S. Hrg. 105–161

FEDERAL TAX POLICY FOR THE DISTRICT OF COLUMBIA

HEARING

BEFORE THE

SUBCOMMITTEE ON
OVERSIGHT OF GOVERNMENT MANAGEMENT,
RESTRUCTURING, AND THE DISTRICT OF COLUMBIA

OF THE

COMMITTEE ON
GOVERNMENTAL AFFAIRS
UNITED STATES SENATE

ONE HUNDRED FIFTH CONGRESS

FIRST SESSION

MARCH 6, 1997

Printed for the use of the Committee on Governmental Affairs

U.S. GOVERNMENT PRINTING OFFICE
39–457 CC WASHINGTON : 1997

For sale by the Superintendent of Documents, Congressional Sales Office
U.S. Government Printing Office, Washington, DC 20402

39–457

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THURSDAY, MARCH 6, 1997

U.S. SENATE,
OVERSIGHT OF GOVERNMENT MANAGEMENT, RESTRUCTURING,
AND DISTRICT OF COLUMBIA SUBCOMMITTEE,
OF THE COMMITTEE ON GOVERNMENTAL AFFAIRS,
Washington, DC.

The Subcommittee met, pursuant to notice, at 9:39 a.m., in room SD–342, Dirksen Senate Office Building, Hon. Sam Brownback, Chairman of the Subcommittee, presiding.

Present: Senators Brownback, Lieberman, and Cleland.

OPENING STATEMENT OF SENATOR BROWNBACK

Senator BROWNBACK. I think we will go ahead and get this Subcommittee hearing started. We have a great set of witnesses coming in front of us to talk about some opportunities for the District of Columbia.

My name is Sam Brownback. I am Chairman of this Subcommittee, and our focus of today's Subcommittee hearing is on making the District of Columbia a shining city on a hill, a capital city worthy of a great Nation. If I could put it in such glowing terms, I have that type of hope. I think we have that kind of opportunity for us to be able to do it in the District of Columbia, a shining city on a hill, worthy of a great Nation. That is my objective, and I know it is shared by the Ranking Member on this Subcommittee as well, Senator Lieberman.

We have a number of good people here to testify today. I would like to recognize from the very outset, if I could, a couple of members of the D.C. City Council. John Ray and Carol Schwartz are here, I believe, if you would stand up. We appreciate very much— and Sandy Allen is here as well. OK. Thank you very much as well for coming. I appreciate that.

Also, if I could, I would like to introduce and will call upon shortly for some brief comments, introductory comments, from Senator Lieberman, who is the Ranking Member of this Subcommittee, certainly a distinguished colleague that has worked hard on the issues of the District of Columbia over the years, and who I think has shown a very sincere desire to do what is best for the District of Columbia. Even though it may not directly benefit his constituencies back home, we all see benefit in having a great capital city, and he has shown that over the years on his work that he has done.

The first panel up will be Eleanor Holmes Norton and Jack Kemp. If I could, in opening, I would say what I would like to do through this panel is look to see how we can create more opportunities for the District of Columbia to become a shining city. We are going to be talking about tax policy today. The District of Columbia, undoubtedly, as everybody knows, is having a great deal of problems. If you look at troubles with the economy, schools, serious crime, all of these—the U.S. Census Bureau is even projecting that the District will lose almost three times as many residents in 1990's as it did in the 1980's if we continue on the same trends.

We cannot let those trends continue. We simply must stop that from happening. And I think we have opportunities to be able to attack that, and today we are going to be talking about tax policy.

Now, if the Federal Government simply wrote a check to cover the District's debt, I think the local failing economy would still remain as a problem, and we would still have problems with schools and unsafe streets. But to fix both problems, we need to explore options that will empower the District to open the floodgates for capital to revive the local economy as part of a comprehensive plan to restore greatness to this city.

This hearing marks the first of many this Subcommittee will hold to examine a comprehensive package of incentive-based policies such as enterprise zones, tax policy, improved public safety, education and welfare reform. I should also mention we had a number of people that wanted to testify today, but we simply were not able to accommodate everyone who wanted to testify, particularly on this issue of tax policy. We would welcome your input into the Subcommittee. The Members would greatly appreciate that if you would put that forward.

Every American citizen, I think, has something at stake in our capital city. We want to make it the best possible place we can, and that is why we launched these hearings. We will move forward with them.

I would now like to turn the podium and the microphone over to the Ranking Member, somebody for whom I have a great deal of respect, even though I am new to the Senate. You start to find your way around pretty quickly about good people to work with, and I have already been up to Senator Lieberman's office to receive his counsel and his thoughts. And I have worked with him, and I look forward to a long, productive relationship—a productive one for the District of Columbia.

Senator Lieberman.

OPENING STATEMENT OF SENATOR LIEBERMAN

Senator LIEBERMAN. Thank you, Mr. Chairman, for those very kind words, and let me begin by thanking you and congratulating you on focusing the first hearing of this Subcommittee during this Congress on the ways in which Congress can be of assistance not only to the District of Columbia but to our Nation's cities as well.

As I am sure we are going to hear from our distinguished panel of witnesses this morning, the District is now and for some time has been in a serious crisis. This Subcommittee, quite appropriately, will in the future be exploring several aspects of the crisis under your leadership, but today's panel is going to focus on how the Federal Government can use tax policy to address the financial problems facing the District.

As I am sure we will hear, these problems are due in good measure to the District's rapidly declining tax and, if I may say so, population base. The District is literally bleeding population, falling from 640,000 to 530,000 residents since 1980, and all indications are that trend not only will continue but will accelerate. In fact, the District has lost more than 10 percent of its population since the beginning of this decade.

The Census Bureau projects that the District will lose almost three times as many residents in the 1990's as it did in the 1980's. In that sense, people are speaking with their feet, and we have to give them a reason to stop moving those feet and stay right here in the District, because with the residents who leave the District goes their income and a significant portion of the District's tax revenues.

We have talked a lot over the years here in Congress about our responsibility to the District and the problems that it has, but all too often we have done much too little. As we begin this Congress, I think we have some reason for more hope. Perhaps one of the best indicators of that hope is the fact that when the President and the congressional leadership of both parties got together and looked for some areas on which they essentially had enough agreement to go forward together, one of the five areas they chose was the District of Columbia.

Mr. Chairman, Senator Mack and I, if I may say so, inspired by a particularly intellectually vibrant and, even at his advanced age, physically vibrant former Congressman from Buffalo. [Laughter.]

Mr. KEMP. Advanced? Advance age?

Senator LIEBERMAN. Right, will soon introduce again legislation that we proposed in the last Congress, which is companion legislation to that introduced by Delegate Norton, which we feel very confident will stem the tide of the District's revenue and population loss by giving people a reason to stay and giving businesses a reason to come and stay, and those are tax and fiscal reasons.

I am sure, Ms. Norton, who has already introduced the companion legislation, her legislation in the House will go into the details of that proposal. So in the interest of brevity, I am going to defer to her on that.

The main point here is there are a lot of different ways to go at helping the District. The President and the administration have introduced a package. This way, if I might borrow from Jack Kemp again, is the way of empowerment. This is not a bailout that we are talking about with tax relief. This is using the tax system to bring people in and stimulate and liberate the creative energy and intellectual and economic capacity of the District and its people and in doing so, we hope, set an example for cities all over America because this is, after all, America's capital city. It is in that sense America's city. We have not treated it well in the past. We have a chance here in this Congress to treat it much better and give its citizens the hope that they deserve.

Thank you, Mr. Chairman.

Senator BROWNBACK. Thank you, Senator Lieberman.

Senator Cleland.

OPENING STATEMENT OF SENATOR CLELAND

Senator CLELAND. Well, it is just wonderful to be with Eleanor Holmes Norton again. We worked together in the Carter administration, and we appreciate your interest and commitment to the District of Columbia, our Nation's capital. It is nice of you to come down, and we appreciate your creative approach to financing for the District.

My old friend, Jack Kemp, it is great to see you again. I feel compelled as a Falcons season-ticket holder to inform you they have a job opening down there for a quarterback.

Mr. KEMP. I will take it.

Senator CLELAND. And especially a quarterback who knows how to deal with third and long repeatedly. [Laughter.]

We are glad to see you, and we look forward to your testimony and comments.

Thank you, Mr. Chairman.

Senator BROWNBACK. Thank you, Senator Cleland.

Our first panel will be the D.C. Delegate, Eleanor Holmes Norton, and Jack Kemp. I do not know that either of them needs much of an introduction.

Ms. Norton, I believe we will go with you first as author of H.R. 549, the District of Columbia Economic Recovery Act. Your testimony is appreciated, and the floor is yours.

TESTIMONY OF HON. ELEANOR HOLMES NORTON,[1] U.S. DELEGATE TO CONGRESS FROM THE DISTRICT OF COLUMBIA

Ms. NORTON. Thank you very much, Mr. Chairman. If I may say so, Mr. Chairman, some of us already miss you. You were a member of the House for a brief, fleeting moment, and I must say that if the alacrity with which you got from the House to the Senate is any indication, I expect this bill to pass this year.

Senator BROWNBACK. We are going to try this month. We may have to slide to April.

Ms. NORTON. I very much appreciate your initiative, Mr. Chairman, in organizing today's hearing on the District of Columbia Economic Recovery Act, which I call the DCERA, as the first hearing of your chairmanship. I am grateful as well because this is also the first hearing on the bill in the Senate. The hearing comes at a propitious moment, considering, as Mr. Lieberman has just said, that the President and the House and Senate leadership have made the capital of the United States one of their five priorities for the 105th Congress.

It is a special pleasure to have the opportunity to testify here with my good friend, Jack Kemp, who is one of the most thoughtful urbanists in the country.

Mr. Chairman, there are three essentials for the recovery of the District. One is underway—the current efforts of the city and the financial authority to restructure and reform the finances and management of the D.C. Government. A second has been introduced by the President—a plan to take on congressionally accrued pension liability as well as some State functions that the District alone among U.S. cities has carried. The third is a tax reduction

[1] The prepared statement of Ms. Norton appears on page 35.

as an incentive to keep and attract taxpaying residents to the city, the subject of the hearing you have organize today.

With your permission, I would like to place the full details concerning the DCERA, including charts and other materials, in the record and simply to summarize its major features here.[1]

Senator BROWNBACK. It is so ordered.

Ms. NORTON. The DCERA has been deliberately designed with bipartisan features that offend neither party. The bill achieves the tax cut, first, by raising the traditional standard deduction and personal exemptions about two-and-a-half times their present value; second, by applying a 15 percent rate progressively up the income scale so that the smaller the income, the larger the cut; and, third, by maintaining the charitable and mortgage deductions to assure that the intent of the bill to encourage residents to remain or settle in the District is fully carried out. The DCERA also exempts capital gains on District investments by District residents and applies the 15 percent rate to investment income on investments in D.C. by D.C. residents.

I would like to direct the rest of my remarks to a few points that may be more difficult for people new to the idea of a tax cut for the District. A tax reduction for a particular city is unusual and counterintuitive for many. I propose a Federal tax cut for the District of Columbia because of the city's unique features. I propose a tax cut for this city because it is the capital of the United States, is experiencing lethal flight in the 1990's at a rate three times those who left in the 1980's, has no State to recycle money back as residents leave, and is barred by Congress from enacting a commuter tax, from extracting a commuter tax from suburbanites who hold the lion's share of the city's jobs while paying nothing for their use of the city services. A tax cut would also eliminate at least some of the disparity between the District and the four territories whose residents pay no Federal income taxes, but like the District, send a Delegate to Congress. The people I represent are third per capita in Federal income taxes and are the only Americans to whom the American Revolutionary slogan "no taxation without representation" still applies.

Because of the District's unique features, I do not pretend that the DCERA is directly applicable to other cities. I do argue that the great cities could directly benefit from allowing some of the ideas incorporated in my bill to go forward. Most large cities have lost population and have been spared the fate that has befallen the District largely because they lie within States that funnel money back from wealthier areas in the State. States and cities would be far better off if middle-income taxpayers remained to revitalize these cities rather than condemning them to becoming non-producing wards of their States. If the DCERA encourages people to remain in the District, some relief from State taxes, for example, might have a similar effect in the States.

At the same time, the DCERA is no substitute for the President's plan to pick up the cost of some State functions. My bill cannot succeed without the President's plan because even with a stabilized middle-income population, no city today could pay for State, county,

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[1] The information referred to appears on page 63.

and municipal functions such as Medicaid, which is bankrupting many States, or prisons, as the District uniquely does. On the other hand, the President's plan cannot succeed without my bill because his plan leaves the overwhelming cost of running the city still to local taxpayers.

Will the DCERA have the desired effect? I believe that it already has. A pick-up in home sales after a long period of decline was reported last week. I do not claim that a bill that has not been enacted is responsible, but I can tell you that real estate agents have been explicitly and aggressively using my bill to market homes. The bad news is that the article reported that most D.C. residents are renters and that actual flight has not significantly abated.

It is clear that in a city where people rent rather than buy houses and an economy in decline, many of these sales may well be to speculators rather than to homeowners who are indispensable to a full revitalization. In any case, there is significant evidence that the bill will allow taxpayer flight in the overwhelming support the DCERA enjoys in every neighborhood of the city and among every income group and race. The breadth and depth of the support of this bill is unusual, including strong support from every member of the City Council, who today represent the richest, the poorest, and the traditional middle-income wards, as well as the Board of Trade and the Metropolitan AFL–CIO Labor Council.

I did not plan it this way, but my point is made by the fact that among those who are in the audience at this hearing today are the members who respectively represent the poorest and the richest wards in the District: Councilmember Sandy Allen from Ward 8 and Councilmember Carol Schwartz from Ward 3.

The abundant anecdotal evidence that many residents are remaining to see if my bill will be enacted is some indication that the DCERA would keep taxpayers here and draw others as well as city services improve.

"But aren't city services, not taxes, the problem?" I am often asked. The answer, of course, is, "Of course." The DCERA, in the absence of a State safety net, uses the tax cut as an incentive for people to remain in a large city with troubled schools and other services. After all, the tax cut would not be necessary if there were already enough reason to remain in the city. The tax cut accomplishes what no amount of subsidy can. The tax cut goes to people, not to the D.C. Government. The tax cut encourages the middle-income taxpayers whose presence alone can revitalize schools and neighborhood institutions and whose tax dollars are indispensable to improving services and keeping them improved.

The many advantages that traditional middle-income taxpayers bring to a city, quite apart from revenue, is perhaps the strongest case for the bill. Cities performed the great American miracle for almost a hundred years of immigration of whites from Europe and migration of blacks from the South in the late 19th and early 20th century. The key to the success of the cities was that people who had some education and opportunities lived in the same place as poor people who had just come. Together they nourished neighborhoods and entire cities. They built the rest of America. The DCERA seeks to re-create this synergy, revitalizing the city not only with their tax dollars but with a multi-class presence that alone can revitalize a city.

This point is lost on those who see cities as places that need money and nothing else. They would send whatever the tax cut would cost directly to the city government. Not only is this politically and economically infeasible; it would not work. It is an insult to treat this city as if it were the functional equivalent of a welfare recipient. The goal must be to help the city help itself. The District still has a highly educated population, has retained its middle class longer than most cities, and has dozens of beautiful neighborhoods and a downtown in the midst of an exciting renaissance. It is also, everyone agrees, one of the Nation's most livable cities. The District maintains a high average income largely because of what remains of its middle class, now in full flight, and because of a committed upper and upper-middle class whose income, especially from Wall Street investments that have been unusually high, obscures the real picture of a rapidly developing huge hole in the middle that will kill the city.

The sheer difference in the cost of housing between the District and the region and the city's poor schools and high crime rate are depleting neighborhoods of their struggling working people and lower-income and middle-income black residents who have been the backbone of neighborhoods across the Anacostia.

However, the District does have a market that the tax cut pulls toward the city. Initially, they will not be people with school children. However, if we retain and attract middle-income singles and young married and retired people, we will have a tax base while we are rebuilding the city's schools and services. The present flight is undermining the work of the city and the Control Board to restructure finances and services because their work cannot bear fruit if the taxpayers who are necessary to support the city leave in the midst of the ongoing reform.

The DCERA is a targeted tax cut, even though all the taxpayers would receive it, because taxpayers in every income group are leaving the city. If the point is to leave the city with a diverse tax base, it would be senseless to leave out some and thereby encourage their continued flight. The tax cut has very progressive effects, but by allowing some reductions to all income groups, it acknowledges that the city as we have known it can survive only if it has rich, moderate, and especially middle-income residents.

The critical link between a middle-income, educated tax base and a job base is the reason I cannot support a capital gains cut without an individual tax reduction for District residents. The analysts confirm what District employers report: that with the loss of its middle-income, educated tax base, job stimulation alone only makes jobs for the suburbs. To assure that jobs will go to D.C. residents who pay for D.C. services, we must help turn around individual taxpayer flight. The capital gains and business relief is important at a time when the District's major employer, the Federal Government, is downsizing. By now, however, it is a truism that business follows an educated or skilled job pool, not tax breaks. I know this well from my experience serving on the boards of three Fortune 500 companies—two of them in your State, Mr. Lieberman—before coming to Congress. I welcome capital gains and investment relief, but only as an adjunct to the real problem—the death-dealing loss of taxpayers who pay most of the freight. It would be useless to the District to simply throw down any old tax cut, and especially one unrelated to the major problem. The problem is that no city, and certainly no stateless city, is viable without middle-income taxpayers. The remedy for this problem is a tax cut incentive designed to maintain and attract these indispensable taxpaying residents.

Mr. Chairman, urban policy has become an empty idea. For decades, the solution to urban problems has been framed almost entirely in government resource terms. There were and remain good and sufficient reasons for greater funding for cities, and there is no greater advocate of more resources for the cities than I am. But there are insufficient funds and little determination to help cities if the only solution we continue to come forward with depends solely on direct funding from Federal and State Government. It is simply not going to happen.

States are indeed funding the big cities the hard way by doling out just enough to keep them from sliding into insolvency and by allowing them to become enclaves of the poor. Cities supported themselves and a good portion of their States as well when they were where middle-income people chose to live. The middle-class tax base that built the cities can revive the cities. Cities today suffer from a poverty of ideas more than from the poverty of their residents. Surely the DCERA is a worthy experiment to see what it can demonstrate that is useful for the country. For the country's capital, the DCERA is more. Thus far, it is the only idea on the proverbial table that holds any promise for keeping taxpayers here and the capital itself alive.

Thank you, Mr. Chairman.

Senator BROWNBACK. Thank you, Ms. Norton. I very much appreciate that bold statement that you put forward. I could not agree more with your concept that the subsidization that we have put forward has just been enough and it is not going to be enough in the future. We have to look at some other way, and that is why I really appreciate your plan coming forward.

Our next presenter on this panel is an All-American, all-pro, and all-friend. I am not sure what all else I could put with that other than all-concerned about our urban areas and what takes place. He has been a strong, strong champion of urban renewal and has put forward aggressive plans on that, and he is a good friend as well.

Jack, we welcome you to the Subcommittee. You honor us by being here, and enlighten us, please.

TESTIMONY OF JACK KEMP,[1] CO-DIRECTOR, EMPOWER AMERICA

Mr. KEMP. Mr. Chairman, thank you, and I agree with Delegate Norton, it is an act of courage and farsightedness for you, a Senator from Kansas, the heartland of America, to put this at the front burner of your Subcommittee, and I applaud you. I am thrilled to be here with Eleanor. I consider her to be one of the most courageous legislators in the United States of America. She is the author

[1] The prepared statement of Mr. Kemp appears on page 39.

of the D.C. Financial Control Board. That took a lot of chutzpah, a lot of courage, and a lot of vision. And I thank my old friend, my rabbi, Senator Lieberman, and Senator Cleland for being here. Coming from Atlanta, he knows full well how important incentives are to economic development in the spirit of Andy Young, our dear friend.

The reason I start off that way, Mr. Chairman, this is bipartisan. This is not a Republican or Democrat. It probably drives some of my friends on the right crazy, drives some of our friends on the left even crazier. One of the problems in this is that on the left they are afraid that someone may get rich. On the right, they are worried that they may be perhaps helping to make a city work.

I believe home rule is essential. I think the only way to have home rule is to do what Delegate Norton has suggested: Do something dramatic. I was going to use the word "radical," but that makes a lot of people fearful. The word "radical" in Latin means the roots of an idea, and the roots of our civilization, as Delegate Norton pointed out, are our cities. That is not to be demeaning to rural America. It is simply to recognize that the cities are the center of our culture, our civilization, education, the arts, the sciences, and the economic entrepreneurship for which America has been well-known. This city is not working. It cannot work the way it was set up to work. It is not the people's fault, Mr. Chairman. We cannot blame the people. They are a resource, not a drain on resources. The city is fundamentally flawed. It was not out of malintentions of anyone. It just was set up incorrectly.

