

The federal “shutdown” should only have a limited effect on economic activity in the USA

US Congress and the President failed to reach an agreement to approve seven of the twelve appropriation bills which needed to be passed by 21st December 2018, leading to the total or partial shutdown of certain public services between 22nd December 2018 and 25th January 2019. This was the longest government shutdown in the history of the United States. The aim of this Focus is to provide a brief explanation of the mechanisms at work in this shutdown, and to detail their potential effects on economic activity. The shutdown seems to have slowed activity by 0.1% in Q4 2018. It could knock 0.2 points off American GDP growth in Q1 2019, with the reaction effect adding 0.1 points in Q2.

Partial closure of the federal government for a record period of time

Only so-called discretionary spending was affected by the shutdown; essential spending, such as the mandatory programmes covering social security, pensions and unemployment benefits, was unaffected.

The shutdown thus affected seven of the twelve government programmes covered by discretionary spending, adding up to a total of 329 billion dollars according to the Congressional Budget Office (CBO), the body responsible for financial auditing and oversight. The five appropriation bills which did make it through congress represent a combined total of around 1002 billion dollars. Furthermore, mandatory spending adds up to 2700 billion dollars. On 25th January, Congress and the White House reached a provisional agreement providing temporary funding for the seven affected areas until mid-February. Since then the prospect of a new shutdown has become less likely: the President has accepted the compromise deal proposed by Democrat and Republican representatives, providing funding for the affected programmes. Meanwhile, he has declared a national emergency in order to obtain federal funding for the construction of a wall on the US border with Mexico.

The sums blocked during the shutdown amounted to 25% of total discretionary spending, affecting around 800,000 of the 2.1 million federal employees, i.e. 40% of the staff and payroll of the federal government. These civil servants were not paid at the end of December, nor in January, but did receive full back pay at the end of the shutdown in late January-early February.

Payroll fell as a result of the shutdown, as did public expenditure on goods and services

The effects of the shutdown are estimated based on the public spending which was effectively halted during this episode, the unpaid wages, a consumption equation, and the input-output table which serves to measure the value added of this blocked or delayed spending.

According to the Congressional Budget Office (CBO), which analysed the effects of the shutdown on the USA's GDP and economic activity, the total wage bill for the 800,000 unpaid civil servants adds up to 9 billion dollars for the five weeks of the shutdown, which spanned two pay days (end of December and mid-January, since US federal employees are paid fortnightly). That amounts to 1.2% of total monthly gross wages, and 0.25% of real quarterly gross disposable income (0.75% of real monthly gross

disposable income). The wages received by federal employees represent around 3.1% of total gross wages in the USA.

The CBO also analysed the contingency funding plans of the departments in question in the event of a shutdown. Public spending on goods and services was slashed by 9 billion dollars between 22nd December and 25th January, a third of which should be offset by spending in February and March 2019, a third more in Q2 and the final third in Q3. In Q1, public spending on goods and services should thus be around 6 billion dollars lower.

Marginal propensity to consume, estimated econometrically, is used to calculate the variation in consumption resulting from an income shock of the kind caused by the shutdown. In addition, the input-output table and an inverted Leontief matrix (see the Brexit Special Analysis which explains and utilises this methodology) are used to calculate the national content of the value added of American household consumption (estimated at 89%), thus converting the effect into points of value added and GDP. The national content of value added of the public spending on goods and services (95%) affected by the shutdown is calculated using the same method.

The wages of the federal employees affected by the shutdown were paid in arrears at the end of January and the start of February, leading to an increase in consumption in February, calculated using the same measure of marginal propensity to consume. Nonetheless, the overall effect should remain slightly negative for Q1.

The shutdown should reduce GDP by 0.2% in Q1, partially offset by an improvement in Q2

Overall, the combined effect of the fall in household consumption and public spending in late December and January, in spite of the partial rebound in February and March, should reduce GDP by 0.1% in Q4 2018 and by 0.2% in Q1 2019. Most of this decrease would come from the fall in public spending on goods and services. Applying the same method, the partial catch-up of public spending should boost GDP by 0.1% in Q2 and Q3. As an annual average for 2019, the direct effect should remain negative (-0.1%).

These results are similar to the figures published by the CBO (-0.1% in Q4 2018, -0.2% in Q1 2019 and +0.1% in Q2 and Q3 2019).

International developments

Nevertheless, these estimates are subject to considerable uncertainty in both quantitative and qualitative terms. Indirect effects, transmitted by the decline in household and business confidence and the postponement of recruitment, purchasing and investment decisions, are not taken into account here.

Indeed, the partial shutdown of the federal government also affected private companies, both directly in the form of subcontractors working for federal agencies (which saw a downturn in orders and activity) and also indirectly in the form of an information shortage faced by investors.

Furthermore, since many government offices were closed, the certification and authorisation procedures for certain products and services were either slowed down or interrupted entirely. This was true of the financial regulatory agencies, affecting public offerings. Some businesses also saw their access to federal subsidies restricted. All of these factors are likely to have weighed upon economic activity, causing businesses to postpone their investment and recruitment decisions. Nevertheless, such effects are difficult to quantify and have not been estimated here. ■

Bibliography

Congressional Budget Office, « The effects of the partial *shutdown* ending in January 2019 », 28 janvier 2019, <https://www.cbo.gov/publication/54937> ■