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Massachusetts and the Financial Crisis

College of Management, University of Massachusetts Boston

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Massachusetts and the Financial Crisis

University of Massachusetts Boston,
College of Management Financial Services Forum
Spring 2012 Report

Jobs
President Obama
American Job Act
Global Financial Crisis
TARP
White House
Massachusetts
Bailout



Massachusetts and the Financial Crisis

Welcome to the UMASS-Boston, College of Management, Financial Services Forum's Spring 2012, short report on the financial crisis, it's impact on unemployment in Massachusetts, policies put in place to combat the crisis and their potential impact on Massachusetts.

Although Massachusetts suffered the consequences of the crisis along with the rest of the US economy, the state weathered the storm relatively well. Now, with the impact of the policies still playing out, there are encouraging signs of recovery which may provide much needed relief for all.

The Financial Services Forum is a source of current information and commentary about critical issues facing the industry in Boston and at the national level, as well as the health of financial services in general. Please visit the Forum's website (www.management.umb.edu/businesscenter/financial_forum.php) for more information.

- Director of the Forum: Arindam Bandopadhyaya, Professor of Finance and Chair of the Department of Accounting and Finance at UMB.
- Research Associates: Amy Shuai Wang, PhD student at Temple University in Philadelphia and Professors Atreya Chakraborty and James Grant at UMB.
- Research Assistants: Diana Kohlhagen, Pojaman Thasana-Ekachit, Xingyuan Fei, Yu Zhang.

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The Global Financial Crisis

The magnitude and extent of the global financial crisis is still felt worldwide and will be so for years to come. It is compared to the Great Recession of the 1930's and it will go down in history books. The global financial crisis started to show its effects in the middle of 2007. Around the world stock markets have fallen, small and large financial institutions have collapsed or have been bought out, and even the governments in the wealthiest countries have had to come up with rescue packages to bail out their financial systems. The financial crisis, many commentators argue, can be traced to the deregulation of the financial system pursued by the Reagan and Clinton Administrations, then continued and deepened under the Bush Administration. The economic model pursued in the US since the 1980s has resulted in a massive change in the concentration of income to the benefit of those at the very top. Many argue that this process intensified even further in the years of 2002-2007. The expansion in the scale and influence of the financial sector was critical to this development.

A look back at other financial crises propose that fear and greed are the common factors of these unsettling events. Periods of unrestricted greed eventually lead to excessive leverage and risk taking and unsustainable asset price levels. The inevitable collapse results in unrestrained fear, which must diminish before any recovery would be possible. In hindsight, the global financial crisis was avoidable. It was the result of human action and inaction. Authorities failed to question unheard of returns and procedures and they did not understand the risks within a system that is so essential to the welfare of the American public. The heads of finance and overseeing agencies of our financial system ignored the warning signs and red flags, including:

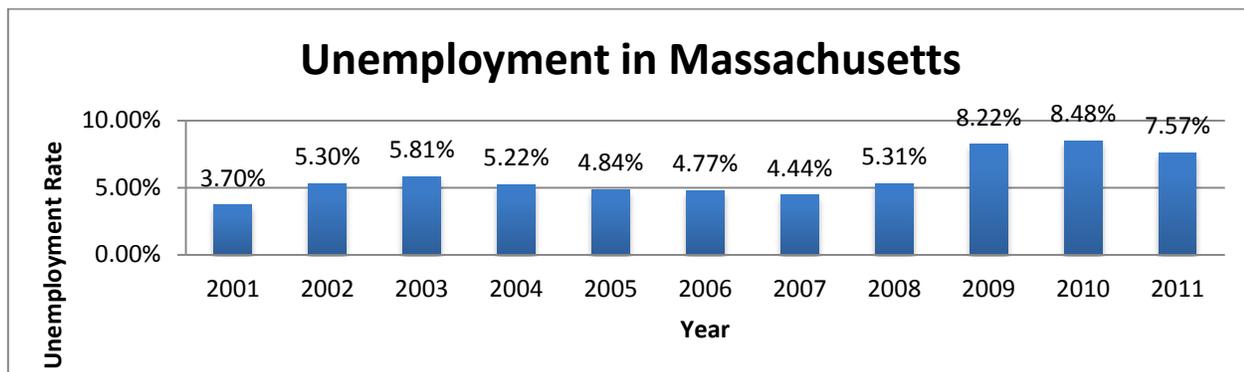
1. Explosion of subprime lending and securitization
2. Unsustainable housing price rise
3. Predatory lending practices
4. Increased amount of private debt in the American household (credit card and mortgages)
5. Unregulated derivatives

Unemployment in Massachusetts

In Massachusetts, from 2001 through 2007 the unemployment rate had always been between 4.5% and 5.5%. But once the economic crisis began to unravel in the US and globally, the

unemployment rate in MA and New England rose the same way as the US unemployment rate. In June 2007, the unemployment rate in MA was at its lowest point since the 5 previous years. The economy was booming and expanding and the stock market was rising. Since the global financial crisis started, the unemployment rate in MA has soared and reached a high of 8.8% at the end of 2009, staying slightly under the US unemployment rate at the time. Governor Deval Patrick faced his biggest economic challenge and had to make decisions on what to cut or reduce in the budget. Massachusetts is the number one state when it comes to debt, with a current debt load of 9% of its GDP.

