federal share at 10 percent or below.

During this period, the general fund of the District of Columbia included the gasoline tax fund, and payments by the District into the policemen's and firemen's relief funds. Also certain local revenues are not treated with consistency through these periods, sometimes recognized as local and other times as federal resources.



The unification of the two local and one county-level governments into a single District government in 1871⁵ with a combined elected and appointed government was largely the result of this persistent local demand for more speedy development and investments.⁶ The territorial government created in 1871 was dismantled just three years after its formation when it ran large deficits, mostly due to the untenability of the *ad hoc* federal fiscal support.⁷

1879 to 1923: Payments as a fixed share of DC expenditures

Ad hoc federal payments to the District continued until 1878, when payments changed to a flat percentage of District expenditures. Congress passed the Organic Act of 1878, creating an unelected government made up of a three-member commission and also approving a flat-percentage federal payment, equivalent to 50 percent of the District’s annual budget (with congressional approval of the annual budget) and any contract over \$1,000 for public works.

This period marks the beginning of the practice of using a federal appropriations bill to approve the District’s local budget. According to the 1878 law, the District Commissioners were required to submit, annually to Congress, an estimated budget reflecting the city’s spending needs. To the extent Congress approved this proposed budget, it was required to appropriate half the amount, with the remaining half funded by local revenue generated through local property taxes.

While this agreement for a 50 percent match lasted until 1921, actual payments received by the city were rarely that high. On various occasions, Congress required that specific appropriations be paid entirely from the District’s own revenues.⁸ Other times, Congress claimed a share of the revenues raised by the District as its own.⁹ Information from federal budget documents show that the federal payments during this period were consistently below 50 percent except for one year, and sometimes as low as 43 percent of the District’s total budget (and an average of 46.1 percent). Beginning in fiscal year 1921, Congress reduced the federal contribution towards the District’s budget to 40 percent. The actual match was, once again, consistently lower, averaging 35.6 percent of general fund expenditures.¹⁰

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1924 to 1973: Lump-sum payment supplements

Beginning in 1924 and lasting until the Home Rule Act of 1973, the federal government adopted a lump-sum payment system. Under this regime, all expenditures incurred by the District were charged against the District’s own revenues and the federal government supplemented the District with a fixed appropriation. At the beginning, this fixed appropriation accounted for about 23 percent of all District spending, but by the time Congress allowed for DC home rule in 1973, the appropriation had dwindled to approximately 10 percent.¹¹ This lack of support from

the federal government, combined with limited taxing power at the local level, meant that city services and infrastructure were continuously underfunded and therefore lacking.

1974 to 1995: More local control and mostly fixed federal lump-sum payments

In 1973, Congress passed the DC Self-Government and Governmental Reorganization Act (Home Rule Act), granting the city limited local control.¹² The Home Rule Act provided for an elected Mayor and a 13-member Council, delegating certain powers to the new government.¹³ However, this new government was prohibited from taxing federal property and nonresident income.¹⁴ Congress also retained legislative veto power over Council actions through passive oversight and required active approval of the District's budget as a part of the federal appropriations process.¹⁵

During the 1973 Home Rule deliberations, the mechanism for determining the amount of the federal payment was once again a source of major disagreement between city officials and Congress.¹⁶ By that time, Congress had already considered multiple approaches towards determining federal fiscal responsibility toward DC. These approaches ranged from a simple "cost of services" method to a more complicated "comparable tax burden" approach where the federal payment would allow the District to have a tax regime with burdens similar to those observed across cities with comparable levels of services.¹⁷

After the 1973 Home Rule Act, the federal government committed to a fixed payment, which initially equaled 43 percent of District's own revenue, but dwindled down to 18 percent by 1992.

Still, there was no clear path forward. A 1972 report prepared by a congressional commission¹⁸ advised against using a single formula to determine the amount of federal payment, but recommended that the costs and benefits attributable to the presence of the federal government be considered in determining the federal payment amount from year to year.¹⁹ The Senate's version of the Home Rule Act had the federal payment fixed at 37.5 percent of the District's own revenue in 1974 and at 40 percent in following years.²⁰ The House, however, replaced this percentage-based payment formula with a fixed payment.

During the first few years after Home Rule, the federal payment exceeded the 40 percent envisioned by the Senate. By 1980, it had dwindled to 30 percent and continued its decline through 1992.

