

Operating Expenditures

The District's local fund expenditures¹ have grown an average of 8 percent annually during the past three years, after a large drop between 1997 and 1998.

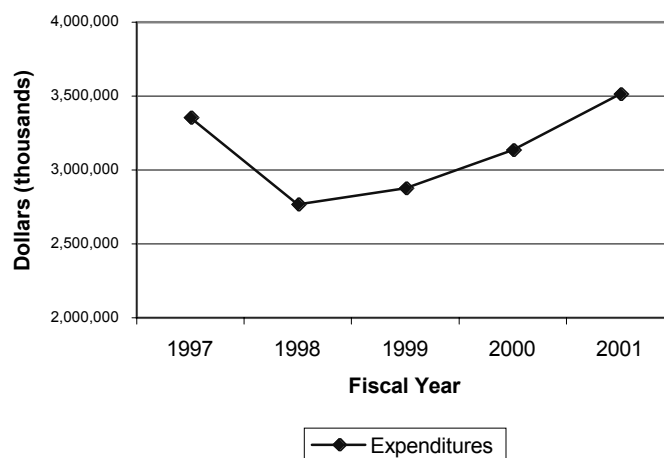
Pressures in certain areas of the budget, especially public education and public health, have contributed to increasing expenditure levels. However, these expenditures have been supported by rising general fund revenue collections. With revenue forecasts showing smaller increases for FY 2002 and FY 2003, as described in the Revenue chapter, but with some of the underlying expenditure pressures still building, the

District faces increased challenges in maintaining balanced budgets.

This chapter examines operating expenditures² by the District in recent years and analyzes where expenditure growth pressures are likely to slow, continue, or expand in the future. Specifically, the chapter:

- Describes the change in expenditure patterns between FY 1997 and 1998 because of the

Figure 5-1:
Local Fund Expenditures, FY 1997 - FY 2001



Revitalization Act, which changed the District's responsibilities and those of the federal government

- Examines the growth in expenditures from FY 1998 to 2001 by area of spending (agency and function)
- Examines the growth by such categories as personnel, materials, and subsidies
- Briefly analyzes mandatory and discretionary spending
- Discusses projections of expenditure growth from FY 2004 to 2006, starting from the FY 2003 proposed budget.

Change in Expenditure Patterns, FY 1997 to FY 1998

The 1997 Revitalization Act³ entailed a major shift in responsibilities between the District and the federal government and significantly changed the pattern of the District's expenditures. As a result of the Revitalization Act, the federal government:

- Took over financing of the operating (and capital) costs of most aspects of the District's court system, and began phasing in the assumption of responsibility for the District's sentenced adult felons;

- Assumed responsibility for the District's accrued pension liability through 1997;
- Increased the portion of the District's Medicaid expenditures it reimbursed from 50 percent to 70 percent; and
- Eliminated an annual payment it made to the District in exchange for taking over these functions—a payment that reached \$660 million in the last years before the Revitalization Act took effect.

The Revitalization Act reduced the District's local fund expenditures by more than \$700 million in several areas, as shown in Table 5-1. Table A-1, in appendix 2 to this chapter, presents further detail.

The Revitalization Act changes are reflected in expenditure levels for several appropriation titles:

- Within the Public Safety and Justice appropriation title, expenditures by the Department of Corrections decreased markedly, as the process of transferring felony offenders to Federal facilities began as part of a multi-year closing of the Lorton Correctional Complex. In addition, Federal assumption of court functions meant that the District spent no local funds and almost

Table 5-1:

District Expenditures, FYs 1997 and 1998, for Selected Agencies Affected by the Revitalization Act

(Dollars in thousands)

	LOCAL FUNDS		GROSS FUNDS	
	FY 1997	FY 1998	FY 1997	FY 1998
Department of Corrections ^a	253,920	93,045	258,834	258,574
Selected Court Functions ^b	139,274	0	142,008	1,228
Police and Fire Retirement System	226,700	47,700	226,700	47,700
Teacher's Retirement System	88,100	8,900	88,100	8,900
Department of Human Services	826,509	359,808	1,608,923	629,842
Department of Health	0	294,040	0	906,431
Total, Selected Agencies	1,534,503	803,493	2,324,565	1,852,675

NOTES:

a) Department of Corrections gross funds expenditures for FY 1998 include a \$162 million transfer from the Corrections Trustee. This transfer does not appear in the District's Comprehensive Audited Financial Report for 1998. In the years thereafter, expenditures from such transfers were included as other-type expenditures for the Department of Corrections, so this amount is included here to maintain continuity.

b) "Selected Court Functions" consist of DC Court of Appeals, DC Superior Court, DC Courts System, Public Defender Service, Pretrial Services Agency, Parole Board, and Judges' Retirement.

- stopped spending its gross funds.
- Federal assumption of the District's unfunded pension liability reduced the District's expenditures in both the Public Safety and Justice (Police and Fire Retirement System) and Public Education System (Teachers' Retirement System) appropriation titles.
- In the Human Support Services appropriation title, the effect of the Medicaid change—the increase in Federal reimbursement from 50 percent to 70 percent of Medicaid expenditures—does not show up in any single agency. The Department of Health (DOH) was split off from the Department of Human Services (DHS) in 1998, the same year the change in Medicaid took place. Tracking Medicaid dollars thus requires comparing expenditures of DHS in 1997 to those of DOH in 1998. However, within these two agencies, the change led to a one-year decrease from \$411 million to \$241 million in local funds for Medicaid expenditures for the District.

Figure 5-2 shows that the most significant decreases in expenditures between FY 1997 and 1998 came in the (1) Public Safety and Justice (45 percent decrease) and (2) Human Support Services (18 percent decrease) appropriation titles. Expenditures in all other appropriation titles rose about 2 percent.

Expenditure Growth by Agency and Function, FY 1998 to FY 2001

Because FY 1997 expenditures look so different from expenditures in FY 1998 and beyond, the remainder of this chapter discusses expenditures from 1998 onward. Tables A-2 and A-3, in appendix 2 to this chapter, provide additional detail on local and gross expenditures in the largest District agencies from FY 1998 through 2001.