Unemployment in MA



Fortunately things are turning around and the unemployment rate is on a positive trend. The Massachusetts economy has been in recovery mode since the summer of 2009, and it has been a relatively good and strong recovery compared to the nation. “The Executive Office of Labor and Workforce Development” reported in January 2012 that:

- The total unemployment rate was 6.8 percent, down 0.2 of a percentage point from the November rate of 7.0 percent, and well below the national rate of 8.5 percent. It is the lowest monthly rate since December of 2008.
- From December 2010 to December 2011, 40,700 public sector jobs have been added in the Bay State, a growth rate of 1.3 percent, with 45,600 private sector jobs added for a growth rate of 1.7 percent. Over the year, the national rate of job growth is 1.3 percent with private sector job growth up 1.8 percent.
- Four of the ten private sectors added jobs in December with gains in Trade, Transportation, and Utilities; Manufacturing; Information; and Financial Activities.

Troubled Asset Relief Program (TARP):

The government has implemented certain programs and bailed out companies in order to stabilize the financial system and the US economy. In October 2008, the Emergency Economic Stabilization Act of 2008 established the Troubled Asset Relief Program (TARP) to enable the Department of the Treasury to purchase or insure troubled assets as a way to promote stability in financial markets. TARP was created to respond to instability in US financial institutions. The financial crisis in 2008 was truly caused by banks that made home loans to consumers who could not afford to pay them back. These mortgages were bundled with other loans and resold to other investors. Since the values of houses did not reach the values estimated by analysts, eventually homeowners began defaulting on mortgages. The investors discovered that the assets in which they had invested were losing money, deeply impacting the banking and financial services sector. Consequently, banks tightened their lending policy to individuals and businesses. Therefore, many businesses did not have capitals to expand their businesses and laid-off employees to downsize their businesses. That was the reason the unemployment rate went up nationally and even doubled in some hard hit states.

The Treasury Department used \$105 billion of TARP funds to buy preferred stock in eight banks: Bank of New York Mellon, Goldman Sachs, J.P. Morgan, Morgan Stanley, Bank of America/Merrill Lynch, Citigroup, Wells Fargo, and State Street. This program required banks to give the government a 5% dividend that would increase to 9%. On 9 June 2009, it was announced that ten of the TARP banks were set to leave the \$700 billion relief program. The banks, including Goldman Sachs, JP Morgan Chase, American Express, and Morgan Stanley, were granted permission to repay a total of \$68 billion and free themselves on the restrictions in place under the TARP act.

The government's bailout of insurances, banks and automakers helped prevent a more severe economic crisis that could have been even more devastating. We believe that we are still a long way from being able to render a final judgment on this program. At this point we can say that this bailout prevented a downward spiral in to which the global financial system was falling. It helped automakers from a complete failure but it did not help (enough) the foreclosure crisis, the unemployment crisis and the lending ability of banks.

The American Job Act (Short Facts Sheet from the White House on 09/08/11)

Policy makers took a number of actions to combat the effects of the financial crisis.

1. Tax Cuts to Help America's Small Businesses Hire and Grow

- Cutting the payroll tax cut in half for 98 percent of businesses: The President's plan cut in half the taxes paid by businesses on their first \$5 million in payroll.
- A complete payroll tax holiday for added workers or increased wages: The President's plan proposed to completely eliminate payroll taxes for firms that increased their payroll by adding new workers or increasing the wages of their current worker (the benefit was capped at the first \$50 million in payroll increases).
- Extending 100% expensing into 2012: This continues to be an effective incentive for new investment.
- Reforms and regulatory reductions to help entrepreneurs and small businesses access capital.

2. Putting Workers Back on the Job While Rebuilding and Modernizing America

- A "Returning Heroes" hiring tax credit for veterans: This provided tax credits from \$5,600 to \$9,600 to encourage the hiring of unemployed veterans.
- Preventing up to 280,000 teacher layoffs, while keeping cops and firefighters on the job.
- Modernizing schools.
- Immediate investments in infrastructure and a bipartisan National Infrastructure Bank, modernizing our roads, rail, airports and waterways while putting hundreds of thousands of workers back on the job.
- A New "Project Rebuild", which planned to put people to work rehabilitating homes, businesses and communities, leveraging private capital and scaling land banks and other public-private collaborations.
- Expanding access to high-speed wireless as part of a plan for freeing up the nation's broadband spectrum.

