

ALASKA LEGISLATURE COMMITTEE FILES 1987-1988 8672

5108 HSTA SB 56 (FILE 2)

680

existing ALB program. If it is irrational to assume that all long time residents "contributed" to the state, it may be equally irrational to assume that all long time residents suffered substantial past hardship.

There is one universal hardship which equates with territorial residency -- the lack of franchise. It is conceivable that a Longevity Bonus Program intended to compensate for that lack of representation would be constitutionally permissible. However, that rationale would only justify the January 3, 1959 residency requirement -- not the 25-year continuous residency provision of the act.

A much closer question is posed by the program's goal of allowing elderly Alaskans to remain in the state who would suffer particularly severe hardship if they were financially required to relocate. Justices Dimond and Matthews of the Alaska Supreme Court believe this may be a constitutionally permissible goal substantially furthered by a durational residency requirement:

"... a state Longevity Bonus ... require(s) lengthy residency. Both those programs, however, are apparently designed to help those individuals who would like to retire in the state but cannot afford to do so because of the high cost of living. The state might well want to limit the benefits to those that would suffer the most hardship by being forced to leave, and it seems reasonable to suppose that a long period of residency would be some indicia of close ties to Alaska and the disruption that leaving might cause." Zobel II, 619 P.2d at 469 n. 13 (Dimond dissenting).

The Department of Law, in fact, has concluded that the Pioneers' Home may be constitutionally defensible as a reasonable means of accomplishing precisely this goal.³² Indeed, one option considered in this report would award longevity bonuses on the basis of hardship caused by relocation -- which in turn would be measured in part by length of residence. By making length of residency "some indicia" (619 P.2d at 469) of the hardship of relocation, the option would avoid the indictment of overbreadth which was fatal to the permanent dividend fund distribution program in Zobel III.

Finally, as to the ALB program's goal of providing an incentive for a specific subclass of Alaska's elderly to remain in the state, the courts in all likelihood would view that purpose as merely discrimination for its own sake. See Zobel III, 72 L.Ed. 2d at 673-679. Presuming that only long-time residents have the requisite "wisdom and experience" to warrant subsidization is hardly likely to impress the U.S. Supreme Court.

B. Varving Goals of Several Longevity Bonus Options.

There is a substantial difference of opinion as to what an amended ALB program should accomplish. As noted previously, the legislature may wish to retain one of the major goals of the existing program -- allowing those elderly with the closest ties to Alaska to continue to live here.

³²1982 Op. Atty. Gen. ____ (November 26, 1982) at 25.

Alternatively, the fiscal consequences of the various alternatives may be the primary consideration. As previously discussed, if legislation in conformity with the Vest settlement is enacted, an additional \$11 million must be appropriated as retroactive bonus payments to July 1, 1982. Several of the options which propose to phase out the program, or which propose a conversion to permanent fund earnings, are partially or primarily directed at this end.

The primary goal of the legislation may also be to protect those currently most dependent upon the bonus. The current Old Age Assistance income level is \$546.00 per month and there are approximately 2,300 elderly Alaskans receiving state assistance. Since the longevity bonus is not included in the calculation of income for state assistance, the practical consequence of a phase out or termination of the program would be to materially reduce the available income of the poorest elderly Alaskans. Moreover, as noted in Section I(3), ante, there are a large number of elderly Alaskans who are currently only marginally above the existing state poverty level.

There are two options particularly sensitive to this goal -- the phase out of the ALB program in conjunction with a correlative rise in state assistance levels, and the option of compensating those who would suffer the most hardship by relocation.

With respect to this goal, however, it should be stressed that the existing ALB program has been purposefully structured so as to not be a "welfare program." Precisely for that reason, the program is administered by the Department of Administration, rather than the Department of Health and Social Services, and any conversion to a "need-based" program will undoubtedly offend the dignity of many elderly Alaskans.

Finally, there is the possible goal of providing a long term, stable bonus program which frees the general fund from increasing commitments. The annuity and state social security options are primarily directed at this goal.

C. Consequential Effects of Any Amendment To The Longevity Bonus Program.

Any change to the Longevity Bonus Program may have two consequences which must be considered: (1) the continued eligibility of ALB recipients for other state or federal assistance programs; and (2) tax consequences on participants.

As noted in Section I(A), ante, under federal law the ALB is excluded from the definition of "income" for many federal assistance purposes.³³ As long as any amendments to the ALB program continue to base eligibility "solely on attainment of age 65 and duration of residency," and remain sufficiently similar to the existing program so as to be fairly called "a program established prior to July 1, 1973," the exemption would be retained.

³³See n. 3, ante.

Obviously, any material changes in eligibility requirements or structure of the program raise the risk that the new benefit will be included as "income," and many elderly Alaskans will be terminated from the applicable federal program. The Department of Health and Social Services has estimated the impacts from a loss of the longevity bonus exclusion. Those estimates appear at Appendix 3 of this report.

Anticipating the same problem with permanent fund dividends, the legislature, in the 1982 Special Session, provided that the state would substitute lost benefits for a period of four months.³⁴ Obviously, and to the extent possible, any amendments to the ALB program should either be tailored to the existing exception, or fall within another separate statutory income exclusion such as a "need based" payment.³⁵

The tax consequences of amendments to the existing ALB program become particularly important with respect to this report's annuity option -- which is treated in detail in Section III (F), post. At the outset, it is sufficient to note that:

1. The existing longevity bonus program is taxed under the Internal Revenue Code;
2. Any ALB program which is based on need, or could be characterized as a "social benefit program for the promotion of the general welfare," would in all likelihood not be taxed by the IRS; and³⁶

³⁴AS 43.23.073.

³⁵See 42 U.S.C. §1382(a)(b)(6).

³⁶See IRS Revenue Rulings, 63-136, 1963-2 C.B. 19; 68-33, 1968-1 C.B. 446; 72-340, 1972-2 C.B. 31; 73-170, 1973-1 C.B. 24.

3. On February 27, 1981, the Internal Revenue Service ruled that dividends distributed under the state's prior permanent dividend fund legislation -- the statute invalidated in Zobel III -- were taxable under the Internal Revenue Code.³⁷ While the IRS has yet to rule on the existing dividend program, it is likely that taxation of the permanent fund dividend could be deferred if it is used to fund the annuity or social security options discussed in this report.

III. DISCUSSION OF ALTERNATIVES

A. Expanding The Class Of Alaska Longevity Bonus Recipients To Include All Elderly With One-year's Residency.

There are currently some 9,425 Alaskans who receive bonuses totaling \$23.23 million. This proposal would require additional appropriations for (1) bonuses for an additional 3,803 people; and (2) additional clerical support in the Department of Administration. The additional costs would total \$12 million in FY 1984, increasing to \$13.7 million in FY 1985.³⁸

These appropriations are in addition to the \$11.4 million retroactive award required under the Vest settlement.

The advantages of this option are two-fold. First, it is one of the constitutionally "safest" options. Second, since eligibility would remain dependent on "duration of residence" -- albeit only one-year -- in all likelihood it would fall within the existing ALE exclusion to federal assistance programs.

³⁷IRS Index Nos. 0061.40-00; 0451.20.00; 0102.00-00.

³⁸Department of Administration draft fiscal note, January 11, 1983.

Additionally, while theoretically any "one-year" elderly Alaskan could take advantage of this program, the demographics of Alaska's elderly (see Section 1(B), ante) are such that the primary beneficiaries of this option would be those who have lived in the state from 10 to 25 years. Whether such a program would encourage in-migration is problematical.

In addition to obvious fiscal disadvantages, this alternative would dilute the dignity and recognition attendant the current bonus to the point of non-recognition.

3. Phase Out The Existing Longevity Bonus Program.

One of the options analyzed by the Sheffield administration would phase out the ALB Program by reducing benefits by \$50.00 each year beginning with FY 1984. By paying \$200.00 a month to 13,223 recipients rather than \$250.00 to 9,425, the net increase to the program in FY 1984 would be \$2.1 million. In fiscal year 1985, however, when the bonus is reduced to \$150.00, there will be a net decrease of \$8.7 million in program costs.

This option has been unfavorably viewed by the administration, and apparently was prepared only as a point of comparison. Despite its fiscal benefits, the proposal protects no one. The poorest of Alaska's elderly would suffer the most. Since, as discussed previously, Alaska longevity bonuses are not counted in existing state and federal assistance income limits, the needy elderly person in Alaska receives, currently, a

subsidized monthly income of \$546 for Old Age Assistance, plus \$250 from the ALB program. This option would thus materially reduce state assistance levels.

C. Phase Out The Existing Longevity Bonus Program With A Contemporaneous Increase In State Assistance Levels.

The apparent "preferred" option of many with the Sheffield administration is to gradually increase state Old Age Assistance levels while at the same time gradually decreasing the amount of the longevity bonus. The program would function in the following manner:

CHART 1.

YEAR	OLD AGE ASSISTANCE LEVEL	ALASKA LONGEVITY BONUS
FY 1983	\$546	\$250
FY 1984	\$596	\$200
FY 1985	\$646	\$150
FY 1986	\$696	\$100
FY 1987	\$746	\$ 50
FY 1988	\$796	\$ 0

In analyzing the fiscal impacts of this alternative, assumptions must be made about how many elderly Alaskans will become eligible for Old Age Assistance as the OAA income level increases, and how many of the newly eligible will be inclined to seek assistance as their longevity bonus gradually diminishes.

Regardless of which assumptions are used, the impacts upon the longevity bonus program, are, of course, identical to the "phase out" option. Those impacts would be as follows:

CHART 2.

ADDITIONAL COST (SAVINGS) TO THE ALE PROGRAM (in millions)

FY 1984	2.1
FY 1985	(3.7)
FY 1986	(19.2)
FY 1987	(30.9)
FY 1988	(44.1)

The fiscal impact upon the Department of Health and Social Services' OAA program is far more difficult to determine. The Department of Administration has used two alternative assumptions -- (1) that of the 13,223 elderly in Alaska, 5% will become eligible and apply for public assistance as the income level is increased to \$796 in FY 1988; or (2) that 25% of the elderly will become eligible and apply for assistance during that period.

We believe that the 25% possibility may be closer to the truth. Approximately 30% of Alaska's elderly have monthly incomes marginally above existing assistance levels -- from \$500-\$300 per month.³⁹ If those figures are accurate, as many as 3,968 will become eligible for public assistance -- in addition to the 2,300 currently on the OAA program.

The second variable involves the size of the benefits which the new clientele will receive. The Department of Health and Social Services has assumed that each new recipient will receive the mean benefit currently given or projected for

³⁹Assessment, op. cit. n. 11 at 31.

existing recipients -- \$295 in FY 1984.

In computing the fiscal impacts for this option, we have used the following three assumptions:

(1) Of the 3,968 elderly whom current data suggest could be eligible for the increased OAA program, 2500 will in fact apply. This figure arbitrarily discounts both those who will decline to apply for psychological reasons, and those who will not apply because the minimal benefits to them are simply not worth the bother;

(2) Because we have discounted those who will receive minimal benefits, we have retained the "mean benefit" assumption employed by the Department of Health and Social Services; and

(3) The new recipients will be evenly distributed over each of the five years -- so that in each year an additional 500 recipients will be added to the OAA program.

Additionally, persons who become eligible for Old Age Assistance will also become eligible for Medicaid. The State's Medicaid budget for FY 1983 is \$65 million dollars. 48% of that figure -- or \$31.2 million -- is paid by the State. Some 23% of that budget -- or \$7.17 million dollars -- is attributable to those currently on Old Age Assistance. If the OAA population doubles over the next five years -- as our assumptions presume that it will -- there will be an additional cost of \$7.17 million (not adjusted for inflation) to this option, chargeable in equal portions to each of the next five fiscal years.

With these assumptions, the following chart illustrates the possible net fiscal impact of this option:

CHART 3

<u>Year</u>	<u># Add. on OAA</u>	<u>Mean Benefit</u>	<u>-----IN MILLIONS-----</u>		
			<u>Added Medicaid Costs</u>	<u>Added ALB Costs (Savings)</u>	<u>Net</u>
FY 1984	500	\$295.02	1.4	2.1	3.27
FY 1985	1000	345.02	2.8	(8.7)	(1.75)
FY 1986	1500	395.02	4.2	(19.2)	(5.90)
FY 1987	2000	445.02	5.6	(30.9)	(14.60)
FY 1988	2500	495.02	7.0	(44.1)	(29.30)

Thus, even with fairly liberal assumptions regarding the number of additional OAA clients and Medicaid costs, this option will begin saving money in FY 1985.

