

Optimal Tax Policy, Retirement Decisions, and Redistribution

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Scope

As people live longer and the population ages, people become more heterogeneous in terms of earning ability, health status and life expectancy. This raises the question how governments can best insure people against declining (and especially low) earning abilities as they grow older. Should the government provide a basic minimum pension benefit or should it link pension benefits to premiums paid? Should it make retirement benefits actuarially fair or should it provide more generous benefits to those who want to retire early because they have depreciated their human capital? Should it help low ability people to maintain their human capital better through education subsidies or cheap (but high quality) health care? Should it insure people against the risk of a long life through annuities (which help those with high earning ability and thus longer expected life)?

In this connection, the government faces a trade off between equity and efficiency. Providing substantial (early) retirement benefits tends to help those with rapidly falling earning abilities (and depreciated human capital who tend to face a shorter expected life) but discourages people from supplying labor for a long time. If people expect to work for a smaller number of years, the return to human capital is smaller and hence investments in human capital go down.

Research Goals

The project employs optimal taxation models to explore the optimal design of pension system in the face of substantial and growing intragenerational heterogeneity in human capital.

Furthermore the links between unemployment, disability and pension insurance will be explored, since unemployment and disability schemes are often used as implicit early retirement schemes. In this connection, the monitoring technology of the government becomes relevant (to what extent can the government observe disability (health status more generally) and inadequate search effort of the elderly unemployed). The intension is to explore how tax subsidies for elderly workers (EITC) and education subsidies and health care subsidies that help people to maintain their human capital (and in case of health care subsidies tend to reach those with health problems) can help to alleviate the labor-market distortions caused by redistributive retirement schemes.