

North Dakota Legislative Council

Prepared for the Legacy Fund Earnings Committee LC# 21.9384.01000 September 2020

TRANSFER OF LEGACY FUND EARNINGS

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
 months of the biennium, the final general fund balance could become negative which would require the
 Governor to direct agencies to reduce 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
 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.

POTENTIAL BENEFITS OF USING A SPECIAL FUND

- Cashflow Transferring the legacy fund earnings to a special fund removes the funding from the general
 fund budget and provides a cash balance for spending in the subsequent biennium. As a result, the cashflow
 should be sufficient to pay for the expenditures.
- Budgeting Using the percent of market value based on historical fund values to calculate the amount
 available to be spent from the special fund allows the Legislative Assembly to budget with known amounts
 rather than estimates. Although investment earnings can vary significantly, the general fund budget would
 not be directly impacted by changes in the investment earnings that occur after the calculation.
- General fund balance The general fund balance would not be directly impacted by the legacy fund earnings
 if the legacy earnings are transferred to a special fund. As a result, any potential shortfall or surplus in the
 general fund would not be attributed to the legacy fund earnings.
- Replacing oil revenues Separating the legacy fund earnings from the general fund budget allows the
 Legislative Assembly to identify the spending of the earnings and may help to ensure the spending levels are
 balanced with the need to replace declining oil and gas tax revenues.
- Appropriate use of legacy fund earnings If the earnings are transferred to a special fund, the Legislative
 Assembly will be able to identify the spending of legacy fund earnings and will be able to evaluate the
 appropriateness of the spending.

CONSTITUTIONAL RESTRICTIONS

The State Treasurer is required to transfer 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. After the earnings are transferred to the general fund, the Legislative Assembly may appropriate or transfer the funding for any legally authorized purpose. The constitution does not limit the purposes for using the legacy fund earnings after the earnings are transferred to the general fund. As a result, the legacy fund earnings may be transferred to a special fund after being deposited in the general fund.