

2015 SENATE GOVERNMENT AND VETERANS AFFAIRS

SCR 4014

2015 SENATE STANDING COMMITTEE MINUTES

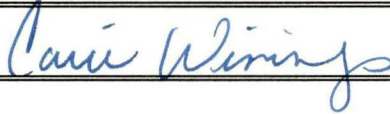
Government and Veterans Affairs Committee

Missouri River Room, State Capitol

SCR 4014
2/19/2015
Job # 24124

- ☐ Subcommittee
☐ Conference Committee

Committee Clerk Signature



Explanation or reason for introduction of bill/resolution:

A concurrent resolution directing the Legislative Management to study reinvestment scenarios and potential priorities for legacy fund earnings.

Minutes:

Attachments 1 - 3

Chairman Dever: Opened the hearing on SCR 4014.

Senator Armstrong, District 36: Testified as sponsor and in support of the bill. The work put into the Legacy Fund Initiative Committee was phenomenal. The people involved came from a variety of background and locations. This fund was set up to span generations. When you are dealing with oil and gas, regardless of technology, eventually it will decline. This resolution is a study to determine different ways to look at spending the money. My wife is from Norway and they have their Sovereign Wealth Fund. They were a poor country for many years and they will never be poor again. With the growth of their fund, which is exponentially bigger than ours, they also have problems with management and different competing interests looking at saving it, spending it, spending some of it, and various other options out there. I think at the end of the day, this is a legislative management study before we start making decisions on the fund. I think it is more important now because of the oil prices currently being down. The more money that you take out of the interest, the harder it is for a fund to build. I think at the end of December 2014 we had \$2.8 billion dollars in the fund. They are many scenarios that could be discussed. I hope that we never spend the principle of that fund unless there is a catastrophic emergency in which we do not have a choice. Reinvesting 75% of the fund back in is what is being recommended. The people want this fund to be a generational fund. They want the fund to replace oil and gas when the time comes. The 25% was simply the 25%. I thought it was a conservative idea. I thought it was a conservative plan. This is just to study the investment scenarios of the fund and delegate if and when we want to have some kind of a plan for the interest whether that would be invest it all, spend it all, etc. We need to have data available to us for decisions to be made. The Sovereign Wealth Fund in Norway is real time and it is the most transparent fund in the world. There is a frustration level of not understanding the fund we have and one of the big things that is important with this fund is that we need to make it transparent and accessible to people.

(7:30)Senator Cook: Last session we passed a similar study, are you suggesting we should study again?

Senator Armstrong: Yes. I think we should continue to look at this. I think that this is important to the legacy of North Dakota and we should focus on knowing how much money this could earn under different scenarios and what we can potentially fund.

Senator Flakoll: During the interim they focused more largely on how to invest the dollars to grow the fund. Is your proposed study more of how to put dollars to work for betterment of the state of North Dakota?

Senator Armstrong: Yes, that and also maybe run some tables of what the earnings could be under different scenarios.

Chairman Dever: Does the "whereas" commenting on the reinvestment of 75% suggest a conclusion to the study at the beginning?

Senator Armstrong: The "whereas" for the 75% was taking what the interim committee's final decision was. I would leave it up to this able committee to change whatever they feel necessary. I am comfortable with that and I know that there are people that won't be. I just want to see it studied so that we know what we are doing before we make any decisions.

Senator Nelson: Where do you see the budget stabilization and legacy fund advisory committee fitting in with this? We seemed to be out of the loop the last time?

Senator Armstrong: I was frustrated as well. I think that this is the one that we need to look at and protect. We need to understand what we are doing with it.

Senator Cook: I want to clarify. This 75% language came from the interim committee?

Senator Armstrong: It came from the group I worked on in the interim. It is the "therefore" stuff that matters.

Senator Flakoll: I view that as just a fact; if that were to happen, the 75%. Not necessarily that we have to do this.

Senator Armstrong: You need a number to start from. Then you can extrapolate the rest.

(13:04)Rod Backman, Legacy Fund Initiative Participant: See Attachment #1 and #2 for testimony in support of the bill.

(15:40) Senator Nelson: Referring to attachment #2, this is the first time I have seen this. There are four legislators on that advisory committee, and could you get this to all committee members?

Rod Backman: I will make sure of that.

Chairman Dever: If we reinvest money into the fund, then that money comes from the earnings, is that still constitutional or statutory?

Rod Backman: As I see it, the constitutional measure simply provides that the earnings go to the general fund. This resolution becomes more of an intent, but I believe this is going to be a decision made by each subsequent legislature. It is up to each legislature to make that decision. Going forward it would be a legislative decision.

Chairman Dever: I think that is true. My question is if 2017 legislature decides to leave the earnings from the fund in the fund, then do those earnings in the next biennium become constitutionally protected or are they available to the 2019 legislature?

Rod Backman: You are right; I do not know the answer to that.

Chairman Dever: My recollection was that the legislature could choose to put additional funds into that fund if they chose.

(17:55)Dina Butcher, Partner, WT Butcher & Associates: See Attachment #3 for testimony in support of SCR 4014.

(21:55) Senator Cook: I had a chance to visit with the deputy tax commissioner from Alaska a few years ago and he also added that when the checks go out, spousal abuse goes through the roof and the jails are full for the next week. You have an obvious interest in this and you spent time on this taskforce, what types of meetings did you have?

Dina Butcher: We met in person on 4 to 5 occasions. We had some committees appointed out of that that studied certain parts of it and those were often teleconference.

Senator Cook: Did you realize that there was a legislative interim committee doing the same thing?

Dina Butcher: Yes, and we looked at what the legislation was that the interim committee was to have done and you did establish a system but it was my understanding that you did not have all of the projections through that committee. I may be wrong on that.

Senator Cook: I am trying to distinguish how we do this and do it right because this creates another legislative interim committee. Why did you not come the legislative interim committee and share your interests and ideas?

Dina Butcher: I have been out of the legislative and government arena for a number of years and this was an experience to learn more about it. I did not have expertise to come before your committee during your meetings.

Senator Cook: My biggest disappointment on that committee as we were studying this issue was that I cannot walk down the streets of Mandan without someone giving me an idea of what to do with the money, yet during the interim committee no one came.

Dina Butcher: I think it is a learning curve issue. When there isn't publicity about something, people don't necessarily know the issues and that is one of the things that I found was so good when we went out into the communities and why I think the conversation has to continue. The broader the base of people who get the information, the more likely we are to come up with the right decisions.

Chairman Dever: Did you talk about how much money it is that we will be asked not to spend in the next session?

Dina Butcher: We did not have that information. I do not recall that being part of the discussion. We looked at all those buckets of funds and saw what you did have available to you which seemed enough to fund North Dakota operations according to whatever budgetary scenarios come from revenues coming in and what you must fund.

(26:00)Patrice Lahlum, Program Consultant, Great Plains Institute and Co-Director, Legacy Fund Initiative: Testified in support of the bill. This project was born out of a 2012 energy delegation to Norway. We went there to study energy policy and technology but we also learned a lot about their Sovereign Wealth Fund. The Attorney General was with us on that trip as well as the Ag Commissioner. The Bank of North Dakota president was with us and the Chancellor of Higher Education. We were told to seek funding to study in depth the legacy fund and future opportunities. We sought grant funding and received a grant from the Northwest Dairy Foundation to fund the initiative. When we launched the initiative we sat down with Senator Wardner to talk about whom would best represent the Senate on our committee. Senator Armstrong and Senator Schneider were the folks that ended up serving with us. We were aware of the study that was taking place in the interim. We followed that process and saw your draft bill indicating your desire to reinvest all of the earnings. We had several state officials at our meetings. As far as our initiatives ability to come before your interim committee, our process did not conclude until November of this year. I reached out to that interim committee Legislative Council staff and you had already held your last meeting. We were hoping to present the initiative recommendations to that interim committee. It was more an issue of timing. We met in person 7 times and had multiple webinar calls with a variety of state officials and others. We spent a lot of time learning, from not only other countries, but a dozen other states that have wealth funds of one nature or another. I hope you can take the time to look at the report and the findings. It was a tremendous opportunity.

Chairman Dever: Closed the hearing on SCR 4014.

2015 SENATE STANDING COMMITTEE MINUTES

Government and Veterans Affairs Committee Missouri River Room, State Capitol

SCR 4014
2/19/2015
Job # 24146

☐ Subcommittee
☐ Conference Committee

Committee Clerk Signature



Minutes:

Attachments 1

Chairman Dever: Opened SCR 4014 for committee discussion.

Senator Flakoll: See Attachment #1 for proposed amendment.

Senator Cook: Moved Amendments proposed. (Attachment #1)

Senator Poolman: Seconded.

A Roll Call Vote Was Taken: 7 yeas, 0 nays, 0 absent.

Motion Carried.

Senator Flakoll: Moved a Do Pass As Amended.

Senator Nelson: Seconded.

A Roll Call Vote Was Taken: 7 yeas, 0 nays, 0 absent.

Motion Carried.

Senator Flakoll will carry the bill.

PROPOSED AMENDMENTS TO SENATE CONCURRENT RESOLUTION NO. 4014

Page 1, line 19, remove "seventy-five percent of annual legacy fund earnings from 2017 through 2039,"

Page 1, line 19, after "if" insert "legacy fund earnings are"

Page 1, line 20, after the comma insert "the fund"

Page 1, line 20, remove "the legacy fund"

Renumber accordingly

TU
2/19/15

2015 SENATE STANDING COMMITTEE
ROLL CALL VOTES
BILL/RESOLUTION NO. 4014

Senate Government and Veterans Affairs Committee

☐ Subcommittee

Amendment LC# or Description: Flakoll Amendment

Recommendation: ☒ Adopt Amendment Attachment #1
☐ Do Pass ☐ Do Not Pass ☐ Without Committee Recommendation
☐ As Amended ☐ Rerefer to Appropriations
☐ Place on Consent Calendar

Other Actions: ☐ Reconsider ☐

Motion Made By Cook Seconded By Poolman

Senators	Yes	No	Senators	Yes	No
Chairman Dever	✓		Senator Marcellais	✓	
Vice Chairman Poolman	✓		Senator Nelson	✓	
Senator Cook	✓				
Senator Davison	✓				
Senator Flakoll	✓				

Total (Yes) 7 No 0

Absent 0

Floor Assignment _____

If the vote is on an amendment, briefly indicate intent:

**2015 SENATE STANDING COMMITTEE
ROLL CALL VOTES
BILL/RESOLUTION NO. 4014**

Senate Government and Veterans Affairs Committee

☐ Subcommittee

Amendment LC# or Description: _____

Recommendation: ☐ Adopt Amendment
☒ Do Pass ☐ Do Not Pass ☐ Without Committee Recommendation
☒ As Amended ☐ Rerefer to Appropriations
☐ Place on Consent Calendar

Other Actions: ☐ Reconsider ☐ _____

Motion Made By Flakoll Seconded By Nelson

Senators	Yes	No	Senators	Yes	No
Chairman Dever	✓		Senator Marcellais	✓	
Vice Chairman Poolman	✓		Senator Nelson	✓	
Senator Cook	✓				
Senator Davison	✓				
Senator Flakoll	✓				

Total (Yes) 7 No 0

Absent 0

Floor Assignment Flakoll

If the vote is on an amendment, briefly indicate intent:

REPORT OF STANDING COMMITTEE

SCR 4014: Government and Veterans Affairs Committee (Sen. Dever, Chairman)
recommends **AMENDMENTS AS FOLLOWS** and when so amended, recommends
DO PASS (7 YEAS, 0 NAYS, 0 ABSENT AND NOT VOTING). SCR 4014 was
placed on the Sixth order on the calendar.

Page 1, line 19, remove "seventy-five percent of annual legacy fund earnings from 2017
through 2039,"

Page 1, line 19, after "if" insert "legacy fund earnings are"

Page 1, line 20, after the comma insert "the fund"

Page 1, line 20, remove "the legacy fund"

Renumber accordingly

2015 HOUSE GOVERNMENT AND VETERANS AFFAIRS

SCR 4014

2015 HOUSE STANDING COMMITTEE MINUTES

Government and Veterans Affairs Committee Fort Union, State Capitol

SCR 4014
3/19/2015
25100

- ☐ Subcommittee
☐ Conference Committee

Committee Clerk Signature

Carmen Hart

Explanation or reason for introduction of bill/resolution:

Directing the Legislative Management to study reinvestment scenarios and potential priorities for legacy fund earnings

Minutes:

Attachments 1-3

Chairman Kasper opened the hearing on SCR 4014.

Senator Kelly Armstrong appeared in support. In 2017 we will have the opportunity to do some things with the legacy fund. I know there is a legacy fund initiative that studies it too. My idea is a little different. If you decide to take out \$20 million out of the fund in 2017, it would be interesting to see the metrics of how much money that cost you over the course of 30 years. What kind of interest would that money have earned for the future of the fund and the future of North Dakota? We need to start dealing with some of those metrics. A big theme over the interim was the transparency of the fund. Outside of property taxes I probably get more questions from my constituents about the legacy fund.

Rep. Steiner On Line 14 you have the principal should only be used as a resource of last resort in times of exceptional need. Some of the voters in my district understand that the interest earnings was to be used in our generation, and I am hearing talk about never touching any of it, locking away all of it for 50 years. Is the intent behind this that you want to study locking it away or are you open to also using interest in our time?

Senator Armstrong The report was to put 75% of the interest back into the fund and spend 25% of the interest. The answer is to study it and really understand it. The legislature is going to make the determinations, and the group knew that from the get go what our recommendations as a group of its private citizens or individual legislators are. It is more to study the impacts of what we do.

Vice Chair Rohr You have that it is directing the legislative management to study, and we are passing a lot of resolutions for studies. If it doesn't get picked, why can't this be done anyway by the State Treasurer?

Senator Armstrong I would just as soon the legislative branch did it versus the executive branch. That is my personal opinion.

Rep. Mooney The people that I talk to are very clear. They are fine with the idea of rainy day funds to insure that we have security in the future, but all the people I have talked to, who are very much private citizens, have told me that they have every expectation that that money that was set aside constitutionally would come back to benefit them.

Rep. Wallman You talk about reinvesting the interest for a dollar return. The other side of this study, the way I am reading it, would be looking at the return of spending some of the interest, because certainly there is a return of the invest in our communities. That would be part of the scope of this study. Is that right?

Senator Armstrong Yes. That was part of the discussions throughout the entire interim. There were a lot of interesting and good ideas about how to do some of these things with the interest income.

Philip Boudjouk, Professor of Chemistry and former Vice President of Research at North Dakota State University, appeared in support. Attachment 1 (7:36-9:25)

Chairman Kasper This handout was a highlight of the study?

Philip Boudjouk Yes, that is right.

Dina Butcher, Partner in WT Butcher & Associates, appeared in support. Attachment 2. (11:50-16:29) She handed out Attachment 3 which was from Rod Backman, Legacy Fund Initiative Participant.

No opposition or neutral.

Rep. Wallman made a motion for a DO PASS AND PUT ON THE CONSENT CALENDAR.

Rep. M. Johnson seconded the motion.

Rep. Karls We are asked to study this, and I thought this group was studying it. Were they not an official interim study committee from the legislature?

Chairman Kasper No, they were not.

Rep. Karls Where did they come from?

Philip Boudjouk The funding came from Northwest Foundation. It was private sector funded.

A roll call vote was taken. 13 Yeas, 0 Nays, 1 Absent.

Rep. Wallman will carry the bill.

