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THE POTENTIAL IMPACT OF THE GREAT RECESSION ON FUTURE RETIREMENT INCOMES

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By many measures the 2007-2009 recession, dubbed the Great Recession by many analysts, was the worst economic downturn since the Great Depression. Millions of jobs were lost, unemployment soared, and wages stagnated for those able to stay employed. Many jobless Americans were out of work for more than a year. As incomes fell, families struggled to make ends meet and poverty rates surged. Declining tax revenues and expanding public expenditures to support unemployed workers and stimulate the economy swelled the federal deficit and squeezed state and local governments. The Great Recession officially lasted 16 months, longer than any recession since the 1930s. Although the National Bureau of Economic Research declared the recession over in 2009, its effects continued to linger in 2011. The labor market remained weak, with the unemployment rate near 9 percent in the early months of the year. Many analysts predict that unemployment will stay above its pre-recession level for years.

In addition to creating financial hardship for millions of working families, the Great Recession could also erode economic security for future retirees. Job loss reduces Social Security and pension credits along with earnings, and leaves workers with less income to set aside for retirement. Many workers are also forced to dip into their 401(k) accounts and other retirement savings when they lose their jobs.

This report uses DYNASIM3, the Urban Institute's dynamic microsimulation model, to examine 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 fully incorporate the effects of the recession. The no-recession simulations use their 2008 assumptions, which were released in March of that year before the labor market had weakened or the recession became apparent. Results compare outcomes by 10-year cohorts, ranging from those age 25 to 34 in 2008 (who turn 70 between 2044 and 2053) to those age 55 to 64 in 2008 (who turn 70 between 2014 and 2023).

DYNASIM3 projects that the Great Recession will reduce annual per capita household income at age 70 by 4.3 percent (or $2,300) for those age 25 to 64 in 2008. This decline is driven primarily by the wage stagnation that occurred during the recession. The model assumes that wage growth resumed in 2010 and continues indefinitely, but it will never make up the wage growth lost in 2008 and 2009. Recession-induced unemployment has little effect on future retirement incomes. Most workers remained employed during the recession, and the drop in work years for those who lost their jobs was generally inconsequential when averaged over an entire career. By contrast, the reduction in wage growth affects nearly all workers—not just the relatively few who lost their jobs—and lasts for their entire post-recession career.

The Great Recession will modestly reduce future retirement incomes for all groups working in 2008, but it will hit younger workers and high-socioeconomic-status groups somewhat harder than others.

- Adults age 25 to 34 in 2008 will see their age-70 incomes fall by 4.9 percent (or $3,000 per person) as a result of the recession. The slowdown in wage growth will accumulate over their entire careers, magnifying its impact. These younger workers were also more likely than older workers to lose their jobs during the recession.

- The recession did not spare older workers, however. It will reduce age-70 incomes for those 55 to 64 in 2008 by 4.1 percent, primarily by lowering Social Security benefits. The benefit formula indexes earnings at age 60. Wage growth before age 60, then, significantly affects future Social Security payments. Wage stagnation during the recession reduces the index factor in the benefit formula for everyone who turns 60 after 2008, effectively lowering the earnings counted by Social Security, even those received long before the recession began. Job losses will also limit later-life employment for those approaching retirement during the recession. Relatively few adults return to work after becoming unemployed in their early sixties.

- Future retirement incomes will fall most (in absolute terms) for those with the highest incomes, who have most to lose. Among the youngest age group, for example, those in the top income quintile will lose $7,500 per person annually, while those in the bottom quintile will lose only $400 per person annually. The drop in earnings will reduce future income from pensions, retirement accounts, and other assets. Low-income groups will not lose much from these sources, however, because few have access to pensions or accumulate significant retirement savings even in good times. In relative terms, however, high-socioeconomic-status groups will not lose much more income than less-privileged groups, because the large absolute losses for affluent groups represent only a small share of their total income.

The recession-induced decline in household income will increase the number of Americans living on very limited incomes at age 70. Among those age 25 to 64 in 2008, the share with incomes below 125 percent of the federal poverty level at age 70 will increase 7.4 percent, leaving an additional 711,000 adults in or near poverty.

Projecting incomes over the next 40 years involves much uncertainty, and future developments could lead to outcomes very different from our forecasts. For example, the unusually long unemployment spells that characterized the Great Recession could seriously scar workers who lost their jobs and lead to worse outcomes than our model projects. Alternatively, average wages could bounce back to their pre-recession levels, offsetting much of the recessionary losses. The recession might also induce some workers to change their behavior to improve their retirement security. They might save more or work longer. However, these options are less feasible for older unemployed workers nearing traditional retirement ages when the recession began.

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