The Washington Region's Declining Economic Brand

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The Washington region has lost position relative to its peers since 2010. The slower economic growth that has resulted from reductions in federal spending over the past six years has generated concomitant reductions in many of the region's rankings based on other economic measures. Understanding the interdependencies between slower economic growth, the wage and salary mix of new jobs, personal income change, the high cost-of-living and housing affordability, declining population growth rates and net domestic outmigration, and economic competitiveness will make it easier to formulate and undertake initiatives for reversing these trends by building on the region's considerable asset base. Given the lengthening duration of these unfavorable economic trends and the continuing loss of position compared to the nation's major metropolitan area economies, it should be apparent that the Washington region's structural economic problems are not self-correcting. Rather, they will require targeted intervention by local business and public sector leaders to reverse the region's underperformance and declining attractiveness to business investment and domestic migration.

The Washington Region's Economic Ranking Is Slipping

The Washington region's experienced rapid economic growth between 1950 and 2010. In 1950, the Washington Region was the nation's ninth largest metropolitan economy, as measured by the value of goods and services it produced, the Detroit metropolitan area ranked fifth, the Pittsburgh metropolitan area ranked eighth and the St. Louis metropolitan area ranked tenth. By 2010, the Washington region's economy had risen to fourth place among the top ten. It followed New York, Los Angeles and Chicago; these three metropolitan areas had held these same rankings in 1950. The Washington region's economy had overtaken five larger metropolitan areas over the sixty years between 1950 and 2010 with St. Louis, Pittsburgh and Detroit falling out of the top ten having been replaced by Atlanta, Dallas and Houston. These changing rankings are shown on Table 1.

This growth pattern reflects the a national economy shifting from a manufacturing base to a professional and business services base. Metropolitan area economies that were unable to shift their base from manufacturing to professional and business services either grew more slowly or experienced decline. In contrast, metropolitan economies attractive to the growth of professional and business services rebalanced and diversified across their economies' sectoral structures and have accelerated over this period.

Table 1

The Top Ten:
How Does the Washington Area Economy Rank

1950	2010	2016*
New York	New York	New York
Los Angeles	Los Angeles	Los Angeles
Chicago	Chicago	Chicago
Philadelphia	Washington	Dallas
Detroit	Houston	Washington
SF/Oakland	Dallas	Houston
Boston	Philadelphia	SF/Oakland
Pittsburgh	SF/Oakland	Philadelphia
Washington	Boston	Boston
St. Louis	Atlanta	Atlanta

Sources: U.S. Bureau of Economic Analysis, The Stephen S. Fuller Institute at the Schar School, GMU
*Estimated; Houston's economy (GRP) is projected to surpass Washington's GRP in 2018 with Washington's ranking falling to 6th place.

As the Nation's Capital, the Washington region never had a dominant manufacturing base but rather was the forerunner among future metropolitan area economies built on a knowledge-based foundation. However, its advanced economic structure had a major flaw; it was not a diversified economy such as found in New York, Los Angeles, Chicago, Boston, Atlanta, Dallas and Houston. Rather, it was a "company town" and in its structural interdependencies had similarities with Detroit (autos), Pittsburgh (steel), and St. Louis (distribution/transportation).

<u>Increases in Federal Spending Drives Growth</u>

The Washington region's economy was able to grow rapidly during the 1950 to 2010 period because the federal government, its core business, was rapidly expanding its national and global footprints during this period. This expansion of the federal government can be seen in the growth of its workforce located in the Capital City. It increased from 227,300 civilian employees in 1950 to its peak in mid-2010 of 387,700 employees for a net addition of 160,400 workers and a gain of 70.6 percent.

But the federal footprint actually grew even faster between 1950 and 2010 than indicated by its substantial increase in its workforce as it began to rely increasingly on outsourcing as a substitute to expanding its workforce. Beginning in 1980, federal procurement spending within the Washington region began its steady expansion and became the principal driver of the region's economic growth over the following thirty years. From 1980, when federal procurement spending in the Washington region totaled $4.2 billion, federal procurement spending increased each year to its peak level in 2010 of $81.5 billion, for a thirty-year increase of 1840.5 percent. In 1996, federal procurement spending in the Washington region exceeded the value of the federal payroll for the first time. At the peak of federal procurement spending in the region, federal contractors were estimated to have employed between 450,000 and 500,000 workers.