Moreover, for those elderly in the \$500 - 800 per month income range who pay some federal taxes, the option would have advantages, since increased need based assistance, unlike the longevity bonus, should not be taxed under the Internal Revenue Code.

One obvious disadvantage of this option is that it transforms the longevity bonus program into a welfare scheme. Persons who currently receive \$796 or less per month -- including the bonus -- will indeed be "held harmless" under the option, but only at the expense of applying for assistance to the Department of Health and Social Services.

Moreover, those current elderly bonus recipients whose monthly incomes (excluding the bonus) exceed \$796 per month will receive no protection under this option.

Finally, because welfare payments are generally viewed by the courts as involving "basic necessities of life" (see §II(A), ante), the durational residency requirement for increased old age assistance must be dropped from one year to 30 days.⁴⁰ The minimum national old age assistance level under the federal Supplemental Security Income system -- which OAA supplements -- is \$234.30/mo.. A person with \$600 a month income in a "minimum benefit" state is presumably ineligible for old age assistance (including Medicaid) in that state, but could become eligible under the Alaska system upon 30 days residency. While the mere prospect of an additional \$196 per month (in FY 1988) is unlikely to induce people to retire in Alaska, the concomitant provision of Medicaid services -- including full nursing home coverage -- may have that effect. If a person can obtain free nursing home coverage -- valued at between \$40 - \$60,000 per year -- simply by spending the month of August in Anchorage, the State may face a rather remarkable in-migration problem indeed.

D. Retaining A Modest Longevity Bonus, While Providing A "Need Based" Supplement.

This option is largely a variant of option C, and has been discussed by the Sheffield Administration as a means of

⁴⁰Shapiro v. Thompson, 394 U.S. 613 (1969).

retaining some longevity bonus payment which could not be considered "welfare."

Under this option, the longevity bonus, as with Option C, would be gradually reduced to, say, \$100.00 per month. As the fiscal information for alternatives B and C suggest, this alternative would result in a savings to the longevity bonus program of \$19.2 million by FY 1986.

To compensate for the loss of \$150.00/mo. to the needy, either State OAA limits could be increased by \$150, or a separate "need based bonus supplement" could be established by the Department of Administration.

The advantage of the latter option is that although based on "need," applicants will not be dealing with the Department of Health and Social Services, and may view the supplement less as a form of welfare. Additionally, since the supplement will be provided under a program other than State OAA, its recipients would not be entitled to Medicaid (including nursing home coverage) unless they are otherwise eligible for OAA under existing limits.

Additionally, the "need" is not necessarily limited to financial need. As this report's discussion of Option I indicates, longevity bonuses may be apportioned according to the hardship which the elderly would face by being forced to retire outside Alaska.

The disadvantage of a separate "need based" program in the Department of Administration is, of course, the necessary creation of a parallel bureaucracy in state government.

The fiscal costs of this option have not been developed by the administration or this report because of the variables involved -- the size of the remaining "basic" longevity bonus, and the question of administration. Costs of administration aside, the net savings to the State should be substantially similar to the FY 1986 figures for Option C -- in which the declining longevity bonus payment would be \$100.00 per month. The projected net savings of \$5.9 million would certainly exceed the costs of even a parallel bureaucracy within the Department of Administration.

E. Gradual Increase In The Age Of Eligibility.

Another option explored by the Administration would reduce the durational residency requirement for a bonus to one year, but raise the eligibility age each fiscal year. For FY 1984, the age would be raised to 66; to 67 in FY 1985; and so on.

This option would have a substantial fiscal impact until fiscal year 1988, at which time mortality would have reduced the class of beneficiaries below existing levels. For FY 1984, the option would cost an additional \$9.5 million dollars beyond existing funding levels, according to the Department of Administration.

This option has been quite unfavorably received. It has been facetiously but not unfairly referred to as the "newcomer's bonus program." A recent migrant born prior to June 30, 1913 would receive a longevity bonus for life, while a long-time Alaskan born subsequent to that date would receive nothing.

F. Self-Sustaining Annuities.

The prior five options were developed by members of the administration, although the administration has not formally "sponsored" any particular approach. Moreover, several of the options -- particularly the "graduated age" and "phase out" options -- were developed more as comparative conversation pieces than as actual proposals.

The following five options -- commencing with the self-sustaining annuity -- were prepared by the authors of this report.

Under the self-sustaining annuity option, individuals would no longer receive a permanent fund dividend under AS 43.23. Rather, those dividends would form the corpus of a self-sustaining annuity account from which the individual would receive an annuity commencing at the age of 65.

According to Department of Revenue projections, the permanent fund dividend payment for FY 1984 will be \$365.00, rising gradually throughout the remainder of this century to \$952 in the year 2000.

Given this level of contribution to the corpus, a self-sustaining annuity account will produce an annuity roughly equivalent to the existing longevity bonus (with a 3 percent annual cost of living adjustment) for those who are currently 40 years or younger, and who will be residents of Alaska each of the next 20 years. For various age groups, the annuity entitlements at age 65 as a percentage of the "target" annuity (\$3000/yr. plus 3% per annum) would be roughly as follows:

Current age	Annuity as a % of target annuity
25	353%
35	161%
40	100%
45	66
55	21

Obviously, some transition measure is necessary for those who are simply incapable of accruing a sufficient corpus by the age of 65 to be entitled to the "target annuity". The general fund, simply put, will be required to make up the difference, although, over time, that "differential" will decrease as annuity accounts assume some significance.

Many of the options explored in this report could suffice as a 20-25 year shrinking general fund obligation. One option particularly tailored to the annuity approach would be to allow those who are at or near the age of 65 to continue to receive their permanent fund dividends in cash, with the PFD being subtracted from the longevity bonus amount. For those in

the 40-50 year age group, the general fund would simply fund the difference between their annuity and the "target" figure.

Under this "transitional measure", the general fund "residual" payment would be based on the amount necessary to supplement the annuity corpus assuming that an individual received a permanent fund dividend every year. There would seem, in this regard, no obligation on the part of the state to give a larger general fund supplement to someone with two PFD credits than to someone with 15.

Thus, in fiscal year 1994, when current 55-year olds first receive their annuity, they would receive a state supplemental of 79 percent of the target annuity -- regardless of the actual PFD credit any individual has accrued.

The remaining question, obviously, is what to do about the person who is currently 55. If that individual's supplement is the same in 1994 as a new annuitant -- 79% -- he will in fact receive less than the new annuitant since he will have only his permanent dividend, rather than a 21% annuity, to make up the difference. Conversely, if the grandfathered PFD recipient received a full target annuity in 1994, he would be at a substantial advantage over the new annuitant. The reason is this: while the new annuitant has earned a substantial portion of his target annuity by foregoing his cash dividend each year, the "grandfathered" recipient has both enjoyed the dividend, and its earning power, over that same period of time.

The question is largely one of equity for the legislature. Either approach is defensible. While the latter scenario would seem to discriminate in favor of the existing elderly, the Alaska Supreme Court has recognized the legitimacy of creating preferential grandfather rights for those who have come to depend upon an existing state program.⁴¹

In either case, the difficulty with this "transition" option is that the longevity bonus program continues to be a substantial drain on the general fund for 20-25 years to come. Under the transition option described above, the FY 1984 budget for the ALB program would be increased by \$6 million dollars over existing funding levels.⁴²

Through Aetna Insurance Co., we investigated the alternative of simply purchasing a lifetime annuity for all those currently 65 or older. Unfortunately, the cost of a lifetime annuity for all Alaskans 65 or older would be prohibitive -- in the neighborhood of \$300 to \$400 million.

Finally, the Legislature should consider using the administration's options C and/or D as a transition measure. The short term fiscal impacts of those options are superior to those of a simple general fund supplement.

⁴¹Commercial Fisheries Entry Commission v. Apokadak, 606 P.2d at 1259-61.

⁴²Assuming that the ALB of the "grandfathered class" is reduced by the \$365 permanent fund dividend, each of 13,223 persons will receive a payment of \$2,635 this year -- totaling \$34 million dollars.

For all of the short term problems of an annuity program, the long term advantages should receive equal time. First, in a period of 20-25 years, the general fund will no longer be encumbered with the longevity bonus program. Second, the eventual size of one's annuity payments would be a function of the number of permanent fund dividend contributions that have been credited to the annuitant's account. We seriously doubt that a successful durational residency claim could be made to this aspect of the program. An annuitant with three years contributions could no more claim that he is due an annuity based on 20 years contribution than could a 1996 resident claim not merely the \$737 cash dividend available that year, but rather some \$6,000 which his predecessors had amassed by being residents of Alaska since 1984.⁴³

We believe that there is a strong case for distributing annuities only to persons who are residents of Alaska at the

⁴³Because future annuities are a direct function of actual past payments to the program, the program does not "reward" presumed contributions but simply returns actual investments. cf. Zobel I, 619 P.2d at 435 (Rabinowitz conc.) Nor is the option akin to a situation where prior tax contributors are excused from funding the present needs of government, as with the tax repeal scheme at issue in Zobel I. At any point in time, each Alaskan is treated quite equally -- being entitled to an annuity credit if he or she resided in the state for six months during the pertinent year.

time. Partially for reasons discussed below, no individual will have a "vested right" to an annuity in the future. A purpose of the annuity program will be to alleviate the particular financial hardships caused by retirement in Alaska -- a purpose which we believe is constitutional. This goal would be served only by confining actual annuity payments to Alaska residents. Second, and particularly if the program is properly viewed as conferring an economic benefit not upon the crediting of an annuity account, but rather upon annuity distribution, the state certainly possesses the right to prefer its own residents in the disposition of its resources.⁴⁴

There are, of course, other issues surrounding the annuity option. Many Alaskans will undoubtedly wish to retain the existing cash benefits of the permanent fund distribution. Alaskans will not be, however, totally without recompense. An annuity account for younger Alaskans in particular -- at least for those planning to stay in the state -- will one day lead to substantial benefits.

Of course, the prospect of a lucrative retirement account is a product of the legislature's continued willingness and ability to devote 25% of permanent fund earnings to the

⁴⁴Reeves, Inc. v. State, 65 L.Ed. 2d 244, (1980); see also White v. Massachusetts Council of Construction Employees, U.S., No. 31-1003 (U.S.S.Ct., Feb. 28, 1933)(distinguishing Hicklin v. Orbeck, 437 U.S. 513 (1978)).

annuity program. Unquestionably, at some point in time, a material percentage of the permanent fund's earnings will be necessary for general government expenses. The point at which that will require access to more than 75% of the fund's earnings is problematical.

The tax consequences of an annuity program warrant detailed discussion. As noted previously, the Internal Revenue Service may well rule that permanent fund cash distributions are taxable. Conversely, if credits to an annuity account equal to the permanent fund dividend are not tax exempt, the real economic value and perceived political worth of an annuity option is substantially lessened.

The annuity program envisioned by this report is not employer/employee related, and therefore would not qualify as an exempt plan under the Internal Revenue Code.⁴⁵ Nor was serious consideration given to qualifying this annuity option as an Individual Retirement Account -- because (1) the state is not a qualified financial institution to administer such an account; (2) the required terms of an IRA were not compatible with the option considered; and (3) any "state required" IRA -- even if possible -- would severely impinge on the tax planning flexibility of individual Alaskans.⁴⁶

Nonetheless, it is our opinion that the annuity option should result in the deferral of both the permanent fund

⁴⁵cf. 26 U.S.C. §401-404

⁴⁶See 26 U.S.C. §403.

dividend contributions and accrued interest under the Internal Revenue Code. The courts and the IRS have generally ruled that contributions to an unqualified "annuity," "retirement" or "deferred compensation" plan are nonetheless tax deferred if the individual is not in "constructive receipt" of the annuity contributions, and the contributions do not represent a present "economic benefit."⁴⁷

Combining the standards of that doctrine with the attributes of the proposed annuity program, the program should be taxed deferred for the following reasons:

1. If the State were to purchase individual annuities with each permanent fund dividend, with each resident being the beneficiary, the resident would have a vested and secured interest in the contribution, and would thus have received a current "economic benefit." If, however, the State were to merely give the annuitant an unsecured promise of payment, purchasing an annuity account with itself as the beneficiary in order to provide a funding source for that promise, there would be no "current economic benefit" and taxation would be deferred.⁴⁸ This is one customary means by which employers obtain tax deferral of an unqualified plan;

2. A person is in "constructive receipt" of an annuity contribution if he has current access to the

⁴⁷U.S. v. Goldsmith, 536 F.2d 810 (Ct.Cl. 1973).