Date: 3-19-15
Roll Call Vote #: 1

2015 HOUSE STANDING COMMITTEE
ROLL CALL VOTES
BILL/RESOLUTION NO. 4014

House Government and Veterans Affairs Committee

☐ Subcommittee

Amendment LC# or Description: _____

Recommendation: ☐ Adopt Amendment
☒ Do Pass ☐ Do Not Pass ☐ Without Committee Recommendation
☐ As Amended ☐ Rerefer to Appropriations
☒ Place on Consent Calendar

Other Actions: ☐ Reconsider ☐ _____

Motion Made By Wallman Seconded By Johnson

Representatives	Yes	No	Representatives	Yes	No
Chairman Jim Kasper	X		Rep. Bill Amerman	X	
Vice Chair Karen Rohr	X		Rep. Gail Mooney	X	
Rep. Jason Dockter	X		Rep. Mary Schneider	X	
Rep. Mary C. Johnson	X		Rep. Kris Wallman	X	
Rep. Karen Karls	X				
Rep. Ben Koppelman	X				
Rep. Vernon Laning	X				
Rep. Scott Louser	X				
Rep. Jay Seibel	X				
Rep. Vicky Steiner	X				

Total (Yes) 13 No 0

Absent 1

Floor Assignment Wallman

If the vote is on an amendment, briefly indicate intent:

REPORT OF STANDING COMMITTEE

SCR 4014, as engrossed: Government and Veterans Affairs Committee (Rep. Kasper, Chairman) recommends DO PASS and BE PLACED ON THE CONSENT CALENDAR (13 YEAS, 0 NAYS, 1 ABSENT AND NOT VOTING).
Engrossed SCR 4014 was placed on the Tenth order on the calendar.

2015 TESTIMONY

SCR 4014

**Testimony of
Rod Backman,
Legacy Fund Initiative Participant
in support of
SCR 4014
to the
Senate Government & Veterans Affairs Committee
Sen. Dick Dever, Chairman
Thursday, February 19 – 9:15 am**

Chairman Dever and committee members, my name is Rod Backman and I'm offering this testimony in support of Senate Concurrent Resolution 4014, which directs legislative management to study potential reinvestment scenarios for the Legacy Fund.

This legislation is based on recommendations that were developed through the year-long Legacy Fund Initiative - a diverse group of North Dakota public, private, community and nonprofit leaders and citizens brought together to develop a consensus vision and policy recommendations to guide the purposes, governance, investments and future expenditures of the state's oil and gas Legacy Fund.

Your committee has been provided a copy of the recommendations, including a detailed appendix that takes an in-depth look at the various Legacy Fund earnings reinvestment scenarios we studied as part of the project.

We analyzed various revenue scenarios for the Legacy Fund over time. The revenue scenarios were developed utilizing oil production projections published by the North Dakota Department of Mineral Resources at the time of writing, as well as data on recent and historical revenue and fund balances.

Project participants ultimately selected a preferred 25-year scenario on which to base the goals and recommendations. The preferred "Reinvest, Replace and Spend" scenario achieves a balance for the Legacy Fund of \$230 billion by 2060, while providing North Dakotans important benefits in the near to medium term.

Under the scenario, the Legislature could reinvest 75 percent of Legacy Fund earnings, with the option to spend 25 percent of annual earnings, from 2017-2039, until oil production peaks and begins to decline. At that point, the Legislature would still spend 25 percent of annual earnings,

but use a portion of the remaining 75 percent of earnings to replace diminishing state oil and gas revenue, while reinvesting the rest into the Fund.

At a time of growing concern over the recent decline in oil prices, the "Reinvest, Replace and Spend" scenario represents a responsible approach to the future that relies on conservative projections for oil production and price. It also appropriately balances benefits for North Dakotans today and for future generations.

We view these projections and scenarios as a starting point for discussion by the Legislature. Given the variable nature of oil production and price and the importance of our Legacy Fund to the state's future, I encourage you to pass SCR 4014 so that Legislative Management can further study potential reinvestment scenarios for the Legacy Fund in advance of the 2017 legislative session.

Looking forward, it will be prudent to develop a broad strategy to manage the Legacy Fund over the next quarter century that meets our obligations to future generations.

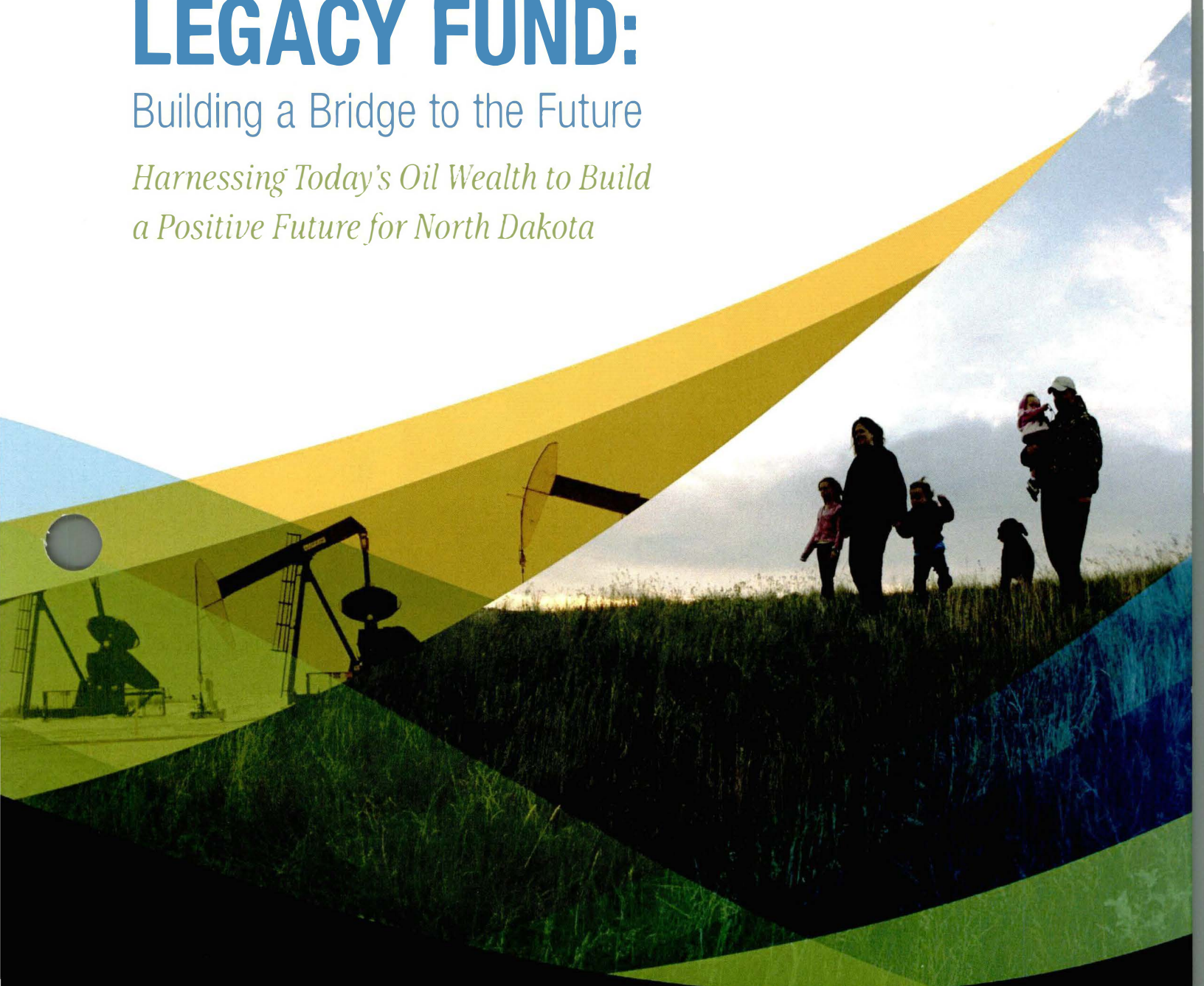
Mr. Chairman and members of the committee, I fully recognize the policies and management of the Legacy Fund is a Legislative decision, but believe this diverse group of North Dakotans have created a well thought out and valuable report for the Legislature to consider as it makes those decisions.

Mr. Chairman and committee members, thank you for the opportunity to testify in support of SCR 4014.

NORTH DAKOTA'S LEGACY FUND:

Building a Bridge to the Future

*Harnessing Today's Oil Wealth to Build
a Positive Future for North Dakota*



NOVEMBER / 2014

RECOMMENDATIONS TO THE GOVERNMENT
AND CITIZENS OF NORTH DAKOTA



**GREAT PLAINS
INSTITUTE**

North Dakota's Legacy Fund: Building a Bridge to the Future

HARNESSING TODAY'S OIL WEALTH TO BUILD A POSITIVE FUTURE
FOR NORTH DAKOTA

LEGACY FUND INITIATIVE PARTICIPANTS

- **Nick Archuleta**, President, North Dakota United
- **Kelly Armstrong**, State Senator, District 36-Dickinson
- **Rod Backman**, Former Director, North Dakota Office of Management and Budget
- **David Borlaug**, President, Lewis and Clark Fort Mandan Foundation
- **Phil Boudjouk**, Professor of Chemistry and former Vice President for Research, Creative Activities and Technology Transfer, NDSU
- **Dina Butcher**, Former Director of North Dakota Division of Community Services and Former Deputy Agriculture Commissioner
- **Steve Burian**, CEO, Advanced Engineering and Environmental Services
- **Lorraine Davis**, Member, Mandan School Board
- **Maria Effertz-Hanson**, Owner, Black Butte Communications and Consulting
- **Mike Eggl**, Senior Vice President, Communications and Administration, Basin Electric Power Cooperative
- **Jon Godfread**, Vice President, Government Affairs, North Dakota Chamber of Commerce
- **Pete Haga**, Community/Government Relations Officer, City of Grand Forks
- **Eric Hardmeyer**, CEO, Bank of North Dakota
- **Terryl Jacobs**, Rancher and President, Slope Electric Board of Directors
- **Cynthia Lindquist**, President, Cankdeska Cikana Community College, Spirit Lake Nation
- **Jim Ringelman**, Former Director of Conservation Programs, Ducks Unlimited
- **Mac Schneider**, Senate Minority Leader, District 42-Grand Forks
- **Cody Schuler**, United Methodist Pastor
- **Larry Skogen**, Interim Chancellor, North Dakota University System
- **Rose Stoller**, Executive Director, Consensus Council, Bismarck
- **Karen Stoker**, Owner, Hotel Donaldson
- **Jessica Thomasson**, Vice President for Social Enterprise, Lutheran Social Services of ND
- **Dan Traynor**, Attorney, Traynor Law Firm
- **Gene Veeder**, Executive Director, McKenzie County Jobs Development Authority

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Acknowledgements

This report and its consensus recommendations for the future of North Dakota's Legacy Fund represent the efforts and contributions of many people and institutions.

We are grateful for the dedication of our Legacy Fund Initiative participants who volunteered their time over the course of seven meetings, several webinars and many conference calls. It has been an inspiration and privilege to work with a group of people who care deeply about the future of our state.

We also thank the many citizens across our North Dakota who took the time to participate in our community meetings and online survey. Their input helped shape these recommendations. Special thanks are due to the North Dakota Association of Tribal Colleges for their assistance in preparing and delivering our online survey to gather citizen input.

Officials from North Dakota, federal agencies, other states, and the country of Norway gladly provided information and presentations to Legacy Fund Initiative participants that informed their recommendations. We want to acknowledge contributions from a number of state and federal agencies, including the Bank of ND, ND Department of Commerce, Office of Management and Budget, ND Public Finance Authority, ND University System, and USDA Rural Development. We also recognize representatives of state natural resource funds in New Mexico and Wyoming who generously shared their own experiences and Norwegian officials and colleagues who helped inspire this project in the first place.

Finally, none of this work would have been possible without the Northwest Area Foundation, North Dakota Natural Resources Trust and the Consensus Council in partnership with the Bush Foundation. We extend our thanks and appreciation for their generous financial support of this project.

~ Patrice Lahlum and Brad Crabtree, Great Plains Institute

EXECUTIVE SUMMARY

For the first and perhaps only time in our state's history, we can meet the needs and opportunities of the present and steward the development of an extraordinary and permanent resource for the future.

In November 2013, the Great Plains Institute convened a diverse group of North Dakota public, private, community and nonprofit leaders and citizens to develop a consensus vision and policy recommendations to guide the purposes, governance, investments and future expenditures of the state's oil and gas Legacy Fund.

North Dakota's Legacy Fund is special. It differs from other constitutional and state special funds in that North Dakota voters established the Legacy Fund to safeguard a portion of oil and gas revenue and grow it for the future. With 30 percent of oil and gas tax revenue flowing into the Fund, the balance of the Legacy Fund has grown substantially and now stands at more than \$2.2 billion. Legislative forecasts predict that the Legacy Fund balance will grow to at least \$6 billion by 2017.

Under the state's Constitution, the earnings from the Legacy Fund become available for expenditure by North Dakota's legislature in 2017. State officials estimate the earnings from the Fund will be at least \$300 million annually by 2017, and those earnings will be deposited into the state general fund. After July 1, 2017, the state legislature can spend up to 15 percent of the principal balance of the Legacy Fund per biennium, if two-thirds of each house of the legislature agrees to the spending.

North Dakota stands at a critical juncture. There has not yet been a broad public conversation in North Dakota about the future of the Legacy Fund since its inception.

Legacy Fund Initiative participants studied national sovereign wealth funds and state-level natural resource funds to gain insight into the purposes and management of various funds. In addition, project participants considered a number of scenarios for the management of North Dakota's Legacy Fund in coming decades.

Identifying a common vision and principles upon which to formulate recommendations for the Legacy Fund was one of the first steps taken by participants in the process:

Vision for the Legacy Fund

North Dakota's Legacy Fund will provide a permanent, sustainable resource for future generations that fosters self-sufficiency, creates opportunity and enhances quality of life for all citizens.

Guiding Principles

- *Implement the highest standards and practices of governance, accountability and transparency to guide Fund policies, procedures, decisions and actions.*
- *Make long-term, sustainable investments in North Dakota's future through the responsible stewardship of revenue generated from a finite natural resource.*
- *Foster and reinforce core values of hard work, self-sufficiency, innovation, equity, and stewardship.*

Priority Number One: Governance, Accountability and Transparency

In their deliberations, LFI participants have consistently emphasized the fundamental importance of managing the Legacy Fund according to the highest standards and practices of governance, accountability and transparency in policies, procedures, decisions and actions. Therefore, LFI participants have developed a “Best Practices” checklist for this report to enable North Dakotans to compare the governance, accountability and transparency of the Legacy Fund against a set of best practices drawn from guiding principles and codes of conduct for other sovereign and state wealth funds. They also recommend that state policy-makers consider modifying the current governance of the Legacy Fund as it grows in scale and importance.

Scenarios for the Future

With a vision and principles in place, project participants analyzed various revenue scenarios for the Legacy Fund over time. The revenue scenarios were developed utilizing oil production projections published by the North Dakota Department of Mineral Resources at the time of writing, as well as data on recent and historical revenue and fund balances.

Project participants ultimately selected a preferred 25-year scenario on which to base their goals and recommendations in this report. It offers state policy-makers a pragmatic middle ground between spending everything and spending nothing. The preferred “Reinvest, Replace and Spend” scenario achieves a balance for the Legacy Fund of \$230 billion by 2060, while providing North Dakotans important benefits in the near to medium term. Under the scenario, the Legislature would spend 25 percent of annual earnings from 2017-2039 and reinvest the remaining 75 percent back into the Legacy Fund until oil production peaks and begins to decline (currently projected for the latter half of the next decade). At that point, the Legislature would still spend 25 percent of annual earnings, but use a portion of the remaining 75 percent of earnings to replace diminishing state oil and gas revenue, while reinvesting the rest into the Fund.

At a time of rapidly growing oil production and state revenues, but also growing concern over the recent decline in oil prices, the “Reinvest, Replace and Spend” scenario represents a responsible approach to the future that relies on conservative projections for oil production and price. It also appropriately balances benefits for North Dakotans today and for future generations.

