



The
STEPHEN S. FULLER INSTITUTE
for Research on the Washington Region's Economic Future

The Roadmap for the Washington Region's Future Economy: Pivoting the Region's Economy Away From Its Federal Dependence—An Assessment

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Washington, DC Is a Company Town

The Washington region has long depended on increased spending by the Federal Government for its economic growth. Since the capital was moved to the District of Columbia in 1800, the economy's performance has been inextricably linked to the Federal Government—Washington, DC is a company town. The consequences of the relationship between the growth (and contraction) of the federal government and the region's economic performance have been most evident in times of international crisis (before and after wartime) and with the shifting of federal policy towards greater federalism or towards decentralization. In recent times, policies aimed at reducing the size of the federal work force and to privatizing federal functions have had significant and long-term impacts on the Washington region's economic performance and the structure of the Washington region's economy.

The growth of federal procurement spending in the regional economy since 1980, when procurement totaled \$4.2 billion, to its peak in 2010, when total procurement spending totaled \$81.5 billion, coincided with the most significant development of the region's economy in its history; the correlation between the growth of federal procurement and the growth of gross regional product (GRP) in the Washington region over this period was 0.95.

Federal spending in the Washington region peaked—reached its all-time high, in 2010. At that time, federal spending of all types—procurement/contracting, payroll, retirement and disability, select grants and loans—totaled up to more than \$170 billion and accounted directly for 39.8% of the region's GRP, the value of goods and services produced within the Washington region's economy.

The economy that emerged from this 30-year growth pattern ranked 4th in value (following New York, Los Angeles, and Chicago) and ranked only behind NYC in the size of its office space inventory. The Washington region was and remains one of the nation's premiere knowledge-based economies and owes this status largely to the presence of the federal government as its driver of economic growth.

Federal Dependence Becomes a Liability

The Budget Control Act of 2011 set in motion a multi-year reduction in federal procurement spending that was paralleled by a reduction in federal employment in the Washington region. While these spending reductions and their economic impacts can be described by what has become known as The Sequester, which spanned the March 2013-September 2014 period, the actual spending reductions and federal job losses date back to 2011. From 2010 to 2013, the federal workforce lost 17,800 jobs (4.6%) and federal procurement outlays declined by \$12.7 billion (15.5%). As a result, the Washington economy stopped growing in 2013 and registered a 0.5% loss of GRP for the year, down from a 3.3% growth rate in 2010. This pattern of decline in federal spending as a share of the region's economy has continued to the present. And, while the economy resumed growing in 2014, its job

growth that year ranked 15th among the nation's 15 largest metropolitan areas and the region's GRP growth trajectory has remained below the nation's GDP through 2015. By 2011, the federal spending that had driven growth for the previous 30 years through 2010 became a drag on economic growth and the drag of this downshift in federal spending continues today.

The Roadmap for the Washington Region's Future Economy

The Roadmap for the Washington Region's Future Economy, released by the GMU Center for Regional Analysis in January 2016 and supported by the 2030 Group and a coalition of 12 non-profit organizations, set out to identify advanced industrial clusters for which the Washington region possessed a competitive advantage that were not federally dependent, were characterized by sales to non-local markets, generated high-value added jobs, and had above-average growth trends. The *Roadmap* analysis identified seven such clusters with 811,193 jobs in 2014 (27.3% of the region's total) that had grown 15 percent during the 2003-2014 period compared to the growth rate for all jobs in the Washington region during this period of 9 percent. The jobs in these advanced industrial clusters had an average salary that was 35 percent greater than the average salary for all jobs in the region.

The *Roadmap* analysis also analyzed these advanced clusters' growth potentials over the 2014-2025 period and found that if they followed the growth trajectory of their respective sectors nationally they would grow 20.9 percent in the Washington regional economy. However, if these clusters tracked their recent regional growth performance (2011-2014) going forward over the 2014-2025 period, they would grow only 7.6 percent.

