Regional Economic Analysis Laboratory

The Projected Economic & Fiscal Impact of Exempting Military Pension Income from South Carolina Income Tax

Robert T. Carey, Ph.D.
Director, Regional Economic Analysis Laboratory
rob@sti.clemson.edu

Study Compiled with Santee-Lynches
Regional Council of Governments
for the South Carolina Military Base Task Force

G. Michael Mikota, Ph.D., Executive Director, SLRCOG
mmikota@slcog.org

February 18, 2015

Strom Thurmond Institute
Clemson University
Perimeter Road
Clemson, SC 29634-0125

Phone: 864-656-4700
http://cu-real.com

Executive Summary

This study examines the impact that exempting military pension income from South Carolina income tax would have on the state's economy as well as state and local net government revenues. The model uses dynamic scoring, that is, it accounts for the impact from economic changes predicted to result from the change in tax policy feeding back into state and local government revenue.

Economic impacts are estimated using the Regional Economic Models, Inc. (REMI) PI+ modeling engine. Economic effects predicted by PI+ are then input to a fiscal impact model; these results are then cycled back through the PI+ model in two iterations in order to increase the precision of the estimated impacts. Two scenarios are modeled: the first assumes that the cost in state government revenue of the tax exemption would be covered by a state budget surplus; the second assumes no such surplus and therefore offsets the cost of the tax exemption by reducing the state government budget (i.e. state government "output") by the amount of foregone revenue. The tax exemption is assumed to phase in over the years 2015-2017; impacts are modeled through 2030. RMSP income covered by the proposed tax exemption in these models is net of deductions already available to all retirees under South Carolina tax law.

It is expected that the increase in disposable personal income resulting from the tax policy will result in a net increase in retired military service personnel (RMSP) locating to the state; however, the size of the RMSP migration response is difficult to predict, given the number of factors that influence RMSP location decisions over and above the standard determinants of economic migration. This study therefore estimates four separate models within each of the two scenarios outlined above, one assuming zero net RMSP migration (i.e., the state simply retains current and projected RMSP); the remaining three models assume increases in RMSP migration of five, ten, and fifteen percent, respectively. Due to the costs associated with relocation, changes in RMSP population are lagged one year behind the change in tax policy in the model. A summary of findings follows.

General Findings (see text of report for citations):

1) As of 2013, there were about 57,755 retired military service personnel (RMSP) residing in SC; of these 52,317 are non-disabled and receiving a pension from DOD (pensions paid to disabled RMSP are not currently taxable). Roughly 50% of RMSP in SC are under 65 years of age.

2) Average military pension income is $24,842 per individual RMSP; total pension paid by DOD to non-disabled RMSP in SC is $1.3 billion (as of 2013).

3) Existing deductions (for all retirees):

    a) $3,000 of retirement income deductible for retirees under 65 years old.
    b) Up to $15,000 of any income deductible for individuals 65 and older.

4) Median income for military veterans, which is inclusive of RMSP, is greater than general population: $35,335 per year as opposed to $23,459.

Model Results:

5) The tax exemption on military pensions has a positive overall economic impact on the state. Only the most "pessimistic" model (assuming the tax exemption is financed by a decrease elsewhere in the state budget and zero net RMSP migration) predicts a small negative economic impact in the years 2016-2018 due to assumed decreases in state government "output". The size of the impact on the state economy is naturally dependent on how many RMSP who migrate to the state as a result of the exemption: the more RMSP migrate to the state, the more positive the economic impact.

6) Local governments see a net increase in revenue within five years of implementation of the tax exemption. In the first few years, local governments see a small increase in net cost to the extent that additional residents are locating to the state (due to increased demand for local government services and infrastructure). This is impacted by the number of RMSP assumed to locate to the state; the greater the number of migrants, the greater the effect on cost over revenue in the earlier years, but a larger number of migrants is correlated with faster revenue growth for local governments in the latter years.

7) State government net revenues decrease initially following implementation due to foregone revenue where the exemption is financed by an offset in the state budget; however, this decrease in net revenue is less than the amount of the tax cut due to increased revenue-generating economic activity. Where the tax exemption is financed out of a budget surplus, there is no negative effect on the state budget.

8) The net impact on state government revenue is positive within six to ten years following implementation due to growth in economic activity. The more RMSP who migrate to the state in response to the policy, the more rapidly net state revenues become positive.