THE GOLD IN THE GRAY

The economic benefits of attracting retired people have gotten states' attention.

BY RON SNELL

When someone says "Americans are aging" bad news usually follows—news about labor shortages, funding problems in Social Security, Medicare, Medicaid and state pension programs, inadequate savings for retirement, health issues, and so forth. But for those who see the glass as half-full instead of half-empty, great possibilities lie in the graying of America. They see attractive possibilities for economic development.

Economic development that depends on the aging of America has a solid base on which to build. The number of Americans over 65 will grow substantially in the next five decades. By 2050, the Census Bureau projects, there will be more than 86 million Americans aged 65 or older—almost 21 percent of the population. Around 21 million of them will be over 85.

GRAY GOLDMINES

While it's true that most Americans don't save enough money for retirement (and not enough Americans save any money for anything) it's also true there are many, many reasonably affluent retired people out there. They tend to be footloose, as anyone knows who's encountered their flocks of Airstream Trailers migrating on the highway. That's where the economic development possibilities begin. Although retired people (65 and older) and those near retirement (55 to 64, in terms of Census Bureau categories) are less likely to move their residence than younger people, enough of them do move to be an important target for states that see retired people as gray goldmines. In recent years a number of states, particularly Gulf Coast states and their neighbors to the north, have regarded this population as an economic treasure trove.

The reasons are straightforward. People who are inclined to move after they retire tend to be among the healthiest and wealthiest of retirees. The sick and the poor stay put. A Florida study on the importance of attracting retired people puts the advantages in a nutshell: "Florida's growth depends on its ability to attract mature residents. The retirement industry is clean, and its benefits are spread to other high job-creating industries such as hospitality, construction and health care." And even though a skeptic might think, well, after all, they will grow older and less healthy, and put a burden on their new state, that's not quite on target.

For one thing, the health care costs of the low-income elderly depend largely on Medicare and Medicaid, one federally funded and the other heavily federally subsidized. And second, the very aged (those over 85) have a tendency, according to the Census Bureau, to return to their places of origin when their health declines, probably to be near family.

As a result, it's not just Florida that's in the business of trying to sell itself to retirees. The study notes with annoyance: "Other states

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are devoting substantial marketing resources to eat into Florida's share of the market." So what's going on? And what do legislatures have to do with this?

SIZE OF MARKET

First some facts about the size of the "market." In the five years from 1995 to 2000, almost 30 percent of Americans over 65 changed their residence. Like younger people, most of them didn't go far—they stayed within the same county. But those over 65 were more likely than younger people to go to a different state, and they were more likely to go to a distant state—one outside their

Do Income Tax Breaks Help Retain the Elderly in a State?

A number of states that are losing residents over 65 have studied the issue.

The loss of talent, personal income and tax revenue that migrating elderly people take with them is only part of the issue. States that forecast stagnant or declining populations as a consequence of low birth rates, emigration and aging will have to address almost unprecedented challenges of population and income distribution, health care, service delivery and public finance. A Michigan study, for example, makes a point applicable to many states: The aging of the population means a lower ratio of working-age people to retirement-age people, challenging the state's ability to provide the services it has committed itself to. Policies that favor seniors in terms of both taxes and benefits will make financial problems worse.

The issues are so overwhelming that they tend to circle back to an issue legislators can actually do something about: taxes on the elderly. For years, Northern states have used tax policy to try to retain the elderly, increasingly offering a mix of property tax breaks and income tax exclusions. The former sometimes are phased out at higher income levels; the income tax breaks tend not to be, since their tacit purpose is to retain the high-income elderly. It is hard to know how successful such policies are, since there's no way to know what would occur in their absence, but the debate in two relatively heavily taxed states offers some light on the issue.

One is Maine, a slow growing state in a slow growing region, and the only one of the 50 states to have become more rural over the past 35 years. Its population under 18 is *falling* and the state is on its way to becoming one of the oldest in the country. It is also among the top 10 states in state and local revenue as a percentage of personal income.

