In fiscal year 2025, the District of Columbia is facing tough choices. Without making difficult decisions now, future years will only get harder.

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D.C. POLICY CENTER

A difficult fiscal future is awaiting the District of Columbia in Fiscal Year 2025 and beyond. The city faces significant budget pressures but has limited resources to address them.

- **When resources are limited, there is a greater need for a government that operates efficiently and predictably.** This can be achieved through rigorous evaluation of program design and execution to determine what investments work the best, meet the highest needs, and with the greatest success.
- **There is also a need for a coherent and cohesive regulatory framework.** The District should reassess its regulatory practices to ensure that the city's regulatory regime is truly addressing public interest, without unnecessarily limiting opportunity for residents and businesses.
- **Our housing policy is now a key economic development tool**. Residents used to move to D.C. for jobs, but with remote work, commute times are becoming less important. The city should evaluate its zoning laws and permitting practices to maximize housing supply to make the city is more affordable, inclusive, and attractive.
- **Diversifying the District's economy away from sectors contingent on federal activity should also be a key priority.** The presence of federal government is no longer providing protection from economic downturns. If anything, the empty federal offices are putting additional strain on economic recovery.

Mayor Muriel Bowser's Fiscal Year 2025 budget submission is delayed, reflecting the difficult decisions the Executive (and, in the coming months, the Council) must make given the dramatic devolution of the city's fiscal picture. The District's challenging long-term economic and fiscal outlook will not allow its budget to grow at the same rapid rate as it did since the beginning of the pandemic. Unfortunately, this will necessitate cuts to programs and spending in Fiscal Year 2025 and beyond.

Cutting programs is hard. Each program is in the budget because it has supporters who believe the program is meeting an important need. However, the District rarely conducts program evaluations to determine the impact and efficiency of a program's design and execution. This must change. When the economy is strong and revenues are on the rise, rigorous evaluation of government programs, policies, and practices does not garner that much interest. However, when there is far less money, there is tremendous value in a government that operates efficiently and predictably, and sets the stage for future growth, opportunity, and prosperity.

In addition to program evaluation, taking stock of regulations, properly assessing their costs and benefits, and making changes where warranted can support entrepreneurial activity, increase the flow of capital from investors, create more jobs for District residents, and can help build more housing that will make the city more affordable and attractive. All of these will open more doors to opportunity and will help grow the tax base. In the past, the city has used its regulatory powers to pursue a variety of goals, including goals that often contradict each other (such as stringent green building regulations, which make it costlier to meet affordable housing requirements, and vice versa). The cost of overregulation is immediate, and falls on residents, rich and poor, and on businesses, new and established. Moreover, the benefits are not always clearly measured against the costs. The city must evaluate its regulations and laws to work toward clear, cohesive practices.

Importantly, in this new fiscal environment with limited resources, the District's leaders must reassess the city's goals and take a fresh look at priorities. This reprioritization, without question, must consider the impact COVID-19 has had on the District's economic reality. In the past, the District has been able to invest in city services, public infrastructure, and a variety of programs, including those that meet the needs of the most vulnerable residents. This is because it was an attractive, compelling city with a constantly growing tax base and accompanying revenue. Today, the magic of the District—be it measured by demographic dynamics, employment growth, office occupancy, or investment interest—has fundamentally weakened. Hence, making the District a more compelling place in which to live, work, and invest should frame budget decision making this year and beyond.

Why are we experiencing such a fiscal challenge this year?

There are three reasons why the budget picture for Fiscal Year 2025 deteriorated so quickly: the loss of one-time and temporary resources; budget pressures the city did not, or sometimes could not, plan for; and weak economic growth that did not, and will not produce any time soon, sufficient revenue growth to fill the consequent gaps.

The loss of one-time and temporary resources that temporarily boosted spending.

The first factor that is contributing to this year's difficult fiscal picture is the disappearance of one-time resources that have allowed the city to spend more than what it brought in each year since Fiscal Year 2020.[1]

During the five-year period from Fiscal Year 2020 through Fiscal Year 2024, the District's recurring revenue, including revenue from new tax proposals, totaled $46.2 billion. During the same period, resources designated to balance the local fund budget were $51.8 billion—a difference of $5.6 billion.[2] This gap was filled by the following:

- $3.2 billion from surpluses or savings from previous years
- $1.1 billion from COVID-19 related federal fiscal aid that was treated like local revenue, paying for both

- one-time and recurring expenditures. (The total pandemic-related federal fiscal aid the city received in this period was approximately $4.75 billion.)[3]
- $903 million in transfers from funds initially intended for other uses like debt service or capital expenditures.
- $344 million in other temporary federal reimbursements.