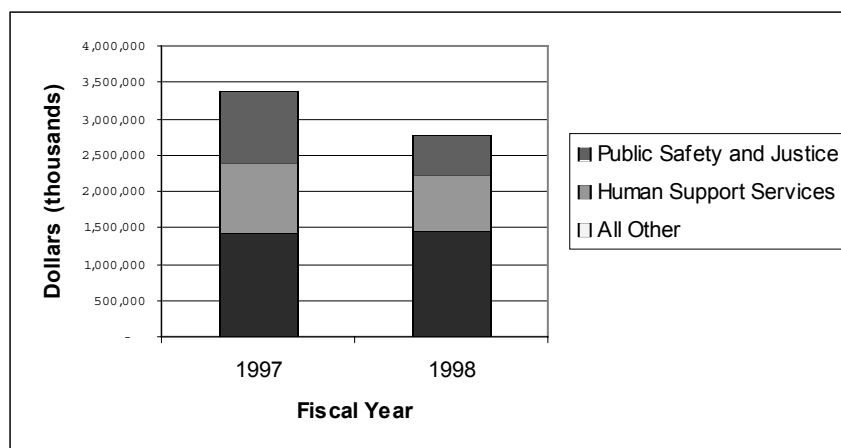
Public Safety and Justice

After the dramatic decrease in expenditures in the public safety area between FY 1997 and 1998, expenditures have grown more slowly than the District-wide totals. Ongoing changes involving the Department of Corrections have resulted in lower spending there, while the two largest agencies in this appropriations title—the Metropolitan Police Department and the Fire and Emergency Medical Services Department—have shown steady growth. The Police and Fire Retirement System required increasing contributions in FY 2000 and 2001 and may be a factor driving future growth in this appropriation title.

- **Department of Corrections.** The Revitalization Act has had a continuing impact on expenditures for Corrections. Between 1998 and 2001, the District phased out the Lorton facility, transferring the last

Figure 5-2:

Change in Local Fund Expenditures with the 1997 Revitalization Act



prisoners on November 20, 2001. In addition, some expenditures in Corrections were moved to the Corrections Medical Receiver in 1999. The result is a decrease in expenditures at Corrections in FY 1999 and 2000 before an increase in FY 2001.

- **Corrections Medical Receiver.** In 1996, medical care within the D.C. Jail, operated by the Department of Corrections, was placed into receivership. A Federal judge determined that court orders regarding improved medical, mental health, and other services were not being met. Starting in FY 1999, the receiver's expenditures were reported separately from Corrections', and this continued through FY 2001, although medical care at the Jail returned to District control in September 2000.
- **Metropolitan Police Department and Fire and Emergency Medical Services Department.** Expenditures at these two agencies rose steadily (except for a decrease in the Fire Department in FY 1999), averaging about 6 percent per year, still below the overall average for the District. These are the two largest agencies in this appropriation title, but their changes were not major drivers of the District's overall expenditures increase.
- **Police and Fire Retirement System.** The District's contributions to the system have increased in the past two years and are projected to increase sharply in FY 2002 and 2003. Benefit changes that have been legislated at both the Federal and local levels have meant more funding is required to cover actuarially determined current costs of future pension benefits. Furthermore, the initial resource allocation between the system and the Teachers' Retirement System, from which it was separated in 1998, has been revisited. Since the Police and Fire Retirement System had initially been relatively underfunded, the District has had to increase its funding in recent years.

Public Education System

The District of Columbia Public Schools (DCPS) is the largest District agency in terms of both employees and local funds expenditures.

DCPS employs about a third of all District employees, and its expenditures are driven heavily by personnel costs. Public Charter Schools (PCS) opened in FY 1998 with expenditures of \$3 million that year. Expenditures topped \$100 million in FY 2001 even as DCPS spending continued to increase. Both agencies are budgeted using a formula that accounts for inflation and for student enrollment growth or decline. Growth in these two agencies has led to overall annual expenditure growth of 16 percent over the past three years in the Public Education System appropriation title.⁴

- **District of Columbia Public Schools.** Expenditures at DCPS have increased sharply despite declining enrollment over the past three years. Enrollment was at nearly 80,000 students in 1996 but has fallen to about 69,000 in 2001. In FY 2001, DCPS expenditures rose to \$727 million, more than a 20-percent increase over FY 2000, primarily because of special education costs and low reimbursement rates for Medicaid-eligible services. Available data show that per-pupil expenditures in special education increased by 33 percent between FY 1999 and FY 2001, more than twice the rate of growth of regular education spending. This increase is due to increases in both the number of special education students and the cost of educating each such student.
- **Public Charter Schools.** The District opened its first charter schools in FY 1998, and enrollments went from slightly over 3,000 to nearly 10,000 over the next three years. The District supports PCS with a subsidy, based on the same formula through which DCPS receives most of its funding. Individual charter schools then are free to make their own choices about spending on salaries, supplies, rent, and all other costs.
- **University of the District of Columbia (UDC).** The other large agency in the Public Education System appropriation title is UDC. UDC is not a primary driver of the District's expenditure increases—in fact, it has shown a decline in expenditures since FY 1999.

- **Teachers' Retirement System.** As mentioned with respect to the Police and Fire Retirement System, the initial resource allocation dating to when the two funds were split has been revisited. The Teachers' Retirement System had initially been relatively overfunded, so the District has been able to reduce its contributions, and contributions are projected to remain low for the next several years.

Table 5-2 shows enrollment and expenditure trends for DCPS and PCS. DCPS expenditure growth in FY 2001 has already been noted, but even in the three prior years, DCPS expenditures had increased at rates—8 percent, 6 percent, and 10 percent—that more than doubled inflation, despite a declining enrollment. PCS expenditures have increased so much in four years that PCS is now one of the largest District agencies, as ranked by expenditure totals. Enrollment in the two systems combined has been increasing since FY 1999, but per-student spending has increased more rapidly.

Human Support Services (Including Receiverships)

Medicaid costs are a large component of expenditures within the Human Support Services appropriation title, which (when including agencies in receivership) have grown at an annual average of 12 percent since FY 1998. The District's expenditure on health care for the needy underwent a major transformation in FY 2001 as most functions at D.C. General Hospital

were contracted out to a private company. Finally, several of the agencies that would otherwise be part of this appropriation title have gone through periods of receivership—that is, the courts have taken over certain operations and mandated some level of service delivery and spending.

