POLICY INTERACTIONS AT RETIREMENT

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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 1/2 years old
  - RMD = f(age, current balance)
  - Penalty is a 50% tax

Pension income
Withdraw from DC/IRA

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

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

Early withdrawal penalty
- If age < 59 1/2
  - Penalty is 10% amount

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

Social Security benefits
Claim Social Security

Combined Income

Partial taxation of Social Security benefits
- 50% of benefits taxable if CI > $32,000
- 85% of benefits taxable if CI > $44,000

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)

Work

Personal income tax
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**Earned income**

- Work

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Required minimum distributions

• If age > 70 ½ years old
  • RMD = \( f(\text{age, current balance}) \)
  • Penalty is a 50% tax

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• 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
1. 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.
Suppose one spouse works, the other is retired.
Suppose one spouse works, the other is retired.

Retired spouse receives Social Security ⇒ partial taxation of benefits.
Suppose one spouse works, the other is retired.
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<table>
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<th>Earnings</th>
<th>Benefits</th>
<th>Withdrawals</th>
<th>Pre-tax income</th>
<th>Post-tax income</th>
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<th>Marginal tax rate from benefits</th>
<th>Average tax rate</th>
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</table>
Suppose both spouses retired

Impact of TDA withdrawals or realizations of capital gains

After-tax income

Before-tax income

Slope: 0.72

$736.80

Slope 0.67

$1181.40

$1181.40
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
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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

- 50% of benefits become taxable
- 85% of benefits become taxable
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  1. Illustrate policy interactions
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