Virginia Budget Blows, As Dot-Com Bubble Pops

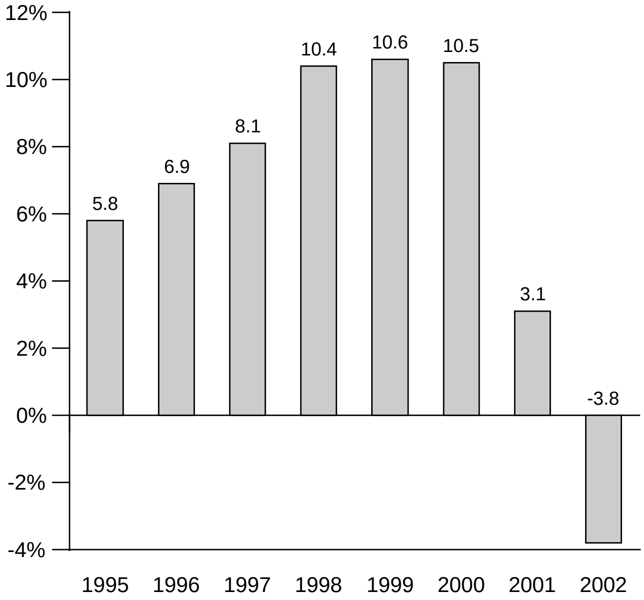
by Mary Jane Freeman

A mere three weeks into the new fiscal year, which began on July 1, Virginia Gov. Mark Warner announced that the state had a $237 million deficit, and that it would get bigger. Warner dropped this bombshell at an impromptu press conference on July 23, convened as he met with Virginia's legislative leadership. Asked if he expects the shortfall to grow to $400-500 million, he replied, "Think larger."

Indeed, especially since the Northern Virginia economy, based on the once high-flying dot-com "New Economy"—with WorldCom and AOL, among others, being big players in the state—has now crashed. Their demise and its ripple effects will mean huge revenue losses to the state. Not to mention, that Virginia's fiscal year 2002 deficit had been nearly $4 billion, and it was rectified only by various fund transfers, tapping "rainy day" funds, and budget cuts. Despite these realities, and while stating that this was the worst revenue decline in 40 years, the Herbert Hoover-like Warner protested that the economic fundamentals are sound.

On the same day, the National Conference of State Legislatures (NCSL), meeting in Denver, Colorado, released its latest survey of states' fiscal condition, which concluded that "conditions continue to deteriorate dramatically." The aggregate budget deficit for FY 2003 (July 1, 2002 to June 30, 2003), for the moment, is estimated will grow to $57.9 billion, based on data from 42 states and tax data from 47. "FY 2002 was tumultuous in nearly every state," the NCSL said. "The fiscal boom of the late 1990s that [began] to sputter in early 2001 came to a screeching halt" by fiscal year's end. Other highlights from the report include: 13 states report budget gaps going into this fiscal year in excess of 10%; 26 states collected less revenue in FY 2002 than the prior year; and 37 states' year-end balances declined from FY 2001 to 2002, with balances as a percent of spending having the biggest percentage drop since FY 1980: The ratio was 8.8% in FY 2001 and fell to 5% in FY 2002. This latter statistic reflects the fact that every spare dime was marshalled to plug the holes and "balance" the budgets. Hoping for an eventual recovery, it assumes revenues will grow 3.7% above FY 2002 levels, which growth is to be fuelled by "sizeable tax and fee increases."

FIGURE 1
Virginia Revenue Growth and Decline, Fiscal Years 1995-2002
(Percent Change)



Source: Virginia Secretary of Finance May 2002 report, "Issues Affecting Virginia' s Financial Position."

'Silicon East'

Without growth in the real economy, however, this is pie in the sky. Warner, the freshman governor who made his fortune in the cellular phone industry and venture capital investments, insists the problem is not corporate accounting scandals in the "New Economy" companies, but rather is a "stalled economic recovery." Even as he admitted that individual income growth was the worst in 30 years, Warner did not face the underlying cause of the state's budget woes: the shift from a producer to a consumer society. Virginia exacerbated the problem by putting many of its eggs in the "New Economy" and stock market baskets.

In May, Warner's Secretary of Finance John M. Bennett issued a report, and put it this way: "From FY 1995 to FY 2000, Virginia experienced extraordinary revenue growth, fuelled largely by a once-in-a-generation boom in the technology and the stock market." Bennett remarked that the previous administration under James Gilmore could only afford expanded "spending commitments and tax preferences . . . in the context of extraordinary revenue growth." Thus, he surmised that "Virginia was . . . destined for a significant budget problem as soon as [that] growth subsided—even without a recession." The footprints of this "destiny" are seen in **Figure 1,** which shows a near doubling of Virginia revenues from 1995 to 2000, and their subsequent crash in 2001 and 2002.

