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Washington Could Ruin Washington

Federal spending cuts will mean fresh economic problems for the Washington, D.C., metro area

By: Danielle Kurtzleben- February 7, 2013

Washington, D.C., avoided the worst of the economic crisis, but the nation's capital may soon face more economic pain than the rest of the nation. Lawmakers are facing the prospect of deep spending cuts, and though those cuts are on the federal level, they would likely hit the seat of national government the hardest, as the federal government and the industries it supports in the D.C. area are forced to make tough spending and personnel choices.

Spending cuts are coming—that much seems certain. Across-the-board sequestration cuts totaling $1.2 trillion over 10 years are scheduled to kick in starting March 1. That includes $500 billion that will be cut from defense spending and $500 billion from nondefense discretionary spending. Taken together, those potential cuts, declining war spending, and spending caps instituted in the Budget Control Act that established the sequester will cause government spending to decline sharply, by 11 percent over the next two years, according to a recent analysis from Goldman Sachs.

On Capitol Hill, neither side seems willing to give up any ground to avoid sequestration. Democrats want more revenue from closing tax loopholes. Republicans, meanwhile, refuse to budge, hoping for Democrats to give more ground on cutting spending.

The pain of those cuts would likely disproportionately fall upon the seat of federal government, as federal agencies potentially freeze hiring and lay off workers. The Washington, D.C., region is also home to myriad companies that benefit from proximity to the nation's politicians, such as the defense contractors located in northern Virginia.

A slowdown in government spending could mean fewer jobs, less consumer spending, and slower growth in the nation's capital. This week, these possibilities took a step closer to reality, when the Obama administration warned in a memo to federal agencies that it may have to "consider placing employees on temporary furlough, or taking other personnel actions, should sequestration occur."

"We're not used to slowdowns. We're not used to stagnation," says Jim Dinegar, president and CEO of the Greater Washington Board of Trade, a group that represents big business in the D.C. metro area, which extends into the suburbs in Maryland and Northern Virginia. Still, D.C. workers could find themselves out of their jobs if sequestration happens, he says.

In part, Dinegar believes that President Obama worsened the local effects of sequestration when he proposed this week to again postpone sequestration cuts, in exchange for a package of short-term spending cuts and tax increases. That could make business owners and executives think differently about their future plans.

"It makes a bad situation somewhat worse because [if I'm a businessman] I'm not hiring people until I know there's a clear path forward," Dinegar says. "I'm not expanding my office space until I know a clear path forward. That's putting a chill on the regional economy."

But Congress's intransigence isn't helping, Dinegar adds, with what he calls its "resignation" that sequestration is coming.

Even if Congress avoids sequestration, other spending cuts are likely, and those would also likely fall disproportionately upon the nation's capital, says one economist.

"As the entitlements and transfers part of the federal budget is growing, it's going to squeeze out the part of the budget that actually produces something," says Chris Edwards, an economist at the Cato Institute. Because lawmakers are loath to cut entitlements, he says, that means more discretionary cuts. And lots of discretionary spending, be it for federal workers or defense contracts, feeds the Washington, D.C.-area economy.

In fact, it's possible that the D.C. region is already seeing a slowdown, says Stephen Fuller, director of the Center for Regional Analysis at George Mason University.

"When you look at job growth we're having and what kind of job growth we've had, we were, between 2000 and 2010, Number 1 in the country. Now we are the 10th-fastest growing" in terms of the number of jobs being added, Fuller says.

The Washington metro area's unemployment rate stood at 5.3 percent as of December—far lower than the national rate of 7.8 percent but also representing its first uptick since 2011. That may not be much of a shift, but Fuller believes that recent sluggish local job creation could be the start of a trend.

How bad could it get? That depends on whom you ask. Fuller is at the bearish end of the spectrum. He estimated in 2012 that the combination of sequestration cuts and already-enacted defense cuts would cost D.C. more than 14,000 jobs, along with 122,800 in the state of Virginia and 36,000 in the state of Maryland. All told, he believes that these cuts would slash 1 million jobs from the nation's payrolls.

Many have questioned Fuller's gloomy projections, however. The National Security Network, a progressive foreign policy organization, on Thursday put the total national job cuts resulting from Pentagon cutbacks at around 300,000 to 500,000. That's still a hit to the economy, but it's also less than half of Fuller's projections.

For his part, Dinegar believes that metro area unemployment will definitely rise if sequestration happens, along with stagnant economic growth in the region. That doesn't just mean slower spending at restaurants and longer unemployment lines; it could worsen quality of life in the District.

He points to D.C.'s Metro transit system, which would lose some federal funding due to the sequester. Between that funding cut and lower ridership that could result from an economic slowdown, he says, that could take $22 million from the Metro's operating budget, or around 1.4 percent of its $1.6 billion operating budget. At first glance, that's not a large bite, but for an agency already facing regular shortfalls, it could mean service cuts.

All of these potential problems would mean an end to a long period of relative economic health in the nation's capital. By the numbers, the Washington, D.C., metropolitan area experienced a remarkably mild recession. The national unemployment rate topped out at 10 percent in late 2009.

The D.C. metro area's jobless figure, meanwhile, only crept as high as 6.7 percent. According to Commerce Department data, D.C. is also one of the relatively few metro areas in the nation that didn't experience a single year of negative growth during the downturn.

Washington, D.C., Mayor Vincent Gray seems to understand the gravity of the situation. This week, in his State of the District Address, Gray advocated diversifying the metro-area economy, with more growth in health care, technology, and hospitality.

Still, that is not to exclude the rest of the country from the potential ill effects of deep spending cuts.

"Certainly the entire country is going to be affected," says Jason Peuquet, research director at the Committee for a Responsible Federal Budget. He points out that federal workers and defense contractors, while concentrated in the Washington area, are found nationwide.

This all makes spending cuts sound like an altogether bad decision, but a broader view complicates the picture. While any large spending cuts could be detrimental to the D.C. and national economies in the short to medium term, particularly given shaky economic growth since the recession, deficit reduction means much greater economic growth potential nationwide in the longer term.

Indeed, there are some who argue that D.C. has been too healthy for too long. The flip side of the federal government buoying the D.C. economy, says Cato's Edwards, is that D.C. benefits at the expense of taxpayers.

"Every dollar we spend on Social Security, for example, comes from someone else through payroll taxes. It's just middle-income America taxing middle-income Americans."

The same thing applies to the large amounts of federal spending that boosts the D.C. area, he says. More than Over 10 percent of all workers in the D.C. metro area are federal government employees, compared to around 2 percent for the nation as a whole.

Whether D.C. is due for some economic pain or not, one thing looks increasingly certain: It's on its way.

"If Congress puts off sequestration this year, other spending cuts are going to come later this year or next year anyway," Edwards says. "The Washington region will have to get used to it."