Over this thirty-year period the almost $900 billion in federal procurement spending within the Washington region fueled its economic growth. The correlation between federal procurement spending and the region's economic growth between 1980 and 2000 has been calculated at 0.95; that is, the growth in federal procurement spending explained 95 percent of the Washington region's economic growth during that period.

There is no question that the growth in federal spending over this thirty-year period supported the Washington region's rise in economic ranking from ninth to fourth place. There is also no disputing that with reductions in federal spending since 2010 the Washington region has experienced a decrease in its relative economic position. By the beginning of 2012, the Dallas metropolitan area economy had surpassed the Washington region's economy with the Washington region slipping one place to fifth among the ten largest metropolitan areas. Until 2012, the Washington region's economy had only gained in the rankings on its competition. Now its economy was growing more slowly than many of its peers and is likely to slide further in these rankings in coming years if these trends continue. Economic growth projections have the Houston metropolitan area economy moving ahead of the Washington region's economy in 2018 with the Washington region slipping to sixth place just ahead of the San Francisco-Oakland metropolitan area economy.

The key factor shaping the Washington region's economic growth rate over the years preceding 2010 was increased federal spending. This ever-increasing trend in federal spending was reversed in 2011 with the passage of the Budget Control Act of 2011. With the decline in federal spending, both federal payroll and procurement, the region's economy has been unable to keep pace with its peers. Figure 1 shows that during the 2010-2016 period the Boston region's economy grew twice as fast as the Washington region's economy, the Atlanta region grew three times as fast, the Seattle region grew almost four times as fast and Houston region and Dallas region each grew approximately five times as fast as the Washington region's economy.

The Washington region's economy averaged a 0.95 percent annual growth rate over the 2010-2016 period. In contrast, during the 2000-2006 period, the Washington region averaged 3.8 percent annual growth. What happened? During the earlier period, the Washington region added 15,900 additional federal workers and federal procurement spending in the region increased from $29.3 billion to $57.1 billion, a gain of $27.8 billion or 94.9 percent. After peaking in 2010 and driven lower by the Budget Control Act of 2011 and the Sequester, the Washington region lost 12,800 federal jobs during the 2010-2016 period and federal procurement spending declined by $8 billion (-9.8%), from $81.5 billion to $73.5 billion. However, federal procurement spending in the Washington region declined more precipitously between 2010 and 2013, when it decreased to $68.9 billion (-15.4% from the 2010 peak) for its low during this period. It should be noted that in 2013 the Washington region's economy contracted by 0.5 percent while the US economy grew by 1.7 percent. Being a company town has its downside. This reversal in federal spending is shown in Table 2.

