

POLICY INTERACTIONS AT RETIREMENT

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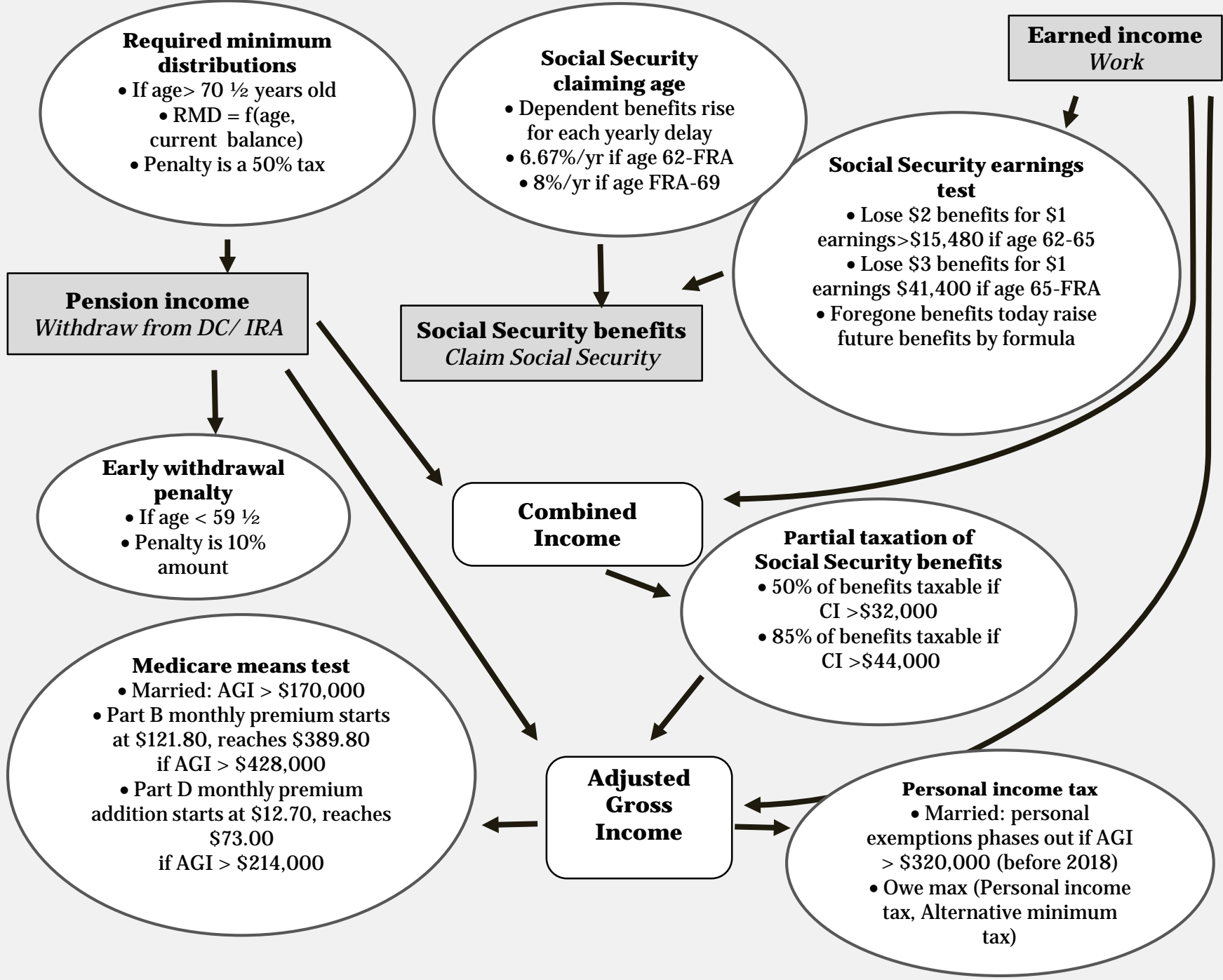
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(preliminary and incomplete)

POLICY COMPLEXITY

- Taxes, transfers, and social insurance are really complicated!
 - Lots of thresholds, lots of explicit or implicit marginal tax rates
 - ⇒ highly nonlinear budget space
 - for many different decisions
- Economists tend to study one or two in isolation
 - Policies, decisions
- Individuals may face them all at once!
 - Especially around retirement

POLICY COMPLEXITY

- Taxes, transfers, and social insurance are really complicated!
 - Lots of thresholds, lots of explicit or implicit marginal tax rates
- Retirement policies are not just complicated, but they also interact
 - Decisions in response to one policy
 - ⇒ alter marginal, average tax rates in another policy, for another decision
- Flow chart
 - Four programs, nine policies
 - Three decisions



Required minimum distributions

- If age > 70 ½ years old
 - RMD = f(age, current balance)
- Penalty is a 50% tax

Social Security claiming age

- Dependent benefits rise for each yearly delay
- 6.67%/yr if age 62-FRA
- 8%/yr if age FRA-69

Earned income
Work

Social Security earnings test

- Lose \$2 benefits for \$1 earnings > \$15,480 if age 62-65
- Lose \$3 benefits for \$1 earnings \$41,400 if age 65-FRA
- Foregone benefits today raise future benefits by formula

Pension income
Withdrawal from DC/IRA

Social Security benefits
Claim Social Security

Early withdrawal penalty

- If age < 59 ½
- Penalty is 10% amount

Combined Income

Partial taxation of Social Security benefits

- 50% of benefits taxable if CI > \$32,000
- 85% of benefits taxable if CI > \$44,000

