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Governnment Shutdown Watch

Economist(s)

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Summary

- A possible government shutdown looms on the horizon, with Congress struggling to pass a bill that would fund the federal government beyond September 30. But what is a government shutdown, and what are the potential economic implications of one?
- A government shutdown impacts the 26% or so of federal spending that is characterized as "discretionary." "Mandatory" spending, such as outlays for Social Security, Medicare and Medicaid, is not part of the annual appropriations process and thus generally continues unabated.
- During a government shutdown, unfunded federal agencies must discontinue non-essential functions. Essential services, such as those related to public safety or national security, continue to operate.
- Civilian federal employment is roughly 2.3 million excluding the self-funded Post Office, and active duty military personnel total another 1.3 million. Federal government employees deemed "essential" continue to work during a shutdown, but they do not receive pay. "Non-essential" employees are furloughed and their activities cease. All workers receive back pay *after* the shutdown ends.
- On Friday, September 19, Republicans in the House of Representatives passed a continuing resolution (CR) that funds the government through November 21. It will take at least 60 votes to break a Senate filibuster and pass the CR through the upper chamber, but so far Senate Democrats have been reluctant to pass the bill. Differing views on the level of spending, the allocation of spending across programs, health care policy and Democratic frustration over the Trump administration's impoundment/recissions are among the issues driving the budget stalemate.
- Past government shutdowns are instructive for assessing the potential economic impact. The *direct* hit to economic growth in the 2013 and 2018–2019 government shutdowns was relatively modest at a few tenths-of-a-percentage point. GDP growth rebounded by a similar amount once the shutdowns ended. That said, not all the lost economic activity was recovered in full, and the *indirect* hit to the economy is more difficult to measure yet nonzero.
- A shutdown could delay influential economic data reports published by government agencies. Following the 16-day government shutdown in 2013, the monthly Employment Situation and Consumer Price Index reports, among others data points, were delayed by about two weeks. Collection, processing and publication delays stretched into the following month as well. This time around, the critical September employment report is due to be released on October 3, while the September CPI report is slated to be released on October 15.
- It is important to note that the current government shutdown episode is unrelated to the debt ceiling. The U.S. debt limit was increased by $5 trillion in the Republican-passed One Big Beautiful Bill in July. As a result, the government would not run out of borrowing capacity in the event of a shutdown, and Treasury security issuance would not be impacted.
- Economic disruption from a prolonged government shutdown and an extended delay of key government data releases would inject additional uncertainty into the monetary policy outlook. Furthermore, even if a CR is passed in the next week that averts a shutdown, another budget fight before year-end seems likely.

Shutdown Showdown

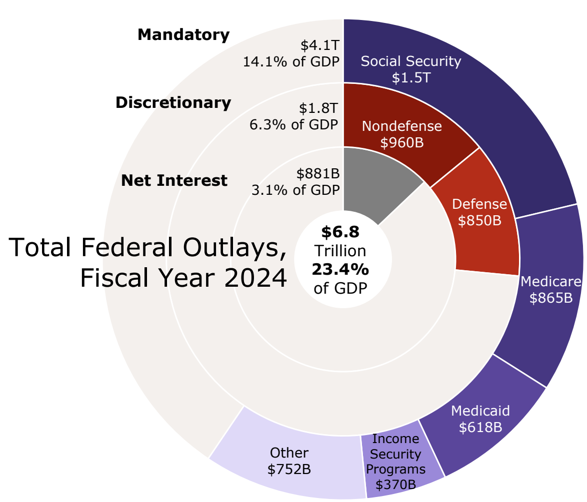
A possible government shutdown looms on the horizon, with Congress struggling to pass a bill that would fund the federal government beyond September 30. But what is a government shutdown, and what are the potential economic implications of one?

A shutdown generally only involves a subset of federal spending and activities, specifically the 25% of the federal budget that is "discretionary" spending.

The term "government shutdown" sounds straightforward, but it masks what is a nuanced phenomenon. A shutdown only involves a subset of federal spending and activities, specifically the 26% of the federal budget that is "discretionary" spending and determined through the annual appropriations process (Figure 1). Each year, Congress debates and passes the 12 annual appropriation bills (sometimes combining them into one large "omnibus" bill) that dictate discretionary spending levels and allocations. If Congress does *not* pass the annual appropriations bills or a continuing resolution (CR), a government shutdown ensues, and the "non-essential" activities that are funded through this process cease.