⁴⁸Id.

contributions without substantial terms and limitations.⁴⁹ Under this report's option, under no circumstances would an annuitant be entitled to withdraw anything until annuities are actually distributed;

3. To underscore the contingent nature of the annuity -- such that the IRS could not reasonably conclude that it represents a "current economic benefit" -- the annuity will only be received if the person is an Alaska resident at the time of the pertinent distribution.

Our only hesitancy in this regard is the February 27, 1981 ruling of the IRS that even if an individual chooses to defer receipt of his permanent fund dividend, it is taxable in the year that it could have been received. The ruling, however, "may not be used or cited as precedent," and, even if of precedential value, is distinguishable from this situation. The ruling is consistent with the proposition that the individual cannot have unfettered discretion in choosing the year in which income will be taxed. While an individual does have unbridled choice in determining when to take a permanent fund dividend, he will have no choice as to the time of receipt of his annuities. Moreover, where a person would have an absolute right to a deferred dividend, he will have no right to annuity distribution unless he is an Alaska resident at the time.

For tax reasons, then, the annuity option must be carefully structured. The former permanent fund dividend must

⁴⁹Id.

be used by the State to purchase an annuity for its own account, with itself as the beneficiary. The annuity income received by the State will then be used as the funding source for the annuity payments -- although technically and necessarily the annuity income could be used for any fiscal purpose.

A far closer question arises with respect to the effect of this option on other public assistance programs. Generally, annuity income is included in the calculation of income for various assistance programs.⁵⁰ If, however, this option can be characterized as a continuation of the longevity bonus program, then the existing longevity bonus income exclusion⁵¹ may persist. If -- consistent with tax considerations -- the only "annuity" is the one purchased by the State as a funding source, then the existing longevity bonus program can be retained in both name and substance, with the amount of the bonus still dependent upon residency history. After all, under the option, (1) a person must be a six month resident in order to obtain a single PFD, and must be eligible for the annuity at the time of distribution;⁵² (2) the amount of annuity is dependent upon the number of PFD's, credited to the individual's account; and (3) the "grandfathered" class of existing elderly would presumably be required to meet a one-year durational residency requirement.

⁵⁰See, 42 U.S.C. §1332(a)(a)(2)(B).

⁵¹See 42 U.S.C. §1332(a)(b)(2)(B).

⁵²See n. 8, ante.

The above, of course, is an argument -- it is not necessarily the law, which in final measure will be largely determined by the federal officials involved. The exposure to existing assistance programs -- at least for those not within the grandfathered transition class -- must be considered a risk of this option.

Even if, however, annuity distributions are considered "income" to various assistance programs, the corpus of the annuity account will not be. A person may be disqualified from a federal assistance program not only if his income exceeds a certain level, but as well if he has alternative available resources which he can upon from at any time. However, in this instance, a true "annuity corpus" does not exist -- since the only annuity runs for the benefit of the State. Moreover, even if federal officials were to view the "corpus" as belonging to the individual, it cannot be withdrawn prior to actual distribution.

G. State Social Security System.

In large part because of the need for a lengthy transition period with a self-sustaining annuity plan, this report also considered the possibility of a state social security system funded by a portion of the permanent fund dividends distributed under AS 43.23.

Under this system, a sufficient portion of each resident's permanent fund dividend would be withheld each year

to fund a retirement program designed to pay each Alaska resident of 65 years or older with one-year's residency \$250 per month, with a moderate cost of living adjustment each year.

In assessing the feasibility of this option, the most important variable was the projected growth in Alaska's elderly population. The difficulties facing the federal social security system are due in part to an increasingly large percentage of elderly in the population.

For fiscal year 1983, the Alaska Department of Labor projects that there will be some 13,672 elderly in Alaska -- approximately 3% of Alaska's population.⁵³ The Department has projected that that population, as a percentage of all Alaskans, will remain relatively static through the year 2000, when, out of a population of 831,000 people, there will be 25,158 elderly.⁵⁴

We believe that those projections are overly conservative, and do not take into account the significant nationwide trend of increased elderly population. Nor do those projections include the retirement years of the post World War II "baby boom" generation -- which will begin about the year 2010.

Accordingly, in projecting the long term impact of this option on permanent dividend distribution, we have used the

⁵³Alaska Population Overview, Alaska Department of Labor, 1981

⁵⁴Id.

national growth patterns projected by the federal Social Security Administration, which are as follows:

<u>YEAR</u>	<u>% OF ELDERLY POPULATION</u>
1950	3.1
2000	13.1
2025	19.5
2050	21.3

Using those assumptions, Travelers' Insurance Co., on our behalf, calculated the percentage of permanent fund dividends which would be required to fund a "pay as you go" system.

For fiscal year 1983, the calculations are relatively straight-forward. Given an aggregate distribution of some \$169 million in permanent fund dividends this year, approximately 25% would be needed to fund a "pay as you go system."

However, even assuming a 3% cost of living adjustment in the payment each year, the percentage needed to fund the program decreases. This is because permanent fund earnings will increase at a rate substantially higher than inflation. From the year 1983 to 2000, the average funding required would be 15 to 19 percent of the distributions, while, in the years 2000 to 2025 (and assuming continued growth in permanent fund earnings) the funding amount would be 10-12 percent.

Thus, if the withholding remains static at 25% over the course of several years, the resultant excess would begin to build a savings account of substantial magnitude, which at some

point in the future would make the program partially, or perhaps totally self-sustaining.

One obvious advantage of this option is that it frees the general fund from ALB obligations immediately. Conversely, by materially reducing the annual permanent fund dividend, it obviously raises some political difficulties.

Additionally, the social security option could likewise be tied to contribution history -- although not in the precise manner of the annuity option. The federal social security system currently fully covers any individual who had "not less than one quarter of coverage ... for each calendar elapsing after 1950 ... except that in no case shall an individual be a fully insured individual unless he has at least 6 quarters of coverage."⁵⁵ Because, in the future, some portion of the benefits will be paid by the "savings account" resulting from the static 25% contribution, we believe that a similar contribution history requirement could be established in the legislation.

Even more so than the annuity option, there would be no "current economic benefit" from the program. By reducing the permanent fund distribution by 25%, and funding a retirement program from which the individual may or may not ultimately benefit, we believe it extremely unlikely that the IRS would conclude that the reduced sum is in some manner taxable.

⁵⁵42 U.S.C. §414(a)(1)

Moreover, we believe there is a substantial likelihood that the existing ALB exemption in federal law could be retained. Indeed, stripped to its essence this option does little more than alter the funding source of the ALB program.

The primary risk of the program is all the more apparent in light of the current difficulties with the federal social security system. While option F would be funded by a currently purchased annuity, younger Alaskans would be contributing to this option on the mere hope that the requisite amount of permanent fund earnings would remain available for the program well into the 21st century. The "savings account" created by the static 25% withholding is intended to alleviate that problem; however, regardless of the rate of growth of that account, there is plainly some risk in this option.⁵⁶

⁵⁶For example, under our population projections, there will be 30,747 elderly in Alaska in the year 2000. The permanent fund distributions for that year under AS 43.23 are estimated by the Department of Revenue to be \$792 million, of which, under our static 25% withholding, \$198 million would be placed in the social security fund. In that year, with a 3% COLA, the maximum monthly bonus will be approximately \$390. Even if every elderly Alaskan is eligible for full benefits under the law's contribution requirements, the maximum payments would be \$120 million -- with a savings account deposit being made in that year alone of \$70 million. Of course, many of these elderly may not be fully eligible, and some who are eligible may not be residing in Alaska during that year.

Finally, there is some advantage to the existing elderly in this system over the annuity option. The existing elderly would have a net loss of only 25% of their permanent fund dividend, rather than the entirety of the benefit under the annuity approach.

H. Health Insurance For The Elderly.

The state of health insurance for the elderly, and indeed for all Alaskans, has already been the subject of considerable study,⁵⁷ and legislative activity.⁵⁸ Because of the obvious critical importance of adequate health care coverage for Alaska's elderly, the option of providing comprehensive health insurance for Alaska's older citizens in lieu of the longevity bonus was included in this report as an option.

While the Department of Law report found that health expenses were a major use of the longevity bonus for only 5.5% of its sample, the 1976 longevity bonus study found that 29% of the bonus recipients used at least a portion of the ALB for medical care, while 11% used a portion of the bonus for "insurance of all kinds."⁵⁹

⁵⁷Alaska Comprehensive Health Care Financing Study, Batelle Human Affairs Research Center (1981)

⁵⁸HB 641, 12th Leg. 1st Sess. (1981)

⁵⁹ALB Survey, op. cit. n. 9 at 22

In fact, almost all of Alaska's elderly receive some kind of public or private health coverage assistance -- either through Medicare, Medicaid, public and private retirement programs, Veteran's benefits or the Indian Health Service/Public Health Service.

When assessing the health insurance option, the two obvious questions are: (1) how severe are the gaps in existing coverage; and (2) how much would it cost to fill those gaps?

The major source of health insurance coverage for the elderly in Alaska is obviously Medicare -- a federal insurance plan which provides hospitalization for those eligible for social security⁵⁰ and medical insurance for an additional fee of \$12.20 per month.

Both the hospital and medical insurance contain substantial deductibles, i.e. the first \$304 of the hospital bill -- and co-payment requirements (20% in the case of medical insurance.)

Nursing home coverage under Medicare is severely limited -- confined to post-hospital care in a "skilled nursing facility" for short periods of time.

It is difficult to determine how many resident Alaskan elderly are on Medicare -- available statistics are bloated by Medicare claims submitted by tourists. There are some 9,323

⁵⁰42 U.S.C. §§ 426, 1395(c). A person ineligible for Social Security may obtain Medicare hospitalization insurance for \$113 per month

retired persons in Alaska receiving social security -- and hence eligible for Medicare.⁶¹

The largest group of elderly Alaskans ineligible for Medicare are rural residents, primarily Natives, who do not have a sufficient wage earning history to qualify for social security. All Alaska Indians, Aleuts and Eskimos are eligible for IHS -- which provides a broad range of services depending upon available facilities. IHS is, however, primarily a direct provider of facilities -- it does not make cash payments for services such as custodial care in a nursing home. Moreover, it is currently facing severe cutbacks in areas such as reimbursement for health-related travel expenses⁶².

The most comprehensive health coverage in Alaska is, of course, Medicaid. To be eligible for Medicaid, one must meet the State public assistance income limitations. As noted previously, there are currently some 2300 elderly Alaska citizens on Medicaid. Medicaid does cover virtually unlimited nursing home residency.

The most glaring deficiency in Alaska health care for the elderly is the lack of coverage for institutionalization in custodial environments such as nursing homes. Nursing home

⁶¹Interview Ms. P. Eubanks, Field Rep. Social Security Admin. (Feb. 24, 1983)

⁶²Interview, Ms. P. Roberts IHS, (Feb. 23, 1983)

rates in Alaska run from \$90 to \$172 per day⁵³. The costs are simply prohibitive for anyone not on Medicaid -- indeed, of the 467 elderly Alaskans currently residing in State nursing homes (other than the Pioneers Homes), all but 31 are there under Medicaid, or Alaska's General Relief Medical Assistance.

Conversely, nursing home rates in Washington, for example, have been estimated by the Department of Health & Social Services to vary from \$50-560 per day. It is not known how many elderly Alaskans are institutionalized in lower forty-eight custodial care facilities; however, it is apparent that unless one is eligible for Pioneer Home placement, a nursing home can be afforded if, at all, only by relocating to the lower forty-eight.

Three private organizations were asked to estimate the premium amount required to supplement Medicare and other coverage for Alaska's elderly to provide health insurance equivalent to the existing Public Employees' Retirement System's retiree coverage, and to include comprehensive nursing home coverage. Neither Travelers Insurance, nor Aetna Insurance felt capable of providing an estimate.