- **Department of Human Services (DHS).** This agency, known as the Department of Human Development until 1998, has undergone a major change in the services it provides. Before 1998, it performed functions later performed by DOH and two receivership functions—the Child and Family Services Agency (CFSA) and the Commission on Mental Health Services (CMHS).⁵ DHS operates a number of Federal programs, such as Temporary Assistance for Needy Families and certain homeless programs. Its Local funds expenditures rose less than 2 percent annually between FY 1999 and 2001, but its gross funds expenditures—including the Federal funds it administers—have increased by 8 percent annually.
- **Public Benefit Corporation (PBC).** The PBC was established in 1996 to operate D.C. General Hospital and associated health care clinics in the city. Expenditures at PBC greatly exceeded originally budgeted amounts in FY 1999 and 2000, and in FY 2001 it was shut down as services were transferred to a private contractor. General PBC operations, like those of D.C. General

Table 5-2:

Enrollments and Expenditures in Two Schools Systems (dollars in thousands)

	DC PUBLIC SCHOOLS		PUBLIC CHARTER SCHOOLS		COMBINED SYSTEMS		
	ENROLLMENT	EXPENDITURES	ENROLLMENT	EXPENDITURES	ENROLLMENT	EXPENDITURES	PER STUDENT*
1996	79,802	498,067	-	-	79,802	498,067	6,241
1997	78,648	481,547	-	-	78,648	481,547	6,123
1998	77,111	520,097	-	3,195	77,111	523,292	6,786
1999	71,889	550,812	3,594	11,113	75,483	561,925	7,444
2000	70,677	604,098	6,980	46,480	77,657	650,578	8,378
2001	68,978	727,360	9,555	104,992	78,533	832,352	10,599

NOTES:

*Per Enrolled Student (whole dollars, not thousands)

Hospital before the PBC's inception, were independent of the District's finances, but the District provided a subsidy from its general fund revenues. This subsidy grew from \$47 million in FY 1999 to over \$130 million in both FY 2000 and FY 2001, including costs of transition to the private contractor in FY 2001.

- **Department of Health (DOH).** The Medicaid program accounts for about three-quarters of DOH local fund expenditures. The Local share of Medicaid expenditures within DOH has increased from \$241 million in FY 1998 to \$270 million in FY 2001. For more detail on Medicaid, see appendix 1 to this chapter.
- **Child and Family Services Agency (CFSA) and the Commission on Mental Health Services (CMHS).** These agencies were placed into receivership in 1999. CFSA returned to full District control in FY 2001. CMHS, now the Department of Mental Health (DMH), has returned to full District control in FY 2002. CMHS expenditures rose 44 percent annually between FY 1999 and 2001, in part due to low reimbursement rates for Medicaid-eligible services.

Financing and Other

Agencies in the Financing and Other appropriation title include various debt service functions as well as the District's reserve funds. Expenditures in this appropriation title have decreased since FY 1998, primarily because of reduced borrowing costs.

- **Debt Service.** The primary debt service function is Repayment of Loans and Interest, for which expenditures have decreased at an average annual rate of 13 percent since FY 1998. The District has been able to take advantage of lower interest rates to refinance some of its debt. In addition, it securitized the future payments due from tobacco companies as part of a settlement reached by the companies and various states in 1998.⁶ With the proceeds of the securitization, the District paid down approximately \$482 million of its outstanding debt, which will reduce required debt service payments for many years into

the future.

- **Budgeted Reserve.** Beginning in FY 2000, the District was required to budget for a \$150 million reserve fund each year. The District could spend the funds thus budgeted under certain conditions after Congressional notification. The District spent \$26.6 million of the FY 2000 reserve, and in FY 2001 it allocated \$104.5 million of that year's reserve for PBC costs. Subsequent legislation has reduced the amounts the District must budget in reserve each year, and the requirement is scheduled to end in FY 2004.
- **Emergency and Contingency (Cash) Reserve Funds.** In FY 2001, the Congress required the District to establish two cash reserve funds, to be filled at the rate of 1 percent of projected local fund expenditures per year until they reached 7 percent by FY 2007. Of this amount, 4 percent will go into the Emergency Reserve Fund and 3 percent into the Contingency Reserve Fund. Subsequent legislation required the District to deposit the debt service savings from the tobacco securitization into these funds as well. The District deposited \$69 million in FY 2001 into the Emergency Reserve Fund, which represented the FY 2001 debt service savings from the tobacco securitization. It also deposited \$33 million in accordance with the 1-percent requirement. This deposit was not a budgeted expenditure but was rather a transfer of cash within the fund balance.

Other Appropriation Titles

Expenditures in other appropriation titles have not shown changes as significant as those discussed above.

- **Governmental Direction and Support.** This appropriation title funds a number of agencies that manage overall government operations, including the Office of the Mayor, the Council of the District of Columbia, and the Offices of Personnel, Corporation Counsel, and the Chief Financial Officer. Expenditures in this appropriation title have grown at 8 percent annually since FY 1998,

- about the same as the citywide average.
- **Economic Development and Regulation.** This is the smallest of the appropriation titles, and expenditures increased at an annual average rate of 5 percent between FY 1998 and 2001.
 - **Public Works.** The Public Works appropriation title is dominated by two agencies: the Department of Public Works (DPW) and subsidies to the Washington Metropolitan Area Transit Authority (WMATA). DPW expenditures have decreased steadily since FY 1998. Subsidies to WMATA, on the other hand, have risen by an annual average of 9 percent over three years. Overall, expenditures increased by an annual average rate of 6 percent, slightly slower than the citywide increase.

