POLICY BRIEF

PIONEER OPPORTUNITY

Unprecedented Massachusetts unemployment projections set the stage for a state budget crisis

By Gregory Sullivan and Charles Chieppo

On April 2, the Bureau of Labor Statistics reported that 6.65 million Americans filed jobless claims in the week that ended on March 28, more than doubling the median projection of.3.3 million claims made by economists surveyed by Bloomberg. This breaks the all-time record of 3.31 million claims, set just a week earlier. By comparison, the previous record number of initial weekly claims was 695,000 in October of 1982. The peak for initial weekly claims during the Great Recession was 661,000.

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The Bureau of Labor Statistics also reports non-seasonally adjusted weekly claims by individual states. Figure 1 ranks the new jobless claims reported by the Bureau of Labor Statistics for weeks 3 and 4 of March as percentage of each state's February 2020 civilian labor force. These data show that Massachusetts is the sixth-hardest hit state, with new jobless claims totaling 8.6 percent of its total civilian labor force. By this measure, Pennsylvania, Rhode Island, Nevada, Michigan, and Hawaii have been the most adversely impacted.

The worse than predicted jobless claim figures are likely to worsen longer-term unemployment forecasts. Even before the bad April 2 unemployment news was announced, Federal Reserve Bank of St. Louis economist Miguel Faria-e-Castro posted a blog entitled "Back-of-the Envelope Estimates of Next Quarter's Unemployment Rate." He estimated that the U.S. unemployment rate would increase to 32.1 percent by June 2020, up from 3.5 percent in February. If this turns out to be correct, it would represent the highest unemployment rate in American history. Figure 2 shows Miguel Faria-e-Castro's forecast unemployment rate in comparison with the Great Recession and its aftermath.

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April 2020

Figure 1. States ranked by new jobless claims in weeks 3 and 4 of March as percentage of February civilian labor force

	Labor Force Feb 2020	Total Jobless Claims, March wks 3 + 4	%
Pennsylvania	6,558,209	783,331	11.9%
Rhode Island	558,452	63,914	11.4%
Nevada	1,559,531	163,717	10.5%
Michigan	4,950,003	439,092	8.9%
Hawaii	669,073	57,676	8.6%
Massachusetts	3,834,913	329,514	8.6%
Louisiana	2,109,846	170,268	8.1%
Ohio	5,829,061	468,438	8.0%
Washington	3,962,600	317,410	8.0%
Kentucky	2,083,955	161,749	7.8%
New Hampshire	779,489	56,833	7.3%
Minnesota	3,121,259	225,669	7.2%
D.C.	414,340	29,330	7.1%
New Jersey	4,564,238	321,330	7.0%
Montana	537,323	34,889	6.5%
Alaska	345,422	22,370	6.5%
Maine	695,024	44,994	6.5%
Delaware	489,107	29,763	6.1%
Indiana	3,396,036	205,998	6.1%
Iowa	1,752,764	99,405	5.7%
California	19,515,998	1,065,060	5.5%
Vermont	340,147	18,227	5.4%
Kansas	1,496,507	78,302	5.2%
Wisconsin	3,109,079	161,755	5.2%
North Carolina	5,114,589	264,964	5.2%
Idaho	891,650	45,826	5.1%

	Labor Force Feb 2020	Total Jobless Claims, March wks 3 + 4	%
New Mexico	961,708	46,287	4.8%
New York	9,551,755	446,402	4.7%
Illinois	6,398,842	292,247	4.6%
North Dakota	404,494	18,253	4.5%
Missouri	3,111,784	138,980	4.5%
Alabama	2,243,967	91,078	4.1%
South Carolina	2,391,831	96,682	4.0%
Tennessee	3,365,911	132,569	3.9%
Nebraska	1,042,417	40,272	3.9%
Maryland	3,280,471	126,517	3.9%
Oklahoma	1,844,281	66,896	3.6%
Virginia	4,462,717	160,381	3.6%
Oregon	2,105,464	72,556	3.4%
Arizona	3,613,058	118,412	3.3%
Texas	14,200,106	431,023	3.0%
Connecticut	1,930,492	58,282	3.0%
Utah	1,630,696	48,250	3.0%
Florida	10,455,537	301,313	2.9%
Mississippi	1,276,525	36,465	2.9%
Wyoming	294,173	8,328	2.8%
Georgia	5,156,201	144,526	2.8%
Arkansas	1,367,278	36,219	2.6%
Colorado	3,186,421	80,558	2.5%
West Virginia	806,517	17,702	2.2%
South Dakota	467,060	8,406	1.8%

Source: U.S. Bureau of Labor Statistics, Civilian labor force, weekly initial jobless claims

The previous high of 24.9 percent occurred in 1933 during the Great Depression. It took 14 years, from 1929 to 1943, and an intervening wartime economy, for the U.S. to regain its pre-stock market crash unemployment rate of 3.2 percent. It finally did so in mid-1943.