Maine's tax treatment of retiree income does not differ much from its treatment of other income. Social Security income is not taxed, but other than that a retired person is eligible for only a $6,000 exclusion minus Social Security income. Maine's highest income tax bracket is 8.5 percent, which single taxpayers reach with taxable income of $18,500. So, the question comes up, does this drive affluent Maine residents to Florida?

Apparently not. A John F. Kennedy School of Government study suggests that more wealthy people over age 55 move into Maine than leave—and that the pattern is the opposite for neighboring New Hampshire, which has no income tax on pension or Social Security income. Though the samples are small, the suggestion is that the effect of taxes on interstate migration is exactly the opposite of what a person would expect.

Wisconsin imposes a lower overall tax burden than Maine (20th by the same measure) and unlike Maine, experiences a net loss of people over 65. Those who leave at the highest rate are those with incomes over $65,000. Does that indicate that Wisconsin should consider reduced taxation for the elderly? The evidence is not conclusive, since from 1995 to 2000, the state lost an average of only 806 people a year out of about 123,000 in the category. A tax break large enough to affect decisions on migration would therefore be extremely expensive in terms of state revenue. The Wisconsin study points out further that Pennsylvania and Illinois, which do not tax retirement income, continue to have higher losses of their elderly population than Wisconsin does.

The implicit contention that taxes on the elderly do not have much effect on a decision to leave or stay in a state is unconvincing to many legislators. The two studies mentioned here make it clear that their conclusions are tentative, being based on insufficient data and small samples. In 2006, Iowa legislators found such reasoning inadequate and voted to exempt Social Security from income taxes and to increase to $32,000 the total income exclusion for seniors filing jointly.

"This bill sends a message that we value and appreciate our seniors," says Senator David Miller. "It will help keep them from leaving Iowa for lower-tax states and taking their financial, philanthropic and civic contributions with them." Given the few tools legislators have to cope with the facts of an aging population and the perceived threat of emigration to other states, it is likely that the few states that continue to tax retirement income like other income will gradually change their policies. But legislators should be aware that hard evidence for the success of retaining the elderly through tax policy is scarce.

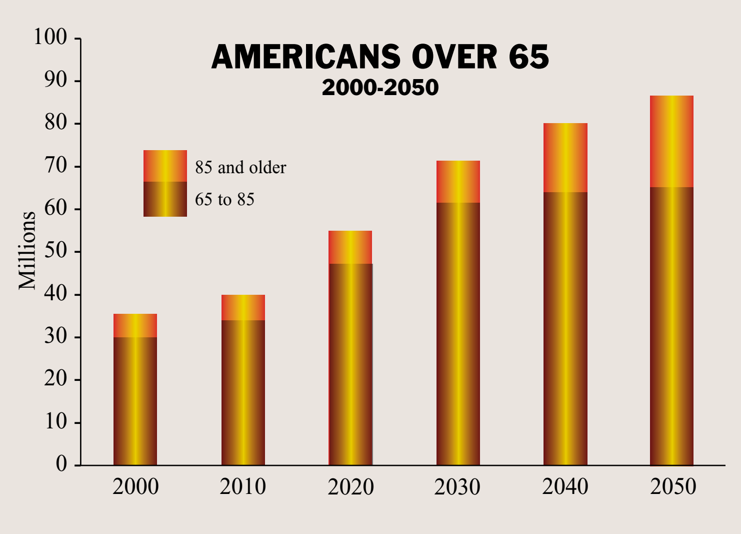
region. The Census Bureau found 1.5 million people over 65 who moved to another state in those five years, and 835,000 who moved to a state outside their region. It also notes that people who moved had higher incomes than those who did not move, and those who moved across state lines had higher incomes than those who moved within a county. So that's the rough outline of Florida's "market": people willing to move from one region to another, and who, as it happens, tend to have higher incomes than other people.

