

The Perception of Social Security Incentives for Labor Supply and Retirement: The Median Voter Knows More Than You'd Think

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Implicit in the structure of the Social Security system is a set of complex incentives for labor supply and retirement. For example, Social Security decreases the benefit payment by about half a percent for each month that someone claims benefits before the full benefit age. This incentive is relatively explicit; others require more detailed knowledge of the benefit rules. For example, because benefits are based on the 35 highest years of indexed earnings, one additional year of earnings generally increases benefits much less for someone who has already accumulated 35 years of earnings than for someone with a shorter work history. We know little about the extent to which people understand these program features, or where they learn what they know.

This study reports on a survey of individuals about their understanding of the Social Security benefit rules. Individual perceptions of the Social Security system matter for at least three reasons. First, if there is a systematic misperception of the Social Security system among voters, political reform of Social Security will likely reflect these misconceptions. Second, a misperception of incentives may lead people to make suboptimal decisions about work, saving, or retirement. Third, the nature of the misperceptions provides useful information on how best to disseminate information about the Social Security program.

The survey was administered to a sample of individuals aged 50 to 70 that is roughly nationally representative on demographic characteristics. The results indicate that a majority of respondents perceive positive labor supply incentives from the Social Security benefit rules. Over two-thirds of respondents report that their benefits will increase if they work an additional year, and over half state that additional earnings before claiming benefits would result in higher benefits. Since an individual's actual labor supply incentives are a complex function of his or her own earnings history, and that of their spouse, we cannot determine whether these perceptions are correct at the individual level. Among those who report positive labor supply incentives, however, the median perceived size of the incentive tends to be larger than what we would expect to apply to a typical worker.

Respondents were also asked about the various provisions of the Social Security system. On these questions, we find high levels of understanding of the provisions on widow(er) benefits and the rules governing how claim age affects benefits. However, individuals generally lack an awareness of the earnings test and the rules on spousal benefits; and only a few people are able to cite which years of earnings are taken into account in the Social Security benefit calculation. Thus, while respondents' understanding of Social Security rules varies across provisions, the rules that are relevant for a larger fraction of the population seem to be better understood.

In other results, we find that people rely strongly on information from the Social Security Administration. About 90 percent of respondents list the annual Social Security statement as an

information source they have used in the past, and four out of the five most highly rated information sources in terms of usefulness are communications from the Social Security Administration. Since it is the most important information source, the way the Social Security Administration presents its information may affect people's decisions. Indeed, we find suggestive evidence that this is the case from an experiment where we changed the presentation of how delayed claiming affects benefits.

Taken together, our results indicate that there is widespread awareness of the incentive effects of the Social Security benefit rules. However, even though the median response to many of our survey questions was often accurate, the variation in responses across individuals suggests larger misperceptions at the individual level, and the potential of improved information dissemination about certain aspects of Social Security benefit rules.

The full working paper is available on our website www.nber.org/programs/ag/rrc/books&papers.html as paper NB08-01.

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