The Hennepin County Aging Initiative

Research highlights: Aging and public finances

This synopsis of published research about aging, and public finances was produced as part of Hennepin County's Aging Initiative. The Aging Initiative was created to help the county anticipate and understand the potential effects of changing age demographics for Hennepin County as an organization, and as a geographic and economic region, and to position the county to foster healthy aging for residents and clients through effective public policy.

More detailed discussion of retirement trends and their implications for the economy can be found in the Aging Initiative report on aging and the workforce.

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Top research findings

The following summary highlights key findings from the research about aging and public finances. A detailed discussion of the following four items is included in the complete report attached to this summary.

1. The retirement of the Baby Boom generation will have the greatest effect on income and payroll taxes, as these types of revenues decrease substantially at retirement.
2. Public expenditures are far higher for retirees than for school-aged children. Most expenditures come in the form of Social Security, Medicare and Medicaid, however expenditures on other services also increase after age 65.
3. Aging will likely decrease revenues available to Hennepin County. Lower income and sales tax revenues at the state level may decrease intergovernmental transfers to the county.
4. Increasing numbers of retirees living on fixed incomes with increasing medical costs may limit the county's ability to raise revenue through property tax increases.

Introduction

The aging of the baby boom generation, Americans born between 1946 and 1964, will have a profound effect on Hennepin County's economy and government finances. Much of the literature on aging and retirement finances focuses on parts of a financial life-cycle with three stages:[1]

I: Asset Accumulation
II: Retirement
III: Late-Life

Individuals accumulate assets during their working years, live off income from these assets in retirement and save the remainder for bequests or to pay for care in late life. The report will focus on the implications of the financial life cycle and an aging population for public finances.

When the oldest Baby Boomers turned 62 in 2008, the most common U.S. retirement age, Minnesota experienced a 30 percent jump in new retirees.[2] The increasing number of retirees will put substantial pressure on public finances at every level of government.

Many of the findings presented in this document come from studies of national data. For this reason it is important to note important differences between Hennepin County, the state of Minnesota, and the United States as a whole. Hennepin County has a lower unemployment rate than the national average (5.3 percent[3] vs. 8.3 percent[4]), higher median household income ($60,800[5] vs. $51,222[6]), and a lower percentage of residents below the poverty line (12.5 percent[7] vs. 14.4 percent[8]). As such, it is reasonable to expect that the economic security outlook for Hennepin County's retirees may be somewhat better than national averages predict. Furthermore, while Minnesota's business cycle closely follows fluctuations in the national economy, the regional economy is well-diversified, making it less vulnerable to market volatility and providing workers with a more stable environment in which to plan for retirement.[9]

Despite our region's relatively strong economic performance, it is important that national findings not be taken lightly. Hennepin County includes significant urban, suburban, and rural populations. This diversity makes Hennepin County a surprisingly apt microcosm of the state and country as a whole. Therefore, there is no reason to believe that national research findings will not be applicable to Hennepin County.

Public finances

Overview

At retirement, workers undergo a profound, sudden lifestyle changes that change their role in public finances. As the rest of the Baby Boom generation retires, they will at once decrease their contributions to, and increase their consumption of, government services – especially Social Security and Medicare. The result will be lower revenues and greater demand for government services per capita at every level of government.[10]

