The Washington Post

Federal austerity could hit the region's economy hard

By V. Dion Haynes
Washington Post Staff Writer
Monday, January 3, 2011; 14

The Washington region rose above all other metropolitan areas in 2010 when it came to economic progress. Bolstered by federal hiring and a boost in procurement, the region recorded the nation's highest net number of jobs gained during a 12-month period as the year came to a close.

But economists are concerned that the momentum may now be threatened as the region's major industry -- the federal government -- prepares to face the budget ax. Many in Congress have expressed an interest in slowing federal spending in order to bring the $1 trillion or so deficit in line.

Welcome to the era of government austerity.

The last time the federal government went down this path, in 1995, the region felt the pain. During a two-year period, the federal workforce in the Washington area shrank by 32,000 with cuts at NASA, Agriculture, Transportation and numerous other agencies. Federal contracts were canceled. The government scrapped construction projects in the area. The after-shocks reverberated throughout the region's economy. Consumer confidence plummeted, driving down retail sales and exacerbating a depressed housing market. Declining federal aid and local tax revenues prompted several jurisdictions, including Prince George's County, to lay off e mployees to help close their budget gaps.

This time, the private sector in metropolitan Washington is more diverse. But federal spending and procurement still represent about one-third of the region's $443 billion economy. Some forecasts suggest that the growth of federal spending and procurement could plunge to 1 percent or below in 2011 from an average of about 8 percent annually during the past several years. That could hurt even if the local economy benefits from improvements this year in the U.S. economy.

"The days of Washington being the leader in terms of job growth and economic strength are really over," said Steven Cochrane, managing director of Moody's Analytics. Experts say federal spending reductions

The Washington Post

Federal austerity could hit the region's economy hard

could cut in half the number of new jobs created in the area to 40,000 from 80,000. "I think there's no way that [the pace of job growth] could be kept up any longer, particularly now that the federal government is undergoing pretty strict scrutiny" of the budget.

In a report submitted to President Obama late last year, the National Commission on Fiscal Reform recommended that the government put all discretionary spending -- including defense and domestic programs -- on the table for review. The report calls for a freeze in discretionary spending in fiscal 2011, followed by "serious belt-tightening" in fiscal 2012 and "substantial moderate cuts" in 2013.

Commission members also are pressing the administration to consider "restructuring" the federal workforce, resizing it based on the government's needs.

Though it likely will be months before firm plans in Congress materialize, experts already are beginning to assess the collateral damage of a deficit-reduction effort on the area's economy. Here's a look at how the sectors potentially could be affected this year by federal spending reductions and other economic factors:

GOVERNMENT

With numerous new initiatives, the government not long ago was planning to hire about 600,000 employees over the next few years -- as many as 120,000 of them in the Washington region, according to the nonprofit Partnership for Public Service, which is helping agencies with recruitment.

Now the organization is projecting that the government likely will reduce those numbers by up to 10 percent.

"We're taking the foot off the gas pedal [so the hiring this year] is slowing down," said John M. Palguta, vice president for policy at the organization. "In 2012, the foot's going on the brake in terms of hiring growth. . . . [Next year] becomes a little more problematic for our area."

Robert Dye, a senior economist at the PNC Financial Services Group in Pittsburgh who

The Washington Post

Federal austerity could hit the region's economy hard

studies this region's economy, laid out a possible scenario for the area: 20,000 federal jobs could be lost from the elimination of government programs and another 30,000 jobs could be lost from the elimination of contracts. "That 50,000 job loss could result in another 50,000 jobs as a multiplier effect through the economy."

LEGAL

Law firms that represent government agencies could see an increase in business from the additional scrutiny Congress may give their clients this year.

But overall, experts say, law firms will face increased pressure from their corporate clients to reduce their prices. More firms are being forced to switch from hourly billing to flat fees and discounts.

"I think clients are a lot more interested in the value of the service that they're getting," said Susan Hackett, senior vice president and general counsel of the Association of Corporate Counsel. "We're seeing an uptick in . . . the amount of business being given to mid-tier or smaller firms -- their value proposition is better."

FINANCIAL SERVICES

The prospect of job losses or even a slowdown in the creation of new jobs is hardly good news for the financial services industry, experts say. Reduced federal spending "slows job growth, slows recovery of housing prices and that is a negative for the banking industry," said Bert Ely, a banking consultant.

In general, because the rising price of gasoline has sparked a greater interest in consumers finding housing near their jobs, the real estate market inside the Beltway is performing better than the market outside it, Ely said. Therefore, he said, he thinks financial institutions inside the Beltway will fare better than those outside it.

COMMERCIAL REAL ESTATE

The federal government has kept the area's office market going during the commercial real estate slump. The good news is that the government's leasing activity in the private

The Washington Post

Federal austerity could hit the region's economy hard

market should continue to increase this year, said Cathy Kronopolus, the General Services Administration's commissioner for public buildings in the Washington region.

The outlook for shopping centers, given a rise in retail sales, is also positive, said Gregory H. Leisch, chief executive of Delta Associates, an Alexandria-based real estate and economic research firm. He said sales should remain strong, because of the area's wealth, even if the government reduces spending.

"We saw a 5 percent increase in retail sales in 2010. I expect that to continue in 2011, driven by an improvement in consumer sentiment," Leisch said.

CONTRACTING

Defense contractors already have been hit by Defense Secretary Robert M. Gates's plan to shift more work in-house and reduce spending over the next three years. Many firms have lost contracts and lost some workers to the government, and industry leaders are worried about what new reductions would mean.

"This is a huge economic force -- we will feel it," said Stan Soloway, president and chief executive of the Professional Services Council, the nation's largest organization of government services contractors.

Professional and business services, of which contracting is a part, represent the biggest chunk of the economy -- 22.8 percent. They also accounted for 18,000 of the 43,700 jobs created in the region from October 2009 to October 2010.

"There's a warning we can't be solely dependent on federal spending," said Stephen S. Fuller, director of the Center for Regional Analysis at George Mason University. "We are bringing in companies that aren't federally dependent, but more needs to be done."