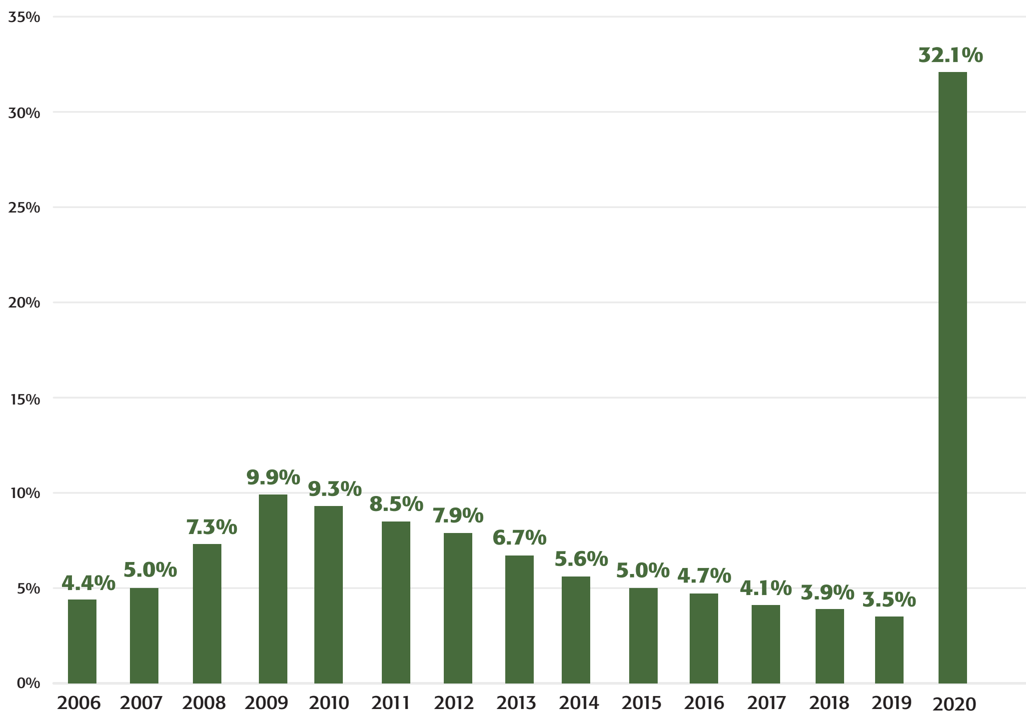
During the Great Depression, the unemployment rate rose much more gradually than is currently occurring. It took four years for unemployment to rise from 3.2 percent in 1929 to its height of 24.9 percent in 1933. If Faria-e-Castro's projection is correct, the suddenness and magnitude of the COVID-19 unemployment increase would be unparalleled.

Massachusetts also experienced an unprecedented surge in unemployment claims in the third week of March. The U.S. Department of Labor reported that non-seasonally adjusted initial unemployment claims rose to 148,452 from 4,712 claims in the first week of March and 7,449 in the second week. The April 3 jobless claims report showed that Massachusetts added 181,062 new unemployment claims in the fourth week of March, bringing the two-week total to 329,514.

Faria-e-Castro estimates that the number of unemployed persons in the U.S. will rise from 5.76 million in February to 52.8 million in June, an eight-fold increase. If Massachusetts also experiences an eight-fold increase between now and June 2020, the number of unemployed persons in the Commonwealth would rise from 106,526 in February to 975,000 in June.