Two areas of the country are the sources of most of the elderly migrants: the Great Plains, in a swath that reaches from the Canadian border of Montana and North Dakota into northwestern Texas, and a huge Northeastern crescent swinging from New England and Minnesota into the northern counties of West Virginia and Kentucky. Except for Alaska, all the states with net losses of more than 1 percent of their residents over 65 in the late 1990s are in that crescent. Losses of the elderly in Great Plains states tend in most cases to be offset within the same state.

Over the five years of the Census Bureau study, New York suffered both the greatest loss in numbers—about 114,000 people over the five-year period—and the greatest rate of loss—4.5 percent of the population over 65. Although Alaska's rate of loss was almost as high as New York's, Alaska's smaller and younger population meant a much smaller loss in terms of people—slightly more than 1,400 in five years.

Where did they go? Generally speaking they went west and south. Florida, Georgia, the Carolinas and Tennessee are one contiguous catchment area; the other is Arizona, Idaho, Nevada, New Mexico and Utah. These two distinct regions had different sources of migrants. For the Southeastern states, they are the Northeast and the Midwest. For the Western group, the source is primarily California and to a much lesser extent, the upper Midwest.

This reveals an important anomaly: Despite an attractive climate and a low cost of living, the Gulf Coast states west of Florida and their northern neighbors (except for Tennessee) have not been magnets for retirees as states to their east have been. In recent years, however, Alabama, Arkansas, Louisiana, Mississippi, Oklahoma and Texas have launched vigorous efforts to capture some of the retirees that Florida sees as its rightful market. If I-95 takes Northeastern retirees to the Carolinas and Florida, why shouldn't I-35 and I-65 take Midwesterners to the Gulf Coast?



BIG SPENDERS

Retired people's stable and discretionary incomes are an attraction. A Louisiana study notes that the 20 percent of the state's population over 65 accounted for 36 percent of consumer expenditures in the state in 2000. Military retirees alone collect $406 million in retirement pay a year. Arkansas notes that retirees who move to the state generally have higher incomes than average in the communities where they settle.

