



## OPTIONS TO ADMINISTER LEGACY FUND EARNINGS

### CURRENT DEFINITION AND PROCESS

The State Treasurer transfers the earnings of the legacy fund to the general fund at the end of each biennium pursuant to Section 26 of Article X of the Constitution of North Dakota. The earnings of the legacy fund include interest, dividends, and realized gains and losses as defined in North Dakota Century Code Section 21-10-12. The current administrative process is based on transferring all the biennial earnings of the legacy fund to the general fund in accordance with these constitutional and statutory provisions.

As a reference, the administration of common schools trust fund earnings reflects a distribution method separate from the earnings of the fund. The earnings of the common schools trust fund are reported in the annual financial statements published by the Department of Trust Lands. The method of distributing earnings from the common schools trust fund is based on 10 percent of the 5-year average of the fund's assets pursuant to Section 2 of Article IX of the Constitution of North Dakota.

### POTENTIAL CONCERNS WITH THE CURRENT ADMINISTRATIVE PROCESS

- **Cashflow** - Even though the earnings are transferred to the general fund on the last day of the biennium, the funding associated with the earnings is included in the current biennial budget as revenue; therefore, the earnings may be appropriated and spent up to 24 months before the cash from the earnings is available to pay for the expenditures. This could result in the general fund having insufficient cash to pay for the expenditures. This issue will become more of a concern as the earnings become a greater share of state revenues.
- **Budgeting** - Under the current process, the Legislative Assembly must finalize the revised revenue forecast for the current biennium as well as develop the state budget for the next biennium prior to the earnings amount being known. Because the earnings are generated from the performance of investments, the earnings can be volatile making it difficult to determine a reasonable and reliable estimate. Any significant variance in the earnings affects the budgets of both bienniums.
- **General fund balance** - Because the earnings are recognized as part of the current general fund budget in which the earnings are transferred on the last day, if the investments experience losses in the last couple of months of the biennium, the final general fund balance could become negative which would require the Governor to direct agencies to reduce their budgets in the final days of the biennium. Alternatively, the general fund could have a large surplus if the investments of the legacy fund experience gains in the last couple of months of the biennium.
- **Replacing oil revenues** - The primary purpose of the fund is to replace oil and gas tax revenues when oil and gas development activity decreases. Legacy fund earnings may not be sufficient to replace declining oil and gas tax revenues if the earnings are fully committed to supporting ongoing spending items before oil production declines.
- **Appropriate use of legacy fund earnings** - The committee is studying the potential uses of legacy fund earnings, which includes consideration of how the earnings can be used for the state's current and future needs.

### SUGGESTIONS PRESENTED TO THE COMMITTEE

The committee received information from the State Investment Board regarding a proposed method of distributing legacy fund earnings. The proposal suggests using a percentage of the market value of the fund based on the average value of the fund over multiple years, similar to the method used for the common schools trust fund.

The committee received information from a representative of the State of Alaska, who recommended transferring a portion of the earnings back to the legacy fund for reinvestment to increase the future returns of the fund.

Interested persons provided comments to the committee at the November 12-13, 2019, meeting regarding proposed uses of the legacy fund earnings. The comments are summarized in a memorandum entitled *Summary of Comments Submitted to the Legacy Fund Earnings Committee* (LC# 21.9223.01000).

## **OPTIONS TO ADMINISTER THE LEGACY FUND EARNINGS**

The potential concerns related to the administration of the legacy fund earnings may be addressed with constitutional or statutory changes.

### **Type of Change**

- **Constitutional change** - The benefits of a constitutional change include clarifying the priorities of the fund and making the changes more permanent (constitutional provisions cannot be changed without a vote of the people). However, a constitutional change may result in timing delays associated with the implementation of a constitutional change, and any future changes to address changing circumstances must be approved by a vote of the people.
- **Statutory change** - Benefits of a statutory change include a shorter time frame to implement the changes and flexibility to make future adjustments as circumstances change. The challenges of a statutory change include the potential for frequent changes and situations in which earnings may be used to meet the short-term needs of the state at the expense of the state's long-term plans.

### **Committee Action**

Although there are a number of options to address the administrative challenges of the legacy fund earnings, the following suggestions for either a constitutional change or a statutory change are intended to provide the committee with a starting point for consideration of any changes the committee may recommend.

#### **Constitutional Change**

The committee could recommend a constitutional amendment and a bill draft to implement constitutional changes relating to the administration of the legacy fund earnings. The constitutional amendment would:

- Use a percentage of the market value to provide distributions from the legacy fund;
- Change the distribution date from the end of the biennium to a specific date in the fall of odd-numbered years; and
- Allow certain criteria to be established statutorily, such as the specific percentage and the destination of the distributions.

The bill draft would:

- Address the use of the legacy fund earnings transferred to the general fund at the end of the 2019-21 biennium as determined by the committee; and
- Establish the percentage and destination of the distributions to be distributed early in the 2023-25 biennium if the constitutional measure is approved by the voters in November 2022.

#### **Statutory Change**

The committee could recommend a bill draft to implement statutory changes relating to the administration of the legacy fund earnings. The bill draft would:

- Direct the State Treasurer to immediately transfer the legacy fund earnings, which are transferred to the general fund at the end of the biennium using the current earnings definition, to a legacy earnings fund;
- Determine the amount available to be spent from the legacy earnings fund by calculating a percentage of the market value of the legacy fund based on the average value of the fund over multiple years;
- Retain any excess earnings in the legacy earnings fund as an earnings reserve fund to offset any potential future decreases in legacy fund earnings;
- Allow for investment of the earnings reserve fund by the State Investment Board using the same policies as the legacy fund;
- Distribute the earnings from the legacy earnings fund in the subsequent biennium (For example, 2019-21 biennium legacy fund earnings would be transferred to the legacy earnings fund at the end of the 2019-21 biennium and distributed for use in the state budget in the 2021-23 biennium); and
- Appropriate or transfer the amount available to be spent as determined by the committee.