People argue very logically from their premise when it comes to the District of Columbia. The problem is they have the wrong premise. You have got to get back, as you are attempting to do, Mr. Chairman, to the premise, to the predicate, to the roots of our city, our Nation's capital, what should be, as you pointed out eloquently, Mr. Chairman, a city set on a hill.

Delegate Norton pointed out that there is a D.C. Financial Control Board. Another element, as the President has suggested, is to remove the burden on the city of having to finance a prison, Medicaid, the unfunded pension liability. They cannot do it from a city tax base. And then on top of that is the problem of the tax code. This is a heavily taxed city. It is not just a heavy tax on the entrepreneur. There is an even heavier tax on the poor. I would make a case that the highest tax in D.C. is on poor women who want to take a job or unemployed fathers and men who want to take their first job and get up on that rung of the ladder that we call the American dream. It is now in this information age a universal dream, writ large. It is happening all over the world.

Atypical of Kemp testimony, I am not going to be lengthy, and I would like to just start with my conclusion. How is that for a radical departure from——

Senator BROWNBACK. Sounds good.

Mr. KEMP. We must remember that the problems in this city are not unique. Philadelphia went through a financial control board. New York City did. They recovered. Mayor Rendell, Mayor Giuliani—one Democrat, one Republican—both doing a terrific job, not only on crime and education, but certainly their economies, while not flourishing, are doing much better and their tax base has expanded.

You can get more revenue and more resources for the government when the economy is expanding than when it is in a contraction. And this city is in a contraction. It is, as I think Senator Lieberman pointed out, bleeding. I would use the word "imploded." And in every problem are the seeds of a solution.

My wife and I visited China two summers ago, and I found out in China there is no word for "crisis." There are just two characters. One is for danger; the other is for opportunity. There is a danger if we do nothing and sit on the status quo, but there is a huge opportunity for the left, the right, the Republican, Democrat, conservative, liberal, the White House, the city, the City Council, the delegate and the Congress to come together and make a huge down payment on urban policy for America by making it work right here in the District of Columbia.

It would be a marriage of convenience. It would be both practical and idealistic. It has to be done to be utilitarian, but there is an ideal behind it, and that is, as—I almost called you a Senator. It is, as Eleanor pointed out, to find a way to reverse this frightening decline of the District of Columbia tax base, and that is through a carefully targeted, carefully and prudently constructed, radical alteration of the tax code for the District of Columbia.

My premise today is that this is a Federal city. This is not like New York. This is not like Philly. This is not like L.A. where I grew up. This is a Federal city. It has, as Eleanor pointed out, no State to pick up the Medicaid portion or the prison burden or the unfunded pension liability. So it desperately needs help, and that does not mean, as she pointed out, that spending alone is the solution. And cutting spending is not alone the solution, albeit the city needs to practice far better management practices, and on that basis, I am sure the D.C. Financial Control Board will have a lot to say. But there is the element that she pointed out in tax reform.

Now, I am an advocate of eliminating the capital gains tax in urban America in carefully drawn green-lined areas from South Central Los Angeles to East Harlem, to East St. Louis, those areas of Atlanta—or any area of the country. There ought not to be any capital gains tax on any man or woman that invests his or her capital, his or her savings into those areas to get capital into the hands of potential entrepreneurs.

Earl Graves of Black Enterprise magazine said the most serious problem in America for minority entrepreneurs is the lack of access to capital. If you cannot get access to capital, you cannot start a lemonade stand, much less a Midas Muffler franchise or a fast-food franchise or become that entrepreneur that men and women are doing all over the country.

Why isn't it happening in our inner cities and particularly why isn't it happening in the District of Columbia?

The tax on income—let me take both capital gains and income tax. The tax on capital gains is unbelievable. Any asset held longer than 4 years in this city is taxed over 70 percent through combined Federal, and local capital gains taxes. Now, let me take the income tax. At $49,000—now, that is not a lot of money, folks; $49,000 in 1997 purchasing power is the equivalent of probably somewhere between $7,000 and $8,000 circa 1972 when I came to the Congress, in 1971. But when you were in the $7,000 income bracket in D.C. in 1971, you probably paid 2 or maybe 3 percent of your income to the Federal Government. But at $50,000 or $49,000, which is a little bit above the median income family, perhaps—but nonetheless, not a lot—you are in a 28 percent marginal income tax bracket. The FICA tax, the payroll tax, is 15 percent. It is close to—an estimate now—over 60 percent. Over 60 percent!

By moving out of the city, your income goes up. And the one point that both Norton and Kemp make, albeit we have come at this perhaps from a different perspective—and that is the bond that has brought us together—is that people respond to rewards. And if the rewards are for unproductive human behavior, irrespective of climate, color, geography, or almost any other artificial distinction, people will respond to the unproductive human activity, i.e., behavior.

My friends who are conservative say, you know, we are going down the rathole because of people responding to those rewards. Doesn't it follow, then, that if you introduce incentives for proper economic and human behavior you can help reverse that trend? And it is true all over the world. Cities have changed their economic climate by changing incentives. That has been used several times. I do not need to—I told the story a little bit earlier. Max, you were not here, but I was telling Joe and Sam that Dublin, Ireland, was absolutely collapsing. The Docklands area, the major portion of Dublin, Ireland, was collapsing, and they decided to introduce radical tax reform into that area of Dublin. Today, there is a renaissance—I like that—a rebirth of Dublin, Ireland. Elat, Israel, on the Gulf of Aqaba, one of the most beautiful cities in the world, is made up of Arabs, Moslems, Christians, Jews, Russian immigrants, sabras from Israel, Saudis, and Egyptians. It has the lowest tax burden of any city in Israel, and it is as heterogeneous a society as you could possibly find, living in harmony with each other because everybody feels like they have a piece of the pie. The only way to create civility is to give people a stake in the system, and that, in my opinion, is what Eleanor Holmes Norton's bill would do.

The third point I want to make is the capital gains tax. Let me say it as emphatically as I can. It is not a tax on the rich. The rich are already rich. They are going to get rich almost in any single society. And if they cannot get rich in the United States, they will move to the Cayman Islands or Bermuda or Monte Carlo or tax shelters. And that is what happened to Sweden, the Swedish welfare State, and that is what happened in Europe. In fact, you cannot find a tennis player anymore in Europe living in his or her own country. They all live in Monaco.

How sad it is to think that people have to move out of the city in order to get a job or to protect their income or to save their family. And I believe that, with all due respect to Congresswoman Norton's idea of eliminating the capital gains tax for any man or woman that lives in the city, I would take it a step further and say if Henry Kravis or Teddy Forsman or any of your fat-cat friends, Senator Lieberman, want to put their capital at risk in the District of Columbia——

Senator BROWNBACK. I thought Democrats did not have fat-cat friends.

Mr. KEMP. We should say no tax on that investment of any man or any woman anywhere in the country that puts his or her capital and savings at risk. And by at risk, I do not mean at risk from crime per se, albeit that is a problem. I am talking about any small business is ipso facto a risk. And you have got to get capital flowing back into the city. And men and women who have access to capital can begin their version of that dream for which this Nation is well-known. So cutting the income tax rate, eliminating the capital gains tax, the exemption that Eleanor Holmes Norton has built into her—I am going to call it a progressive flat tax for lack of a better word. It makes it progressive because low-income people would not face a tax on their income up until they have achieved a few steps of the ladder in which they then can perform as well as anybody else. But giving people access to rungs of the ladder is essentially what this is all about. It will attract capital. It will stop the implosion. It will build a tax base, and I would not be Jack Kemp if I did not say that we will get more revenue at a lower rate.

Sorry for introducing that dynamic analysis, but I really think the Congress is stuck on this idea that if you lower the rate, there is prima facie evidence that you will lose revenue. Not in all cases. If you lower the rate on D.C., make this a great city again, our tax base will expand and we will get more revenue for men and women who are working than we will from people who have to depend upon the social safety net.

A postscript to all this. James Julius Wilson, University of Chicago professor, *New York Times* magazine article maybe 2 or 3 months ago, suggested the most serious problem in the United States of America—now, some people can argue with this, but this is one very distinguished academic suggesting that the most serious social problem in America is the lack of jobs, the lack of employment, the lack of opportunity in urban America. And we can begin to reverse that, in my opinion, by doing something to incentivize this great city again to encourage the formation—the recapitalization of this great city, and I heartily endorse this effort. I hope that does not hurt its chances, but I would say, Mr. Chairman, we have got to get moving. Every day we do not pass her bill, your bill—I understand you are going to be a cosponsor, Sam—it is getting worse.

Churchill said, "Success is never final, defeat is never fatal. It's courage that counts." And let me say this is a time for courage. This is a time for someone from Kansas to stand up on behalf of the District of Columbia and say to his residents, "When you come to the District of Columbia to visit the Nation's capital, as I know you do, you want to see prosperity, civility, jobs, a great city. Or do you want to allow as an American this marvelous capital city to continue to suffer the burden it has suffered over the past number of years?"

I would like to submit my testimony for the record.

Senator BROWNBACK. It will be put in, although it is tough to get in written words the passion that you feel, and I appreciate that very much.

Thank you both for testifying. We will take a round of questions.

If I could ask my fellow Subcommittee Members, we have several other witnesses, and so I do not know if we want to take a long time.

I would ask, Ms. Norton, if I could, in particular, if we did this tax bill, if we did your tax bill or Senator Lieberman's tax bill, which his would expand capital gains to non-D.C. residents, what would you envision the District of Columbia would look like as far as its revenue base in this city in 5 years? Have you projected that out or had others project out what that would actually do in the District of Columbia?

Ms. NORTON. It is an important and good question, Mr. Chairman. The difficulty with it is the innovative nature of the bill. Nothing remotely like it has occurred. For that reason, by the way, we have a provision in the bill that will require the Department of Treasury to monitor its effects very closely, and we say precisely what to monitor by income group so that we can see if this works, with what income groups, in what parts of the city, whether with business, whether with individuals.

But I have to say to you, Mr. Chairman, it is hard to find anybody who does not think that when a tax cut of this size—if a tax cut of this size would come forward, that you would not begin like a magnet to pull certain kinds of people into the city. We certainly do not believe that there would be initially an across-the-board effect.

My goal in the first couple of years is quite modest. Stop the hemorrhage. One of the reasons we have to pass the bill this year is that if we go much beyond this session of Congress, this is becoming a moot point. No city has ever recovered its tax base entirely, but I think you can keep a tax base from flowing out, and thereby encourage others to move in.

On capital gains and why I have restricted it to D.C. residents, it is in part because we do not know the effect on the surrounding the region. You get more people in the region—interestingly, they are less afraid about the residents because it is such a bad rap on the District. They figure people are not going to sell their half-million-dollar homes and come flying back to the District. They are not as sure about capital gains, and I am not sure about what effect it would have from other parts of the city either. Very frankly, I do not think it would drain business from the rest of the country to come into the District.

At the very least, it seems to me, if one started with capital gains and residents and we had no effect, we could then move to the next step. In no case would it make any sense to start and stop with capital gains, whether for residents alone or for the region, because the real problem in a city which has never had a large business base, anyway, because the Federal employer was the employer, the real problem has been that the people who have supported the city for 200 years—remember, it has had this kind of tax base all that time, and it has always been its own State. Those people are leaving, and nobody who looks closely at this city thinks that with a business base alone, for example, that you could support the city. So you got to have both of them, and if you had both of them, I think it is pretty hard to argue nothing would happen.

At the very least, given what is happening, I do not think we can afford to doubt that something would happen, because we literally are left without other ideas on the table.

Mr. KEMP. Could I add a postscript?

Senator BROWNBACK. Please.

Mr. KEMP. Just imagine if you left the national capital gains tax at 28 percent and unindexed and eliminated it in the city. You would have almost a shelter. I think that would be a mistake, personally. I want to help the city. I do not want to do it at the expense of creating a dodge or a Cayman Island type of area of the country. I think that would end up with speculation.

So I strongly support bringing down the tax rate across the board on capital gains and indexing, but eliminating it not only in the District of Columbia for the whole city—the whole city. The whole city should be green-lined for a message to the world that we want to attract the talent and the capital necessary to put this great city back up on a hill as an example to the rest of the world.

Ms. NORTON. Could I reinforce that point, Jack, for a moment about the whole city and the capital gains effect? My folks from Councilwoman Allen's Ward 8 have subway travel out there. They can get to mostly any place in this city. But the more traditional approach that has not worked in this city and has had limited effects in other cities of confining the tax break to the poorest area of the city does not work. And it does not work because, in fact, an employer is not going to go to a part of the city where the poorest people are, where there is the most crime, and where the job pool is least skilled. But the employer might well come to a city like this and—my folks from the poorest areas across the Anacostia and out in Northeast, they can get to the middle of town. Where they cannot get to is to parts of Virginia and Maryland where all the job growth is because the subways may go out there, then you have to catch something to go to East of the Hill. The subway line goes out there, but it does not get as far as where the jobs are. So we have got to bring jobs to the city without doing what Jack initially did. Jack was talking about dynamic. Jack, you know, initially focused—and in a real sense, it makes sense to focus in some cities on certain areas of the city. But it would make no sense in this city, if you want to keep middle-income people here, to do capital gains in poor areas. Thank you very much. We have poor people. We have to support them. We have to have middle-income people here to help support them.

Senator BROWNBACK. That is a good point.

Senator Lieberman.

Senator LIEBERMAN. Thank you, Mr. Chairman. Thanks to Delegate Norton, to Jack Kemp, my pastor, I want to say, by way of a home-and-away series here. [Laughter.]

How did you know that I have fat-cat friends, incidentally? Well, forget that. You can answer that off the record.

The two of you are——

Mr. KEMP. You are a Democrat, aren't you?

Senator LIEBERMAN. Yes. The two of you—this is going nowhere, Jack. [Laughter.]

The two of you are really a wonderful partnership on behalf of this. You bring all sorts of head and heart to this topic, and I just hope to God that we can get this or something very close to it moving.

In listening to you—and I am going to do this real briefly—it seems to me that we are seeing a couple of things. One, that the traditional urban policy, in some ways it goes back to the 1960's, not that it has been a failure, it has done some good things. But if it had totally worked, most of America's cities, including D.C., would not be in the condition they are in today. So it is time for something new.

Beginning, I think, in the late 1970's, Jack, you and Bob Garcia, I think partially inspired by Margaret Thatcher and the Governor of Puerto Rico, as I have heard you tell the story—actually, when I have heard you tell the story, you actually take it back to Moses, if I remember correctly. [Laughter.]

Mr. KEMP. Joseph.

Senator LIEBERMAN. To Joseph in Egypt, I am sorry. I like that one better. But you had this insight that, you know, part of what was happening in the cities is that businesses were leaving; they were taking the tax base and the job base with them, and we had to create an incentive for them to come back. And the best way to do it, because we believe in the reward system here in America, that incentives affect people, was lower the taxes on business, bring in investment, create some more growth. We finally had the beginning of an experiment that, when we adopted the enterprise zone empowerment community legislation in 1993, though it was not as broad as we had wanted when we had worked on it earlier, but it was a beginning. It is still in the infancy of its testing, but there are enough examples to show that what is logical works.

So we are trying in this legislation to apply that powerfully to the District, but Delegate Norton really has taken this one logical, very significant step forward, which is to say if we reach that intellectual conclusion, that programmatic conclusion about business and capital, then let's look at what is really ailing our cities, and you have described it very well. Most cities in America are becoming like a lot of other countries in the world that we used to deride because they had no middle class—the very rich, the very poor, and the instability that comes with that. And how do we get the middle class back? Lower the taxes. You know, lower their taxes and they will come, to paraphrase the "Field of Dreams," which we would like again to make the District into.

Now, the question—do you have an estimate on this bill, again, Ms. Norton, the cost of this bill?

Ms. NORTON. The cost of this bill is probably half a billion, $600 or $700 million. No very precise costing out has been done.

Senator LIEBERMAN. Annually. OK. Now, people will say to you, as they said to Connie Mack and me—I am delighted that the Chairman, Senator Brownback, apparently will cosponsor this bill with us. At least that is what Jack Kemp announced here today. I would be honored to have you as a cosponsor. But people have said to us, well, that is a lot of money.

Your answer, and let me ask it to you again because, at least as I have heard it before, is, well, if you can find a cheap—I have heard you say it. If you can find a less expensive way to bring middle-class people, black and white and any ethnicity and race characteristic, back to this city and America's cities, tell me.

Have you heard anything? Has anybody given you any better way to do that?

Ms. NORTON. I indicated that challenge, Senator Lieberman, because I truly am open to ideas that would do the same thing, and the silence has been deafening on that. You know, when people come back and tell me, for example, well, if I had that kind of money, I would give it directly to the city. Really? To the city government?

Senator LIEBERMAN. Yes.

Ms. NORTON. One of the reasons I think that I have support for this bill is because I give it to residents, who in turn rebuild their city, rather than to the city government which has no track record in recent years of rebuilding their city. And we could never pump enough money into a city emptying out of people to rebuild a city in any case.

It is interesting that the District kept its tax base for longer than most cities. This says something about the capital of the United States, the panache associated with that, and it says something about how livable the city is. So you have a kind of urban type—a kind of pool that would live here.

I am fourth-generation Washingtonian. I grew up in this city when they had segregated schools. I have to tell you that if my grandfather, who entered the D.C. Fire Department in 1902, or my father saw this city, they would be ashamed of it. This is not—the city of the past is my city. There is a city in the future that is my city. But the proud people I grew up with would not claim this as their city. Their city is a self-sufficient city. Their city is a city that in the midst of segregation was not a city that led them to believe that they were less equal.

Their city is a city where by sheer dint of getting some education and doing what you had to do, you overcame everything. To see this city, which had a large black and white middle-class population for so long implode on itself, the city of Howard University, the city where Dunbar High School, my high school, where even when it was segregated, people came from all the best schools in the United States to recruit kids to go to the best school, this is not my city. It can become my city again if you do one thing, and that is, give an incentive to people like my sister who moved her family to Montgomery County to live where they would rather live in the city of their birth.

Senator LIEBERMAN. Amen.

Mr. KEMP. Joe, could I——

Senator LIEBERMAN. Please.

Mr. KEMP. I do not live in the city. My wife and I have lived in Bethesda, Maryland, ever since we came to Congress in 1971. I think the people of northern Virginia and southern Maryland have a big stake in a renaissance or an economic recovery in the District of Columbia. This is not a zero-sum game. It will help the suburbs. It will help communities surrounding.

What would be better than to come to a Nation's capital thriving with that type of spirit that is caught in the voice of Eleanor Holmes Norton's history?

One other point has to be made. You mentioned the founding of this idea. Just real quickly, Luis Munoz Marin, the Governor of Puerto Rico, he was a socialist in academia, and when he became the governor, he said it was fun to sit around in academia and talk about redistributing a loaf of bread, i.e., as a socialist. But when he became the governor and he saw people starving, he quickly came to the solution that you can create more loaves of bread when you incentivize the economy to create bakeries.

What Eleanor Holmes Norton is doing, metaphorically speaking, is helping to create bakeries, and bakeries can only be done through private enterprise. This is a Federal city. I do not think there should be any tax, which shows how radical I am. A Federal city should not be taxed at the Federal level. Puerto Rico has no Federal tax. Our territories have no Federal tax. They should have their own tax system, and we should get off their backs. But we are not going to do that just yet, so as far as I am concerned, this is the best solution to a vexing problem.

One last statistic. The urban economy in America is close to $900 billion. It is bigger than the whole Canadian economy, writ large. There is a tremendous talent. Now, you either look at this problem as intractable, or you look at it, as you are doing, as an opportunity. And it is an opportunity to prove that entrepreneurial, democratic—small "d"—capitalism can work in urban America. If we do not do it now, we are going to lose the zeitgeist because that is the zeitgeist for the whole world. That is the spirit of the whole world.

Nelson Mandela announced last week he is going to privatize and incentivize his economy on behalf of the colored and black South Africans. To do what? To empower them. I am going to be embarrassed if they do it earlier in a post-apartheid regime than we can do it in the United States of America, the land of the free and the home of the brave.

Senator BROWNBACK. We may need to bring him here to testify.

Mr. KEMP. Yes, bring him.

Senator LIEBERMAN. Mr. Chairman, I want to pose a final question, and maybe a brief answer, which is this: We have this proposal, which is, admittedly, expensive, though I think worth every penny of it. We now have a proposal from the administration regarding pension costs, etc.

As we go forward in this Congress—and I think we are going to do something significant here—my guess is that the Congress will not be prepared to do both because of the total cost of both. And the question that I invite you to think about and that we are going to have to think about is: Do we pick pieces of each, or if we have to make a choice, what do we choose?