Having selected a preferred scenario, participants established goals for the future of the Fund. These goals build on one another and will require prudent, intentional management to grow the Legacy Fund's principal over a 25-year timeframe:

Goals for the Legacy Fund

- *Provide a resource of last resort in times of exceptional need.*
- *Provide for a significant portion of the state's future needs by compensating for the reduction in revenues once oil and gas production begins to decline.*
- *Beginning in 2017, invest in bold, visionary, and transformative actions that build assets and enhance quality of life for North Dakota citizens today and in the future.*

The Legacy Fund goals described above can only be accomplished through the power of compounding interest. Turning potential into reality will require citizens and their elected representatives to sustain a commitment to wise management of the Fund over time.

Fortunately, given North Dakota's present fiscal strength—with billions of dollars in oil and gas, sales tax and other revenue flowing into and overflowing out of multiple state funds—we have abundant alternatives to the Legacy Fund to meet the current spending priorities in our state.

Building upon the vision, principles and goals, this report outlines a broad strategy to manage the Legacy Fund over the next quarter century that meets our obligations to future generations, while contributing meaningfully to the lives of North Dakotans today.

Legacy Fund Strategies

- *Reinvest 75 percent of annual Legacy Fund earnings from 2017 through 2039 to grow the Fund principal, after inflation, to benefit future generations of North Dakotans.*
- *Use existing state resources to address critical needs and priorities of citizens and communities today, rather than drawing on the Legacy Fund.*
- *Allocate 25 percent of annual Legacy Fund earnings from 2017 through 2039 to bold and visionary purposes that build a bridge to a future.*

In order to achieve the strategies outlined above, the report includes detailed recommendations for the proposed allocation and use of 25 percent of the annual Legacy Fund earnings from 2017 through 2039.

Participants propose the establishment of a North Dakota Legacy Foundation to involve the legislative and executive branches of government to administer Legacy Fund initiatives and guide the use of annual Fund earnings, subject to oversight by the Legislature. The Legacy Foundation's role would include gathering public and expert input, identifying priorities for recommendation to the Governor and Legislature, and coordinating state agencies and private sector entities in planning and undertaking initiatives.

LFI participants recommend that the Governor and Legislature identify a critical priority for the state each biennium and charge the Legacy Foundation with developing a program of action to address that priority with Legacy Fund earnings and other state and private resources. They envision that priorities chosen each biennium will span a wide range of important issues as future governors and Legislatures respond proactively to the changing circumstances of our state over time.

Based on their own discussions and input from citizens, LFI participants strongly encourage the Governor and Legislature to choose the development of a comprehensive strategy and action plan for building a world class pre-K through 20 education system as the first Legacy Foundation priority for the 2017-19 biennium.

Additionally, project participants recommend that the Legacy Foundation focus on a few key priorities for impact. Three ongoing initiatives are proposed in education scholarships, innovation and infrastructure that the Foundation could coordinate. By 2020, the Legacy Fund could provide about \$63 million to each of the three initiatives, or about \$189 million total. This could grow to \$131 million in 2025, \$222 million in 2030 and \$459 million annually in 2040 to each of the three recommended initiatives:

INITIATIVE #1: ENDOW A HIGHER EDUCATION SCHOLARSHIP PROGRAM IN NORTH DAKOTA

As part of developing and implementing the broader strategy and action plan for pre-K through 20 educational excellence recommended in this report, LFI participants encourage state legislators to continue exploring how Legacy Fund resources could be utilized to endow a higher education scholarship program.

INITIATIVE #2: FOSTERING INNOVATION THAT BUILDS A BRIDGE TO THE FUTURE

LFI participants recommend that a "Genius Initiative" be established to foster transformative private and public sector innovation that builds a bridge to the future by leveraging our current success in energy and agriculture to expand and accelerate economic diversification and increase our state's productive potential.

Funded by a portion of annual Legacy Fund earnings not reinvested, the proposed Genius Initiative would support applied research, development and demonstration of technologies and best practices, program and service delivery, and public-private partnerships that have significant potential to increase prosperity, create opportunity and enhance quality of life for citizens today and generations to come.

INITIATIVE #3: INVESTING IN 21ST CENTURY ECONOMIC AND COMMUNITY INFRASTRUCTURE

The LFI participants encourage state policy-makers to dedicate a portion of annual Legacy Fund earnings not reinvested after 2017 toward long-term economic and community infrastructure investments that are bold, visionary and transformative and that provide returns or allow for repayment of principal to the Fund. They specifically recommend investing rather than spending Fund earnings on infrastructure in order to leverage the impact over time.

LFI participants do not advocate appropriating Legacy Fund earnings for traditional infrastructure purposes. North Dakota's infrastructure needs in the near term are enormous and driven to a large extent by oil and gas development. These needs will exceed available proceeds from Legacy Fund earnings by a large margin in the early years.

In offering these consensus recommendations for consideration by state policy-makers and citizens, LFI participants believe that we as North Dakotans today are blessed with an extraordinary bounty of oil and gas resources, which most states and countries will never share, and that is available to us for a limited time. We have an obligation through the Legacy Fund to take advantage of this window of opportunity to build a bridge to a future that provides our children and grandchildren with opportunities and options similar to those we enjoy today.

PROJECT OVERVIEW

Rationale. North Dakota's rapidly growing Legacy Fund currently stands at \$2.2 billion and has been projected conservatively to reach \$6 billion by 2017, when Fund returns first become available for expenditure. Assuming no change to existing state tax treatment of oil and gas production, the principal of the Legacy Fund could reach tens of billions of dollars by 2030 and well over \$100 billion by 2050—in a state with a population of just 725,000 people.

Stakeholder Dialogue. GPI brought together North Dakota leaders in 2013 and 2014 to participate in the Initiative's broad-based and collaborative policy dialogue. The key deliverable of the dialogue is consensus policy recommendations - the cornerstone of this report - that Initiative participants hope will inform the public and policy-makers and help guide future evolution of the Fund.

Citizen Participation. The work of stakeholders participating in the policy dialogue was strengthened by community forums and online input surveys that gathered citizen input on a long-term vision for the future of North Dakota and how the Legacy Fund can serve as a mechanism to help achieve that vision. The community forums incorporated and expanded upon citizen input already gathered through the North Dakota Chamber of Commerce's 2020 & Beyond and USDA Rural Development's North Dakota 2.0 initiatives.

Consensus Recommendations. Following deliberations that incorporated briefing materials and expert input, Legacy Fund Initiative participants prepared this report to:

- articulate broader long-term purposes for the Fund;
- propose governance mechanisms appropriate to its future multi-billion dollar scale; and
- outline principles, strategies and priorities for Fund investments and expenditure of future returns.

Informing State Policy. Later in 2014 and early 2015, dialogue participants will formally present their report and results of the statewide community forums to state legislators and other officials, private sector leaders, the media and the public.

Project Funding. The Legacy Fund Initiative was convened with grant funding from the Northwest Area Foundation. The North Dakota Consensus Council and North Dakota Natural Resources Trust provided grant funding to support the community and online input project elements.

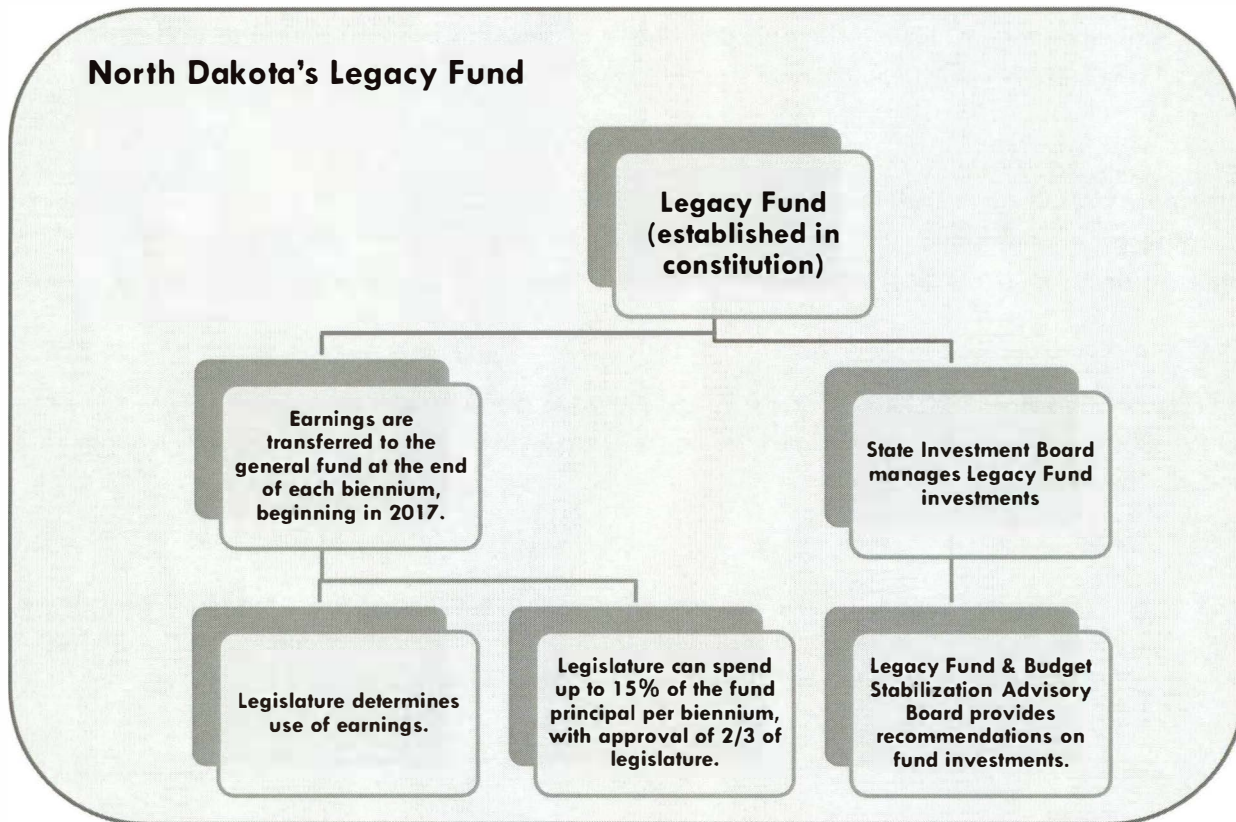
NORTH DAKOTA'S LEGACY FUND

Sixty-three percent of North Dakota voters passed a legislative-referred constitutional measure in 2010 establishing the Legacy Fund and mandating a formula set-aside of 30 percent of the state's oil and gas revenues for the future. The measure placed limits on how and when the future principal and returns can be spent, but was silent with respect to specific investment and expenditure priorities of the Fund.

The balance of the Legacy Fund has grown substantially and now stands at more than \$2.2 billion. Legislative forecasts predict that the Legacy Fund balance will grow to at least \$6 billion by 2017, when the principal and earnings first become available for expenditure. Monthly deposits are made into the Legacy Fund from the oil and gas tax collections. In addition, the legislature has the authority to deposit additional monies from other sources into the Legacy Fund. Current law requires that if the balance of the state's Strategic Investment & Improvement fund exceeds \$300 million, 25 percent of additional revenue going to that fund must be transferred to the Legacy Fund.

The earnings from the Legacy Fund become available for expenditure by North Dakota's legislature in 2017. State officials estimate the earnings from the Fund will be at least \$300 million annually by 2017, and those earnings will be deposited into the state general fund. The earnings must be transferred to the general fund; however, the legislature has the option either to spend those funds or reinvest the earnings back into the Legacy Fund, or a combination of both.

The principal of the Legacy Fund can also be utilized after 2017. The constitutional language prescribes a method by which principal from the Legacy Fund can be expended. After July 1, 2017, the state legislature can spend up to 15 percent of the principal balance of the Legacy Fund per biennium, if two-thirds of each house of the legislature agrees to the spending.



The constitutional language adopted in 2010 directs the State Investment Board to manage investments for the Legacy Fund. The State Investment Board is responsible for investment of several funds, including the Legacy Fund. The board hires the state investment director and other advisors.

State Investment Board

Governor

State Treasurer

Commissioner of University & School Lands

Director of Workforce Safety & Insurance

Insurance Commissioner

Teachers' Fund for Retirement Board (3 members)

Public Employees Retirement System Board (2 of the elected board members)

Public Employees Retirement System Board (1 member)

In addition, the legislature established a Legacy Fund & Budget Stabilization Advisory Board to develop recommendations for the investment of funds in the Legacy Fund and the Budget Stabilization Fund. The legislature also established a goal for the investment of the Legacy Fund, which is "principal preservation while maximizing total return."

Legacy Fund & Budget Stabilization Advisory Board

Two state senators (appointed by majority leader)

Two state representatives (appointed by majority leader)

Director of the Office of Management & Budget

President of the Bank of North Dakota

Tax Commissioner

WHAT WE LEARNED FROM OTHERS

In 2012, GPI organized a high-level delegation of North Dakota public and private leaders to learn from Norway's world class experience in fossil and renewable energy production, environmental best practices, and responsible management of oil and gas wealth for future generations. There, they were briefed by representatives of Norway's \$950 billion Pension Fund Global, the world's largest sovereign wealth fund and widely recognized as a global model.

Norway has worked hard to avoid the so-called "Dutch Disease" or "resource curse" that can result after a significant natural resource discovery. A term coined by *The Economist* after The Netherlands' discovery of significant natural gas deposits in the North Sea in the 1960s, an economic crisis occurred from the new energy wealth that caused the value of the Dutch Guilder to rise substantially, leading to all other non-oil and gas related products losing competitiveness in important export markets.

Great Britain experienced the same economic problems in the 1970s when the price of oil spiked and oil drilling in the North Sea quickly became economical. Britain ultimately became a net exporter of oil; however, their currency (the pound) increased in value and a recession occurred as a result of uncompetitive exports and the demand for higher wages.

Some of the key lessons learned from Norway's experience with its sovereign wealth fund were to 1) develop an approach to governance, investments and expenditures that is based on a shared, long-term vision for the future, rooted in the values of the society that the fund serves; and 2) achieve consensus on that approach before the fund accrues substantial value and makes decisions more complex and potentially contentious.

North Dakota stands at a critical juncture in this regard. There has not yet been a broad public conversation in North Dakota about the future of the Legacy Fund since its inception, yet legislative and interest group proposals to earmark a portion of the Fund emerged during the 2013 legislative session.

Legacy Fund Initiative participants studied additional national sovereign wealth fund and state-level funds to gain additional insight on the purposes and management of various funds. There are more than 50 sovereign or state/provincial funds across the globe, each with assets of \$2 billion or more. According to the Sovereign Wealth Fund Institute, wealth funds around the world control more than \$6.7 trillion in assets.

There are several state-level permanent funds in the United States, with long-standing models in Texas, Alaska, New Mexico and Wyoming. Texas was the first state to establish a permanent fund for education in 1854. That fund was established with a \$2 million appropriation from the Texas legislature with the express purpose of benefitting public schools in Texas. Texas established a second permanent fund to help fund public higher education in the state. The Public University Fund provides revenue to the University of Texas and the Texas A&M University systems.

Alaska established a permanent fund in 1976 by constitutional measure. The Alaska Permanent Fund receives revenue from the royalties of oil and gas production, and Alaska citizens are paid an annual dividend from the fund. State law governs how the fund principal is invested and includes an asset allocation class for infrastructure investment.

Wyoming established their permanent fund in 1974 from a portion of mineral severance tax revenues. Income from the Permanent Wyoming Mineral Trust Fund is transferred to the state's general fund for state use. The Wyoming fund can also make low interest loans to local entities.

The Severance Tax Permanent Fund in New Mexico was established by the state legislature in 1973 from oil and gas severance taxes. New Mexico voters later enshrined the fund in the constitution to protect the corpus of the fund. The income from the fund is transferred to the state government for use.