Figure 1

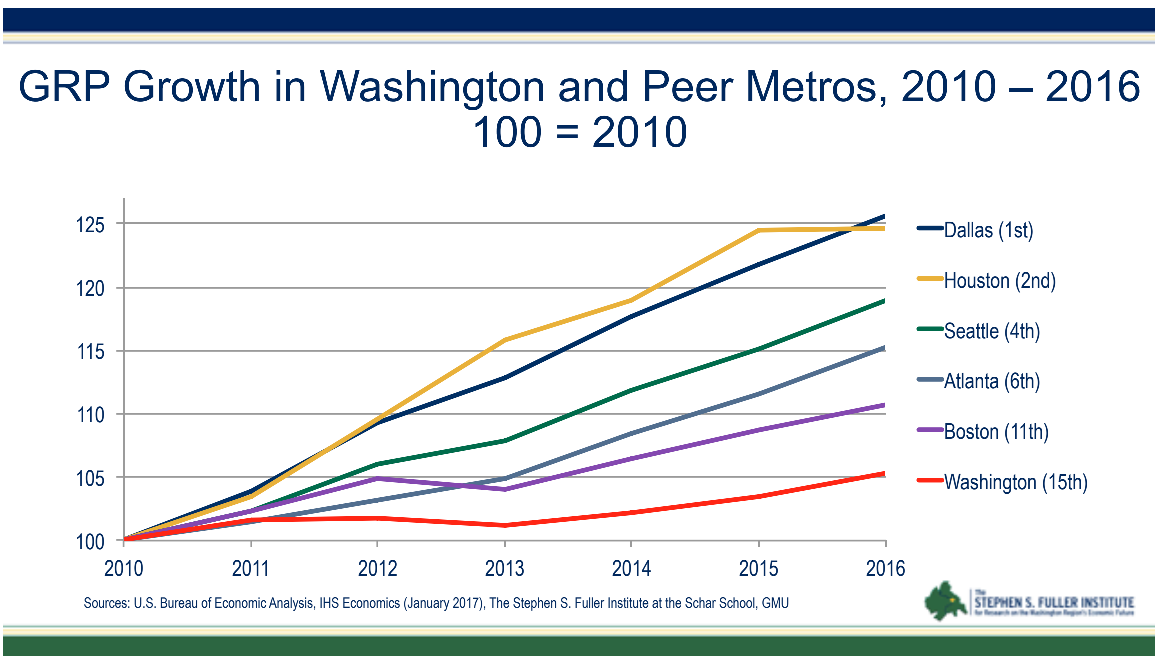


Table 2

Change in Federal Spending in the Washington Region 2000-2006 and 2010-2016

	2000 - 2006		2010 - 2016	
	#	%	#	%
Federal Employment	+ 15,900	+ 4.9%	- 12,800	- 3.4%
Federal Procurement	+ $27.8 b	+ 94.9%	- $8.0 b	- 9.8%

Sources: U.S. Bureau of Labor Statistics, Consolidated Federal Funds Report, USAspending.gov , The Stephen S. Fuller Institute at the Schar School, GMU

The Mix of Jobs has Become Less Favorable

The reductions in federal spending since 2010 have had a concomitant impact on the mix of jobs that the region has generated. Rather than growing federal jobs and federal contractor jobs, with salaries averaging near $100,000, the region has been growing more jobs in local-serving sectors—education and health services, leisure and hospitality services (includes restaurants), and retail trade—having average salaries about one-half of those found in the federal and professional and business services sectors.

During the recession, the Washington region lost 180,300 private sector jobs across all but one of its sectors; educational and health services did not lose any jobs during the recession. Since 2010 through May 2017, the Washington region has generated 382,200 private sector jobs or 201,900 more jobs than it lost. Three, largely local-serving sectors—educational and health services, leisure and hospitality services and retail trade—accounted for 221,500 jobs or 58 percent of these 382,200 new jobs. Three sectors have not generated any new jobs since the recession and are still contracting or holding steady at their post-recession lows, one sector has replaced 60 percent of its job losses (construction), and two sectors have just zeroed out their job losses experienced during the recession.

The professional and business services sector, the region's largest sector with 752,600 jobs and 22.9 percent of all public and private sector jobs in the region, has added 88,900 jobs since the recession accounting for 23.2 percent of the job gain. However, it has barely increased its share of the region's total job base since 2010 and this sector is the region's most important sector for advancing its economy.