However, insurance consultants frequently used by the state for matters such as the public employees Supplemental Benefits System estimated that to provide supplemental coverage

⁵³Alaska Nursing Home Census, Alaska Department of Health & Social Service, 12/31/82

for Medicare, insurance could be provided at a premium of approximately \$70 per individual per month. This would include comprehensive nursing home coverage.

Medicare is currently a primary insurer -- that is, the State could provide for Supplemental coverage without endangering basic Medicare eligibility. Moreover, and in all likelihood, supplemental State coverage could properly provide otherwise uninsured Alaska Natives with those costs not covered by the Indian Health Service.

The major difficulty is Medicaid. Medicaid eligibility is very much contingent upon the unavailability of "resources".⁶⁴ Currently, the State only pays 48% of a Medicaid's patient bills. If a State health insurance policy was considered a "resource" the State could find itself footing the entirety of a Medicaid patient's bill.

Of course, the State would hardly need to "supplement" any Medicaid coverage -- Medicaid coverage itself being essentially inclusive. The statute, could simply exempt Medicaid recipients from the coverage of the policy. The issue posed by such an enactment is whether the State would be frustrating the Congressional goals behind Medicaid -- which is to provide a health coverage means of last resort -- thereby running afoul of the Supremacy Clause.⁶⁵

⁶⁴42 U.S.C. §1332(g)(1)(B)

⁶⁵Florida Lime & Avocado Growers v. Paul, 373 U.S. 132 (1963)

Assuming that the State could continue to merely supplement Medicare, IHS facilities and existing private and retiree coverages, and that the consultants' figures are accurate, there remain two difficulties with the health insurance option. First, it is of no benefit to Alaska's needy elderly -- who will merely continue with Medicaid coverage at the price of their longevity bonus.

Secondly, there is the potentially severe problem of in-migration. If a year's residency in Alaska⁶⁶ were all that were required for free and unlimited nursing home coverage, the potential of in-migration may be severe. There are two potentially justifiable components of the program which could mitigate this potential:

1. If a purpose of the health insurance option is to allow Alaska residents to continue to reside in the state even if nursing home coverage is required, nursing home coverage could be limited to Alaska institutions, just as many states

⁶⁶It is possible, although we believe unlikely, that a court would rule that supplemental health insurance coverage would constitute a "basis necessity of life" -- dropping the maximum possible durational residency requirement to 30 days. The program would be supplemental to a host of existing assistance insurance programs, and would not be based on need. See Memorial Hospital v. Maricopa County, 415 U.S. at 261.

limit resident tuition discounts to in-state universities.⁶⁷ The difficulty, obviously, is that existing Alaskan nursing home capacity is limited. Whether unlimited nursing home coverage for all Alaskans would result in the expansion of existing facilities is debatable;

2. For the reasons cited with respect to the annuity and social security options, eligibility for health insurance coverage might properly be based upon contribution history if (a) a portion of the individual's permanent fund dividend is used to help fund the insurance program; and (b) the funding is in excess of current needs, in order to amass the same type of "savings account" envisioned with respect to the social security option.

I. LONGEVITY BONUS PREMISED ON INDIVIDUALIZED
RELOCATION HARDSHIP.

As noted in Section II(A), ante, there is some judicial support for the view that it is permissible for Alaska to establish a program intended to benefit those who would suffer the most hardship by financially-coerced relocation from the state, and to measure that hardship in part by duration of residence.

This option relies upon that support, and involves three steps:

⁶⁷Scarns v. Malkerson, 326 F.Supp. 234 (D. Minn. 1970), affa mem. 401 U.S. 985 (1971)

1. cataloging those criteria which would differentiate those Alaska elderly who would suffer relatively more hardship by being forced to retire outside the state, and who need financial assistance in order to remain in-state;

2. translation of those subjective criteria to a point system similar to that used by the Alaska Commercial Fisheries Entry Commission; and⁵⁸

3. structuring of that point system such that (a) administrative costs are minimized; and (b) successful applicants are confined to a pool roughly equivalent in number to existing bonus recipients.

Indeed, the structure of this option is similar to the Alaska Limited Entry Act -- which translates certain very subjective criteria -- such as "economic dependence on the fishery" -- into an objective point system. It does so, of course, at a bureaucratic price -- approximately \$2.5 million a year for a pool of applicants originally roughly equivalent to those which this option would affect. It also does so at other costs, which will be discussed below.

It is not difficult to catalog the criteria which would set our "relocation hardship" pool aside. Duration and continuity of residence would be one criteria, as would, perhaps:

1. income;
2. location of family;

⁵⁸See AS 16.43

3. location of property; and
4. ethnic, religious, and cultural ties.

Although income and duration of residency would play a role in determining eligibility, no one factor alone would be dispositive.

It would not be difficult to translate these factors into a point system; nor would it be particularly difficult to structure that point system to limit the class of successful applicants. The proposal, however, does suffer from the following disadvantages:

1. Since most Alaskan elderly have lived here more than 10 years most Alaska elderly will suffer some demonstrable hardship from relocating elsewhere -- although a certain percentage obviously do not require a longevity bonus to remain;

2. The alternative also involves the establishment and funding of a new bureaucracy -- an intrinsically unworthwhile undertaking, but one which nonetheless would cost far less than simply opening the class to all elderly Alaskans;

3. Perhaps the most obvious disadvantage is the burden that it would place upon elderly Alaskans themselves. There would presumably be a lengthy application form, together with evidentiary requirements, and in some cases, adjudicatory hearings. The Limited Entry Commission is currently involved in some 120 judicial appeals -- a number which is either at or below historic levels. According to the Commission's FY1984

budget presentation, there is a current backlog of some 325 administrative adjudications.

Attorneys will be required -- regardless of what efforts are undertaken to make the process simple and informal. The difficulties facing the elderly applicant are thus rather apparent.

J. GRANDFATHERING

This report closes with one of the simpler alternatives -- opening the class of longevity bonus recipients to all elderly Alaskans with one year's residency, and terminating the program for the future. Persons eligible or becoming eligible this year will be "grandfathered" and will receive a longevity bonus for life. The fiscal impacts of this alternative are, for FY1984, identical to option A, and will obviously decline in the future due to mortality and relocation.

The obvious advantage of this program is that it protects those currently on the longevity bonus program. Equally, it deprives those approaching the age of 65 with any expectation of receiving a bonus.

We believe that this option is constitutionally permissible. The Alaska Supreme Court shares the general view of the constitutionality of grandfathering laws -- as long as the grandfathered class itself is constitutionally defined.⁶⁹ Plainly, the state legislatures

⁶⁹Commercial Fisheries Entry Commission v. Apokadak, 606 P.2d at 1259-61.

have the right to terminate social programs while protecting those who have come to rely on their benefits.

4. CONCLUSION

As noted at the outset, the purpose of this report is merely to provide a threshold feasibility review of various options for amending the longevity bonus program. Through discussions with administration officials, legislative staff members, consultants and private industry, we have attempted to highlight the major issues surrounding each alternative, and provide at least rough information on each question raised. If, after the Judiciary Committee has identified two or three relatively attractive options, the effort expended over the past three weeks on 10 proposals can be condensed into the pursuit of three, proposed legislation and a more intricate analysis of the preferred options can be promptly transmitted.

copy
P.S.

REPORT
TO THE FOURTEENTH LEGISLATURE - FIRST SESSION
AND
TO GOVERNOR BILL SHEFFIELD
FROM
THE STATE SPECIAL COMMITTEE ON THE
ALASKA LONGEVITY BONUS PROGRAM



February 1, 1985

REPORT TO THE FOURTEENTH LEGISLATURE - FIRST SESSION
AND TO GOVERNOR BILL SHEFFIELD FROM THE STATE SPECIAL
COMMITTEE ON THE ALASKA LONGEVITY BONUS PROGRAM

together with

DISSENTING VIEWS AND ADDITIONAL COMMENTS

February 1, 1985

TABLE OF CONTENTS

	<u>PAGE</u>
Introduction	3
Recommendation: Annuity Approach	3
Other Options Considered	7
Major Features	17
1. <u>Front-loading</u>	17
2. <u>The 3% Escalator</u>	23
3. <u>Administrative Costs of the Program</u>	23
4. <u>Choice of Benefits</u>	24
5. <u>Setting the Amount of the Longevity Bonus</u> <u>Payment</u>	24
6. <u>Residency Questions</u>	25
7. <u>Federal Income Tax Considerations</u>	25
8. <u>Annuity Credits Are Not a Vested Right</u>	27
9. <u>Protection of Alaska's Existing Elderly</u>	28
10. <u>Possible Participation Rates</u>	30
11. <u>Impact on OAA and Medicaid</u>	32
12. <u>Costs of Various ALB Alternatives</u>	35
The Benefit Concepts' Proposal	41
The Alaska Pioneers' Home	43
Conclusion	44
Dissenting Views	after 45

Introduction.

In June, 1984, the Alaska Longevity Bonus Program (AS 47.45) was declared unconstitutional because it required recipients to have resided in Alaska both prior to statehood and for 25 consecutive years. The Thirteenth Legislature, 2nd Sess., repealed these lengthy residency requirements, thus opening the program to new participants. Ch. 38, SLA 1984. However, the amended law, by its own terms, is to be repealed effective June 30, 1985. Id., Sec. 11.

The legislation also established the State Special Committee on the Alaska Longevity Bonus Program to "determine the feasibility of replacing the longevity bonus program, as amended by this Act, with an annuity program, a needs-based program, or other longevity program." Id., Sec. 7. This is the committee's report.

Recommendation: Annuity Approach.

The committee has developed a proposal which would phase out the existing longevity bonus program and replace it with individual annuity accounts funded primarily by the permanent fund dividends of participants. 1/ The proposal has been

1/ Three different annuity approaches were initially considered by the committee: (1) SB 465, introduced in the 1984 legislature by several senators; (2) an amended version of HB 700, also introduced in that legislature; and (3) a draft bill prepared by Senator Bill Ray (D., Juneau). The Ray bill became the vehicle for the Committee's proposal. All three proposals involved

introduced in this legislature as SB 56. Under the committee bill, Alaskans who choose to participate in the program will receive monthly benefits, after reaching age 65, of at least the \$250 which is currently provided by the bonus program, inflated by three percent annually.

The program is available to those who reach age 65 after 1985. Under the bill, Alaska's existing elderly will receive their current \$250 bonus, inflated by three percent annually, without having to forego their permanent fund dividends.

The committee bill provides that each year every Alaskan (except those who are 65 or older before 1986) will receive his or her permanent fund dividend in the form of a credit to an annuity account, unless the individual affirmatively elects to receive cash. 2/ Section 2 of the bill envisions that the

foregoing a permanent fund dividend in return for some type of future annuity benefit.

SB 465 would have paid \$16.50 per month to each elderly Alaskan for every permanent fund dividend foregone -- to a limit of \$250 per month.

HB 700 would have given each Alaskan one annuity share for each foregone dividend. Each year, one third of the money available for permanent fund dividends would then be divided by the number of annuity shares held by those over the age of 65. Each elderly Alaskan would receive a portion of that annuity fund commensurate with the number of shares held.

The committee was advised by legal counsel that HB 700 and SB 465 created greater constitutional risks than did the Ray proposal; the committee therefore focused on the concept embodied in Senator Ray's bill.

2/ This aspect of the committee proposal reflects a change from

legislature may, at least in the early years, "front-load" the program by appropriating additional funds into the annuity account, which will be attributed to individual accounts on a prescribed formula. Under that formula, state contributions are greatest for those approaching retirement age, and decline for younger Alaskans. Beginning at age 65, a participant receives an annuity based on his contributions and any front-loading -- plus earnings accumulated on those amounts. 3/

Even with front-loading, it will be years before annuity payments are sufficient to replace the longevity bonus. The ALB program is thus retained at a level which, for those turning 65 after 1985, will be reduced annually. 4/ Under the bill, a "target amount" for the ALB is established (Section 8), which is \$250 per month (in FY 1986) inflated by 3% each year. That target amount is then reduced by the maximum possible annuity which would be available to a 65-year old who has participated in

earlier annuity bills, which required an election to forego cash payment. Because, in the future, the annuity program will be the only state source of non-need-based retirement assistance, the committee believes that each Alaskan should be required to come to grips with the long-term consequences of a decision to take the dividend in cash.

