United States Senate
Committee on Appropriations

The Subcommittee on Defense

Hearing on Sequestration and the Defense Industrial Base

Testimony by

Stephen S. Fuller, Ph.D.
Dwight Schar Faculty Chair and University Professor
Director, Center for Regional Analysis
School of Public Policy
George Mason University
Arlington, Virginia 22201
November 13, 2013

Good Morning Chairwoman Mikulski and Committee members. Thank you for this opportunity to testify on the impacts of the sequester and other federal spending reductions on the U.S. economy and by association, the Defense Industrial Base. There can be no question that the U.S. economy continues to struggle to sustain its weak recovery that began 52 months ago. GRP growth in 2013 is now projected to be 1.5 percent, the slowest annual growth rate since the recovery began in mid-2009.

Analyses reported by major forecasters have put the cost of the sequester at between 0.8 and 1.0 percentage points of GDP; that is, the U.S. economy would have grown 0.8 to 1.0 percentage points faster had federal spending in FY 2013 remained the same as it was in FY 2012. The cost of the shut down is included in these estimates; separately the shutdown added an estimated 0.2 percentage points, possibly 0.3, percentage points of lost GDP. This subtraction will clearly show up in the weak fourth quarter GDP growth rate when it is released in three months.

The common question is where can we see the impacts of these DoD and other federal agency spending reductions? The usual metric measuring these impacts is job growth or job loss. In this instance, this metric is not as revealing as was expected. With respect to federal employment, while substantial savings were achieved as part of the sequester, it was not achieved by lay offs but rather a combination of furloughs and payroll savings from leaving vacated positions unfilled. In October, the federal civilian workforce was smaller by 94,000 workers than in October 2012. Not having to initiate the sequester until March or later in the fiscal year, enabled federal program managers to accumulate unspent payroll to return to OMB as sequester savings. In October, 12,000 federal positions were lost in one month. So, this reduction in the federal workforce is not finished.

Federal contracting has reflected a different pattern of impacts. The impacts of reduced federal contracting are cumulative. Contracts not let, not extended or not renewed in FY 2013 will have a substantial portion of their impacts in FY 2014 as these contract cancelations were for future work; some of these impact for contracts curtailed in FY 2013 will not show up in the economy for several years. The numbers look something like this: the $85 billion reduction in budgetary authority resulted in a actual spending reduction of $44 billion in FY 2013, and another $22 billion in spending reductions in the last quarter of 2013 (first quarter of FY 2014). The remainder of the spending reductions for this past year's sequester totaling $19 billion will occur in annual 2014 and beyond. The impacts of these contract reductions will be cumulative and affect the contractors and their workers into the future.

These spending reductions have direct effects of the prime and sub-prime contractors and their suppliers and vendors. Cutbacks in federal contract work result in layoffs, buy outs, or the repositioning of workers into non-federal work. These losses of workers and reductions in payrolls and non-payroll expenditures have a multiplier effect within the economy. These direct spending reductions and their supply chain effects account for approximately 55% of the total impact; the remaining 45% is recorded in reduced spending across consumer goods and services, retail trade, education and health services, leisure and hospitality services and on through the broader of the economy.

While this is not the only condition undermining the performance of the U.S. economy it is certainly a continuing condition. The meager job growth numbers generated this year owe something to the sequester. In a normally expanding economy, monthly job gains should range around 300,000. The U.S. economy isn't close to this growth rate.

Still, shouldn't the job losses due to DoD and other federal agency contracting reductions be measurable? With these former DoD contract workers being shifted to non-DoD work and others who have taken buy-outs or been laid off, many are back at work working for different clients on different types of work these shifts in the workforce are not easily measured. However, it helps to explain the slower job growth overall. The net job growth is less than it would have been otherwise had DoD and other federal agency contracting been sustained at FY 2012 levels.

There are some sub-sectors that are showing decline, however, when measured against both short-term and long-term growth trends. For example, employment in aircraft manufacturing is down more than 10,000 jobs this year and more than 15,000 jobs when compared to this sub-sector's pre-2011 growth rate. Physical, engineering and life sciences research has also lost approximately 5,000 jobs over the past twelve months and almost 25,000 jobs compared to its pre-2011 growth trend. A sector-by-sector analysis would confirm slower growth (jobs not gained) as the primary effect of the sequester as the full employment effects of the sequester have been muted by the continuing slow growth of the economy, which itself provides the best measure of these sequester-related impacts.

The opportunity costs of reduced DoD and other federal agency contract outlays in FY 2013, building on DoD spending reductions during FY 2012 as required under the Budget Control Act of 2011, are taking a significant toll on the U.S. economy and on the specifically impacted sectors in which the prime federal contractors are concentrated. These impacts are clearly visible in the economy's weakest performance since 2009. This damage will continue to accumulate, undermining the workforce and the nation's capacity to support future growth, as long as these targeted spending reductions continue.

Thank you.