Figure 1. Federal and state/local taxes by age of taxpayer

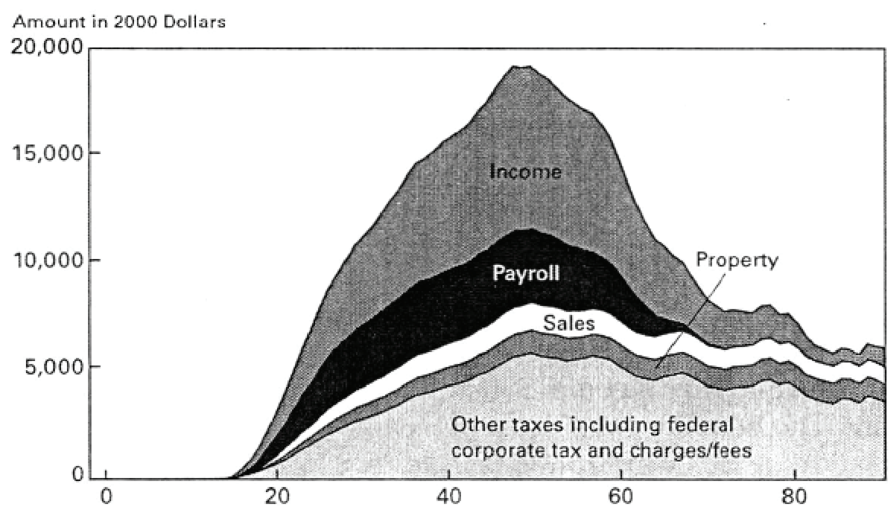


Figure source: Lee, R.D and Edwards, R.D. (2001). The Fiscal Impact of Population Change. Boston Federal Reserve Bank

Data source: March CP S, U.S. Census Bureau Surveys of 1994 and 1995, inflated to 2000

Aging and income taxes

Tax payments drop precipitously at retirement, with most of the change occurring in income and payroll taxes. The Minnesota Department of Revenue estimates that two-thirds of Social Security, one-quarter of pension and IRA income, and 28 percent of total income of the average Minnesota senior is tax exempt.[11] For this reason, as well as the progressive state income tax structure, income tax payments decrease far more than income at retirement. It is estimated that between the ages of 55 to 59 and 65 to 69, the income of the average Minnesotan falls 18 percent while income taxes paid decrease 40 percent.[12] Payroll taxes decrease as retirees go from net payers to net beneficiaries of Social Security and Medicare.

As aging affects income tax revenue, local jurisdictions may see reductions in State and Federal aid. In fact, simply changing the 2007 age distribution, labor force participation rates, and mix of income type to those expected in 2035 while holding total population, income and tax laws steady results in a reduction of 7.5 percent in state income tax revenue by 2035.[13] Inflation-adjusted State and Federal transfers to Hennepin County already have declined $77 and $9 per capita, respectively, between 2003 and 2010.[14] It is highly likely that intergovernmental aid will continue to decline.

Figure 2. Changes in constant dollar budget revenues per capita by funding source: Hennepin County 2010 versus 2003