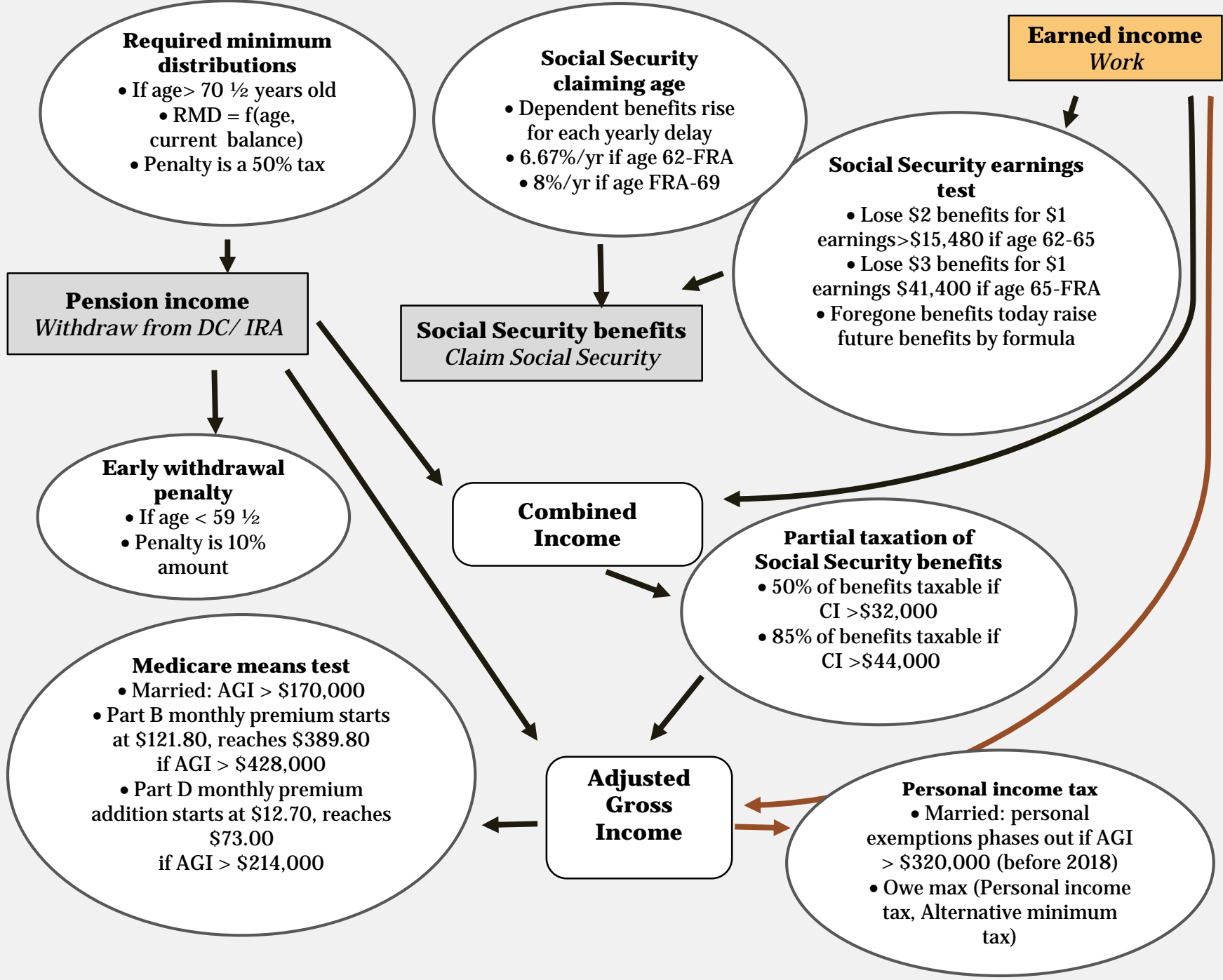
Medicare means test

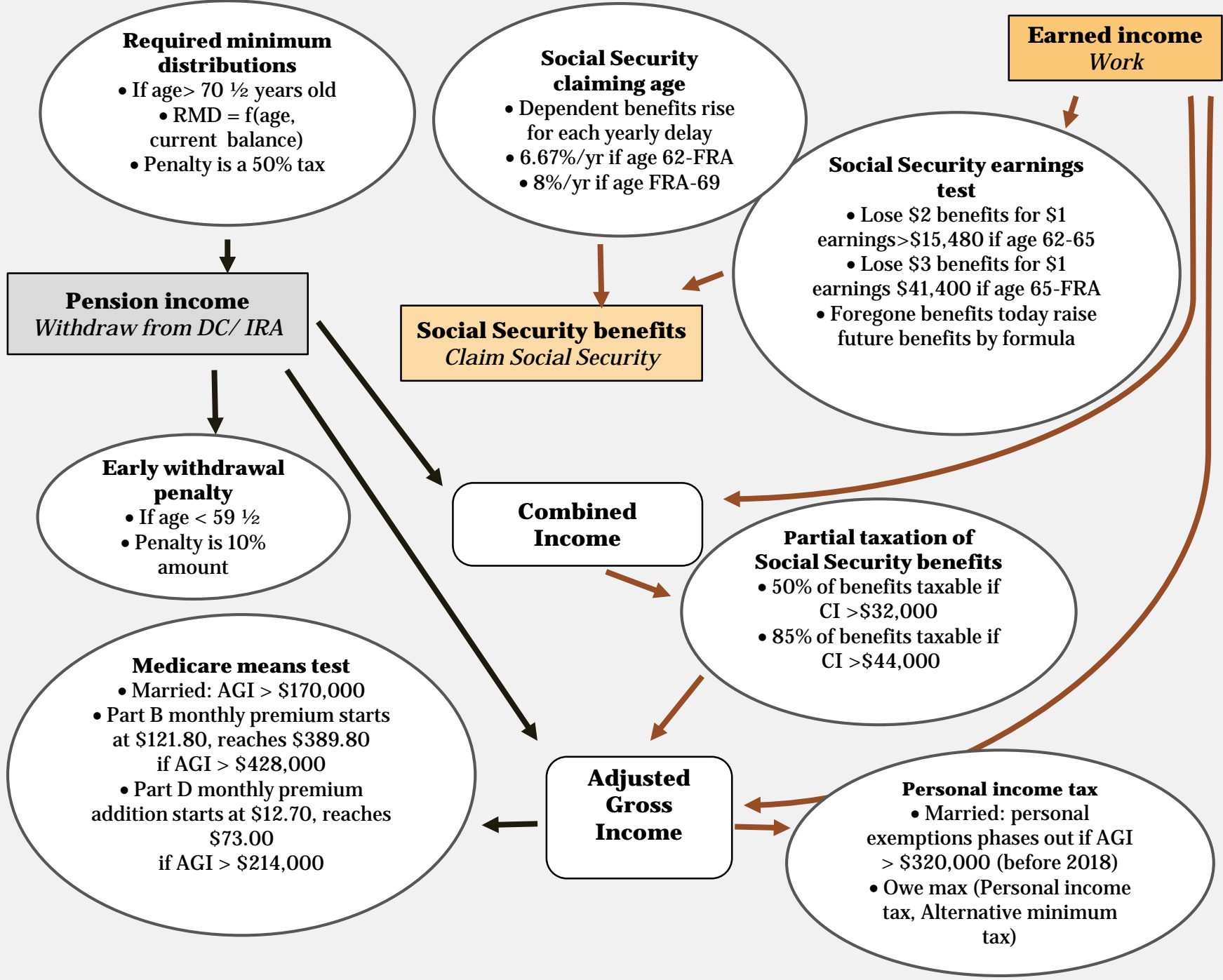
- Married: AGI > \$170,000
- Part B monthly premium starts at \$121.80, reaches \$389.80 if AGI > \$428,000
- Part D monthly premium addition starts at \$12.70, reaches \$73.00 if AGI > \$214,000