3/ Under the committee bill a participant who dies before age 65 will forfeit his accumulated annuity credits (see the discussion of survivor options at 17, post); the amounts forfeited will be reallocated to surviving participants and thus will increase their annuities.

4/ The longevity bonus itself is, of course, available to all elderly Alaskans whether or not they have also established annuity accounts.

the program in each year since the program's inception. For example, if the inflated ALB "target" for a particular year is \$280, and a person turning 65 who received an annuity credit in each year of the program would be entitled to an annuity of \$100 per month, the ALB payment for all recipients would be \$180. That \$180 will not vary according to the actual participation histories of individual ALB recipients.

Over the years, individual annuity accounts will become greater, and each year the longevity bonus payable to new recipients becomes correspondingly smaller. By the year 2003, the committee projects that the maximum possible annuity will be sufficient to bring an end to the general-funded ALB program, except for those relatively few who were 65 or older before 1986, and are still receiving ALB payments in that year. This is best illustrated by the following chart:

/////

/////

/////

/////

/////

/////

/////

/////

/////

/////

/////

Maximum Possible Annuity 5/ ALB (for all new recipients)

1986	4.37	\$245.63
1990	32.50	248.88
1995	106.27	219.92
2000	255.70	122.45
2005	533.39	-0-

Other Options Considered

The committee invited its members, and others, to suggest alternatives other than an annuity program. Only one was advanced -- a "means test" program under which elderly Alaskans earning less than \$25,000 per year would receive a payment of \$250 per month. Those earning more than \$25,000 would receive a payment of \$100 per month. To qualify for the \$250 bonus, the applicant would be required to submit his or her tax return to the Department of Administration.

This program is intended as a permanent replacement for the ALB. However, the program envisions that the size of the payments, and the \$25,000 income limit, remain constant over the years. In terms of real income, the effect is as follows:

5/ Annuity projections are without "front-loading."

	<u>Maximum Income Eligibility for Bonus (year)</u>	<u>Amount of Bonus</u>	<u>Size of Alternate Bonus</u>
1986	\$25,000	\$250	\$100
2000	\$10,569	\$104	\$41.60
2010	\$ 5,902 <u>6/</u>	\$ 59	\$23.60

It is estimated that, initially, 80% of Alaska's elderly will be eligible for the \$250 bonus. Because that maximum income requirement drops each year in terms of real income, so too does the percentage of eligible elderly. Thus, less than half of Alaska's elderly will be eligible for the bonus in the year 2000, and only 30% will be eligible in the year 2010.

The committee rejected this means test proposal for the following reasons:

1. Any welfare program is contrary to the intent of the ALB program and is vigorously opposed by Alaska's elderly. The Longevity Bonus Program now says to Alaska's elderly that they are a precious human resource, and that it is in the state's interest to provide them with the wherewithall to remain in Alaska after retirement. The means test payment, on the other hand, carries with it quite different, and less favorable connotations.

6/ This is below Alaska's \$7032/year poverty level.

2. Of those who are potentially eligible for the \$250 means test payment, many may not apply because of its welfare connotations. This is strongly suggested by available statistics. Currently, nearly 6,700 ALB recipients -- or 40% of all recipients -- have incomes below the current eligibility limit for existing Old Age Assistance and Medicaid benefits. These benefits are substantial -- averaging \$2,640 per year for OAA and an additional \$2,500 per year for Medicaid. Yet, of the income-eligible, only 2,526 -- or roughly 38% -- have in fact applied for OAA and Medicaid. Certainly, some of the remaining income-eligible have not applied because they have more assets than current law allows. Nonetheless, these statistics manifest an aversion to need-based assistance which has deterred many of Alaska's apparently eligible elderly from applying for substantial benefits.

3. Thus, while 20% of Alaska's elderly will be ineligible for the \$250 bonus, an additional percentage of existing ALB recipients will lose their current benefits because of their unwillingness to participate in a welfare program. For these reasons, this means test proposal fails a threshold test which should be a cornerstone of any longevity bonus legislation. Any ALB alternative, the committee believes, should provide those who have received the ALB over the years with the same benefits as under current law.

4. The proposal hurts both existing and new ALB recipients in another way. Because the real value of both the benefits and

the income ceiling will decrease over the years, fewer elderly will find themselves eligible, and those who are eligible will receive smaller benefits. By the year 2000, for example, less than half of Alaska's elderly will be eligible for a benefit with a real value of \$104 per month, while the majority will receive a token payment with a real value of \$41.60.

5. The proposal is substantially more expensive than the committee bill. Even though: (1) the committee bill protects existing elderly, while this means test proposal does not; and (2) the committee bill inflates the ALB annually, while the means test proposal does not, enactment of this means test proposal would cost nearly \$2 billion more than the committee bill over the next 50 years. Moreover, that cost would be born when the state could least afford it -- after the turn of the century, when oil revenues are projected to rapidly decline. It is important to the committee to develop an ALB alternative which phases out general fund obligations after the year 2000. As part 12 of this report discusses, while post-1999 costs under the committee bill are projected to be \$285 million, 21st century costs under the means test proposal would be roughly \$2.28 billion.

6. The committee has several concerns regarding the \$100 payment for which all elderly would be eligible. First, the committee does not know what that payment is intended to accomplish. It is doubtful that \$100 per month is a sufficient sum to allow any elderly to remain in the state who would

otherwise be financially required to leave. The payment may thus at once be too small to accomplish any social goal, and yet large enough to constitute a substantial drain on the state treasury.

Additionally, many elderly may view the \$100 payment as tokenism. If that is not the case now, it will certainly become so in the future when the real value of that payment shrinks to \$41 (2000) and \$23 (2010).

Finally, since the \$100 and \$250 payments are fundamentally different in purpose, the committee believes that they should be administered under separate programs. The \$100 payment is apparently intended as a residual ALB. On the other hand, the \$250 payment is a form of welfare. This payment, the committee believes, should be administered by the Department of Health and Social Services under the state's welfare laws. Otherwise, the state will, in essence, be creating two welfare bureaucracies -- one for Old Age Assistance, and one for the mis-named "longevity bonus."

7. Fewer people will meet the \$25,000 eligibility requirement as the years go by. Thus, by the year 2010, only 30% of Alaska's elderly will be eligible for this means test payment. Why, it might fairly be asked, are 80% of today's elderly in "critical" need of the higher payment, while only 30% will require the payment in years hence? For one who is currently denied the larger payment, or who may be denied it in the future solely because of inflation, this precise question will invariably be asked, and may be asked in the courts.

8. Finally, in requiring one year's residency in order to receive the \$250 means test payment, the proposal raises a substantial constitutional issue. The current ALB's one-year durational residency requirement is constitutional because the bonus is not dependent upon "need." Under both the federal and Alaska constitutions, if a program provides "the basic necessities of life," a 30-day residency requirement is the maximum constitutionally permissible. Memorial Hospital v. Maricopa County, 415 U.S. 250, 259 (1974); Shapiro v. Thompson, 394 U.S. 618 (1969). Generally, benefits which are accorded on the basis of the recipient's income tend to be viewed by the courts as involving "basic necessities." For example, in Jeffrey v. Colorado State Department of Social Services, 599 P.2d 874 (Col. 1979), the Colorado Supreme Court struck down the lengthy durational residency requirement of that state's old age pension program, and held that the program provided basic necessities of life. The state argued, unsuccessfully, that its program was more akin to an income supplement, rather than a form of welfare. The court, however, ruled that because the size of the pension was a function of the applicant's other income, a 30-day residency requirement was required:

[The state] attempt[s] to avoid the strict scrutiny - compelling state interest test mandated by Shapiro by characterizing the old age pension program as an 'annuity.' However, unlike true annuity or pension programs which are unaffected by a recipient's other income, the old age pension benefit is directly and proportionately reduced by the amount of other income. Thus, the characterization of the old age pension program as an "annuity" puts form over substance and

disregards the nature of the program, which is to fulfill basic needs and not to supplement separate income.

599 P.2d at 879. Emphasis added.

The means test proposal has been defended because of its high income limits. This does make the program different from that involved in Jeffrey, and the committee agrees that this defense could be made in good faith. To the committee, however, that is not enough. Early in the committee's deliberations, the committee agreed to develop a proposal which would avoid serious new constitutional issues and the threat of continued litigation. While any legislation which treats some people differently than others may result in litigation, the means test proposal raises a serious and substantial residency discrimination issue, and therefore does not meet the committee's goal. 7/

For these reasons, the committee does not believe that the means test proposal is a viable alternative to the existing ALB program.

The committee was also aware of the "stair-stepping approach," under which the ALB program is slowly phased out through an annual increase in the eligibility age. Under legislation which passed the House of Representatives during the

7/ Additionally, it should be noted that the issue will become more serious in future years. This is because while the income level is high at the outset, it shrinks dramatically, and in real value falls below the state's existing poverty level in the year 2008.

previous legislature, the eligibility age would begin to rise above 65 in 1991. Although no "stairstepping" proposal was ever advanced by anyone for formal committee review or action, the committee is aware of some continued interest in developing this concept outside of this committee's deliberations. The proposal thus warrants some comment.

First, the term "stairstepping" is a misnomer, since it connotes a gradual phasing out of the ALB program. In truth, the stairstepping approach causes the most abrupt program termination of any option considered, and also results in the most severe discrimination between groups of Alaskans. Under the stairstepping approach, if a person was born on or before June 30, 1925, the state would pay him or her \$250 per month for life. For persons born on July 1, 1925 and thereafter, the state would pay nothing. And, it is irrelevant whether that person is now an Alaskan. A current non-resident who is now 62 would receive \$250/month when he or she moved to Alaska, while a current 59-year old Alaskan would receive nothing. There is thus nothing gradual, or "stairstepped," about this process.

The stairstepping approach would be more expensive than the committee bill, 8/ and much of this added expense would be born after the turn of the century when the state can least afford it. See Section 12. Yet, despite its high cost, stairstepping would

8/ Assuming, of course, that the two had similar provisions dealing with the erosion of the real value of the bonus.

benefit fewer Alaskans. For example, some have assumed that participation in the annuity program is necessary in order for future elderly to benefit from the committee bill. This is not true. Under stairstepping, a person turning 65 in 1991 would receive no ALB whatsoever, while that same person would receive a 1991 ALB of \$222.61 under the committee bill, even if that person had never participated in the annuity program. Thus, for similar total costs, and substantially lower 21st century costs, the committee bill extends the benefits of the ALB program to many more Alaskans.

Most fundamentally, the committee believes that there is a need for future state participation in the building of retirement security that is not recognized in the stairstepping approach standing alone. Apart from the ALB, the principal form of non-need based assistance is, of course, Social Security. Yet Alaska's elderly receive the same Social Security payments as those who reside where the cost of living is much lower. Moreover, Alaska has a uniquely high percentage of elderly who are ineligible for Social Security because of a lack of wage-earning history. Thus, in one area of the state -- Northwest Alaska -- 66% of the region's elderly reported the ALB as their principal source of income.

As oil revenues decline, and economic activity in the state becomes more uncertain, it is entirely possible that the state's future elderly will find themselves in a more precarious position

than today. And, at that point, the state -- for these same economic reasons -- may be unable to help.

One obvious impact of abolishing the ALB program through "stair-stepping" is an increased Old Age Assistance case load. Certainly, when those near the poverty line are denied \$250 per month, they will simply turn to the welfare system, and the state will realize no net saving. Moreover, and as discussed previously, many ALB recipients who are apparently eligible for OAA and Medicaid have in fact not applied for these benefits. Over the years, the ALB program has been defended on the ground that it has enabled many Alaskan elderly to remain off the welfare roles. Statistics bear this out, indicating that many of those ALB recipients who are eligible for OAA and Medicaid have been able to remain off these programs because of the bonus.

For these reasons, stair-stepping by itself is also not being recommended to the legislature.

On the other hand, the principal advantage of "stair-stepping" is the protection which it affords those who are currently on the ALB program, and who have come to rely on both the Longevity Bonus and the permanent fund dividend to sustain themselves. The committee concluded that forcing Alaska's existing elderly to forego their Permanent Fund Dividend in order to assure continued receipt of the "target" Longevity Bonus might work a hardship on these older Alaskans. As a result, the committee decided to include in the bill a so-called "grandfathering" provision which allows those reaching age 65

before 1986 to take their Permanent Fund Dividend in cash and still receive a full Longevity Bonus for the remainder of their lives. The committee legislation, then, is intended to blend the most salutary aspects of both an annuity approach and "stair-stepping."