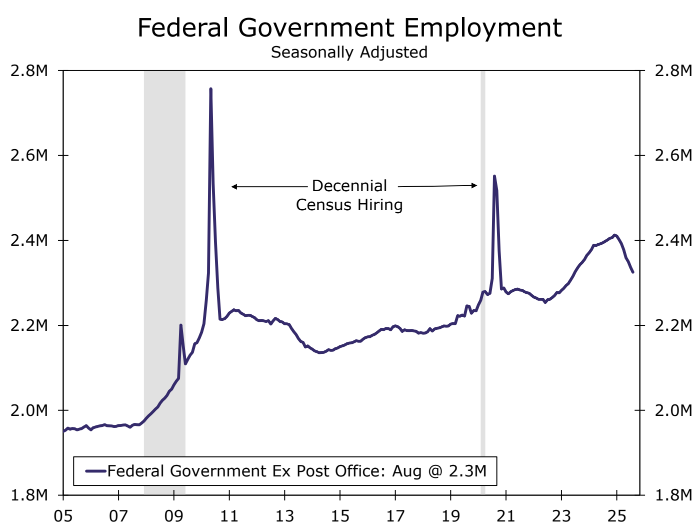
Discretionary spending includes many of the government activities and agencies that spring to mind when thinking about government operations. Examples include the military, border security, air traffic control, the National Aeronautics and Space Agency (NASA), the Federal Emergency Management Agency (FEMA), the Internal Revenue Service (IRS) and some veterans benefits. In contrast, "mandatory" spending is determined by a variety of eligibility requirements, formulas and other processes. Examples of mandatory spending include Social Security, Medicare and Medicaid. For the most part, mandatory spending continues uninterrupted during a government shutdown.[1]

Figure 1



Source: Congressional Budget Office and Wells Fargo Economics

Figure 2



Source: U.S. Department of Labor and Wells Fargo Economics

Civilian federal employment is roughly 2.3 million excluding the self-funded Post Office (Figure 2), and active duty military personnel total an additional 1.3 million.[2] Federal government employees deemed "essential," such as those performing critical national defense functions or providing medical care, continue to operate during a shutdown. However, these workers generally do not receive pay during the duration of a shutdown. Once the shutdown concludes, essential workers will receive back pay. "Non-essential" employees are furloughed, and their activities cease during a shutdown. Furloughed federal employees do not work and are not paid during a shutdown, but like "essential" workers, they also receive back pay after the shutdown ends.

Once the shutdown concludes, federal government workers will receive back pay, but they are not paid for the duration of the shutdown.

Thus far, Congress has enacted none of the 12 full-year appropriations bills to fund the government for Fiscal Year 2026, which begins October 1. On Friday, September 19, Republicans in the House of Representatives passed a continuing resolution (CR) that funds the government through November 21. It will take at least 60 votes to break a Senate filibuster and pass the CR through the upper chamber, but so far Senate Democrats have been reluctant to pass the bill. Different views on the level of spending, the allocation of spending across programs, health care policy and Democratic frustration over the Trump administration's impoundment/recissions are among the issues driving the budget stalemate.

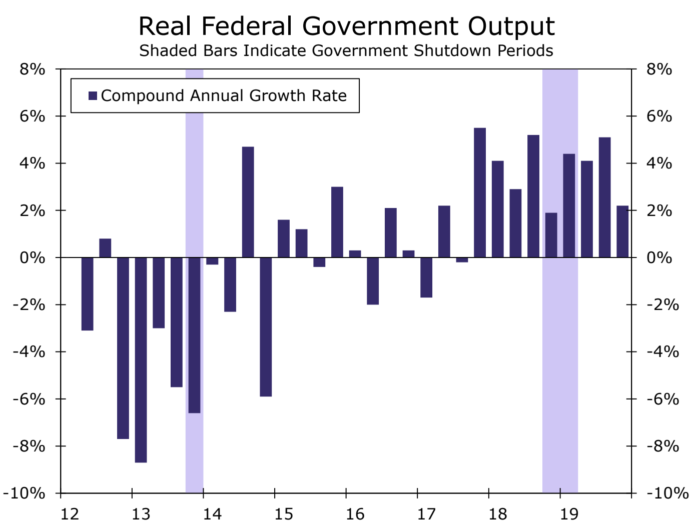
A Dent to Economic Growth, but Not a Derailment

The direct effects of both the 2013 and 2018–19 shutdowns on economic growth were relatively small and short-lived.