This trajectory hit Warner as he took office in January, when the deficit was $3.2 billion, and then grew to $3.8 billion within a month. Outgoing Governor Gilmore's proposed budget addressed the $3.2 billion deficit by calling for many one-time revenue and saving measures amounting to almost $2 billion. For example, $467 million was taken from the state's rainy day fund, $259 million was from the Medicaid Intergovernmental Transfer fund, and $223 million was from the Literary Fund to pay part of the cost of teacher retirement and Social Security. As the Bennett report commented, "One-time actions use up future budget flexibility, because future revenue growth is essentially tapped in advance." But Warner adopted these measures, and must do more, as the deficit grew after his inauguration—unless he looks to a solution beyond the borders of his state, as Presidential pre-candidate Lyndon LaRouche has proposed.

To balance the FY 2002 budget, cuts totalling nearly $545 million were made, including: $118.4 million by recalculating (lowering) Virginia's payment into the Virginia Retirement System (VRS); $50 million from unclaimed VRS accounts; $91.7 million from a 3% across-the-board cut to agencies' budgets; $46 million by holding back 70% of a car tax credit; and $12.4 million by reducing the number of families deemed eligible for aid under the Family Access to Medical Insurance program.

Warner's July 23 news of greater-than-projected revenue decline also prompted him to initiate a "reforecasting" of the biennium 2002-04 budget, and to notify all state agencies to halt unnecessary expenditures. Even before this news, Warner had proposed hefty spending reductions for the next two biennium budget years. His plan called for $798 million in budget cuts in FY 2003 and $765 million in FY 2004. As of May, the cuts were to include: $294 million in across-the-board agency spending; $291 million less to colleges and universities; $97 million saved by lowering the state's payment into the VRS; $77 million by reducing the state's payment toward VRS "fringe benefits" such as retiree health care, group life insurance, and sickness and disability payments; and $55 million from local school construction. Reality will dictate that these cuts will have to be deeper.

But Warner and legislators cling to self-deluded hopes of a recovery even as they acknowledge, "This is a far worse predicament than we were in ten years ago," as Vincent F. Callahan, Jr. (R-Fairfax), chair of the House Appropriations Committee, quipped as he left the meeting with Warner. Rather than admit that the dot-com, stock market, and housing bubbles upon which they have come to rely for revenues into the General Fund, have burst, Virginia's politicians prefer to squeeze blood out of a stone, arguing that Warner should exhaust his Executive powers to unilaterally cut spending before they consider any other options.

Telecom Corridor on the Skids

Reality is, however, pricking their delusional plans. On July 21, WorldCom, the nation's second-largest long-distance telephone and data services company, filed the largest-ever bankruptcy petition in U.S. history. The telecom giant is headquartered in Loudoun County, Virginia—nicknamed "Silicom-East" by Lyndon LaRouche, who had accurately forecast the doom of the phony Internet "New Economy." WorldCom became Loudoun County's second-largest employer.

Loudoun County had great plans as it wooed WorldCom to come and set up shop. One deal offered by the county to WorldCom was $4 million in public funds if it would locate in this "major crossroads of the new economy," as the *Washington Post* dubbed it. The WorldCom campus was expected to bring in related businesses, build new office space, and employ nearly 20,000 new workers. The county government approved 7.4 million square feet of construction on the 534-acre campus, but as of July 2002 only 2 million square feet, less than one-third, had been built, and only 5,000 of the promised 20,000 jobs had materialized. Nearly 2,000 of those 5,000 were laid off prior to WorldCom's bankruptcy filing. The deluded Pollyannas now argue that, despite WorldCom's demise, the county has "plenty of educated workers," so it won't be so bad. The less deluded are starting to admit that the telecom debacle has led commercial vacancy rates to more than double and new business construction to drop off sharply. They expect that WorldCom's bankruptcy restructuring will lead to substantial new layoffs as well as a slowdown in related businesses.

Built on the "New Economy"/stock market bubbles, Northern Virginia, and Loudoun County in particular, experienced explosive growth from 1991 to 2001. Northern Virginia, comprised of 17 counties and/or incorporated cities, had a 25% increase in population, while Loudoun County's rate was 97%. The economic base of this growth, however, as of 2001, was 70% concentrated in the services, high-tech, and "white collar" managerial sectors, while agriculture, mining, construction, and manufacturing comprised 11.3% of the economic activity. Residential housing construction, to accommodate this influx, mushroomed. As of 2001, sixty-four percent of the new units were built in three areas: Fairfax, Loudoun, and Prince William counties. Commercial and industrial units sprouted-up like weeds, creating a glut of vacant real estate as the bubbles began to deflate. The official commercial building vacancy rate for Northern Virginia is 15%, and in actuality, much higher. Prior to the WorldCom bankruptcy, Loudoun County's official commercial vacancy rate stood at 17%. It is now expected to double to 33%. By way of comparison, the office vacancy rate in Silicon Valley has risen from 3.5% in the late 1990s to 32% today.