The virtue of an annuity approach is that it enables the state and each individual Alaskan to set aside funds now for those perhaps more difficult years ahead. It is a program designed to substitute private thrift for public largesse. The committee also believes that the permanent fund dividend is an appropriate source of funds for the annuity program. The purpose of the annuity program is much like the purpose of the permanent fund itself. Moreover, one purpose of the dividend program -- to give each Alaskan a stake in the management of the permanent fund -- will be enhanced if Alaskans' retirement security is at least in part dependent on wise stewardship of that fund.

Major Features.

1. Front-loading. The committee envisions that the legislature may add additional sums to individual annuity accounts. Under "front-loading," a person will receive an annuity account credit greater -- and perhaps substantially greater -- than the amount of cash he or she could have received. It is the committee's hope that the legislature will consider front-loading for each of the program's first three years.

The committee initially analyzed the annuity concept without front-loading. Even without front-loading, annuity payments eventually replace longevity bonus payments from the general fund. Nonetheless, the committee feared that because annuity payments were low in the early years, those Alaskans who are now near retirement age would not participate in the program. Moreover, general fund contributions did not begin to see significant reductions for about 10 years.

Front-loading provides a substantial incentive to individuals to forego immediate cash in favor of retirement security. While it costs more in the initial years, that cost is incurred in years in which oil revenues are expected to remain high. Moreover, general fund contributions to the ALB program taper off rapidly. In other words, because front-loading causes the maximum possible annuity payment to increase, residual longevity bonus payments decrease more rapidly. Thus, dollars invested in early years through front-loading result in a decrease in general fund obligations in later years.

Under the committee bill, substantial front-loading now would actually result in a net savings over the life of the ALB program -- at least in nominal dollars. Thus, if \$79 million were appropriated for front-loading over the next three years, that investment would result in a return of \$82 million in reduced ALB payments over the next 25 years. In constant 1986 dollars, the ultimate cost of investing \$79 million now is \$30 million.

Additionally, front-loading serves other important purposes which the committee believes warrant the cost in constant dollars:

(1) The committee bill will work only if Alaskans participate. If they do not, Alaska's future elderly may still place demands on the general fund; and

(2) A premium may fairly be placed on the current availability of funds. If \$1.00 of general funds front-loaded now returns 75¢ (in constant dollars) years hence, the fact that the general fund has that \$1.00 now, but may not have the 75¢ later, is of some relevance.

Whether front-loading extends beyond the three-year period envisioned by the committee depends on the availability of funds, actual participation rates, and the projected rate of return on subsequent front-loading investments. If front-loading has succeeded in creating substantial participation, continuation would seem unnecessary, since those Alaskans already in the annuity program would be unlikely to drop out. On the other hand, if participation is low, the legislature may wish to consider inducements other than front-loading.

The committee settled on a front-loading concept weighted in favor of older Alaskans. Several other options were also considered. The first was a per-capita contribution made to each Alaskan who chose an annuity credit. Under this option, the annuity accounts of those near retirement age did not increase enough to substantially increase the "maximum possible annuity."

Thus, it did not significantly reduce long-term general fund obligations. Nor did it satisfy the goal of providing the greatest incentives to those who may need them most.

To better accomplish this goal, the committee next considered a straight \$10 incremental increase in front-loading based on age: that is, participants would receive \$10 for each year that they were older than age 17 -- up to age 65. ^{9/} This option produced a better result in terms of reduced general fund obligations, but it still did not increase annuity payments fast enough to be a significant incentive -- to older Alaskans in particular -- to participate in the program.

Finally, projections were run on the option embodied in the bill: persons 18-34 years old would receive a base amount of front-loading in addition to the dividend -- for example, \$50. Those over 34 would receive a percentage increase (for example, 10%) for each year of age over 34, up to age 65. Under this option, front-loading increases on a curve rather than a straight line -- increasing dramatically as an individual approaches age 65. Thus, a \$50 base with 10% per year increases results in a 34 year old receiving \$50, a 50 year old \$211, and a 64 year old approximately \$800.

The incentive to join the program, then, increases dramatically as retirement age approaches. It is this aspect

^{9/} Thus, an 18 year old would receive \$10, a 38 year old \$210, and a 65 year old \$480.

which is most appealing to the committee, for the following reasons:

First, older Alaskans are most in need of incentives to participate. Because initial annuity payments are small, many may be tempted to take a cash payment which is larger than the annual annuity which it will yield. Then, years later, that person will suffer materially reduced benefits because of that short-sighted decision. On the other hand, younger Alaskans need not participate in the program every year in order to build a sizeable annuity. Based upon projections available to the committee, a 47 year old (in 1986) would be required to participate every year in order to achieve the target annuity when he reaches 65 in the year 2004 -- the year the ALB program disappears. Recognizing that financial circumstances may require a cash election in some years, and that some individuals may be ineligible for a dividend in some years, the committee concluded that additional incentives are appropriate beginning at age 35 in order to help ensure that the maximum possible number of Alaskans will achieve the target annuity.

Second, while older Alaskans will receive more at the outset, the front-loading given younger Alaskans will be invested for a longer period of time. To the extent that the percentage differential is commensurate with account earnings, the eventual return to both old and young will be quite similar.

Finally, this option actually costs less in front-loading dollars than the straight line approach -- even though the now-elderly receive larger amounts.

Two additional points regarding front-loading warrant note. First, and as discussed earlier, under the committee bill those who reach age 65 before 1986 do not participate in the annuity program because they are guaranteed a full longevity bonus for life. As a result, in 1985, there will be no front-loading for any individual over the age of 64. In future years, the incremental increase in front-loading will end at age 65, and those over age 65 will receive the same amount of front-loading as a 65-year-old.

Second, the committee bill envisions that the source of front-loading funds may be the earnings of the undistributed income account of the Alaska permanent fund. In past years, permanent fund earnings have exceeded the amount necessary to pay dividends and inflation-proof the fund itself. The resulting surplus comprises the undistributed income account, which has a current balance of \$557 million. That account itself yields annual earnings which are greater than that necessary to provide front-loading, and which are available for appropriation.

The committee concluded that these earnings are an appropriate source of funds for front-loading for one obvious reason: as with the basic structure of the annuity program itself, this aspect of the bill will devote current permanent fund earnings in a manner which will substantially decrease

general fund obligations in later and perhaps leaner years. Once again, however, only earnings are involved. It must be stressed that nothing in the committee bill in any way impairs the integrity of the permanent fund itself.

2. The 3% Escalator.

Since the beginning of the ALB program in 1972, the original \$100 payment has been periodically increased to its current \$250 limit. While that increase seems large, it has, in fact, roughly kept pace with inflation. If the ALB is retained, the committee believes that it is unreasonable to assume that no increase in the ALB will ever be made. The persistent erosion in the real value of the ALB would at some point become so severe that relief would be necessary. For example, assuming a 6% inflation rate, a \$250 ALB now will be worth only \$104 in 15 years.

There are two ways of dealing with the gradual erosion of the value of the ALB. The first is to leave the problem to future legislatures. The second is the approach taken in the committee bill, which provides a modest 3% annual adjustment intended not to precisely keep pace with inflation, but rather to provide certainty in the amount of the payment.

3. Administrative Costs of the Program. The committee bill provides that the legislature may appropriate funds from the annuity account to pay the administrative costs of the annuity

program. 10/ Thus, the costs of the program will be borne by the annuity participants, whether the funds are privately placed or not.

The bill states that administrative costs will be "equitably allocated" among annuity accounts; it is the committee's intent that an equitable allocation will take into account such factors as numbers of participants, age, and relative account balances.

4. Choice of Benefits. Most annuity programs offer participants a choice of options, such as joint and survivor benefits. The primary reason for survivor benefits in employment annuity programs is that among married couples there is often only one wage earner. Survivor benefits are thus available to insure that the dependent spouse is not left without income. Since the annuity program is available to both spouses, just as is the present longevity bonus program, the committee opted for simplicity and did not include a choice of benefits. 11/

5. Setting the Amount of the Longevity Bonus Payment. Section 8 of the bill provides that the longevity bonus payment -- for those who have not reached 65 before 1986 -- is determined by deducting from that payment the maximum possible annuity

10/ If the states chooses to place the funds with private carriers, any costs shifted to the carrier under the contract would also be paid from the annuity accounts.

11/ A death benefit for those who die prior to reaching age 65 has been included in the Senate State Affairs Committee substitute for SB 56.

available to a person who turns 65 in the year in question. The bill uses the annuity available to a 65-year-old because that annuity is the smallest available (among those who have received the maximum possible credits). A 75-year-old with the identical contribution of a 65-year-old will receive a larger annuity because his life expectancy is shorter, and his capital will be returned faster. Thus, some Alaskans will receive more than the target amount during the early years of the program, and no elderly Alaskans (with full participation) will receive less.

6. Residency Questions. The bill has no residency requirements for receipt of annuity payments. Permanent fund dividends are, of course, only available to Alaska residents -- so that an individual must be an Alaskan to contribute to an annuity account. 12/

7. Federal Income Tax Considerations. Currently, both the permanent fund dividend, and the ALB, are taxable as ordinary income under the Internal Revenue Code. The committee engaged tax counsel to determine whether the result would be any different under the committee bill. Specifically, the committee asked whether a person will be taxable on the cash he could have received as a dividend even though, under the new program, he is only credited with the right to receive a future annuity from the state. Counsel advised the committee that, because the annuity

12/ The longevity bonus program will still require that an individual be a one-year resident to receive a bonus.

program is unique, there is no legal precedent which provides a definite answer.

Based on analogous federal tax authorities, tax counsel believes that a crucial factor in determining whether or not an Alaskan receiving an annuity credit will avoid current federal income taxation is the amount with which the legislature "front-loads" the annuity credit in the year the credit is granted. If the legislature provides a substantial front-load to the annuity credit for a particular year, an Alaskan receiving a credit that year should not be subject to tax until annuity payments are actually made on retirement. However, if the legislature provides little or no front-loading in a particular year, there would be a substantial risk that those receiving annuity credits would be taxable immediately on the amount of cash they could have elected in lieu of the credit.

Tax counsel also advised the committee that available precedent does not provide firm guidance on the minimum front-load necessary to support deferred tax treatment of annuity credits. There is an example in the IRS regulations which suggest that a front-load of 25% or more of the annuity credit would be sufficient; however, tax counsel believes that a lesser amount may suffice. Because of this uncertainty, tax counsel suggests that if the committee proposal is enacted, it would be in the state's best interest to obtain an advance ruling from the Internal Revenue Service on the question.

The uncertainty surrounding the tax status of annuity credits, and the substantial risk of taxability when front-loading ends, did not weigh heavily in the committee's recommendation. This is because, at worst, Alaskans would be required to pay taxes on the amount of the dividend just as they do now. Moreover, the committee saw its job as finding an alternative to the ALB program which met the basic goals expressed in this report. It was not charged with simply finding a tax shelter.

Finally, apart from the potential taxability of a permanent fund dividend credited to an annuity account, two favorable tax aspects of the committee proposal should be mentioned:

1. All interest income credited to individual annuity accounts would, under current IRS regulations, be taxable only as it is paid out after reaching age 65; and

2. Front-loading credits would not be currently taxable.

8. Annuity Credits Are Not a Vested Right. The committee bill provides that an individual does not receive a vested or property right to an annuity payment until that payment is made. Funds must be appropriated annually by the legislature from the annuity account to make annuity payments. Although the clear legislative intent of the bill is to provide annuity payments to those who have participated in the program, the committee bill neither binds future legislatures nor creates a dedicated fund. Thus, the legislature may legally appropriate annuity funds for any public purpose. An individual's right to an annuity payment

prior to dispersal is an unfunded, unsecured promise of the state. Thus, a future annuitant is in no better legal position than any unsecured creditor of the state.

As a result, the bill is silent with regard to the garnishment of annuity credits. Prior to annuity payments, there is nothing to garnish or attach, nor anything that can properly be regarded as "income" or an "asset."

9. Protection of Alaska's Existing Elderly. As noted previously, persons who reach the age of 65 before 1986 will not be required to forego their permanent fund dividend in order to receive a \$250 per month Longevity Bonus, inflated 3% annually. The committee decided to integrate this aspect of "stair-stepping" because it concluded that many retired Alaskans have come to rely upon both the ALB and the permanent fund dividend, and -- since they are now retired -- would be unable to make adequate arrangements to mitigate the impact of an abrupt denial (or reduction) in either payment.