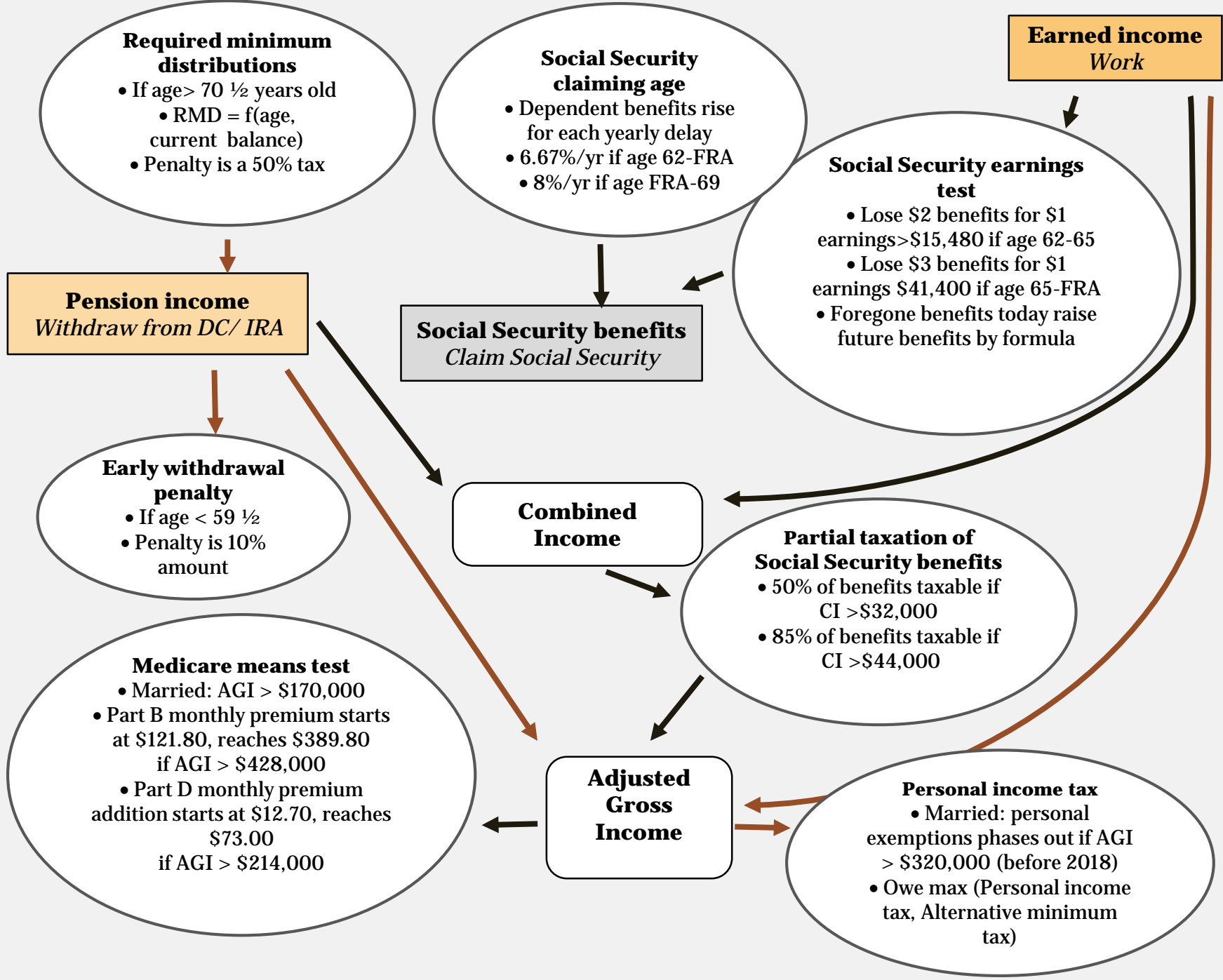
Adjusted Gross Income

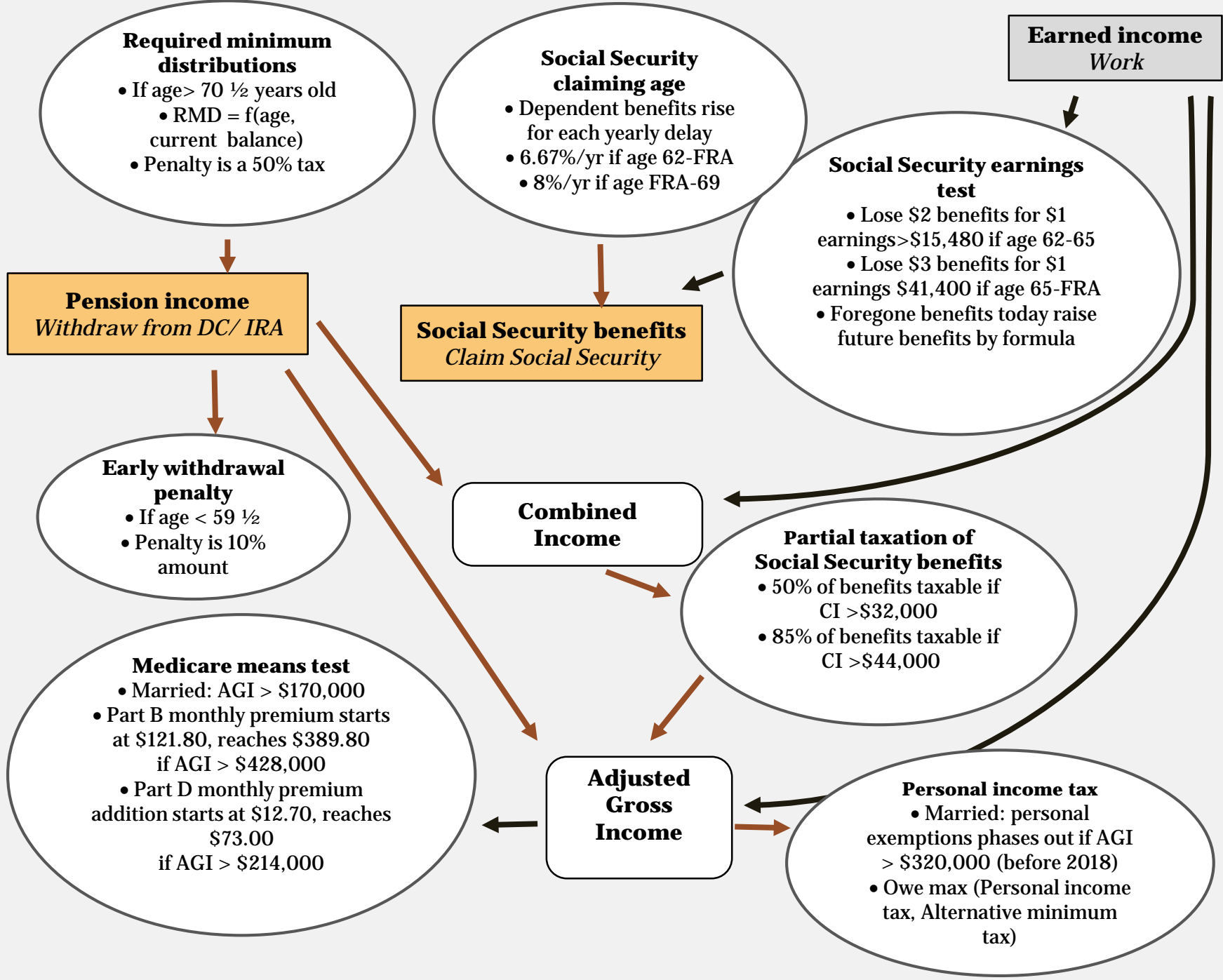
Personal income tax

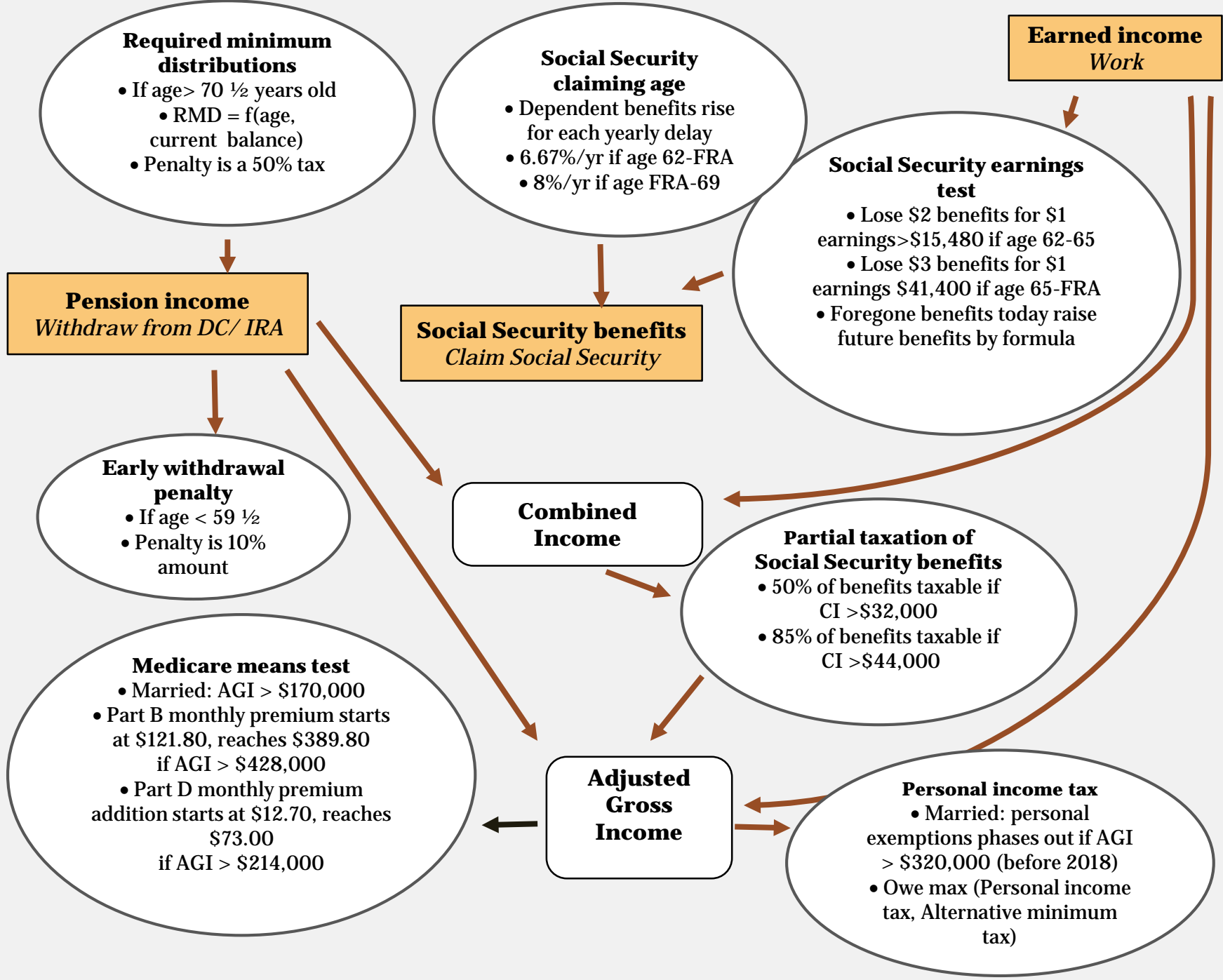
- Married: personal exemptions phases out if AGI > \$320,000 (before 2018)
- Owe max (Personal income tax, Alternative minimum tax)