Summary of Expenditure Growth By Agency and Function

The District's expenditure growth since FY 1999 has been concentrated in several large agencies. The overall growth rates of expenditures in FY 2000 (over FY 1999) and FY 2001 (over FY

2000) were 8.9 and 10.8 percent, respectively. However, the growth rate is far lower if just four agencies are removed from the data:

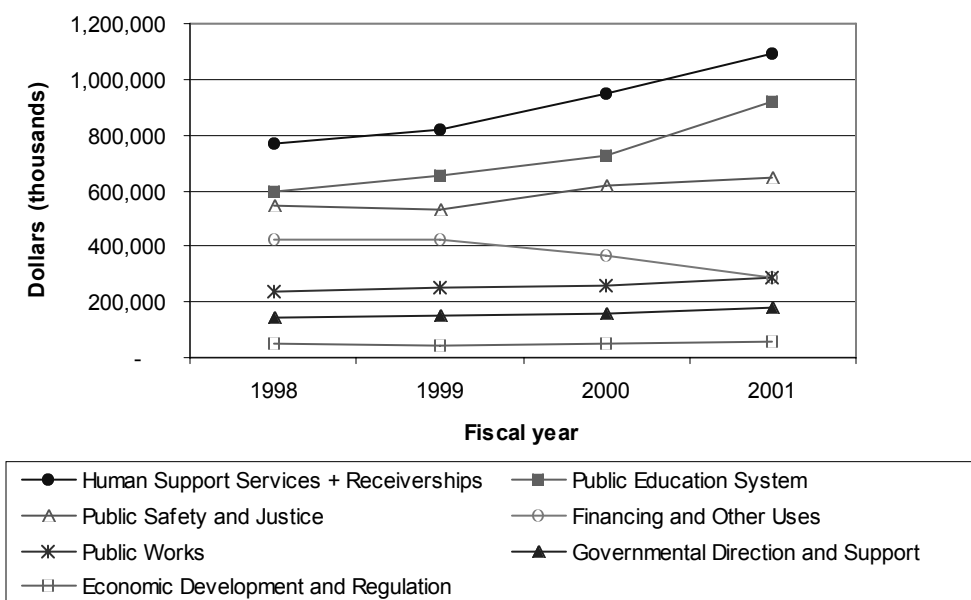
- D.C. Public Schools
- Public Charter Schools
- Commission on Mental Health Services
- Public Benefit Corporation Subsidy (plus transition costs in FY 2001)

Expenditure growth in these four agencies was 28.5 percent and 29.3 percent in FY 2000 and 2001, respectively. Excluding these four agencies, District expenditures grew at only 2.5 percent in FY 2000 and 3.1 percent in FY 2001.

On the other hand, reductions in debt service played a major role in the low growth rates for the remainder of the District. Excluding long-term debt payments and interest, in addition to the four agencies listed above, results in expenditure growth of 5.6 percent and 8.2 percent in FY 2000 and 2001, respectively, for the remainder of the District.

Figure 5-3 shows that expenditure growth in the Human Support Services (including receiverships) and Public Education System appropriation titles has driven the District's overall growth in expenditures.

Figure 5-3:
Local Fund Expenditures by Appropriation Title, FY 1998-FY 2001



Expenditure Growth by Object Class, FY 1999 to FY 2001

Analyzing the District's expenditures by object class—that is, by the type of services paid for, such as personnel, supplies, or fixed costs for rent or utilities—provides another perspective on what the District spends its funds on. This section compares expenditures for FY 1999, 2000, and 2001; data from FY 1998 at this level are not fully consistent with later years.

The broadest classification of this type is between personal services (PS) and nonpersonal services (NPS) expenditures. The PS category includes regular salaries and wages, overtime and other additional costs, and fringe benefits, while NPS expenditures include rent and utilities, contractual services, equipment, subsidies and transfers, and debt service.⁷ NPS expenditures have risen slightly faster than PS expenditures over the past two years (see Figure 5-4). Table A-4, in appendix 2 to this chapter, provides further details.

PS expenditures, which make up slightly more than 40 percent of all expenditures, rose at an average annual rate of 8 percent between FY 1999 and 2001. Within the PS category, expenditures on extra pay, the category including overtime, increased at a 13 percent annual rate between FY 1999 and 2001. This category also includes differential pay for night, weekend, and holiday work, as well as bonuses. Over 70 percent of the District's extra pay expenditures each

year are in four agencies: three public safety agencies (Metropolitan Police Department, Fire and Emergency Medical Services Department, and the Department of Corrections) and D.C. Public Schools. FY 2001 extra pay expenditures were somewhat higher than usual because many employees—union and nonunion—received a bonus at the end of the year. Despite recent increases in health insurance costs, overall fringe benefits have increased at only a 5-percent annual rate between FY 1999 and 2001, more slowly than the rate for all PS costs.

NPS expenditures increased at about 11 percent annually between FY 1999 and 2001. Within NPS categories, debt service expenditures fell by 18 percent annually, while subsidies and transfers, the largest NPS component, increased by 16 percent annually—from \$727 million to \$979 million over two years. The subsidies and transfers category includes the District's contributions to Medicaid and other entitlement programs, as well as to Public Charter Schools, whose growth has been described previously. Contractual services expenditures rose by 24 percent annually.

Expenditures by Classification as Mandatory or Discretionary

More than 60 percent of the District's expenditures are outside of its control, at least in the near term, in that they are required to fulfill financial or contractual obligations (such as the repayment of debt, with interest) or to comply with Federal

Figure 5-4:

Personal Services and Nonpersonal Services Expenditures, FY 1999 – FY 2001

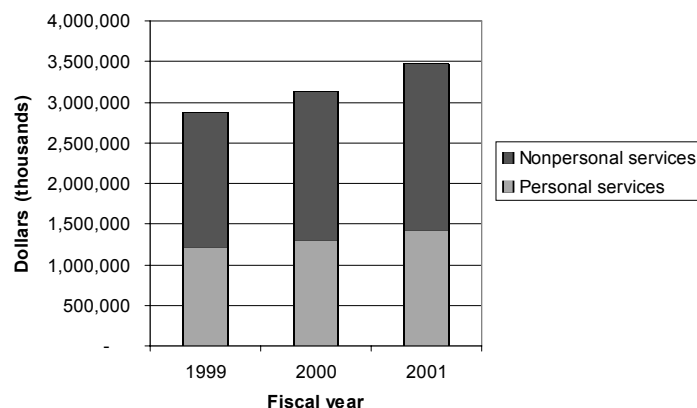


Table 5-3:

Mandatory and Discretionary Expenditures, FY 2002 Approved Budget

(Thousands of dollars)