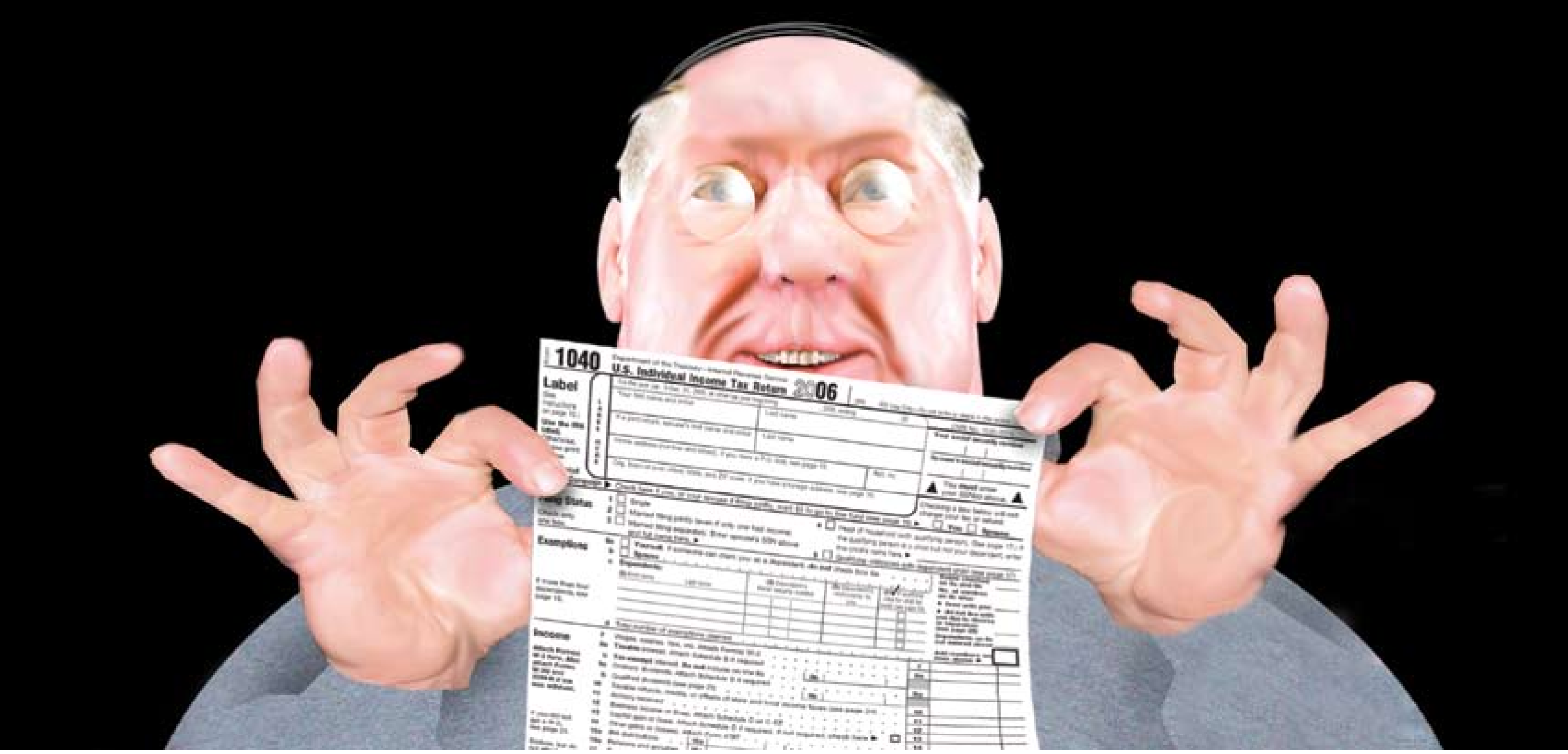
Moreover, these states note, retiree income is stable and tends to be spent. Retirees buy or build homes; their spending creates new demands for goods and services; they enhance the income, sales and property tax bases; and they can strengthen communities with talent and willingness to volunteer. Their spending may help preserve small town retailers and local health services, and otherwise benefit the local quality of life.

One widespread tactic to attract retirees is publicizing the attractiveness of certain designated retirement communities. Mississippi's Hometown Retirement Cities, for example, are selected because of their cost of living, level of taxes, crime rate, availability of quality medical care, and recreational, educational and cultural opportunities. The Texas Certified Retirement Community Program adds employment opportunities and the availability of public transportation to the mix. In West Virginia, designated retirement communities have banded together to advertise themselves jointly in conjunction with the state Development Office. Alabama's Robert Trent Jones Golf Trail (a set of seven golf complexes financed by the state retirement system) are said to attract the wealthy to nearby retirement housing complexes.

Behind such designations lies careful analysis of the advantages and possible costs of attracting retirees to a state, state government efforts to aid communities in reshaping themselves to attract retired people from beyond the state borders, and sophisticated advertising campaigns. Some states have carefully tracked the origin of the retired people moving into them in order to target potential migrants in states where word-of-mouth and personal relationships may already have advertised their attractions. There is nothing casual about the process, says Matthew Kisber, Tennessee's Commissioner of Economic Development: "We are working to implement programs that would establish retirement migration as an economic development strategy."

TAX ATTRACTIONS

One important element in the competition for retirees is tax policy. Florida's absence of personal income taxes has long been credited as one of its attractions. In recent years it has felt competition from Gulf Coast neighbors that have targeted tax breaks at retired people. Alabama and Mississippi have exempted pensions from state income taxes. Georgia's exemption will rise to $35,000 for tax year 2008. Louisiana allows a full exemption for federal civil service and military pensions. Texas has no personal income tax, and Tennessee's is limited to investment income. Arkansas has kept its retirement income exemption at a regionally low $6,000. Oklahoma has raised its exemption to $10,000 for the stated pur-



pose of attracting retired people to the state.