The consequences of faster or slower growth in the region's advanced industrial clusters on the region's other jobs were found to be significant. At the slow-growth rate (7.6%) for cluster-based jobs, the region's total job base would only increase by 4.0 percent. In contrast, if the cluster-based jobs achieved their higher potential growth rate (20.9%), this cluster-based growth would support a 14.4 percent job growth rate for the region's total job base. These growth forecasts are shown in Table 1 for each cluster and for total jobs in the Washington region.

Job Growth in the Washington Region, 2014-2016

The Washington region has added more than 131,800 net new jobs during the last two years. This job growth has been the best two-year performance since 2004-2005 when the Washington region added 135,000 jobs and federal spending in the region was booming. This acceleration in job growth from February 2014 when the job growth was negative (compared to February 2013), during a period in which federal spending in the Washington region was not growing, is important but its significance could be misinterpreted.

**Table 1: The Washington Region's Advanced Industrial Clusters
Job Growth Forecast, 2014-2025**

	Low		High	
	Jobs	% Change	Jobs	% Change
Advocacy	122,303	5.7%	138,868	20.0%
Information Communications Technology	213,621	4.5%	224,872	10.0%
Science & Security Technology	135,707	9.6%	147,104	18.8%
Biological & Health Technology	58,388	5.4%	67,929	22.6%
Business & Financial Services	218,851	15.1%	269,053	41.5%
Media & Information	36,292	1.5%	41,667	16.6%
Business & Leisure Travel	87,807	2.2%	91,512	6.5%
All Clusters	872,969	7.6%	981,005	20.9%
All Jobs in Washington MSA	3,092,270	4.0%	3,402,570	14.4%

Source: Inforum, University of Maryland, December 2015

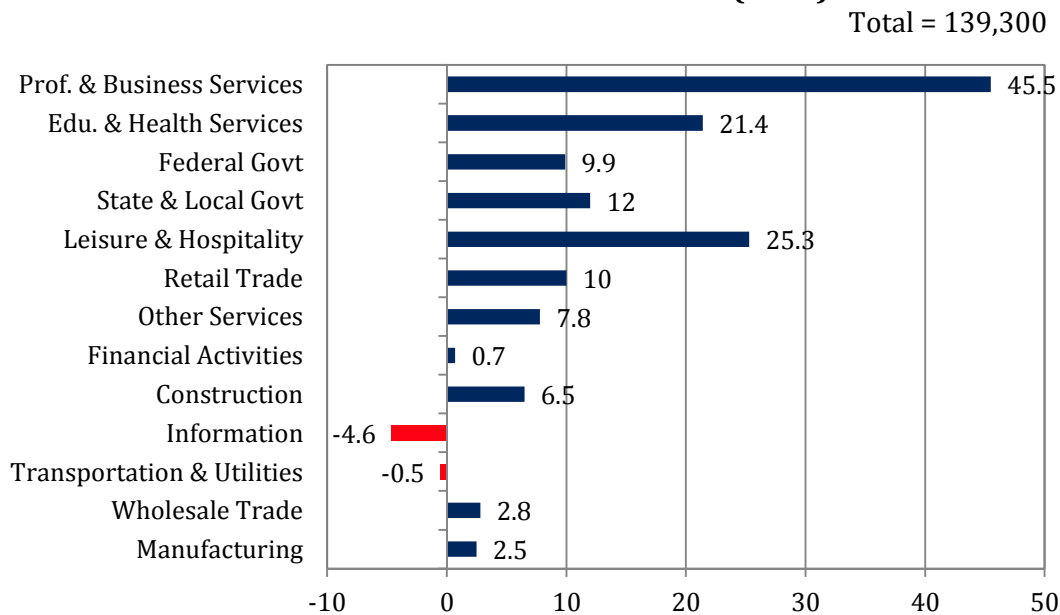
It would be too convenient to conclude that because the regional economy generated its best job growth (72,400) in 2016 since 2000 and that growth followed a strong year of job growth in 2015 (59,400), that the Washington region's economy has successfully pivoted away from its federal dependence and is on the growth trajectory outlined in the *Roadmap*. While job numbers are important—more is better than less—what is even more important as a measure of the economy's output production potential is the quality of these jobs; that is, whether the mix of new jobs is skewed towards higher-value added, export-based jobs that offer the Washington region its greatest potential for long-term growth. The distribution of the new jobs generated in the Washington region's economy since the Sequester is presented in Figure 1 on page 4.

