



MANUFACTURING POLICY INITIATIVE AT SPEA

INSIGHT INTO MANUFACTURING POLICY

How Does a Federal Government Shutdown Impact Manufacturing?

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How does a federal government shutdown impact manufacturing? The most recent shutdown—from December 22, 2018, to January 25, 2019, the longest in U.S. history—provides a useful illustration of both the direct and indirect role of the government in this critical sector of the economy.

What is a Government Shutdown?

A government shutdown—a uniquely American phenomenon—occurs when funding lapses for nonessential discretionary functions of the executive branch that are subject to annual appropriations from Congress. A shutdown ends when legislation to appropriate funds is enacted.

Since 1976, the U.S. Federal Government has shutdown 21 times. Most of these shutdowns do not last very long (over a weekend or a single day during the work week) and have a minor impact on the public and on government workers and contractors. In nine instances, however, the shutdown lasted more than seven days.

Not all of the federal government is closed during a shutdown. Certain essential services, such as those related to public safety, continue to be provided. Major programs like the military, Medicare, and Social Security—that is, mandatory spending programs—continue to operate. Programs that are not funded through annual appropriations—such as the U.S. Postal Service—are unaffected. And some discretionary programs may continue to operate if the parent agency has surplus funding that can be utilized until it runs out.

The latest shutdown effected discretionary activities in the judicial branch and certain departments and agencies whose appropriations bills were not enacted in time. Thus, it represented a partial shutdown. Approximately 800,000 civilian employees were in agencies impacted by shutdown. Of these, roughly 300,000 were furloughed, and 500,000 forced to work without pay (see Table 1). As part of the agreement to end the shutdown, these government workers were paid retrospectively—similar to the outcome of every other government shutdown.

Macroeconomic Impact on the Economy

Because the economy is bolstered by government spending, a temporary reduction in government spending will be detrimental to economic growth—and some loss in gross domestic product (GDP) will never be recovered. Furthermore, the economic impact of a government shutdown is non-linear. A shutdown that lasts twice as long will have more than twice the drag on the economy.

The Congressional Budget Office (CBO) estimated that, as a result of the most recent shutdown, 0.1% of GDP was lost in the fourth quarter of 2018 and 0.02% of annual GDP will be lost for 2019. Tax revenues will be lowered by \$2 billion in fiscal year 2019 because of the shutdown. Although some of the loss in GDP is expected to be recovered after the shutdown, the expected net impact is a \$3 billion loss to the economy. Other estimates (e.g., Moody’s and Oxford Economics) pegged the cost of the shutdown even higher.

One might think that a government shutdown should save taxpayers money, but this is incorrect. A shutdown costs money, and here’s why: (1) federal employees eventually receive every penny they are due, even for work not done, (2) some taxes and fees won’t be collected during a shutdown, (3) the government will owe payments plus interest as a result of a shutdown, (4) the economy will take a hit and therefore so will tax revenue, and (5) administrative costs are imposed (i.e., each agency must follow certain procedures when shutting down and restarting).

Table 1. The Most Recent Government Shutdown, by the Numbers

<i>Description</i>	<i>Estimate</i>
Length of shutdown	35 days
Federal employees working without pay	500,000
Federal employees furloughed	300,000
Total number of federal employees impacted	800,000
Percentage of federal workforce impacted	40%
Percentage of federal budget impacted	25%
Expected loss in GDP due to shutdown	\$3 billion

Source: Congressional Budget Office

Adverse Impacts on Manufacturing

These estimates of the macroeconomic impact do not include many indirect impacts on the private sector, including manufacturers. These indirect impacts are not trivial and can be significant for any firm that is counting on government action to do business.

Government Contractors. About one fifth of federal government contract spending is for purchased goods—all of which are manufactured items—and four-fifths is for services. In the most recent shutdown, some of the affected agencies (NASA, the Federal Aviation Authority, and the Department of Homeland Security) relied on contractors more than the others. Although federal employees received back pay after the shutdown ended, federal contractors did not, as most government contracts require payment for services rendered. Many government contractors, therefore, did not get paid even as they paid their employees. For contractors that are small businesses, the shutdown had an immediate negative impact on cash flow. Even some larger contractors had to furlough their employees during the shutdown.

New Products. Many kinds of manufactured products—and most of the highest value-added products—require some type of government review, approval, registration, certification, or licensing before entering commerce. During a shutdown, such activity is often halted and a backlog is created once federal workers return to the job. All of this increases uncertainty and slows down innovation and productivity.

The most recent shutdown negatively impacted the following programs related to new products, including Environmental Protection Agency review of new chemicals, new pesticides, and new vehicles to meet emission standards; Food and Drug Administration review of new drugs and medical devices where user fees had not yet been paid; Federal Communication Commission certification of new technology products with a transmitter (e.g., new mobile phones, Wi-Fi routers, TVs, and computers); Department of Treasury approval of new labels for nationally distributed beer and wine; FAA authorization and certification of new aircraft, and waivers for unmanned aircraft systems (drones).