In 1991, Congress enacted the District of Columbia Budgetary Efficiency Act,²¹ which set the federal funding for the District for fiscal years 1993, 1994, and 1995 at 24 percent of the city's own revenue from two years prior. Much of this decision was shaped by the Rivlin Commission Report,²² which recommended a federal contribution of 30 percent. This approach was scuttled

in 1995,²³ however, when the Federal Payment Reauthorization Act of 1994²⁴ fixed the annual payment to \$660 million for fiscal years 1995 through 1999.²⁵

Ultimately, the federal payment was not enough to keep the city afloat. A combination of factors drove the city to insolvency, including poor financial management, pressures from previous unfunded liabilities, and a rapidly eroding tax base. The deficits, which became unavoidable by 1989 (\$90 million), were projected to increase to over \$700 million by 1996.²⁶

That year, Mayor Marion Barry appointed the Commission on Budget and Financial Priorities, headed by Alice Rivlin, to develop a fiscal strategy for the District of Columbia. Their report, published in 1990, made recommendations to improve the financial management and fiscal position of the city, but it was largely abandoned. By 1995, the accumulated deficit had ballooned to \$722 million. The city was not able to provide basic services or pay its vendors. With a continuously worsening fiscal picture, the District's bond rating fell to junk level, making it impossible to obtain a line of credit.²⁷

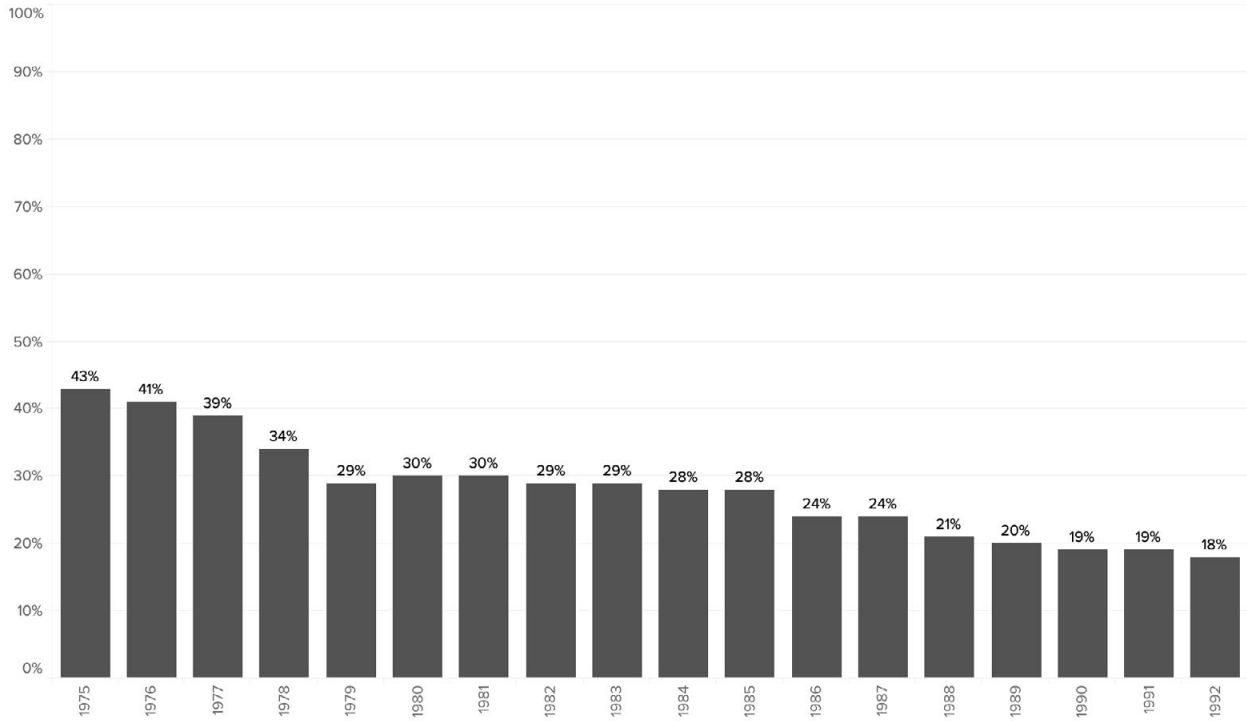
1997 to today: Feds assume some expenditure obligations, but budget limitations remain

Congress intervened in 1995 when the District faced insolvency and was no longer capable of delivering basic services. That year, Congress passed legislation to establish the District of Columbia Financial Responsibility and Management Assistance Authority (commonly known as the Control Board).²⁸ The Control Board had broad powers over the District's elected officials in fiscal matters, including any budgetary decisions, contracting, and borrowing. It could even overturn laws adopted by the Council and reject the Mayor's appointees. In return, it was expected to improve service delivery, access to capital markets, and operational efficiency of the District government. Importantly, it was required to balance the District's budget four years out.²⁹

Congress took control over District finances in 1995, and passed the Revitalization Act in 1997, which replaced the fixed federal payment with assumption of certain costs and liabilities.

