EXECUTIVE SUMMARY

Much of the today's economic dynamism in the District of Columbia is the result of a difficult and politically fraught decision made 20 years ago by Congress and local leaders to transfer financial control of certain District responsibilities to the federal government. The National Capital Revitalization and Self- Government Improvement Act of 1997, known as the Revitalization Act, was enacted in August 1997, and it proved a turning point for the District.

The *State of Business in the District of Columbia* explores the growth and development of the economy, industry, and workforce in the District over the last two decades—a tumultuous and transformative period. It tracks the story of DC's remarkable growth over the last two decades, illustrating how the District has weathered the storms of the past to place itself at the forefront of American cities in the 21st century.

The 1990s was not a good decade for the District. The nation was rocked by a national recession in the early 1990s, and DC lost 21,000 jobs by 1992. Elsewhere in the country, jobs rebounded, but a federally engineered local recession, in the form of federal job cuts, kept the District struggling. What followed was a period of fiscal indiscipline that devastated the city's finances and pushed more residents and businesses out of DC. Between 1990 and 1997 the District lost 63,000 jobs (9.1 percent of total employment) and 75,000 residents (12 percent of its population). The 1990s produced a lost economic decade, with repercussions still seen in comparisons between the District and the Metro area.

The years that followed were transformative. Job recovery began in 1998, and today's total employment exceeds 791,000 workers, an increase of 25 percent since 1997. The District's population boomed in the last 11 years and added more than 114,000 net new residents. The population now stands at 681,000. The District's economy stayed resilient during the Great Recession with only minimal job losses as housing prices soared, incomes increased, and, with a strong tax base, the District's finances showed tremendous improvements. Today the District has higher income and population growth then the rest of the region, and continues to attract educated, high- skilled residents from the rest of the country. Since the Great Recession, the city has surpassed the nation and the metro area in economic growth.

Today, the District is a very different city. More of the economic activity shifted from the public to the private sector. Earnings increased by 73 percent in real terms and earnings by DC residents grew even faster, by 87 percent during the same period. Since the end of the Great Recession, the District has been outperforming the metropolitan area in employment, jobs, and output growth. And the city has responded to increased demand for its real property remarkably well. The District added 53 million square feet of office space and 61 million square feet of residential space (about 61,000 units) since 2001. Some of these new developments replaced existing buildings, but others, like The Wharf at the Southwest Waterfront, are creating density where it did not exist before.

The population growth has transformed the city. The District has once again become attractive to families. But families live in different parts of the city now. East of the River no longer holds the bulk of the District's residents (and children). That standing now belongs to the Central Corridor. Restaurants and shops that have spread to these neighborhoods are still largely missing in neighborhoods East of the River. The population increases have made the District whiter, wealthier, and younger, and this has contributed to the increasing income divide. Housing costs reinforce this trend. Middle class wage earners flock to the suburbs in search of affordable housing, where upward mobility is strong and income inequality is relatively smaller compared to the District.

The District draws its workforce from a large pool of high-skilled labor. Two thirds of the District's workforce has a college degree or more, and it attracts some of the highly talented workers across the region. Salaries in the District are among the highest in the nation. In 2016, District's median salary was 1.7 times the salaries across the nation. And that is not just because it has high-paid federal jobs. The skills profile of the District's workforce makes its employees desirable, not just in the District, but everywhere.

Because many moving to the District have already secured jobs, residential employment has grown faster than the jobs in DC. The District added 47,000 more employed residents between 2012 and 2016. Since 2011, resident employment has grown faster than jobs in DC, suggesting that more and more residents are living in the city and working elsewhere. This has a fiscal benefit, too. The District's income tax base is increasing faster than salaries paid in the District.

Finally, the District government is fiscally strong. The District's economy has become more resilient and it has weathered the Great Recession with smaller losses than many other jurisdictions in the area. The city's general revenue has risen fast enough to fully implement a major tax-reduction package approved in 2013, while increasing public spending on key areas such as education and housing. As a result, the District has become more competitive with surrounding jurisdictions.