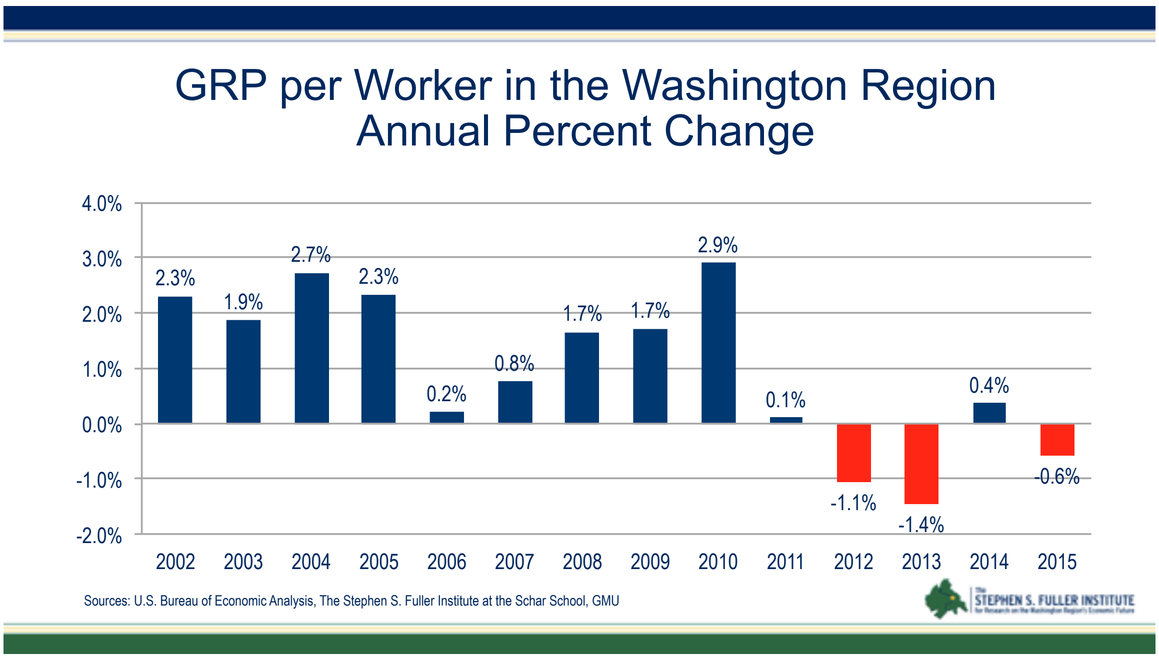
The professional and business services sector includes most of the federal contractors' jobs, and these have declined since 2010. This sector also includes most of the region's jobs in non-federally dependent, export-based, high-value added businesses, the foundation for a more diversified economy to compensate for reductions in federal spending going forward. However, these non-federally dependent, non-local serving (export-based), high-value added businesses have not performed as well since 2010 in the Washington region as their counterpart businesses have elsewhere in the U.S. (SFI, The Roadmap for the Washington Region's Economic Future: Comparative Performance of Regional and National Clusters, March 30, 2017).

Personal Income Growth Is Slowing

The consequences of slower economic growth overall and the less-favorable mix of job growth since 2010 are apparent in recent personal income trends for the region. One of the most simple and most revealing calculations is the average per worker contribution to the region's total gross regional product (GRP), the value of the goods and services that are produced in the Washington region (see Figure 2).

For the period 2002-2006, the average per worker contribution to the region's GRP increased 1.9 percent annually. In contrast, the average per worker contribution to the region's GRP during the 2011-2015 period was a negative 0.5 percent per year. The Washington region had added a significant number of new workers during this period but the resulting mix of workers—fewer higher-value added and more lower-value added—reduced the average per worker contribution to the economy's total output.

Figure 2



With value-added per worker declining, the region's household and personal earnings trends should have become less favorable since 2010 and they have. Interestingly, the Washington region continues to rank number 1 among the 15 largest metropolitan areas when measured by average household income. One reason for this top ranking is that the region has more workers per household than its peers and continues to rank number 1 for the number of workers per household. The region also has substantial wealth and household income includes earnings from investments, transfer payments and other unearned sources.

Personal income data, recently released by the U.S. Bureau of Economic Analysis (BEA), reflect the effects of the region's changing job mix that has favored lower-value added, local-serving jobs growth over higher-value added, export-based job growth. For the period 2010-2015, per capita personal income in the Washington region increased 11.6 percent. This growth rate ranked 15th among the 15 largest metropolitan areas. The San Francisco-Oakland metropolitan area ranked 1st with a 30.3 percent increase in per capita personal income over this period. As shown in Table 3, during the 2000-2006 period, when the Washington economy was growing rapidly with real GRP averaging 3.8 percent annual growth, the Washington region ranked 4th among the nation's largest 15 metropolitan areas for its rate of increase in per capita personal income.