Ms. NORTON. You make a good point, and I have been trying to think through the notion of cost and paying for the bill. The President's bill is paid for. He has found, understanding that his bill would get no place if it did not have offsets—he uses the Federal payment because in the outyears D.C. gets more than the Federal payment, and apparently Frank Raines has gone through dozens of accounts to supplement the $700-some million the Federal payment represents.

Now, my bill had the speaker of the Republican leadership in the House and the Senate without being paid for, and I assumed that people were going to face that at some point. I do not think that one can pay for my bill by extracting some from the President's bill.

Senator LIEBERMAN. Your hope is that we have both. And I suppose the other way to go, the Republican leadership—I know this was being talked about last time, which was that it would be part of the—whatever the total sum allocated for tax cuts, that this would be part of that.

Mr. KEMP. Think of the cost of not doing anything. What is the cost of the bridge loans right now going to the District of Columbia from the Treasury Department? That is not included in the District payment. We are making bridge loans right now, as we did to Mexico in the 1980's, we are making bridge loans to D.C. through the Treasury Department. And the cost of not doing something, in my opinion, is enormous. What is the amount of money we spend subsidizing the conversion of corn into ethanol?

Senator BROWNBACK. Not enough. [Laughter.]

Mr. KEMP. What is the amount of money we subsidize businesses to do things?

Senator BROWNBACK. That was started by Moses, you know, corn into ethanol.

Mr. KEMP. I have gone from preaching to——

Senator BROWNBACK. Yes, meddling. I am going to give Max here a couple of minutes, and then we do need to get on to the next panel.

Senator CLELAND. Well, thank you, Mr. Chairman.

Let me just say that this sounds, Jack, a lot like some of the wonderful ideas, wonderful thinking that you have had before, merging the concept of empowering individuals with a tax cut. I thought it was fascinating in the conclusion of your statement that you talked about the entire District as a possible enterprise zone or a possible empowerment zone in which not just tax cuts were possible, but other forms of legislation. For instance, I am on the Small Business Committee, and one of the things we are looking at, Kit Bond has got some legislation to look at HUBs, historically underserved business areas, both urban and rural, and providing certain priorities and incentives in terms of Federal contracting.

In other words, do you see the District of Columbia as possibly a model enterprise zone or entrepreneurial zone or empowerment zone that the Federal Government, through tax deductions and other incentives, can make a model for the Nation and hopefully provide some solutions for urban America itself?

Mr. KEMP. Yes, I really do. And I applaud your comments. I do not know that we need to engage in—I am not for redistribution of income. I do not want to tax someone else in order to subsidize anyone of less financial magnitude. But I do believe that this would be a model for an urban policy for America.

Governor Engler of Michigan has eliminated all taxes in renaissance zones. Now, I am not suggesting you eliminate all taxes ad infinitum, but all over the world we know there are countries that do things entrepreneurially, politically speaking, to—the word keeps creeping into our conversation—incentivize people's behavior. And I think this city would be a perfect—I do not want to use "demonstration," but it would be a model, an example to the rest of the country. You could not do exactly the same thing, but I think this city is different and it requires urgent transfusion of political courage and political wisdom and incentive-oriented economics.

Senator CLELAND. Are we third and long with a tough call in the huddle?

Mr. KEMP. Metaphorically speaking, as an old quarterback, third and long is probably the most fun part of the game. [Laughter.]

Senator CLELAND. Bless your heart. That is the opportunity, see.

Mr. KEMP. Most people run drop plays. We throw long.

Senator CLELAND. Well, we thank you for your passion and thank you for your testimony and your thoughtfulness in terms of problems of urban America.

This is just one of the many that you have chosen to tackle and speak out on, and we appreciate that more than you know.

Ms. Norton, we appreciate your legislation, hopefully to codify a dramatic new departure here for our Federal city that I think is worthy of note and worthy of exploration. And we appreciate your testimony today.

Mr. Chairman, thank you very much.

Senator BROWNBACK. Thank you very much, Senator Cleland.

Thank you very much, Ms. Norton, and thank you very much, Mr. Kemp. We very much appreciate your testimony.

Senator BROWNBACK. The next panel will be Dan Mitchell of the Heritage Foundation, a tax expert with the Heritage Foundation and of some nationwide note, and William Niskanen, the Chairman of the Cato Institute. These are two tax experts to examine this proposal or others as potential options.

I would like to, as we are in transition, recognize—I believe we have another D.C. Councilmember, Hilda Mason, in the audience. Ms. Mason, would you care to stand? We very much appreciate your attendance here at our hearing as well today, and any submission of statements you would like to make, I would be happy to hear of that.

First we will call up Dan Mitchell. As I mentioned, he is a tax expert with the Heritage Foundation of some note. Gentlemen, we do have your written testimony. We appreciate that. I apologize for the length of time we took back and forth on the past panel, but we hope you will give us some insight as you dissect these proposals of how we get the city moving again, how you would go about it, what you think the best way is to do it. And if you would care to truncate your testimony and get right to the gravamen of what you are about, let us have it.

Mr. Mitchell, the floor is yours.

TESTIMONY OF DANIEL J. MITCHELL,[1] McKENNA SENIOR FELLOW IN POLITICAL ECONOMY, HERITAGE FOUNDATION

Mr. MITCHELL. Thank you very much, Mr. Chairman and Members of the Subcommittee. It is an honor to be here to discuss the proposed District of Columbia flat tax.

The question for Congress, of course, as you look at this proposal, is whether or not this is the key to rejuvenating the city's economy.

[1] The prepared statement of Mr. Mitchell appears on page 45.

And on some base level, there is no question that providing a tax preference to District residents will make the District a more attractive domicile, especially for taxpayers facing Federal tax rates of 28 percent or above.

But when analyzing this proposed District flat tax, one of the most important questions is to look at how a flat tax—the principles behind a flat tax, and the most important principle that a flat tax is equality. All taxpayers are treated the same under a flat tax irrespective of the source of their income, the use of their income, or the level of their income. And once policymakers decide that the law should apply equally to all people, there are certain features of a tax system which inevitably follow. These are:

One rate. By definition, you are not treating taxpayers equally if you impose more than one rate.

It is also a key feature of a flat tax that you treat all income equally. And in today's system, between capital gains taxes, corporate income taxes, personal income taxes, estate taxes, a single dollar of income can be subject to several layers of tax. This is a particularly shortsighted policy since every economic theory that I am aware of, including Marxism, recognizes that capital formation is the key to economic growth.

Finally, another feature of a flat tax which does not necessarily follow from equal application of the law is simplicity. All the flat tax proposals that people think of in Washington usually follow the model that was developed by Professors Hall and Rabushka out of the Hoover Institution, which is designed to maximize simplicity in the tax code.

While understanding these features of a flat tax, now let's apply them to the proposed single-rate Federal tax system for D.C. residents. First and foremost, the proposed legislation is not really a flat tax. The bill retains all of the provisions of the current tax code that impose multiple layers of taxation on savings and investment. Nor could it be really said that it will result in a simpler tax code. The result will probably be just the opposite.

Last but not least, the bill violates the core principle of a flat tax by creating a special tax preference based on geography.

Now, these observations, incidentally, are not offered as reasons to oppose the legislation. Indeed, many supporters of a pure flat tax, knowing that fundamental reform will not happen for the Nation as a whole until after the turn of the century, believe the D.C. flat tax will advance the issue by generating more evidence on the positive effects of lower tax rates. Indeed, I am sure I will be citing some of those things if Congress goes forward with this proposal. And also because the tax code already is riddled with discriminatory provisions, adding one more on the basis of geography probably does not really change the fundamental nature of the code.

In short, the D.C. flat tax is really more a question of politics and strategy than it is a question of sound tax policy.

Then, of course, as lawmakers look at whether to accept this legislation, they should be realistic about what the D.C. flat tax can and cannot accomplished. First of all, it will accomplish almost everything supporters say: employment, earnings, home values, business formation, local tax revenue. It is hard to imagine how those things could not go up under this proposed legislation. The amount of the increase is a matter of speculation, of course, and would probably depend on whether taxpayers felt the preference would stay in place for a long time. Also, of course, there would be a vigorous debate about whether or not the improvement in all these indices would simply represent a transfer of resources from Maryland and Virginia, or whether they would represent additional wealth creation, which is, of course, what everybody really hopes for.

What the D.C. flat tax will not accomplish, however, is that it will not solve problems associated with failing government schools and lack of public safety. Legislators leaning in favor of a D.C. flat tax may want to link their support to reforms such as comprehensive school choice that would allow parents to pick the school that would best address their children's educational needs. In addition, a special tax preference for the District could have a perverse effect if the economic expansion that followed was used as a reason to put off long overdue restructuring of the city's budget.

In conclusion, I applaud the Chairman for addressing this critical issue. Washington is our Nation's capital, and lawmakers should use their powers, granted by the Constitution, to make this city a better home for residents and a source of pride for all Americans.

Senator BROWNBACK. Thank you, Dan. I appreciate that.

Mr. Niskanen, Chairman of the Cato Institute, welcome to the Subcommittee. Thank you for being here and please give us your testimony.

TESTIMONY OF WILLIAM A. NISKANEN,[1] CHAIRMAN, CATO INSTITUTE

Mr. NISKANEN. Thank you, Mr. Chairman and Mr. Lieberman.

As a resident of the District of Columbia, I welcome your attention to the severe problems of the District Government. I conclude, however, that no potential change in Federal tax policy would significantly reduce these problems.

Let me first address the tax bill introduced by Delegate Norton. Although this proposal would reduce my personal Federal tax liability by over $5,000, I must nevertheless conclude that this is bad tax legislation. This bill, and much of the discussion about the fiscal problems of the District, I believe is based on two false perspectives:

One false perspective is that the District Government faces a special problem because "it has no State to recycle income from wealthier areas." In fact, personal income in the District per District resident is about 42 percent higher than the national average personal income, higher than in any State, and about one-third higher than in the adjacent States of Maryland and Virginia. The District has an unusually high fiscal capacity without any special Federal tax preferences and without taxing commuters who are residents of Maryland and Virginia.

The other false perspective is that higher District revenues are either necessary or sufficient to reduce the major problems of the District. In fact, the current District budget is now about $9,400 per resident. That is over twice the national average combined State and local expenditures per resident. It is higher than in any

[1] The prepared statement of Mr. Niskanen appears on page 49.

State. Moreover, the District budget does not include the substantial Federal expenditures for the Metro, the parks, the museums, the zoo, and about half of the police who operate in the District.

Despite this huge budget and despite a huge Federal expenditure independent of the District budget, the District has one of the Nation's worst school systems, among the highest crime and infant mortality rates, a deteriorating physical infrastructure of buildings and roads, a huge unfunded pension liability, and a continuing exodus of middle-class families. In the absence of a major change in the incentives and constraints faced by the District Government, more money would not significantly reduce any of these problems.

Now, let's address the specific effects of the Norton proposal, in each case based upon the data for 1993, the latest year for which such data are available.

On a static basis, the proposal would reduce Federal revenues by about $700 million. Based on 1993 data, the number is about $714 million. About 50 percent of the direct benefits would accrue to the 8.5 percent of District tax filers with adjusted gross incomes over $75,000. Delegate Norton has said that this is a progressive flat tax and that somehow the tax cuts decline with income. That is really rather misleading. The tax cuts as a proportion of income decline with income, but the absolute tax cuts go up very rapidly with income.

The benefits to the middle class with incomes from $30,000 to $75,000 would be in the range of $2,000 to $3,000 per tax unit, not enough to pay the tuition for one child at most private schools.

The primary indirect effect of the Norton proposal would be to induce more high-income individuals and families to reside in the District, most of whom are much less affected by the terrible quality of the public school system and most of whom would be spatially separated from most crime. This would increase the loss of Federal revenues relative to the static estimates and, of course, would increase District revenues. I doubt whether this proposal would increase the low District home ownership rate because the reduction in the marginal tax rate would reduce the value of the deduction for home mortgages.

It is less clear how this proposal would affect the middle-class families who are now leaving the District at a rapid rate. There is little reason to expect the quality of the public schools to increase or the crime rate to decline. The proposal would probably increase property values and property taxes in middle-class neighborhoods. This would probably deter some middle-class families from moving to the District, and it would encourage some of those who are now here to take their capital gains and move out.

On net, I expect this proposal would increase, not reduce, the polarization of the District population between the rich and the poor without any significant reduction of the District's major problems. Satisfactory schools and safe streets are the two essential conditions to maintain a middle-class community, and this proposal would not address either condition.

Some provisions of the Norton proposal, I suggest, would have much smaller effects than may be first apparent. For major businesses operating in the District, it is probably not possible to identify the interest, dividends, and capital gains specific to investments in the District. So the 15 percent rate on capital income would probably be limited to that for firms with no investments outside the District and the zero rate on capital gains only to the sale of such firms or privately owned real property in the District. This proposal, thus, would provide only a very weak incentive for major firms to invest in the District.

For several reasons, I suggest, the Norton proposal would also not produce an objective test of the effects of a general reduction in Federal tax rates. It would not be a useful model for what might help other cities or other parts of the country. Much of the effects of a lower flat tax on earnings by District residents would be cross-border effects that would be a wash with a national flat tax. On the other hand, the effects of a general reduction of the tax on capital income would be proportionately much larger than would be observed from the effects only on investments in the District. For those, including myself, who favor a general reform of the Federal tax system, the District would not provide a useful laboratory to test or to demonstrate these effects.

Where does that leave the case for changing Federal tax policy specific to income generated in the District? Back, I suggest, to where we started. Congress should not make any changes in the Federal tax code specific to the District. There is a good case for general tax reform, which I hope is revived soon. There are a number of important specific policy changes that would help the District. The Norton proposal does not address either of those issues. Both of those issues are important, but they are longer and more complex stories for another day.

Thank you for your attention.

Senator BROWNBACK. Thank you very much, Mr. Niskanen. I appreciate that.

Could I pose to each of you—there are a number of reasons that I am personally interested in this. Perhaps one of the most important is what, Mr. Niskanen, you discount as far as the ability of this to show us what a flat tax, a zero capital gains does nationwide. It is my theory that the American people are pragmatically conservative. They are conservative, but they want to make sure that this works.

Now, I am not suggesting that this is the experiment. I think this works. And to show that—now, you discount it. You say this is not a good model. Mr. Mitchell, you say that perhaps it can be used as a good model. Why do you think—or do you think there are other things we are going to have to tie into that to make it a legitimate look at this as a policy proposal?

Mr. MITCHELL. What I said was that I would be certain to use positive numbers that came out of this experiment, were it to happen. I do think opponents of tax reform would have a very reasonable point to say that maybe these are not really effects of lower tax rates, maybe these are just people moving from Maryland and Virginia. I would still base the bulk of my case on the evidence between flat tax States and non-flat tax States, which shows higher income, higher job growth if you have a flat tax. I would still base the bulk of my arguments on international evidence which shows that countries with low flat taxes grow faster and create more jobs than countries with so-called progressive systems. I would still base my case primarily on evidence from America's own Federal tax history. The decades in which we cut tax rates have inevitably created above-trend prosperity versus decades where we have increased tax rates we have had just the opposite.

But, nonetheless, if we do a D.C. flat tax, I will still use those numbers to advance the cause, even if the other side might have ways of trying to counter them.

Senator BROWNBACK. Mr. Niskanen, you think this would be not a useful product or way to go at it at all?

Mr. NISKANEN. Well, because so much of the effects would be cross-border effects. That would overstate the effects of reducing the tax rate on income. I think the particular problems of the capital gains proposal in the Norton proposal would actually understate the effects of reducing the capital gains rate.

But we have a continuing national experiment in this country that is a consequence of our Federal system, and I think that provides very much better evidence than any evidence that would accrue to the effects within the District.

Senator BROWNBACK. OK. Mr. Lieberman.

Senator LIEBERMAN. Very briefly, Mr. Chairman.

Mr. Niskanen, I think I understand your basic view, but do you have any different reaction based on the fact that the bill that Senator Mack and I introduced has the capital gains reduction or elimination for investments in the District from anywhere—in other words, from people who are living outside the District?

Mr. NISKANEN. I think that would have more effect on the District. It would also be a bigger loss of Federal revenues.

Senator LIEBERMAN. Right.

Mr. NISKANEN. It would have more effect on the District. You still have this awkward problem of identifying capital gains that are specific to a multi-state firm operating in the District.

Now, when that firm sells a specific piece of property, that is one thing. But there is no non-arbitrary way of attributing capital gains in a multi-state firm to the activities of that firm in the District. So it is an awkward—you still have that awkward administrative problem.

Senator LIEBERMAN. I think you have a helpful question there, which we really have to do some work on. Something has been done on that by the folks really outside the Congress who have helped Eleanor Holmes Norton and Connie Mack and I draft this legislation. But some work does have to be done to define the circumstances under which the capital gain would be enjoyed. In other words, you would not want to have a company that just has its headquarters and 20 employees in the District and is investing all over America to take capital gains as a result of that.

I have seen capital gains elimination, and I have seen some State proposals, to go back to your reference to the Federal system, where you only—and this is—you have a definitional problem here. You have to be able to write this and enforce this, but that the capital gain reduction or elimination is only enjoyed on jobs created within the enterprise zone, activities that are within the enterprise zone. That takes some accounting.

Let me just ask both of you, since you have been thoughtfully critical of the proposals made here, what you would do if you were

Congress, accepting that we have a goal here, which is to help the capital city. And I understand you said a lot of this goes, as we all agree, to the quality of the schools, fear of crime. But how do we do that in a way that is different from what we have been trying to do and has not quite succeeded yet?

Mr. NISKANEN. The one measure that would help the District as well as help other American cities more than any other measure would be genuinely broad school choice. That is the single most important condition that is affecting the location decisions of middle-class families.

I see no meaningful prospect of improving the quality of the D.C. public school system. I think it is like trying to reform a State enterprise without changing the market in which that State firm operates. And as long as the D.C. public school system has a monopoly on government-financed schools in the District, it will continue to have what I regard as a terrible performance.

It is the primary reason that middle-class families, mostly middle-class black families, are leaving the District. The $700 million that would be lost to the Federal treasury from the Norton proposal is more than the total school budget for the District of Columbia, which itself is now about 50 percent more per student than the national average. And so there is a huge amount of money there that could be used for a variety of purposes.

There are other policies that you should also address in subsequent hearings.

The only policy that would provide both separation of roles between municipal roles and State roles and, in addition, give District residents a full vote in Congress is retrocession to the State of Maryland. And that ought to be high on your priority list. The District then would become a county within the State of Maryland. The income tax and sales tax would be Maryland tax rates, not District tax rates, which are much higher in both cases. The District would be subject to the municipal and education codes of the State of Maryland. That requires a special deal between the Feds and the State.

The State would, for example, insist that the Federal Government pick up the cost of the unfunded pension liabilities, and quite properly so. The State would want to have a long-term commitment to a rule for determining the annual Federal subsidy to the District that is basically an in-lieu payment for the fact that the Federal Government is not subject to property taxes.

There are some other measures that I think would be helpful as well. A good bit of the government services that are now provided at the District level could be decentralized to wards or to neighborhoods. There are no economies of scale in the provision of municipal services with the sole exception of wastewater treatment. That is already maintained on a regional basis. And a good bit of devolution to wards and to neighborhoods would help provide a better mix of activities that are specific to the concerns of people in different wards.

One other measure ought to be considered. It would have to be worked out in conjunction with both Maryland and Virginia, and that is to have a peak-hour, peak-direction congestion fee for commuters to and from the District. The way to do that, I believe, is to give the governments of the originating county half the revenues of the totals. That would do a number of things. One is it would raise on the order of $250 million a year for the District; it would also raise on the order of $250 million for the suburban counties. It would significantly reduce congestion in the peak hours, and it would increase ridership on the Metro system.

Those are all interesting proposals. The District would also benefit by shifting the property tax burden from structures more on to land. There have been some dramatic experiments of this nature around the country in which assessment increases are specific to the value of the land, but not to the structures on the land, and that has been very helpful in reviving selected urban areas around the country.

So there are a lot of measures, many of which I have spelled out in some detail in our Cato report on the District. I encourage you to pay attention to that, and that it is important to hold a series of hearings on this matter because no one measure is going to solve all the problems. But I must conclude that the particular measure that was addressed today has almost nothing to do with the major problems of the District.

Senator LIEBERMAN. A forthright answer. Some interesting proposals, and I look forward to particularly hearing Mayor Barry's response to the idea of returning to Maryland. [Laughter.]

Senator BROWNBACK. Mr. Mitchell.

Mr. MITCHELL. As I indicated in my testimony, I am actually ambivalent about whether or not this legislation should be passed. But if it were linked to some of the ideas that Dr. Niskanen was talking about, specifically school choice, then I think it would have a hugely positive impact on the District, although most of the benefits would probably come from the school choice proposal. I have never done the calculations myself, but I have read figures indicating that the per pupil cost of sending a child to one of the D.C. Government schools is quite similar to the cost for the elites to send their kids to some of the more wealthy private schools in the area. To me that is just a moral outrage that you would want to trap children in schools that clearly are not working when you could voucherize the system and give them extraordinarily improved educational opportunities. I just cannot understand why someone would be against such a proposal.