The Control Board quickly discovered that long-term solvency for the city would require significant federal resources and could not immediately be solved solely by sound fiscal management.³⁰ The city had high needs stemming from years of disinvestment and a concentration of relatively low-income residents that relied on government services and social programs. DC's infrastructure, social services, and schools needed significant investments and repairs. The city not only lacked fiscal resources but was constrained by federal preemptions that severely limited revenue raising capacity. To solve the city's structural and fiscal problems, the city needed reliable support from the federal government.

Figure 2.
Federal payment as a share of District's own revenue, before earmarks, 1975 through 1992



Sources: Committee Report on the Hearings and Testimony on two House Bills (H.R. 7558 and H.R. 7845) on the Federal Payment held in June and September of 1980. Available from the Congressional Printing Service (Serial No: 96-16); General Accounting Office, various reports on the District of Columbia. District of Columbia General Fund History is provided by the Office of the Chief Financial Officer.

Notes: The chart combines information from multiple sources with various definitions of general funds. The federal share is the share of actual appropriations, and not authorizations, which could be greater.



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To provide much-needed stable support from the federal government, the Clinton Administration announced the Revitalization Plan in January of 1997, later called the Revitalization Act.³¹ The plan had the following terms: To reduce the spending pressures on the District, the federal government took over the District's \$5 billion unfunded pension liability (which had been created by and managed by the federal government prior to Home Rule), the operation and financing of the District's courts, and responsibility for the District's incarcerated residents. To improve financial management of the city, the Office of the Chief Financial Officer was permanently established as an independent agency. The Office of the Chief Financial Officer would have the sole authority over fiscal management, administration of tax laws and borrowing, and would ensure that the budget be developed on sound revenue forecasts and be balanced over a four-year period.

To help ensure sound financial management of the city, the Office of the Chief Financial Officer was permanently established as an independent agency.

In return, the \$660 million federal payment was eliminated.³² Along with these changes, Congress also increased the federal match for the city's Medicaid expenditures from 50 percent to 70 percent;³³ and provided federal tax relief for District residents and businesses.³⁴ The Medicaid match remains in place, but the federal tax relief has since expired.

The Revitalization Act, nevertheless, kept congressional control over the District intact. But on the upside, the Revitalization Act provided a level of stability by swapping the unreliable federal payment with the more reliable federal assumption of some of the District's recurring expenditures (e.g., courts, prisons, and pension liability). However, it did not remove federal limitations on taxation and spending. The District still could not tax nonresident income tax or remove federally enacted property tax exemptions. Nor could it remove the federal height limit on buildings, which constrains the District's tax base, or adopt spending measures entirely free from congressional intervention.³⁵

The Federal Fiscal Relationship: Looking Forward

The District and the federal government never settled on a stable fiscal relationship that worked well for both parties. For most of its history, the District suffered from underinvestment that can, at least in part, be attributed to the lack of stable and proper fiscal supports from the federal government in several fields including education and infrastructure. Federal policies toward DC were often insensitive to the city's needs or came too late with too many constraints about how the city could shape its own fiscal policy.

With local autonomy in the last two decades, however, the District has transformed from financial insolvency to an economic powerhouse. Since 1997, the city has adopted 23 consecutive balanced budgets and completely transformed from one of the poorest fiscal records to having balance sheets, reserves, and credit ratings that are the envy of cities around the country. DC's business policies have significantly increased its tax base and made it an attractive destination for residents, businesses, and workers. As the prospect for statehood becomes more and more real, the city should be assessing new dynamics—both challenges and opportunities—to establish a permanent and stronger fiscal platform.

Based on the strong fiscal management of the past decade, the city has proved that it has the discipline and wherewithal to manage its finances under statehood. Indeed, it can be argued that the city's fiscal position strengthened as its fiscal autonomy increased.