Under last session's House bill, those who had reached the age of 60 before 1986 would have received a full ALB for life, although the amount of that bonus would not be increased in future years. The committee considered and rejected the option of extending this protection to 60-year-olds for three reasons:

1. Assuming a retirement age of 65, those under that age will have 1-5 years to make necessary arrangements to accommodate either the loss of a cash dividend, or incremental reductions in the ALB payment. Current retirees, on the other hand, have

little or no ability to alter their financial condition. Thus, while any age group might be said to have some "expectancy" to both an ALB and a cash dividend, that "expectancy" is more immediate, and more critical, for existing retirees;

2. Exempting 60-year-olds from the ALB reduction of the committee bill would not simply postpone the inevitable financial disparity between two groups of Alaskans -- it would aggravate it. Under the House bill, the first reduction in payments would occur in 1991. Because of the growth in the "maximum possible annuity" by that time, the initial difference in monthly ALB payments between an exempt recipient, and a non-exempt recipient who did not forego his dividend, would be \$67.21 per month. Conversely, under the committee bill, differential payments will begin in 1986, and will initially be \$11.92 per month. The committee felt that if some smaller differential were felt immediately, the need to begin participation in the program now would be more apparent to non-exempt recipients. In other words, immediate "stair-stepping" may well encourage higher annuity participation, which in turn will reduce the actual differential treatment between exempt and non-exempt recipients; and

3. The ALB program cannot go on forever. Indeed, it has been a goal of the committee to develop a proposal which phases out general fund obligations near the turn of the century -- when oil revenues are predicted to dramatically decline. If the bill were to protect existing 60-year-olds, the committee projects that the state would still be making general-fund ALB payments of

\$74.9 million in the year 2000, and general fund obligations would not end until the year 2029. Moreover, extending the bill's protection to 60-year-olds would cost an additional \$330 million over the life of the program. In drawing the necessary dividing line between those who can continue to receive the full benefits of existing law, and those who cannot, economic feasibility plays an appropriate role. For the reasons above-stated, the committee believes that the line is best drawn at age 65.

10. Possible Participation Rates. The committee attempted to estimate likely participation rates for the legislation's annuity program. Currently, participation rates in certain voluntary employee retirement plans exceed 50%. There are, however, differences between those plans, and the annuity program established by the committee's bill. Under most employee plans, contributed funds can be withdrawn upon termination, or in case of substantial hardship. Under the committee bill, however, no benefits can accrue until retirement. Additionally, high participation rates in employee plans are, in large part, a function of intensive educational efforts which cannot be duplicated on a statewide basis -- particularly in Alaska. Finally, participation rates for employee plans may be irrelevant in predicting participation by the jobless and very poor.

On the other hand, with front loading, matching contributions which participants receive may be, at least for older Alaskans, substantially more than typical matching payments

by employers. Additionally, under any employee plan, an employee must dedicate a portion of his or her regular monthly salary -- each dollar of which may already have been budgeted for regular family needs. The permanent fund dividend, on the other hand, is an irregular source of income which (for some Alaskans) is not a component of the regular family budget, and hence more readily disposable.

Given these differences, and the unique nature of the annuity program established by this bill, the committee does not believe that any meaningful projection, or even range of projections, can be provided.

If participation rates are very high, by the year 2003 state Old Age Assistance payments may be substantially decreased. Indeed, it is conceivable that a successful annuity program could virtually eliminate the need for old age welfare payments. For example, by the year 2010, every elderly Alaskan who has fully participated in the program will be receiving a monthly annuity of \$1,047.88.

On the other hand, if participation is very low, the state may experience increased old age assistance obligations as the residual longevity bonus phases out.

The only way to guard against future increases in OAA clientele is either to maintain the existing ALB program -- an option which the committee believes is cost-prohibitive -- or convert the ALB itself into a form of welfare. Other options studied (including stairstepping) would not simply threaten, but

inevitably lead to higher OAA obligations. The committee bill, on the other hand, offers Alaska's future elderly at least the opportunity to ultimately avoid the need for OAA assistance -- an opportunity which at least some Alaskans will accept. In other words, even with modest levels of participation, the result would be better than under "stair-stepping."

11. Impact Upon Eligibility For Old Age Assistance and Medicaid.

If an elderly Alaskan earns \$586 or less per month, he or she is eligible to receive federal Supplemental Security Income and/or state Old Age Assistance. There are currently some 2,450 elderly receiving this assistance, and the average benefit is \$240 per month.

Elderly who are eligible for OAA are also eligible for Medicaid. Medicaid benefits are accessed by almost half of the OAA recipients, and the average non-nursing home benefit is \$2,500 per year.

If an elderly Alaskan earns less than \$900 per month, he or she is eligible for nursing home benefits under Medicaid. These benefits are substantial -- averaging \$135 per day, or \$50,000 per year for each individual.

Until 1984, and by virtue of a specific exclusion in federal law, ALB payments did not count as "income" in determining eligibility for SSI or Medicaid. See 42 U.S.C. §1982a(b)(2)(B). However, when the ALB program was changed in

-1984, Congress also amended the exclusion to protect only those who:

1. are 65 years of age on or before September 30, 1985; and
2. have 25 years of continuous residency in Alaska by that date.

This change in federal law has had the following effect on the SSI, OAA and Medicaid eligibility in Alaska:

1. Some 750 current recipients of OAA will experience a loss or reduction in benefits because they are now eligible to receive the ALB, but fall outside the amended federal exclusion. These individuals have not, however, suffered a net loss in cash benefits, since ALB payments have merely replaced previous OAA/SSI payments. While these individuals are the subject of discrimination, since they cannot retain both their ALB and their previous OAA/SSI benefits (as can long-time Alaskans), that discrimination is solely the product of federal law. If the state undertook to cure this discrimination by replacing lost federal SSI benefits, \$1.4 million would be required for FY 1986.

2. Some 314 of the 750 affected OAA/SSI recipients will also lose non-nursing home Medicaid coverage -- a benefit which averages \$2,500 per year. This is a substantial loss which is not compensated for by the ALB program. The amount of lost federal Medicaid benefits to these 314 individuals is only \$413,847 for FY 1986. The state could therefore compensate for these lost federal benefits at relatively small cost.

3. The most substantial impact of the recent federal law change is upon nursing home patients. 36 elderly Alaskans who are currently in nursing homes may lose their Medicaid nursing home coverage as a result of this change. To pay these individuals' nursing home costs entirely through state funds would require a \$720,000 additional appropriation in FY 1986.

The committee bill neither alleviates nor aggravates the problems associated with OAA/SSI benefit reductions, or reductions in non-nursing home Medicaid payments. Unless the legislature were to adopt a needs-based ALB program, virtually any option which the legislature might chose would leave the affected elderly in the same position as under current law. 13/

The committee proposal would, however, probably benefit existing nursing home residents. Under the bill, persons residing in a nursing home are ineligible to receive the ALB. This exclusion, the committee believes, is consistent with and furthers the intent of the ALB program. Its effect is to benefit existing nursing home residents who will lose access to the \$250 a month ALB, but at the same time will retain their eligibility for \$50,000 per year nursing home payments.

13/ Under current federal law, payments which are predicated on need are not counted as "income" for federal assistance purposes. Thus, the means test proposal discussed earlier may avoid the problems discussed in this section -- assuming that federal officials were willing to treat a \$25,000 income limit as truly differentiating the "needy" from the "non-needy."

12. Costs of Various ALB Alternatives. The committee has estimated the costs of various alternatives. Although population figures (and hence program costs) in future years are difficult to predict, several of the alternatives studied -- including the stair-stepping approach and the means test proposal -- envision general fund expenditures well into the next century. The committee felt that it was particularly important to at least estimate costs beyond the year 2000 for two reasons.

First, it has been a goal of the committee to develop a program which phases out general obligations after the turn of the century -- when oil revenues are projected to dramatically decline. Estimating post-2000 expenditures is thus particularly important.

Second, some options envision higher immediate investment in return for lower long term obligations. Others involve smaller near-term expenditures -- an attribute which is paid for in the years to come. A fair comparison, then, can only be made by looking at total expenditures over the life of each alternative.

Chart 1 indicates the costs of making continued ALB payments under four alternatives. This chart assumes that -- whatever program is chosen -- an escalation in the ALB payment will be made as the years go by. As the chart indicates, the cost of continuing the current, expanded ALB program is prohibitive. The second option, the "Annuity Program," reflects the committee bill without grandfathering Alaska's existing elderly. Under this

option, in order to receive the target amount, existing elderly would be required to forego their permanent fund dividends.

The third option -- the "Annuity Program w/1986 Stairstep" -- reflects the ALB costs of the committee bill itself. The "Stairstep" approach refers to last session's legislation, which would begin stair-stepping in FY 1991. Finally, projections on the means test proposal which assume escalation have not been run.

Assuming that the legislature provides a 3% per annum increase in the ALB payment, the ALB costs of the options considered are as follows:

Chart 1

ALB COSTS THROUGH 2034
WITH 3% ESCALATOR (in millions)

	<u>Nominal \$</u>	<u>Constant \$</u>	<u>Present Value</u> ^{14/}
Current Law	13,087	2,501	1,393
Annuity Program	964	605	496
Annuity Program w/1986 Stairstep	1,290	735	584
Stairstep	1,455	745	577
Means Test	N/A	N/A	N/A

14/ The term "Nominal \$" is self-explanatory. The term "Constant \$" refers to costs expressed in 1986 dollars -- assuming 6% annual inflation. The term "Present Value" refers to the amount of money which, if invested now, would endow the various options through the duration of each.

Conversely, if the legislature held the amount of the ALB constant over the years instead of providing a regulator escalator, the ALB costs of the option would be:

Chart 2

ALB COSTS THROUGH FY 2034
WITHOUT ESCALATION (in millions)

	<u>Nominal \$</u>	<u>Constant \$</u>	<u>Present Value</u>
Current Law	5,419	1,391	880
Annuity Program	619	432	369
Annuity Program w/1986 Stairstep	864	539	444
Stairstep	1,040	586	470
Means Test	3,199	945.9	634.9

In addition to the general fund costs of (1) continuing the current ALB for existing recipients, and (2) providing a gradually reduced ALB for new recipients, the committee bill envisions that individual annuity accounts will be "front loaded" with funds drawn from the earnings of the undistributed income account of the Alaska permanent fund.

Estimating the costs of "front loading" is a three step process. First, the committee assumed that the legislature would provide sufficient front loading to allow those 35 and younger to receive a \$50 base supplement, and those over 35 to receive a supplement which is increased 10% for each year of age up to 65. Second, the committee assumed that participation rates would be very low in younger Alaskans, and extremely high for those older Alaskans receiving the greatest front-loading. The cost of "front load payments" under those assumptions -- with and without

the grandfathering of existing recipients are reflected in Chart 3.

Finally, the effect of front loading is to more rapidly reduce the "target" ALB, and hence reduce general fund obligations. Thus, the net cost of any front loading must be offset by "ALB savings," which are also reflected in Chart 3:

Chart 3

EFFECT OF 3-YEAR FRONT LOADING
(in millions)

	<u>Nominal \$</u>	<u>Constant \$</u>	<u>Present Value</u>
<u>Annuity Program (3% Esc.)</u>			
Front-Load Payments	113	101	96
(ALB Savings)	<u>(126)</u>	<u>(69)</u>	<u>(31)</u>
Net Cost (Savings)	(13)	32	65
<u>Annuity Program (No Esc.)</u>			
Front-Load Payments	113	101	96
(ALB Savings)	<u>(91)</u>	<u>(57)</u>	<u>(46)</u>
Net Cost (Savings)	22	44	50
<u>Annuity & 1986 Stairstep (3% Esc.)</u>			
Front-Load Payments	79	71	67
(ALB Savings)	<u>(82)</u>	<u>(41)</u>	<u>(31)</u>
Net Cost (Savings)	(3)	30	36
<u>Annuity & 1986 Stairstep (No Esc.)</u>			
Front-Load Payments	79	71	56
(ALB Savings)	<u>(56)</u>	<u>(30)</u>	<u>(23)</u>
Net Cost Savings	23	41	44

The net costs (or savings) of front loading for any particular program can then be added (or subtracted) from the appropriate column of Charts 1-2. From that exercise, it is

apparent that front loading does not materially affect the cost ranking of any of the options considered.