Loudoun County's Dot-Bomb Fiasco

A look at the labor force composition of Loudoun County during 1991 to 2001 provides a snapshot of the pervasiveness of the bubble economy. As the county's "2001 Annual Growth Summary" reported, "Employment . . . increased by 143.8% . . . between 1991 and 2001"; it bragged that "much of

TABLE 1

Loudoun County, Virginia: Selected Industries Employment Growth, 1991-2001

Industry Year	Number of Employees 1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	Percent of Total Employment, 2001	Percent Change, 1991-2001
TCPU*	6,382	6,550	6,625	7,011	8,162	8,669	9,426	10,773	12,225	13,643	14,711	15.1	130.5
Retail Trade	6,209	6,272	6,724	7,283	8,019	8,514	9,827	10,311	12,569	14,721	16,158	16.6	156.9
Services	8,823	8,940	10,207	11,659	12,237	13,609	15,178	16,436	21,651	24,465	29,983	30.8	239.8

Source: Loudoun County, Virginia, "2001 Annual Growth Summary," May 2002.
* Transportation, Communications, Public Utilities

that growth occurred in the Service and Retail Trade sectors." Indeed, the area is speckled with shopping malls and commercial industrial parks. Of the top five employers in 2001, two were telecoms (WorldCom/UUNet and AOL), two were airlines (United Air Lines and Atlantic Coast/United Express), and the fifth was the county public hospital.

Table 1, extracted from the county's report, shows that 62.5% of jobs in the county are in the consumer, rather than producer category of employment. From 1991 to 2001, the Transportation, Communications, and Public Utilities (TCPU) sector added 5,285 jobs, growing by 130.5%; as of 2001, it represented 15% of the job market in the county. The Service sector added 21,000 jobs, growing by 239.8%, and represented 30.8% of the job market in 2001. The TCPU and the Service sectors are the two categories accounting for most Internet, high-tech computer-related jobs. This consumer-society-driven economy necessarily nurtured the retail business, which grew by 156.9%, representing 16.6% of the job market in 2001. Another category which grew at a comparable rate was the construction sector (137.5%), adding 5,780 jobs over the ten years, of which 4,312 were added from 1997 to 2001, the height of the housing bubble boom. Agricultural jobs grew by 193%, but with an absolute increase of 1,593 jobs over ten years; manufacturing grew by only 59.7%.

The next shoe to drop is the housing market. In "Danger! U.S. Housing Bubble May Blow Up the Markets" (*EIR*, June 21, 2002), we showed the size and vulnerability of Federal Reserve Chairman Alan Greenspan's Fannie Mae/Freddie Mac housing bubble, and the spectacular price inflation of homes in the Northern Virginia area. Loudoun County's housing bubble has followed trend. **Table 2** shows the housing price inflation from 1991 to 2001 in the county. The average sales price of single-family detached homes increased 89% in that period, while single-family attached home prices rose 56%, and condominium prices went through the stratosphere, at 153%.

The WorldCom and AOL implosions, accompanied by their hundreds of layoffs, and compounded by United Airlines' precarious financial existence, will accelerate the bursting of Loudoun County's housing bubble. Hundreds of jobs have been lost in just the first six months of this year. Rev. Ralph Weichman of Our Savior's Way Lutheran Church in Ashburn, Virginia, where WorldCom's campus is located, reported to the *Washington Post,* "Husbands and wives are asking themselves what their future is here. Managers talk about how difficult it is to fire people on a regular basis. One man had to fire people in four separate phases and said he couldn't take it any more. A number had signed on to big jobs with stock options that have become worthless." Another Loudoun man told the *Post,* "We're coming back to reality. The tech companies were all puffed up, thinking they were Arnold Schwarzenegger, when they were really skinny kids on the beach. All tech is off steroids."

There are no local solutions to any of these dire economic conditions. The best hope is that the reality check hitting Virginia's governor, legislators, and citizens will cause them to now admit that Lyndon LaRouche was right, and that it is time for his New Bretton Woods reorganization of the world economy.

TABLE 2

Loudoun County, Virginia: Housing Price Inflation, 1991-2001

(Average Sale Price of Units Sold)

	Single Family Detatched	Single Family Attached	Condominium
1991	210,048	146,303	95,848
1992	208,928	143,131	94,051
1993	215,460	145,958	93,364
1994	222,003	145,957	103,458
1995	229,515	155,007	99,474
1996	239,569	150,687	101,319
1997	246,772	154,032	100,629
1998	264,715	156,092	133,572
1999	290,851	165,590	117,686
2000	346,205	188,679	134,958
2001	396,016	228,150	243,159

Source: Loudoun County, Virginia, "2001 Annual Growth Summary," May 2002.