These temporary resources have allowed the city to grow its local fund spending by 35 percent through that time even while recurring revenues grew by 17 percent. The result is a dramatic mismatch between expenditures and revenues over multiple years. To wit, in Fiscal Year 2019, the District's recurring revenues were 4 percent greater than its recurring expenditures. Between Fiscal Years 2020 and 2024, recurring revenue, overall, was 4.5 percent below recurring expenditures.[4]

Importantly, the most current financial plan[5] continues this practice. Between Fiscal Years 2025 and 2027, the projected recurring revenue is still 5 percent below the planned recurring expenditures, and the gap is almost entirely filled with savings and surpluses from previous years—a practice that cannot be continued forever.

Known and unknown pressures for which the city did not plan.

The second factor contributing to the bleak fiscal picture is the budget pressures that were previously unaccounted for in the city's approved financial plan and must now be resolved. Unlike many other states and localities, the District must balance its budget for a four-year financial plan period. While this is an extremely valuable fiscal management practice, it is imperfect. The financial plan must follow the law, so it does not account for current year expenditures that are not legally required to continue in future years. In reality, some spending must be continuously incurred out of practical (or political) necessity, even when this is not legally required.

One such pressure stems from the District's public schools. Schools are facing an imminent fiscal cliff as they lose the targeted federal fiscal aid known as the Elementary and Secondary Schools Emergency Relief (ESSER) funds at the end of Fiscal Year 2024. A D.C. Policy Center report published in February 2024 estimated that District's public schools stand to lose 15 percent of the instructional dollars they received in Fiscal Year 2024.[6] Local Education Agencies (LEAs) will need to account for this gap to continue to provide the same level of services in coming years. Because there is no legal requirement to make up for the loss of the federal funds, the financial plan does not include any resources needed to fill the gap.[7]

Given continued needs in the public school system,[8] such a loss would be devastating to the District's public schools. The Executive has recognized this need and made school budgets a priority for Fiscal Year 2025. To fill the gap in public school budgets, Mayor Bowser proposed a historic 12.4 percent increase to the foundation level funding formula for Fiscal Year 2025.[9] This amount, which we estimate to be somewhere between $310 million and $345 million, is not in the most current financial plan.

Another pressure stems from WMATA's own looming fiscal cliff. The system is losing $1.4 billion in pandemic-related federal fiscal aid at the end of this fiscal year.[10] For current levels of WMATA service and operations to continue, regional governments that are parties to the WMATA compact must chip in additional operating subsidies. City leaders have announced that the city is planning to commit $200 million in additional subsidy in Fiscal Year 2025.[11] This amount is also not currently reflected in the financial plan.

The education and WMATA fiscal cliffs alone add over half a billion dollars of spending that the city had not planned for but may have to incur in Fiscal Year 2025. Additionally, there is $385 million in other one-time local spending in the fiscal year 2024 budget spread across multiple programs and other one-time federal fiscal aid money invested in popular programs such as the Housing Production Trust Fund, local rent supplements, and the SNAP program. The current financial plan and the baseline budget for Fiscal Year 2025[12] exclude these. While these are not budget pressures in the technical sense—the city has no legislative mandate to continue these investments—they are pressures nonetheless because of the ongoing need in D.C. communities.

The financial plan also does not include items that cannot be reliably estimated such as higher than expected growth in inflation, change in debt service needs due to interest rate swings, or pressures from collective bargaining agreements that had not yet been negotiated at the time of budget formulation. The city must also meet certain reserve requirements. These cannot be forecasted and are therefore excluded from the financial plan.
When all these different pressures and unanticipated needs are combined, they add up to over an estimated $1 billion dollars.

Tepid growth which limits revenue.

The third factor contributing to difficult budget decisions is the anemic economic picture. The national economy is growing, but this is not translating into higher employment or strong economic growth in D.C. Additionally, the pandemic has significantly altered migration patterns, work from home trends, and the demand for office space. As a result, the city is no longer as attractive to investors as before, which translates into a much weaker long-term revenue picture than to what the city has been accustomed.

To be sure, given the uncertainties, the long-term impacts of the COVID-19 pandemic were difficult to assess. For example, shortly after the onset of the pandemic, in September 2020, revenue estimators projected that local revenue would bounce back in Fiscal Year 2022 with a 5.8 percent growth, and then, would grow at 3.5 percent and 3.8 percent respectively in Fiscal Years 2023 and 2024.[13] This did not materialize. Local revenues declined in Fiscal Year 2023 by 1.8 percent and are projected to remain flat in Fiscal Year 2024 and are expected to growth at around 2 percent in the coming years—a historically low figure.[14]

The worrisome long-term revenue outlook underscores the importance of structural changes in the way the District approaches budgets, regulations, and priorities.

