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.

The two-week total of 9.96 million seasonally-adjusted new jobless claims is a jaw-dropping number, considering that 1.7 million individuals in total were receiving unemployment benefits in the U.S. in the week ending March 14.

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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Charles Chieppo is a Pioneer senior fellow. Previously, he was policy director in Massachusetts’ Executive Office for Administration and Finance and directed Pioneer’s Shamie Center for Restructuring Government. While in state government, Charlie led the successful effort to reform the Commonwealth’s public construction laws, helped develop and enact a new charter school funding formula, and worked on state workforce issues such as pension reform and easing state restrictions against privatization.
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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.
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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](image-url)

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)**

![Graph showing Massachusetts state income tax receipts (FY2007–FY2011)](image)


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.

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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. If Massachusetts is forced to spend down its $1.7 billion unemployment reserve fund, borrow large amounts to restore it, or dip too deeply into its recently restored $3.3 billion rainy day fund, it will undermine its fiscal health and return to the bad old days when Wall Street agencies downgraded our state credit rating and weakened our ability to conduct the people’s business.

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.

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