Government shutdowns have become all too familiar in recent years and thus are not uncharted territory for the U.S. economy. Since the 1980s when shutdowns started to occur under the modern budget process, most have been relatively short, spanning just a few days and not having a discernable impact on the economy. But over the past 12 years or so, there have been two lengthy shutdowns that proved more disruptive. From October 1–16, 2013, all federal government agencies ceased non-essential operations. The most recent shutdown (December 22, 2018–January 25, 2019) was only "partial," with impacted agencies only accounting for about 25% of discretionary federal spending. Yet, while narrower in scope, the 2018–2019 shutdown became the longest on record at 35 days.

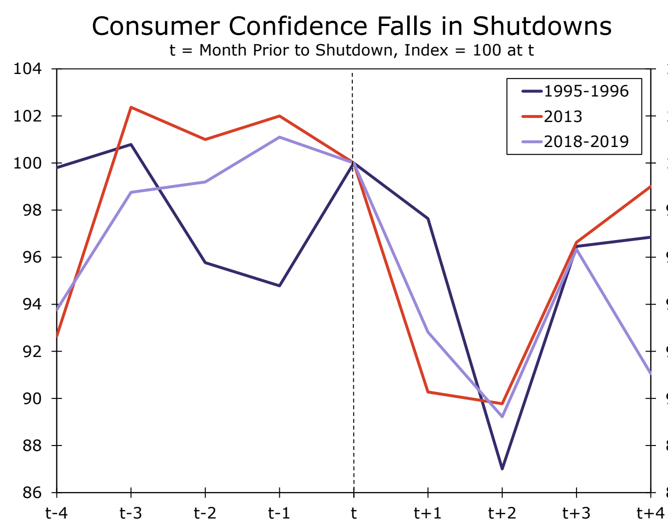
The *direct* effects of both the 2013 and 2018-19 shutdowns on economic growth were relatively small and short-lived. The Bureau of Economic Analysis (BEA) estimated that the 2013 shutdown directly reduced real GDP growth in the fourth quarter of that year by 0.3 percentage points.[3] For the five-week partial shutdown ending in January 2019, the BEA estimated the shutdown reduced real GDP growth by 0.1 percentage points in Q4-2018 and 0.3 percentage points in Q1-2019 (the shutdown spanned both quarters).[4] The hit to real GDP growth primarily stemmed from the reduction in hours worked by federal government employees, as hours worked are used as a measure of government output. Yet, the direct hit to real GDP growth soon washed out. The federal government component of real GDP growth rebounded after the shutdown ended and hours worked returned to normal (Figure 3).

Figure 3



Source: U.S. Department of Commerce and Wells Fargo Economics

Figure 4



Source: The Conference Board and Wells Fargo Economics

The indirect hits to the economy are more difficult to measure yet nonzero.

That said, not all lost economic activity is recovered in full. The Congressional Budget Office (CBO) estimated a small (<0.1%), yet nonzero reduction in projected annual GDP in 2019 as a result of the partial government shutdown.[5] Furthermore, these estimates only attempt to account for the *direct* hit to economic growth from the shutdown.

The *indirect* hits to the economy are more difficult to measure yet should not be ignored. As noted earlier, federal workers are now required by law to receive back pay for the shutdown period.[6] As a result, furloughed workers would still be counted as employed in the establishment survey of payroll employment (although classified as "unemployed on temporary layoff" in the household survey). However, both furloughed and employees working through the shutdown are not paid until *after* the shutdown has ended. This often extends to private sector workers as well, such as government contractors. Amid the delayed pay and uncertainty over how long savings need to stretch, affected workers are likely to reduce discretionary spending on the margin. Some of that spending may be merely delayed, but some, such as dining out, may not be, leading to a permanent loss of economic activity. Furthermore, the uncertainty created for private sector firms that contract with the government can disincentivize the long-term investments needed for certain activities, such as building a factory that delivers military equipment to the Pentagon.