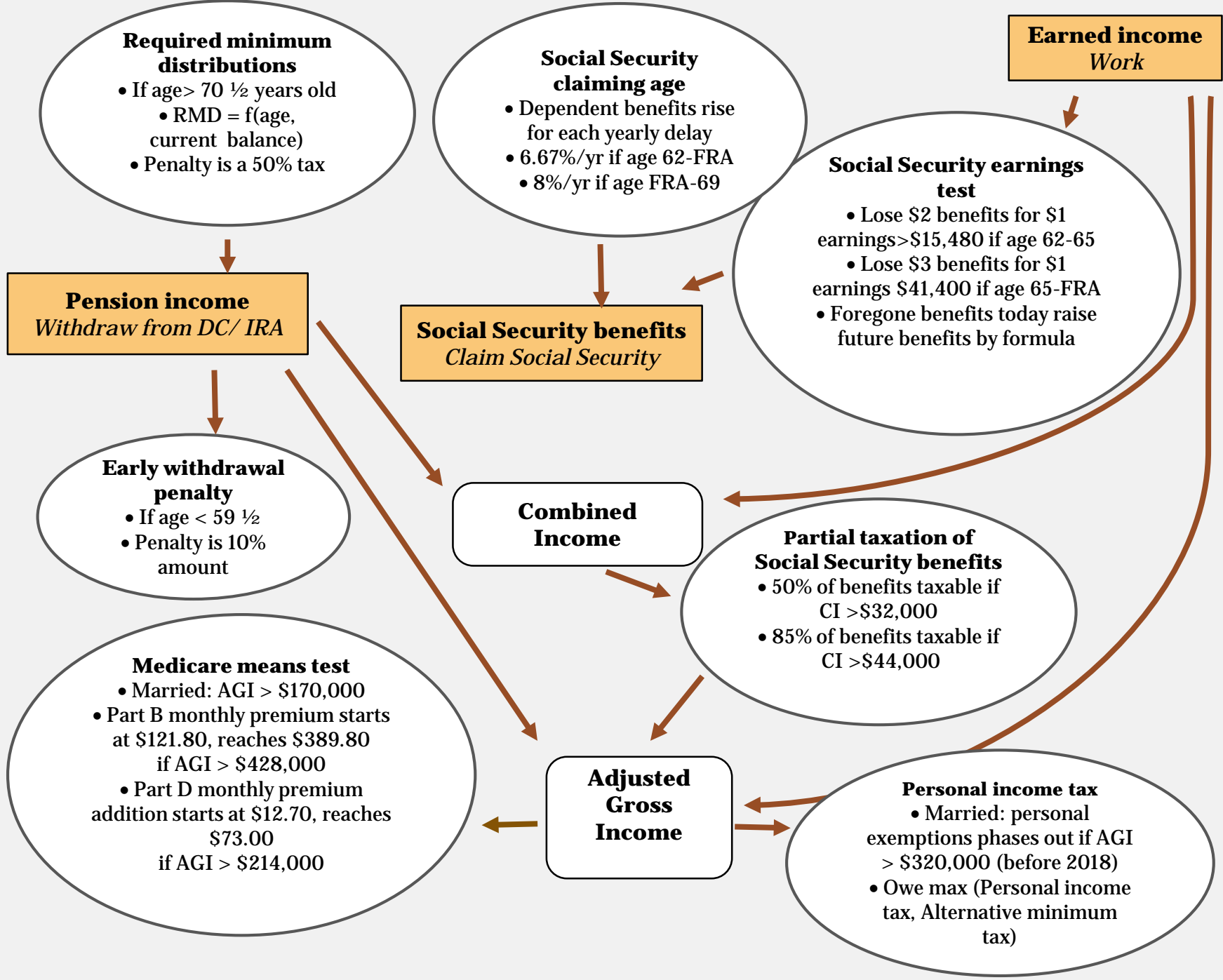


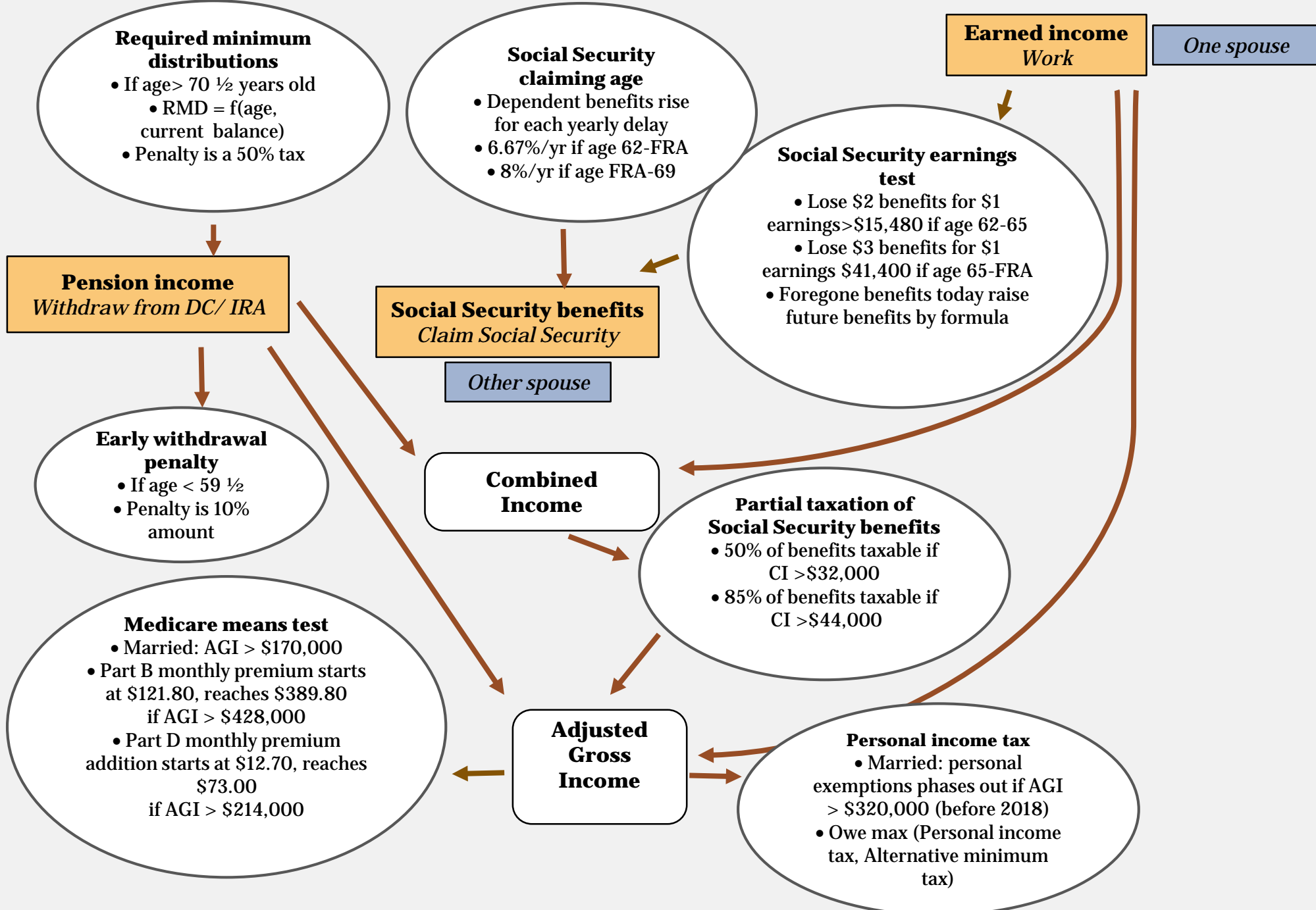












POLICY COMPLEXITY

- Taxes, transfers, and social insurance are really complicated!
 - Lots of thresholds, lots of explicit or implicit marginal tax rates
- Retirement policies are not just complicated, but they also interact
- Literature
 - People make mistakes
 - overreact to salient incentives
 - underreact to non-salient incentives
 - Auerbach, Kotlikoff, Koehler, & Yu (2017)
 - continued work incentives are much smaller than we realize

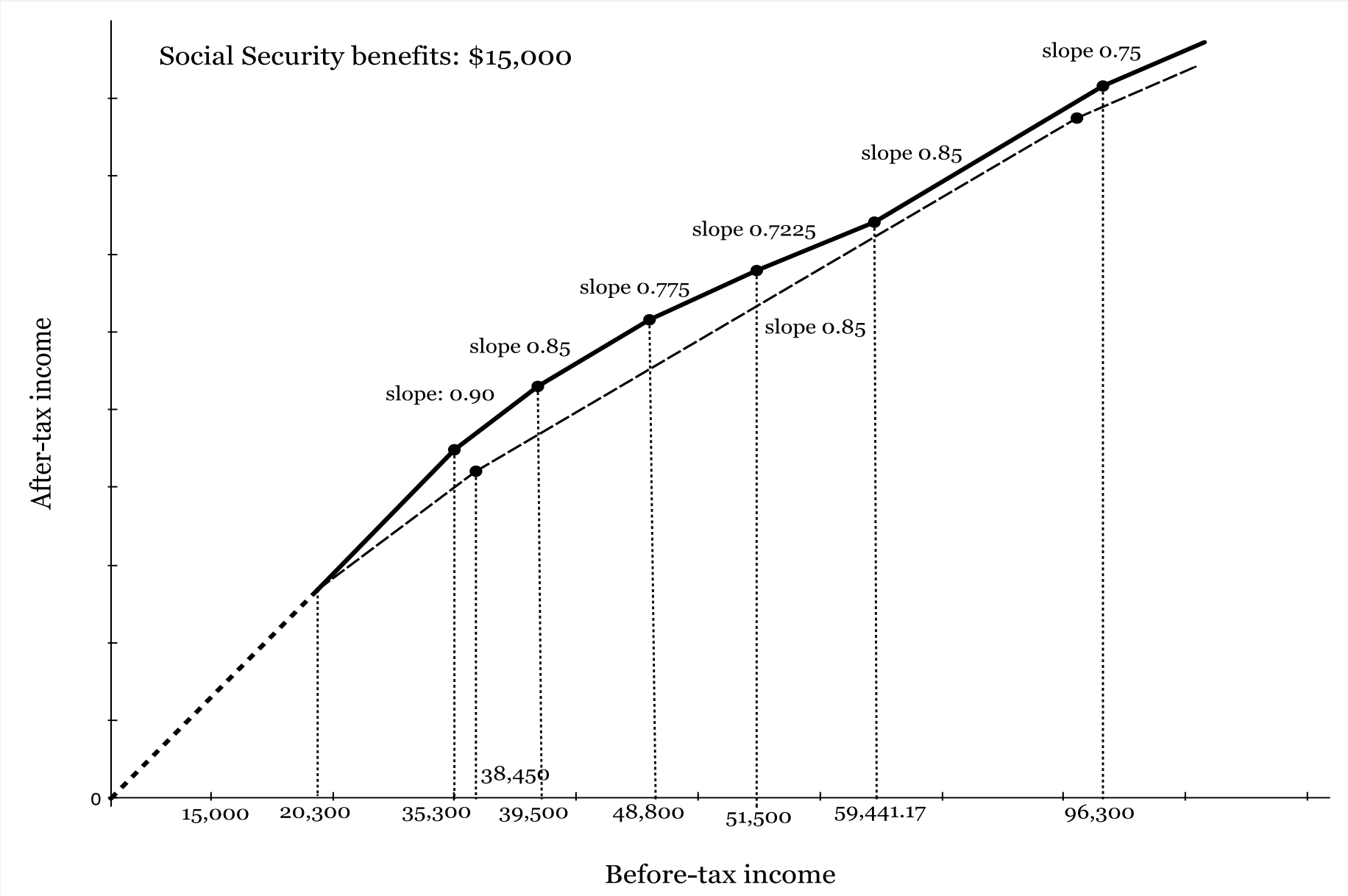
POLICY COMPLEXITY

- Our goals
 1. Illustrate policy interactions
 2. Demonstrate how many households are affected at typical points of life cycle
 3. Analyze how people respond
 - overreact to salient incentives → do people with differing incentives respond similarly
 - underreact to non-salient incentives → do people with similar incentives respond differently
- Policy implications
 - Policy goals are difficult to meet when they're not transparent

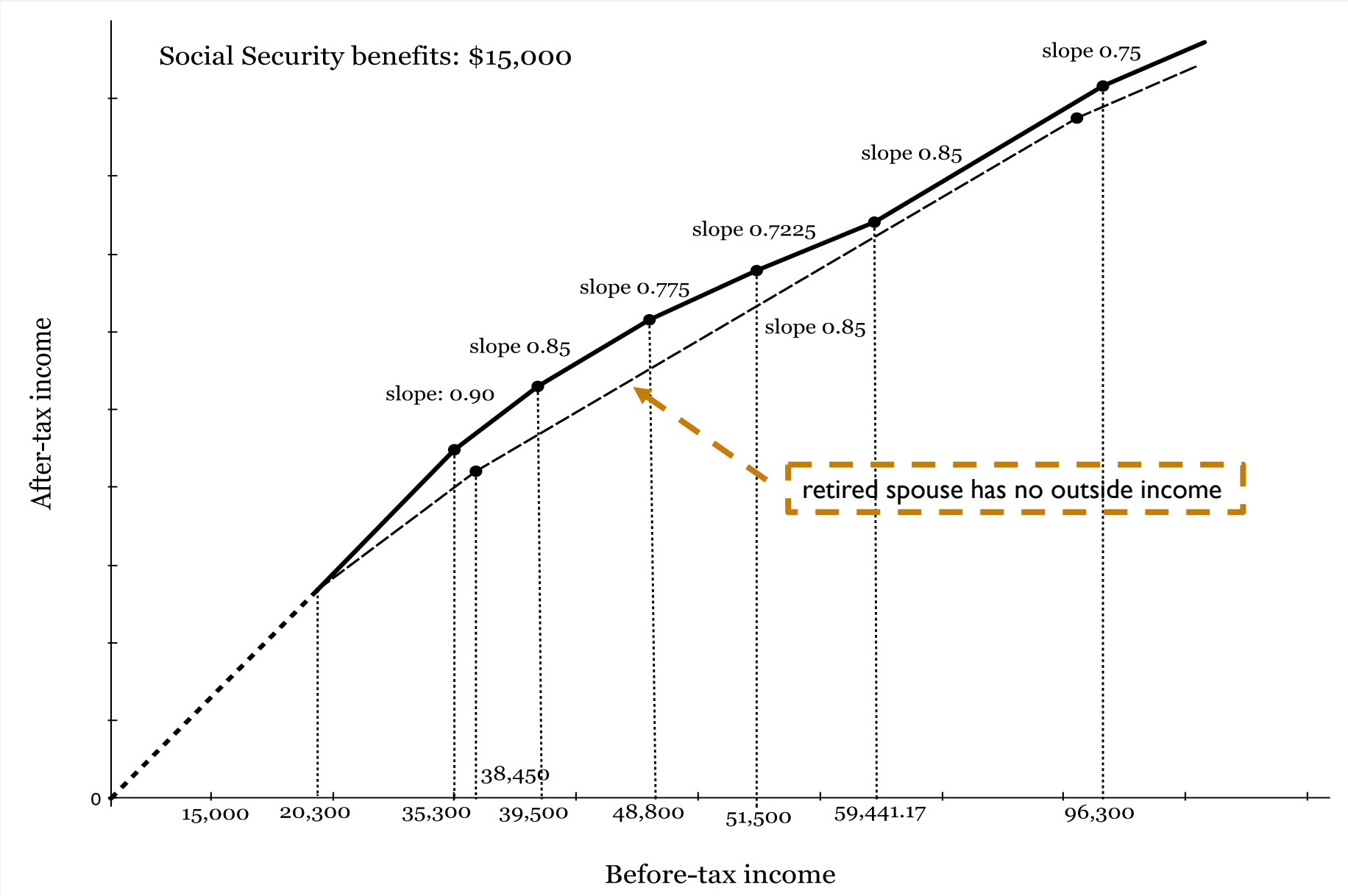
I. ILLUSTRATE POLICY INTERACTIONS

- Flow chart
- Budget constraints
 - Focus on some common situations
 - Focus on pre-tax versus post-tax income
- Tables
 - How MTRs, ATRs differ for same income level from different sources