Senator BROWNBACK. Good comments. Gentlemen, we are going to proceed to the next panel. Thank you very much for your thoughtful, direct comments. We will look forward to working with you as we put forward, as I noted at the outset of this hearing, a comprehensive plan working for the District of Columbia.

Thank you very much.

Mr. MITCHELL. Thank you.

Mr. NISKANEN. Thank you.

Senator BROWNBACK. The next panel will consist of the Mayor of the District of Columbia, Marion Barry, who shares something with my son. Yesterday was my son's ninth birthday. Mayor, I do not think you are 9, but I want to wish you a happy birthday, today, I understand, and you grace us by your presence. We appreciate very much your coming and attending.

We do have your testimony, so if you would like to truncate those comments and get right to the direct point of what you would like for us to know about, we would appreciate that. Thank you very much for coming here today. Mayor Barry.

TESTIMONY OF HON. MARION BARRY, JR.,[1] MAYOR, DISTRICT OF COLUMBIA

Mayor BARRY. Thank you very much, Mr. Chairman and Senator Lieberman. Let me express my deep appreciation for the opportunity to spend some time with you about the critical issue of Federal tax policy and the way it affects the District of Columbia.

Senator LIEBERMAN. Mayor, if you will excuse me, I want to just welcome you and offer my apology. I am about 10 or 15 minutes late to another meeting I was supposed to be at. I am going to stay a while to hear the beginning of your testimony, but please understand if I go. I will take the comments with me and read them.

Mayor BARRY. Thank you very much, Senator, and in reference to the questions about receding to Maryland, first of all, Maryland does not want to do it; we do not want to do it. So that would not even be a shotgun marriage. That would be nothing. If I would want anything, it may be to get Arlington County and Alexandria back into the District. That is where it was before it was ceded back to Virginia.

Chairman of the Subcommittee, the debate over appropriate Federal tax policy is not new. As far back as 1916, a Joint Select Committee of the Congress undertook to determine the proper role of the D.C. Government and the expenses of the U.S. Government. The history of this city has gone from elected officials to an appointed Governor, to an appointed lower house and elected other house, and then back to commissioners, now to elected form of government. So we have had this debate about the form of government for a long time.

We cannot ignore the fact, Mr. Chairman and Members of the Subcommittee, that the District is unique. It is our Nation's capital. There are only 60 square miles in this city. We cannot annex any other land, and we also must be mindful of the fact that over 57 percent of all the land in the District of Columbia is tax-exempt—57 percent—which means our tax base is very, very narrow.

You also must remember that, unlike other cities and counties and States that want to, we cannot tax income at its source; $19 billion of income earned in Washington, 70 percent of the total, goes outside of our city. If I lived in Camden, New Jersey, and worked in Philadelphia, Pennsylvania, I would pay a wage tax of about 4 percent to the city in Pennsylvania and would deduct that from my State taxes in New Jersey. If we were to apply the same formula of 4 percent, we would be talking about $720 million of income. I think it is unfair for people to work here, use our roads, our streets, our police protection, our fire, and not pay taxes to pay for them. In spite of real arguments, politically it is not going to happen because the Senators of Maryland and Virginia and the Congress people are going to protect that $720 million from being taken from their treasury. We cannot forget about that.

[1] The prepared statement of Mayor Barry appears on page 53.

We also cannot forget about the fact that there are almost 170 foreign governments located here that do not pay any property taxes or any other kind of taxes, again, using our roads and streets, etc. So the Federal payment traditionally has been the way of compensating for that lack of income from property, but not enough. It is $76 million. It should be double that amount if you looked at the market value.

Also, Mr. Chairman, we cannot ignore the fact that this city government has the responsibilities of a State government. Forty-six percent of our total budget goes to State functions. No other city in America operates a State prison with 7,000 felons. We are paying 50 percent of a Medicaid budget which is $400 million of our money. The Congress, at Home Rule left a $306 million unfunded pension liability from fire, police, teachers and judges pensions. When you add all that money up, you find that 46 percent of our money goes to State functions, which means that we are forced to have a higher tax rate in the District. And the personal income tax I think is about 9.6 percent. Our corporate tax is higher than the corporate tax in Maryland and Virginia. Therefore, it puts the District at an unfair disadvantage in terms of competition when one wants to move their company to the District.

If you look at the economies and economics of it, and the fact that we are landlocked, the property values in the District are higher in terms of commercial property. So when you add all that together, we are uniquely situated. And so there have been a number of discussions about how and what we ought to do. We would like to just briefly refer to one proposal called "The Orphaned Capital," by Carol O'Cleiraecain, who did an outstanding job of looking at the District, and she came to the conclusion with the basic premise that the District has the economy of a city and not of a State, therefore, the revenue system should reflect a typical city-State relationship.

The proposal meets many of the criteria for a revenue system. It will streamline the tax system, reduce the number of taxes, and lower tax burdens on both individuals and businesses.

In conjunction with the President's plan, I would like to suggest that we keep a portion of the Federal payment. This payment is not contingent on the State functions being transferred. It is contingent on a PILOT, payment in lieu of taxes, for Federal property in the District of Columbia. The number she suggested is $382 million, which is a fairly good number. We could round it off at $400 million if we wanted to. But we cannot trade State function transfers for the Federal payment. This is done all over America. In Boston, there is a voluntary PILOT from the universities and from other non-profit institutions. But it seems to me the Federal Government has the responsibility, since it owns 41 percent of the land, to continue that level of payment.

Let me also say that we strongly support the President's plan as a first step. The President recognizes that these are legitimate State functions.

Let me just say, Mr. Chairman, parenthetically, if we were able to tax income in Washington earned by non-D.C. residents, we would be less enthusiastic about transferring these State functions because we would then have the State income taxing authority to capture income and to pay for these State functions. But in the absence of that authority, we ought to have these burdensome State functions transferred in terms of our prison system, and our Medicaid is disproportionate to any other city or State in America. New York comes close, 25 percent, but most counties and most cities pay less than 10 percent of their own local budget toward the Medicaid. And we know Medicaid is growing by 10 or 15 percent a year nationally.

To give you an example, we started in 1973 with $17 million Medicaid payments, both Federal and local, and last year it was over $800 million. So you can see the tremendous burden that the taxpayers of the District are paying.

We know the story of the unfunded pension liability where firefighters, police officers, judges, and teachers had a Federal pay-as-you-go system until 1979, and then given to us. It has now grown to almost a $5 billion unfunded pension liability, so we support that Presidential proposed because it would save the District $306 million in 1998 alone if that were to take place.

Our court system—the President appoints District of Columbia judges. So we do not have anything to do with the judges, anyway. The U.S. attorney prosecutes all major crimes here, all misdemeanors, the only place in America where the U.S. attorney prosecutes local crimes. Therefore, for the U.S. Government to pay for the courts is an equitable situation.

Also, Mr. Chairman, hundreds of thousands of cars come into our city every day, many of whom bear Federal workers. Seventy percent of the Federal workforce, which is about 300,000 people, live outside of the city. And those cars coming into our 1,100 miles of streets cause an undue strain on our roads and streets, potholes popping up, even though we have done about 40,000. These cars add to it and the people who drive these cars and pollute our air do not pay one nickel in taxes to pay for the upkeep and care of those roads.

So you have all of these burdens here, and that is why we support the President's plan of $125 million for an infrastructure fund.

Also, Mr. Chairman, we also support our Metro, but the District Government is subsidizing Metro by $175 million, local money, whereas in Prince George's County and Montgomery County the State pays their subsidy. Again, we are not asking for that to be transferred to the Federal Government, but we want to point that out.

Now to Ms. Norton's plan. Mr. Chairman, if you look at equity and fairness, the D.C. residents should not be paying any taxes at all. We do not have a right to vote in the Senate or in the House of Representatives. In the early parts of this Republic, we all know the history of where the Founders of this Republic went to war against the British around a very simple notion of taxation without representation. I am not proposing we go to war against the Federal Government, but certainly we should not pay any taxes if we were to be logical about it. Puerto Rico and Guam do not pay any taxes. They are similar to us in terms of voting status. So the Norton proposal is a more practical, realistic way of dealing with it.

Let me say just from the very beginning, regardless of what the economists say and others say, all of us know that the Norton proposal in and of itself is not going to keep people in the District of Columbia. It is going to require what we are already doing, working as hard as we can to reduce crime on the streets of Washington, D.C., and we have had a 23 percent reduction in homicide in the last 4 months. Senator, even one homicide is too much for me, but at least it shows we are going in the right direction. Robberies are down. Stolen automobiles are down by 15 percent.

We are reforming our school system. I heard the gentleman who testified before about school choice and how this would be so revolutionary to solve our economic problem. It does not make a lot of sense because a significant number of middle-income people do not have kids. Look at the census data. They do not have any children in school. And if you look at who is leaving the city, it is primarily people in Wards 7 and 8, which is east of the Anacostia River, not Ward 3, not Ward 2, where a significant number of middle-income people live. And so the schools are important, no question about that. They need reforming, and we are working with General Becton to do so. But that is not—if you had school choice—and many of us have some reservations about that—that would not be—what you are trying to do is find a way to stabilize this economy.

We are paper-thin. Our economy is paper-thin. We have 630,000 jobs in the District of Columbia, and almost 300,000 of those are Federal jobs, which means we are basically a knowledge-based economy. We are a Federal Government economy. And when the Federal Government downsizes, as it has, it affects our economy tremendously. In the last 10 years, we lost over 40,000 Federal jobs in the District of Columbia, which means that our economy is largely dependent on this Federal Government. The second part of our economy is the service industry, over 100,000 people.

So in terms of Ms. Norton's proposal, I support it unequivocally. I would like to suggest, though—and there was some discussion about it from the dais—that we ought to look at ways to expand the capital gains provision of it. I know it is a difficult task to try to figure out how you are going to have a company with just an office here and investing, an individual who just has an apartment here investing in stock and bonds and other things outside of the District. But I think it would go a long ways to look at a way to try to give us a better broad net as it affects capital gains, because investment opportunities in the District are to some extent limited in terms of the kind of businesses that we have here and the kind of economy that we have. But we support Ms. Norton in her efforts. I would like to thank you and others for supporting that legislation as well.

Another thing about the Norton proposal is that we have to find a way, all of us, to get our Democratic—my Democratic friends, to support this proposal. My own view, Senator, if they do not support this, they have to come up with something equal to or better. Thus far, the President on down has not come up with an alternative to this proposal. And in the absence of an alternative, let's support this one and let's get it out of the Senate, let's get it out of the House of Representatives, and put it on the President's desk. It seems to me that he would have a hard time not signing it once it gets there.

So, in summary, we are desirous of stabilizing our economy. We are desirous of a fair and equitable way of looking at our tax situation. Let me also say that there are those who say, well, these are just all management problems; if the District were managed better, you would not have to worry about these State functions.

That is not true. You can look at the flawed structure here. You can have the best manager in the world—and we have our share of management problems like any other city, but we are making significant and steady progress. The best managers, if you took a Lee Iacocca, who was credited with bringing Chrysler back, could not bring this back with that kind of a structure we have here where this 46 percent of our budget goes to State functions, we cannot tax income at its source, and the other inequities where we have a higher tax burden in the District than most of our suburban jurisdictions, therefore putting us at an unfair advantage.

So I am urging you to support the President's plan with some additions to it in terms of keeping a portion of the Federal payment, to add the University of District of Columbia to his plan because it needs support as a State institution, and add later, maybe in 1999, the mental health system which costs us about $190 million. No other city operates a State mental health institution and that is what we are doing.

I thank you for having this hearing. I am optimistic that out of this and others will come a basic direction that will help us with our financial recovery and make Washington, with our help locally, the capital we want it to be where we will have safe streets and good schools and a good spirit.

Thank you.

Senator BROWNBACK. Thank you, Mayor. I appreciate you coming in. There are a couple of questions that I have.

You are supportive of Representative Norton's proposal, but you would expand the capital gains to non-D.C. residents.

Mayor BARRY. I think that would give us a broader base of opportunity, and also I think that if we were to use this as a model for other places in the country, you would probably want to do the same thing as opposed to just limit it to the jurisdiction where you had the absence of a capital gains tax.

Senator BROWNBACK. And we are talking in general about going to more of an incentive-based system to help here in the District of Columbia rather than a subsidy-based system.

Mayor BARRY. Right.

Senator BROWNBACK. Which Representative Norton was saying, we have been down the road of the subsidy-based system, it has been our urban policy for 20 or 30 years, and look what we have gotten to in many of our urban areas. Do you support her in that, that we need to get away from a subsidy-based system to an incentive-based system?

Mayor BARRY. Well, I think in the District, if you were to transfer these State functions, I would not call those subsidies. Absent that, we do have to get into an incentive-based system.

I have looked at empowerment zones and other zones around the country, and these tax credits and other devices really are not enough to attract major businesses to Anacostia, where I live, and other places like the Anacostias of the world.

Senator BROWNBACK. We have to get a broader set of incentives coming together, is that——

Mayor BARRY. Absolutely. You got to. If you look at the bottom line—you are a business person, and others know that. There is an economic bottom line you look at when you are trying to decide what you are going to do with your business. And if it is cheaper to operate it right across the line over in Roslyn or Crystal City, that is where you go. And to go to Anacostia requires a great deal more incentives to help you economically than what we got now on the table.

Senator BROWNBACK. That is what strikes me, and I am new to these issues. I am new in the Senate.

Mayor BARRY. I am learning about them, too.

Senator BROWNBACK. And I am looking forward to learning more, but it seems to me that you have to get a broad, comprehensive plan together for this to work, and that a part of it is the tax policy and incentives based on the financial system. Part of it is schools, and part of it is people feeling safe. Part of it is the streets.

Mayor BARRY. Right.

Senator BROWNBACK. It has got to all come together for it to work, and if you miss any one of these parts, you are not going to be near as successful or you may not be successful at all. Even if you have every great incentive in the world and people are not safe, they still probably are not going to come. That is why in my looking at this, I think you have to go to a broad-based, comprehensive set of incentive type of packages and proposals for us working together.

Mayor BARRY. I agree.

Senator BROWNBACK. And this is part of the opening steps.

Mayor BARRY. Mr. Chairman, let me say that we certainly—I agree with that, with the broad approach. We certainly would do more than our share, locally, that which is under our control, to create an environment that is safe, that is positive, to reform these schools. But the Federal Government has a responsibility to do the reform because you have the authority to do the tax reform and other kinds of incentives that will make it.

The other problem we face with it, Mr. Chairman, is that some people just do not like an urban environment. They would rather be in a much more sedate suburban environment.

Senator BROWNBACK. Of course, some of us like rural areas, too.

Mayor BARRY. Yes. But there a lot of people who love it, but we have to make it easier for them to stay here and to do business here.

Senator BROWNBACK. Well, not only that, this is the Federal city, which I think is an important thing that we miss a number of times.

Let me direct your attention to the President's proposals on it, if I could, because you were supportive of basically the Federal Government reassuming several of these functions that it had previously at one time, and then sent them back to the District, and then now coming back with those.

You have to do some talking to me and convincing me on some of those ideas, where we would take items from a troubled District of Columbia system maybe to a troubled Federal management system. I am not sure holistically as a Nation we get further that way. I could see perhaps where it does some relief for the District of Columbia, but does it long term solve the problem or not?

Mayor BARRY. Mr. Chairman, take each of those items. Take the pension system. What the President proposes is that the Federal Government take the assets, which are almost $4 billion, and the liabilities, which are about $4.5 billion—it is about $8 billion when you add it up, and you deduct what you already have, so you net about $4.5 to $5 billion. That is easy to administer. They propose a trustee system. The Federal Government operates pension systems—and some people say poorly, but you have the Civil Service Retirement System, you have Social Security, which is a type of pension system, operated by the Federal Government. Or you take the area of the courts. Prior to 1970, the Federal Government—all crimes were prosecuted, major crimes, in Federal court. And there were those who said the Federal court system may have some inequities in it, but it is a system that runs fairly well.

If you take the area of prisons, the Federal Bureau of Prisons has a fairly decent track record in managing America's prisons when you do the analysis and the studies. Now, the problem is not the Federal Bureau of Prisons. It is a problem, I think, of the criminal justice system which some people say has a lot of inequities. But at least they know how to manage.

I think in areas that they are assuming control and payment for, they are capable of managing. There are some areas that the Federal Government does not manage very well, and we would not propose that they take any of that. There is some question as to whether or not they could manage our mental health system immediately with them not having so much experience in it. But I am convinced that in the areas that the President has proposed to take over, the Federal Government can do a job equal to or better than what we could do.

Senator BROWNBACK. Well, I will look forward to talking with you further on that.

Mayor BARRY. We are supposed to go out and visit Lorton and some other places, so we can talk more about the Federal Government's ability to manage. Or take Medicaid. Medicaid is easy. It is just changing the formula from 50 percent to 30 percent for us. There are some States that have the Federal Government reimbursement as high as 80 percent. So that is just a matter of a formula change in the Medicaid allocations. I think Arkansas has about a 68 percent reimbursement, Mississippi 70-some percent. So that is not a difficult one to hopefully convince you that that can happen just with a formula changes. The others we can talk about whether or not they can do that or not.

In terms of the prisons, the Federal Government is proposing a transition period of 3 to 5 years where we would have a trustee that would begin to phase in that part of the operation to the Federal Bureau of Prisons. So to me that is a workable solution in terms of getting them ready for this major prison system that we have here called the Department of Corrections.

Senator BROWNBACK. Well, Mayor, thank you very much for coming here. We share the same objective for the District of Columbia to be a shining example, and I know you want to work and have worked tirelessly to do that. I thank the number of Councilmembers that have joined us as well here who have the same objective, and I have that same objective. We have a process to go through now as we work together to try to design a comprehensive, incentive-based system that we all believe in our hearts and in our souls will work to make Washington, D.C., a Nation's capital worthy of a great Nation. That is what my objective is.

This is the first of a number of hearings that we will hold on this. We will invite you and other Councilmembers back, and also to visit directly at other times on this as we move on forward.

Mayor BARRY. Mr. Chairman, let me recognize Ms. Hilda Mason and Carol Schwartz from the Council.

Senator BROWNBACK. Yes, I had recognized them once previously.

Mayor BARRY. Oh, OK. Thank you.

Senator BROWNBACK. But I am delighted to have them here as well.

Mayor BARRY. Also, Mr. Chairman, may I just make a point? I have been studying world capitals to see how their nations treat their capitals. And if you look at Paris, the French really sort of look at Paris as the grande dame of the Nation and put a lot of energy and effort, not just money but a lot of other efforts and resources into the capital. The same with London, and I was in Beijing, China, last November. Even in Communist China, Beijing is looked upon as the heart of the nation.

So it seems to me that at least we are beginning to get that feeling here in America, that Americans are beginning to see Washington as our capital and not somebody else's capital, and are beginning to recognize the opportunity and the challenge to assist us, not because of any gifts or not because of any paternalistic kind of thing, but because we deserve it as our Nation's capital.

Senator BROWNBACK. Thank you very much.

Thank you all for coming. The Subcommittee meeting is adjourned.

[Whereupon, at 11:38 a.m., the Subcommittee was adjourned.]

APPENDIX

ELEANOR HOLMES NORTON
DISTRICT OF COLUMBIA

COMMITTEE ON
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Congress of the United States
House of Representatives
Washington, D.C. 20515

COMMITTEE ON
GOVERNMENT REFORM AND
OVERSIGHT

SUBCOMMITTEE
RANKING MINORITY MEMBER,
DISTRICT OF COLUMBIA

STATEMENT OF CONGRESSWOMAN ELEANOR HOLMES NORTON
AT THE SENATE D.C. SUBCOMMITTEE HEARING ON
THE DISTRICT OF COLUMBIA ECONOMIC RECOVERY ACT (DCERA)

March 6, 1997

I very much appreciate your initiative, Mr. Chairman, in organizing today's hearing on the District of Columbia Economic Recovery Act (DCERA) as the first hearing of your chairmanship. I am grateful as well because this is also the first hearing on the bill in the Senate. The hearing comes at a propitious moment, considering that the President and the House and Senate leadership have made the capital of the United States one of their five priorities for the 105th Congress.

Mr. Chairman, there are three essentials for the recovery of the District. One is underway -- the current efforts of the city and the Financial Authority to restructure and reform the finances and management of the D.C. government. A second has been introduced by the President -- a plan to take on congressionally accrued pension liability as well as some state functions that the District alone among U.S. cities has carried. The third is a tax reduction as an incentive to keep and attract taxpaying residents to the city, the subject of the hearing you have organized today.