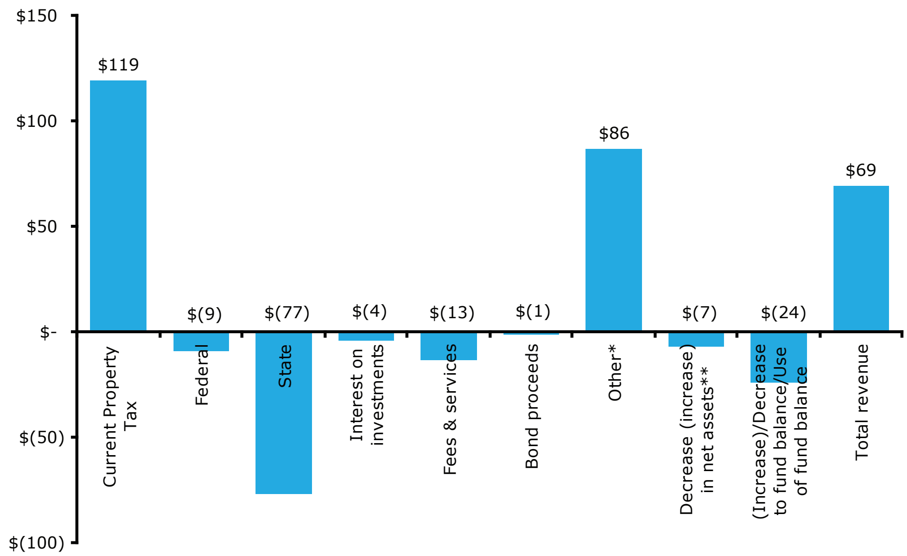


Figure source: Hennepin County Research, Planning and Development

Data source: Hennepin County Office of Budget and Finance, CAFR 2003 and 2010

* Other includes: intrafund revenues, local taxes, fines and forfeitures, license and permit fees.
** Changes in net assets in the County's enterprise funds: MHP, Solid Waste Enterprise, Radio Communications, and Glen Lake Golf Course.

Aging and sales taxes

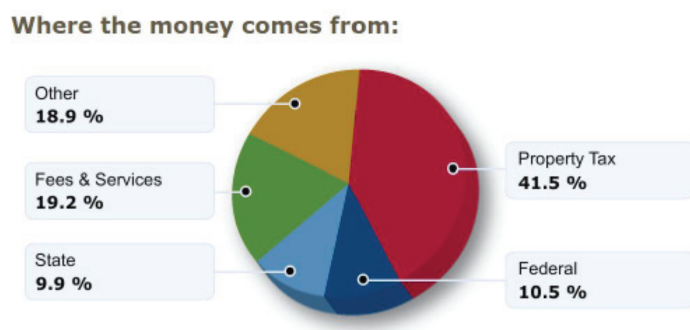
Sales taxes may be less affected by increasing retirement rates. While retirees shift consumption from taxable items such as restaurants and transportation to non-taxable items such as groceries and healthcare, it is unclear whether aging will decrease sales tax revenues.[15] On one hand, a 2004 study from the University of Michigan puts the decrease at 5 percent for the typical state. On the other, a recent study from Peter Fisher of the University of Iowa estimates that aging by itself will decrease total Minnesota sales tax revenues by 0.2 percent.[16]

Aging and property taxes

Property taxes made up 41.5 percent of Hennepin County budgeted revenues in 2011 and it is reasonable to expect that the county will have to rely increasingly on this revenue source for its operations.[17] As previously discussed,[a] it is unlikely that an aging population will have a predictable effect on residential property values in Hennepin County. Whether the County can expect "normal" appreciation of property tax assessments, even from a depressed baseline, over the next ten years, is dependent on the state of the economy, foreclosure rates, consumer optimism, interest rates and other factors.

While aging is unlikely to destabilize residential property tax assessments, research is less clear about how aging will affect the county's political ability to increase property tax levies. Some research addresses the idea of "grey peril," the suspected aversion of retirees to paying higher taxes, particularly for funding schools. While there appears to be an inverse correlation between population age and public spending, particularly on education, the effects appear milder than most "grey peril" hypotheses predict.[18] Some studies have found that retirees are less likely than younger cohorts to vote for tax levies for public education. However, this aversion to property tax hikes is far stronger for state-wide initiatives than it is for local initiatives.[19] These factors are important, since retirees are by far the most active participants in local elections.[20]

Figure 3.