In addition to studying other state permanent fund models and uses, LFI participants reviewed several international and academic methods to measure and evaluate the governance, accountability and transparency standards and practices of funds worldwide.

An international framework for governance and transparency was established in 2008 by an international working group of sovereign wealth funds. The working group worked in conjunction with the International Monetary Fund to develop a framework of principles for governance and accountability, investment practice conduct and to ensure better understanding of sovereign wealth funds. Their work led to the creation of the Santiago Generally Accepted Principles and Practices for sovereign wealth funds. Several studies have been conducted to assess the degree of compliance with the Santiago Principles for major sovereign wealth funds. In addition to the Santiago Principles, other indices, including the Truman Blueprint and the Linaburg-Maudell Transparency Index encompass elements that address governance, accountability and transparency.

LEGACY FUND PROJECTIONS: THE LANDSCAPE OF THE FUTURE

Legacy Fund Initiative (LFI) participants considered a number of scenarios for the management of the Legacy Fund in coming decades. Projections for oil production published by the Department of Mineral Resources at the time of writing, as well as data on historical revenue and fund balances for recent biennia, were used to estimate the future growth of the Legacy Fund under these scenarios. More details on this analysis are provided in Appendix 1.

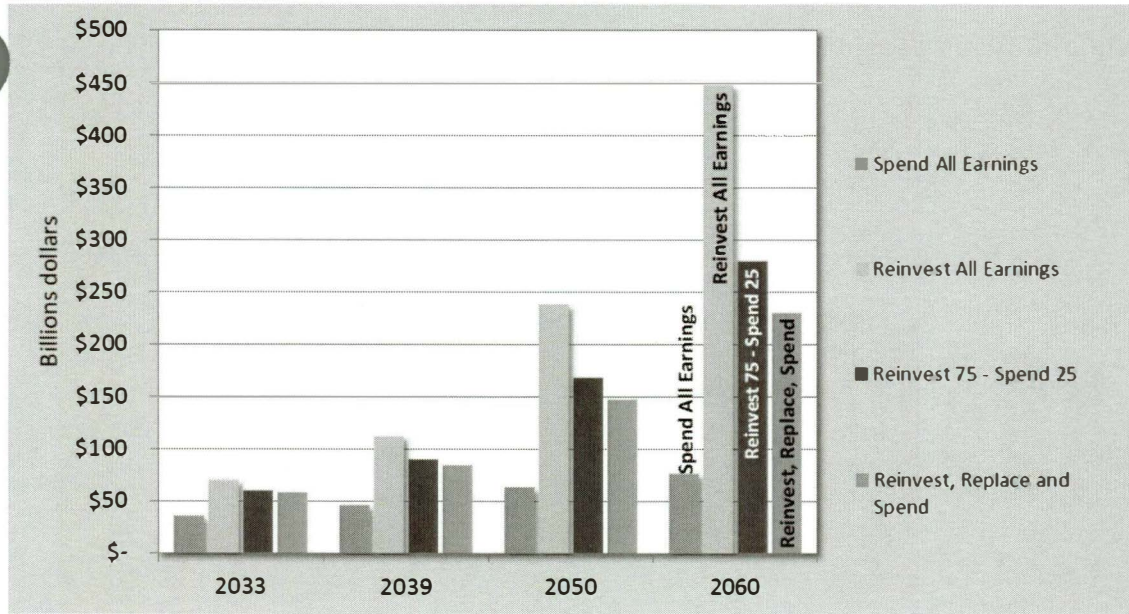
For this report, LFI participants present the results of four scenarios to illustrate the factors that were considered when formulating recommendations on how to manage the Legacy Fund. These scenarios are:

1. **Spend All Earnings:** As allowed under current law, the Legislature spends 100 percent of annual earnings starting in 2017.
2. **Reinvest All Earnings:** The Legislature would reinvest 100 percent of earnings back into the Legacy Fund.
3. **Spend 25—Reinvest 75:** The Legislature would spend 25 percent of annual earnings starting in 2017, while reinvesting the remaining 75 percent back into the Fund.
4. **LFI Preferred Scenario: Reinvest, Replace, and Spend:** Under this preferred scenario, the Legislature would spend 25 percent of annual earnings starting in 2017 and reinvest the remaining 75 percent. Then, once oil revenue starts to decline, the Legislature would continue to spend 25 percent of annual earnings, but use a portion of the remaining 75 percent of earnings to replace diminishing oil and gas revenue, while reinvesting the remaining earnings into the Fund.

Scenario 1 of Spend All Earnings and Scenario 2 of Reinvest All Earnings represent the Fund's potential "floor" and "ceiling", respectively, illustrating projected outcomes if annual earnings are either completely spent or completely reinvested. Scenario 3, or Spend 25-Reinvest 75, presents a management plan that provides near term benefits to North Dakota, while reinvesting significant earnings and rapidly growing Fund principal for future generations. Finally, LFI participants preferred Scenario 4, or Reinvest, Replace and Spend, which combines near term benefits and long term sustainability, while sustainably offsetting declining state oil and gas revenue as projected oil production peaks and begins to fall in the decades to come.

The following figures illustrate the Legacy Fund's growth under the four scenarios detailed above. Figure 1 portrays the growth of the Legacy Fund's principal balance over the next four and a half decades. If all earnings are spent starting in 2017, the Legacy Fund may reach a maximum balance of about \$77 billion dollars by 2060. However, if all earnings are reinvested, the Fund may reach a balance of \$448 billion by 2060 (this, however, prevents any near- to mid-term benefit or use of the Fund). Under LFI participants' preferred scenario of Reinvest, Replace and Spend, near to mid-term use of some Fund earnings, along with substantial reinvestment of earnings, achieves a balance of about \$230 billion by 2060.

Figure 1. Legacy Fund principal balance amount under four scenarios over time



The next figure demonstrates how much funding might be made available for higher education scholarship, innovation and infrastructure investment initiatives proposed by LFI participants from withdrawals of 25 percent of Legacy Fund annual interest earnings, as in Scenarios 3 and 4. By 2020, the Legacy Fund could provide about \$63 million to each of the three purposes, or about \$189 million total. This could grow to \$131 million in 2025, \$222 million in 2030 and \$459 million annually in 2040 to each of the three recommended purposes.

Figure 2. 25 percent of annual earnings to three proposed initiatives (in millions of \$)

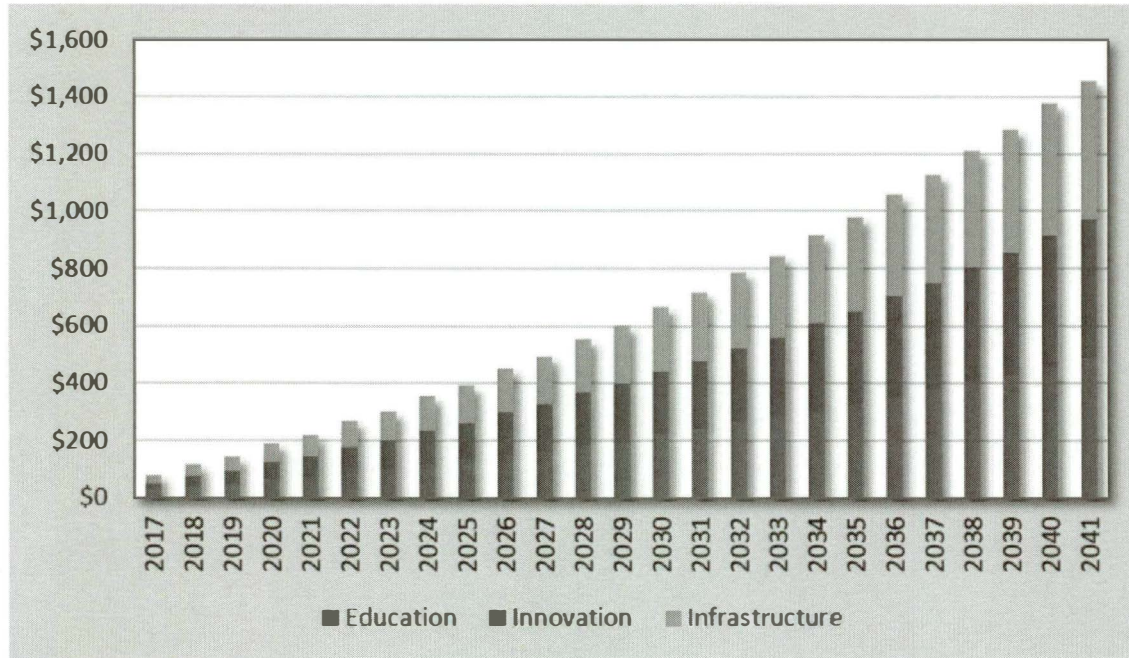
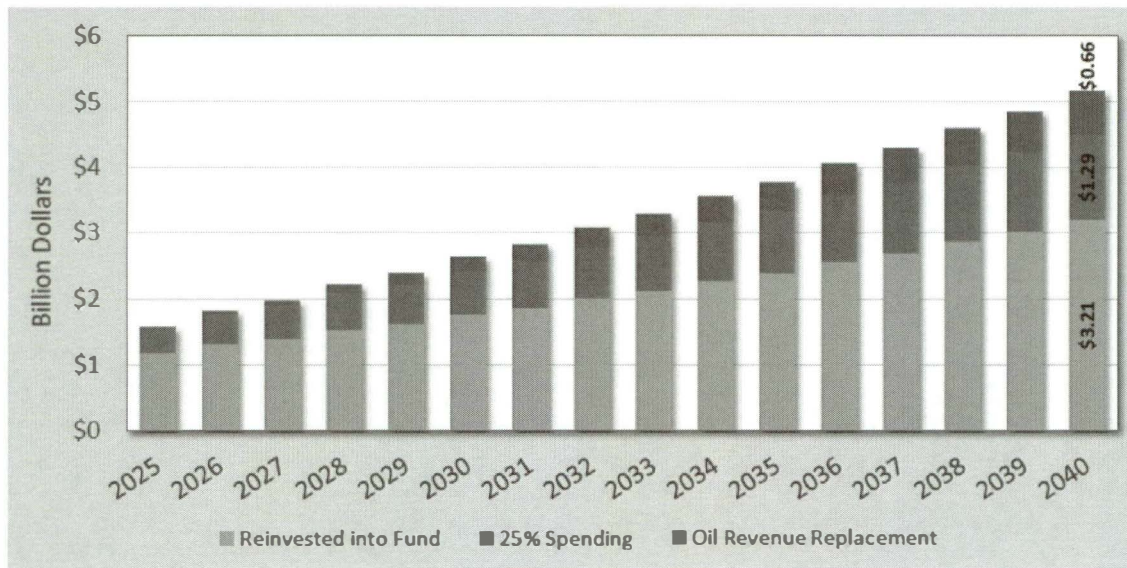


Figure 3. Three simultaneous uses of Legacy Fund annual earnings



The final figure (above) in this executive summary breaks down the Legacy Fund's annual earnings into three uses under LFI participants' preferred Reinvest, Replace and Spend scenario:

1) spending 25 percent of earnings, 2) replacing declining state oil revenue, and 3) reinvesting the remainder of annual earnings into the Fund. By 2040, the Legacy Fund could be providing \$1.29 billion in additional state spending, \$660 million to offset declining oil revenue, and \$3.21 billion for reinvestment into the Fund—all from annual earnings alone. Under responsible management scenarios, these figures only grow larger with every year, along with the Fund's potential to deliver extraordinary benefits to North Dakotans.

Overview of Consensus Recommendations for the Future of the Legacy Fund

VISION, GUIDING PRINCIPLES AND PURPOSES OF THE LEGACY FUND

The constitutional ballot measure that created the Legacy Fund established explicit limitations on how and when the principal and earnings from the Fund can be spent. However, the constitutional language otherwise provides policy-makers with little guidance for charting the Legacy Fund's future. Therefore, Legacy Fund Initiative (LFI) participants made it one of their first priorities to forge agreement on a proposed vision, principles and goals, which they recommend for consideration by state leaders and citizens to supplement existing constitutional provisions and help guide the Legacy Fund going forward.

VISION

LFI participants offer the following vision to guide long-term stewardship of the Legacy Fund:

North Dakota's Legacy Fund will provide a permanent, sustainable resource for future generations that fosters self-sufficiency, creates opportunity and enhances quality of life for all citizens.

GUIDING PRINCIPLES

LFI participants recommend three core principles to guide the decisions and actions of state policy-makers and Legacy Fund managers:

- ***Implement the highest standards and practices of governance, accountability and transparency to guide Fund policies, procedures, decisions and actions.***

Despite their different viewpoints and backgrounds, LFI participants consider sound governance, accountability and transparency to be the first priority and that the ultimate success of the Legacy Fund will depend on policy-makers and managers achieving the highest standards and practices of

integrity and openness. Citizens consulted in community meetings across the state strongly concurred with this emphasis.

- ***Make long-term, sustainable investments in North Dakota's future through the responsible stewardship of revenue generated from a finite natural resource.***

The Legacy Fund is special. It differs from other constitutional and state special funds in that North Dakota voters established the Legacy Fund to safeguard a portion of oil and gas revenue and grow it for the future. Although we cannot predict future priorities with certainty, LFI members emphasize our obligation to manage the Legacy Fund sustainably and permanently to provide future generations with options and opportunities comparable to our own and to ensure that any near-term use of the Fund clearly benefits both citizens today and generations to come.

- ***Foster and reinforce core values of hard work, self-sufficiency, innovation, equity, and stewardship.***

LFI participants encourage policy-makers to be mindful of the "resource curse" and negative economic, social and cultural impacts from sudden wealth experienced by other states and countries and to manage the Legacy Fund in ways that sustain and strengthen the core values we cherish and which define North Dakotans at their best. We should avoid, for example, the complacency and dependency fostered by the Alaska Permanent Fund's practice of issuing annual checks from earnings to all individual residents.

KEY GOALS

Informed by insights gleaned from the projections and scenarios presented previously in this report, LFI participants propose three goals for the Legacy Fund. These goals build on one another and will require intentional management to grow the Legacy Fund's principal over a 25-year timeframe. Achieving these goals is feasible under a range of earnings reinvestment scenarios for the Fund.

1. ***Provide a resource of last resort in times of exceptional need.***

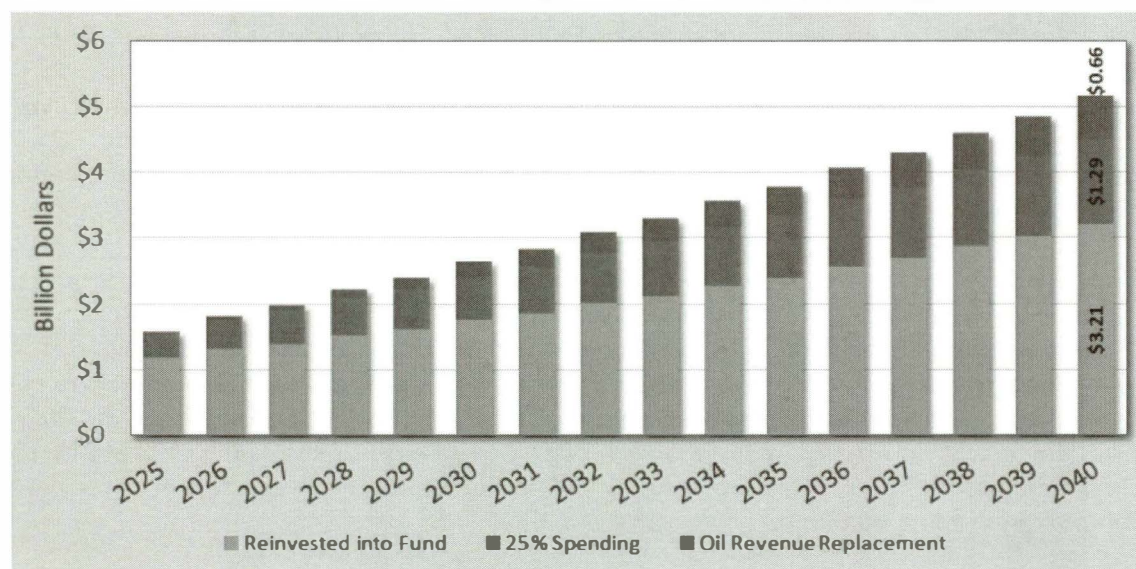
Based on current projections, the principal of the Legacy Fund will reach \$6 billion in the 2017 biennium, which LFI participants believe amply meets this first goal. LFI participants deliberately set a very high bar for "exceptional need" that would merit the Legislature drawing on earnings and potentially the principal of the Legacy Fund. They recommend defining exceptional need according to two criteria: 1) exceeds the combined resources of state "rainy day" funds such as the Foundation Aid Stabilization Fund, Property Tax Relief Fund, Budget Stabilization Fund and other state special funds and programs; and 2) the federal government is unwilling or unable to offer significant financial assistance.