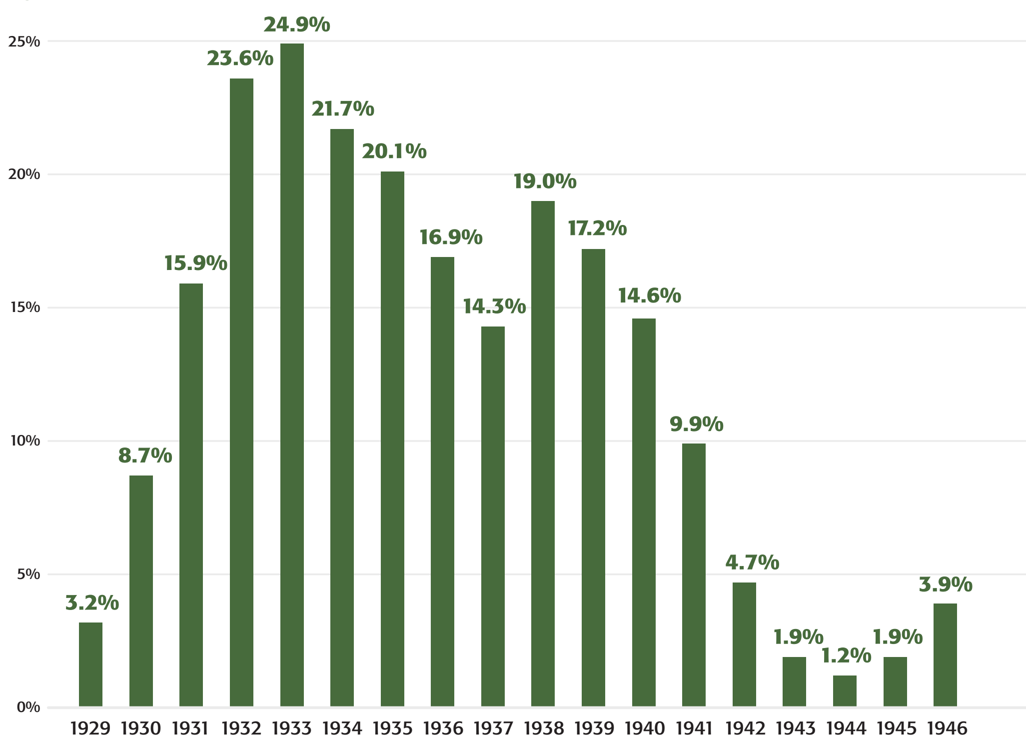
He estimated that the U.S. unemployment rate would increase to 32.1 percent by June 2020, up from 3.5 percent in February. If this turns out to be correct, it would represent the highest unemployment rate in American history.

Figure 2. U.S. unemployment rate (2006–2020), Great Recession period to present, with Faria-e-Castro's estimate for second quarter of 2020



Source: U.S. Bureau of Labor Statistics, compiled by thebalance.com; Federal Reserve Bank of St. Louis

Figure 3. U.S. unemployment rate (1929–1946) - Great Depression period



Source: U.S. Bureau of Labor Statistics; compiled by thebalance.com

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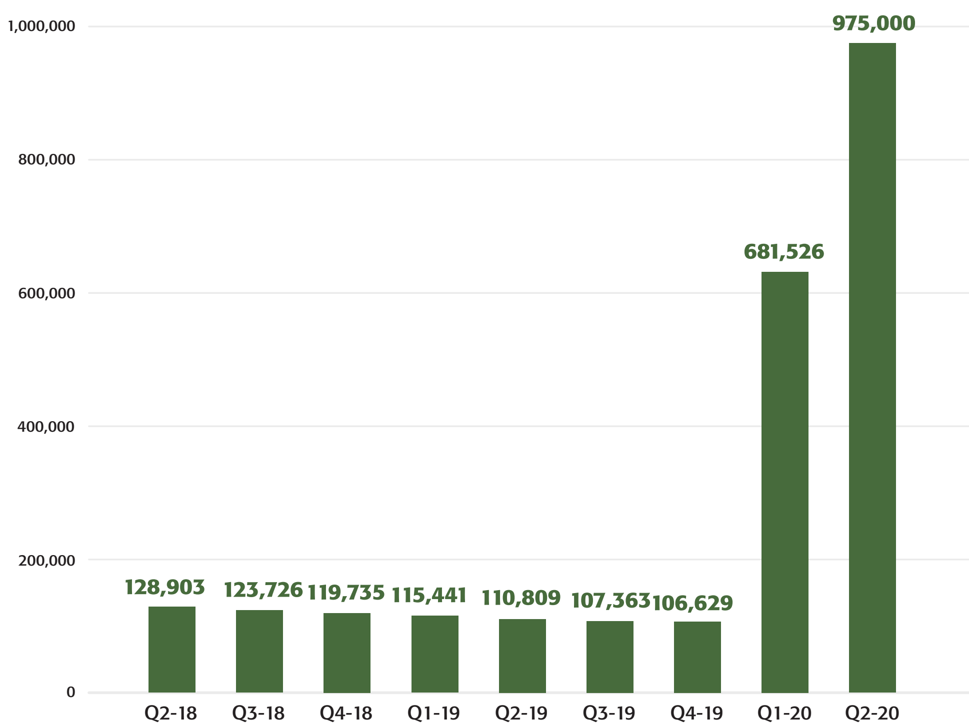
Massachusetts' 329,514 new jobless claims do not tell the full story of its total unemployment increase during the past two weeks. Since only 57 percent of people who become unemployed in Massachusetts get unemployment insurance **(UI),** the total number of people who have become unemployed in Massachusetts during the third and fourth weeks of March is much larger than 329,514. By including newly unemployed people who do not qualify for UI, the total number of newly unemployed people projects to be approximately 575,000. If these are added to the 106,526 unemployed persons in Massachusetts reported by the U.S. Bureau of Labor Statistics for February, 2020, the number of unemployed people in Massachusetts projects to be 681,526 for Q1-2020. Using Faria-e-Castro's back-of-the-envelope estimate for the U.S. Q2-2020 as a guide, Massachusetts projects to have 975,000 unemployed persons by the end of June 2020. If that happens, the Massachusetts unemployment rate would rise from 2.5 percent in February, 2020 to 25.4 percent in June, 2020