While these secondary, indirect effects are largely localized to areas with a high share of federal government employment, like the D.C. metro area, the general mood of the U.S. consumer typically has soured amid heightened discord in Washington. As illustrated in Figure 4, the Consumer Confidence Index lurched lower during previous government shutdowns. Therefore, we see the direct effect estimates by the BEA and CBO as likely lower bounds to the total impact on the U.S. economy.

It is important to note that the current government shutdown episode is unrelated to the debt ceiling. The U.S. debt limit was increased by $5 trillion in the Republican-passed One Big Beautiful Bill in July. As a result, the government would not run out of borrowing capacity in the event of a shutdown, and Treasury security issuance would not be impacted.

Reduced Visibility at an Inopportune Time

A shutdown could delay influential economic data reports published by government agencies, such as the jobs report and CPI.

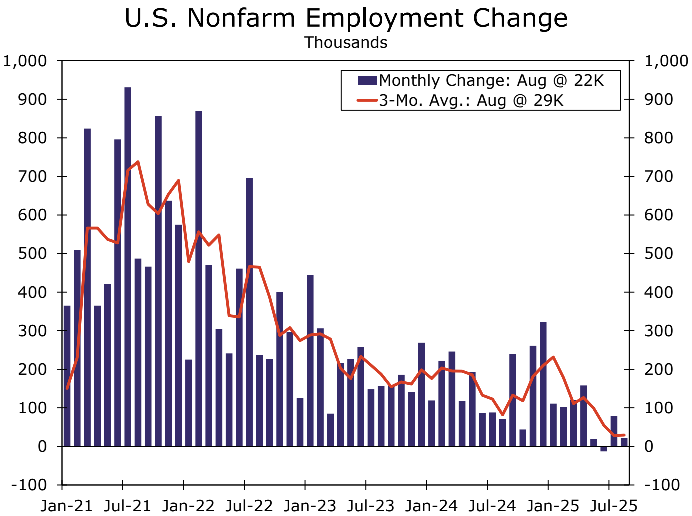
Not only would a shutdown reduce economic growth modestly, but it would create a data vacuum at a time when the path ahead for the economy remains uncertain. A shutdown could delay influential economic data reports published by government agencies, as employees involved in collecting and processing the information are deemed non-essential.

In the 2018–19 partial government shutdown, data blind-spots were largely limited to reports published by the Department of Commerce, such as personal income & spending and GDP. The first look at GDP growth for Q4-2018 was delayed about a month, as was December 2018 data on retail sales and personal income & spending. Data collection at other agencies, most notably the Bureau of Labor Statistics (BLS) within the Department of Labor (DoL), continued during that period because the DoL was an agency that was funded by Congress in advance of the shutdown.

Today, none of the 12 appropriation bills have become law as of this writing. Thus, a full government shutdown, should it come to pass, would leave more holes in the data picture by also impacting key BLS releases on inflation and the labor market, as was the case in the wider 2013 shutdown. Following that 16-day closure, the monthly Employment Situation, Consumer Price Index and Producer Price Index reports, among others, were delayed by about two weeks. Collection, processing and publication delays stretched into the following month as well. The disruptions spilled over into other economic indicators which use government data as input sources, such as the Federal Reserve's Industrial Production report.

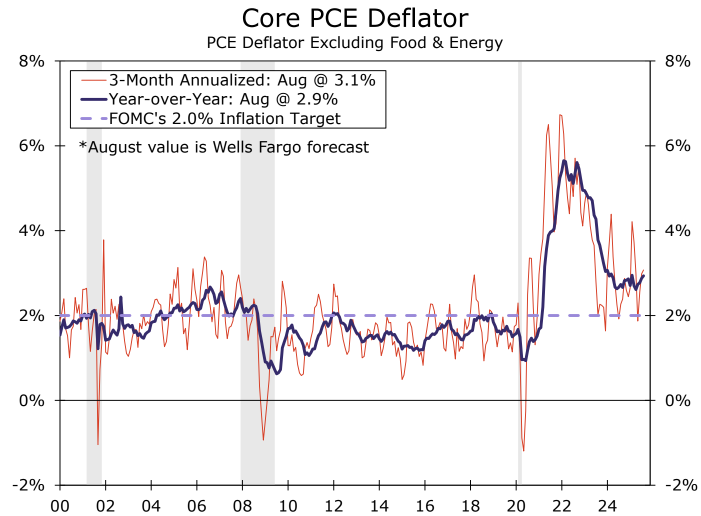
While releases were delayed, data quality for the period reflecting the shutdown was largely unaffected, with the BLS reporting normal-range response rates for the October 2013 employment and PPI reports. However, the sample of prices used to calculate the CPI for October that year was about 75% of the usual amount, and these additional strains, were they to occur, would come at a time when the Bureau of Labor Statistics is under heightened scrutiny. This time around, the critical September employment report is due to be released on October 3, while the September CPI report is slated to be released on October 15.