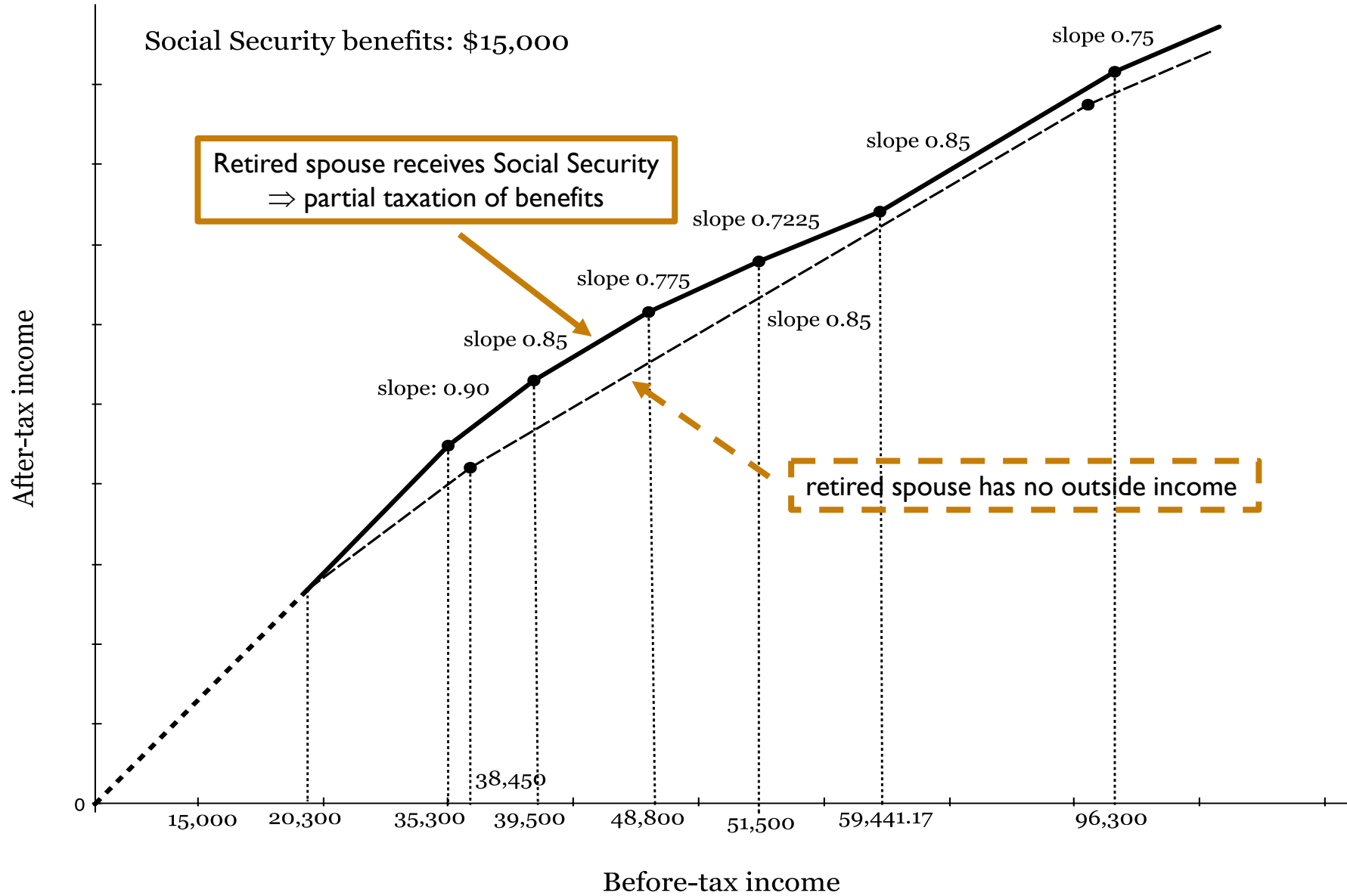
Suppose one spouse works, the other is retired