	LOCAL FUNDS	PERCENT OF LOCAL BUDGET
Fixed Costs		
Utilities	56,571	
Communications	18,152	
Rent	64,707	
Security and Custodial	20,571	
<i>Subtotal Fixed Costs</i>	<i>160,001</i>	<i>4.5%</i>
Debt Service, Retirements, and Lawsuits		
Repayment of Loans and Interest	247,902	
Repayment of General Fund Recovery Debt	39,300	
Short-Term Borrowing	500	
Police and Fire Retirement System	74,600	
Teachers' Retirement System	0	
Settlements and Judgments	23,450	
Federal Contribution to Local Funds	38,193	
<i>Subtotal Debt Service, Retirements, and Lawsuits</i>	<i>423,945</i>	<i>11.9%</i>
Subsidies		
Wash. Metro Area Transit Authority	148,622	
Wash. Metro Area Transit Commission	83	
School Transit Subsidy	3,100	
Metro. Wash. Council of Governments	367	
Health Care Safety Net Administration	75,000	
<i>Subtotal Subsidies</i>	<i>227,172</i>	<i>6.4%</i>
Entitlement Programs^a		
Medicaid	268,832	
Unemployment Compensation	8,200	
Disability Compensation	27,986	
<i>Subtotal Entitlement Programs</i>	<i>305,018</i>	<i>8.5%</i>
Receiverships		
Child and Family Services Agency ^b	102,480	
Department of Mental Health ^b	132,813	
<i>Subtotal Receiverships</i>	<i>235,293</i>	<i>6.6%</i>
Mandated Programs (per-pupil formula)		
DC Public Schools (LEA portion only) ^{b, c}	501,923	
Public Charter Schools	142,257	
<i>Subtotal Mandated Programs</i>	<i>644,180</i>	<i>18.0%</i>
<i>Reserve Funds</i>	<i>183,254</i>	<i>5.1%</i>
Total Mandatory Expenditures	2,178,863	61.0%
Total FY 2002 Local Funds Budget	3,574,493	
Total FY 2002 Discretionary Expenditures	1,395,630	39.0%

NOTES:

a) Does not include all entitlements. Including others, such as Temporary Assistance to Needy Families, would increase the portion of the budget classified as "mandatory."

b) Budget reduced by amount of fixed costs, to avoid double-counting.

c) This includes only the Local Education Association (LEA) portion of the DCPS budget, that is, the portion determined through the legislated funding formula.

or local legislation or court order (see Table 5-3). An analysis of the approved FY 2002 budget by mandatory or discretionary functions provides insight into the extent to which the District has control over certain portions of its budget.

The primary categories of mandated spending are as follows:

- **Fixed costs.** The District must pay certain bills, such as utilities and rent, when they come due.
- **Debt service and other financial requirements.** The District must make certain payments to avoid defaulting on financial responsibilities. These include debt service payments, contributions to pension plans, and payments to settle lawsuits. Included in this total is the Federal contribution to local funds, which must be used for designated purposes, such as the D.C. Resident Tuition Support program.
- **Subsidies.** Various regional organizations, such as WMATA, assess the District annually, and the District makes payments based on these assessments. In addition, the District budgeted \$75 million for the Health Care Safety Net Administration in FY 2002 for the contract to take over provision of certain health care services.
- **Entitlement programs.** The District makes certain expenditures to fulfill Federal mandates regarding entitlement programs such as Medicaid. Note that the total shown here does not include other Federal programs, such as Temporary Assistance to Needy Families or certain other DOH and DHS programs, whose budgeted amounts were more difficult to isolate. Including these programs would raise the total described as “mandatory.”
- **Receiverships.** The District must make expenditures to comply with court orders regarding the two agencies that were placed in receivership in 1999.
- **Formula-driven mandated programs.** The District budgets for both DCPS and PCS based on funding formulas that are set in local legislation.
- **Reserve funds.** The District budgeted a

\$150.0 million reserve for FY 2002 and also budgeted \$33.3 million for transfer to the Emergency Reserve Fund. Both were required by Federal legislation.

Because the District has discretion over less than 40 percent of its expenditures, “across-the-board” cuts in expenditures can be relatively painful. For example, a 5 percent reduction in overall expenditures, if spread as broadly as possible, would require a 12.5-percent reduction in those items that are actually subject to reductions.

Some of the expenditures classified here as “mandatory” are the result of District policy decisions. For example, the District could choose not to subsidize school children’s use of mass transit or to change retirement benefits for employees in defined benefit retirement plans. Even in the entitlement programs, the District could reduce expenditures by choosing to restrict eligibility to only those who must be covered because of Federal minimum eligibility standards. Finally, to some extent, fixed costs can be controlled by maximizing the efficient use of District-owned locations and looking for space consolidation opportunities in leased buildings. Thus, over time, the District can control expenditures in some of these areas. However, within a given year, these expenditures can be fairly viewed as being outside the District’s control.

Summary of Projections for Expenditures for FYs 2004, 2005, and 2006

This section details the expenditures forecast in the District’s financial plan, providing general growth assumptions as well as specific assumptions in certain areas. The forecast begins with the FY 2003 proposed budget. Expenditures are then projected for the next three years, based on assumptions about growth in certain expenditure categories and agencies. In most agencies, growth is projected using general factors for PS and NPS growth. In some agencies, the forecast uses more specific growth factors. One-time items in the FY 2003 proposed budget are subtracted before making projections for FY 2004 and beyond.

While analyzing recent expenditures to see

where costs have been rising can highlight areas requiring special attention, simply projecting future growth based on past growth is somewhat unrealistic. Through the budget process, future expenditure growth will be constrained by revenues, which are anticipated to grow fairly slowly in FY 2002 and FY 2003, as described in the Revenue chapter. Thus, it is unlikely that expenditures will grow at the same 8-percent rate as the past three years, nor are they likely to continue to grow at 8 percent in FY 2004 and beyond.

Growth by Object Class

Personal Services

The general growth rate for PS expenditures is assumed to be 3.3 percent in FY 2004 and 3.5 percent in FY 2005 and 2006, or one percentage point above the Washington area CPI forecast. Recent union labor negotiations have resulted in increases higher than inflation, and city leaders recognize a general desire to try to keep nonunion salaries increasing at approximately the same rate as union salaries. One underlying assumption is that the District's work force remains the same size as today – that is, there are no significant increases or decreases in the number of District employees.

Extra pay, the category including overtime, differential pay (for night or weekend work, for example), and bonuses, is projected to grow at the general PS growth rate. As salaries increase, the cost of extra pay that is tied to salaries increases proportionally. If an employee earns time-and-a-half for certain work schedules, the cost will go up proportionally to the employee's base rate, assuming that the amount of work on these work schedules remains the same. Despite recent increases in the extra pay category, the assumption for the forecasts is that the hours of overtime and other work that falls into this category will remain at its current proportion of all work hours. Thus, costs in this category are projected to rise at the general PS rate.