While these are great developments, there are some pitfalls:

First, high-wage and middle-wage job creation has slowed down as private sector activity is increasingly shifting to services. New jobs are coming from retail and hospitality, two of the lowest paying industries in the District. The first wave of losses in high-paying jobs happened in the public sector before the mid-2000s, as the federal government moved more of its operations and employment out of the District. The city now holds 34 percent of all government jobs in the area compared to 40 percent in 1997. The more recent wave of losses in high-wage jobs are in professional, management, and technical occupations. But more importantly, the District is losing middle-wage jobs in areas that are typically seen as the backbone of middle-class white-collar employment, especially in office support and sales occupations.

Second, while incomes have increased, so has economic segregation. Everyone did not equally benefit from the economic growth. Income gaps between the District's richest and poorest residents have increased. While incomes more than tripled in the Central Corridor, they have declined, especially among families, East of the River. The metropolitan Washington area provides many opportunities for upward economic mobility, enticing the middle class out of the city. [1].How ever, DC itself experiences some of the lowest economic mobility in the country.[2] District offers its own push factor: faced with high costs of housing, and the lack of amenities such as grocery stores in their immediate neighborhoods, many low-income residents are moving to the suburbs.

Third, business conditions have improved with the implementation of the 2013 tax package, but District businesses still face significant challenges. Corporate tax rates are now on par with Maryland, but still above the rate in Virginia's northern counties, and requirements on the businesses—from minimum wage to licensing requirements—can be deterrents. Survival rates are low, compared to the U.S.: 48 percent of today's new firms will still be in the District after their first five years of operation while the comparable metric for the U.S. is 58 percent. Even in booming sectors, such as restaurants, this churn among businesses has been high and shows signs of increasing. While total employment is on the rise, job stability appears to be going down. In 2016, of every 25 jobs that opened, 24 made up for a job lost elsewhere in the city.

Fourth, jurisdictional fragmentation and tensions among the localities that make up the metro area threaten growth. Collaboration with surrounding jurisdictions is weak. Transportation is the prime example as the region struggles to find a stable, long-lasting solution to the financial woes of the Metro system. It is not clear if the markets have yet priced in the risks associated with a failing Metro, but if leaders cannot develop a solution, the region could see shifting patterns in employment. Almost no other efforts exist between the District and its neighboring jurisdictions to collaborate on housing, workforce development, labor laws, or social safety nets—areas where such collaboration would be most meaningful.

Since the Revitalization Act, the District has become a more desirable place to live, work, and conduct business. The Revitalization Act solved many fiscal problems and has resulted in a stable and strong economic outlook for the District. The next challenge for the city is to empower its residents and businesses across all neighborhoods to bring the same level of vibrancy to all communities, including those that have been excluded from the economic growth. The District has some of the strongest government programs for protecting its most vulnerable citizens, and the city has invested in improving education, housing, and social supports. But these have not been enough to close the increasing economic gap. Economic integration and economic mobility are deeply connected, and living in more economically integrated neighborhoods benefits low-income families the most. The next step for the District is to make all neighborhoods attractive to all types of residents of all income levels. And businesses have a large role to play in this shift.

The District's businesses, especially small and local businesses, have been an important source of economic and human capital growth in the city, and more so among minority and immigrant populations. Local small businesses are not just good for services and access to jobs—two desperate needs in some of communities—but they also are critical to improving neighborhood vitality. With shifting demographics and increasing incomes, District businesses are facing rising costs, changing demands from their clients, and higher rates of consolidation. Recent research shows that business displacement is more permanent in neighborhoods with single-business establishments, and empty storefronts stay empty longer in neighborhoods with increasing costs.[3] That is, the impact of many policy decisions—from zoning to civil infractions to licensing requirements—could impose restraints on businesses that increase economic segregation. Since the Revitalization Act, the District has excelled at reducing tax burdens on its businesses. It is time to consider the impacts of other regulatory restrictions.

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[1] Chetty et al. (2014), "Where is the Land of Opportunity? The Geography of Intergenerational Mobility in the United States, "*Quarterly Journal of Economics* 129(4): 1553-1623, 2014

[2] Chetty R. & Hendren N. (2017),*The Effects of Neighborhoods on Intergenerational Mobility II: County-Level Estimates,* National Bureau of Economic Research Working Paper No. 23002, Revised Version.

[3] Meltzer R. (2016), "Gentrification and small business: Threat or opportunity?" *Cityscape* 18(3), US Department of Housing and Urban Development, Washington DC.