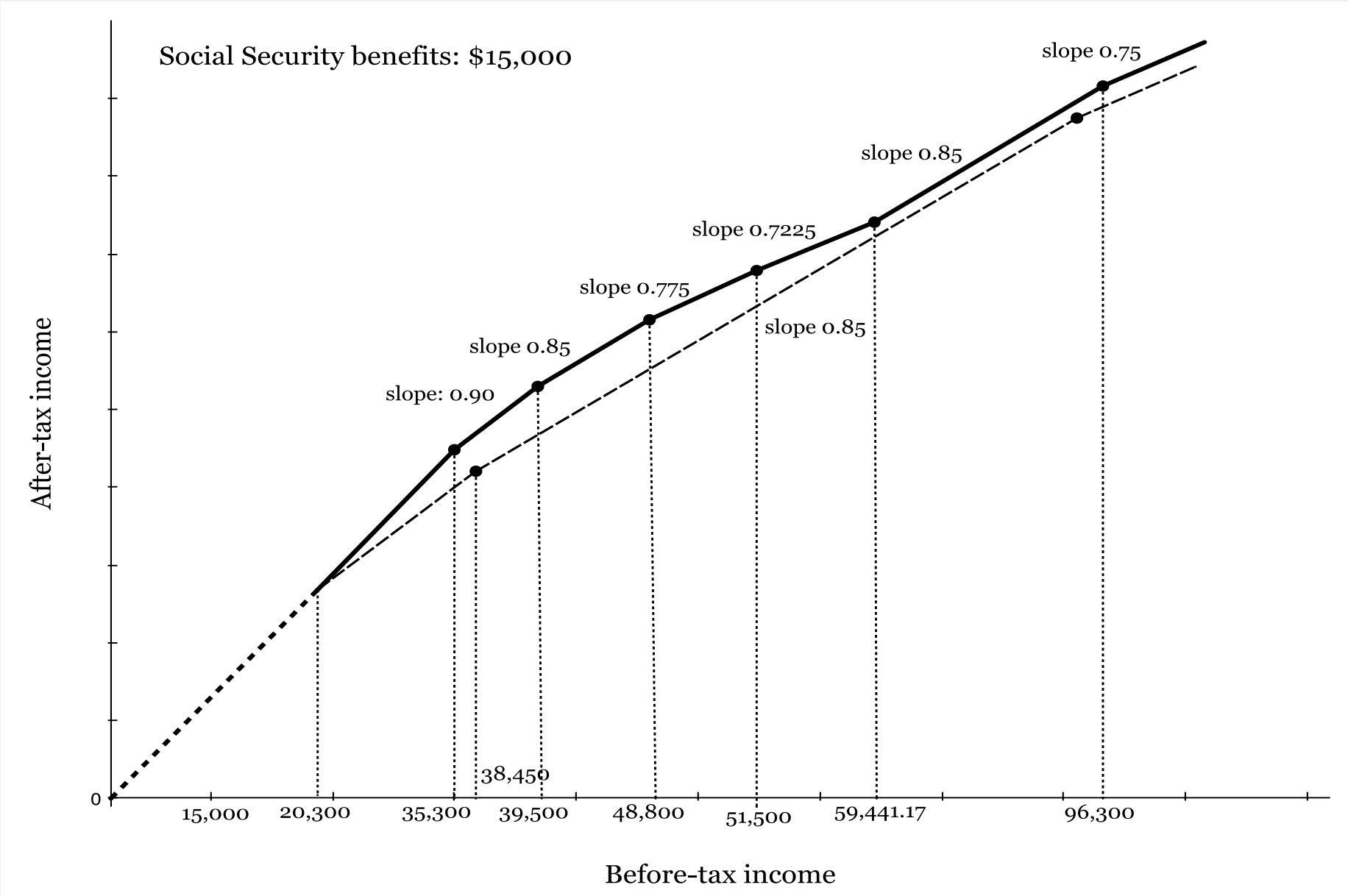
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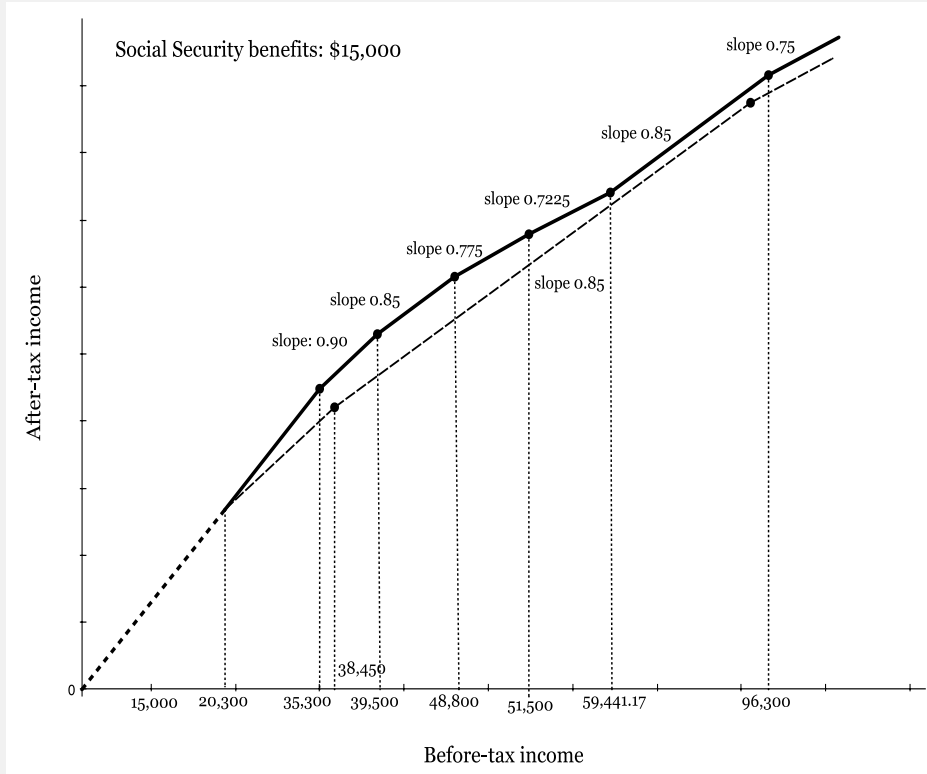
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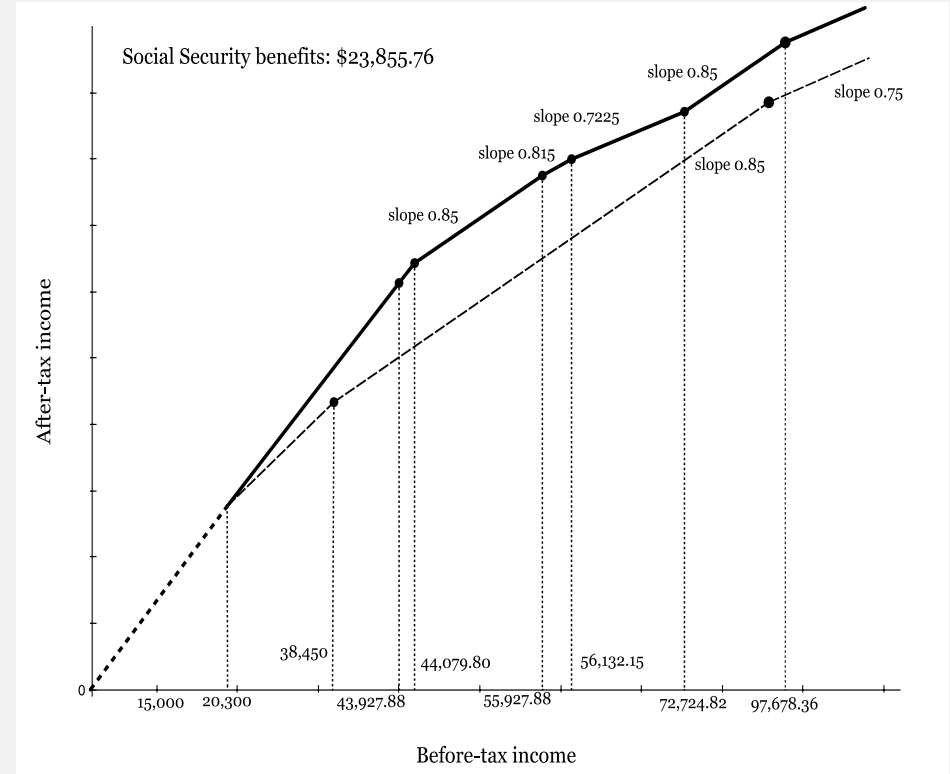
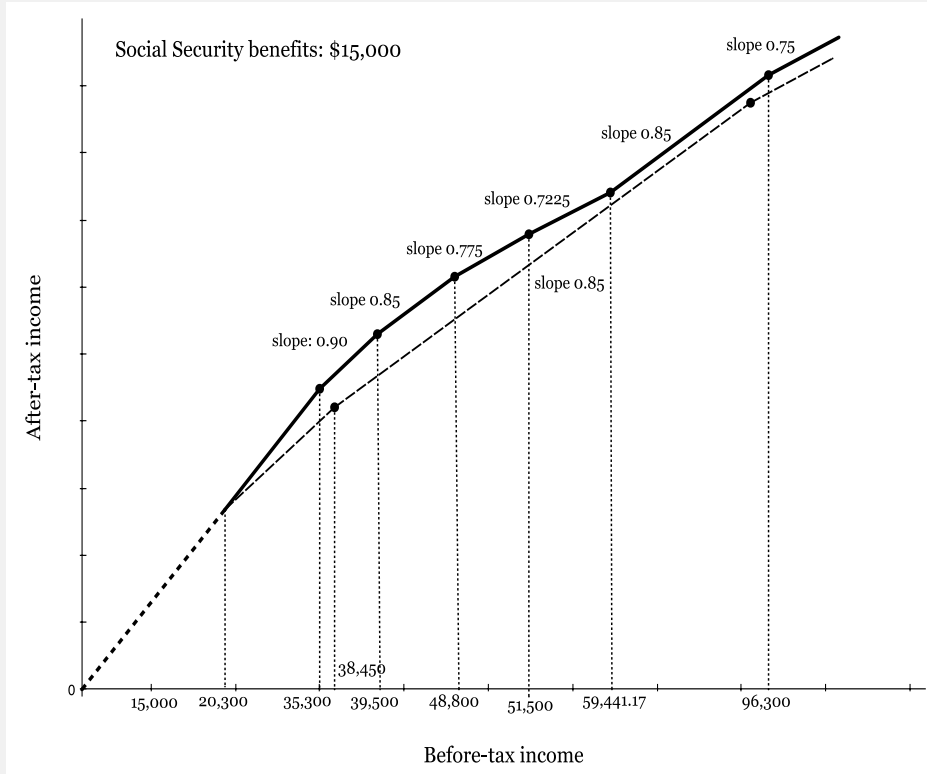
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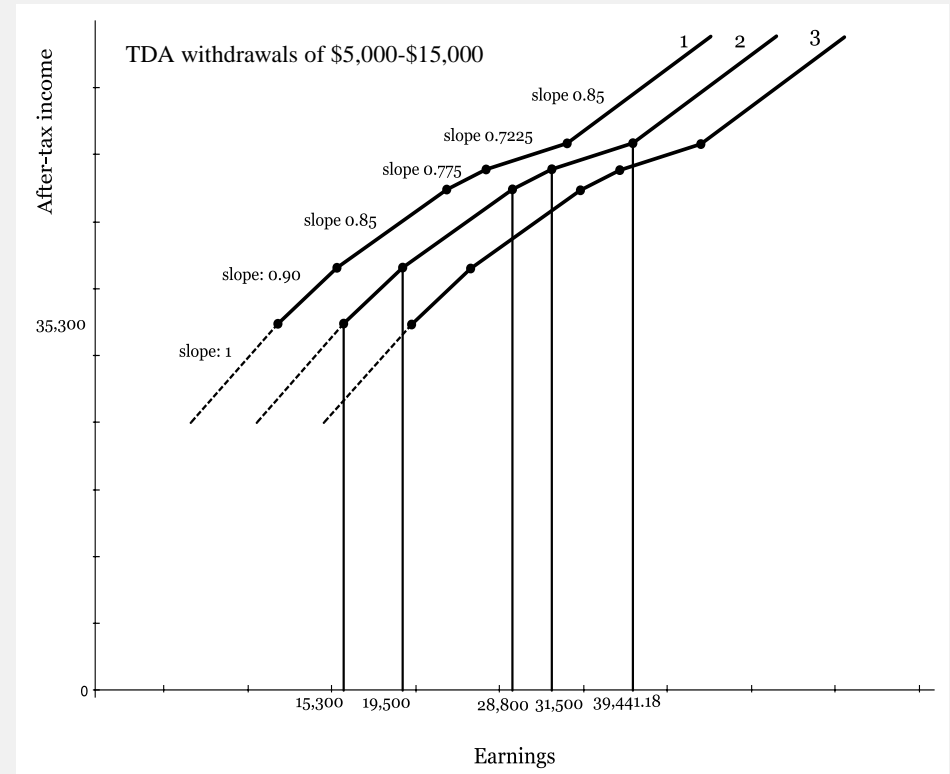
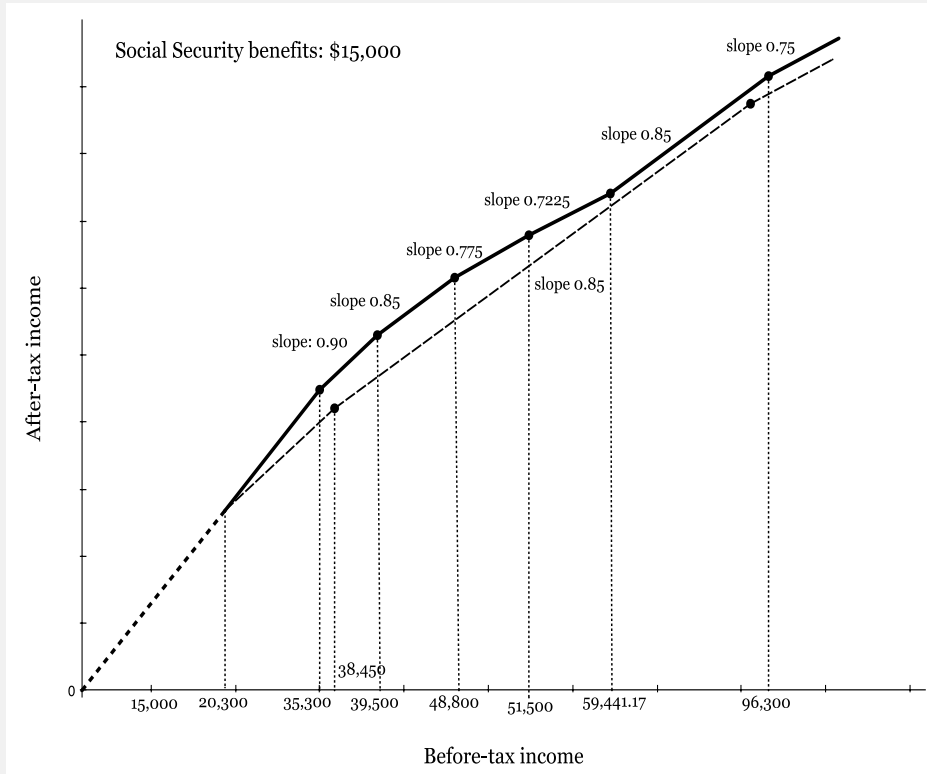
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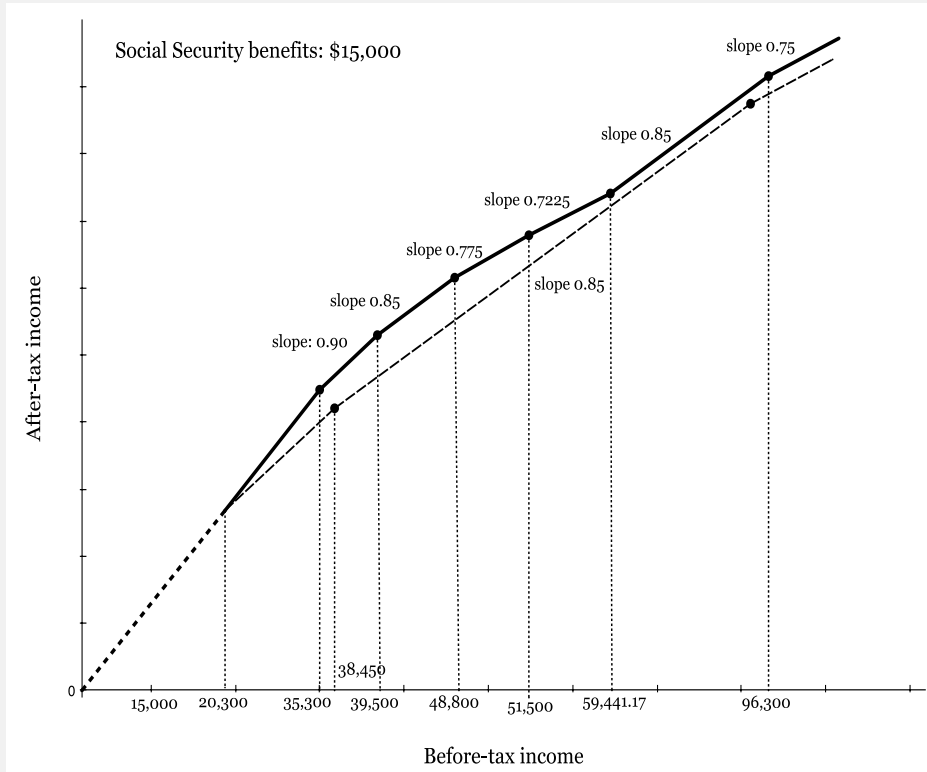
Suppose one spouse works, the other is retired