Fringe benefits are assumed to grow faster than other PS expenditures. About half of the District's fringe benefit expenditures are for health insurance. After several years of moderate increases, relative to double-digit growth of the

early 1990s, health insurance costs rose rapidly in the past year – resulting in a 14 percent increase for the District. The projections assume health insurance costs will rise at 10 percent per year for the next three years. Other fringe benefits are assumed to grow at the general PS rate of 3.3 to 3.5 percent, because the cost of most other fringe benefits, most notably District employees' retirement plans, are tied to salaries. The fringe benefits category as a whole is thus assumed to grow at 6.7 percent annually.

Nonpersonal Services

The general growth rate for NPS expenditures is assumed to be 2.3 percent in FY 2004 and 2.5 percent in FY 2005 and 2006, the Washington area CPI forecast. Exceptions are as follows:

- Contractual services, which have been rising faster than general NPS expenditure growth, are assumed to increase at 3.3 to 3.5 percent annually. A great deal of contractual services spending is for salaries of contractors, thus, the forecasts use the rate of increase for PS expenditures.
- Most debt service expenditures are in specific debt service "agencies," which have specific growth paths that are described below. A small portion of debt service is in operating agency budgets as part of the master lease program. Master lease debt service is assumed to increase at 2.3 to 2.5 percent per year, reflecting agency needs that expand at the general inflation rate.

Growth by Agency or Program

The following agencies or programs are assumed to grow at rates that deviate from the general assumptions for each object class or have special circumstances meriting discussion.

D.C. Public Schools

Expenditures by DCPS grew rapidly in FY 2001, and rapid increases are occurring in FY 2002 and are built into the FY 2003 proposed budget. For the projections, however, the Local Education Agency (LEA) portion of the DCPS budget is assumed to grow at 2.3 to 2.5 percent per year, which is the Washington area CPI forecast. This is the rate that would be used in the legislated for-

mula that funds the LEA portion of the DCPS budget. Using this rate for the projections assumes that:

- Enrollments will remain constant over the next three years;
- Expenditure increases that have occurred in FY 2001 and 2002, and that are budgeted for in FY 2003, have made up for any structural needs, including special education, that had been omitted from the DCPS budget in prior years; and thus
- Growth according to the legislated funding formula will be sufficient to meet DCPS needs in the coming years.

The discussion of Medicaid below has a separate impact on DCPS.

Medicaid

Medicaid growth within DOH has been modest, averaging 4 percent annually from FY 1998-2001. By analyzing where expenditures have been growing most rapidly within Medicaid, a specific forecast for Medicaid has been built up from the individual components of Medicaid. The result of this analysis is a growth rate forecasted at between 8.2 and 9.0 percent each year.

Medicaid growth outside of DOH was a primary factor in the District's expenditure increase in FY 2001, continues in FY 2002, and is built into the FY 2003 proposed budget. One of the major causes of Medicaid growth at DCPS and DMH is the lower-than-expected reimbursement rate from the Federal government. The District has budgeted a reserve against uncollected Medicaid revenues. For FY 2003 and FY 2004, the District will use the proceeds of the

tobacco securitization to finance this reserve. Beginning in FY 2005, tobacco securitization proceeds will go into the Tobacco Trust Fund.

The projections assume these agencies will improve their Medicaid collections over time. These projections do not mean the amount of Medicaid-related expenditures will decline – in fact, they are projected to increase. However, the local funds share of total costs in this area will decline, if the Federal reimbursement rate improves.

Health Care Safety Net Administration

Contract costs for the Health Care Safety Net Administration are projected to grow at 5 percent per year, reflecting increases in health care costs that are likely to exceed the general rate of inflation.

Debt Service

Long-term debt service expenses are projected to increase, but they are at somewhat lower levels than in FY 1998 and 1999. The Certificate of Participation payments for the building at One Judiciary Square will continue at \$7.95 million per year through 2013. The General Fund Deficit Bonds, on the other hand, will be repaid fully in FY 2003, so that expenditure is not carried in future years. Finally, a small amount of short-term borrowing is anticipated each year. Projected debt service payment schedules are shown in Table 5-4.

Washington Metropolitan Area Transit Authority (WMATA) Subsidy

During the next three years the District's subsidy to WMATA is forecast to increase at a 5 percent

Table 5-4:

Projected Payment Schedules for Debt Service Agencies

(Thousands of dollars)

	FY 2003	FY 2004	FY 2005	FY 2006
Repayment of Loans and Interest	267,451	341,362	372,517	403,432
Certificate of Participation	7,950	7,950	7,950	7,950
Repayment of General Fund Deficit Bonds	39,300	0	0	0
Short-Term Borrowings	1,000	1,000	1,000	1,000

annual rate. Systemwide fare revenue, which reduces the need for subsidies, is expected to grow only 3 percent annually, reflecting current rates and a 3 percent annual growth in combined bus and rail ridership. This rate is slower than that experienced in months prior to September 11th, when tourist and other mid-day use was strong and demand was also responding to fare simplification and final rail extensions. Since labor negotiations are ongoing for the three-year contract beginning July 1, 2002, overall pay costs cannot be projected with precision. Cost savings achieved for FY 2003 through advance fuel purchase swaps at current low rates may not be repeated in the outyears.

Subsidies and Transfers Related to PS Expenditures

Expenditures in four agencies are classified as transfers that are, in fact, related to PS costs. They are:

- Police and Fire Retirement System
- Teachers' Retirement System
- Unemployment Compensation Fund
- Disability Compensation Fund

Expenditures in these four agencies are projected to grow at the PS growth rate of 3.3 to 3.5 percent.

Reserve Funds

For detail on the District's various reserve funds, see the Financial Plan chapter.

Appendix 1: Medicaid

Medicaid is funded by the Federal and state governments to provide medical care and services to certain individuals and families with low incomes and resources. Since the 1997 Revitalization Act, the District's program has been funded by District expenditures and a Federal matching rate of 70 percent. The Federal match is paid as a reimbursement—that is, the District spends one dollar on medical services, submits a claim to the Federal government, and receives a 70-cent reimbursement upon determination that the claim is valid and has been submitted properly.