Finally, under stair-stepping, those who do not reach age 65 by FY 1990 will receive no longevity bonus. Of those who are denied the bonus in the future, a portion will apply for state Old Age Assistance. As noted previously, a number of current ALB recipients are apparently eligible for OAA and Medicaid but have not applied because of the bonus. There is thus a segment of Alaska's elderly who are now eligible for OAA and Medicaid, and who might apply for benefits under those programs if the ALB were denied.

It is difficult to predict the number of elderly who would actually turn to state welfare assistance if and when the ALB program were terminated. Currently, one out of every 2.65 income-eligible ALB recipients actually applies for OAA. Under the "moderate low" scenario of Chart 4, one half of those elderly would apply for OAA. Under the "moderate high" scenario, two-thirds of the eligible elderly would apply for assistance once the bonus program were terminated. Cumulative costs, 15/ in increased OAA and Medicaid benefits, through the year 2010 under these two scenarios are as follows:

15/ The cost estimates in Chart 4 should be viewed as substantially equivalent to constant 1986 dollar estimates. Although they are technically nominal dollars, they assume no increase in OAA or Medicaid benefits as the years go by. If one assumes that OAA and Medicaid benefits keep close pace with inflation, these estimates would then better reflect constant

Chart 4

INCREASED OAA/MEDICAID COSTS THROUGH 2010
(in millions)

Moderate Low

81.3

Moderate High

150.2

It is possible that increased OAA costs would also result from the committee bill. Although, under the bill, the ALB is gradually phased out, rather than abruptly terminated, those new elderly who have not participated in the annuity program may eventually find themselves in need of welfare assistance. The degree of that problem, of course, is a function of participation rates -- which are difficult to determine. However, because -- under the committee bill -- the ALB is phased out, rather than abruptly terminated, 16/ and because a portion of Alaska's population will participate in the annuity program, the committee believes that -- even with low participation rates -- the impact of the bill upon old age assistance programs is likely to be less severe than under the stairstepping approach.

Finally, the committee looked at the cost of various options after 1999. As noted previously, it has been a goal of the

dollar costs.

16/ Thus under stairstepping, a person turning 65 in 1991 would receive no ALB whatsoever. On the other hand, under the committee bill, a person turning 65 in 1991, and who has not participated in the annuity program, will still receive a longevity bonus of \$222.61 per month.

committee to develop a longevity bonus program in which general fund obligations would be minimized as oil revenues declined. Chart 5 indicates the cost of stairstepping, the means test proposal and the annuity program with and without stairstepping, which would be incurred in the 21st century:

Chart 5

COSTS INCURRED AFTER YEAR 1999
(in millions: Nominal \$)

<u>3% Escalation</u>	
Annuity Program	69.9
Annuity Program w/1986 Stairstep	285.3
Stairstep	588.3
Means Test	N/A
 <u>No Escalation</u>	
Annuity Program	0
Annuity Program w/1986 Stairstep	128.4
Stairstep	291
Means Test	2,486.2

The Benefit Concept's Proposal

The committee investigated an approach proposed by Benefit Concepts, Inc. and Kidder Peabody & Co., Inc. The proposal is essentially an investment program for endowing the longevity bonus program. That is, a substantial investment (approximately \$350 million) would be made in the initial years of the program, and the return from that investment is estimated to be sufficient

to make the declining longevity bonus payments required under the committee's annuity approach. 17/

Benefit Concepts proposes that the state invest in single premium whole life insurance policies (SPL's) taken out on Alaska's elderly. The state would be the owner and beneficiary of the policies. Benefit Concepts' projections indicate that this type of investment would be superior to other options which they believe would be appropriate for such an investment plan, such as guaranteed investment contracts (GIC's), corporate bonds or government securities.

The Benefit Concepts proposal was analyzed by the actuarial firm of Johnson & Higgins at the committee's request. That firm concluded that (1) the costs of the program may be understated when compared with data used by OMB (see footnote); (2) should the state consider "endowing" the ALB program, it should not limit its choices to the low risk alternatives considered by

17/ Subject to available funds, the state could "endow" any program by investing enough cash to produce the revenue to pay the costs of the program. Indeed, the concept of "endowment" is implicit in the "present value" calculations made by the Office of Management and Budget for the longevity bonus alternatives analyzed. Two points deserve attention. First, in order to avoid dedicated fund problems, the income from any such investment would be deposited in the general fund, and subject to annual appropriation to pay program costs. Second, the assumptions used by Benefit Concepts in making their cost estimates differ in two important respects from the assumptions used by OMB. Benefit Concepts used different population projections, and assumed a different interest environment. Both these differences understate the cost of their proposal when compared with programs using OMB estimates. The committee, therefore, cautions against direct cost comparisons.

-Benefit Concepts, but should also examine other investment options; and (3) the primary advantage of the SPL approach over other low risk investments is the substantial tax advantage available to some insurance companies in providing this type of policy. These tax advantages are under scrutiny by the federal Treasury Department, and could well be eliminated through revisions to the Internal Revenue Code in the near future. It would be likely that an insurance company would insist on passing any tax changes through to the policy holder, thus removing the advantage of this type of investment.

The committee is unable to make a firm recommendation regarding this proposal to the legislature but believes that the concept may warrant further consideration by the state's financial experts.

The Alaska Pioneers' Home

On July 30, 1984, Governor Sheffield requested the committee to consider expanding its inquiry to include Alaska's Pioneers' Home Program. Because of time constraints, and the fact that the committee developed an alternative to the ALB program which has no application to the Pioneers' Home, the committee was unable to consider alternatives to this program in any depth.

The committee, however, shares Governor Sheffield's concerns over the program. Under AS 47.25.030, an individual must have resided in Alaska for 15 consecutive years, or 30 total years, in


order to be eligible for admission to the homes. Plainly, that requirement raises substantial constitutional questions.

To date, no one has filed suit over the Pioneers' Home eligibility requirements. It is this committee's recommendation that the legislature develop and consider alternatives to the existing residency requirements during this session. The pressure and tension created by the Vest litigation has made it more difficult, over the past 2½ years, to develop a sound replacement for the ALB program. That experience need not, and should not be repeated for the Pioneers' Homes.

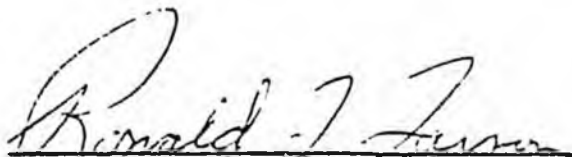
One alternative for replacing the current residency requirements warrants note. The legislature may wish to develop a point system that would determine eligibility for Pioneers' Home admission based upon the hardship that would be suffered if the applicant were forced to seek housing out of state. Location of home, family and friends would all be relevant to assessing that hardship; yet hard and fast residency rules would be avoided.

Conclusion

The undersigned members of the committee respectfully recommend that the legislature consider and enact the annuity proposal discussed in this report.



Governor Jay S. Hammond



Representative Ronald Larson

Bill Ray
Senator Bill Ray

Olga T. Steger
Olga T. Steger

~~Valmar M. Kerttula~~
Senator Valmar M. Kerttula

Robert C. Kallenberg
Robert C. Kallenberg

JAN 12 1985

IN THE _____

BY _____

_____ BILL NO.

IN THE LEGISLATURE OF THE STATE OF ALASKA

FOURTEENTH LEGISLATURE - FIRST SESSION

A BILL

For an Act entitled: "An Act amending the longevity bonus program and the permanent fund dividend program in order to establish an annuity program; and providing for an effective date."

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF ALASKA:

* Section 1. FINDINGS AND PURPOSE. The legislature finds and declares that

(1) it is in the public interest to continue the longevity bonus program. However, as oil reserves decline over the years, it will become increasingly difficult to provide the benefits of the longevity bonus program through the general fund. As a result, that program must be phased out over the years;

(2) it is appropriate that individuals save for their own retirement, and it is also appropriate that the state establish both means and incentives for Alaska residents to set aside retirement funds. Accordingly, it is a purpose of this legislation to create an annuity program, and to encourage Alaskans to participate in that program by authorizing general fund supplements which would result in annuity payments which are larger than an individual could earn through private investment of the permanent fund dividend;

(3) many retired Alaskans have made their retirement plans in reliance on the availability of both the existing longevity bonus and the permanent fund dividend. Accordingly, the legislature finds that it is appropriate to continue both those programs for these individuals;

(4) the most suitable source of funds for the annuity program created by this Act are those permanent fund earnings currently distributed as dividends. This Act applies the annual permanent fund dividend of younger Alaskans to annuity accounts unless the individual alternatively elects to receive cash. In so doing, this Act will promote wise stewardship of the permanent fund by giving each participant a direct financial stake in its long-term profitability; and

(5) neither the longevity bonus program, nor the annuity program, should be viewed as a form of welfare. Other state and federal programs are available to meet the basic necessities of life, and amounts received by any individual under this Act are not calculated on the basis of need.

* Sec. 2. AS 43.23.005 is amended to read:

(c) A parent, guardian, or other authorized representative may claim a permanent fund dividend on behalf of an unemancipated minor or on behalf of an incompetent individual who is eligible to receive a dividend [PAYMENT] under this section.

* Sec. 3. AS 43.23.005 is amended by adding a new subsection to read:

(d) A person who is eligible to receive a permanent fund dividend under this section, or who is authorized to claim a dividend on behalf of another under (c) of this section, may elect to receive cash in lieu of an annuity share. Alternatively, a person may elect to receive not less than 25 percent of his dividend in cash and the remainder as an annuity credit. A person exempt under AS 47.45.015(b) will automatically receive cash without the necessity of election.

* Sec. 4. AS 43.23.015 is amended to read:

Sec. 43.23.015. APPLICATION AND PROOF OF ELIGIBILITY. (a) The commissioner shall adopt regulations under the Administrative Procedure Act (AS 44.62) establishing the process for determining the eligibility of individuals for permanent fund dividends. The

commissioner may require an individual to provide proof of eligibility, and the commissioner may use other information available from other state departments or agencies to determine the eligibility of an individual.

(b) The department shall prescribe and furnish an application form for claiming a permanent fund dividend. The application must contain a statement of eligibility and a certification of residency in substantially the following form:

I certify that

() I am a state resident on the date of this application and I have been a state resident for at least six months immediately preceding the date of this application; or

() (name), the individual on whose behalf I am applying, is a state resident and has been a state resident for at least six months immediately preceding the date of this application.

I understand that a false claim of residency to obtain a permanent fund dividend for myself or for another is a criminal offense and that if convicted I will forfeit future permanent fund dividends and that I will lose or must repay all permanent fund dividends that have been credited or paid to me, including any accrued interest in my annuity account. I understand that this penalty is in addition to any criminal penalties imposed.

(signature of individual,
parent, guardian, or other
authorized representative)

(c) Except as provided in (d) of this section or as may be provided by regulations adopted by the department, an individual must personally sign the application for permanent fund dividends,

including the certification of residency required under (b) of this section.

(d) The application and certification of residency of an unemancipated individual under 18 years of age or of an incompetent individual must be signed by the individual's parent, legal guardian, or other authorized representative.

(e) If a public agency claims a cash [PERMANENT FUND] dividend on behalf of an individual under (i) of this section, the public agency shall hold the dividend in trust for the individual. Money held in trust under this subsection shall be invested by the commissioner in accordance with AS 37.10.070.

(f) A minor or an incompetent individual may not maintain a claim against the state or any officer or employee of the state based either on the manner in which the parent, guardian, or authorized representative other than a public agency of the state managed or disposed of permanent fund dividends received on behalf of the minor or incompetent, or any election made or not made on that individual's behalf under AS 43.23.005(d).

(g) If an individual is aggrieved by a decision of the department determining the individual's eligibility for a permanent fund dividend or the individual's authority to claim a permanent fund dividend on behalf of another, the individual may appeal that decision to the superior court in accordance with AS 44.62.560. An appeal under this section does not entitle the aggrieved individual to a trial de novo. The appeal shall be based on the record of the administrative proceeding from which appeal is taken and the scope of the appeal is limited to matters contained in the record of the administrative proceeding.