Suppose one spouse works, the other is retired

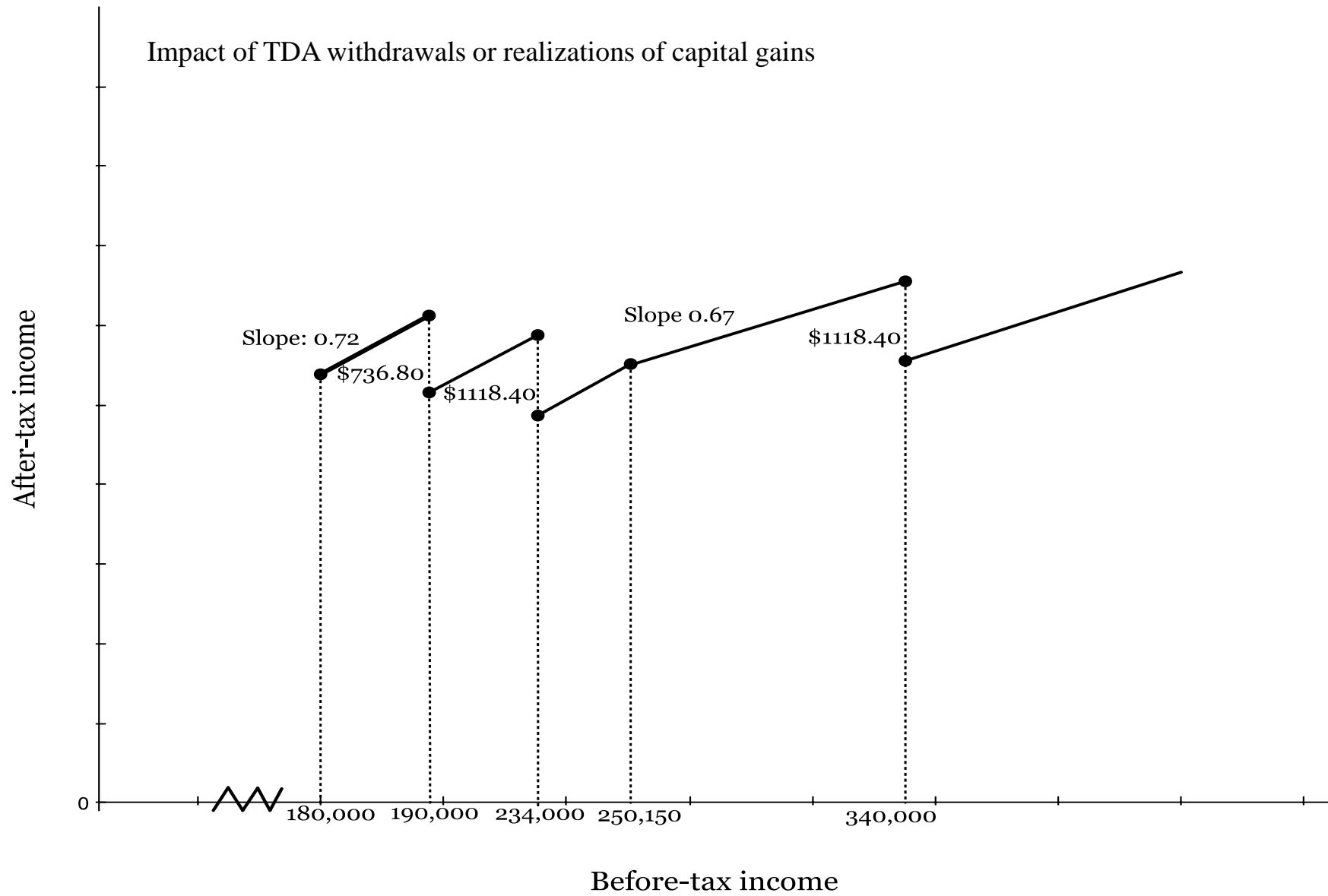


Suppose one spouse works, the other is retired



Earnings	Benefits	Withdrawals	Pre-tax income	Post-tax income	Marginal tax rate from		Average tax rate
					earnings	benefits	
30,000	15,000	0	45,000	42,855.00	0.225	0.037	0.048
60,000	15,000	0	75,000	66,855.00	0.150	0.128	0.109
30,000	0	15,000	45,000	41,017.50	0.150	0.128	0.089
60,000	0	15,000	75,000	66,517.50	0.150	0.128	0.113
25,000	0	15,000	40,000	36,767.50	0.150	0.075	0.081
25,000	15,000	0	40,000	38,715.00	0.150	0.025	0.032