Figure 4. Massachusetts unemployment rate (Q2-2018 to Q4-2019), with projections for Q1-2020 and Q2-2020 as described above



Source: U.S. Bureau of Labor Statistics; Pioneer Institute analysis for Q1-2020 and Q2-2020 as described

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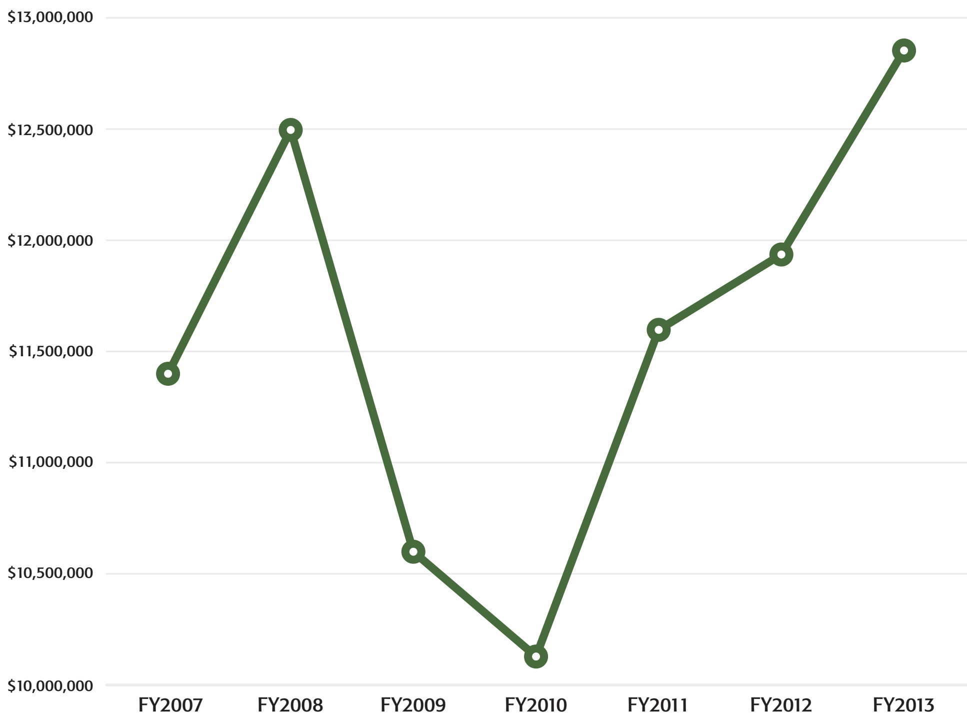
Other economists have projected that the unemployment rate will not rise as much as Faria-e-Castro estimates. Goldman Sachs sees the unemployment rate rising to 15 percent by the middle of the year. St. Louis Federal Reserve President James Bullard forecast that it will skyrocket to 30 percent, but that the economy will then snap back strongly.

A steep rise in unemployment in Massachusetts will inevitably put a serious strain on state government finances. During the Great Recession, Massachusetts Income tax revenues declined from $12.5 billion in FY2008 to $10.6 billion in FY2009, a drop of $1.9 billion. They declined further to $10.1 billion in FY2010, a drop of $2.4 billion from the FY2008 level.