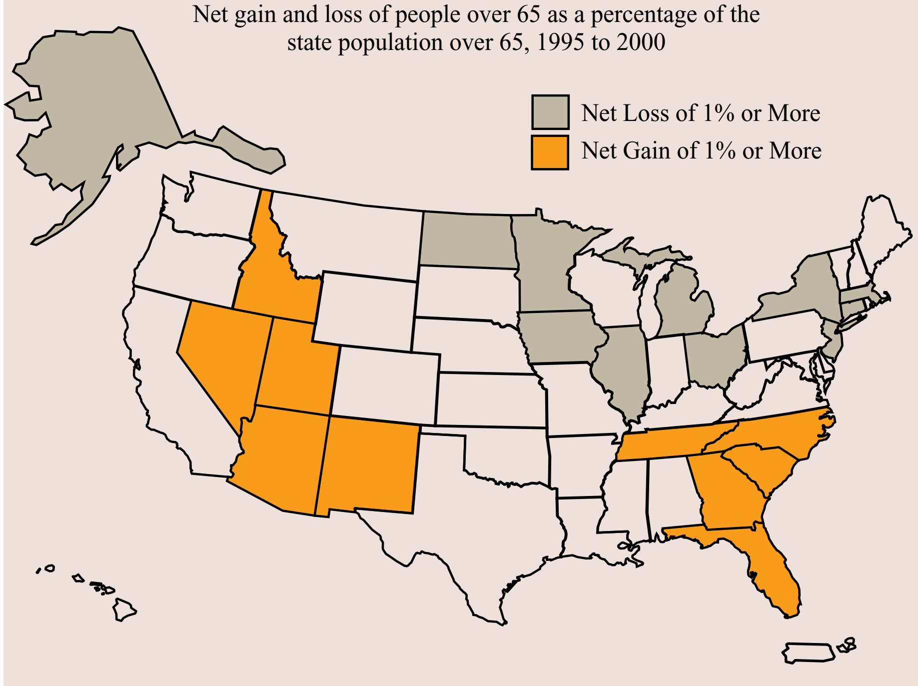
A policymaker then has to ask: Do all these programs actually make a difference? Do advertising, designation of retirement communities, building golf courses, or cutting taxes on retirement income actually bring more people to a state, or are they simply heaping rewards on the heads of those who would come anyway? This is the same tough question that legislators encounter in other economic development activities: do tax cuts bring the car assembly plant to your state, or just reward a company for a decision it would have made anyway? The difference is, of course, that except for the tax breaks for retirement income, existing programs to attract retirees do not cost very much.

Some of the academic work suggests that promotional efforts are not really necessary. While it seems clear that retired people prefer lower taxes to higher taxes—who doesn't?—and that taxes can have an effect on the decision where people will move, the actual effect seems to be very slight. The same is said to be true of the level of public services—if a county were to increase spending on public safety by 70 percent, that might attract one or two more retired people a year to the county. This suggests that high taxes could be an impediment to attracting people, but that low taxes don't necessarily have much effect. That could especially be so now that most states give very favorable treatment to retirement income.

In fact, what may be most important in attracting retired people are things a state government can't control—climate, mountains, coastlines and general amenities. The Florida study found that what baby boomers most value about a state are weather, natural features, kinship, social attractions, health care and social services, and economic issues. Few of those are very susceptible to government management, although they can be enhanced or damaged. A South Carolina study (funded by the state Department of Parks and Tourism) concluded that "the government's role should focus on providing and promoting the amenities that make South Carolina a desirable state to live in for all age groups, for tourism and attracting industry. Retirees, other migrants and tourists will then automatically find the state." That may be the final word on the subject.

WHERE OLDER PEOPLE ARE MOVING

Net gain and loss of people over 65 as a percentage of the state population over 65, 1995 to 2000



Source: Bureau of the Census, August 2003