

“Economic Effects of Government Shutdowns”

Testimony by

Matthew D. Shapiro¹

Committee on Small Business
U.S. House of Representatives

February 6, 2019

Thank you for the opportunity to testify about the effects of the recent partial government shutdown on government workers and contractors, small businesses, and the overall economy.

The recent government shutdown had an immediate and direct effect on government workers and contractors who were not paid during the shutdown. Many households live paycheck to paycheck. An average government worker’s household has about a week’s worth of cash in their checking account at the end of a two-week pay period; roughly 20 percent have only a day’s worth of spending on hand just before their payday. Hence, many government workers needed to take multiple steps to make payments and meet expenses when they went payless during the recent shutdown. Contract workers who went payless, in addition to having similar low cash buffer, had little prospect of being paid retroactively.

Research on the 2013 government shutdown provides some concrete evidence about how government workers coped with a drop in pay and provides insights into how the direct effects of the lost pay affect the economy in general and small businesses in particular. In October 2013,

¹ Matthew D. Shapiro is the Lawrence R. Klein Collegiate Professor of Economics, University of Michigan, Ann Arbor Michigan. This statement reflects his views and not necessarily those of the University of Michigan.

when government workers received a reduced paycheck owing to the shutdown, they took a number of measures.

First, on average, they cut overall spending by an amount equal to about half the pay shortfall. Households with a low cash buffer cut spending more sharply. Households who had an adequate cash reserve to absorb the temporary loss of income cut spending only modestly.

Second, many deferred payments including mortgage, rent, and credit card payments.

It is also interesting to note what they did not do. There is little evidence that workers affected by the 2013 government shutdown borrowed by incurring new charges on their credit cards. Those who entered the shutdown with little cash and substantial credit preferred to cut back spending rather than accumulate new debt.

Because the 2013 shutdown was resolved quickly and workers were promptly paid retroactively, it had little lasting effect on workers' financial condition or on the overall economy. Workers who deferred mortgage payment or rent were able to make payments once they received retroactive pay—often within the month—so there was no discernable effect on their credit.

While the coping strategies of affected workers in the recent shutdown appears to have been similar to that in 2013, the severity of the shutdown for affected workers and contractors led to much greater economic impacts.

Because the recent shutdown started at the beginning of a pay check cycle for Federal workers, the first payday during the shutdown was completely payless, rather than the 40 percent reduction in pay experienced in 2013.

Because of the length of the shutdown, affected workers faced a second payless payday on the day the shutdown was finally resolved.

Very few households—less than one-quarter according to my estimates—have sufficient cash buffer to offset a month with no pay. Hence, as the shutdown entered its fifth week last month, there was considerable risk of a sharp drop in economic activity had it continued. The out-of-pocket costs of coming to work—commuting costs or child care expenses—are significant and needed to be paid by those mandated to work without pay. From the worker’s perspective, the temporary expedient of skipping a payment of rent, mortgage, credit card, cellphone, utility, insurance, or doctor’s bill—something that might have at first seemed fairly low risk given the shorter duration of past shutdowns—was a looming financial disaster for many households. The prospect of receiving past due notices on such bills had the shutdown continued into another month justifiably led to growing panic and despair among those affected. This impending financial distress almost surely impelled sharp drops in discretionary spending leading up to the second missed paycheck—with no pay coming in and late payment notices in mailboxes, households would have been cutting whatever spending they could.

Some small businesses were likely affected by this drop in consumer spending. Small businesses serve the many consumer needs for discretionary purchases. So the flip side of the sharp drop in consumer spending among affected workers was a drop in sales of these businesses. Examples include restaurants and coffee shops, dry cleaners, corner grocery stores, parking lots, movie theaters. Household cutbacks focus on discretionary purchases—such as eating out—or big ticket items that can be deferred—such as car or appliance purchases. Many of these

establishments that offer these goods and services are small businesses. Businesses in locations where Federal workers and contractors live or work were disproportionately affected.

Systematic data are hard to come by, but again the 2013 shutdown provides some evidence. We estimate that the average Federal worker affected by the shutdown cut coffee shop and fast food spending by \$1.50 per week during the shutdown in 2013. Adjusting for the long duration and sharper cut in pay in the recent shutdown, that translates into an estimated \$15 million cut in total spending at fast food outlets and coffee shops. That's less than a tenth of percent of sales nationally, but given the geographical concentration, small businesses in areas such as Washington DC must have seen very significant drops in business.

Workers' deferred payments also affected businesses. Many of these payments—those on mortgages, credit cards, or utility and phone bills—were due to large financial institutions and companies that were likely little affected. Late rent payments, in contrast, may go to landlords who themselves owe payments to creditors and to the small businesses who service their properties. The shutdown may have placed such businesses under stress, which could have been quite severe had it continued much longer and therefore affected a second cycle of monthly payments.

More comprehensive estimates of the effect of the shutdown are available from official statistics and macroeconomic models.

