ROBERT P. STRAUSS & YUNNI DENG

The fiscal implications of Pennsylvania's aging population

Ben Franklin quipped that death and taxes were inevitable. But here in Pennsylvania, that's not been quite true for the elderly. Our elderly, dramatically growing in absolute and relative numbers, can generally expect state services such as long-term care but *no* taxes on their public and private retirement income. Death continues to remain inevitable, though at a later and later age.

The state budget is showing serious signs of stress. The problem will get much worse in the next 10 years. Here are some historical facts about the composition of the personal income tax base, spending on the elderly and what we predict the spending and tax situation for them will be by 2025:

Over the period 1971-2013, Pennsylvania's personal income tax base rose proportionately with respect to broadly measured personal income. However, spending pressures for the elderly in terms of health care and long-term care, grew disproportionately. For every 1 percent increase in Pennsylvania's personal income, the personal income tax base grew by 1 percent. But spending on seniors out of the general fund and off budget grew by 1.4 to 1.5 percent.

Given the Census Bureau's demographic projections of the Keystone State's increasingly older population and the fact that seniors have above average need for public services, especially long-term care, our elected officials will continue to grapple with this fiscal mismatch.

Pennsylvania's population for the next 10 years will be stable at around 12.5 million. But there will be, by 2025, 1 million *more* seniors than today and consequently that many *fewer* working-age adults.

Pennsylvania, along with Mississippi, entirely excludes *private* retirement income. Pennsylvania also entirely excludes *public* retirement income from its individual income tax base along with six other states.

Of the 43 states and the District of Columbia with some form of personal income taxation, 16 states entirely tax private retirement income. Eleven entirely tax state and local retirement income. Nineteen states partially tax private retirement income and 20 partially tax state and local retirement income. Exclusion of employer pension contributions from employee taxable income, and exclusion of actual employee receipt of pension income later on is, in effect, a lifetime tax forgiveness or tax expenditure program.

The revenues forgone due to excluding public and private retirement income from Pennsylvania's personal income tax (PIT) base were $2.5 billion or 21.5 percent of personal income tax collections in 2014. This foregone revenue also amounted to 8.8 percent of the general fund. It's hardly peanuts. While both service outlays and tax expenditures for the elderly are predicted to grow by 2025, the vast increase in the number of relatively young and their tax expenditures will witness an equivalence in 2025 of foregone revenues or tax expenditures for the elderly compared to service outlays for the elderly in 2025.

TNS

Put in other words, if tax expenditures for the elderly could be eliminated by subjecting retirement income to the state PIT, new monies coming in would nearly pay for the increased service costs to the elderly in 2025.

A more balanced approach to the tax treatment of retirement income would be to exclude Social Security benefits from the Pennsylvania personal income tax base but subject all other public and private retirement income above the poverty line to the current PIT rate of 3.07 percent. This would go a long way to balancing the state's budget during the next 10 years and more properly align overall our taxes with our overall benefits received.

Unbalanced, the General Assembly will have to find $5 billion to $7 billion from everybody else to pay for services received. Finally, including the same portion of retirement income to the *local* PIT base will go a long way toward shoring up local school and municipal budgets over the next 10 years.

Robert P. Strauss is a professor of public policy and economics at Carnegie Mellon University. Yunni Deng is research analyst for the International Monetary Fund.