2. ***Provide for a significant portion of the state's future needs by compensating for the reduction in revenues once oil and gas production begins to decline.***

To fulfill a commitment to provide future generations of North Dakotans with options and opportunities comparable to our own, LFI participants recommend that the Legacy Fund be managed to achieve sufficient growth in principal, so that future earnings from the Fund can offset fully, and sustainably over time, the post-peak reduction in oil and gas revenues that will occur once production starts to fall. Based on conservative oil production projections used in this report, this peak and subsequent decline in production could begin in the latter half of the next decade.

By growing the Legacy Fund's corpus through reinvestment of 75 percent of earnings from 2017 through 2039, Figure 3 shows that earnings from the Fund easily replace the projected oil and gas revenue shortfall and continue to do so as the revenue gap grows during the latter years of the 2017-39 period, while still allowing for expenditure of 25 percent of annual earnings in the interim. Indeed, under LFI participants' preferred Reinvest, Replace and Spend scenario for the Legacy Fund, North Dakota can sustainably 1) spend an 25 percent of annual Fund earnings through 2039 and beyond; 2) replace future state revenue losses from declining oil and gas production; and 3) still grow the Fund balance in real inflation-adjusted dollars through reinvestment of earnings—all indefinitely into the future.

Figure 3: Three simultaneous uses of Legacy Fund annual earnings



3. Beginning in 2017, invest in bold, visionary, and transformative actions that build assets and enhance quality of life for North Dakota citizens today and in the future.

Starting in 2017, LFI participants urge state policy-makers to dedicate a portion of Legacy Fund earnings to extraordinary and transformative initiatives that benefit North Dakotans today and well into the future. Toward that end, LFI participants recommend that the Governor and Legislature identify a major state priority each biennium to be addressed with Legacy Fund earnings, and they also propose three ongoing initiatives described later in this report—higher education, innovation and infrastructure investment initiatives—to be supported by annual earnings from the Fund.

LFI participants believe these initiatives will not only position the state for the future, but also demonstrate tangible, ongoing benefits to the public, thereby reducing the likelihood of legislation or an initiated measure that risks undermining the long-term integrity and potential of the Fund. As shown in Figure 3, annual utilization of 25 percent of the earnings after 2017 still enables the Fund to replace state oil revenue after it begins to decline and for the Fund balance to grow at a healthy rate into the foreseeable future, while guarding against unforeseen risk. Under this approach, the Legacy Fund can serve as an engine of opportunity and quality of life for North Dakotans today and a sustainable resource for future generations.

25-YEAR STRATEGY FOR ACCOMPLISHING LEGACY FUND GOALS

As the preceding scenarios amply demonstrate, the Legacy Fund goals described above—providing a resource of last resort at times of exceptional need, sustainably replacing state oil and gas revenue with Fund earnings after production begins to decline, and financing transformative investments in world-class education, innovation, infrastructure and other key priorities for North Dakota—can only be accomplished through the power of compounding interest.

Turning this potential into reality will require citizens and their elected representatives to sustain a commitment over time to 1) manage the Legacy Fund as a truly permanent fund; and 2) reinvest sufficient earnings in early years to grow the principal to a level that generates annual earnings adequate to support the above goals, while still increasing the real value of the Fund after inflation.

Fortunately, given North Dakota's present fiscal strength—with billions of dollars in oil and gas, sales tax and other revenue flowing into and overflowing out of multiple state funds—we have abundant alternatives to the Legacy Fund to meet current spending priorities. For the first and perhaps only time in our state's history, we can now meet the needs and opportunities of the present and steward the development of an extraordinary and permanent resource for the future. We cannot afford to squander this moment.

Recognizing our privileged position and the responsibility placed on North Dakotans and their leaders today, LFI participants recommend a broad strategy to manage the Legacy Fund over the next quarter century. The 25-year duration of the strategy is intentional. The timeframe corresponds well with different scenarios for reinvestment of earnings to achieve desired growth in the principal of the Fund and to mitigate impacts on state revenue after projected oil and gas production peaks and starts to fall. In addition, we mark the 125th anniversary of statehood this year, and North Dakota will celebrate its 150th birthday 25 years from now in 2039, encouraging us to look to the future and the transformative role the Legacy Fund can play in shaping our state.

LFI participants hope that the proposed strategies for the Legacy Fund outlined below will inform an ongoing and evolving dialogue about how the Legacy Fund can meet our obligations to future generations, while contributing meaningfully to the lives of North Dakotans today.

1. *Reinvest 75 percent of annual Legacy Fund earnings from 2017 through 2039 to grow the Fund principal, after inflation, to benefit future generations of North Dakotans.*

LFI projections for the Legacy Fund indicate that this level and timeframe for earnings reinvestment from 2017 (when the Legislature first has the option to spend earnings) through 2039 can position the Fund to provide a resource of last resort in times of exceptional need and sustainably replace state oil and gas revenue through annual Fund earnings once production begins to decline (holding constant estimates of oil production and price and state tax treatment of oil and gas production).

2. *Use existing state resources to address critical needs and priorities of citizens and communities today, rather than drawing on the Legacy Fund.*

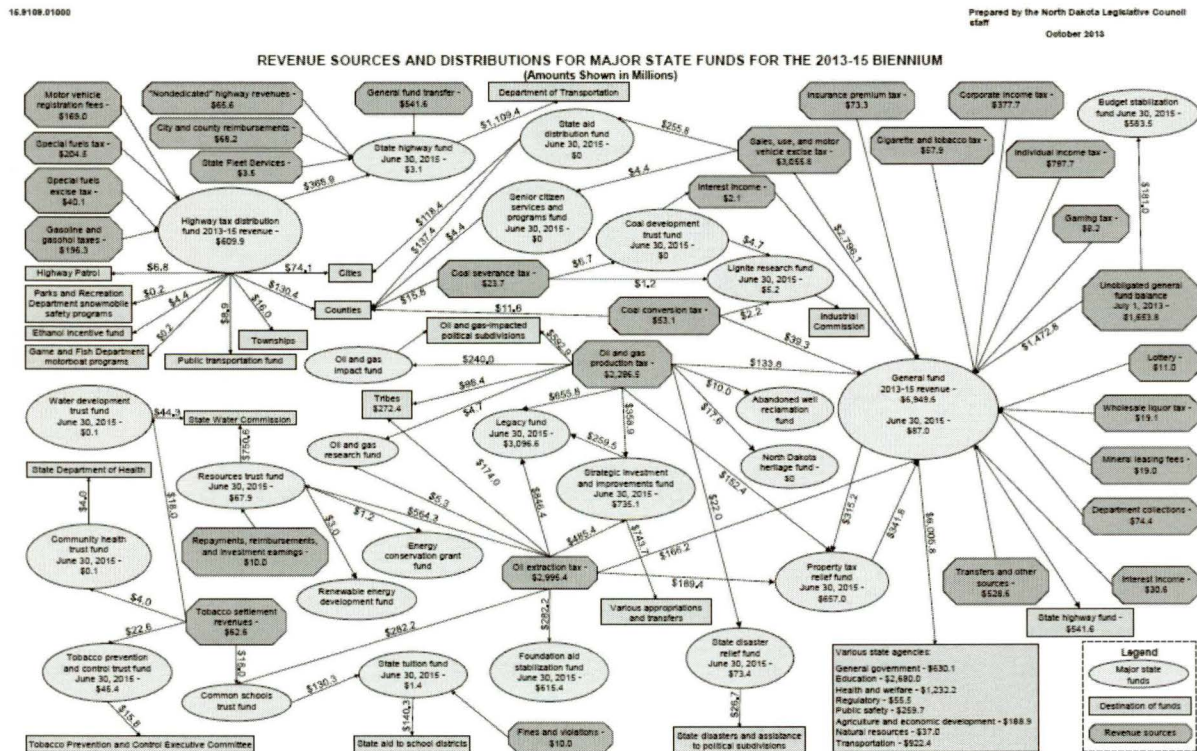
LFI participants recognize that our state currently faces critical issues and challenges driven primarily by rapid oil and gas development that require urgent attention, and they call on state policy-makers to utilize available non-Legacy Fund resources to respond to these needs. State revenues continue to grow, and state special funds, such as the Property Tax Relief Fund, the Strategic Investment and

Improvement Fund, the Budget Stabilization Fund, the Resources Trust Fund and the General Fund, all enjoy robust and growing balances, which will exceed \$3.5 billion this biennium based on Legislative Council estimates.

In LFI community meetings organized to gather public input, citizens from across the state expressed frustration at what they perceive to be significant unmet local needs at a time when state coffers are overflowing. Members of the public warned that the Legacy Fund risks being targeted as source of immediate funding, if state policy-makers fail to take steps to allocate other state resources to respond adequately to short-term priorities.

LFI participants recommend that state policy-makers undertake statutory and constitutional reforms to North Dakota's approach to allocating revenue to multiple funds or "buckets" to facilitate their more effective use. This method utilized for historically smaller existing funds has been adapted to new funds in order to manage rapidly growing and much greater state revenues. As the chart below prepared by North Dakota Legislative Counsel illustrates, the resulting state budget structure can be confusing, makes difficult basic citizen understanding of and accountability for available funds, and creates barriers in responding to current state needs and priorities. This complex budget system may, if unaddressed, make the Legacy Fund politically vulnerable to demands for short-term expenditures that undermine the long-term integrity and potential of the Fund.

North Dakota State Budget Structure



In responding to unmet needs in the state, LFI participants encourage policy-makers to tackle the following current priorities identified through two comprehensive statewide community planning efforts, the Greater North Dakota Chamber of Commerce's 2020 and Beyond and USDA Rural

Development's North Dakota 2.0, which consulted citizens of all walks of life from communities across the state:¹

- Establish a world-class pre-K through 12 and higher education system that includes adequate resources for early childhood education.
- Provide access to quality and affordable housing for all North Dakotans.
- Ensure adequate and affordable health care for all North Dakotans and address the immediate needs of our rural health care systems.
- Attract, develop and retain a strong workforce, while providing access to quality child care.
- Protect and enrich North Dakota's natural resources and environment to provide continued recreation and tourism opportunities.
- Maintain North Dakota's friendly business climate, while reducing North Dakotans' tax burden.
- Ensure that North Dakota's primary industries – agriculture and energy – are sustained for the long-term.
- Provide for a robust, long-term statewide transportation and infrastructure system, including water projects and flood control.
- Identification of current Legacy Fund uses to demonstrate near-term benefits and maintain public support for safeguarding the Fund for future generations.

3. *Allocate 25 percent of annual Legacy Fund earnings from 2017 through 2039 to bold and visionary purposes that build a bridge to a future.*

Public support for a 25-year strategy to manage the Legacy Fund for significant future growth in principal will erode over time without clear evidence of benefits to citizens today. Fortunately, the preferred Reinvest, Replace and Spend scenario in Figure 3 demonstrates that spending 25 percent of annual Fund earnings from 2017 through 2039, while reinvesting the remaining 75 percent each year, can responsibly replace declining state oil and gas revenue on an ongoing basis after production starts to fall and still provide an additional and rapidly rising annual income stream estimated at \$189 million in 2020 and over \$1.2 billion by 2039.

LFI participants recommend that any expenditure of Fund earnings by the Legislature after 2017—as allowed under the state Constitution—be limited to transformative investments that demonstrably benefit both future generations and North Dakotans today. They encourage legislators to seek broad statewide public input and expert review and assessment before spending Legacy Fund earnings.

Toward that end, LFI participants propose the creation of a North Dakota Legacy Foundation in state statute, modeled after the existing Economic Development Foundation, to provide a mechanism to advise and assist the Legislature in utilizing this proposed revenue stream of 25 percent of Fund earnings over the 2017-2039 period.

To stimulate discussion among North Dakota policy-makers and the public regarding the most impactful potential uses of Legacy Fund earnings in advance of 2017, LFI participants recommend that the Governor and the Legislature work with the proposed Legacy Foundation to identify a major state priority each biennium to be addressed by the Foundation with Legacy Fund earnings. They recommend that the first priority for the 2017-19 biennium be the development of a strategy and action plan for building a world class pre-K through 20 educational system.

¹ This list combines the results from both planning efforts, and Initiative participants have tentatively proposed the first five as the top priorities for the state.

In addition to identifying a biennial priority for the state, LFI participants recommend the following ongoing initiatives that would also be supported by a portion of annual earnings not reinvested into the Legacy Fund:

- **Endowing a higher education scholarship program** to help North Dakotans reach their full potential and to attract talent and capital to our state and communities;
- **Establishing a “Genius Initiative” to foster transformative private and public sector innovation** that increases prosperity, creates opportunity and enhances quality of life;
- **Investing in 21st-century economic and community infrastructure** to expand and diversify North Dakota's productive potential and to improve our communities.

The proposed North Dakota Legacy Foundation and recommended initiatives are described in greater detail later in this report.

ENSURING BEST PRACTICE GOVERNANCE, ACCOUNTABILITY & TRANSPARENCY

In their deliberations, LFI participants have consistently emphasized the fundamental importance of managing the Legacy Fund according to the highest standards and practices of governance, accountability and transparency in policies, procedures, decisions and actions. It is helpful to compare our state's performance in this area against other states and countries, especially given that the projected growth of the Legacy Fund will likely place North Dakota in the top rankings among the largest sovereign wealth funds and state natural resource funds in the world today.

LFI participants have developed a checklist in order to enable North Dakota policy-makers, the media and citizens to compare the governance, accountability and transparency of the Legacy Fund against a set of best practices drawn from guiding principles and codes of conduct for sovereign wealth funds internationally and state natural resource funds in the U.S.

BEST PRACTICES CHECKLIST

Governance

1. The legislature sets the overall objectives for the Legacy Fund.
2. A mechanism is in place, with diverse representation, by which to receive public input periodically on Fund objectives and investment policy and to recommend any changes to the legislature and Fund governing body or bodies, taking into account sound management principles.
3. The governance framework establishes clear and effective division of roles and responsibilities in order to facilitate accountability and operational independence.
4. The state's statutory framework supports effective operations.
5. Diverse representation and clearly defined procedures are in place for the appointment of members of the governing body or bodies that exercise oversight. In

addition, professional and ethical standards are clearly defined and made known to the members of the governing body, management and staff.

Accountability

6. The accountability framework is clearly defined in legislation, rules and policies.

6-a. The investment policy is clear and consistent with its defined objectives, risk tolerance, and investment strategy, as set by the governing body or bodies, and is based on sound portfolio management principles.

6-b. There are clear policies, rules, procedures, and arrangements regarding the general approach to the receipt, investment, withdrawal, and expenditure of funds, with all appointees, staff and other responsible parties having fiduciary responsibilities, including the prudent investor rule².