Notes

¹ When the Founding Fathers proposed that the United States capital should be a federal district, and not a state, they were hoping to ensure that no single state would have “undue influence over the central government.” The expectation was that few people other than federal employees would live in the District. And given that most federal jobs were patronage jobs before the establishment of the civil service, lack of voting rights would also prevent them from voting to keep the incumbent in place. Rivlin, “The Fiscal Problem of Being Washington DC.”

² This is taken from a 1931 statement by Robert Simmons, Congressman from Nevada during a hearing held by the Select Committee on Fiscal Relationship in the House of on a house resolution proposing to create a committee within the House to oversee the fiscal relationship between the District and the federal government. The Congressman then goes on to explain that the fixed contribution from the federal government to the District would end up in fraud, waste, abuse and extravagance.

³ Per a 1939 hearing which cites a report prepared by the Treasury Department in 1878.

⁴ David Mould and Missy Loewe, *Remembering Georgetown: A History of the Lost Port City* by David Mould & Missy Loewe, Foreword by Jerry A. McCoy | The History Press Books.

⁵ District of Columbia Organic Act of 1871 is an Act of Congress that repealed the individual charters of the cities of Washington and Georgetown and established a new territorial government for the whole District of Columbia. Though Congress repealed the territorial government in 1874, the legislation was the first to create a single municipal government for the federal district. This government had a presidentially appointed territorial governor, an upper house, and a Board of Public Works, a popularly elected lower house, and a non-voting delegate to House of Representatives Richards, “History of Local Government in Washington, DC”.

⁶ Whyte, “The District of Columbia Territorial Government, 1871-1874.”

⁷ During this period, Alexander “Boss” Shepherd served as the head of the Board of Public Works, spending \$18 million on improvements including grading city streets, paving them (for example, Pennsylvania Avenue was not paved until 1873), planting trees, and covering the fetid Washington Canal. He was only authorized to spend \$6 million Richardson, Alexander Robey Shepherd : The Man Who Built the Nation’s Capital..

⁸ For example, for fiscal years 1880 through 1916, the expense of maintaining the Washington aqueduct was charged half to the United States and half to the general revenues of the water department; for the fiscal year 1917 and thereafter it was charged wholly to the water revenues. The District’s water department was funded entirely through its own revenues, through a fund established in 1880.

⁹ These were largely fines collected in criminal cases in the supreme court of the District and fines collected in the police court. Appropriation acts from 1913 to 1919 provided for reimbursing the United States in amounts totaling \$2.5 million, made up of revenues improperly credited to the District or expenditures which, in the opinion of Congress, had been improperly charged to the United States. This information is compiled from Congressional testimony delivered between 1930 and 1935.

¹⁰ Congress, however, did not repeal the provision in the organic act that called for a 50-50 match. Instead; rather, they enacted the 40-60 change through the appropriations bill, for only one year, and then repeated it in the next year’s budget bill. The 50-50 provision was finally repealed in 1923, when the 40-60 percent arrangement was made permanent.

¹¹ Testimony of Mrs. Harvey Wiley presented to the US Senate in January of 1958.

¹² Pub. L. No. 93-198, 87 Stat. 774 (enacted December 24, 1973).

¹³ Currently, the only elected governance body in the District was the School Board, which has its own contentious history with the federal government. Just like governance over the city, governance over schools frequently shifted between elected and appointed boards over the District's history. In 1968, the Congress adopted legislation (Public Law 90-202) to create a fully elected school board with 11 members.

¹⁴ It was also prohibited from changing the Federal building height limitation, altering the court system or changing the criminal code until 1977.

¹⁵ In a 1983 decision, the Supreme Court invalidated one-house legislative vetoes in *INS v. Chadha* (Supreme Court of the United States, *INS v. Chadha*, 462 US 919). That decision required Congress to modify the procedure for ordinary District legislation and for amendments to the District Charter. Congress decided to make amendments proposed by the District presumptively valid, unless Congress enacted and the President signed a joint resolution of disapproval. In so doing, Congress left in place the narrow limitations on the District's Charter amendment authority.

¹⁶ DC Appleseed Center, "The Case for a More Fair And Predictable Federal Payment for the District."

¹⁷ Bell, "Financing the District of Columbia."

¹⁸ The "Nelsen Commission" named after Ancher Nelsen, the Chairman of the Committee on the Organization of the District of Columbia.