Source: Hennepin County Office of Budget and Finance

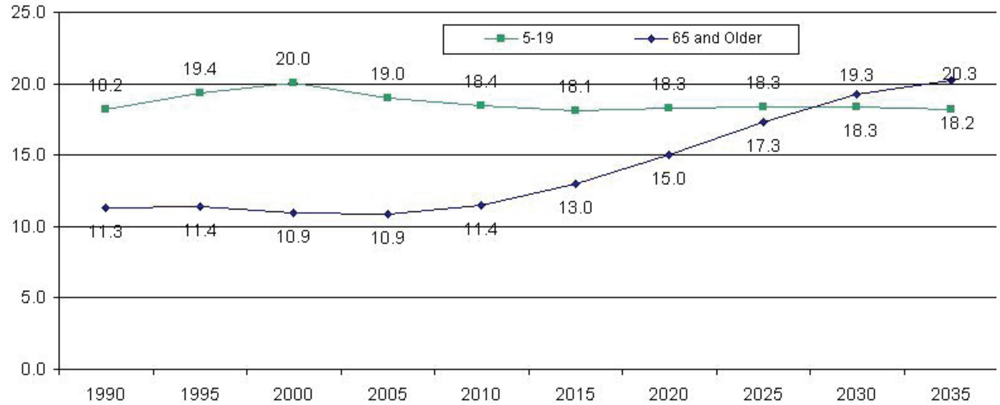
While capacity may exist for Hennepin County to increase residential property taxes, it is possible that a combination of recent property tax hikes and an aging population will make it more difficult. Hennepin County and other local taxing jurisdictions will have to walk a fine line on property taxes in order to maintain its revenue base while retaining the support of increasingly numerous elderly residents living on fixed incomes and facing rising healthcare costs.

[a] See document entitled "Aging, Retirement and The Economy"

Aging and public services

The aging population will put increased pressure on public services as government service provision shifts to the elderly. By 2030, it is projected that there will be as many Hennepin County residents who are old enough to retire as there will be in school.[21]

Figure 4. Hennepin County: Percent of population comparing 65 and older and school age



Data source: Population Projections (Minnesota State Demographic Center); 1990-2009 data drawn from Missouri Census Data Center Population Estimates by Age. http://mcdc.missouri.edu/websas/estimates_by_age.shtml; downloaded October 2010.

This increase in the number of older residents will put pressure on government finances. Most of this increase will come in the form of Federal entitlements such as Social Security and Medicare. However, spending on public assistance and Medicaid also increases at retirement ages, meaning that aging will put pressure on services provided by the State of Minnesota and through Hennepin County.

Figure 5. Federal and state/local benefits by age of taxpayer

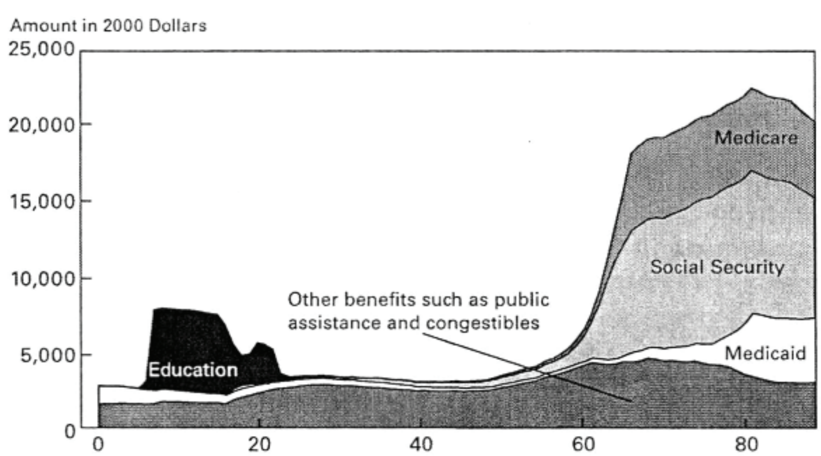


Figure source: Lee, R.D and Edwards, R.D. (2001). The Fiscal Impact of Population Change. Boston Federal Reserve Bank

Data source: March CP S, U.S. Census Bureau Surveys of 1994 and 1995, inflated to 2000

Conclusion

The convergence of predictions about individual financial security in retirement, public revenues and public expenditures does not paint a particularly optimistic picture for the future. While it is important to recognize major threats to financial stability in the public sector, it is also important to remember that all predictions come with a degree of uncertainty. Economies often adjust as predicted constraints emerge, changing in unpredictable ways and creating substantial opportunities for those prepared to take advantage of them. It is important, therefore, to take account of these projections, not because we can know exactly what will happen, but rather, because increased awareness can help us recognize and respond to an ever-evolving economic landscape.

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