6-c. Asset management is consistent with what is generally accepted as sound asset management principles.

6-d. Investment decisions aim to maximize risk-adjusted financial returns in a manner consistent with its investment policy, and based on economic and financial grounds.

6-e. A framework that identifies, assesses, and manages operational risks is in place.

7. Third-party involvement in operational management is based on economic and financial grounds and follows clear rules and procedures.

8. A comprehensive annual report and accompanying annual audit of operations and performance financial statements is clearly disseminated to the public, including summary content accessible to laypersons.

Transparency

9. The governing body operates and maintains a prominent and easy-to-use public website that includes:

9-a. The history, policy purpose and funding sources for the Legacy Fund;

9-b. The membership of the governing body(ies) and minutes of their meetings;

9-c. The legal relationship with other state funds and institutions;

9-d. Laws, policies, rules, procedures, or arrangements in relation to the general approach to funding, withdrawal, and spending;

9-e. Clear and updated information regarding investment fees paid and returns on investment of principal;

9-f. Annual reports and independent annual audit results;

² The prudent investment rule is a fiduciary standard that governs investment decisions. The rule requires investment diversification to help alleviate shortfalls in any one particular investment category.

9-g. A description of professional and ethical standards, investment policies and the risk management framework; and

9-h. Relevant contact information for operational staff and governing body or bodies.

10. More frequent information from an annual to even daily frequency, such as investment returns, investment fees paid, annual independent audits and annual reports, that is automatically and continuously updated and posted electronically in an easily accessible and readily understandable manner for the general public.

Future Changes to Legacy Fund Oversight

LFI participants recommend that state policy-makers consider modifying the current governance of the Legacy Fund as it grows in scale and importance. Historically, the State Investment Board has been tasked with managing retirement funds. Specifically, the Legislature should consider modifying the make-up of the State Investment Board by the time the Legacy Fund balance exceeds the combined total balance of the retirement funds managed by the Board. In addition, a separate board may need to be established to manage retirement accounts, which would maintain representation of appropriate stakeholders.

THE NORTH DAKOTA LEGACY FOUNDATION: BUILDING A BRIDGE TO THE FUTURE

LFI participants are urging state policy-makers to be both responsible and bold by committing to a prudent strategy of reinvesting 75 percent of Legacy Fund earnings for the next quarter century, while dedicating the remaining quarter of annual earnings to transformative initiatives that provide significant benefit to North Dakotans today and also help to build a bridge to the future. They propose the establishment of a North Dakota Legacy Foundation to involve the legislative and executive branches of government to administer these initiatives and guide the use of annual Fund earnings, subject to oversight by the Legislature. Addressing future priorities for the state effectively will require the participation and guidance of public and private sector experts who may not serve in the Legislature. The Legacy Foundation's role would include gathering public and expert input, identifying priorities for recommendation to the Governor and Legislature, and coordinating state agencies and private sector entities in planning and undertaking initiatives.

Proposed Structure and Approach

In creating a North Dakota Legacy Foundation, LFI participants suggest that legislators look to the North Dakota Economic Development Foundation as an effective model in state law for supplementing state legislative capabilities and oversight with private sector expertise and participation. They suggest that the North Dakota Legacy Foundation have a nine-member board of directors appointed by the Governor and with qualifications set by the Legislature to ensure diverse personal and professional backgrounds; geographic, gender and ethnic diversity; and interdisciplinary experience and expertise that spans priority areas identified by the Legislature. Board terms should be staggered to ensure that members possess the appropriate expertise and background as major priorities change under executive and legislative branch direction. Board appointments and requirements should focus on needed disciplines and expertise, rather than specific officeholders. Additional temporary and/or ex-officio board members could be appointed to provide sufficient expertise in identified topic area(s).

The Legacy Foundation should focus on a few key priorities for impact. LFI participants propose three ongoing initiatives in education scholarships, innovation and infrastructure which are described below. In addition to these three ongoing initiatives, they encourage the Governor and Legislature to work with the Legacy Foundation board of directors to identify a major statewide priority each biennium for the work of the Legacy Foundation and the use of Legacy Fund earnings during the upcoming two-year period. LFI participants believe the Legacy Foundation must evolve to reflect changing needs of our state over time. The Governor and Legislature affirming a biennial priority for the Legacy Foundation every two years will help ensure that the use of Legacy Fund earnings remains adaptable and responsive to future issues and opportunities as they emerge.

After approving the biennial priority for the state, the Governor and legislators would task the Legacy Foundation board and staff with undertaking a fundamental, broad-based and statewide assessment of the identified issue. Based on this assessment, the Legacy Foundation would outline a strategic program of action for consideration by the Governor and Legislature, recommend a funding level to accomplish the work, and incorporate clear milestones and outcomes for accountability and success.

The Governor would include in biennial budget requests modest funding for the administration of the Legacy Foundation and for its assessment, program development, and coordination roles. The Legislature would also appropriate the more significant funding required to support the program of action for the biennial priority of the Legacy Foundation and the entities selected to help implement it through a competitive request for proposal (RFP) process, as well as funding for the ongoing education scholarship, innovation and infrastructure programs.

PRIORITY INITIATIVES FOR THE LEGACY FOUNDATION

LFI participants have engaged in extensive deliberations and sought citizen input on ways that the Legacy Fund can meaningfully impact the lives of North Dakotans today, while safeguarding a prudent earnings reinvestment strategy that will deliver much greater dividends for our state in the future. This final section of the report outlines proposed initiatives that will enhance opportunity and quality of life for citizens now and far into the future, including three ongoing initiatives aimed at achieving world-class education, innovation and infrastructure.

As previously discussed, under the preferred scenario of reinvesting 75 percent of Fund earnings from 2017-2039, allocating 25 percent of annual earnings to priority initiatives over the same period, and sustainably replacing state oil and gas revenues as they begin to decline, LFI projections indicate that a quarter of annual Fund earnings would yield an estimated \$78 million in 2017 and rise to \$1.2 billion by 2039.

LFI participants hope that these recommended priority initiatives, together with the opportunity to provide a substantial annual income stream without jeopardizing the long-term growth objectives of the Fund, will inspire further dialogue among state policy-makers and the public regarding potential targeted, high-impact uses of Legacy Fund earnings.

PROPOSED STATE PRIORITY FOR THE 2017-19 BIENNIUM: DEVELOPING A STRATEGY AND ACTION PLAN FOR A WORLD CLASS PRE-K THROUGH 20 EDUCATIONAL SYSTEM

As noted above, LFI participants recommend that the Governor and Legislature identify a critical priority for the state each biennium and charge the Legacy Foundation with developing a program of action to address that priority with Legacy Fund earnings and other state and private resources. They envision that priorities chosen each biennium will span a wide range of important issues as future governors and Legislatures respond proactively to the changing circumstances of our state over time.

Based on their own discussions and input from citizens, LFI participants strongly encourage the Governor and Legislature to choose the development of a comprehensive strategy and action plan for building a world class pre-K through 20 education system as the first Legacy Foundation priority for the 2017-19 biennium. They propose this initial focus for the Legacy Foundation in conjunction with a complementary recommendation that Legacy Fund earnings or principal endow an ongoing higher education scholarship program described below.

Background

Targeted use of Legacy Fund earnings—together with existing state and other resources as part of a broader strategy for educational excellence—can help our state build a global top-tier education system, from pre-kindergarten through K-12, vocational-technical, undergraduate and graduate programs. This will help North Dakotans realize their full potential in our rapidly changing and diversifying economy that demands increasing skills and education. Furthermore, comprehensive excellence in education will serve as a magnet to attract experienced and skilled people and their families to North Dakota, who can help meet our current workforce challenges and enrich our state and communities.

Some U.S. states have deployed resources from their permanent natural resource funds to improve their educational systems significantly. For example, Wyoming draws on permanent funds to support a scholarship program and to endow university faculty positions. On a larger scale, Texas has harnessed its state endowment from oil revenues to help transform its universities into an internationally recognized higher education system that provides opportunity to Texas students, while attracting faculty, students and resources from all over the world.

Recommendations

LFI participants believe that North Dakota policy-makers should learn from and improve upon the examples of other energy-producing states and countries that have capitalized on their resource funds to achieve educational excellence.

Toward that end, they specifically recommend that state policy-makers task the proposed Legacy Foundation with coordinating the development of a comprehensive and system-wide strategy for fostering educational excellence that includes three major components:

- 1) an integrated pre-K through 20 approach (early childhood education through graduate and professional programs);
- 2) improving and building institutions; and
- 3) targeted efforts to increase affordability of, access to and completion of vocational-technical, academic and professional programs.

The Legacy Foundation could convene key education stakeholders in the state to coordinate development of this strategy for how Legacy Fund resources, in conjunction with the Common Schools Trust Fund, other

state special funds and other public and private resources, could help build a world class pre-K through 20 system and report back to legislators and other state policy-makers.

In addition to strategic investments in higher education, LFI participants believe that expanding access to early childhood education represents an urgent need in our state, and that we must strengthen our K-12 system to improve the achievement and preparedness of students entering vocational-technical and academic programs.

PROPOSED ONGOING INITIATIVES TO BE SUPPORTED BY LEGACY FUND RESOURCES

In addition to the Legacy Foundation focusing on a major priority of the state each biennium at the Governor and Legislature's direction, LFI participants propose the following ongoing initiatives for consideration by state policy-makers in order to harness the portion of Legacy Fund earnings not reinvested to the benefit of citizens today and far into the future.

Initiative #1: Endow a Higher Education Scholarship Program in North Dakota

As part of developing and implementing the broader strategy and action plan for pre-K through 20 educational excellence outlined above, LFI participants encourage state legislators to continue exploring how Legacy Fund resources could be utilized to endow a higher education scholarship program.

Background on Scholarship Discussions in the Legislature

Education represents the one policy area where legislators have already begun active consideration of options for utilizing Legacy Fund resources. During the 2013 North Dakota legislative session, two ideas were proposed to dedicate a portion of Legacy Fund dollars—one using earnings and the other principal of the Fund—to a new higher education scholarship fund. Each was introduced as a resolution, which if passed by the legislature, would have placed a constitutional measure on a future ballot. These scholarship ideas did not pass the legislature.

Recommendations

LFI participants support legislators' efforts to endow a higher education scholarship program with Legacy Fund resources (either through appropriation of earnings or dedication of a portion of Fund principal), especially given the high and growing level of student indebtedness in North Dakota. However, they also urge state policy-makers to craft a scholarship program as one component of the larger educational strategy described above and to address barriers beyond affordability, including access and degree/certificate completion.

In addition, LFI participants encourage legislators to provide support for North Dakotans to study out of state and for out of state students to attend North Dakota institutions. They believe that Legacy Fund resources should be used to expand and diversify the skills base and experience of our state's workforce. Toward that end, North Dakota students who seek education or training out of state, but commit to return to work in our state for a given period of time, should be eligible for tuition or other support. Similarly,

providing tuition support to qualified out-of-state students who agree to work in North Dakota after graduation can help expand our state's talent pool, spur economic development and innovation, and strengthen our communities.

Initiative #2: Fostering Innovation that Builds a Bridge to the Future

North Dakotans today are blessed with an extraordinary bounty of oil and gas resources that most states and even countries will never share and that is available to us for a limited time. We have an obligation to take advantage of this window of opportunity to build a bridge to a future that provides our children and grandchildren with opportunities and options similar to those we enjoy today.

Therefore, LFI participants recommend that a "Genius Initiative" be established under the auspices of the proposed North Dakota Legacy Foundation to foster transformative private and public sector innovation that leverages our current success in energy and agriculture to expand and accelerate economic diversification and to increase our state's productive potential. Funded by a portion of annual Legacy Fund earnings not reinvested, the proposed Genius Initiative would support applied research, development and demonstration of technologies and best practices, program and service delivery, and public-private partnerships that have significant potential to increase prosperity, create opportunity and enhance quality of life for citizens today and generations to come.

Genius Initiative Objectives

LFI participants suggest the following objectives to guide the Genius Initiative:

- Move our state's economy up the value chain and down the supply chain in energy, agriculture, technology, manufacturing and other sectors to avoid oil and agricultural boom-and-bust cycles of the past;
- Position our state as a Silicon Valley of renewable and alternative energy innovation and commercialization;
- Extend production of oil and coal-based energy over generations, while offsetting emissions and environmental impacts through carbon capture and enhanced oil recovery;
- Foster asset-building, self-sufficiency and permanent elimination of poverty among low-income children, families, and senior citizens;
- Enhance communities, stewardship of natural resources and iconic places, and our history, arts and culture to attract creative and skilled people to live, work and innovate in North Dakota; and
- Reduce long-term cost and improve effectiveness of government services and operations.

Targeted Support for Innovation

Under executive and legislative branch oversight, the Legacy Foundation would, through the Genius Initiative:

- Provide risk capital for critical private, government and nonprofit sector innovation that is unlikely to garner adequate support through conventional channels;
- Enable development and demonstration of economic, social and environmental solutions that, if successful, can be scaled up and implemented by the private and public sectors; and
- Attract further investment from government, private sector and philanthropic sources to increase impact.

Role of the Legacy Foundation in Administering the Genius Initiative

The Governor and Legislature would work with the Legacy Foundation board of directors to identify priorities for innovation and then task the Foundation with developing a proposed scope of work and program each biennium for legislative review. With approval of the program and required appropriations by the Legislature, the Legacy Foundation would issue a Genius Initiative RFP(s) to which public, private and nonprofit institutions would be eligible to respond, with a preference for consortia of collaborating institutions. The successful institutions or consortia would then implement the funded activities under the oversight of the Foundation's board and staff and with periodic progress reports to the Governor and Legislature.

In those cases where feasibility and demonstration efforts supported by the Genius Initiative prove successful, regular public and private sector funds would be used to scale up broader implementation, rather than drawing further on Legacy Fund earnings.

Initiative #3: Investing in 21st Century Economic and Community Infrastructure

The LFI participants encourage state policy-makers to dedicate a portion of annual Legacy Fund earnings not reinvested after 2017 toward long-term economic and community infrastructure investments that are bold, visionary and transformative and that provide returns or allow for repayment of principal to the Fund. They specifically recommend investing rather than spending Fund earnings on infrastructure in order to leverage the impact over time.

However, LFI participants do not advocate appropriating Legacy Fund earnings for traditional infrastructure purposes. North Dakota's infrastructure needs in the near term are enormous and driven to a large extent by oil and gas development. These needs will exceed available proceeds from Legacy Fund earnings by a large margin in the early years.

LFI participants believe that immediate needs for traditional infrastructure investment are urgent and must be addressed now by the Legislature with current resources drawn from state special funds other than the Legacy Fund. Depending on the type of infrastructure in question, options include the Oil and Gas Impact Grant Fund, Resources Trust Fund, Strategic Investment and Improvement Fund, and Common Schools Trust Fund. Specifically, the Legislature should consider statutory or other changes needed to facilitate the flexible and responsible use of these funds to respond to the state's broad range of infrastructure needs, rather than drawing on proceeds from the Legacy Fund in the near term.

In addition, community leaders participating in meetings hosted by the Legacy Fund Initiative recommended that the 25 percent of all revenues in excess of \$300 million that currently flows from the Strategic Investments and Improvements Fund into the Legacy Fund should, instead, be allocated and spent on critical infrastructure needs in the near to medium term.

