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Effects of a Short-Term Lapse in Appropriations on Economic Activity

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Appropriations for fiscal 2014 were not enacted by October 1, the beginning of the new fiscal year. As a consequence of this funding gap, government agencies have scaled back their operations to cover only those activities involving "the safety of human life or the protection of property." We estimate that each week that the government is shut down will reduce the annual rate of growth of real GDP by 0.2 percentage point in the fourth quarter and increase the rate of growth by the same amount in the first quarter as activity returned to baseline. This estimate is uncertain and there is probably more scope for the shutdown to have a larger effect than a smaller one. The rest of this memo briefly outlines the staff's thinking about the possible economic effects of a short-term funding gap.

- The principal effect of a short-term lapse in appropriations is the furlough of those civilian employees who are not involved in activities related to health and safety.
  - The Defense Department has announced that 50 percent of its 800 thousand civilian employees are furloughed, while military employees are exempt from furloughs.
  - We estimate that about 45 percent of the 1.4 million nondefense civilian workforce has been furloughed, ranging from 5 percent at Veterans Affairs to 95 percent at the Education Department (based on press releases from many agencies).
  - Compensation of federal civilian workers amounts to 1½ percent of GDP. A one-week furlough of about 45 percent of the workforce would reduce real compensation by 14 percent and real GDP growth by 0.2 percentage point (at annual rates).
- If this is only a short-term shutdown, then federal purchases excluding compensation during the current quarter would probably be little affected by the shutdown.
  - However, a longer-term shutdown would probably reduce these purchases and have larger negative effects on economic activity.
- After previous shutdowns, furloughed employees were paid for their days off, leaving nominal compensation and nominal GDP unaffected (and boosting the GDP deflator by the amount that real GDP is suppressed). It is possible that Congress would authorize such payments again this time.

   - However, given the tight appropriations in place and the likelihood of furloughs later this fiscal year, employee pay might not be restored this time. The loss in pay could lead employees to lower their spending, further reducing economic activity.
- These estimates do not include any effects on economic activity stemming from financial market reactions or reductions in consumer and business sentiment. These effects would probably be small if the shutdown is transitory and not seen as foreshadowing more significant disruptions.