Getting the budget right

The pressures the District is facing in the Fiscal Year 2025 budget are larger by order of magnitude than the additional resources the city has for that year. The OCFO estimates that in Fiscal Year 2025, after paying for recurring expenditures for programs required by current law,[15] the city will only have approximately $193 million left over to solve an estimated $1 billion problem.[16] This sobering arithmetic will necessitate budget cuts—an exercise the District did not have to engage since the Great Recession, more than a decade ago. And unlike the Great Recession, which turned out to be a temporary setback, the impact of the pandemic is structurally transformational, putting the city on a lower growth path in the years to come.

In the face of temporary setbacks, budget cuts have typically relied on attrition, hiring or salary freezes, or haircuts across all agencies. The District used all these tools during the Great Recession, and some of these tools are expected to be in play in this year's budget preparation. However, with little hope for rapid revenue growth, budgets should be shaped by prioritization, program assessment, and impact. For each item of spending city leaders should ask: Is this investment the best use of available resources? Is this investment creating the desired outcome? Is this investment the most efficient way of reaching the desired outcome?

Fortunately, the District has some information to begin to answer these questions. The City Administrator publishes annual performance plans for each agency under Executive control.[17] Agencies also respond to Council performance oversight questions, which can be quite detailed and provide important insights on program performance.[18] Nonetheless, the city needs a transparent and systematic way through which performance information is incorporated into budget decisions.

Understandably, the hardest part of the budget-cutting exercise is the inevitability of cuts to investments supporting the direst needs. Public education and human services account for over half of the District's local fund budget and 60 percent of the city's overall spending. They are also the areas with greatest needs. The city will be well served to identify which programs in these two clusters best meet community needs, and which are duplicative, outdated, or underperforming.

Rethinking regulations

While many of the factors that are changing the District's economy–such as work from home preferences or inflationary pressures–are not under the city's control, D.C. government has significant impact on the city's economy through regulations. In the past, with growing spending, District leaders were able to use the city's regulatory regime to pursue multiple, and sometimes contradictory goals. This is no longer possible.

The case of land use regulations in the District demonstrates this point. The District primarily regulates the use of land through zoning, which prescribes where and what can be built, and through building codes and permitting, which dictate how one can build.[19] Building codes are necessary to ensure safety and zoning, when properly designed, can increase the appeal of a city.[20] But when land use regulations are overly restrictive (as in the case of zoning) or unpredictable (as in the case of implementation and enforcement of the building codes), they increase housing costs for residents and make housing production far more difficult.

First, by limiting supply, restrictive land use policies increase prices. Second, costly reviews associated both with zoning changes and with permitting and inspection processes increase the cost of construction and add risk to projects. Third, artificial limitations on how land can be used reverberate through project proformas, incentivizing the production of larger, more expensive single-family homes rather than more affordable duplexes or triplexes; or tiny, expensive apartments targeting affluent singles and couples rather than larger units in multifamily buildings that can accommodate families.[21] All of these impede the District's own affordability goals by making both subsidized affordability and inclusionary zoning far costlier.

The burden of these restrictions almost invariably falls on the shoulders of the District's most vulnerable residents, amplifying and prolonging economic and racial segregation. When housing is more expensive, lower-income households are more likely to be excluded from the opportunity of living in highly resourced neighborhoods. This means they cannot easily benefit from work opportunities in high-productivity and high-return areas or take advantage of the amenities in neighborhoods with significant public or private investments. The segregation effect also works through wealth, as restrictive land use practices both limit homeownership—a major means of wealth accumulation—among lower-income households and artificially boost the value of existing homes and the wealth of those who own them.

A similar case can be made for business licensing regulations. There *is* a public benefit associated with business licensing. Licensing empowers the District to track businesses to ensure they operate within the District's laws. There is also a cost, especially when business licenses are prohibitively expensive and difficult to obtain. Expensive and complicated licensing limits entrepreneurial activity (a private cost) and makes the District less attractive to entrepreneurs (a public cost). Once again, aspiring entrepreneurs, often with meager means, disproportionately bear these costs: they have less money to pay for a business license, or insufficient experience to deal with the inevitable complications in obtaining one.