¹⁹ Ultimately, the Home Rule Act required the mayor to estimate, and include in the city's proposed budget, the costs and benefits of being the nation's capital. The estimate would include lost revenues due to lack of commercial and industrial property and businesses; revenues lost due to federal preemptions to taxing authority; the net cost of providing services to businesses that only do business with the federal government (and therefore do not contribute to the District's tax revenue); the costs of services provided for the federal government without reimbursement; other expenditures the city has to incur because of the presence of the federal government; benefits provided by the federal government through grants-in-aid not available to other municipalities; benefits from direct services from the federal government, and the relative tax burdens.

²⁰ DC Appleseed Center, "The Case for a More Fair And Predictable Federal Payment for the District."

²¹ Pub. L. 102-102 105 Stat. 495 (Effective Aug. 17, 1991).

²² Named after Alice Rivlin who chaired the Commission on Budget and Financial Priorities of the District of Columbia, *Financing the Nation's Capital*, November 1990.

²³ A compromise shaped by Charles Diggs, who replaced John McMillan as the chairman of the House District Committee. Initially the District demanded an elected mayor and a city council, full control over the city's own budget, legislative authority over city's own affairs, and an automatic federal payment to the city. Diggs, who knew that the House would not agree with these demands, offered three concessions to the Southern Democrats: control over budget, presidential authority to take over the police force in an emergency, and a prohibition on the city council from changing the city's criminal code. For details of the events that happened during this period, see Pearlman, *No Democracy's Capital: Black Political Power in Washington, DC, 1960s–1970s*, 200–220.

²⁴ Pub. L. 103-373 105 Stat. 3488 (Effective Oct. 19, 1994).

²⁵ O’Cleireacain, *The Orphaned Capital*, 152.

²⁶ Wepman, “Reforming the Power of the Purse: A Look at the Fiscal and Budgetary Relationship between the District of Columbia and the U.S. Congress.”

²⁷ Bouker, “The DC Revitalization Act: History, Provisions and Promises.”

²⁸ District of Columbia Financial Responsibility and Management Assistance Act of 1995, Pub. L. 104-8 109 Stat. 97 (effective Apr. 17, 1995).

²⁹ The District was required to keep a balanced budget for four years before the Control Board could be dissolved. This provision is still in place, meaning that the Control Board could return if the District fails to balance its budget—among other triggers, known as the seven deadly sins. These include: borrowing money from the treasury (during a control board period); failing to provide sufficient funds to a debt service reserve fund; defaulting on loans, bonds or notes; failing to meet payroll; having a cash deficit at the end of any quarter; failing to make pension payments; and/or failing to make payment under an interstate compact. DC Vote, “Davis Introduces DC Budget Autonomy Legislation.”

³⁰ According to Jon Bouker’s excellent review of this period, within its first 20 months, the Control Board reviewed and approved over 1,500 contracts; removed the contracting authority from the Department of Human Services; oversaw repairs to the District’s emergency vehicles; privatized city functions to cut costs; and rejected any proposal to increase spending; forced one cabinet members to resign, rejected all contracts they deemed questionable, regularly stopped Council legislation fired the public school superintendent, revoked the powers of the independent School Board; and appointed its own superintendent.

³¹ The National Capital Revitalization and Self-Government Improvement Act of 1997 was enacted as Title VII of the Balanced Budget Act of 1997 (Public Law 105-33; 111 Stat. 712, approved on Aug. 5, 1997).

³² The Congress committed to a one-time \$190 million infusion in 1998 and unspecified supports for subsequent years). And the city was forced to balance its budget in a shorter period than originally envisioned, forcing deeper cuts.

³³ This was codified as a part of the appropriations bill for 1998.

³⁴ The Taxpayer Relief Act of 1997 (Public Law 105–34, 111 Stat. 787, enacted Aug 5, 1997) included a \$5,000 home buyer credit, a \$3,000 wage credit for employers hiring District employees, capital gains exemption on certain assets, and tax-free bonds in District census tracts with higher concentrations of poverty. While these are benefits for DC residents not available in other states, they depress the District’s own tax revenue along with federal tax collections.

³⁵ The District of Columbia Management Reform Act of 1997 Pub. L. 104-8 109 Stat. 97 (effective Apr. 17, 1995). Further, through what is known as the “Faircloth Attachment,” the Revitalization Act significantly curtailed the District’s Home Rule during the Control Board period by giving the Board full control over mayoral appointments and control of the city’s agencies. These provisions disappeared when the Control Board passed the District of Columbia Management Restoration Act of 1999 (Pub. L. 106-1, signed into law March 5, 1999) which restored Home Rule.

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info@statehoodresearchdc.org

1310 L Street, NW, Suite 325, Washington, DC 20005