Table 3

Per Capita Personal Income Growth Rank

2000-2006	2010-2015
Los Angeles	SF-Oakland
Miami	Seattle
Phoenix	Dallas
Washington	Detroit
Philadelphia	Chicago
SF-Oakland	Houston
Boston	Los Angeles
Houston	New York
New York	Minneapolis
Seattle	Philadelphia
Minneapolis	Boston
Chicago	Phoenix
Atlanta	Atlanta
Dallas	Miami
Detroit	Washington

Sources: U.S. Bureau of Economic Analysis, The Stephen S. Fuller Institute at the Schar School, GMU

Cost-of-Living Remains High

The U.S. Bureau of Economic Analysis also has calculated the cost-of-living for all metropolitan areas in the U.S. These estimates confirm what is well known about the Washington area; that is, the Washington region is an expensive place in which to live. Overall, the cost-of-living in the Washington region was 19.1 percent higher than the U.S. average placing it in 3rd place among the largest 15 metropolitan areas following the San Francisco-Oakland and New York metropolitans that were tied for 1st place with a cost-of-living 21.9 percent greater than the U.S. average.

This cost-of-living calculation broke out rental housing costs: rental housing in the Washington region cost 69.1 percent above the U.S. average and ranked 2nd to San Francisco-Oakland with New York in third place. The price level in the Washington region for Other Services (excluding rent) also ranked 2nd; this time New York ranked 1st and San Francisco-Oakland ranked 3rd.

Population Growth Has Slowed

The high cost-of-living and an emerging employment structure characterized by an increasing percentage of lower-value added and, therefore, lower-wage jobs have diminished the Washington region's attractiveness for domestic migration.

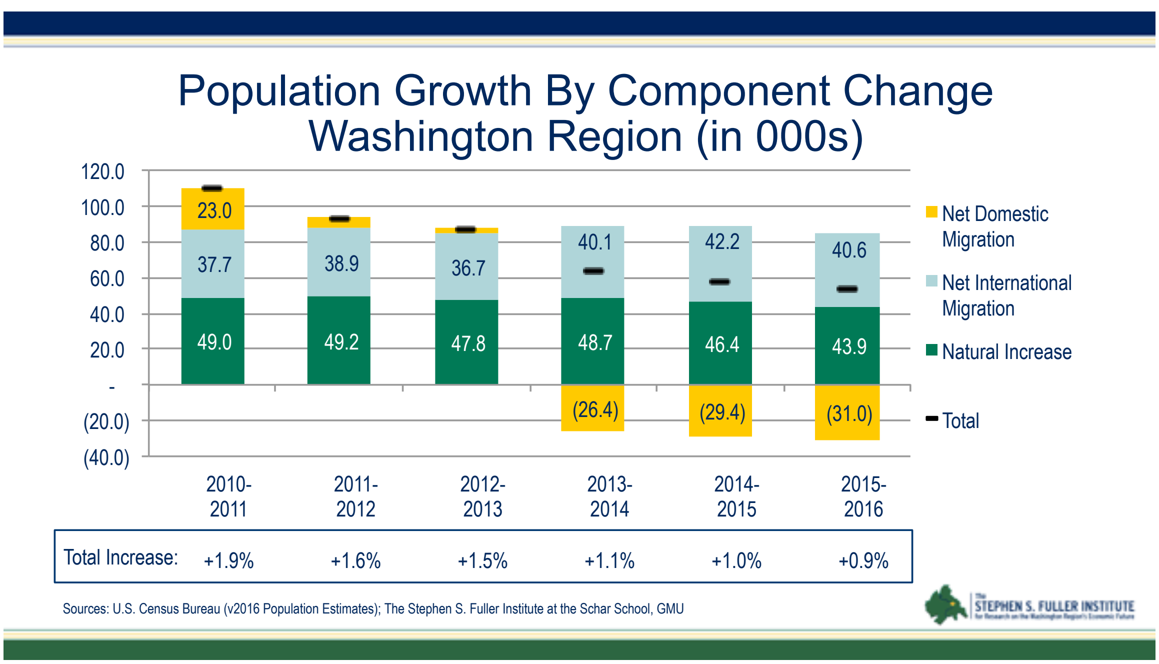
Population is always in motion, moving from one jurisdiction (and other countries) to another for various reasons. One of the principal motivations for these inter-jurisdictional moves is to seek greater economic opportunities and/or an improved quality-of-living. Research has confirmed that on average better-educated movers are willing to move the greatest distances to achieve a better return on the cost of relocating. This research also confirmed that these better-educated workers tend to be working in services, such as professional and business services, to a greater extent than manufacturing or other occupations with below-average wages.

