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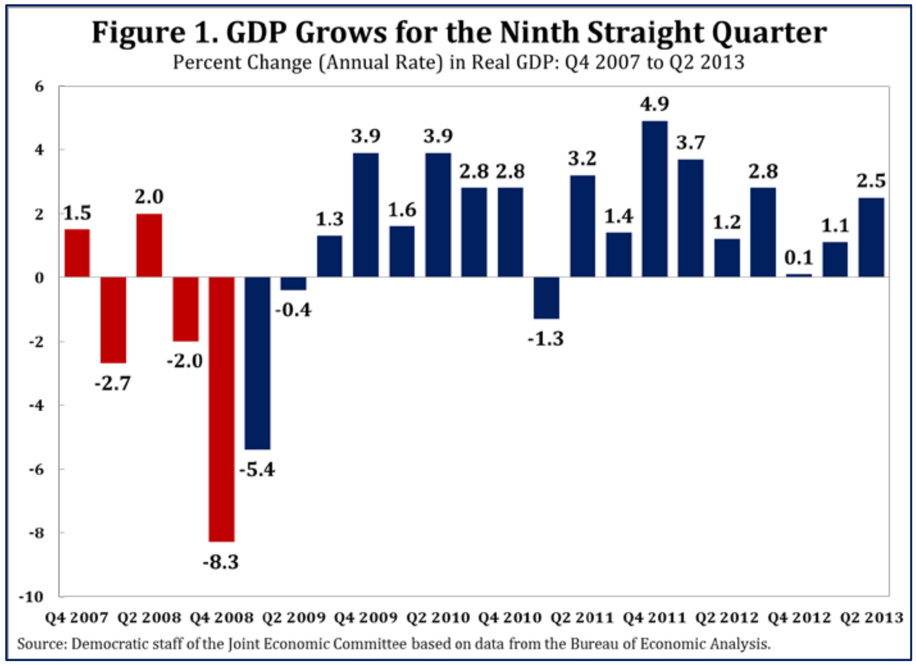
The Economic Consequences of the Federal Government Shutdown

Ten Ways the Shutdown is Hurting the Economy

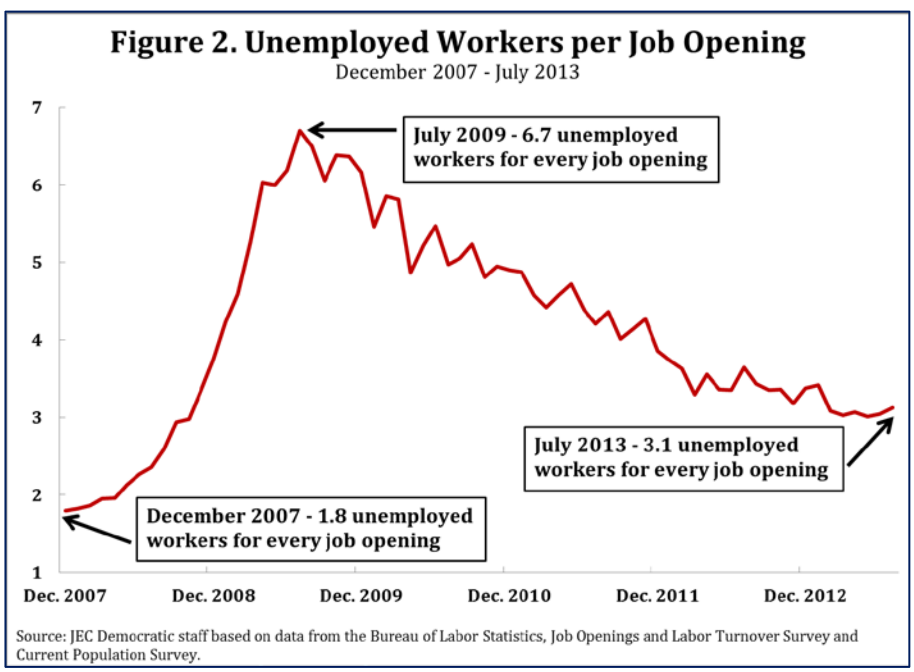
The federal government shutdown presents an unnecessary risk to the U.S. economy at a crucial point in the economic recovery. The current funding impasse will reduce gross domestic product and create uncertainty for businesses, consumers and investors. This report discusses some of the major economic consequences of the shutdown.

THE U.S. CONGRESS JOINT ECONOMIC COMMITTEE DEMOCRATIC STAFF
Senator Amy Klobuchar, Vice Chair

1. A fiscal drag on the economy and consumer spending. The federal government shutdown comes at a crucial point in the economic recovery. Private-sector job growth has increased for 42 consecutive months, gross domestic product has grown for nine straight quarters (**Figure 1**), and the housing market rebound continues. New single-family home sales have risen 12.6 percent over the past year and existing home sales recently reached a six and one-half year high. The decline in the number of unemployed workers for every job opening illustrates the progress made in the labor market during the recovery (**Figure 2**). There are now about 3 unemployed workers for every job opening while there were nearly 7 unemployed workers for every job opening in 2009. This ratio is almost back to its 2007 level of 2 unemployed workers for every job opening.