Both the Executive and the Council have recognized the importance of reforming business licensing practices. In 2021, as a part of her budget plan supporting post-pandemic recovery, Mayor Bowser proposed reducing business license fees to $99 for two years. In the meantime, the Council passed the BEST Act,[22] which streamlines licensing processes and reduces license fees, though it has not yet funded this bill. The city can do more, for example, by increasing the Clean Hands limit,[23] or by automatically issuing a temporary one-year basic business license when someone registers a business. These practices will increase opportunity by allowing the applicant to begin implementing their business plan without having to tangle with burdensome licensing requirements or having to worry about settling small amounts of debt in order to establish Clean Hands.[24]

Another example of costly regulations is professional licensing. When appropriately implemented, professional licensing has a tremendous public benefit, as it ensures that people practicing in certain occupations have the necessary education and skills. But when used injudiciously, licensing can limit competition, create undue burdens on businesses and employees, and limit upward mobility. A 2019 D.C. Policy Center study[25] found that nearly half of the 125 occupations[26] that require licensing in the District do not require significant post-secondary credentialing (such as those required for doctors, counselors, social workers, or teachers). Many of these occupations pay living wages, but licensing requirements close the path of opportunity for those who are willing to work hard or learn on the job, but otherwise cannot afford licensing requirements. This does not bode well for the District's most vulnerable residents.

There is a great amount of work that must be done to ensure the District's regulatory regime does not impede much needed growth. Here, the District has an advantage: it has a single, merged government that combines the functions of a state government, local government, a city, and a school district. This creates the unique opportunity to implement system level regulatory reforms. The most important step the city can take is to systematically assess and reassess the costs of current and future regulations, not just on the government and its operations, but also on the residents and businesses.

The need to prioritize.

Ever growing financial resources in the last decade allowed the District to pursue multiple policy goals without clear prioritization. As the city ponders how to cut its budget or to right size its role in and impact on the District's economy, the city's elected officials must also ask: what are the most important priorities for the District for the next five to ten years?
Thinking through these priorities, it is important to recognize that the pandemic has eroded the District's competitive edge in multiple ways. For example, in the past, residents had typically moved to the District for jobs, and moved out for housing.[27] Now, with telework, commute time is less important, and having a job in D.C. is not as compelling a reason to move to the city.[28] As such, having attractive and affordable housing options in the District has become more important in making the District competitive and compelling. In other words, our housing policy is now an important economic development policy.[29]

Similarly, the role of the federal government in D.C.'s economy has changed.
In the past, the presence of the federal government rendered the District "recession-proof." During the Great Recession, for example, while private sector employment declined, federal hiring increased, lifting the District's economy.[30] Now, with a persistently high share of federal workers working from home, the federal government's presence is no longer providing the same level of protection from economic downturns. In fact, federal telework is putting increased strains on the District's office market and the Downtown economy. Diversifying the District's economy away from the sectors contingent on federal government activity is challenging, but it should be a key priority.

Facing the challenges of Fiscal Year 2025 and beyond, the District finds itself at a pivotal moment. As the city grapples with the loss of one-time resources, unanticipated budget pressures, and tepid economic growth, the status quo has become unsustainable. The imperative to reassess priorities, conduct full and careful program evaluations, and reform regulatory practices will be necessary to chart a course towards fiscal stability and future prosperity.

Endnotes

1 See for example Sayin Yesim (2021). "The long view for the District's budget: What is awaiting the District in Fiscal Year 2022 and beyond." Available at https://www.dcpolicycenter.org/publications/budget-long-view/

2 Data is compiled from the budget books for Fiscal Year 2024, 2023, and 2022, published by the Office of the Chief Financial Officer. Available at https://cfo.dc.gov/budget.

3 Some of this amount was budgeted in the federal portion of the District's budget. Also, excluded from this amount are direct supports to residents such as stimulus checks, unemployment benefits, and child tax credit expansion; supports for businesses that included grants, forgivable loans under the paycheck protection program, and low-cost Economic Injury and Disaster Loans; and other supports the federal government provided for health care providers, child care centers, and universities. When all added together, the amount of federal fiscal aid committed to the District of Columbia was $17 billion, or about 6 percent of personal income earned in the city throughout those five years. The data on the federal fiscal aid are obtained from covidmoneytracker.org. The data on the District's personal income are from the Bureau of Economic Analysis, available at https://www.bea.gov/data/income-saving/personal-income-by-state.

4 This calculation is based on the information presented in the District's budget books.

5 The most current financial plan was approved last year as a part of the Fiscal Year 2024 budget and covers Fiscal Years 2024 through 2027.

6 In addition, schools also received one-time local funding outside of the formula in support of various COVID-related initiatives, which is included in the 15 percent estimate. For details on this calculation, see Sayin, Yesim and Chelsea Coffin (2024). "The fiscal future of public education in the District of Columbia." D.C. Policy Center. Available at https://www.dcpolicycenter.org/publications/dc-fiscal-future-in-education/

7 The District's financial plan does not include an annual increase in foundation level funding for public education because each increase is passed by specific law approved through the budget, even though those increases are routine.

