

Labor Supply Responses to the Social Security Tax-Benefit Link

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National Bureau of Economic Research
December 2006

Policy Abstract

A key question for Social Security reform is whether workers currently perceive the link on the margin between the Social Security taxes they pay and the Social Security benefits they will receive. In this study, we develop a methodology for estimating the incentive effects of the marginal Social Security benefits that accrue with additional earnings on three measures of labor supply: hours, labor earnings, and retirement. We show how three sources of discontinuities in the marginal Social Security benefit formula can be exploited to identify these incentive effects. The study finds that retirement increases sharply when the current year's earnings crowd out a prior year's earnings in the Social Security benefit formula. This result is consistent with individuals responding to incentives implicit in the Social Security benefit formula, but further analysis is needed to determine whether the Social Security rules cause this result.