3. Pathways Back to Work for Americans Looking for Jobs

- As part of an extension of unemployment insurance to prevent 5 million Americans looking for work from losing their benefits, the President's plan included innovative work-based reforms to

prevent layoffs and give states greater flexibility to use unemployment insurance funds to best support job-seekers.

- A \$4,000 tax credit to employers for hiring long-term unemployed workers.
- Prohibiting employers from discriminating against unemployed workers when hiring.
- Expanding job opportunities for low-income youth and adults through a fund for successful approaches for subsidized employment, innovative training programs and summer/year-round jobs for youth.

4. Tax Relief for Every American Worker and Family

- Cutting payroll taxes in half for 160 million workers this year: The President's plan will expand the payroll tax cut passed last year to cut workers payroll taxes in half in 2012 – providing a \$1,500 tax cut to the typical American family, without negatively impacting the Social Security Trust Fund.
- Allowing more Americans to refinance their mortgages at today's near 4 percent interest rates, which can put more than \$2,000 a year in a family's pocket.

The American Job Act for Massachusetts

1. Tax Cuts to Help America's Small Businesses Hire and Grow

- A plan to cut the payroll tax in half to 3.1% for employers on the first \$5 million in wages, providing broad tax relief to all businesses but targeting it to the 98 percent of firms with wages below this level. In Massachusetts, 140,000 firms are targeted to receive a payroll tax cut under the American Jobs Act.

2. Putting Workers Back on the Job While Rebuilding and Modernizing America

- \$50 billion in immediate investments for highways, transit, rail and aviation (immediate investments of at least \$850,700,000 in Massachusetts that could support a minimum of approximately 11,100 local jobs).
- Invest \$35 billion to prevent layoffs of up to 280,000 teachers, while supporting the hiring of tens of thousands more and keeping cops and firefighters on the job (provide \$591,800,000 in funds to Massachusetts to support up to 6,300 educator jobs).
- \$25 billion investment in school infrastructure that will modernize at least 35,000 public schools

(\$378,600,000 in funding to support as many as 4,900 jobs).

- \$15 billion in a national effort to put construction workers on the job - rehabilitating and refurbishing hundreds of thousands of vacant and foreclosed homes and businesses - \$40,400,000 in Massachusetts.
- \$5 billion of investments for facilities modernization needs at community colleges - in MA, \$68,800,000 in funding in the next fiscal year for its community colleges.

3. Pathways Back to Work for Americans Looking for Jobs

- This could help put the 123,000 long-term unemployed workers in Massachusetts back to work.
- President is reiterating his call to extend unemployment insurance, preventing 49,300 people looking for work in Massachusetts from losing their benefits in just the first 6 weeks.
- Could place 2,500 adults and 9,200 youths in jobs in Massachusetts.

4. Tax Relief for Every American Worker and Family

- A typical household in Massachusetts, with a median income of around \$59,000, will receive a tax cut of around \$1,830.



Signs of Recovery:

We believe that there are signs that the economy is improving and showing positive sign of recovery.

- December holiday spending was up 15% over a year ago.
- The jobless rate approached a 3-year low; unemployment fell to 8.6% (7.0% in MA as of November 2011).
- Manufacturing has expanded 29 months in a row.
- Automobile sales are up 37%, the industry had the best year since 2008.
- Private construction is at its highest since December 2009.
- Corporate earnings have been positive as many companies hold a record amount of cash.
- As companies release more of their cash and try to win over investors still hesitant about putting their money back into stocks, markets have been on an upward trend.

- Corporations are increasing dividends.
- Massachusetts was the fourth fastest-growing state in the nation in 2010.

Conclusion

The world is near the end of a global recession that has caused widespread business contraction, increases in unemployment, and shrinking government revenues. Although data show that we are recovering from this financial crisis, we can still see that unemployment is unacceptably high, small businesses are still trying to recover and large corporations are still holding on to an enormous amount of cash. From individuals through small businesses to large corporations, there is still a lot of uncertainty about the future of the global and especially the US economy. This latest financial crisis has shown us the dependency of countries with each other and has also exposed some weaknesses and fundamental errors in financial systems worldwide. The uncertainty of the US economy is also magnified by the political future with the election coming in November 2012. As presidential primaries heat up, the candidates will pledge to help businesses and create jobs. Many candidates talk about the economy yet few of them are providing the vision to truly energize it and create tangible economic opportunity that will get us back to the place where we were, on TOP.

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