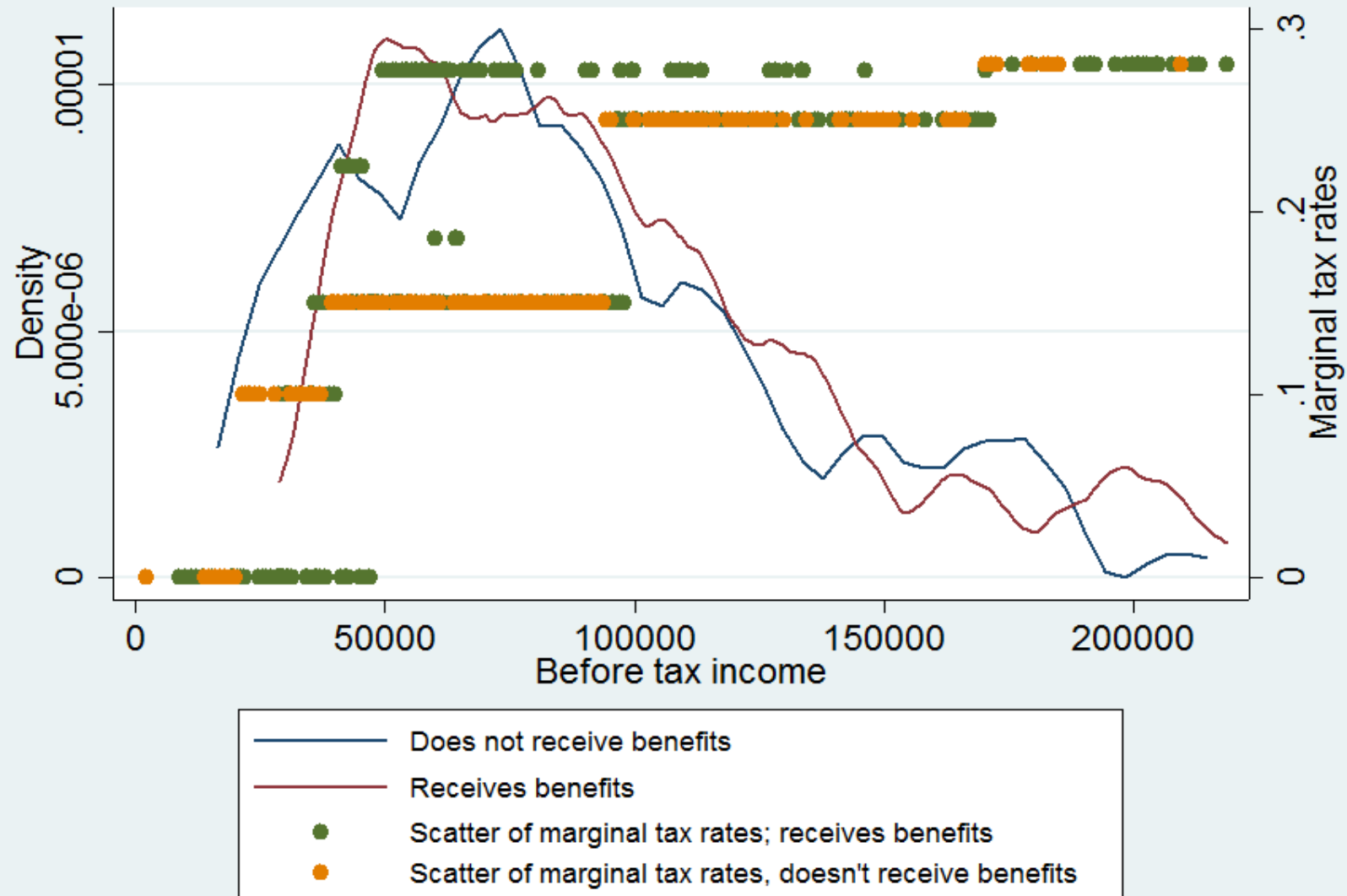
Suppose both spouses retired



2. DEMONSTRATE HOW MANY PEOPLE ARE AFFECTED

- Health and Retirement Study
 - 2014, RAND
 - One spouse works, the other is retired

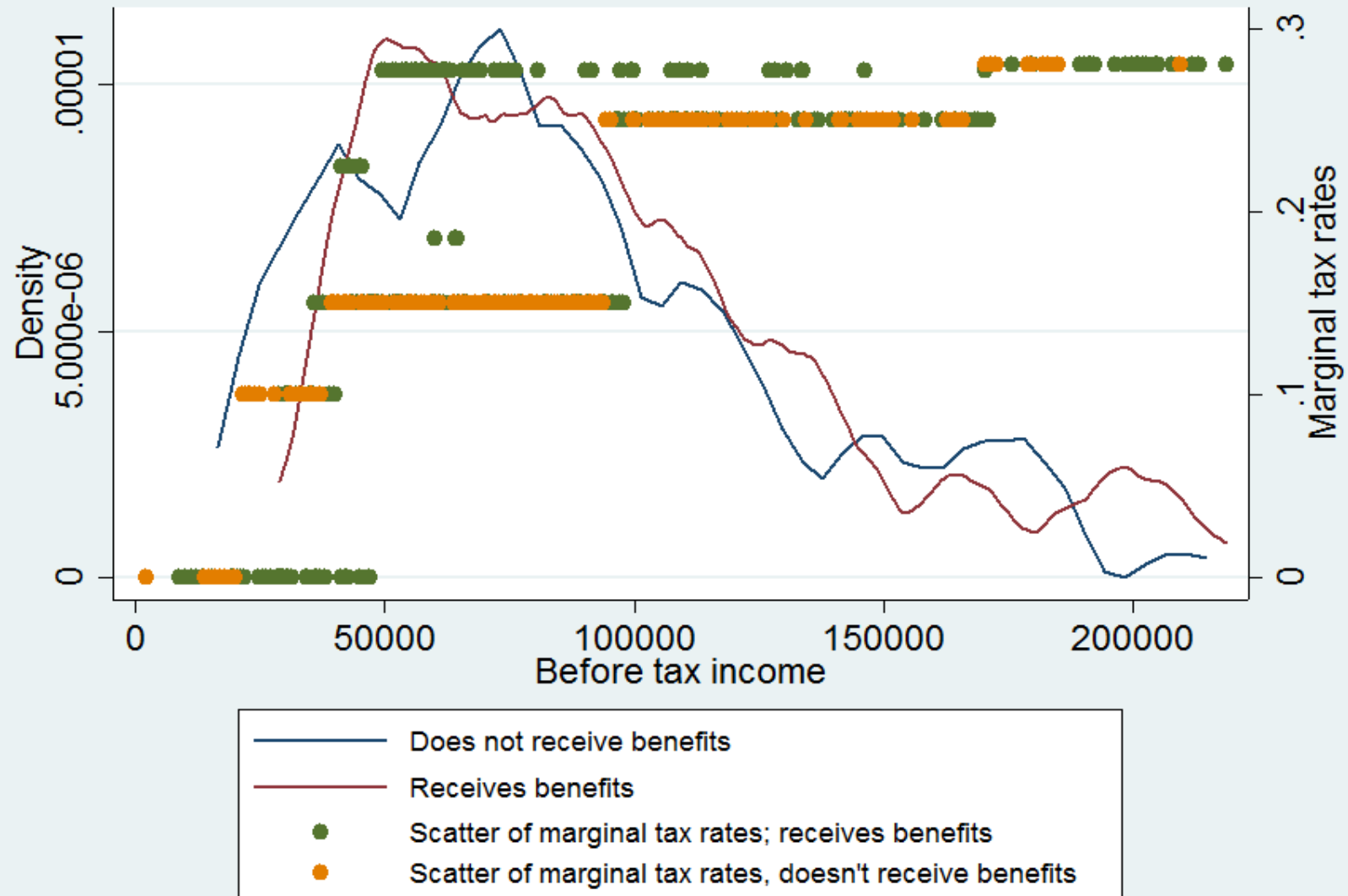
HRS, one spouse works, the other is retired



3. ANALYZE HOW PEOPLE RESPOND

- Health and Retirement Study
 - 2014, RAND
 - One spouse works, the other is retired
 - overreact to salient incentives → do people with differing incentives respond similarly
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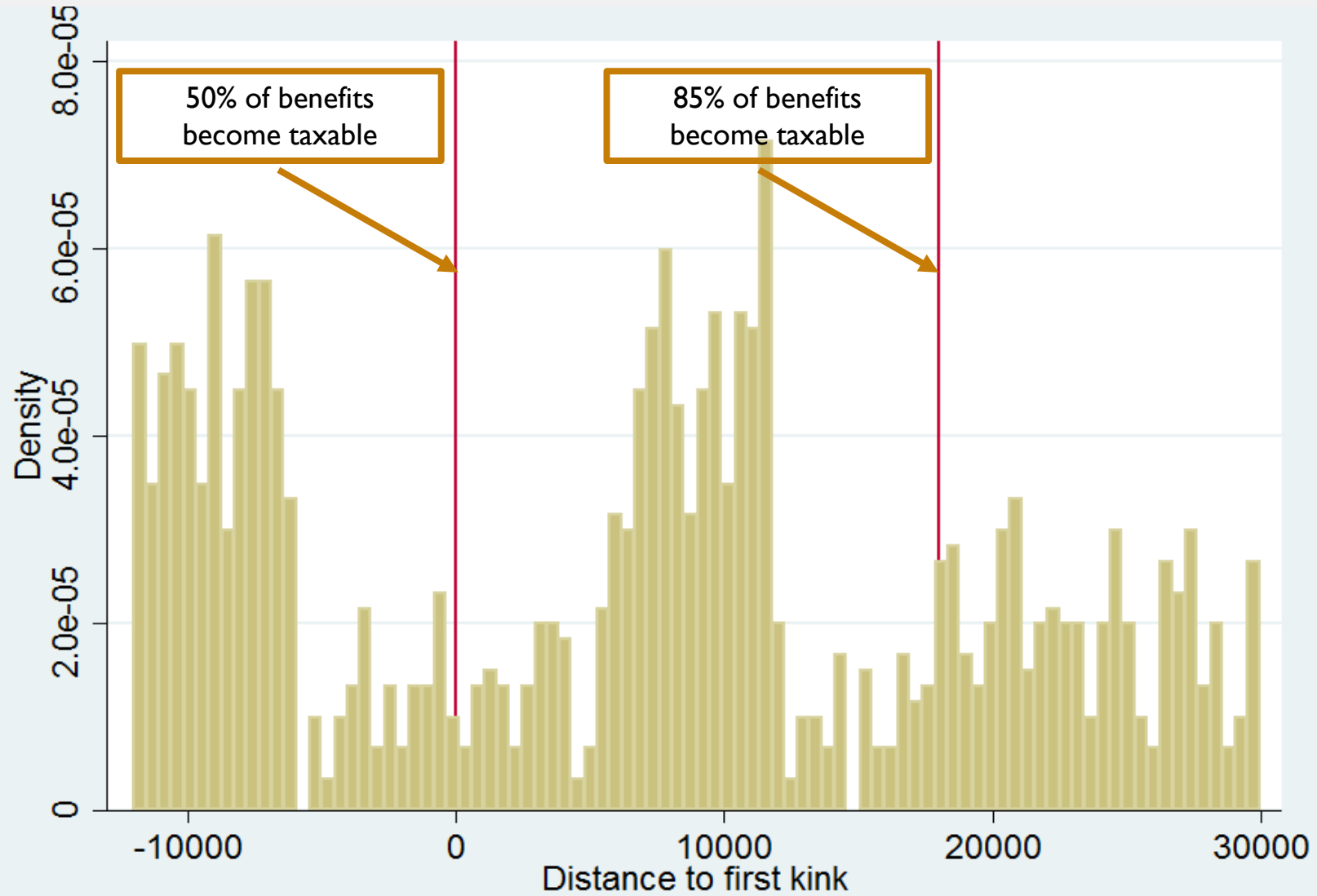
HRS, one spouse works, the other is retired



3. ANALYZE HOW PEOPLE RESPOND

- Health and Retirement Study
 - 2014, RAND
 - Household receives Social Security benefits
 - do they respond to partial taxation thresholds

Histogram of annual income among households that receive Social Security



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