Issues related to the reimbursement process have partially driven the Local funds Medicaid expenditure increases in recent years. If claims are not submitted or submitted improperly, the District does not receive its Federal match. Thus, an expense that was budgeted at 30 cents of Local funds (and 70 cents of Federal funds) becomes instead an expense of one dollar of Local funds. This change then appears as a 70-cent increase in Local funds Medicaid expenditures.

Although DOH processes all Federal Medicaid reimbursements for the District, several other agencies besides DOH have Medicaid expenditures, primarily DMH (formerly CMHS) and DCPS. Much of the FY 2001 expenditure growth in DMH and DCPS was the result of Medicaid costs that were not reimbursed by the Federal government. Local fund Medicaid expenditures are difficult to isolate within these two agencies, so no trend can be seen. Beginning in FY 2002, Federal reimbursements DOH receives for other agencies' Medicaid expenditures are tracked separately in the DOH budget, so the District will have a better picture of its overall Medicaid expenditures.

The District is not alone in its Medicaid expenditure growth—most other states are facing Medicaid pressures. In part because of the recent economic downturn, officials in Tennessee and Florida are discussing changes that might reduce Medicaid eligibility, and Washington state might seek to increase cost-sharing on the part of its Medicaid recipients.⁸

Appendix 2: Data Tables for Operating Expenditures

Table A-1:

Effects of the Revitalization Act on District Expenditures, FYs 1997 and 1998

(Thousands of dollars, excluding Enterprise agencies)

	LOCAL FUNDS		GROSS FUNDS	
	FY 1997	FY 1998	FY 1997	FY 1998
Metropolitan Police Department	239,660	257,962	261,440	269,092
Fire and Emergency Services Department	97,518	108,961	98,098	109,317
Police and Fire Retirement System	226,700	47,700	226,700	47,700
Department of Corrections ^a	253,920	93,045	258,834	258,574
Selected Court Functions ^b	139,274	0	142,008	1,228
<i>Subtotal, selected public safety</i>	<i>957,072</i>	<i>507,668</i>	<i>987,080</i>	<i>685,911</i>
D.C. Public Schools	481,547	520,097	554,017	634,240
Teacher's Retirement System	88,100	8,900	88,100	8,900
Public Charter Schools	0	3,195	0	3,195
<i>Subtotal, selected public education</i>	<i>569,647</i>	<i>532,192</i>	<i>642,117</i>	<i>646,335</i>
Department of Human Services	826,509	359,808	1,608,923	629,842
Department of Health	0	294,040	0	906,431
Public Benefit Corporation Subsidy	32,135	42,873	32,135	42,873
<i>Subtotal, selected health and human services</i>	<i>858,644</i>	<i>696,721</i>	<i>1,641,058</i>	<i>1,579,146</i>
Department of Public Works	98,345	110,366	105,530	119,322
WMATA Subsidy	129,002	126,746	129,002	126,746
Repayment of Loans and Interest	347,304	347,358	426,992	347,358
<i>Subtotal, selected public works, financing, and other</i>	<i>574,651</i>	<i>584,470</i>	<i>661,524</i>	<i>593,426</i>
All other agencies	401,005	446,696	509,203	558,745
District total	3,361,019	2,767,748	4,440,982	4,063,562

NOTES:

a Department of Corrections gross funds expenditures for FY 1998 include a \$162 million transfer from the Corrections Trustee. This transfer does not appear in the District's Comprehensive Audited Financial Report for 1998. In the years thereafter, expenditures from such transfers were included as other-type expenditures for the Department of Corrections, so this amount is included here to maintain continuity.

b "Selected Court Functions" consist of DC Court of Appeals, DC Superior Court, DC Courts System, Public Defender Service, Pretrial Services Agency, Parole Board, and Judges' Retirement.

Table A-2:

Local Funds Expenditures by Fiscal Year for Selected Large Agencies

(Thousands of dollars, excluding Enterprise agencies)

	FY 1998	FY 1999	FY 2000	FY 2001	Annual Growth Rate 1999-2001
Metropolitan Police Department	257,962	276,338	297,327	309,820 ^a	
Fire and Emergency Services Department	108,961	102,482	112,749	129,197 ^a	
Police and Fire Retirement System	47,700	35,100	39,900	49,000	
Department of Corrections	93,045	71,589	70,484	80,325	
Corrections Medical Receiver	0	8,499	13,300	10,820	
<i>Subtotal, selected public safety</i>	<i>507,668</i>	<i>494,008</i>	<i>533,760</i>	<i>579,162</i>	<i>4.5%</i>
D.C. Public Schools	520,097	550,812	604,098	727,360 ^b	
Teacher's Retirement System	8,900	18,600	10,700	200	
Public Charter Schools	3,195	11,113	46,480	104,992 ^c	
<i>Subtotal, selected public education</i>	<i>532,192</i>	<i>580,525</i>	<i>661,278</i>	<i>832,552</i>	<i>16.1%</i>
Department of Human Services	359,808	188,684	197,109	194,168	
Child and Family Services Agency	0	97,217	74,836	96,069	
Commission on Mental Health Services ^d	0	105,369	129,177	217,704	
Department of Health	294,040	310,781	325,339	356,499	
Public Benefit Corporation Subsidy	42,873	46,835	138,161	136,912 ^e	
<i>Subtotal, selected health and human services</i>	<i>696,721</i>	<i>748,886</i>	<i>864,622</i>	<i>1,001,352</i>	<i>12.9%</i>
Department of Public Works	110,366	106,748	99,624	96,950	
WMATA Subsidy	126,746	131,604	135,531	163,073	
Repayment of Loans and Interest	347,358	363,194	315,656	228,364	
<i>Subtotal, selected public works, financing, and other</i>	<i>584,470</i>	<i>601,546</i>	<i>550,811</i>	<i>488,387</i>	<i>-5.8%</i>
All other agencies	446,697	451,886	523,386	569,764 ^f	8.4%
District Total	2,767,748	2,876,851	3,133,857	3,471,217	7.8%

NOTES:

Details may not sum to totals because of rounding.