Despite those improvements, long-term unemployment rates remain elevated, and key sectors of the economy, like manufacturing and construction, have not recovered to their pre-recession levels. A federal government shutdown will be a significant drag on the U.S. economic recovery. Economist Mark Zandi testified at a Joint Economic Committee hearing last month that shutting down the government for three or four weeks would do substantial economic damage, reducing real gross domestic product (GDP) by 1.4 percentage points in the fourth quarter.[1] He also noted that this likely understates the economic fallout, as "it does not fully account for the impact of such a lengthy shutdown on consumer, business and investor psychology."[2] According to a recent survey by the Pew Research Center, 75 percent of those surveyed said a shutdown would negatively affect the economy.[3] Sixty-one percent of respondents said that the shutdown would have a major effect on the economy.[4] These survey results foreshadow a decline in consumer confidence and consumer spending.



2. Harm to furloughed workers and private-sector employers. The federal government is America's largest employer, and its economic activity is equivalent to 22 percent of the nation's GDP.[5] Beyond the reduction in economic activity caused by reduced federal spending, there will be a significant reduction in spending by the roughly 800,000 federal employees who have been furloughed. Delayed paychecks for federal workers create uncertainty and will slow economic growth this quarter.

In addition, the federal government is the country's largest employer of contractors and subcontractors, many of whom do vital work in areas with a direct impact on economic activity, including public health, education and infrastructure. If a shutdown persists, contractors will begin to furlough countless workers. For example, during the 1995-96 shutdown, one-fifth of all federal contracts in the Washington, D.C. area were put on hold.[6] For example, Lockheed Martin recently announced plans to furlough thousands of workers due to the government shutdown.[7]

The federal government shutdown comes on the heels of substantial budget cuts under the sequester, which is already on track to cut $984 billion in federal spending.[8] According to the Congressional Budget Office (CBO), absent the sequester, real GDP would be 0.7 percent greater by the end of fiscal year 2014, and the economy would generate 900,000 additional jobs.[9]

3. A negative impact on the housing market. The housing market continues to recover. Sales of existing single-family homes increased 12.8 percent over the 12 months ending in August. In addition, housing prices continue to rise. According to the S&P/Case-Shiller Composite 20 Home Price Index, home prices have risen for 18 consecutive months through July 2013.

But the shutdown could create significant headwinds. The Federal Housing Administration (FHA) and Department of Veterans' Affairs (VA) are delaying insuring new home loans, likely holding up purchases of homes by buyers counting on FHA- or VA-guaranteed loans. More than 22 percent of all mortgages are backed by one of those federal agencies. Each week that the government is shut down could prevent thousands of homeowners from obtaining a FHA-guaranteed mortgage. In 2012, the FHA insured 1.3 million mortgages, most of which were for purchasing homes rather than refinancing.[10] FHA borrowers are often first-time borrowers who may not be able to become homeowners without access to this program.[11]

4. An immediate reduction in tourism revenues. The government shutdown has forced the National Park System to close all of the nation's national parks. This has a direct economic impact on neighboring communities. The National Park System received nearly 279 million recreation visits in 2011.[12] Park visitors spent nearly $13 billion in local gateway regions (within roughly 60 miles of the park). Direct spending by tourists, which includes lodging and meals, generated nearly $10 billion. Those visits generated an additional $5 billion in secondary effects, which include jobs created and support services for those employees.[13]

The impact of the shutdown in terms of the closure of major U.S. tourist sites may also have broader ripple effects on the travel and tourism industry, which accounts for one out of every eight jobs in the United States. Tourism is among the top ten industries in 48 states and the District of Columbia in terms of employment.[14]

5. The economic spillover effects of reduced public health services. The shutdown was forced on the United States government just as flu season was beginning. Because of the shutdown, the Centers for Disease Control and Prevention (CDC) "would be unable to support the annual seasonal influenza program."[15] A non-epidemic flu season typically leads to the loss of 36,000 lives, the hospitalization of 200,000 people and direct economic costs to U.S. employers of over $10 billion.[16] A full-blown flu epidemic, exacerbated by the inability of the CDC to support the annual seasonal influenza program, would have economic consequences that are far more severe. There are additional public health and related economic risks associated with the Department of Health and Human Services being forced to furlough over 40,000 employees (the majority of its staff). This includes the Food and Drug Administration being unable to support the majority of its food safety activities, including routine inspections and monitoring of imported food.[17] Such routine inspections have, in recent months, uncovered the sale of food products contaminated with salmonella.[18] New patients are also not being accepted into clinical research at the National Institutes of Health.[19] The combined economic effect of reduced public health services by the federal government could be substantial.