Because the annual appropriation for the Department of Labor had been enacted, the availability of employment data from the Bureau of Labor Statistics was not affected by the shutdown.

There are two sources of monthly data on employment: data collected from establishments and data collected from households. In the jobs report last Friday, furloughed Federal workers were counted as employed since they would be paid retroactively. Hence, the furlough had little effect on the strong jobs report for January. In the unemployment statistics, furloughed workers are counted as on temporary layoff and therefore add to the unemployment rate. In January, 175,000 furloughed workers were among the unemployed—contributing to the uptick in the unemployment rate to 4.0 percent.²

The Department of Commerce was affected by the shutdown, so other economic statistics are delayed. The Bureau of Economic Analysis (BEA) was scheduled to release the GDP statistics for the fourth quarter of 2018 on January 30. That release has been delayed with no announcement as of yet for when the businesses, policy makers, and the public will get this first comprehensive assessment of the performance of the economy at the end of last year. Some data required for calculating GDP were not collected during the shutdown. Specifically, the Census Bureau could not field the Advance Retail Trade survey in January, so key data on consumer spending are missing. These will have to be filled in using retrospective surveys, so information on the overall state of the economy may be delayed by as much as a month.³ Other data of

² BLS analysis suggests that some furloughed workers responded to the survey that they were away from work rather than on layoff. The BLS does not adjust the unemployment rate to reflect such underreporting of layoffs, but reports the unemployment rate in January would have been slightly higher had all furloughed workers in the Household Survey reported that they were on layoff.

³ In past shutdowns, the Census Bureau have asked businesses for retrospective reports when the government has reopened. Though it has not announced it plans, I expect that the Census Bureau will collect December and January retail trade statistics when it fields its next survey in the middle of this month.

particular concern to small business, notably housing starts, were not released in January owing to the shutdown.

What are the effects on the shutdown on economic growth in the short run? Economists estimate these short-run effects by calculating the loss in total income and then by calculating the direct effects on spending of those who lost the income. These estimates also account for the spillover or “multiplier” effects, for example, when a coffee shop that serves Federal workers cuts hours of its employees in response to slack demand. The Congressional Budget Office has estimated that GDP will be 0.2 percent lower this quarter and 0.1 percent lower over the year owing to the effect of the shutdown on aggregate demand. That GDP is projected to rebound somewhat from the initial drop reflects the presumption that government workers will make up some of the lost spending from December and January when they get paid retroactively. Contractors are not expected to be paid retroactively, but might partially recoup lost payments as work that was delayed during the shutdown gets made up. The CBO estimates are based on parameters that are consistent with what my research found about the drop in spending and the post-shutdown rebound in 2013.

There are reasons, however, to be concerned that the rebound in spending will be more muted than in past shutdowns. The agreement to end the shutdown gave the Federal workforce and the economy a three-week reprieve. Absent an agreement to fund the government beyond mid-February, both workers and businesses are presumably behaving with caution. For Federal workers, this could mean trying to build up a cash buffer against the risk of a new shutdown. For

businesses who serve Federal workers or contract with the government, this could mean delaying new hiring or delaying purchases of equipment.

There is a growing body of evidence that uncertainty about government policy is a drag on the economy. February 2019 is likely to be another data point supporting these estimates.

The University of Michigan has a long-standing survey of consumer sentiment that provides insights into how consumers across the country reacted to the shutdown. The Michigan Survey of Consumers showed a sharp decline in consumers' confidence about the economy. The index dropped 7.2% from December to January, a very sharp decline. The survey asks respondents what news is affecting their outlook. Many mentioned the shutdown. This decline in sentiment signals a weakening economy. It may be reversed, but probably not until a longer-term budget agreement is in place.

The estimates of the effects of the shutdown on the economy that I have discussed mainly relate to the direct and indirect effects of the lost income of government workers and contractors, and how this spills over into the sales of business. There are other effects—much harder to quantify but equally important—from having the Federal government operating partially for five weeks.

The deterioration of the air transportation system was highly visible, and the events at LaGuardia Airport on January 25, 2019 likely helped prompt the temporary agreement to reopen the government. Even before the impending crisis at the end of the shutdown, uncertainties about delays made planning trips difficult and likely lead to cancellations of business and personal travel.

Federally-funded research projects were curtailed, with possible permanent loss of scientific data.

Businesses regulated by the Federal government faced delays in their operations and may have lost business opportunities as they waited for regulatory approvals.

Small businesses and farms participating in Federal programs faced liquidity problems as payments on government contract or approval of SBA loans were delayed.

Those doing business with the government, awaiting regulatory approvals, awaiting loan approvals, or trying to get information will face delays as the affected agencies clear the backlogs associated with the five-week closure. These disruptions likely have a cumulative and persistent effect on business output and productivity.

Perhaps a silver lining from the recent shutdown is that the widespread disruptions it caused made salient the many Federal functions that provide vital services to businesses and the public. Interruptions in these vital functions have a real cost to the overall economy and individual American's well-being.