

Federal Budget Cuts Could Reverse Massachusetts Recovery

Looming reductions strike at the state's innovation economy

President Obama recently unveiled a \$3.8 trillion budget request which forecasts a deficit for fiscal year 2012 that will top \$1.3 trillion. It is likely this budget will fail to be adopted by Congress, highlighting the continuing gridlock in Washington DC among Democrats and Republicans over how best to achieve meaningful deficit reduction while, at the same time, not harming the fragile national economic recovery underway.

The Massachusetts economy benefits greatly from the infusion of billions of dollars in direct federal government spending, nearly \$84 billion in the most recently reported fiscal year—2010. A large portion of these funds, over 40 percent, go directly to Massachusetts residents in payments like Social Security. Federal contributions to the state and local governments also support a variety of programs and efforts. The salaries of federal workers here top \$4.5 billion. Massachusetts is also the fifth-highest recipient of Department of Defense expenditures, at over \$14.5 billion, and much of the state's prowess in education and innovation leadership is underwritten by an estimated \$7.7 billion in federal funding for research and development activities.

Significant cuts to federal spending would have a significant impact on the state economy. The currently mandated federal budget cuts are set to take effect in 2013, reducing federal spending by \$1.2 trillion over the next ten years. The Budget Control Act of 2011 requires that these cuts be split equally between defense and nondefense programs and includes reductions to Medicare and other mandatory spending programs. As of this writing, various proposals were circulating to circumvent these cuts, particularly those to the defense budget, so it is important to keep in mind that the impacts reported below assume that the Budget Control Act is implemented as written and our model for Massachusetts, built using REMI, a dynamic forecasting and comprehensive economic tool that answers "what if" questions about the state's economy, relies heavily on this assumption.

Prior analyses of the impact of budget cuts have focused primarily upon those that result from cuts in the federal defense budget. Our analysis incorporates the across the board cuts that would be implemented in all budget areas. We estimate that job losses in Massachusetts resulting from the currently mandated federal budget cuts will exceed 52,000 in 2013 and last over the ten years. This figure is the average difference between an employment forecast in the absence of the impending budget cuts, and the forecast of employment in the event these budget cuts are implemented.

While these job losses pale next to the state's total employment of nearly 3.5 million, they are by no means insignificant, particularly considering the pace of job growth in recent years. "A reduction in state employment of 52,000 is over 20 percent larger than the entire net increase in employment the Commonwealth experienced during 2011 when net job growth was an estimated 40,500," said Dr. Martin Romitti, *MassBenchmarks* Managing Editor and Director of Economic and Public Policy Research at the UMass Donahue Institute.

The pattern of these job losses strike at the very heart of the Massachusetts Innovation Economy. In addition to the 10,000+ federal civilian and military jobs that our model estimates would be lost, other leading industries would be substantially affected. We estimate Professional and Technical Services, with a loss of nearly 10,000, and in Health Care and Social Assistance, with a loss of over 6,000 jobs would be two of the more heavily impacted sectors. These cuts would be largely due to cuts in the defense budget and to Medicare provider payments. Other cuts are spread throughout the state's industrial mix. While the types of jobs that can be expected to be lost range widely, on average these jobs require higher levels of educational attainment and are high paying with benefits. Significantly, these are the sectors that have allowed the Massachusetts economy to outperform the nation in recent years, a fact that underscores the stakes for the Bay State in ongoing federal budget debates.

What is also not captured fully by these numbers is the collateral damage the cuts could trigger. There is no way to conjecture what future innovations would be lost without the support to the state's high-technology sector provided by federal dollars. A large number of important inventions and innovations in modern times can be traced to federal support of research and development. In addition, the numbers by themselves do not capture the importance of industrial clusters in high-technology economic growth. No technology develops on its own, but instead requires the complex interactions of many companies combining their specific technological knowhow to come up with "the next big thing". "These clusters require a critical mass of activity to thrive, and large federal budget cuts threaten this diverse community of firms," noted Dr. Robert Nakosteen, *MassBenchmarks* Executive Editor and Professor of Economics at the University of Massachusetts Amherst.

These budget and job cuts are not inevitable. Congress and the President could finally agree on a Grand Bargain to rationalize budget cuts and combine them with revenue increases. The allocation of cuts could also be very different than in our assumptions in making these estimates, which are based on the sequestration rules and past patterns of sector-specific expenditures in Massachusetts. It is possible for instance, and has in fact been speculated, that a leaner military could depend on more high-technology support systems, favoring the state's comparative advantage. Still, planned federal budget cuts loom as a Damoclean sword over the state's economy.

Federal Budget Cut Scenario, Massachusetts Job Loss, 2013-2022

Sector	Average Job Loss
Agriculture, Forestry, and Fishing	68
Mining	119
Utilities	62
Construction	1,801
Manufacturing	1,965
Wholesale Trade	1,022
Retail Trade	2,241
Transportation and Warehousing	951
Information	1,075
Finance and Insurance	2,769
Real Estate and Rental and Leasing	1,019
Professional and Technical Services	9,882
Management of Companies and Enterprises	550
Administrative and Waste Services	3,227
Educational Services	2,164
Health Care and Social Assistance	6,238
Arts, Entertainment, and Recreation	841
Accommodation and Food Services	1,396
Other Services, except Public Administration	2,169
State and local government	3,055
Federal civilian and military	10,379
Total	52,993

Source: REMI; Model assumptions developed by UMDI

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