During that recession, Massachusetts unemployment rose from 4.6 percent in FY2007 to a high of 8.3 percent in FY2010.

It is difficult to estimate the potential decline in state income taxes that would result from a jump in unemployment from 2.5 percent to 25.4 percent. The biggest unknown is how long stay-at-home directives and employer shut-downs will last. Also unknown is the duration of the recovery period and the extent to which many small and medium-sized employers will suffer long-term or permanent damage resulting from cash-flow problems during the COVID-19 shut-down. Figure 5 shows the steep decline in income tax revenue during the previous recession.

Figure 5. Massachusetts state income tax receipts (FY2007–FY2011)



Source: Commonwealth of Massachusetts Department of Revenue Monthly Report of Collections and Refunds FY2007–FY2013

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Because of the unusual nature of this recession, it is difficult to gauge how big a decline in sales tax revenue Massachusetts can expect. During the Great Recession, state sales and use tax revenues only dropped by about 5 percent, from $4.1 billion in FY2008 to $3.9 billion in FY2009, before rising again to $4.6 billion in FY2010.The COVID-19 recession is fundamentally different from prior recessions because consumers are refraining from spending not only because of reduced income or economic uncertainty, but because governments have effectively ordered non-essential businesses to close. Figure 4 shows that sales and use tax revenue recovered shortly after the Great Recession began.

Figure 6. Massachusetts state government revenues FY2007–FY2011

	FY2007	FY2008	FY2009	FY2010	FY2011	FY2012	FY2013
Sales and Use Taxes	4,075,549,005	4,098,360,887	3,880,434,148	4,626,023,190	4,920,863,636	5,079,516,585	5,184,726,063
Income Taxes	11,399,648,546	12,496,141,234	10,599,324,949	10,128,035,448	11,597,151,311	11,935,966,872	12,853,989,329
Total Revenue	20,005,492,241	21,185,496,505	18,692,924,004	18,993,183,132	21,036,873,567	21,683,703,619	22,697,392,178
Unemployment rate	4.60%	5.40%	8.10%	8.30%	7.30%	6.60%	6.90%

Source: Commonwealth of Massachusetts Department of Revenue Monthly Report of Collections and Refunds FY2007–FY2013

Congress has provided $150 billion in financial assistance to for state and city governments through the Coronavirus Aid, Relief, and Economic Security Act. The fund will be allocated proportionally by population, and Massachusetts is expected to receive approximately $2.67 billion. In addition, Congress has temporarily increased the federal matching rate on Medicaid from January 1, 2020 until the COVID-19 public health emergency ends. Congress has also provided an extra $600 per week in unemployment benefits to each recipient for up to four months, extended benefits to previously ineligible categories of workers, and extended the period during which benefits can be collected after the regular unemployment period ends, through December 31, 2020. These federally funded supplements to the current unemployment system will help individuals and families cope with financial strain, stimulate our local economy, and restore some of the income tax revenue that otherwise would be lost since unemployment benefits are taxable in Massachusetts. The $1,200 rescue checks that most federal taxpayers will be receiving through the Coronavirus Aid, Relief, and Economic Security Act are advanced tax credits for the federal 2020 tax year and will not be counted as taxable income for federal and state income tax purposes, so they will not serve to supplement Massachusetts state income tax revenues While the expanded unemployment benefits included in the relief legislation are very important, the legislation did not address the ballooning costs to the state of paying the first 30 weeks of benefit for a flood of new unemployment claims.

The steep stock market declines that began in mid-February, coupled with uncertainty about the duration of the pandemic, has resulted reduced economic activity in the U.S. Reuters reports that economists have slashed 2020 growth expectations and investors fear corporate defaults and more mass layoffs would lead to a deep and lasting global recession. Morgan Stanley and Goldman Sachs have forecast that gross domestic product will fall 30.1 percent and 34.0 percent, respectively, in the second quarter.

The COVID-19 pandemic has set the stage for a budget crisis in Massachusetts. It has created an unprecedented surge in unemployment, reduced consumer spending, shuttered businesses, shrunken MBTA revenue, decreased pension fund investment earnings, increased Medicaid costs, and quelled business activity. It is critically important for state government leaders to formulate a best case/worst case analysis of the potential effects of the COVID-19 recession on state government revenues and expenditures and make plans to address the crisis.

Governors Baker and Cuomo have made strong cases for increased federal aid to the states, which operate under constitutionally mandated balanced budget provisions. Massachusetts leaders should join with their counterparts in other states to lobby Congress for large block grants to assist state governments.

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