6. Constraints on economic policymaking due to lack of information. The shutdown has forced a number of federal agencies to suspend their gathering and reporting of critically important economic data. For example, the Bureau of Economic Analysis (BEA) will not be able to report a number of key economic indicators, including the gross domestic product. The Bureau of Labor Statistics (BLS) is not updating its employment and inflation statistics and did not release its September jobs report as scheduled on Friday, October 4th. Policymakers use the information provided by these agencies to make informed decisions. The Federal Reserve, which previously announced that it will continue its policy of low-interest rates based in part on employment indicators, will have to decide when to unwind its asset purchase program (known as quantitative easing) without knowing the state of the labor market. Similarly, financial markets are operating without the ability to gauge key aspects of U.S. economic performance. This could result in significant market distortions and heightened market volatility.

7. Harm to the most vulnerable population. A prolonged government shutdown will harm the most vulnerable segments of the population and slow economic growth. For example, the shutdown may delay benefits under the Supplemental Nutrition Assistance Program (SNAP). Ninety-seven percent of SNAP benefits are spent during the month they are received, which has an immediate impact on the food industry and supports jobs for grocers, truck drivers, food production workers and farmers.[20] The U.S. Department of Agriculture (USDA) estimates that $1 in SNAP benefits increases GDP by $1.79 and every $1 billion in SNAP spending generates as many as 17,900 jobs.[21] Moody's Analytics has also determined that SNAP has the highest multiplier among fiscal policies.[22] More than 80 percent of SNAP-recipient households are below the poverty line and more than half of SNAP benefits go to families living in extreme poverty (those with incomes at or below half of the poverty line).[23] A prolonged shutdown may also delay monthly benefits for the Supplemental Nutrition Program for Women, Infants and Children (WIC). Almost nine million mothers and children living near or below the poverty line rely on the program.[24] In addition, the USDA stated that no new funds will be available to support the Food Distribution Program on Indian Reservations and other nutrition programs.[25]

8. Harming farmers, ranchers and agriculture exporters. America's farmers and ranchers make an important contribution to the U.S. economy by ensuring a safe and reliable food supply, improving energy security and supporting job growth and economic development.[26] The federal government plays a key role in supporting the agriculture industry and promoting exports.

Many of USDA's key statistical reports have been suspended, including all market news reports, National Agricultural Statistics Service reports, and other statistical reports and projections. The monthly crop estimate due out October 11 will likely be delayed. That report often leads to large swings in the market value of corn, soybeans, wheat and cotton.

USDA's funding for new export promotion activities have also been suspended. In 2012, U.S. agricultural exports—including both bulk and high-value products—totaled $141.3 billion, the highest level on record.[27] Agriculture exports made up 10 percent of U.S. exports in 2012.[28]

9. Delays in financing for small businesses. With the government shutdown, the Small Business Administration (SBA) is not processing new applications for its loan programs, preventing small firms from accessing the capital they need to build and grow their businesses. [29] Tight credit conditions have been a challenge for small businesses during the recovery, and this delay in financing will present a new hurdle for small firms.[30] In FY 2012, the SBA's 7(a) loan program, which enables small businesses to access up to $5 million in financing for a variety of uses, approved more than 44,000 applications, totaling more than $15 billion in loans and supporting close to 445,000 jobs.[31] The 7(a) program guarantees a percentage of each loan and is the government's principal loan program to help small businesses. Financing to help small firms sell their products abroad also dries up during a government shutdown. The Export-Import Bank has stopped all new financing for U.S. exporters and this disproportionately impacts small businesses.[32] In FY 2012, close to 90 percent of the Export-Import Bank's transactions were with small businesses.[33]

10. Increased uncertainty for financial markets as U.S. approaches debt limit. In addition to the consequences discussed above, the shutdown of the federal government has shaken market confidence in Congress' willingness to raise the statutory debt ceiling and avert a default on U.S. government obligations. If the debt limit is not raised by October 17, extraordinary measures being taken by the Treasury Department will run out, and the U.S. government will default on some of its commitments.

House Republicans have refused to pass a continuing resolution without defunding or delaying the Affordable Care Act, causing a government shutdown. There is now significant concern that Congress may not lift the debt ceiling in a timely manner. Failure to lift the debt ceiling would prevent the U.S. from honoring its commitments to households, businesses and governments.

In 2011, Congress waited until the last minute to increase the debt ceiling, with negative economic consequences, including the Dow Jones Industrial Average dropping 2,000 points, a downgrade of the U.S. credit rating by Standard & Poor's (S&P), a sharp drop in consumer confidence and $1.3 billion in additional borrowing costs for fiscal year 2011 alone. This year, a last-minute increase of the debt ceiling could have even greater economic consequences, given that markets are already shaken up by the government shutdown. And the economic consequences of an outright default – which Federal Reserve Chairman Ben Bernanke has said would be "catastrophic"[34] – would be worse by orders of magnitude.

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