How Will the Great Recession Affect Future Retirement Incomes?
Barbara A. Butrica, Richard W. Johnson, and Karen E. Smith

The financial impact of the 2007–2009 recession will reverberate into retirement for many working families. Because wages grew very slowly during the downturn, the recession will reduce lifetime earnings, limiting savings and future Social Security and pension incomes. Retirement security for workers in their late fifties when the recession began will be hit especially hard because of the way Social Security computes benefits.

The Great Recession
By many measures the 2007–2009 recession, dubbed the Great Recession, was the worst economic downturn since the Great Depression. Gross domestic product fell 2.6 percent in 2009, the greatest single-year decline since 1938 (Bureau of Economic Analysis 2011). Unemployment soared and long-term joblessness was widespread. As incomes fell, many families struggled to make ends meet and poverty rates surged (DeNavas-Walt, Proctor, and Smith 2010).

Earnings stagnated for those who remained employed. The national average wage fell 1.5 percent in 2009, the only annual decline since Social Security began calculating the measure in 1951 (Social Security Administration 2011). It grew just 2.3 percent in 2008, and 2.8 percent in 2010, well below the 1994–2007 average growth rate of 4.2 percent (Board of Trustees 2011).

The Great Recession lasted 18 months, longer than any recession since the 1930s, and its effects lingered long after it officially ended. The labor market remained weak in 2011. Many analysts predict that unemployment will stay above its prerecession level for years.

The financial repercussions will last into retirement for today’s working families. Retirement incomes depend largely on how much people earn in their working years. Social Security ties benefits to lifetime earnings, and most employer-sponsored defined benefit pensions are linked to final salary and years of service. Balances in 401(k) plans depend on employee and employer contributions, both of which are generally tied to pay.

Impact on Future Retirement Incomes
We use DYNASIM3, the Urban Institute’s dynamic microsimulation model, to measure the impact of the Great Recession on future retirement incomes. The analysis projects average incomes to age 70 for adults who were age 25 to 64 in 2008, and compares them to what retirees would have received if the recession had not occurred. The baseline simulations use the Social Security trustees’ assumptions from 2010, which incorporate the effects of the recession. The no-recession simulations use their assumptions from 2008, before the labor market had weakened or the recession became apparent. The simulations isolate the effects of high unemployment and slow wage growth on retirement income. They do not show the impact of the crashes in housing and equity values, which are incorporated into both simulations.

For adults age 25 to 64 in 2008, the Great Recession will reduce average age-70 incomes by 4 percent, or about $2,300 annually (in 2007 dollars). Annual age-70 incomes will fall more—for adults age 55 to 59 when the downturn began (figure 1). Older unemployed adults have trouble finding work (Johnson and Mommaerts 2011), and the recession will further limit their opportunities, resulting in less employment and lower earnings at age 70 for those now nearing traditional retirement ages.

Social Security benefits and income from pensions and other assets will fall 4 percent for those in their late fifties in 2008. Slow wage growth during the recession doesn’t noticeably affect lifetime earnings for these workers, who completed much of their careers before the recession hit. But because Social Security is indexed to the economy-wide average wage in the year beneficiaries turn 60, wage stagnation lowers the index factor for everyone who turns 60 after 2008. For Social Security purposes, the recession effectively reduces even those earnings received before 2008, resulting in permanently lower Social Security benefits.
High unemployment and stagnant wages will have less impact on future retirement incomes for those in their early sixties when the recession began, because the downturn will not affect how their Social Security benefits are indexed and many had already left the labor force. Still, average annual age-70 incomes will fall 3 percent ($2,000) for those age 60 to 64 in 2008, primarily through lower postretirement employment rates. By contrast, average annual age-70 incomes will fall 5 percent ($3,000) for those age 25 to 34 in 2008. Their incomes will fall more because they were most likely to lose their jobs, and the impact of their lower wages will accumulate over much of their working lives.

There is, of course, much uncertainty surrounding these forecasts. We still do not know how the recovery will play out. Strong wage growth in coming decades might bail out younger adults. They might also adjust their behavior to make up for these losses, such as by saving more, working more hours, or delaying retirement. For most of those now nearing retirement, however, the die is cast. They have little time to save more, and employment prospects are limited for those out of work. Declines in the stock market and housing values associated with the financial crisis make matters worse. The Great Recession dealt an unexpected blow to the oldest boomers’ retirement security, a growing concern for many even before the economy faltered.

Notes
1. The Social Security trustees just released their 2011 assumptions, which show an even larger fall in wages between 2008 and 2009 than the 2010 assumptions. Additionally, the trustees now project even slower wage growth in the postrecession years.
2. For details, see Butrica, Johnson, and Smith (2011).

References


Acknowledgment
This brief was funded through a generous grant from the Rockefeller Foundation.