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OLDER IOWANS, ECONOMIC SECURITY AND STATE FISCAL POLICY

Iowa is among the leading states in the percentage of its population over the age of 65. As the baby-boom population heads toward retirement, Iowa will continue to age as a state.

Older Iowans are more likely to be on fixed incomes and to require medical care and services. As a result, they are hardest hit by rising health-care costs (particularly pharmaceutical drugs and long-term care living arrangements), energy costs, and property taxes. Through the Medicaid program, state governments set many of the policies for long-term care programs, both nursing-home care and in-home services. Maintaining these services for older Iowans will become an increasing fiscal challenge to Iowa government. Clearly, Iowa government has a major role and responsibility in providing economic security for older Iowans.

At the same time, elderly Iowans have acquired an increasing share of the state's overall wealth. Federal and state programs have provided new options to defer taxes on income until the retirement years, through pensions and individual retirement and savings accounts.

In Iowa and across the states, there have been calls to exempt all retirement income (Social Security, public, and private pension income) from state income taxation (Governor Vilsack made such a proposal in 2005). While politically appealing, the Iowa price-tag for such an exemption ($225 million, or about 4 percent of the state's budget) is very large. This only tells part of the story, however. The United States Congressional Budget Office has projected substantial growth in such retirement income over time – from 8.62 percent of the gross domestic product (GDP) in 2003 to 16.32 percent in 2075. Within only 20 years, the share of the GDP that retirement income represents will grow by nearly 50 percent. That means that a proposed exemption that represented 4 percent of the state budget in 2005 will represent 6 percent of the budget in 2025 (see Table 1, below).

Table 1. Projected Growth in Retirement Income as a Share of Gross Domestic Product (GDP) – 2003-2075

	2003	2013	2025	2050	2075
Social Security	4.36%	4.80%	5.64%	6.37%	6.85%
Defined Contribution	1.36%	2.33%	3.70%	5.18%	5.96%
Defined Benefit	2.90%	3.15%	3.51%	3.33%	3.51%
Total	8.62%	10.28%	12.85%	14.88%	16.32%
% Growth from 2003	--	19.26%	49.07%	72.62%	89.33%

Source: United States Congressional Budget Office

As Table 1 shows, the greatest growth in pension income is for defined contribution benefits, which include 401(k) and 403(b) plans that are disproportionately used by higher income wage earners. If earned income is not taxed at the time it is earned or

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at the time it is withdrawn as pension benefits, this substantially narrows the overall tax base. Further exemptions on pension income primarily benefit high-income older Iowans who are not facing economic insecurity.

Under current Iowa law, retired Iowans already receive preferential treatment for both Social Security income and pension benefits (the first $6,000 in pension income is exempt from taxation for a single retiree, and the first $12,000 for a married retired couple). Iowa's considerable existing preferences for retirees in its income-tax policies are shown in Table 2 at right.

Table 2. Existing Iowa Income Tax Disparities
Tax Filers with Retirement Income vs. Regular Income, 2004

Adjusted Gross Income	Retired Individual	Working Individual	Retired Couple	Working Couple
$20,000	none	$ 667	none	$ 504
$35,000	$ 356	$1,503	none	$1,485
$55,000	$1,572	$2,622	$ 640	$2,870
$80,000	$2,904	$4,185	$2,211	$4,840

Source: Iowa's Personal Income Tax: Reform for Iowans at Any Age

Tax policy needs to be based on sound tax principles, including fairness and revenue sufficiency. Older Iowans have a need for economic security and the tax system should not threaten that security. At the same time, further tax exemptions for retirement income end up eroding the overall tax base that is needed to support many of the services that older Iowans rely on. While it may be politically appealing to call for elimination or reduction of the tax on pension benefits, the results could actually be to create a fiscal situation that places older Iowans at increasing risk, while principally benefiting older Iowans who already have greater resources and benefits from their life and work in Iowa.

This IFP Backgrounder was adapted from an Iowa Fiscal Partnership report, "Iowa's Personal Income Tax: Reform for Iowans at Any Age," April 2005, by Charles Bruner and Mike Crawford of the Child and Family Policy Center in Des Moines.

The full report is available on the web at http://www.iowafiscal.org.

Iowa Fiscal Partnership

The Iowa Fiscal Partnership is a joint initiative of the Iowa Policy Project and the Child & Family Policy Center, two nonprofit, nonpartisan Iowa-based organizations that cooperate in analysis of tax policy and budget issues facing Iowans. IFP reports are available on the web at http://www.iowafiscal.org.