8 Coffin, Chelsea, and Hannah Mason (2024). "State of D.C. Schools, 2022-23. D.C. Policy Center. Available at https://www.dcpolicycenter.org/publications/state-of-dc-schools-2022-23/.

9 Foundation level is the base level of funding schools receive for each of their enrolled student. This level can be modified based on student grades, learner characteristics, or special education needs. https://www.washingtonpost.com/education/2024/02/13/dc-schools-budget-proposal-funding-cuts/

10 Per the American Rescue Plan Act, data from covidmoneytracker.org.

11 Letter sent from D.C. leaders to WMATA on February 1, 2024.

12 See the Fiscal Year 2025 Current Services Funding Level Budget analy-

sis published by the OCFO on February 28, 2024. Available at https://cfo.dc.gov/node/1709836.

13 OCFO September 2020 revenue estimate available at https://ora-cfo.dc.gov/node/1499041/

14 OCFO February 2024 revenue estimate, available at https://ora-cfo.dc.gov/publication/22924-february-2024-revenue-estimates-fy-2024-—-fy-2028

15 This represents 5.7 percent growth to the recurring part of the Fiscal Year 2024 budget—again a number much greater than the projected revenue growth.

16 This includes the sum of available resources projected in the Fiscal Year 2025 Current Services Funding Level budget and the additional revenue projected for Fiscal Year 2025 in the February 2024 revenue estimate.

17 These reports can be found here: https://oca.dc.gov/node/160652.

18 These responses, if filed by Council committees, can be found here: https://dccouncil.gov/committee-oversight/.

19 For a detailed analyses including a literature review on the impacts of restrictive land use regulations, see Sayin, Yesim (2019). "The Economic Costs of Land Use Regulations." D.C. Policy Center. Available at https://www.dcpolicycenter.org/publications/economic-cost-land-use/

20 It is important to note that the origins of zoning have been exclusionary and racist. Zoning grew largely out of demand from landowners who wanted to keep property values intact by keeping out what they considered to be sources of nuisance, but the intent moved quickly away from addressing nuisance to segregating immigrants, people of color, and low-income residents from desirable neighborhoods. A literature review is provided in Sayin (2019).

21 Sayin, Yesim (2018)." Taking Stock of Districts Housing: Capacity, Affordability, and Pressures on Family Housing" D.C. Policy Center. Available at https://www.dcpolicycenter.org/publications/taking-stock-full-report/

22 B24-0301, 2021. (D.C. 2021). Business and Entrepreneurship Support to Thrive Amendment Act of 2021.

23 At present, residents are denied a business or professional license if they owe $100 or more in taxes and other fines and fees.

24 Sayin, Yesim (2022). "D.C. Council testimony on Bill 24-301, the "Business and Entrepreneurship Support to Thrive (BEST) Amendment Act of 2021" Available at https://www.dcpolicycenter.org/publications/best-act-2021/

25 Sayin, Yesim (2019)." The impact of occupational licensing requirements in D.C." Available at https://www.dcpolicycenter.org/publications/occupational-licensing-2019/

26 This number excludes over 50 health and mental health occupations.

27 Sayin, Yesim (2015). "Residents Move into the City for Jobs, Move Out for Housing." District Measured. Available at https://ora-cfo.dc.gov/blog/residents-move-city-jobs-move-out-housing

28 Sayin Yesim (2021). "The declining importance of commute times." D.C. Policy Center. Available at https://www.dcpolicycenter.org/publications/the-declining-im-

portance-of-commute/. Additionally, recent research shows that the distance between where people live and where they work increased considerably for those who have been hired since the COVID-19 pandemic began. The mean distance rose from 10 miles in 2019 to 27 miles in 2023, and the share of workers living more than 50 miles from their employer rose 7-fold from 0.8% to 5.5%. For details, see Akan, et. al. (2024). "Americans Now Live Farther from Their Employers." WFH Research. Available at https://wfhresearch.com/wp-content/uploads/2024/03/DistanceToWork.pdf

29 Calma, Emilia (2024). "Historic preservation penalties should be weighed against the costs of reduced development, not increased." D.C. Policy Center. Available at https://www.dcpolicycenter.org/publications/historic-preservation-2024/.

30 Sayin, Yesim (2020). "Tax policy under the District's new fiscal normal." D.C. Policy Center. Available at https://www.dcpolicycenter.org/publications/tax-policy-under-new-fiscal-normal/