^a FY 2001 figures includes Federal funds within the Local budget for Emergency Preparedness and 9/11 Reimbursements.^b Excludes 9,768 spent in FY 2001 against FY 2002 budget.^c Excludes 31,884 spent in FY 2001 against FY 2002 budget.^d Now known as the Department of Mental Health.^e Includes transition costs.^f Excludes 617,230 spent on refunded bonds in FY 2001.

Table A-3:

Gross Funds Expenditures by Fiscal Year for Selected Large Agencies

(Thousands of dollars, excluding Enterprise agencies)

	FY 1998	FY 1999	FY 2000	FY 2001	Annual Growth Rate 1999-2001
Metropolitan Police Department	269,092	283,131	306,281	319,501 ^a	
Fire and Emergency Services Department	109,317	102,891	112,855	129,216 ^a	
Police and Fire Retirement System	47,700	35,100	39,900	49,000	
Department of Corrections	258,574	240,680	248,526	212,495	
Corrections Medical Receiver	0	12,605	13,300	10,820	
<i>Subtotal, selected public safety</i>	<i>684,683</i>	<i>674,407</i>	<i>720,862</i>	<i>721,031</i>	<i>1.7%</i>
D.C. Public Schools	634,240	666,007	771,759	817,227 ^b	
Teacher's Retirement System	8,900	18,600	10,700	200	
Public Charter Schools	3,195	25,239	49,936	104,984 ^c	
<i>Subtotal, selected public education</i>	<i>646,335</i>	<i>709,846</i>	<i>832,395</i>	<i>922,410</i>	<i>12.6%</i>
Department of Human Services	629,842	335,401	359,650	387,919	
Child and Family Services Agency	0	146,232	138,740	177,243	
Commission on Mental Health Services ^d	0	196,543	206,713	287,335	
Department of Health	906,431	974,492	1,008,098	1,110,207	
Public Benefit Corporation Subsidy	42,873	46,835	138,161	136,912 ^e	
<i>Subtotal, selected health and human services</i>	<i>1,579,146</i>	<i>1,699,503</i>	<i>1,851,362</i>	<i>2,099,616</i>	<i>10.0%</i>
Department of Public Works	119,322	116,933	107,450	104,352	
WMATA Subsidy	126,746	131,604	135,531	163,073	
Repayment of Loans and Interest	347,358	363,194	315,656	228,364	
<i>Subtotal, selected public works, financing, and other</i>	<i>593,426</i>	<i>611,731</i>	<i>558,637</i>	<i>495,788</i>	<i>-5.8%</i>
All other agencies	559,972	806,983	858,419	814,684 ^f	13.3%
District Total	4,063,562	4,502,470	4,821,675	5,053,530	7.5%

NOTES:

Details may not sum to totals because of rounding.

^a FY 2001 figures includes Federal funds within the Local budget for Emergency Preparedness and 9/11 Reimbursements.^b Excludes \$9.8 million spent in FY 2001 against FY 2002 budget.^c Excludes \$31.9 million spent in FY 2001 against FY 2002 budget.^d Now known as the Department of Mental Health.^e Includes transition costs.^f Excludes \$617.2 million spent on refunded bonds in FY 2001.

Table A-4:

Local Funds Personal Services and Nonpersonal Services Expenditures by Fiscal Year

(Thousands of dollars, excluding Enterprise agencies))

	FY 1999	FY 2000	FY 2001	Annual Growth Rate 1999-2001
Regular salaries and wages ^a	965,659	1,010,397	1,126,640	8.0%
Extra pay ^b	83,883	100,496	108,028	13.5%
Fringe benefits ^c	173,555	177,624	190,523	4.8%
<i>Subtotal, PS</i>	<i>1,223,098</i>	<i>1,288,516</i>	<i>1,425,192</i>	<i>7.9%</i>
Fixed costs ^d	122,517	144,689	144,183	8.5%
Subsidies and transfers	727,034	894,276	979,253	16.1%
Debt service	412,005	361,704	279,530	-17.6%
Contractual services	235,392	270,707	364,772	24.5%
Other NPS	156,805	173,967	278,287	33.2%
<i>Subtotal, NPS</i>	<i>1,653,752</i>	<i>1,845,343</i>	<i>2,046,025</i>	<i>11.2%</i>
Total	2,876,850	3,133,859	3,471,217	9.8%

NOTES:

Details may not sum to totals because of rounding. Because of rounding differences in different data sources, totals vary slightly from those in table A-2.

^a Full- and part-time, continuing and term.^b Includes overtime, bonuses, and differentials for nights, weekends, and holidays.^c Includes contribution to Police and Fire Retirement System and Teachers' Retirement System.^d Utilities, telecommunications, and rent.

Notes:

¹ Local funds expenditures are generally those financed by revenue the District raises itself, through its own taxes and certain fees. Gross funds expenditures are those financed by all revenue sources, including Local revenues, Federal grants and entitlements, private grants, and other revenues. Except where otherwise noted, expenditures figures in this chapter are for Local funds only.

² The chapter does not discuss capital expenditures, which are described in the Capital chapter. Furthermore, it includes only agencies in the District's general fund. For other funds, such as enterprise funds, proprietary funds, and component units of the District, see the appendix on the District's fund structure and projected fund balances.

³ Title IX, National Capital Revitalization and Self-Government Improvement Act of 1997, of the Balanced Budget Act of 1997 (P.L. 105-33).

⁴ In FY 2001, both DCPS and PCS received permission for the first time to spend part of their upcoming year (FY 2002) appropriation in the last quarter of the current year (FY 2001). This change allowed both systems to match their spending more closely to the school year calendar. To maintain comparability with prior years, FY

2001 expenditure totals in this chapter exclude the FY 2002 funds that DCPS and PCS spent in FY 2001.

⁵ CMHS is now the Department of Mental Health.

⁶ Securitization is a financing method whereby a party sells bonds to investors based on a future stream of payments. The securitizing party receives funds up front from the proceeds of the bond sale. The investors receive periodic payments—principal plus interest—on their bonds, with the securitizing party making payments as the future income stream materializes.

⁷ In this section, the District's contributions to the Police and Fire and Teachers' Retirement Funds are considered PS expenditures. Data presented here will vary slightly from the District's accounting basis, which places these contributions in the Subsidies and Transfers category within NPS.

⁸ Center on Budget and Policy Priorities, "Federal Aid to State Medicaid Programs Is Falling While The Economy Weakens," by Leighton Ku and Edwin Park, October 26, 2001.