With your permission, I would like to place the full details concerning the DCERA, including charts and other materials, in the record and simply to summarize its major features here.

The DCERA has been deliberately designed with bipartisan features that offend neither party. The bill achieves the tax cut first, by raising the traditional standard deduction and personal exemptions about two and a half times their present value; second, by applying a 15% rate progressively up the income scale so that the smaller the income, the larger the cut; and third, by maintaining the charitable and mortgage deductions to assure that the intent of the bill to encourage residents to remain or settle in the District is fully carried out. The DCERA also exempts capital gains on District investments by District residents and applies the 15% rate to investment income on investments in D.C. by D.C. residents.

I would like to direct the rest of my remarks to a few points that may be more difficult for people new to the idea of a tax cut for the District. A tax reduction for a particular city is unusual and counterintuitive for many. I propose a federal tax cut for the District of Columbia because of the city's unique features. I propose a tax cut for this city because it is the capital of the United

815 15th Street N.W., Suite 100
Washington D.C. 20005-2201
(202) 783-5065
(202) 783-5211 (Fax)

1424 Longworth House Office Building
Washington, D.C. 20515-5101
(202) 225-8050
(202) 225-3002 (Fax)
(202) 225-7829 (TDD)

2041 Martin L. King Avenue, S.E.
Suite 300
Washington, D.C. 20020-5734
(202) 678-8900
(202) 678-8844 (Fax)

States, is experiencing lethal flight in the 90s at a rate three times those who left in the 80s, has no state to recycle money back as residents leave, and is barred by Congress from enacting a commuter tax from suburbanites who hold the lion's share of the city's jobs while paying nothing for their use of city services. A tax cut would also eliminate at least some of the disparity between the District and the four territories whose residents pay no federal income taxes, but like the District, send a delegate to Congress. The people I represent are third per capita in federal income taxes and are the only Americans to whom the American revolutionary slogan "no taxation without representation" still applies.

Because of the District's unique features, I do not pretend that the DCERA is directly applicable to other cities. I do argue that the great cities could directly benefit from allowing the ideas incorporated in my bill to go forward. Most large cities have lost population and have been spared the fate that has befallen the District largely because they lie within states that funnel money back from wealthier areas in the state. States and cities would be far better off if middle income taxpayers remained to revitalize these great cities rather than condemning them to becoming non-producing wards of their states. If the DCERA encourages people to remain in the District, some relief from state taxes might have a similar effect in the states.

At the same time, the DCERA is no substitute for the President's Plan to pick up the cost of some state functions. My bill cannot succeed without the President's plan because even with a stabilized middle income population, no city today could pay for state, county and municipal functions, such as Medicaid and prisons, as the District uniquely does. On the other hand, the President's Plan cannot succeed without my bill because his Plan leaves the overwhelming cost of running the city to local taxpayers.

Will the DCERA have the desired effect? I believe that it already has. A pick-up in home sales after a long period of decline was reported last week. I do not claim that a bill that has not been enacted is responsible, but I can tell you that real estate agents have been explicitly and aggressively using my bill to market homes. The bad news is that the article reported that most D.C. residents are renters and that actual flight has not significantly abated. It is clear that in a city where people rent rather than buy houses and an economy in decline, many of these sales may well be to speculators rather than to homeowners who are indispensable to a full revitalization. In any case, there is significant evidence that the bill will slow taxpayer flight in the overwhelming support the DCERA enjoys in every neighborhood of the city and among people of every income group and race. The breadth and depth of the support for the bill is unusual, including the strong support of every Member of the City Council who together represent the richest, the poorest, and the traditional middle income wards, as well as of the Board of Trade and the Metropolitan AFL-CIO Labor Council. The abundant anecdotal evidence that many residents are remaining to see if the bill will be enacted is some indication that the DCERA would keep taxpayers here and draw others as well as city services improve.

But aren't city services, not taxes the problem, I am often asked. The answer, of course, is "of course." The DCERA, in the absence of a state safety net, uses the tax cut as an incentive for people to remain in a large city with troubled schools and other services. After all, the tax cut would not be necessary if there were already enough reason to remain in the city. The tax cut accomplishes what no amount of subsidy can. The tax encourages the middle income taxpayers whose presence alone can revitalize schools and neighborhood institutions and whose tax dollars are indispensable to improving services.

The many advantages that traditional middle income taxpayers bring to a city, quite apart from revenue, is perhaps the strongest case for the bill. Cities performed the great American miracle for almost a hundred years of immigration of whites from Europe and migration of blacks from the South in the late 19th and early 20th century. The key to the success of the cities was that people who had some education and opportunities lived in the same place as poor people who had just come. Together they nourished neighborhoods and entire cities. The DCERA seeks to recreate this synergy, revitalizing the city not only with their tax dollars but with a multiclass presence that alone can revitalize a city.

This point is lost in those who see cities as places that need money and nothing else. They would send whatever the tax cut would cost directly to the city government. Not only is this politically and economically infeasible; it would not work. It is an insult to treat this city as if it were the functional equivalent of a welfare recipient. The goal must be to help the city help itself. The District still has a highly educated population, retained its middle class longer than most cities, has dozens of beautiful neighborhoods, has a downtown in the midst of an exciting renaissance, and is one of the nation's most livable cities. The District maintains a high average income largely because of what remains of its middle class. Now in full flight, and because of a committed upper and upper middle class whose income, especially Wall Street investments that have been unusually high, obscure the real picture of a rapidly developing huge hole in the middle. The sheer difference in the cost of housing between the District and the region and the city's poor schools and high crime rate are depleting neighborhoods of its struggling working people and its lower middle income and middle income black residents who have been the backbone of neighborhoods across the Anacostia.

However, the District does have a market that the tax cut pulls toward the city. Initially they will probably not be people with school children. However if we retain and attract middle income singles and young married and retired people, we will have a tax base while we are rebuilding the city's schools and other services. The present flight is undermining the work of the city and the Control Board to restructure finances and services because their work cannot bear fruit if the tax payers who are necessary to support the city leave in the midst of the ongoing reform.

The DCERA is a targeted tax cut, even though all of the taxpayers would receive it because taxpayers in every income group are leaving the District. If the point is to leave the city with a diverse tax base, it would be senseless to leave out some and thereby encourage their continued flight. The tax cut has very progressive effects, but by allowing some reductions to all income groups, it acknowledges that the city as we have known it can survive only if it has rich, moderate and especially middle income residents.

The critical link between a middle income, educated tax base and a job base is the reason I cannot support a capital gains cut without an individual tax reduction for District residents. The analysts confirm what District employers report: that with the loss of its middle income educated tax base, job stimulation alone only makes jobs for the suburbs. To assure that jobs will go to D.C. residents who pay for D.C. services, we must help turn around individual taxpayer flight. The capital gains and business relief is important at a time when the District's major employer, the federal government, is downsizing. By now, however, it is a truism that business follows an educated or skilled job pool, not tax breaks. I know this well from my experience serving on the boards of three Fortune 500 companies before coming to Congress. I welcome capital gains and investment relief but only as an adjunct to the real problem -- the death-dealing loss of taxpayers who pay most of the freight. It would be useless to the District to simply throw down a tax cut unrelated to the problem. The problem is that no city, and certainly no stateless city, is viable without middle income taxpayers. The remedy for this problem is a tax cut incentive designed to maintain and attract these indispensable taxpaying residents.

Mr. Chairman, urban policy has become an empty idea. For decades, the solution to urban problems has been framed almost entirely in resource terms. There were and remain good and sufficient reasons for greater funding for cities, but there are insufficient funds and little determination to help cities if the solution depends solely on direct funding from federal and state governments. States are indeed funding the big cities the hard way by doling out just enough to keep them from sliding into insolvency and allowing them to become enclaves of the poor. Cities supported themselves and a good portion of their states as well when there were where middle income people chose to live. The middle class base that built the cities can revive the cities. Cities today suffer from a poverty of ideas more than from the poverty of their residents. Surely, the DCERA is a worthy experiment to see what it can demonstrate that is useful for the country. For the country's capital, the DCERA is more. Thus far, it is the only idea on the proverbial table that holds any promise for keeping taxpayers here and the capital itself alive.

Recapitalizing The District Of Columbia
Statement Of
Jack Kemp
Before
U.S. Senate Committee On Governmental Affairs
Subcommittee On Oversight Of Government Management, Restructuring, And The District Of Columbia
March 6, 1997

Thank you, Mr. Chairman for inviting me to address the Subcommittee this morning on the subject of revitalizing our Nation's Capital City. As you know, this is a subject near and dear to my heart, and I want to commend you for holding these important hearings.

In particular, Mr. Chairman, let me say how much the people of the District of Columbia appreciate your leadership on this matter. You have always been a stalwart supporter of tax cuts for the District, and I look forward to working with you in the Senate now to help devise the most powerful package possible of economic incentives for the District.

I, for one, think my good friend Eleanor Holmes Norton, Delegate for the District of Columbia in the U.S. House of Representatives, has given us a pretty good start with her bill, the DC Economic Recovery Act (DCERA). I know you agree, Mr. Chairman, and I applaud your decision to sign on as an original cosponsor of the Senate companion to that bill when Senators Connie Mack and Joe Lieberman reintroduced it here in the Senate.

The Premise Of Reform

The premise of the Norton, Mack, Lieberman, Brownback. approach to revitalizing the District of Columbia is that the *only* way to make the District a viable city is to promote economic growth and opportunity for residents within the City; and that the *best* way to promote growth and opportunity is to reduce the tax burden in a way that not only gives working and middle class city residents a permanent tax cut but also gives them access to more capital and ownership of assets. That's why we propose that the federal government cut its personal income tax rate on D.C. residents to a flat 15 percent, with a generous standard deduction, and eliminate the capital gains tax altogether.

The last time I spoke to a congressional committee on this matter was July 31, 1996 before the House Committee on Government Reform and Oversight. At that time I was quite critical of the Clinton Administration for abandoning the District. In fact, the silence from 1600 Pennsylvania Ave. on the crisis in the District was so palpable that I likened it to telling the city to drop dead. Since that time, I am happy to say, that the Clinton Administration has put forward its own plan to deal with the District's problems. I acknowledge and commend that action.

Unfortunately, the Administration's plan is not well conceived. Apparently, it was put together inside the Old Executive Office Building without consultation with anyone in City Hall or on Capitol Hill, and it fails to grasp, and hence fails to address, the fundamental problems confronting the Nation's Capital, foremost among which is that it lacks a viable economy, its residents lack jobs and access to capital and credit.

THE DISTRICT'S DOWNWARD SPIRAL

Recent estimates show that the District has experienced a net loss of 75,000 jobs in the last five years. Moreover, Steven Fuller of George Mason University has shown in a study released last month that the District has been in an economic contraction for three years which is so severe that it is slowing growth in the suburbs. The same study shows that for every $1 in growth generated in the District, the Maryland and Virginia suburbs will experience $1.44 to $1.57 in growth—the first time this link has been firmly established.

The city's population has fallen to 554,000, with the middle class and business owners leading the exodus. Since 1970, Washington has lost 25 percent of its population and has already lost more people in the 1990s (52,900) that it did in the 1980s.

Not only have people fled the city, so have businesses. Taxes are a major reason why. A 1994 study conducted by the George Washington University Center for the Advancement of Small Business found that the number-one reason for businesses leaving Washington was taxes of all types controlled by the city.

Let me hasten to add that in the District's current state, it will not be sufficient to cut taxes—it's necessary but not sufficient. The city has been mismanaged for many years, and that must be corrected. Thanks to the support and encouragement of Eleanor Holmes Norton, Senate Majority Leader Lott, Speaker Gingrich, Congressman Tom Davis, and Bill Walsh, DC's Financial Control Board has finally begun to bring some sanity back to the management of the city. But fixing city government is not enough.

Crime surely drives residents out of the city. Current crime rates in Washington, DC are simply unacceptable, and juvenile crime is particularly disgraceful. In 1992, the most recent year for which FBI figures are available, children up to age 17 were arrested for violent crimes in the District at a rate of 1,487 per 100,000. That national figure was 483. If the crime situation in New York City can be reversed so dramatically, there is no earthly reason why it cannot be reversed just as dramatically here in the District of Columbia. It is simply a matter of will. I urge Mayor Barry to sit down with Mayor Guiliani and explore what was done successfully in New York that might be applicable in the District.

Mediocre city services and a deplorable public education system also combine to keep Washington, DC in a downward spiral. For all of its many flaws, one element of President Clinton's plan for the District does make sense. Privatization of some city services will mean more efficient delivery of services.

Where the schools are concerned, personally, I would like to see the District be the first city in the nation to implement a universal school choice program. Can you imagine the renaissance in the District's education system if every parent were given a voucher for each child equal to an amount even approaching the current per pupil expenditure in the District of $7,458?

Further, the President has suggested a rearrangement of governmental responsibilities between the city and the federal government. It may make sense for the federal government to assume some responsibilities in exchange for reducing or eliminating the annual $660 million federal payment. Just as there may be appropriate changes in the relationship between the federal government and the states, we should closely examine whether it makes sense to make some alterations in the relationship between the federal government and the city's government.

We should, however, reject the idea of a net increase in federal money into the District's government. Opening the federal spigot would only take momentum away from the progress that the Control Board has made in taming the city's bureaucracy. More federal money would be the wrong signal at the wrong time.

CUT THEIR TAXES AND THEY'LL COME BACK, BUILDING THEIR BUSINESSES BEHIND THEM

A necessary condition for pulling Washington, DC out of its tailspin is to rejuvenate its economy, and getting the tax system right is a necessary precondition to economic revitalization. The right kind of tax cuts will help reverse flight from the city and create a fertile environment for an urban renaissance in our nation's capital.

That is where the Norton, Mack, Lieberman; Brownback, Kemp tax plan comes into play—as a springboard to revitalization. Replace the current graduated federal income tax structure for District residents with a flat 15 percent rate. Personal exemptions would be raised so that single residents earning up to $15,000, single heads of households earning up to $25,000, and couples earning up to $30,000 would be removed from the federal tax rolls. District residents would have to pay no capital gains taxes on the sale of city investments. And, as an aside, Mr. Chairman, I would go further and eliminate the capital gains tax on any investment made inside of the District whether or not it was made by a District resident. First get the capital flowing into the city; the people will follow.

Clearly, flattening the tax rates represents the most dramatic aspect of the DCERA plan. It is a tax cut for the middle class. The current steeply graduated local income tax (with a top rate of 9.5 percent) on top of the highly graduated federal income tax (with rates reaching 39.6 percent), on top of the payroll tax (with combined rates above 15 percent) means that District residents face some of the most punishing marginal income tax rates in the country. A twoearner family with after tax income of only $50,000 confronts marginal tax rates on work of almost 65 percent. It's outrageous.

Is it any wonder that enterprising entrepreneurs and successful middle-class professionals are fleeing the city? That's why a permanent tax cut for the middle class is the keystone of any revitalization plan for the District. It is essential to bring back middle class residents to the District who will go to the PTA meetings and man the neighborhood watches and bring real neighborhoods back to the Nation's Capital. The pathos of disintegration in the District is illustrated by the lament of a realtor quoted recently in *The Washington Post:* "In the last eight years, I have sold to only 2 families with children . . . I used to know which schools are in which neighborhoods. I couldn't even tell you today, the issue comes up so seldom. It's not like Virginia where people want to know which schools are where."

The Norton, Mack, Lieberman, Brownback tax proposal for the District is exactly the kind of sizeable tax cut for city residents that can begin to make a difference. The average DC resident would see a 44.3 percent cut in their tax liability. Because of the large personal exemptions, lower income taxpayers would see an even larger percentage cut on average.

DCERA also eliminates the capital gains tax for city residents on investments made within the city, and I understand the Senate version will expand this provision to cover anyone who invests in the District. Bravo. Mr. Chairman, let me attempt to lay to rest once and for all the pernicious idea, held far too widely here on Capitol Hill, that eliminating the capital gains tax would be a huge windfall tax cut for the rich. Just the opposite is true. Repealing the capital gains tax would help the most those at the very bottom of the economic pyramid.

Rich people who own business and financial assets have a world of choice about where they invest and under what circumstances they realize their capital gains. For every tenth of a percent that government reduces the expected after-tax rate of return to capital by levying a capital gains tax, an entire universe of potential investment opportunities simply dry up and blow away. In the absence of a capital gains tax, there are many relatively low-return, risky ventures that still can entice investors to put their capital at risk—but just barely. Add a capital gains tax, and suddenly these enterprises aren't worth it to investors. Capital dries up.

The higher the tax on capital gains—as the economists say, the bigger the "tax wedge"—the more ventures become economically unviable. And, they begin drying up from the bottom first. Low-return, high-risk ventures evaporate, leaving those on the bottom rungs of the economy in the lurch while the affluent with capital to invest find a safer haven in government bonds. It is precisely the marginal high-risk, low-return enterprises—those very ventures that poor people in inner cities can realistically aspire to undertaking—that the capital gains tax knocks off the board.

Please understand, the only way for someone to realize a capital gain is to put after-tax, ordinary income at risk. Money first must be earned by the sweat of one's brow and taxes paid on it before it becomes available to be put at risk in search of a capital gain. If you raise the tax on capital gains, potential investors will simply look for less risky, lower-taxed alternatives in which to put their money. They won't put their money into a local Jiffy Lube or Midas Muffler franchise-small business. They will put it into tax-free municipal bonds. Or, they will borrow against their assets, pay accounts and borrowing fees, invest the proceeds in a higher-return venture and write off the interest against their income tax. Who is hurt the most? The rich guy who is inconvenienced and gets less or the potential entrepreneur who get nothing because he cannot get the capital to start his own small business?

Four out of five dollars put at risk in this economy generate capital losses, not capital gains. The higher the tax we levy on the reward for putting capital at risk—i.e., the higher the capital gains tax—the lower the after-tax rate of return investors can expect, and the less capital they will put at risk. Moreover, since capital evaporates first from the bottom of the economic pyramid, high capital gains taxes mean less capital will be available to the capital-starved inner cities like the District of Columbia.

Let me give you a perfect example of the kinds of unintended consequences I am talking about. I happen to know for a fact that Midas Muffler, which does business as a franchise company, has a very difficult time finding black franchisees in inner cities. Why? Don't people in inner cities need mufflers for their cars too? Of course they do. The explanation is simple: there is a lack of capital available to inner-city entrepreneurs to pay the franchise fee and purchase the required equipment to open a muffler shop. It has nothing to do with race. The problem isn't that potential franchisees are being denied capital because of their race. It is quite simply that doing business in America's inner cities is a very expensive and risky proposition under any circumstances. When government adds to the costs of doing business by imposing costly regulations and exorbitant taxes, the after-tax rate of return potential investors can expect to receive from a muffler shop in an inner city is just not large enough to entice them to put their capital at risk.

This problem is particularly acute in Washington, DC. Within the confines of the District, with a population of about a half-million residents, there are exactly two Midas Muffler shops. Contrast this to Memphis, TN, also a city of roughly a half-million residents, where there are 8 Midas Muffler shops. Now, this anecdote is not a scientifically rigorous test by any stretch of the imagination. But it is suggestive, and it illustrates that when politicians aim capital gains taxes at the rich man's wallet, they invariably miss their target and hit the poor man right in the heart.

CONCLUSION

The budget and management problems faced by Washington, DC are not unique. Washington is not the first city to require outside assistance to help resolve a complicated fiscal dilemma. Don't forget Philadelphia, New York and Cleveland. The DC Economic Renewal Act is not the final answer to the District's problems but it is a beginning. Some of the left will oppose the plan—afraid that someone, somewhere, somehow might get rich. A few on the right also may object—reluctant to give Mayor Barry a chance to succeed.

Marriages of convenience are not expected to be joyous. But in this crisis, there is an unexpected moment of opportunity for both Mayor Barry and the Congress. For Mayor Barry, it is a chance to retain control over the affairs of his city and preserve home rule. For the Republican Congress, it is an opportunity to demonstrate the power of our ideas. We have an opportunity to transform the federal city from the most visible example of everything that's wrong with urban America into the shining symbol of renewal for the nation.

Thank you, Mr. Chairman.

The Heritage Foundation

The Heritage Foundation 214 Massachusetts Avenue, N.E. Washington, D.C. 20002-4999 (202) 546-4400

Congressional Testimony

Daniel J. Mitchell
McKenna Senior Fellow in Political Economy
The Heritage Foundation

Mr. Chairman and members of the Committee, it is an honor to be here today to discuss the important issue of how best to rejuvenate the economy of our nation's capital. Specifically, the Committee is examining whether a single rate tax regime should be part of the District's economic recovery plan.