An examination of the types of jobs the region has added to its base since 2014 is revealing. Professional and Business Services jobs are outperforming their historic share, accounting for 33 percent of all new jobs while accounting for 23 percent for all jobs in the workforce. This is the good news.

Countering the Professional and Business Services jobs, with their high average salaries and high-value added to GRP, is even greater growth among Education and Health Services, Leisure and Hospitality Services and Retail Trade. Combined, their job growth accounted for 42.1 percent of the total job gain during the last two years. What makes this comparison important is that these three sectors are characterized by an average salary that is less than one-half of the average salary of Professional and Business Services jobs.

It is also noteworthy when examining Figure 1 to consider that these four private sectors accounted for 74.8 percent of all new jobs and all of the other non-government jobs spread across seven sectors only accounted for 9.5 percent. Gains in federal, state and local government jobs during this two-year period accounted for 15.7 percent of the new jobs. This distribution does not reveal any obvious or accelerated pattern of diversification away from public sector jobs or among the region's private sectors. Rather, the private sectors appear to becoming less diversified and more concentrated within fewer sectors.

**Figure 1: Washington Region's Job Change by Sector
December 2014 to December 2016 (000s)**



Source: Bureau of Labor Statistics (Quarterly Census of Employment and Wages);
The Stephen S. Fuller Institute at the Schar School, GMU

Has the Washington Region's Economy Pivoted Away from its Federal Dependence?

The *Roadmap* defined seven advanced industrial clusters for which the Washington region possessed a distinct competitive advantage, that were non-federally dependent and that were export-based and high-value added. These clusters also had strong growth expectations within the national economy over the coming decade. These clusters and their projected growth to 2025 are presented in Table 1.

The key performance measure for the Washington region's economy is not how many jobs it has added but whether the economy has been able to generate jobs of the quality needed to replace the federally dependent jobs that are no longer driving the region's economic growth. Has the Washington region's economy successfully pivoted away from its historical federal spending dependency to an export-based

economy that is competitive in national and global markets? The answer to this question is NO!

While it is still early in the forecast period (2014-2025), job growth data for the March 2014 to March 2016 period, the immediate two years following The Sequester, informs this conclusion¹. See Table 2.

**Table 2: The Washington Region's Advanced Industrial Clusters
March 2014 to March 2016**

	Job Change	% Change	% of Total
Advocacy	3,300	2.9%	3.2%
Information Communications Technology	4,120	2.0%	4.0%
Science & Security Technology	(420)	-0.4%	-0.4%
Biological & Health Technology	1,280	10.4%	1.3%
Business & Financial Services	5,030	2.8%	4.9%
Media & Information	(690)	-2.4%	-0.7%
Business & Leisure Travel	1,410	2.0%	1.4%
All Clusters	14,030	1.9%	13.7%
Non-Cluster, Private	76,010	4.9%	74.4%
Government	12,160	1.8%	11.9%
All Jobs in Washington MSA	102,200	3.5%	100.0%

Source: Bureau of Labor Statistics (Quarterly Census of Employment and Wages);
The Stephen S. Fuller Institute at the Schar School, GMU

During this two-year period, the Washington region's economy generated 102,200 jobs. It should be noted that for the twelve-month period immediately preceding this two-year period (March 2013 to March 2014), the Washington region generated no net new jobs, the federal workforce declined by 15,000, and federal procurement spending grew just 2.5 percent and had declined \$10.9 billion (13.4%) from its 2010 peak. These baseline economic conditions preceding March 2014 would support the notion that the job growth that was generated since The Sequester was not federally dependent and would support the premise that the Washington region's non-federally dependent business base had moved beyond its federal dependence and had successfully positioned itself in the national and global market place.

¹ The employment data on the clusters in March 2014 and March 2016 are from the U.S. Bureau of Labor Statistic's Quarterly Census of Employment and Wages. These clusters exclude all public sector jobs and sub-sectors that were non-disclosed and could not be estimated and will differ somewhat from Inforum's December 2015 analysis.