International Trade. A government shutdown adds friction to the flow of international trade. Domestic manufacturers that depend on imports or exports are negatively impacted. For example, during the most recent shutdown, revisions to the Harmonized Tariff Schedule were not being updated. The Department of Commerce International Trade Administration ceased investigating antidumping and countervailing duty cases. Exclusion requests from the 2018 steel and aluminum tariffs were not being processed, leading to a reported backlog of 100,000. Toward the end of the shutdown, the U.S. Trade Representative had to stop processing exclusion requests on the Section 301 tariffs on Chinese imports. The Department of State was not processing routine (non-emergency) export or import licenses for arms and defense services. The Bureau of Industry and Security in the Department of Commerce halted the processing of export license requests. These consequences negatively impacted the bottom line of affected firms.

Foreign Investment. Foreign investment in the U.S. is subject to a national security review by the Department of Treasury’s Committee on Foreign Investment in the United States. Such reviews—which typically occur prior to the desired transaction—were halted during the recent government shutdown, and just when the scope of these reviews had been expanded under legislation enacted within the last year. This resulted in significant delays because few firms choose to complete a transaction without the certainty of a green light from Treasury.

Hiring. During the most recent shutdown, the federal government’s e-Verify service, which allows employers to check on the legal status of potential employees, was unavailable, causing a delay in hiring. This was especially problematic for firms in certain states that require such a background check and eligible job candidates in terms of lost pay.

IPOs and Business Mergers. The shutdown delayed the Securities and Exchange Commission (SEC) review of initial public offerings for companies that plan to go public. The SEC was also unable to process filings, provide interpretive advice, and issue no-action letters. The Federal Trade Commission review of business mergers was delayed during the shutdown.

Regulatory Activity. In many cases, a government shutdown halts changes to existing regulations, new regulations, and the issuing of new or revision of guidance documents. And because the Trump Administration is pushing deregulation, cost savings associated with deregulatory actions were delayed during the recent government shutdown. For example, EPA’s Office of Air and Radiation suspended all rulemakings, including deregulatory rulemakings.

For manufactured goods subject to federal oversight, inspections may be curtailed during a government shutdown. Examples during the recent shutdown include FDA inspections of factories that process foods or manufacture nutritional supplements. The fear of a negative impact on consumer confidence led some manufacturers to choose to halt production and withhold product offerings until federal inspectors returned to their job.

Federal Loans and Loan Guarantees. Some federal programs provide benefits to manufacturers in terms of direct payments, grants, loans, and bonds. A government shutdown delays the awarding of, and the processing of applications for, such direct benefits. For example, during the most recent shutdown, Small Business Administration loan approvals and loan guarantee approvals were put on hold.

Administrative Proceedings. Many types of administrative proceedings are halted during a government shutdown. During the most recent shutdown, pending proceedings of the SEC were halted. The National Labor Relations Board ceased docketing or investigating charges of unfair labor practices.

Permitting Decisions. Where manufacturers need to obtain a permit for their operations, a government shutdown curtails review and delays approval or disapproval. For example, EPA delayed signoff on factory permits required under the Clean Water Act and Clean Air

Act during the most recent shutdown. When such permits are required prior to capital improvement projects, delays in approval also delay job creation.

Economic Data. The work of federal statistical agencies is halted during government shutdowns. Many private sector investment decisions are based on the latest economic data gathered and disseminated by federal agencies such as Census Bureau, the Bureau of Labor Statistics, and the Bureau of Economic Analysis. The work of such statistical agencies, which is expected to be released at a regularly scheduled date and time, was delayed during the most recent government shutdown. This was particularly important in December, a critical time of year for investment decisions.

Conclusions

When the federal government shuts down, U.S. manufacturing is impacted in numerous ways. The most recent government shutdown had both direct and indirect, temporary and permanent impacts, on the manufacturing sector. Uncertainty over the length of the shutdown made the impact more severe than it would otherwise have been.

Peer Reviewers: Emily Sanchez, Director, Economics & Data Analytics, American Chemistry Council and Chad Moutray, Chief Economist, National Association of Manufacturers

For further reading:

Center for a Responsible Federal Budget, 2019. Q&A: Everything You Wanted to Know about Government Shutdowns. <https://www.crfb.org/papers/qa-everything-you-should-know-about-government-shutdowns>

Congressional Budget Office (CBO), 2019. *Effects of the Partial Shutdown Ending January 2019*. January. <https://www.cbo.gov/system/files?file=2019-01/54937-PartialShutdownEffects.pdf>

Congressional Research Service, 2018. *Shutdown of the Federal Government: Causes, Processes, and Effects*. December 10. <https://fas.org/sgp/crs/misc/RL34680.pdf>