The proposal introduced by DC Delegate Eleanor Holmes Norton, popularly known as the DC flat tax, would create a separate federal tax system for taxpayers residing in the district for at least 183 days in any given year. Supporters hope that the imposition of a low tax rate of 15 percent on DC-source income will boost productive economic activity. This low tax rate, combined with a generous personal allowance -- $15,000 for individuals and $30,000 for a married couple – unquestionably will make the District a more attractive domicile, especially for taxpayers facing federal tax rates of 28 percent or above.

The question for Congress, of course, is whether to grant this special tax status. Lawmakers would be well served, as they contemplate this issue, to review the key principles of the flat tax. Such an exercise highlights both the promises and pitfalls of creating a special tax preference for District residents.

When analyzing the flat tax, the most important principle is equality. All taxpayers are treated the same under a flat tax -- irrespective of the source of their income, the use of their income, or the level of their income. Once policy makers decide that the law should apply equally to all, there are certain features of the tax system which inevitably follow. They are:

One rate – In the public's eye, the defining feature of the flat tax is the replacement of today's discriminatory five-rate structure with a single low rate of less than 20 percent. This single rate is important not only because it treats all taxpayers equally, but also because a single, low rate will minimize the tax burden on productive economic behavior.

Tax only once – Fair treatment of all taxpayers also requires that income be taxed only one time. Under the current code, because of capital gains taxes, corporate income taxes, personal income taxes, and estate taxes, a single dollar of income can be subject to several layers of tax. This policy clearly discrimihates against income that is saved and invested rather than consumed. This is a particularly short-sighted approach since all economic theories – even Marxism – recognize that capital formation is the key to economic growth and higher wages.

Simplicity – A tax system based on equal application of the law does not necessarily have to be simple, but flat tax proposals based on the model developed by Robert Hall and Alvin Rabushka of the Hoover Institution make every possible effort to reduce the tax system's intrusiveness and compliance costs. A flat tax, for instance, dramatically simplifies the tax code by taxing interest and dividend income at the source (i.e., apply the one layer of tax at the corporate or financial institution level rather than expecting the IRS to track and monitor disbursements to millions of shareholders or depositors).

These important features can now be used to properly assess the proposed single-rate federal tax system for DC residents. First and foremost, the proposed legislation is not a flat tax. The bill retains all of the provisions of the current tax code that impose multiple layers of taxation on savings and investment. Nor could it be said that the legislation will result in a simpler tax code. The result will probably be just the opposite. Last but not least, the bill violates the core principle of a flat tax by creating a special tax preference based on geography. Equality under the law presumably would not be realized if residents on one side of a river (or, for that matter, on one side of a street) had special access to a favorable tax regime.

These observations, incidentally, are not offered as reasons to oppose the legislation. Indeed, many supporters of a pure flat tax, knowing that fundamental reform will not happen until after the turn of the century, believe a DC flat tax will advance the issue by generating more evidence on the positive effect of lower tax rates. Moreover, because the tax code already is riddled with discriminatory provisions, it would be stretching credibility to assert that adding one more on the basis of geography would really make much of a difference.

In short, the DC flat tax is really more a question of politics and strategy than it is a question of sound tax policy. Finally, as lawmakers decide whether to accept or reject the legislation, they should be realistic on what the DC flat tax can – and cannot – accomplish.

What a DC flat tax will accomplish:

Almost everything supporters say is true. The DC flat tax will increase employment, earnings, home values, business formation, and local tax revenue. How much of an increase is a matter of speculation, and would probably depend on how long taxpayers felt the tax preference would be in place. One prediction that can safely be made, however, is that public policy experts will vigorously differ on the degree to which the District's improved economy represents additional wealth creation or simply a shift of resources from Maryland and Virginia.

What a DC flat tax will not accomplish:

While a tax preference will boost the District's economy, tax policy alone will not solve problems associated with failing government schools and lack of public safety. Legislators leaning in favor of the DC flat tax may want to link their support to reforms such as a comprehensive school choice plan that would allow parents to pick the school – public or private, religious or secular – that best addressed their children's educational needs. In addition, a special tax preference for the District could have a perverse effect if the economic expansion that follows is used as a reason to put off long-overdue restructuring of a bloated city budget.

In conclusion, I applaud the Chairman for addressing this critical issue. Washington is our nation's capital, and lawmakers should use their powers, granted by the Constitution, to make the city a better home for residents and a source of pride for all Americans.

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Federal Tax Policy for the District of Columbia

Testimony

by

William A. Niskanen
Chairman
The Cato Institute

Mr. Chairman and members of the subcommittee: As a resident of the District of Columbia, I welcome your attention to the severe problems of the District government. I conclude, however, that no potential change in federal tax policy would significantly reduce these problems.

Let me first address the tax bill introduced by District Delegate Eleanor Holmes Norton. Although this proposal would reduce my federal tax liability by over $5,000, I must conclude that this bill would be bad tax legislation. This bill, and much of the discussion about the fiscal problems of the District, is based on two false perspectives:

- One perspective is that the District government faces a special problem because it has "... no state to recycle income from wealthier areas." In fact, personal income per District resident is about 42 percent higher than the national average and is higher than in any state. The District has an unusually high fiscal capacity without any special federal tax preferences and without taxing commuters who are residents of Maryland and Virginia.
- The other false perspective is that higher District revenues are either necessary or sufficient to reduce the major problems of the District. In fact, the current District budget is now about $9,400 per resident--about twice the national average state and local spending per resident and higher than in any

state. Moreover, the District budget does not include the substantial federal expenditures for the Metro, the parks, museums, the zoo, and about half of the police. Despite this huge budget, the District has one of the nation's worst school systems, among the highest crime and infant mortality rates, a deteriorating physical infrastructure, a huge unfunded pension liability, and a continuing exodus of middle class families. In the absence of a major change in the incentives and constraints faced by the District government, more money would not significantly reduce any of these problems.

Now, let's address the specific effects of the Norton proposal, in each case based on the data for 1993 (the latest year for which such data are available). On a static basis, the proposal would reduce federal revenues by nearly $700 million. About 50 percent of the direct benefits would accrue to the 8.5 percent of District tax filers with adjusted gross incomes over $75,000. The benefits to the middle class with incomes from $30,000 to $75,000 would be $2,000 to $3,000 per family, not enough to pay the tuition for one child at most private schools.

The primary indirect effect of the Norton proposal would be to induce more high-income individuals and families to reside in the District, most of whom are less affected by the quality of the public school system and would be spatially separated from most crime. This would increase the loss of federal revenues and increase District tax revenues. I doubt whether this proposal would increase the low District home ownership rate; the reduction in the marginal tax rate would reduce the value of the deduction for home mortgages.

It is less clear how this proposal would affect the middle class families who are now leaving the District at a rapid rate. There is little reason to expect the quality of the public schools to increase or the crime rate to decline. The proposal would probably increase property values and property taxes in middle class neighborhoods; this would probably deter some middle class families from moving to the District and to encourage some of those now here to take their capital gains and move out. On net, I expect this proposal would increase the polarization of the District population between the rich and the poor without any significant reduction of the major problems. Satisfactory schools and safe streets are the two essential conditions to maintain a middle class community, and this proposal would not address either condition.

Some provisions of the Norton proposal, I suggest, would have much smaller effects than may be first apparent. For major businesses operating in the District, it is probably not possible to identify the interest, dividends, and capital gains specific to investments in the District. So the 15 percent rate on capital income would probably be limited to that from firms with no investments outside the District and the zero rate on capital gains only to the sale of such firms or privately owned real property in the District. This proposal, thus, would provide no specific incentive for major firms to invest in the District.

For several reasons, I suggest, the Norton proposal would also not produce an objective test of the effects of a general reduction in federal tax rates. Much of the effects of a lower flat tax on earnings by District residents would be cross-border effects that would be a wash with a national flat tax. On the other hand, the effects of a general reduction of the tax on capital income would be proportionately larger than would be the effects only on investments in the District. For those, including myself, who favor a general reform of the federal tax system, the District would not be a useful laboratory to test or demonstrate these effects.

Where does that leave the case for changing federal tax policy specific to income generated in the District? Back where we started. Congress should not make any changes in the federal tax code specific to the District. There is a good case for a general tax reform. There are specific policy changes that would help the District. But those are longer and more complex stories for another day.

Thank you for your attention.

MAYOR MARION BARRY, JR.
SENATE SUBCOMMITTEE ON OVERSIGHT OF GOVERNMENT MANAGEMENT, RESTRUCTURING, AND DISTRICT OF COLUMBIA

REMARKS FOR USE IN TESTIFYING ON MARCH 6, 1997

Chairman Brownback, members of the subcommittee, I appreciate very much the opportunity to talk with you about the critical issue of federal tax policy and the way it effects the District of Columbia. You have assembled a distinguished group of witnesses and I know their contributions will add to the evolving support for the District and the realization that tax policy is a mandatory part of whatever approach is taken toward the District's problems.

The debate over appropriate "Federal Tax Policy for the District" is not new. In 1916, for example, the Joint Select Committee of the Congress undertook to determine the proper proportion of the expenses of the District to be borne by the United States Government. We are now seeking a 21st century consensus on the same topic. Unless the consensus is reached soon, and in a way that stabilizes the revenue base, the District will continue to experience greater government financial instability. It will not allow us to provide services to a hundreds of thousands of people who commute into the District everyday to work, or visit the Nation's Capitol.

Because it provides services to ½ million D.C. residents as well as millions of people, workers and visitors who come into the city daily and utilize District services such as police, fire, ambulances, roads, and all manner of infrastructure, support and services, the wear and tear on our city as a result of this traffic exacts an enormous toll.

The District of Columbia has a land area of 60 square miles and a water area of 9 square miles. Public rights-of-way account for 13.4 square miles of the District acreage, or more than 22 percent of the land area. When these public rights-of-way are excluded, the land area is 29,968 acres, more than 56.7 percent of which is classified as tax-exempt, including 41 percent owned by the federal government and 5.4 percent owned by the District government. 8,500 acres of the federal government acreage, or 28.4 percent of the District of Columbia's land is park area. Much of the remaining 12.6 percent of federal land is used for office buildings and museums. The other tax exempt categories include religious, educational and charitable organizations, cemeteries, hospitals, and foreign government property. The assessed value of federal real property was $20.8 billion and the assessed value of other tax exempt property is $8.0 billion. The total assessed value of all land and improvements was $80.9 billion. This, Mr. Chairman, is an indication of the unique nature of the District as its relates to our need for federal tax relief.

Several proposed remedies to this crisis have recently come forward:

* THE PRESIDENT'S NATIONAL CAPITOL REVITALIZATION AND SELF-GOVERNMENT IMPROVEMENT PLAN

* DR. CAROL O'CLEIRAECAIN'S STUDY OF 'THE ORPHANED CAPITAL,' AND

* CONGRESSWOMAN NORTON'S FEDERAL INCOME TAX RECOMMENDATIONS.

In addition, the Council of the District of Columbia and I have established a Tax Revision Commission to recommend changes to the revenue structure. Everyone agrees that the financial structure of the District of Columbia is inherently flawed. Everyone should agree that the District is a special city -- the capital of the United States and, in many ways the capital of the world. Yet, as Dr. O'CLEIRAECAIN argues, the District's long-term fiscal problems stem from it being the nation's capital.

* Congress ultimately determines the District's budget and its taxes.

* Congress has defined the District's physical presence, set it boundaries and stipulated its appearance including the height of its buildings.

* And Congress has determined that the residents of the District will not have a voting voice in either house of Congress.

As long as the District of Columbia is subsidizing the Maryland and Virginia suburbs because of our inability to tax income at its source, we cannot realistically expect to solve our financial problems. Until this structure is fixed, it is premature to discuss the management structure of the District Government.

With my full concurrence, the Tax Revision Commission has adopted several goals for a revised tax system, including the following:

1. The revenue system must be stable and predictable, including the revenue contributions from the Federal Government. Without stability, we can never guarantee fiscal integrity. One key is to design the revenue system as a whole -- to insure that all the components, when taken together, will produce a reliable revenue stream. That means the federal government must make a fiscal commitment, and honor that commitment as the District completes the rest of the revenue revision process.

2. The tax system must be streamlined to allow cost-effective and fair administration. Otherwise, we can never guarantee high-quality customer service or that all taxpayers pay their fair share.

3. The distribution of the tax burden should be compassionate and, at the same time, should not discourage better-off households from living in the District.

4. Tax policies should be designed so that businesses are not unduly discouraged from operating in the District.

The Tax Revision Commission also is focused on comprehensive redesign of the revenue system. Some results of their work should be available by mid-summer. When viewed against the requirement above, each of the three major proposals has some very great strengths. Unfortunately, each also has weakness.

The President's Plan

The President's Plan recognizes the federal government's responsibility for assuming operation of state functions. The plan is a good first step in right direction. This plan offers;

- Improvements for some of the District's most pressing infrastructure problems -- the prisons and transportation,
- Greater support for several growing and volatile areas of expenditure -- Medicaid, the prisons, and the unfunded pension liability,
- Administration of the District's individual income tax, and
- A program of grants and tax incentives for economic development.

The annual federal payment and annual contribution to the pension fund would be removed. The proposal is particularly strong in stabilizing the expenditure side of the budget -- by easing some of the great uncertainties in appropriations.

The Executive's proposal, however, is not a comprehensive plan for revenue stability. In the short-term, the District is unlikely to have a net benefit in the operating budget. Over the longer-term, these benefits should be greater, due to growth in the economy and changes in operations of prisons and Medicaid. Still, the problems of reconstructing the tax and revenue system would remain to be resolved, including the revenue that would be offered by the Federal Government.

However, I don't believe the President's plan is strong enough. As you know, 41 percent of the land in the District is owned by the federal government. 300,000 commuters come into the District each day. The federal payment to the District is not a gift, it is a payment in lieu of taxes and our inability to tax income at its source. Consequently, the more we examine the President's plan, the more it seems that the federal payment should not be removed in its entirety in FY 1998. We need to examine the federal payment issue further.

Furthermore, the President's plan should adjust support for UDC. The federal government is our state and UDC is our state university. Lastly, however, the President's plan does not adjust another major state function, that being our mental health services. They cost the District $190 million per year. This is surely a state function and should be in the President's plan.

Norton's Proposal

Congresswoman Norton's proposal offers District residents approximately a 50% reduction on Federal Income Tax due on District-based incomes. The federal tax structure would be revised for District residents to a flat tax base.

I want to especially thank you Mr. Chairman, and particularly Republican members of Congress and former Vice Presidential candidate and Congressman, Jack Kemp, for the early and strong support for Mrs. Norton's District Tax Proposal.

Our challenge is convince our Democratic friends that Mrs. Norton's proposal has great merit. I would hope that Democrats would take the lead from the insightful support of the bill by Senator Lieberman.

Mrs. Norton's proposal is strong in two ways -- 1) it reduces federal taxes for residents who have District-based incomes (other territories such as Puerto Rico and Guam pay no federal taxes). At the very least our taxes should be reduced, given the fact that we share the same status as these territories -- no representation in Congress. 2) It encourages those who work in the District to live here. The impact on the District's own revenue, however, is indirect. The important issues about local tax reform would remain to be addressed.

However, I am of the position that we should not pay any federal taxes at all because we are denied franchise in the U.S. Congress.

The Orphaned Capital

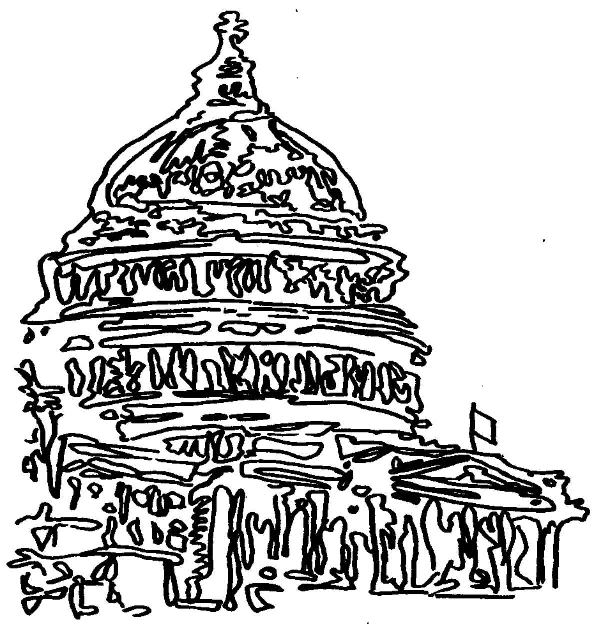
Carol O'CLEIRAECAIN of The Brookings Institution proposes a comprehensive redesign of the District's revenue system. The basic premise is that the District has the economy of a city and, therefore, the revenue system should reflect a typical city-state relationship. The proposal meets many of the criteria for a revenue system. It would streamline the tax system, reduce the number of taxes, and lower tax burdens on both individuals and businesses. This proposal has great merit. It will assist the city to become more competitive in the region in regards to its tax attractiveness. I have a copy of the Brookings study here if you do not have one. The primary problem in adopting these recommendations is the need for a predictable and stable federal revenue commitment. The federal payment is eliminated in the proposal and the recommended tax reform is funded by specific state-type financing from the federal government. However, a payment in lieu of taxes (PILOT) for federal property is recommended. The report estimates the PILOT would be about $382 million. Without a strong, predictable partnership with the federal government -- as any other city might have with its state -- the risks to the District are high in adopting these proposals.

It should be noted that fiscal treatment of federally owned real property has no policy, specific regulation, or guiding principle. In the past, Congress has recognized a responsibility to some local governments for making some form of tax or payment in lieu of tax to account for the federal presence in these localities. However, what has resulted is the creation of uncoordinated and ad hoc special tax payment programs which have developed over the years. These payments are in a fact a result of specific members of Congress' ability to lobby for these payments to their own jurisdictions.

A myth has been perpetuated for a long time, that the District of Columbia is given special treatment in the form of a federal payment, when in fact there are other programs, such as PILOT's, made to other states and localities. These payments can be full, partial or arbitrary tax equivalency payments based on market value of the property. Other payments for shared profits on fees collected or the sale of merchandise, are provided to states and/or localities.

While we have not found the answer to long-term fiscal stability for the District, the ingredients for a solution are at hand. With both the Executive and Legislative branches seeking creative options for a new relationship with the District, this promises to be the moment for stronger ties. This strengthened relationship is at the heart of a comprehensive, long-term solution for the District.

Once again Senator, we face an historic opportunity to correct over two hundred years of a flawed relationship between the District and the federal government. With your continued leadership, as demonstrated today, we will not lose this golden opportunity. I thank you Senator Brownback.



**The Capital of the United States
cannot survive without
a tax cut to stem lethal
taxpayer flight**

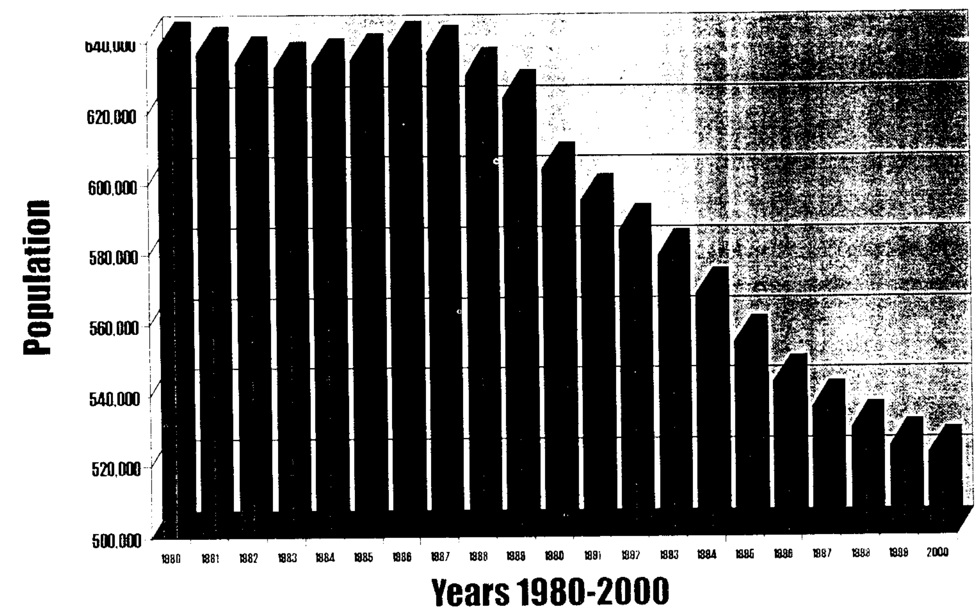
THREE ESSENTIALS FOR D.C.'S RECOVERY

I. Federal Tax Relief to Stabilize Deadly Taxpayer Flight

II. Federal Contributions to Pension Liability and State Functions

III. Financial and Management Restructuring of D.C. Government and Services

Frightening decline of D.C. tax base



Census projection: D.C. to lose almost 3 times as many residents in the 1990s than in the 1980s

THE DISTRICT OF COLUMBIA ECONOMIC RECOVERY ACT (DCERA)

NO PLAN WILL SAVE THE DISTRICT
IF CURRENT TAXPAYER FLIGHT TRENDS CONTINUE

In 1993
65% of filers had an income less than $30,000
83% of filers had an income less than $50,000
11.5% of filers had an income between $50,000 and $100,000, compared with almost 20% nationally

Adjusted Gross Income Range	Total District Filers	Percent of Total District Filers
Under $15,000	97,423	33.7%
$15,000-$29,999	91,498	31.6%
$30,000-$49,999	52,386	18.1%
$50,000-$74,999	23,650	8.2%
$75,000-$99,999	9,838	3.4%
$100,000-$199,999	10,280	3.6%
$200,000+	4,287	1.5%
Total Filers	289,362	100%

IT IS WORSE NOW

Source: Basile, Baumann, Prost Associates; Internal Revenue Service (1993); *Sales and Marketing*.