However, the data in Table 2 do not support that conclusion.

- Of the 102,000 net new jobs, only 14,030 or 13.7 percent can be classified as being jobs in the Washington region's advanced industrial clusters;
- Cluster-based job growth increased only 1.9 percent while non-cluster job growth increased 4.9 percent over this two-year period; and,
- Government job growth—federal, state, and local—increased 1.8 percent.

The conclusion from these job growth data for the first two years (March 2014-March 2016) of the post-Sequester era is that the economy is being driven by non-cluster based jobs and that the majority of these are local serving (e.g., retail trade, food services, health services, consumer services, housing) and that the Washington region's economy has not yet begun to pivot. Yes, federal spending is not driving economic growth but neither is the growth of the Washington region's advanced industrial clusters.

These clusters' performances have been uneven during this two-year period, as shown in Figure 2 on page 7. Two of the clusters' annualized growth rates are not even close to their projected performance ranges as represented in Table 1. One cluster's growth rate sits at the bottom of its projected growth rate range and one, Advocacy, sits near the top of its projected range. There are three clusters that could be classified as over-performing but only one of those—Biological and Health Technology—is off the chart. Given this strong performance, it is unfortunate this is the Washington region's smallest advanced industrial cluster. Overall, the clusters' first two-year performances have been disappointing, averaging only a combined 1.0 percent annual growth rate, placing it in the bottom quartile of the projected range for the 2014-2025 period.

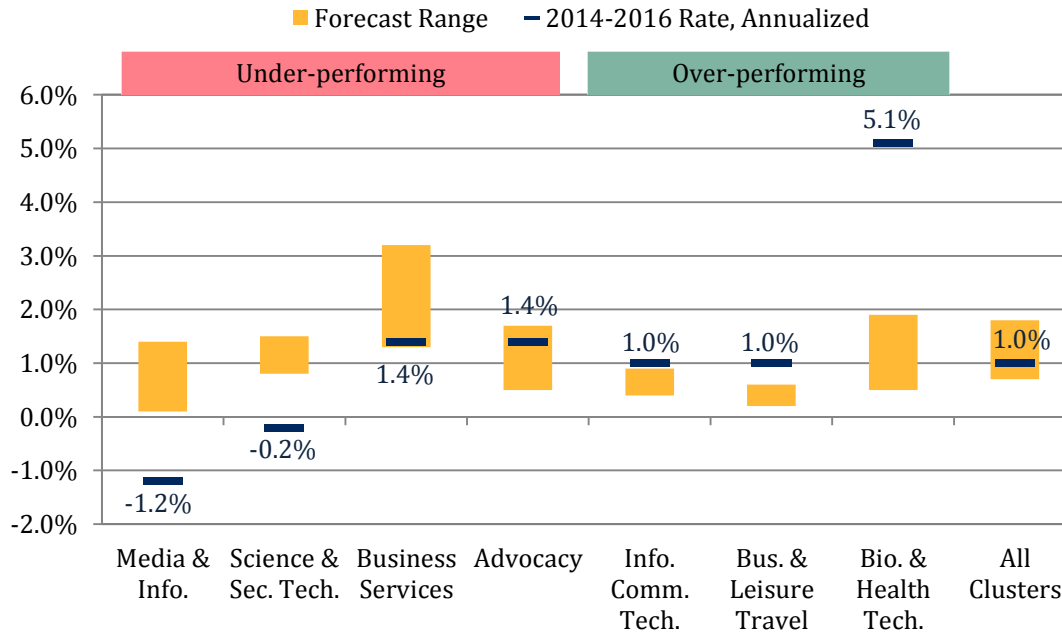
What Is the Long-Term Cost of this Growth Trajectory?

What is the significance of this poor performance—an unfavorable job mix as measured by their value added—and how will this pattern impact the economy's GRP and the quality-of-life that the region's economy can support? A comparison of the average salaries associated with the jobs characterizing the Washington region's advanced industrial cluster and its non-cluster jobs is shown in Figure 3 on page 7. Private sector, cluster-based jobs support an average salary double the average for non-cluster private sector jobs. While the average salaries reflect a range across the clusters, even the lowest average salary—business and leisure travel services at \$53,360—is greater than the average for all non-cluster jobs.