Considerations and Criteria for Investing Legacy Fund Earnings in Infrastructure

Based on their own extensive deliberations and on input from North Dakota citizens, LFI participants recommend the following considerations and criteria to guide potential investment of Legacy Fund earnings in infrastructure:

- Limit any infrastructure investment role to utilizing a portion of annual Legacy Fund earnings, avoiding investment of principal;
- Supplement existing private and public capital by targeting critical needs and opportunities that the private market and existing government programs cannot adequately address;
- Realize benefits for North Dakotans today, while investing, instead of spending, Legacy Fund proceeds in order to sustain principal or even grow the Fund for the future (or potentially establish a separate infrastructure fund(s));
- Engage genuinely long-term through investments up to 40 years in duration, for assets that last up to 50 years or more; and
- Focus on extra-ordinary opportunities that generate economic, social and environmental benefits and enhance quality of life for North Dakotans well into the future.

Potential Infrastructure Applications for Legacy Fund Investment

LFI participants encourage state policy-makers to think broadly about the types of infrastructure that might be eligible for investment of Legacy Fund earnings. For example, pressing workforce development needs and overall livability concerns in North Dakota are expanding our understanding of critical community infrastructure today to include both affordable housing and child care facilities.

Future infrastructure priorities will look very different than the overwhelming needs of today's energy boom. Therefore, LFI participants emphasize that we cannot and should not decide today what all future priorities for Legacy Fund infrastructure investment ought to be. In that spirit, they offer the following examples of potential infrastructure investment as illustrative of opportunities that Legacy Fund earnings might address (no order of priority):

- Accessible and affordable statewide high-speed broadband capacity;
- CO₂ pipelines to help sustain and extend oil production over decades, while reducing the environmental impact of our energy sector;
- Intra-state natural gas pipeline capacity to provide a market for Bakken gas, while enabling value-added economic development such as fertilizer production and addressing problems such as the recent propane shortage;
- Essential regional water supply for municipal, rural and industrial purposes;
- Permanent community flood protection across the state;
- Real estate development that meets critical local demand for affordable housing and child care facilities; and
- Alternative transportation systems to serve evolving state and community needs.

Recommendations for Oversight and Implementation

Accountability and transparency in the investment of Legacy Fund earnings in infrastructure will be critical. The Legislature could designate the proposed North Dakota Legacy Foundation to administer the future investment of Legacy Fund earnings in infrastructure projects. The Foundation could coordinate project planning, review, and implementation with state agencies, federal and local governments, and relevant private entities. Alternatively, given the pace of development and the scale and duration of long-term infrastructure plans in our state, the Legislature may wish to consider establishing a broader infrastructure authority to ensure a coordinated and integrated approach, including oversight of any investments of Legacy Fund earnings in infrastructure projects.

In addition, state policy-makers should explore new and flexible models for implementing infrastructure projects that utilize Legacy Fund earnings. For example, LFI participants have discussed how community development block grants could serve as a model for disbursing resources to local governments to finance

community infrastructure revolving loan funds. Such an approach would ensure that Legacy Fund earnings deliver infrastructure benefits to North Dakota communities in perpetuity.

CONCLUSION

Through wise management, North Dakota's Legacy Fund has the potential to truly provide a permanent, sustainable resource for future generations that fosters self-sufficiency, creates opportunity and enhances quality of life for all citizens.

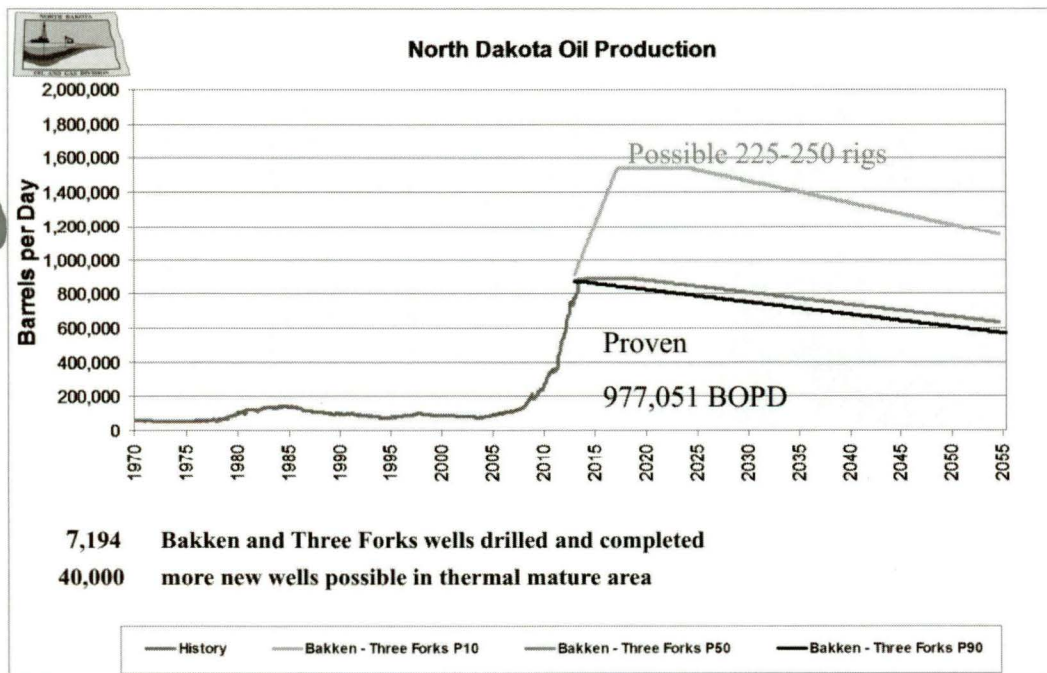
By embracing a sound 25-year strategy, we can advance bold and visionary ideas that provide benefits now, while building a bridge to our future. Turning this potential into reality will require citizens and their elected representatives to sustain a commitment over time.

The Legacy Fund can serve as an engine of opportunity and quality of life for North Dakotans today and a sustainable resource for future generations.

APPENDIX A

Oil Production

To estimate future growth of the Legacy Fund, projections for North Dakota oil production were used to calculate potential production and extraction tax revenue. At the time of this analysis, the Department of Mineral Resources (DMR) has published three projections for oil production: a conservative projection based on historical production (*Proven*), a minimum projection depicting a linear decline in production from current levels (*P90*), and a moderately aggressive production growth scenario (*P10*). In both the Proven and P90 scenarios, oil production never exceeds about 930 thousand barrels per day and only diminishes from 2014 and on. In reality, oil production actually exceeded one million barrels per day in 2014. Therefore, the P10 scenario was used for this analysis, with oil production reaching a peak of about 1.7 million barrels per day between the 2017 and 2025. While the P10 scenario was originally meant as an aggressive projection by DMR, it is possible that this is still a somewhat conservative estimate, especially since actual 2014 production slightly exceeds the levels projected by the P10 scenario, and more recent estimates even put peak production at around 2 million barrels per day.

Figure 1.1 Department of Mineral Resources Oil Production Scenarios

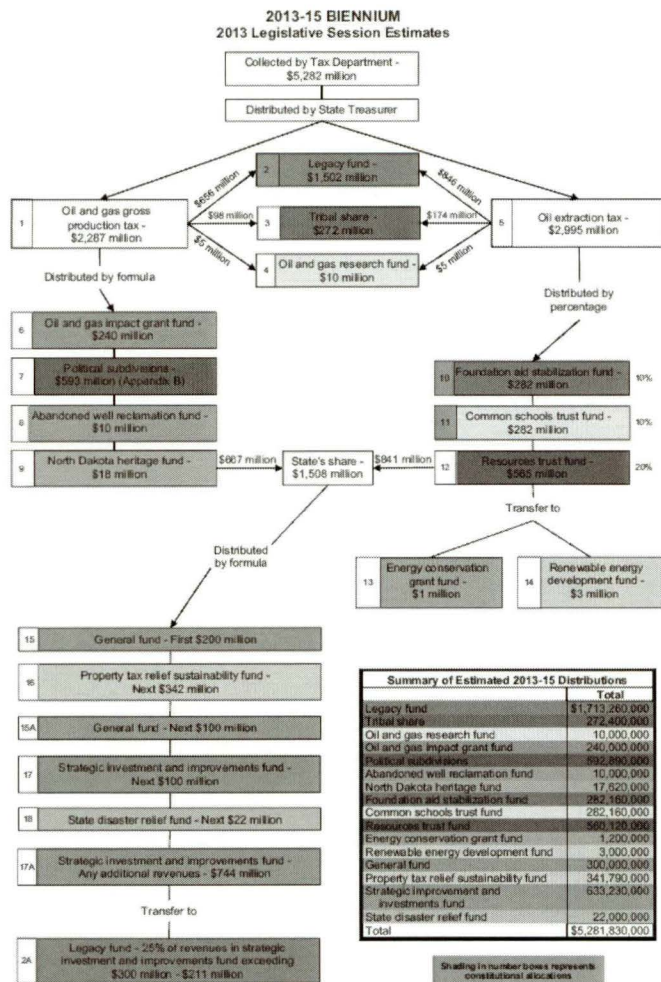
Source:

<https://www.dmr.nd.gov/oilgas/presentations/ActivityUpdate2014-06-11NCSLBismarck.pdf>
Revenue Projection

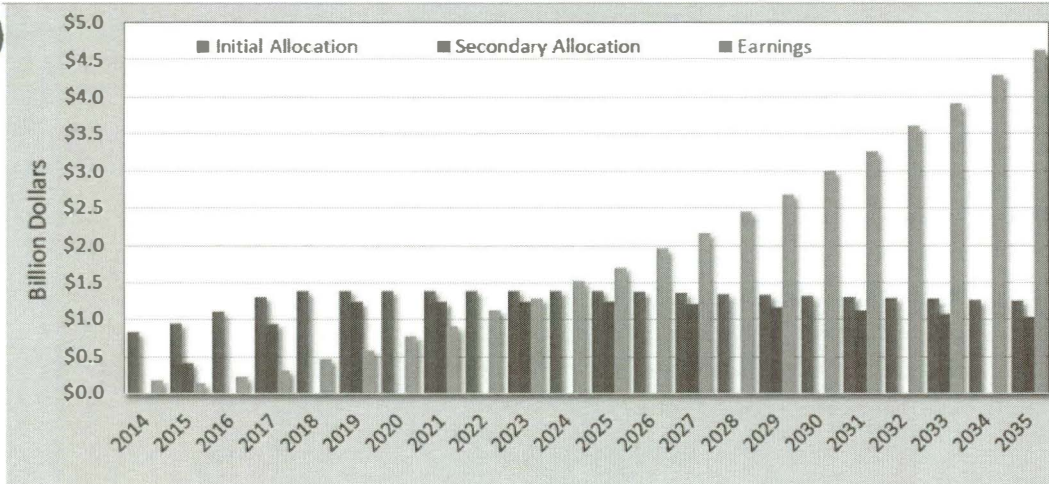
By combining projections for oil production with extraction and production tax revenue estimates for 2014 and 2015, proportional revenues for future years were calculated. Thirty percent of this revenue is allocated annually to the Legacy Fund as part of the initial Fund contribution, while the remainder goes to other programs. As detailed in Figure 1.2, as the remainder of production and extraction tax revenue is allocated to other programs and funds in the North Dakota's Biennium budget, any remaining funds after

all other funds' needs are met are then transferred to the Legacy Fund (box 2A in Figure 1.2). For this analysis, 2013-2015 Biennium budget allocations to the Legacy Fund, done annually for the initial allocation and biennially for the final remaining funds transfer, were used as a basis for calculating increases in future Legacy Fund contributions in proportion to growth in oil production according to the P10 projection discussed above.

Figure 1.2



For consistency and for the purposes of projection, this analysis held all other values constant so that contribution limits in other funds and programs remained the same. In reality, budget decisions, economic factors and political choices may result in modifications to many of the funds that receive production and tax revenues between the Legacy Fund's initial and secondary revenue allocations. However, as shown in Figure 1.3, while the secondary revenue allocation does provide a significant contribution to the Fund and would be sensitive to such changes, in the long run earnings represent the most significant factor in Fund growth (but only in scenarios in which earnings are retained and contributed back into the principal).

Figure 1.3 Initial, secondary and earnings contributions under an earnings retained scenario**Fund management assumptions and scenarios**

Under the Constitution, earnings from the Legacy Fund will be transferred to the state general fund, beginning in 2017. Legislators will have the option to spend those earnings or to reinvest all or a portion of those earnings back into the Fund to grow the principal. A number of scenarios for the management of the Legacy Fund principal and earnings were considered by Legacy Fund Initiative participants. Among these were:

Scenario 1: Spend All Earnings As allowed under current law, the Legislature may spend 100 percent of annual earnings starting in 2017.

Scenario 2: Reinvest All Earnings :

The Legislature would reinvest 100 percent of earnings back into the Legacy Fund.

Scenario 3: Spend 25–Reinvest 75

The Legislature would spend 25 percent of annual earnings starting in 2017, while reinvesting the remaining 75 percent back into the Fund.

***Scenario 4: Reinvest, Replace and Spend (LFI Preferred Scenario)**

The Legislature would spend 25 percent of annual earnings starting in 2017 and reinvest the remainder. Then, once oil revenue starts to decline, the Legislature would continue to spend 25 percent of annual earnings, but use a portion of the remaining 75 percent of earnings to replace diminishing oil and gas revenue, while reinvesting the rest into the Fund.

Scenarios 1 and 2 are meant for illustrative purposes. Scenario 1, or “Spend All Earnings”, shows the minimum amount of growth that the Legacy Fund might see when all annual earnings are spent from 2017 on (as under current law) and the Fund’s principal balance depends solely on oil production revenue. Scenario 2, or “Reinvest All Earnings” provides a maximum ceiling under which all earnings are retained. It is between these two scenarios that Legacy Fund Initiative participants considered other possible scenarios for managing Fund earnings and contributions.

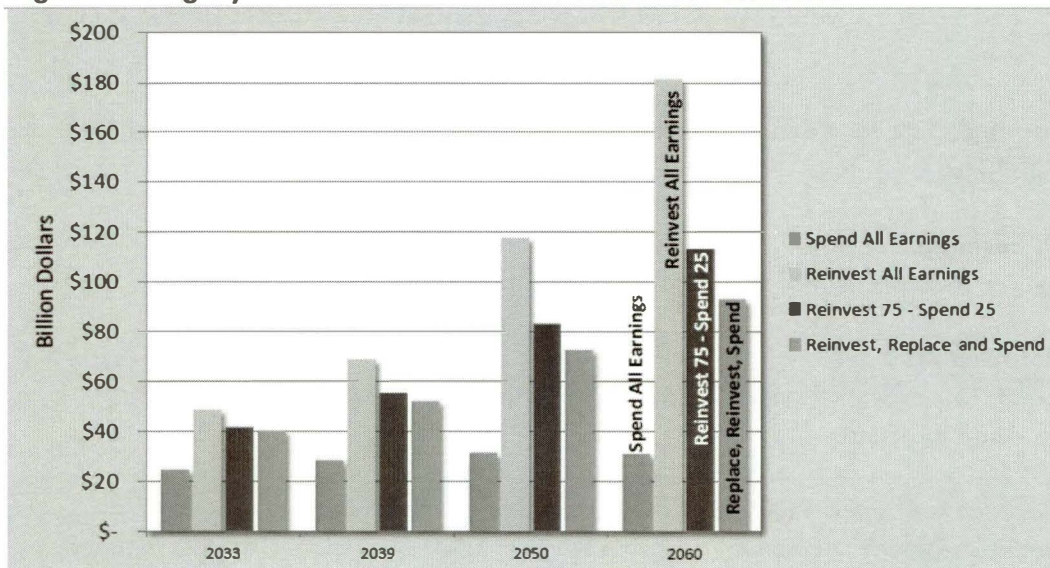
Scenario 3, or "Spend 25-Reinvest 75" provides for a nearer-term allocation of Fund resources by taking one quarter (25 percent) of annual earnings starting in 2017 to spend on other programs and uses, while retaining the remaining 75 percent of earnings for reinvestment. This scenario illustrates that with a modest withdrawal of a portion of earnings, a large revenue stream can be created in the near-term while still preserving long-term growth of the Fund.