DCERA PROVIDES SIZABLE PROGRESSIVE TAX REDUCTIONS

	IRS DEDUCTION	DCERA DEDUCTION
Single Filer	$6,550	$15,000
Head of Household Filer	$8,450	$25,000
Married-Joint Filer	$11,800	$30,000

Income Range	Number of Filers	Percent Reduction in Tax Liability*
Under $15,000	50,390	100%
$15,000-$29,999	87,117	79%
$30,000-$49,999	52,060	51.2%
$50,000-$74,999	23,568	44.2%
$75,000-$99,999	9,822	36.8%
$100,000-$199,999	10,259	35.7%
$200,000+	4,286	34.2%
Total Filers	237,502	44.3%

* Includes a tax rate of 15% and charitable and mortgage deductions, which are retained.

DCERA FEATURES

- Progressive Tax Cuts According to Income

- Mortgage Interest Deduction, Charitable Deduction, and Earned Income Tax Credit Retained

- No Bracket Creep to Retract Tax Savings

- Employee Pension and Social Security Income Qualify

- Old IRS Rate on Investments Outside of D.C.

- No Capital Gains Taxes on D.C. Investments by D.C. Residents

- Low DCERA Rate to Encourage Investments in D.C.

SAFEGUARDS AGAINST UNNATURAL INCREASES IN COST OF LIVING

- **Requires Proof of D.C. Residency For 183 Days Annually**
- **Applies Only to Wage and Salary Income Earned in D.C. or Metropolitan Region**
- **Applies to Investment and Dividend Income Earned Within D.C. Only**
- **Capital Gains Relief to D.C. Residents Only and on D.C. Investments Only**
- **Old IRS Rate on Investments Outside D.C.**
- **Annual Treasury Study to Protect Against Unintended Consequences**
- **Stand-by Legislation Examples**
  - **Council Passed Legislation Freezing Property, Sales, and Income Taxes Effective Upon Enactment of DCERA**
  - **Cap on Property Tax Rates and Growth of Assessments (Similar to TRIM, P.G. County)**
  - **Surtax on Capital Gains Derived from Excess Profits**
  - **Revolving Fund for Zero Percent Interest Loans (Or Tax Credits) to Cover Unusual Increases in Home Prices**
  - **Maintenance of Rent Control**

BENEFITS TO CITY AND RESIDENTS

- Expands Tax Base to Fund Improved Services
- Stimulates Job Growth through Income Tax and Capital Gains Reduction
- Encourages Home Ownership in D.C., which has the lowest home ownership rate among the 50 states (D.C. 36%; national 64%)

The Washington Post

B6 WEDNESDAY, OCTOBER 23, 1996

Sharper Drop in D.C. Population Foreseen

Census Bureau, Revising Two-Year-Old Estimate, Predicts Decrease of 31,000 by Year 2000

By D'Vera Cohn
Washington Post Staff Writer

The District's population will drop more sharply than previously forecast because a growing influx of new immigrants will fail to offset an increasing flow of people out of the city, according to new census projections released yesterday.

The city's population, now 554,000, will drop to 523,000 by 2000, according to the new forecast. That figure is 14,000 lower than a census projection published two years ago. In their new forecast, officials increased their estimates both for immigration and outmigration, resulting in a larger net loss than previously projected.

The continuing population hemorrhage—of blacks and whites alike, if current trends continue—is likely to shrink the city's already eroding tax base and further reduce its ability to provide basic services. At the same time, the District will be confronted with an expanding population of low-income immigrants.

As it predicted two years ago, the U.S. Census Bureau forecasts that the District's population will rebound after 2000 because of immigration, but at a slower pace than previously forecast: It will be in 2020, not 2015, that the city's population will surpass the 1990 Census count of 606,900.

The change in the District's forecast is driven to some extent by national trends that also will affect suburban jurisdictions. For Maryland and Virginia, the new census predictions show more immigrants moving in and fewer people moving from other states than previously forecast. Over the next three decades, Virginia is predicted to rank eighth among states in the number of new immigrants; Maryland is predicted to rank ninth.

Both Maryland and Virginia will grow steadily, according to projections. Maryland, which has 5 million people, is predicted to have 5.3 million by 2000. Virginia, which has 6.6 million people, is expected to have 7 million by 2000.

Demographers and economists said the census prediction for the next few years appears reasonable, although the pace of immigration could be slower than anticipated because of a crackdown on benefits to non-citizens in the new federal welfare reform law. They said the region's growth increasingly will be driven by immigration and births, not—as in the booming 1980s—by a flood of new residents from other states.

"This is probably the pattern we're going to be looking at for quite a long time," said economist Stephen Fuller, of George Mason University.

One reason is that U.S. residents are less willing to move because of tighter job markets, slow housing markets and the difficulty of moving a two-career family. Immigrants tend to be young, mobile and ready to relocate to a better economy than the one they left, he said.

"Capital cities tend to be attractive to immigrants," Fuller said. "In almost every other country . . . the capital city is the most important city. The capital city here—even though not the most important city in the country—is an attractive city" despite the problems that are driving middle-class residents away.

Overall, Fuller sees immigration as a plus for the local economy. Immigrants often "will do any kind of work" and are less likely than the population overall to claim welfare. He said immigrants often are entrepreneurial; this region ranks among the top cities nationally in Hispanic-owned businesses, for example.

But Robert Manning, a sociologist at American University, said the immigrants feeding the District's population growth are more likely to need help than those who move to the suburbs. They are less likely to speak English and are more likely to be poor, single, without relatives or other social ties. He's also concerned about "the next crisis: Nobody talks about the second-generation Latinos who don't speak English and who have a high dropout rate."

The growing number of immigrants in the area has fueled complaints from blacks about Asian-owned businesses in the city and protests from some suburban parents about the growing cost of services to foreign-speaking children.

But immigration is not a widely perceived crisis here, as it is in California. When Ken Billingsley, a demographer with the Northern Virginia Planning District Commission, was in San Diego recently, many people said immigration was the area's biggest problem.

One reason for Washington's popularity with immigrants, he said, is "the word may be getting back that you're not going to run into the same kind of hostility, and the jobs are still there."

Washington Business Journal
September 6-12, 1996

D.C. tax base plunges

The working population falls at a record rate

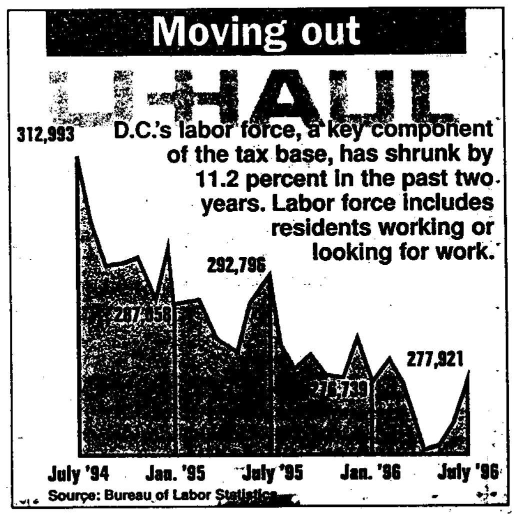

Moving on: Two-year exodus of D.C. workers rivals 1968 post-riot slump.

By FRED O. WILLIAMS
and THOMAS C. HALL
Staff Reporters

Despite the efforts of the D.C. financial control board, working people are leaving the District at a pace unmatched in the city's history — an accelerating exodus carrying dire consequences for Washington's tax base.

Since July 1994, some 33,815 D.C. residents have vanished from the employment rolls, a drop of 12 percent, according to the U.S. Bureau of Labor Statistics. During the same two-year period, the unemployment level held steady — indicating that the drop in working popula-

See WORKERS page 60



Workers

continued from page 1

tion is due to residents pulling up stakes.

"The only rates that were close to this were after the '68 riots," said Charles W. McMillion, chief economist for MBG Information Services in Washington. "We don't know who these people are, but the general feeling is that it's the middle class."

At current exit rates, the District will lose half its working residents by late 2003, just seven years from now.

Personal income taxes are the second-biggest source of local revenue for District government, just behind property taxes. But receipts from both are already falling: In 1995, the city took in $643.6 million in personal income taxes, down from $650.6 million in 1994.

Despite the downturn in revenue and loss of taxpayers, the city is forecasting higher income tax receipts for this year and next.

"There may be fewer taxpayers, but there's still growth in income among people in the higher income brackets," said an economist in the D.C. Department of Finance and Revenue. "If we didn't have a lot of upper-income people in the city, we'd be in real trouble."

To stop the flight, Del. Eleanor Holmes Norton (D-D.C.) has introduced legislation that would limit federal income taxes to a "flat" rate of 15 percent for District residents, a measure that proponents expect would appeal mostly to upper-income people.

The flat-tax proposal, which faces long odds of passage in Congress, would require the District to freeze all current local tax rates. The city, however, would share in any windfall enjoyed from attracting new residents and taxpayers.

"The District is not supported by business or the federal government — it's supported by taxes on its residents," Norton said. "We need more of them, and that's why it's critical that we do something to bring people back."

The decline in the working population comes on top of already steep population losses earlier in the decade. From 1990 through 1995, D.C. lost 52,900 residents, according to Census Bureau figures, 8.7 percent of the total population.

"This is a desperate situation for the District," said George Grier, an economist with the Greater Washington Research Center. "The people who have the most resources are the ones who can get out most easily."

While attention has focused on cutting city spending, economists say that further reductions in city services will only feed the departures.

"You can't cut your way to solving this problem," McMillion said.

Economists note the snowballing nature of population loss — falling tax revenues spur more cuts in services, in turn causing more residents to move out. The erosion of the tax base increases pressures to raise taxes on non-residential sources like commuters and commercial property. The total number of jobs in the District, at 630,000, is more than double the city's working population of 252,000.

Norton said that the District's job base has been relatively stable, despite a broad downsizing by the federal government.

"Most cities cry that the jobs are gone, but that is not our problem," Norton said. "We have plenty of jobs here, but two-thirds of the jobs go home to Maryland or Virginia at night."

The flight from the District is out of step with some urban centers, which have actually gained working population since 1994, BLS statistics show. The working population grew by 5.6 percent in Detroit and about 0.3 percent in New York since 1994.

Nor is D.C. in step with the metro region as a whole. In the statistical area that includes the Maryland and Virginia suburbs, working population has grown 1.4 percent in the past 24 months.

"In the District's case you have to point to the decline of city services as well as the reduction in employment opportunities" caused by federal and local government downsizing, said Chris Walker, director of community and economic development services at the Urban Institute.

Inadequate schools are the chief reasons cities loose population, he said, followed by crime. The prescription for stopping the exodus? "Fix the schools," he said, while acknowledging that that is "the toughest nut to crack."

The most troubling aspect of D.C.'s working exodus is that it seems to have worsened despite the appointment of the financial control board, which was hoped to shore up city finances and restore faith in services. The average working population fell 2.5 percent in 1994 and then slid a precipitous 5.7 percent last year, as 15,567 residents fell from the ranks of the employed. That compares with the decline in employment during the 1990-91 recession — except this time, the departing workers didn't show up on unemployment rolls, indicating that they didn't lose their jobs — they simply left the city. The labor force — population either working or looking for work — fell from about 300,000 in July of '94 to 275,000 this past July.

If there is a bright side, it's that home prices in shrinking cities trend downward, eventually putting the brakes on departures.

"At some point, it becomes economic to buy central-city property and put the kids in a private school," Walker said.

While acknowledging a slow market for condos in the city, real estate agents downplayed the effect of the exodus on sales of single-family houses.

"I'm having a very good year," said Constance Maffin, president of the Washington D.C. Association of Realtors and a salesperson at Pardoe/Pardoe & Graham Real Estate. "Things are selling if they're priced right." Her buyers have included childless couples, those moving up from a condo and "empty nest" retirees moving back into the city for its conveniences.

However, the Realtors' statistics show that the number of unsold single-family homes on the market in 1995 was up 24 percent from 1990's level. The average number of listings climbed above the 2,000 mark in 1992 and has hovered close to 2,300 since, the Realtors' figures show.

Maffin said that the figures may reflect an especially slow market in 1990-91, when owners may have been discouraged from listing their houses during the area's real estate downturn.

However, the increase in unsold homes coincides with a declining population, and with a weakening of the condo/co-op market, which has seen unsold listings rise by 27 percent since 1990.

The Washington Post

Thursday, April 18, 1996

The Washington Post

AN INDEPENDENT NEWSPAPER

A Tax Cut to Stabilize D.C.

D.C. DEL. Eleanor Holmes Norton's bill to cut federal income taxes for District residents is a thoughtful proposal to stabilize this city's uniquely threatened tax base and demographic core. It is at once imaginative enough to attract bipartisan support in Congress and realistic enough to make a serious difference over time. The District has been losing its middle-class heart to the suburbs. No matter how well Congress, the control board and local leaders do in cleaning up past financial horrors, the prospects for a sturdy tax base are slim to none without some incentive for residents and businesses to stay and for others to come in.

Del. Norton's measure would replace the current federal income tax schedule with a fixed rate of 15 percent. It also would more than double the federal personal exemption. This would eliminate federal income taxes for single residents who make up to $15,000 a year, for single heads of households who make up to $25,000 and for married couples filing jointly who make up to $30,000. Deductions for mortgage interest and charitable contributions would stay in effect, as would the ability to file under the current system if the taxpayer preferred. D.C. residents would pay no capital gains taxes on the sale of investments in local business. The proposal's 15 percent rate would be applied to wages earned by D.C. residents either in the city or suburban jurisdictions, as well as to District-generated dividends and investment income.

It is essential to the success of this plan that the local government not jack up taxes to skim the amounts that would return to residents from a federal tax break. That promise needs more than verbalizing by the mayor and city council. Though it is difficult to calculate exactly how this plan would restructure the population, at the start it could cost the federal Treasury hundreds of millions of dollars a year in lost revenues. But other proposals to put the capital city on a sound footing—federal funds, a tax on suburban commuters' salaries, statehood—carry their own heavy political and financial burdens. And as Ms. Norton and others in Congress have noted, if this tax-incentive proposal helps stabilize the city, other urban areas may have a model to follow.

Del. Norton knows as well as anyone that tax incentives alone won't remake the District of Columbia. Other conditions—start with the public schools and security—must improve if the District hopes to keep and attract a vital base of working families with younger children. But her proposal offers a practical way to help spur the revival the city desperately needs.

The Washington Times

TUESDAY, APRIL 16, 1996

A serious plan for what ails the District

D.C. Delegate Eleanor Holmes Norton, who played such an influential role in establishing the District's financial control board last year, has another good idea. Coinciding with the annual tax-payment date, Mrs. Norton yesterday offered a visionary plan —the District of Columbia Recovery Act — that would slash federal income taxes for residents and businesses of the District. The short-term goal is to staunch the middle-class flight from the District, and the long-term hope is to encourage middle- and upper-income families to return or relocate in droves to the nation's capital.

Those are exceedingly tall orders that are virtually certain never to happen unless tangible incentives are provided. Without a return of middle-class families, however, it is equally certain that expanding the District's own tax base and generating local private-sector job creation — two measures indispensable to the long-term fiscal solvency of the national capital — will prove to be pipe dreams. Having the benefit of witnessing firsthand the accelerated flight of more than 50,000 residents since 1990 and understanding the long-term economic devastation such a trend portends for her remaining constituents, Mrs. Norton, whose liberal credentials are impeccable, has offered a plan to overcome the challenges she faces rather than satisfy the class-warfare ideology some of her colleagues embrace.

Mrs. Norton's radical proposal would establish a single federal income tax rate of 15 percent in place of the current brackets that move from 15 percent to 39.6 percent. To introduce progessivity to her plan, which she calls the Progressive Flat Tax, she provides for significantly higher exemptions ($15,000 for singles, $30,000 for married couples filing jointly and $25,000 for heads of household) to replace the current combined standard deduction and personal exemptions ($6,400 for singles, $11,550 for married couples filing jointly and $8,250 for heads of household). Mortgage-interest and charitable deductions would remain, as would the option to file under the current system.

Income-tax liabilities for District residents would be reduced across the board. For incomes under $15,000, federal income taxes would be eliminated; in the $15,001-$30,000 range, taxes would decline by an average of nearly 80 percent; for incomes between $50,001 and $100,000, the crucial solidly middle-class range, taxes would decline between 44 percent at the low end to 37 percent at the high end. In the District, 65 percent of filers have incomes below $30,000, and 83 percent have incomes below $50,000. Only 11.5 percent have incomes between $50,001 and $100,000, compared to nearly 20 percent nationally — where, it must be noted, the cost of living is generally much lower. For its long-term solvency, the District clearly needs to attract more middle-class families, the very sort of stable demographic group that is fleeing.

And it needs new and re-invigorated businesses just as badly. To this end, Mrs. Norton's plan would eliminate capital-gains taxes on D.C. investments by D.C. residents and would apply its 15 percent rate against D.C.-generated dividends and income.

Cognizant of the offputting conditions of D.C. public education, Mrs. Norton is not so naive as to believe that tax cuts alone will immediately attract hordes of middle-class families with school-aged children. That's a luxury for long-term consideration. Her plan would, however, address the immediate crisis of middle-class flight by providing incentives for people to stay. It would also extend a welcome mat to the region's prosperous households and entrepreneurs, whose payment of local taxes could one day lead to a reduction in those oppressive burdens as well.

The social, economic and budgetary ills afflicting the District, which this page routinely catalogues and laments, are so extreme that nothing short of a major assault from multiple angles is likely to prove effective in the long run. Establishing the control board was an indispensable first step. The Norton plan on taxes would be a worthy successor.

THE WALL STREET JOURNAL
THURSDAY, APRIL 18, 1996
WHITE OAK, MARYLAND

Flat Tax on the Potomac?

The flat tax received a political equivalent mugging by everyone from the elite media to Republican Presidential candidates this winter. But guess who just asked for a flat tax? The Beltway itself. Specifically, Eleanor Holmes Norton, the District of Columbia's Democratic delegate in Congress, has just proposed a dramatic incentive-based tax reform for the nation's capital. Its centerpiece is a flat 15% federal income tax rate.

Ms. Norton's plan has the enthusiastic support of both Mayor Marion Barry and D.C. Council Chairman David Clarke. They point out that the District's population has fallen to 554,000 with the exodus of most of the middle class. Ms. Norton says the District's high taxes "have been a major factor in taxpayer flight." Her message to Congress is clear: "The only way to keep and attract new residents and to rebuild our tax base is to offer a meaningful financial incentive."

Her plan would affect only federal taxes, leaving the District's punitive income tax unchanged. However, District residents would enjoy real savings at the federal level because the plan would exempt the first $30,000 in income for married couples (shades of Steve Forbes). Charitable and mortgage deductions would be retained, and capital gains taxation would be eliminated on investments in the District that are held by residents. The flat rate would apply to any resident who lives at least half the year in the District and also pays its income taxes.

Some in Congress will object to D.C. residents getting a tax break while their constituents outside the Beltway have to pay marginal rates that can exceed 40%. Well, then, make it clear that Washington's flat tax would be a proving ground for nationwide tax reform.

Another conventional objection will be that the flat tax envisioned by Ms. Norton would bring in less revenue than the current system. So what? D.C. is already halfway down the drain. In any event, Federal Reserve Board Member Larry Lindsey has argued that economic growth would reduce the revenue loss significantly. The District could also be required to privatize and streamline its bloated government as a condition for having its federal taxes lowered.

We believe, along with Speaker Newt Gingrich and Jack Kemp, that the Norton plan merits consideration. A simple, flat tax would surely encourage a significant return of the middle class to the District. Without their presence, there is no hope. The status quo is bankrupt. When the political writers start sniffing at the details of Ms. Norton's flat tax the way they did with Steve Forbes's proposal, maybe she should ask them what was the last useful idea any of them had for reviving her utterly beleaguered city. Instead of carping, the Norton plan deserves some support.