Figure 5



Source: U.S. Department of Labor and Wells Fargo Economics

Figure 6



Source: U.S. Department of Commerce and Wells Fargo Economics

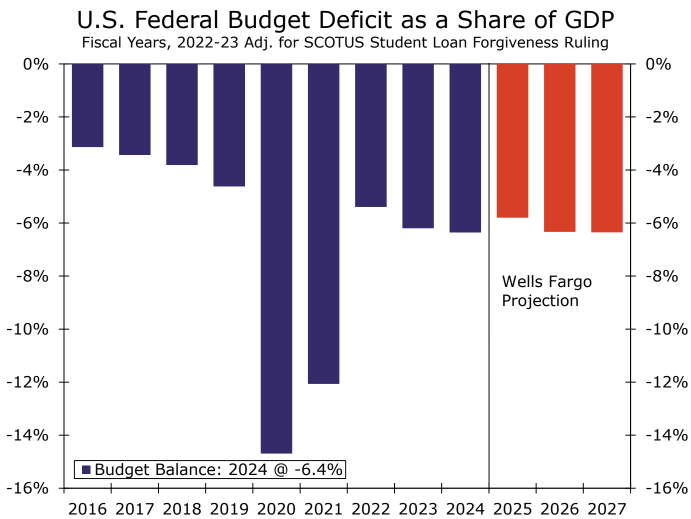
Recent data point to a mixed and conflicting picture of the U.S. economy. Real GDP grew at a 1.4% annualized pace in the first half of the year but looks to have accelerated in Q3. The labor market has shown notable signs of weakness of late, including a sharp slowdown in hiring and a four-year high in the unemployment rate (Figure 5). Furthermore, the Fed's preferred inflation measure, the core PCE deflator, remains stubbornly above the central bank's 2% inflation target (Figure 6).

Monetary policymakers are moving carefully as a result. Having reduced the fed funds rate by 25 bps at its previous meeting, the FOMC has signaled it wants to proceed cautiously amid upside risks to both unemployment and inflation. Economic disruption from a government shutdown and an extended delay of key government data releases would inject additional uncertainty into the monetary policy outlook. Determining the correct policy setting in real-time is never easy, and it would be made all the more difficult by a prolonged government shutdown.

Economic disruption from a government shutdown and an extended delay of key government data releases would inject additional uncertainty into the policy outlook.

If a government shutdown occurs, we do not anticipate it having a material impact on the federal fiscal outlook. Our forecast for a federal budget deficit of $2.0 trillion in FY 2026 (~6.3% of GDP) likely would be unchanged (Figure 7). Furthermore, even if Congress is able to pass a CR and stave off the looming shutdown, the budget battle is far from over. A CR with a late-November deadline simply would punt for another two months on FY 2026 funding decisions. An October 1 shutdown may still be avoided, but we suspect this topic won't go away anytime soon.

Figure 7



Source: Congressional Budget Office and Wells Fargo Economics

Endnotes

1 – For further reading, see the Congressional Budget Office's glossary for key budget terms. (Return)

2 – This figure excludes the 600K employees of the U.S. Postal Service, which is a self-funded agency of the federal government. Postal service workers would continue to deliver mail and receive paychecks during a shutdown. (Return)

3 – U.S. Department of Commerce: Bureau of Economic Analysis. Technical Note on Gross Domestic Product, Fourth Quarter of 2013 (Advance Estimate). January 30, 2014. (Return)

4 – U.S. Department of Commerce: Bureau of Economic Analysis. Technical Note on Gross Domestic Product, First Quarter of 2019 (Advance Estimate). April 26, 2019. (Return)

5 – Congressional Budget Office. The Effects of the Partial Shutdown Ending in January 2019. January 2019. (Return)

6 – Government Employee Fair Treatment Act of 2019, Public Law No. 116-1. 2019. (Return)

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