It is said that residents vote with their feet. If the quality-of-life or the economic opportunities are better in another jurisdiction, the tendency will be that these more-competitive jurisdictions will attract a net increase in migration; that is, the population will grow faster than the national average and exceed population growth attributable to natural increase (births minus deaths).

Population growth has slowed in the Washington region since 2010, declining from an annual rate of 1.9 percent to 0.9 percent in 2016. This is worrisome as the rate of population growth is highly correlated with economic growth. New residents drive the housing market, swell the workforce, and increase the demand for goods and services that fuels further growth in local-serving businesses.

The sources of the Washington region's recent population change confirm the declining competitive attractiveness of the Washington region as a destination for U.S. residents on the move. The sources of population change are presented in Figure 3 for the last six years.

Figure 3



For the last three years, since the Sequester, the Washington region has experienced net domestic outmigration with an average of 28,933 more residents moving out to another location outside of the Washington metropolitan area than moving into the Washington region from elsewhere in the U.S. And, this trend has worsened each year over this three-year period.

The Washington region has become dependent on international migration to grow its adult population, to increase the region's labor pool, and to drive housing demand. While natural increase remains an important source of population growth, the region's fertility rates are below the U.S. average, consistent with the higher labor force participation rates for women in the Washington region. And, natural increase does not increase the workforce in the current period so the region's ability to grow its economy, fill vacant jobs, and diversify away from its long-term federal dependence will be constrained by the absence of net domestic migration.

Residents are either moving away at a faster rate or not moving to the Washington region to the extent that they did historically or doing both. What is most troublesome is that it is the younger-age cohorts, including the millennials, who are moving out and/or not moving in. This outmigration of younger workers will result in the resident workforce becoming older and the region becoming more dependent on daily in-commuting from outside the metropolitan area boundaries to fill the economy's growing labor force requirements.

The Washington region ranks 1st in the percentage of its workforce that consists of non-residents. This significant and growing dependency on non-resident workers (commuters) adds to the traffic congestion and long-distance commuting requirements that have resulted in the Washington region ranking 1st among the largest 15 metropolitan areas for the annual hours of vehicle delay and ranking 2nd for the percent of commuting trips that exceeds 60 minutes (each direction). This trend in long-distance commuting is compounded by the region's high housing costs.

The Washington Region's Declining Rankings

The Washington region's rankings across a variety of metrics have declined or worsened over the past ten years as shown by comparing the competitive position of the Washington region among the nation's largest 15 metropolitan areas in the pre-recession and post-recession periods. For many of the economic, income, comparative attractiveness, cost-of-living and quality-of-life measures, the Washington region has clearly lost position relative to its peers since the Great Recession with this decline having been accelerated in some cases by the unfavorable consequences of the Sequester in 2013. A selection of these metrics is presented on Table 4.