Eleanor Holmes Norton

OUTLOOK SECTION, WASHINGTON POST, 7-21-96

Why D.C. Needs a Tax Break

In a recent Outlook article, Steven Pearlstein opposed legislation providing federal tax reductions for D.C. residents and businesses ["D.C.'s Flat Tax: Gimme a Break," June 30]. Instead of allowing D.C. residents to keep and use their own money to revive their city, he proposes minor, wishful-thinking subsidies from the federal government. Yet for the third year in a row the D.C. appropriation is being cut, and deficit reduction, not new government subsidies, is this decade's continuing congressional theme.

Pearlstein suggests his own alternatives; he says that my bill, the D.C. Economic Recovery Act (DCERA) gives a tax break to some who don't need it. And he argues that the tax reduction would drive up property values. In developing the DCERA, we anticipated his arguments and built in safeguards.

Pearlstein's feeble remedies would leave the D.C. fiscal crisis intact, as would any

Taking Exception

subsidy-based solution. To meet this crisis, subsidies would have to be large and would have to increase annually and significantly to make up for catastrophic taxpayer flight. The District lost more residents in the first half of this decade than it did in the entire 1980s.

Pearlstein suggests giving a break on D.C. income taxes to D.C. government workers to lure those who now live in the suburbs into the city. This would, of course, cost the District something like $40 million annually. Congress "could subsidize" the D.C. government for "any short-term loss of revenue," Pearlstein says, but he does not say for how long. Mind you, D.C. has been down at least $100 million in revenue each year since 1994, and it has a budget of $5 billion.

His second solution is a warmed-over, skimpy commuter tax, a federal subsidy to the D.C. government that he estimates might raise a mere $115 million. Instead of commuters paying a tax to the District, Congress would pay a "commuter fee" for federal employees from Maryland and Virginia who commute into the District.

Pearlstein argues that his penny-pinched solutions are more targeted and efficient. But they are also ineffective, because they fail the adequate revenue test. And he is wrong to say that tax cuts for D.C. residents are untargeted and inefficient at a time when the fundamental problem is that residents in every income category are rapidly abandoning the city—exactly the problem this bill is meant to remedy.

In suggesting unachievable and ineffective federal subsidies, Pearlstein misses the need for a minimum, reliable tax base. Each year expenses go up. Yet Pearlstein's pint-size commuter "fee" would go down because of federal downsizing. Moreover, any federal subsidy, even if adequate, would undoubtedly get stuck as the federal payment has been: no increases from 1985 to 1990; no increases from 1991 to the present.

Congress is unlikely to put the District on a permanent annually increasing dole. The old-fashioned way—a city bought and paid for by its own residents—is not only preferable, it is the only way to meet increasing expenses and have a livable, even viable city.

Under the DCERA, D.C. residents could claim tax breaks sizable enough to make up for the city's many financial and urban problems. A $15,000 exemption (instead of today's $6,400) would go to single filers, not $25,000 as Pearlstein states; a $25,000 exemption to heads of households (instead of $8,250), and $30,000 to married joint filers (rather than $11,550).

Applying a 15 percent rate up the income scale, after the deduction, produces a decidedly progressive tax: for example, no tax for those who earn less than $15,000, and a 51 percent tax reduction for those earning $30,000-$50,000. This latter group is where the District has taken its greatest population loss.

Pearlstein makes references to rich people who he says will benefit from the reduction. Actually, the middle class would be the big winners because almost all their income comes from earnings, not investments; they would therefore qualify for the reduced DCERA rate. The rich are rich because of returns on investments or dividends that originate from outside the District—like IBM stock. Their wealth would not get the favorable DCERA 15 percent rate.

More actual dollars might go to the rich, because they pay more in the first place. But the reductions in the DCERA are skewed toward low-income filers. Today, families making $100,000 and more account for 5.1 percent of those who file, and provide 51 percent of tax collections. Under DCERA their burden would increase to more than 60 percent. To take a point in the middle, residents below $100,000 would get 1½ times the cumulative dollar benefits of those who earn above $100,000.

Meanwhile, we have given a lot of attention to avoiding unintended consequences, especially gentrification and unnatural increases in property values. Pearlstein offers not one reason why these safeguards would not work, except "experience elsewhere." Actually, there is no experience elsewhere comparable to to the DCERA approach of attracting taxpayers through steep tax reductions, and certainly no experience with the safeguards we will implement.

D.C. property values have been a particular casualty of the financial crisis. Depressed property values are one reason D.C. is losing revenue. They must be boosted to fund services as well as to allow homeowners to recover their investments.

The DCERA has been carefully structured to create a much-needed market impact on housing values that takes into account the inherent difficulties of urban life in the District. And it is calculated to be insufficient to create an artificial increase in demand for housing.

Moreover, most of the remedies for unnatural effects in housing are not in the DCERA but in the home rule District government.

BY MARGARET SCOTT

They include extension of existing rent control and other measures I expect the D.C. Council to enact. Beyond a freeze on property tax rates, they might include, for example, a revolving fund for zero-percent loans (or a tax credit) for home buyers to cover only the increase (or a portion of the increase) in home prices, with the money to be paid back when the house is sold, and a surtax on capital gains derived from excess profits.

There is no risk-free way to help a stateless city with state, county and municipal responsibilities get back on its feet with a steady stream of sufficient revenue. The DCERA will require a monitoring mechanism to check unintended consequences before they can do harm. Pearlstein's prescriptions and his criticisms do no harm. The problem is that they won't do the District any good.

The writer, a Democrat, represents the District of Columbia in the House of Representatives.

Congress of the United States
House of Representatives
Washington, DC 20515

20 QUESTIONS
and Answers

THE DISTRICT OF COLUMBIA ECONOMIC RECOVERY ACT

1. **Q:** Why does the District need a tax reduction?

   A: According to Census projections, the District will lose nearly three times as many residents in the 1990s as the 1980s. The District's tax base is declining so rapidly that it is doubtful that it will have the ability to support itself, notwithstanding even the most dramatic reduction in the size of its government or President Clinton's welcome proposal to fund some costly state programs. The President's plan assumes there will be a large enough tax base to fund the great majority of D.C. government costs locally. Census reports, however, project such a large decline that this assumption is highly unreliable. The President's proposal leaves 90% of D.C. government costs currently funded by locally raised revenues to be picked up by D.C. taxpayers.

2. **Q:** Why should the District have a federal tax reduction that is not available to other jurisdictions?

   A: The District is the only city without a state to recycle revenue from wealthier areas; the only city that pays for state, county and municipal functions; the only city prevented by Congress from taxing commuters who use city services; and the only jurisdiction that pays federal income taxes and all other federal taxes without full congressional representation and full self government. The District is also the capital of the United States.

3. **Q:** What taxes will the bill reduce?

   A: The bill reduces federal income taxes for D.C. residents on their D.C. sourced income and on D.C. sourced investment income. The bill eliminates capital gains taxes for D.C. residents on D.C. capital gains.

4. **Q:** Who can qualify for this tax reduction?

A: Only bona fide District residents can qualify. A bona fide resident is one who has maintained his or her place of abode in the District, been physically present in the place of abode for at least 183 days of the taxable year, and files District of Columbia income taxes.

5. Q: Can a resident who works outside of the District benefit from the tax reduction?

A: A resident of the District who works in the metropolitan D.C. region qualifies under the DCERA.

6. Q: How much tax reduction is possible for each income category?

A: The tax reductions are progressive and sizable. Each income category is covered in order to achieve a balanced tax base to stem the flight that is occurring among all income categories of taxpayers and working people. However, the tax cuts are steeply progressive with the greatest cuts to those with the least income. See attached charts.

7. Q: How do the IRS standard deduction and exemption differ from the DCERA standard deduction and exemption?

A: Bona fide residents will be able to claim deductions on their D.C. sourced income of $15,000 for single filers compared with $6,550 now; $25,000 for heads of household compared with $8,450 now; and $30,000 for joint filers compared with $11,800 now.

8. Q: What tax rate will apply?

A: After taking large deductions (see question #7), a 15% tax rate will apply up the income scale to D.C. sourced income so as to yield progressive results -- the lower the income, the greater the reduction in taxes.

9. Q: Can D.C. residents also claim the mortgage interest deduction and the charitable deduction?

A: Yes. One goal of the DCERA is to encourage taxpayers not only to live in D.C. but also to invest in homes and to give generously to charitable efforts, especially for the poor and disadvantaged. The District now has the lowest home ownership rate among the 50 states and D.C. – 36% compared to 64% nationally (1990).

10. Q: Are capital gains exempted?

A: Yes, no tax is imposed on capital gains for District investments by District residents. This provision is meant to stimulate investment in D.C. businesses and other economic development. Businesses are leaving D.C. just as rapidly as individual taxpayers and families while the District's major employer, the federal government, is rapidly downsizing.

11. Q: What about income from outside the District or the region?

A: Income earned from non-D.C. sources will not get the benefit of the DCERA.

12. Q: Will pension income be eligible for the tax reduction?

A: Income from a D.C. resident's qualified pension plan will be considered D.C. sourced and thus eligible for the tax reduction (qualified pension plans require a limit on the amount of income a worker can set aside annually). Most employee pensions will qualify, including 401(k) plans and IRAs. Retirement income from non-D.C. investments outside a qualified plan will not get the benefit of DCERA.

13. Q: Will social security income be eligible for the tax reduction?

A: A D.C. resident's social security income will be considered D.C. sourced and thus eligible for the tax reduction.

14. Q: Will investment income be eligible for the tax reduction?

A: Investment income on activity within the District will be considered D.C. sourced and thus eligible for the tax reduction.

15. Q: Does DCERA have safeguards against unnatural increases in the cost of living to prevent D.C. from becoming a tax haven for the rich?

A: Yes. DCERA has numerous safeguards to prevent unnatural cost of living pressures. The Council has already enacted a freeze on D.C. income, property and sales taxes effective upon enactment of the DCERA. Examples of other stand-by legislation include a cap on property tax rates and growth in assessments (similar to TRIM in P.G. County); a surtax on capital gains if derived from excess profits; a revolving fund for zero percent interest loans (or tax credits) to cover unusual increases in home prices; and the maintenance of rent control. Other features in the bill will safeguard against unnatural increases in the cost of living. The bill benefits only D.C. residents who spend most of each taxable year physically in the city; applies only to wages earned in D.C. or the metropolitan region; applies only to investment income earned on D.C. investments; and exempts capital gains taxes only on D.C. investments.

16. Q: When will the tax reductions in the bill take effect?

A: The tax reductions will take effect immediately for the taxable year in which the bill is enacted.

17. Q: What if the bill produces problems that we did not forsee?

A: The bill requires the Secretary of the Treasury to prepare an annual study to determine the effectiveness of the bill. If the Treasury study reveals unintended consequences, the bill can be amended to fix those problems.

18. Q: Does a D.C. taxpayer have a choice of the DCERA rate or the current IRS code?

A: The bill has a "hold harmless" provision that allows a taxpayer to file under the current system or the DCERA.

19. Q: Will a D.C. taxpayer have to file two separate federal tax forms to benefit from DCERA?

A: No. For the majority of District tax filers, one simple form will be used.

20. Q: What are the chances that DCERA will become law?

A: In the current tax cutting climate in Congress, a tax reduction for D.C. is more likely to be enacted than other options. The bill already has the support of key members of the majority that controls the House of Representatives.

ELEANOR HOLMES NORTON
DISTRICT OF COLUMBIA

COMMITTEE ON
TRANSPORTATION AND
INFRASTRUCTURE

SUBCOMMITTEES
PUBLIC BUILDINGS AND
ECONOMIC DEVELOPMENT
WATER RESOURCES AND
ENVIRONMENT

Congress of the United States
House of Representatives
Washington, D.C. 20515

COMMITTEE ON
GOVERNMENT REFORM AND
OVERSIGHT

SUBCOMMITTEE
RANKING MINORITY MEMBER,
DISTRICT OF COLUMBIA

STATEMENT OF CONGRESSWOMAN ELEANOR HOLMES NORTON AT A PRESS CONFERENCE TO INTRODUCE THE DISTRICT OF COLUMBIA ECONOMIC RECOVERY ACT

January 28, 1997

I am introducing the District of Columbia Economic Recovery Act (DCERA) as my first bill of the 105th Congress because it would be irresponsible not to do so. With taxpayer flight continuing unabated, a tax cut incentive to keep taxpayers here has become an imperative. America's Rome is burning while Congress is fiddling. And despite local efforts, taxpayers perceive the city as if recovering in slow motion and have quickened their pace to leave. Today, taxpayers are in full flight. Only a dramatic and focussed incentive can keep them here.

In the absence of a state, a unique tax incentive is fully justified, is profoundly fair, and absolutely essential. The tax cut is justified and fair because District residents pay the full load of federal taxes while lacking full representation and full home rule, and they have no state to recycle income from wealthier areas. Instead, the city is burdened with just the opposite. The Congress has imposed on D.C. residents the cost of providing services for commuters while protecting them from paying any part of the rising cost of those services. The tax cut is essential because every plan and proposal, including the recent, welcome proposal by President Clinton, will pick up only a small fraction of the costs the District taxpayers bear. As important and gratifying as the President's plan is, its basic assumption is that there will be a large enough tax base here to pay for most of the costs of the city. That assumption defies the latest census data. This city is on track to lose nearly three times as many residents in the 90s as in the 80s. Today, the city's population has dropped to where it was in 1933. Yet the President's proposal will leave 90% of D.C. government costs that are currently funded from locally raised revenues to be picked up by a tax base that is being miniaturized.

The analysts agree on the two basics necessary for the city to recover: an adequate tax base and relief from state functions and pension liability. We are gratified that the President's proposal strides in the direction we must go to fund at least some of the functions no city could bear today. My bill assures that his plan will not be stillborn. Stated painfully, but plainly, the President's plan will fail if taxpayers contimue to leave at the present rate.

The DCERA has been carefully crafted as a bipartisan bill consistent with the principles of both parties. It is sizable enough to attract Republicans and to act as a realistic incentive for D.C.

815 15TH STREET, N.W., SUITE 100
WASHINGTON, D.C. 20005-2201
(202) 783-5065
(202) 783-5211 (FAX)

1424 LONGWORTH HOUSE OFFICE BUILDING
WASHINGTON, D.C. 20515-5101
(202) 225-8050
(202) 225-3002 (FAX)
(202) 225-7829 (TDD)

2041 MARTIN L. KING AVENUE, S.E.
SUITE 300
WASHINGTON, D.C. 20020-5734
(202) 678-8900
(202) 678-8844 (FAX)

Recycled Paper

residents to remain. It is steeply progressive in the tradition of Democrats in general and the 1963 JFK tax cut in particular. Once the bill is passed, half of D.C. residents will be off the federal income tax rolls. Tax cuts for working people will range from 79% to 34%, depending on income. The smaller the income, the greater the cut.

To encourage investment in a city desperate for business, the DCERA taxes small D.C.-based business at the 15% rate and eliminates capital gains, but only for District residents, thus accomplishing two goals at once. It helps reverse the huge business exodus from a city that is dangerously overdependent on the rapidly downsizing federal sector, while encouraging business people to reside here -- the only way to take advantage of the DCERA. Already impoverished, the District's business sector lost 1,800 businesses between 1990 and 1995.

Equally important, the bill contains protections against gentrification and unnatural increases in the cost of living. For example, the DCERA applies only to bona fide D.C. residents who spend 183 days of each taxable year physically in the city, to wages earned in D.C. or the metropolitan region, and to investment income earned on D.C. investments only. The bill exempts capital gains taxes only on investments in D.C. by D.C. residents. Stand-by legislation further guards against unnatural increases in the cost of living. Examples include: a City Council bill passed last year at my request that freezes property, sales, and income taxes effective when the DCERA is enacted; a measure similar to TRIM in Prince George's County that limits property tax rates and the growth of assessments; a surtax on capital gains if derived from excess profits; and a revolving fund for zero-percent interest loans (or tax credits) for home buyers to cover unusual increases in home prices, with the money to be paid back upon the sale of the home; and the maintenance of rent control. The bill also requires the Secretary of the Treasury to prepare an annual study to determine the effects of the bill, thus allowing each year for the correction of unintended consequences, if any. However, the analysts and experts who have studied the DCERA closely do not predict unusual effects but rather indicate that the market will discount for urban conditions in general and conditions and services in D.C. in particular in the prices of property and other investments.

Our greatest risk at this late hour, is that even a tax cut may be too little to check the flight. At the very least, however, the overwhelming support for the bill among residents of every ward, every income group and every racial and ethnic background is some evidence that the bill will help keep taxpayers here who might otherwise leave. The DCERA will give us time to improve services and to more fully regenerate our tax base. The introduction of the DCERA and the strong support it has won in the Congress has already raised resident morale and contrasts sharply with the long-running dearth of support for other approaches to help the District in the House and Senate.

Time is running out to stop the taxpayer drain. We must hope that we have not already passed the point of no return. Once a city loses a critical mass of taxpayers, it loses the capacity to turn taxpayer losses around. No city has ever reversed a taxpayer hemorrhage. With the city on life support and no state safety net to rescue the District, the greater risk is doing nothing.

Only blinders to the last great injustice on American soil could lead any American to question a bill reducing federal taxes on the residents of the nation's capital. Third per capita in federal income taxes, District residents stand alone in shameful defiance of the American principle of no taxation without representation. The four territories pay no federal income taxes yet have the same representation in Congress as the District. The four territories have full self government; the District's limited home rule is self government only when the Congress says so. The Congress will compound the harsh civic injustice it imposes if it also insists on taxing the District's tax base into extinction. With the DCERA, District citizens ask only to rebuild their own city with their own money. Their country owes them that, and more.

THE PRESIDENT'S PLAN:

THE NATIONAL CAPITAL REVITALIZATION AND SELF-GOVERNMENT IMPROVEMENT PLAN

THE WHITE HOUSE

Office of the Press Secretary

For Immediate Release **January 14, 1997**

THE PRESIDENT'S NATIONAL CAPITAL REVITALIZATION AND SELF-GOVERNMENT IMPROVEMENT PLAN:

FACT SHEET

- The plan has two goals:
  - To revitalize Washington D.C. as the Nation's capital, and
  - To improve prospects for "home rule" to succeed.
- The plan will:
  - Relieve the District government of major financial and managerial responsibilities -- including certain pension plans and parts of the criminal justice system -- that are beyond its financial capacity, and resolve the city's cash shortfall that stems from its accumulated deficit;
  - Invest considerable resources to improve the city's criminal justice system and capital infrastructure;
  - Strengthen the District's economic base; and
  - Draw on the Federal government's technical expertise to help make the city government effective in such areas as income tax collection, education and training, housing, transportation, and health care delivery.
- Over five years, this plan will invest $3.9 billion of Federal budgetary resources in the Nation's capital. Among other things, the plan provides:
  - $885 million for new capital spending on prison renovation and construction;
  - $891 million to operate prison facilities;
  - $681 million to operate the court system;

- – $125 million in 1998 to begin rebuilding the city's transportation infrastructure;
- – $117 million to improve District tax collection;
- – $917 million to increase the Federal share of D.C.'s Medicaid payments; and
- – grant and tax incentives for economic development in the District.

- In exchange, the plan will end the yearly Federal appropriation and other payments to the District, saving $3.56 billion over five years.

- Thus, the <u>net Federal costs of the plan come to $339 million over five years</u>.

- The plan also proposes that the Federal government assume responsibility for the District's existing pension plans for law enforcement officers, firefighters, teachers, and judges.

  - – Upon their transfer to the Federal Government, the plans would close (that is, they would accrue no new liability).
    - The existing pension assets would pay the beneficiaries.
    - Starting in 2007, the Federal government would pay off, over an extended period of time, the $4.3 billion in unfunded liability associated with these plans -- much of which was transferred from the Federal government to the District in 1979.
  - – The District would establish new plans for current employees.

- <u>Over five years, the plan would save the District about $770 million</u>.

  - – Federal budget costs will be less than District budget savings in part because pension assets, rather than Federal budget resources, will be used to pay beneficiaries until 2007.

- <u>The proposed Federal spending is all dependent on the District government taking certain actions to improve its performance</u> -- as outlined in a Memorandum of Understanding that will be reached between the Federal government, the District government, and the Financial Authority.

- The plan will benefit the city, the region, and the Nation:

  - – It benefits District residents by reducing their government's financial burdens, improving the delivery of city services, and investing in the criminal justice system, economic development, and transportation.

– It benefits the region because of the city's economic recovery; the financial support given to the police, fire, teachers, and judges pension funds; the rebuilding of the District prison system; and the improvement of a key component of the regional transportation infrastructure.

– It benefits the Nation because it begins to create a capital city that we can all be proud of, improves its transportation system, and helps ensure the safety of residents and visitors.

○