Beyond these salary differentials, the key question must be: if this pattern of economic growth continues how will it impact the growth trajectory of the Washington region's economy? The full value added to GRP for each of these

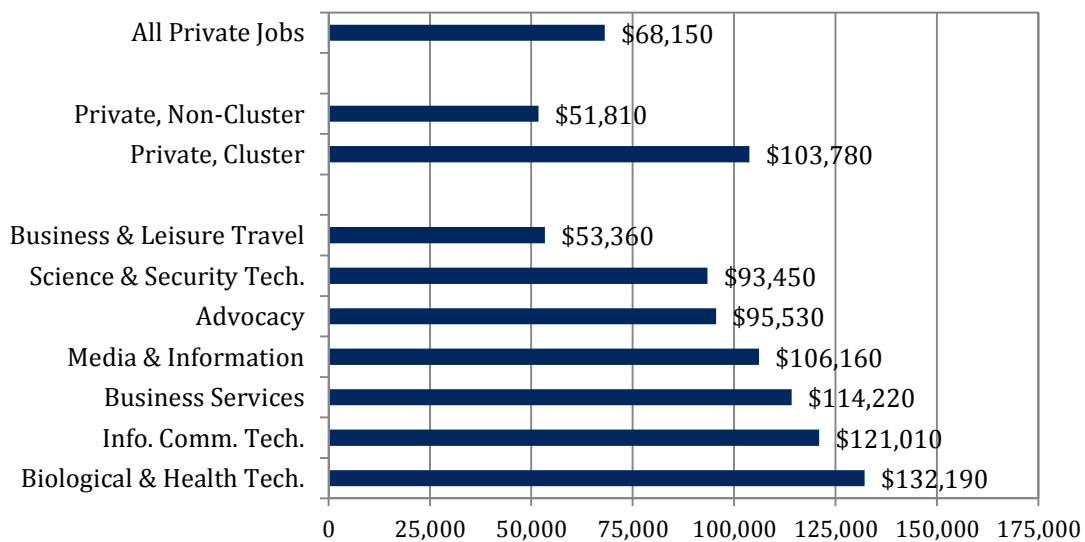
clusters substantially exceeds their respective average salary, by 50 to 60 percent for many clusters and by greater multiples for other clusters

Figure 2: The Washington MSA's Advanced Industrial Clusters Annual Growth Rates



Source: Bureau of Labor Statistics (Quarterly Census of Employment and Wages); The Stephen S. Fuller Institute at the Schar School, GMU

Figure 3: The Washington Region's Advanced Industrial Clusters Average Wage in 2015