Table 4. Ranking the Washington Region Pre- and Post-Recession

Rank among 15 Largest Metropolitan Areas

	Pre-Recession Rank	Current Rank	Change in Rank	
Economy				
Job Growth, 3-Year Average	7	15	Worsened	⇧
Gross Regional Product	4	5	Worsened	⇧
Employed Resident Growth (3-Year Average)	6	14	Worsened	⇧
Household Wealth				
Median Household Income	1	1	No Change	⇔
Per Capita Personal Income Growth (3-Year Average)	4	15	Worsened	⇧
Competitive Attractiveness				
AFIRE, Top 5 U.S. Cities	2	unranked	Worsened	⇧
AFIRE, Top 5 Global Cities	2	unranked	Worsened	⇧
Net Domestic Migration Rate	10	12	Worsened	⇧
Net Foreign Migration Rate	2	3	Worsened	⇧
Cost-of-Living				
Regional Cost of Living (Price Parity, all items)	3	3	No Change	⇔
Regional Rental Costs (Price Parity, rents)	3	2	Worsened	⇩
% of Renters Paying 30%+ of Income on Rent	14	10	Worsened	⇩
% of Owners Paying 30%+ of Income on Owner Costs	8	9	Improved	⇧
Quality-of-Life				
Annual Hours of Vehicle Delay	1	1	No Change	⇔
% Commuting 60+ Minutes (to job in metro area)	2	2	No Change	⇔
% of Households with 1.51+ occupants per room	11	9	Worsened	⇧
Average Workers Per Household	2	1	Worsened	⇧

These metrics confirm that as the Washington region's economy has slowed its pace of growth and experienced a less-favorable mix of job growth, that the personal income growth of the region's residents also has slowed, migration rates have diminished to the point that net domestic migration has been negative for three consecutive years, and the ranking of the region for domestic and international commercial real estate investment has significantly declined.

The economic weaknesses that have made the Washington region less competitive as a destination for domestic migration are magnified by the region's uncompetitive cost-of-living and high housing costs, especially rental costs where the Washington region ranks second among all metropolitan areas with rental costs averaging 69.1 percent greater than the U.S. average. With higher costs-of-living, including higher housing costs and higher costs of Other Service (both ranking 2nd highest relative to the 15 largest metros in the U.S.), and the region's number 1 ranking for annual hours of vehicle delay—time lost to congestion and its number 2 ranking for commuting time exceeding one hour each direction, the quality-of-life offered by the Washington region has become increasingly less competitive with the nation's other major metropolitan areas.

Lower relative income growth and above-average cost-of-living do not present a favorable brand for the Washington region. Considered in that context, the fact that Washington region ranks first in the number of workers per household may not be so much a positive measure of the region's economic vitality but rather may reflect the reality of living in the Washington region that requires almost every adult to work in order to be able to afford the region's attractive quality-of-life. In other words, that a greater percentage of the Washington region's age-eligible residents is working than in its peer metropolitan areas may be a necessity rather than a choice.

Countering The Washington Region's Declining Economic Brand

The Washington region possesses significant assets to drive its future economic growth and upon which a more diversified and globally competitive economy can be built. A short list of the assets, that distinguish the Washington region from its peers, is presented in Table 5. These assets should provide the foundation for public and private sector efforts to diversify the region's economy away from its federal dependency and to accelerate the expansion of the region's non-federally dependent, export-based, high-value added businesses.

But just knowing that the Washington region has important assets and a potentially competitive position among its peers will not guarantee that the Washington region can escape the consequences of being a company town. Rather, it will require targeted initiatives that likely will disrupt existing business patterns and historic institutional relationships with the intended result that the Washington region becomes nationally and globally recognized as an attractive place in which to reside and to invest. The Washington region will also need to offer competitive business costs and an affordable quality-of-life. Also, to achieve and maintain a competitive position in the national economy, the qualities and capacities of the Washington region's fundamental infrastructure must be able to support an advanced knowledge-based economy.

Table 5

Washington Region's Competitive Advantages

Capital City/Federal Government Center
International Governments and Institutions
Connectivity to the World
Concentration of Government and Business Leaders
High Quality-of-Life
Diverse Population
Breadth of Higher Educational Services
Educated Work Force
High Level of Labor Force Participation
Advanced Occupational Specializations

In order to respond to and reverse the Washington region's declining economic brand will require collaborative efforts among the region's business leaders and established business organizations and local public officials and government professionals. The region's leadership must be effective in working across state and local political boundaries and across jurisdictional self-interests. The Washington region is not likely to escape the limitations of its company town economy without targeted initiatives to change the trajectory of an economy that has been shown to be lagging its competition. The Washington region has the fundamental assets to achieve its economic potentials. The question remains whether it has the will to undertake the strategic intervention required to redirect the region's economic path going forward.