

2008 Recession Effects on Retirement Contribution Plans Analysis

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Retirement Systems and the Financial Shock of the 2008 Recession

Following the 2008 recession, the U.S. pension landscape has changed dramatically over the past three decades regarding the type of retirement plan. The country has experienced a shift in the most prevalent system of retirement plans, from defined benefit plans to defined contribution plans (Munnell & Rutledge, 2013).

The transition has brought about an alteration of responsibilities and risks from bosses to workers, who are now compelled to make their own decisions on retirement savings. Notably, for a defined contribution pension to give satisfactory returns at retirement, premiums have to be given out regularly throughout the work life. The reason is that once a worker registers in the scheme and elects the contribution amount, the employee will continue contributing in the following years due to prevailing inertia. Conversely, employees can elect to increase, stop, or decrease contributions in a certain period in response to capital market or labor market shocks (Dushi, Iam & Tamborini, 2013). Changes in contributions caused by unexpected economic shocks can potentially jeopardize the accrual of funds in direct contribution retirement accounts, thereby significantly affecting account balances at retirement.

Exploring how the 2008 recession affected profit-sharing plans as well as other defined retirement contributions is important as it helps us understand the extent to which workers changed their premiums over time, especially in the backdrop of economic and financial crises. In light of this, the review adds to the prevailing literature on the effects of the financial crisis by exploring the changing aspects of employee involvement and contributions to defined contribution pension plans in the 2008 recession while comparing such dynamics with the prior period. Importantly, the review looks into the degree to which changes in contributions are related to income change over the very period. By exploring the impact of the 2008 recession on profit-sharing plans as well as other defined retirement contributions, the review provides insight into effective responses to economic shocks. The findings presented in this review demonstrate significant variability in contributions and point out that inertia does not characterize employees' behavior with regard to contributions to defined contribution plans, particularly during the 2008 recession.

During the 2008 recession, the U.S. witnessed rising unemployment and falling stock prices, retirement assets, household wealth, housing prices, and spending. The financial and fiscal crisis has

had significant effects on numerous outcomes, including retirement plans, spending, and household assets (Tower & Impavido, 2009). The financial and economic downturns affected the retirement savings of workers in the pensions provided by employers in a number of ways. For instance, employment and earning losses, together with decreasing financial assets, have discouraged employees from contributing to defined contribution pension plans. What is more, households nearing retirement changed their retirement behavior after being hit by the deterioration in equity values as well as home prices by deferring retirement and increasing savings (Tower & Impavido, 2009). Given these variations, it is conceivable that the 2008 recession impacted participation as well as contribution to defined contribution pension plans.

Employment Loss, Market Decline, and Reduced Pension Contributions

The 2008 recession influenced defined contribution pension contribution behavior in the U.S. through several channels. To begin with, the reduction in employment puts downward pressure on the defined contribution of participants (Dushi, Iam & Tamborini, 2013). Consequently, the percentage of unemployed individuals declined from over 65% in 2007 to 60% by 2010, with the rate of unemployment increasing from 5% in 2008 to 10% by December 2009. Additionally, there was an increase in labor underutilization and a rise in the number of underemployed part-time workers. This, in turn, reflected slack demand. Such changes in employment and the consequent changes in employees' earnings had a significant effect on profit-sharing plans and contribution decisions pertaining to defined contribution plans.

Secondly, the financial crisis prompted by the 2008 recession contributed to a decrease in proprietors' matching contributions. In view of Pino & Yermo (2010), about 20% of private-sector employers reduced or suspended their matching contributions. As a result, many workers reduced their defined contribution amounts. Moreover, high market volatility and sharp stock market declines contributed to changes in defined contribution behaviors (Pino & Yermo, 2010). Besides, there are other channels, for instance, variations in access to credit and household wealth, that prompted households and individuals to receive early distributions and loans from their retirement accounts while also altering their contribution behavior for purposes of meeting debt obligations and consumption needs.

Findings by Yermo & Severinson (2010) reveal that a higher percentage of workers substantially reduced or stopped their contributions during the 2008 recession compared to the period before the recession. The contribution rates and contribution amounts were considerably reduced during the 2008 crisis, exceeding in scale, and there was a slight upsurge during the prior period. The findings also point out the role played by earnings change in altering employees' defined contribution amounts (Pino & Yermo, 2010). In this sense, employees who suffered decreased incomes were considerably more likely to decrease or stop their contributions compared to those who did not.

According to Tamborini, Purcell & Iams (2013), employees increasingly prefer to raise their liquid savings during economic downturns to ensure that their savings are more readily available for use in case the need arises. In unison, some employees, especially those who are not liquidity-constrained, can fail to transform their behavior due to inertia or because of other reasons. In any case, others may choose to increase their contributions due to wage increases.

Household Debt, Employer Practice, and Lessons for Retirement Security

Employees and employers learned great lessons from the 2008 recession. For instance, employees learned that they should not borrow money just because they can qualify to borrow (Pino & Yermo, 2010). The reason is that the 2008 recession was prompted by the collapse of a huge credit bubble, which was fuelled by low-income minority borrowers who were eligible for loans. Similarly, employers learned that stock prices could keep falling over a very long time. Investors, hence, learned that they should buy when prices fall and sell when they are high. Importantly, employers learned that they could not avoid risk by avoiding the stock market since investing involves trade-offs (Pino & Yermo, 2010). In this sense, investors understood that with stock, you only lose money when the market falls. Importantly, investors learned that thinking only about the risk is not enough. Rather, they should look the other way and understand that with bonds, they risk losing purchasing power due to inflation. It is, hence, wise to divide your money between bond investments and stock. The reason is that stocks can grow your money to match the cost of living.

According to Munnell & Rutledge (2013), despite the vital role played by the consistency of defined contribution pension contributions in retirement security, evaluation of defined contribution behavior during times of financial and labor market shocks is limited, especially at the population level. In view of Tower & Impavido (2009), a strand of existing literature makes use of administrative records of specific investment firms to evaluate cross-sectional totals of retirement account activities of account holders in times of recession. Much as these studies extensively explored account activities such as balances, participation decisions, and investment decisions, they failed to link data for the same individual across years, thereby failing to measure changes in contribution amounts, particularly at the individual level. Dushi, Iam & Tamborini (2013) assert that prior research making use of administrative records from retirement investment workers has revealed that the majority of participants in defined contribution plans during the recession stayed the course with only marginal changes occurring in retirement account activity.

Overall, the economic shocks experienced during the 2008 recession raise pertinent questions on how workers' contributions to defined contribution plans changed over the period in the United States. The country has experienced a shift in the most prevalent system of retirement plans, from defined benefit plans to defined contribution plans. The 2008 recession had an intense impact on retirement security and defined retirement contributions. The transition has brought about an alteration of

responsibilities and risks from bosses to workers, who are now compelled to make their own decisions on retirement savings. What is more, the sluggish recovery from the recession has had a long-lasting effect on the quality of life of employees and employers. The nature of the present retirement scheme has left employees and employers vulnerable to the collapse in the housing and equity markets while also inducing many to arrange for later retirement.

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