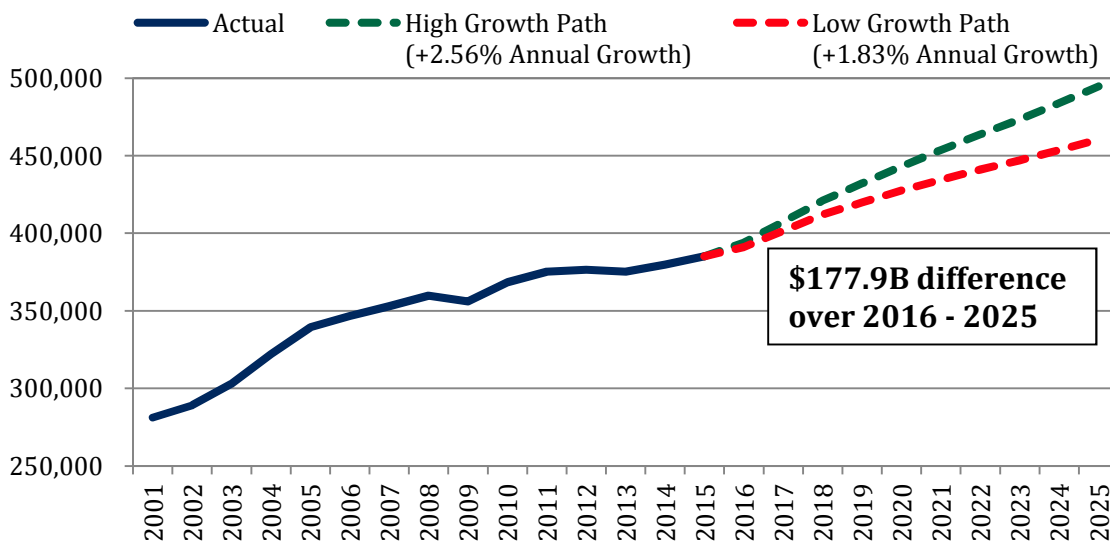


Source: Bureau of Labor Statistics (Quarterly Census of Employment and Wages); The Stephen S. Fuller Institute at the Schar School, GMU

The answer to that question is shown in Figure 4. It can be seen that the impact of continued underperformance of the region's clusters is a significantly lower economic growth rate, the result of which will be a smaller economy in 2025 than had these advanced industrial clusters grown at a faster rate and achieved their full growth potential. This is the difference between an average annual GRP growth rate of 1.83 percent and 2.56 percent.

If cluster-based job growth continues to underperform its potential to 2025, the region's private sector generated GRP will be \$460.4 billion (in 2016\$s), up from \$385.2 billion in 2015. However, if cluster-based jobs average the upper-level forecast over the next nine years, the region's private-sector-generated GRP would total \$494.6 billion. While the one-year GRP difference in 2025 would total \$34.3 billion, the total difference between realized growth and potential growth over the 2016-2025 period is cumulative with each year's underperformance totaling up to performance differential of \$177.9 billion.

**Figure 4: The Washington Region's Private Sector GRP, 2002-2025
(Millions of 2016 \$s)**



Source: The Stephen S. Fuller Institute at the Schar School, GMU

Conclusions

It appears as if the Washington region has “recovered” from the shock of The Sequester; that is, it is growing jobs again at a very respectable rate and its economy—its GRP—is accelerating. At the end of 2016, the Washington economy appeared well on its way back to its historic path with growth exceeding U.S. GDP in good years while continuing to be cushioned from full downside effect of the national business cycle. However, appearances can be deceiving.

There is little evidence that the Washington economy has pivoted away from its historic dependence on federal spending to grow in the long run. The evidence provided by the first two years' economic performance following The Sequester confirms that while federal spending no longer constitutes as large a percentage of the region's GRP, the difference between federal spending in 2010 (the peak GRP dependence) and its current smaller share has not been made up by the growth of the region's non-federally dependent advanced industrial clusters.

The short-term cost of this failure to pivot the region's economy to national and global markets by accelerating the growth of its non-federally dependent export base and high-value added businesses, for which the Washington region possesses a competitive advantage is potentially large. Under-performing the region's growth potential sets the economy on a lower growth trajectory from which recovery becomes more problematic the longer this slow-growth trajectory continues.

The GDP cost of growing the region's advanced industrial clusters at their recent historic rates to 2025 in comparison to growing these clusters at their full potential rate is the difference between the region's economy growing at an annual rate of 1.83% and 2.56%. The GRP cost (foregone economic growth) of this slower growth rate in 2017 would be only \$5.8 billion. But, each year that this differential growth rate continues, the annual value of foregone GRP increases. In 2018, this annual GDP cost would be \$8.9 billion. In 2020, this annual loss or unrealized GRP gain would total \$12.2 billion. Over the full period, 2016-2025, these annual GDP costs of under-performance would accumulate to a very significant cost; the Washington region's economy would have generated \$177.9 billion less growth than it could have been realized had only its advanced industrial clusters grown at their respective projected average national rates over this same period.

Today, the Washington region's economy remains bound to federal spending—federal employment and payroll and procurement. Breaking the region's historic federal-spending dependence and pivoting to a private sector driven, nationally and globally competitive economy, is not a natural process. It is not likely to happen in the absence of targeted intervention, regional collaboration, and political leadership. To successfully pivot away from the Washington region's company town economy will require increased and deliberate focus on advancing the region's competitive knowledge-based economic clusters and expanding the markets for their services and products to non-federal customers worldwide.