Scenario 4, or "Reinvest, Replace and Spend", represents LFI participants' preferred scenario. It replicates the same 25 percent annual expenditure of Fund earnings, while also providing additional funding to replace diminishing state oil and gas revenues. At some point after North Dakota has met its maximum oil production potential, production and extraction tax revenue will begin to decline and the Legacy Fund can be used to provide supplemental income to make up the balance. As a result of the additional funding in this scenario, the state will see an effectively constant level of revenue despite declining oil production (see below for more information).

Projection of Legacy Fund Balance

Projections were calculated for each of the four scenarios according to the methodology detailed above. Annual levels of extraction and production tax revenue, principal balance and earnings were estimated in proportion to oil production projections.

Figure 1.4 Legacy Fund balance over time under four scenarios



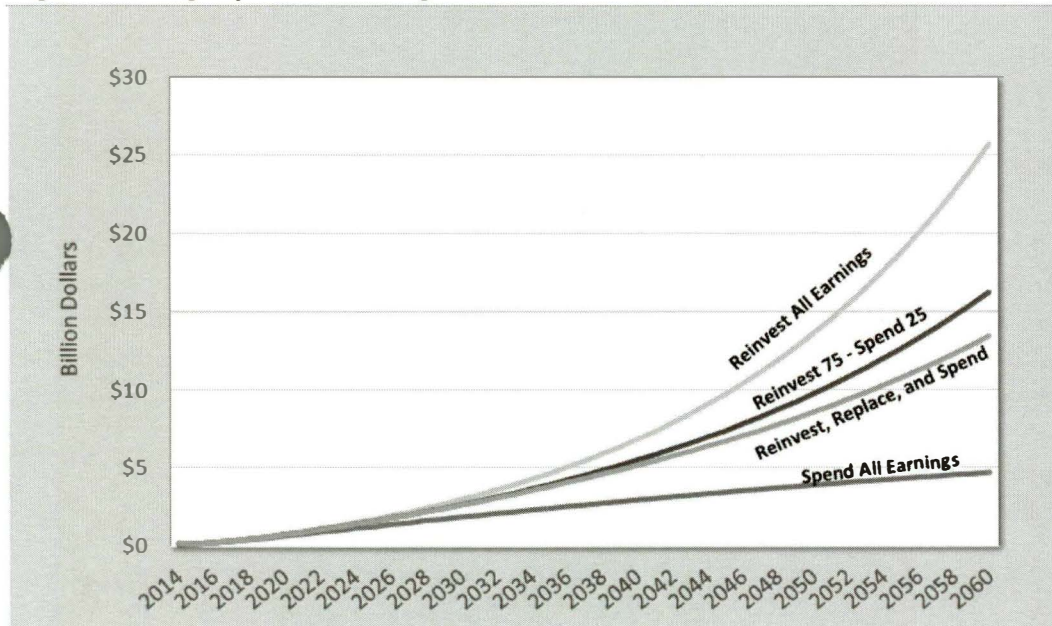
According to the assumptions used in this analysis, the Legacy Fund will grow to about \$35 billion by 2033 under the Spend All Earnings scenario, and will see modest growth relative to other scenarios to about \$77 billion by 2060. This scenario assumes that all earnings from the Fund will be spent each year (which is allowed as of 2017 under current law), rather than reinvested into the Fund. Thus, Legacy Fund growth under the Spend All Earnings scenario is entirely dependent on oil production and extraction tax revenue rather than on earnings.

Under the three scenarios in which earnings are either totally or partially retained, the Legacy Fund sees virtually exponential growth over a few decades as earnings are compounded and reinvested into the Fund balance. Under the maximum Reinvest All Earnings scenario, in which all annual earnings are reinvested, the Fund has the potential to grow to almost \$450 billion by 2060. The Legacy Fund also sees great potential for growth in the remaining scenarios in which a portion of earnings are spent: up to \$279 billion in the Spend 25-Reinvest 75 scenario and \$230 billion in the Reinvest, Replace and Spend scenario.

Annual Earnings

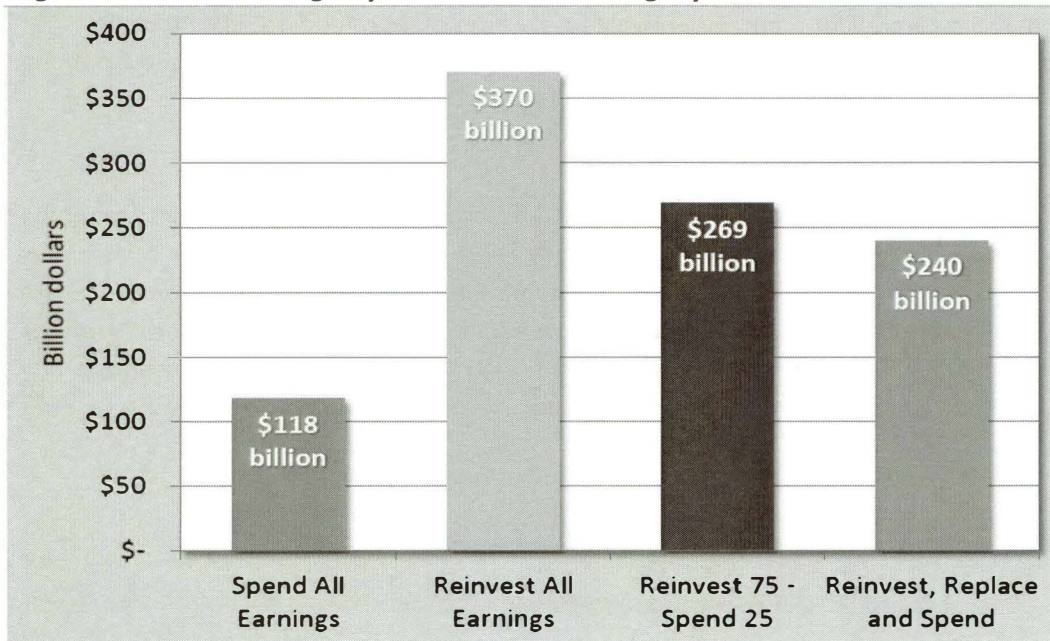
As explained above, the primary driver of growth in the Spend All Earnings scenario is revenue from oil production and extraction tax revenue contributions to the Legacy Fund. Under the three other scenarios, in which earnings are partially or totally retained, earnings become the primary driver of growth and far exceed contributions made by production and extraction tax revenue. By the year 2034, annual earnings in these three scenarios (about \$5 billion) are double those earned in the Spend All Earnings scenario (about \$2.5 billion), and continue to grow at an accelerating rate as earnings are retained and compounded.

Figure 1.5 Legacy Fund Earnings under four scenarios



The difference in annual earnings adds up quickly over a few decades, and by 2060 the resulting sums provides a dramatic contrast between scenarios (see Figure 1.6). Under the Spend All Earnings scenario, where no earnings are reinvested, the Legacy Fund will earn a total of about \$118 billion dollars by 2060. Under the Reinvest All Earnings scenario, however, the Legacy Fund has the potential to earn more than triple that figure, or about \$370 billion dollars in earnings alone. Finally, the two remaining scenarios--Spend 25-Reinvest 75 and Spend, Replace, and Reinvest—earn a total of about \$269 billion and \$240 billion in earnings, respectively. A closer look at these scenarios takes place later in the following pages.

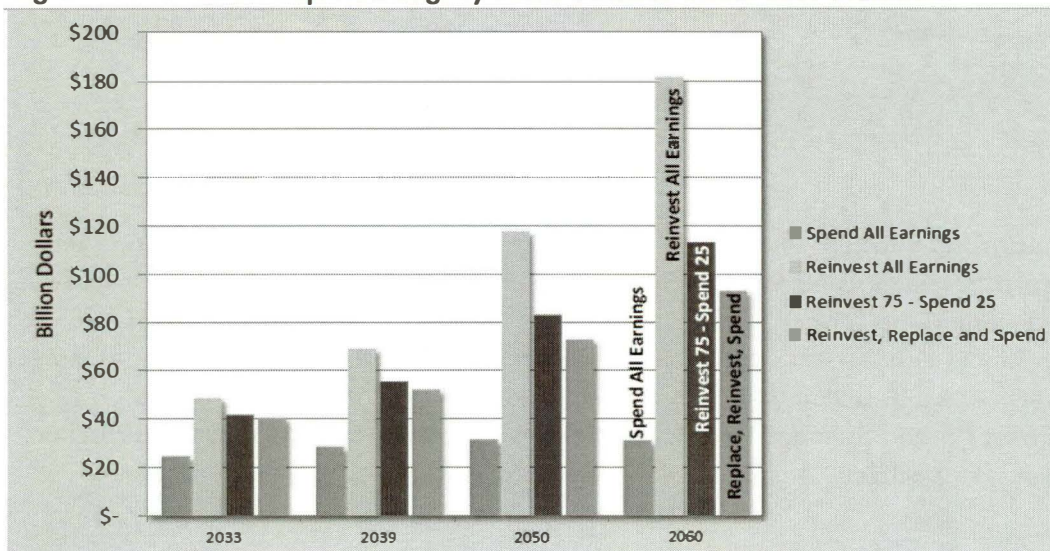
Figure 1.6 Total earnings by 2060 under four Legacy Fund scenarios



Adjusting for inflation

The figures presented in this analysis are meant to report the nominal dollar amounts that the Legacy Fund will achieve and earn as a managed account and do not reflect the potential effects of inflation. To consider the actual purchasing power of the Legacy Fund in the decades ahead, an average long term inflation rate of 2 percent was assumed and applied to the results of this analysis. Figure 1.7 presents the results from Figure 1.4 after being adjusted for inflation.

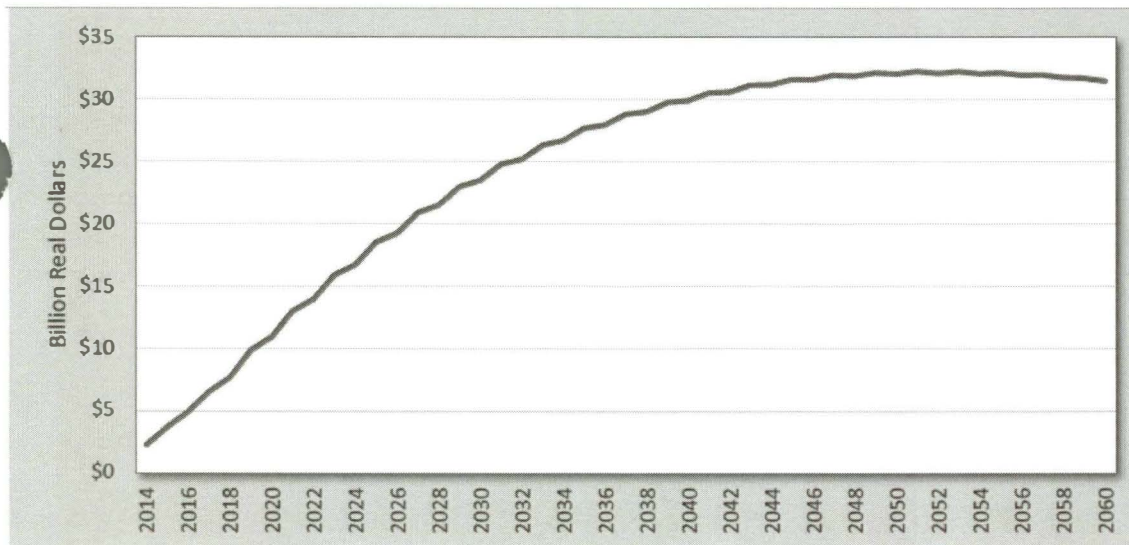
Figure 1.7 Inflation adjusted Legacy Fund balance under four scenarios



While the adjustment does reduce the long term projection for growth when diminished purchasing power under inflation is considered, the contrast between scenarios remains just as significant. By 2033, the Legacy Fund under the Reinvest All Earnings scenario (\$49 billion) is almost double the value of the Fund under the Spend All Earnings scenario (\$25 billion). By 2060, this difference becomes even starker as the Spend All Earnings scenario sees relatively minimal growth (\$31 billion) while the Reinvest All Earnings scenario grows to \$181 billion. Meanwhile, the remaining two scenarios grow to \$113 billion under the Spend 25-Reinvest 75 scenario and \$93 billion in the Spend, Replace, and Reinvest scenario.

Adjusting for inflation reveals an important factor in determining how to manage the Legacy Fund. While inflation may diminish the purchasing power of the Fund, in most scenarios the annual compounding of earnings will exceed the effect of inflation to achieve very significant growth. However, in the Spend All Earnings scenario, in which all earnings are spent and not reinvested in the Fund, inflation may have a detrimental effect. As shown in Figure 1.8, as Fund growth is solely dependent on diminishing oil tax revenues, inflation may actually reduce purchasing power significantly enough to negate any growth, effectively *shrinking* the Fund over time, if no earnings are reinvested.

Figure 1.8 Legacy Fund balance adjusted for 2 percent annual inflation under Spend All Earnings Scenario



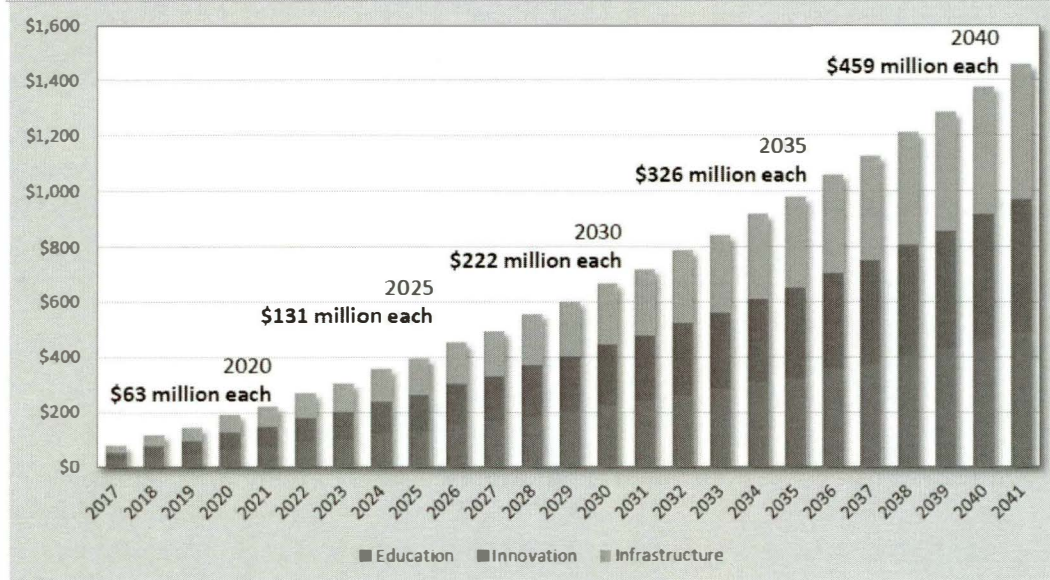
Revenue Stream from Spending 25 Percent of Annual Earnings

Scenario 3, or Spend 25-Reinvest 75, is meant to estimate the amount of funds available and the long term growth of the Legacy Fund, if 25 percent of annual earnings were used starting in 2017. As shown above, this scenario does produce significant growth, resulting in a fund balance of about \$60 billion by 2033, \$168 billion by 2050, and \$279 billion by 2060. By reinvesting 75 percent of earnings each year, the Fund is still able to achieve significant growth, while also providing a generous stream of state revenue.

To illustrate how much funding just 25 percent of annual earnings would provide, this analysis assumed the earnings would be split equally for three different purposes such as education, an innovation grant

program, and long-term infrastructure investment. Figure 1.9 presents the growth of these three programs over time. By 2020, the Legacy Fund could provide about \$63 million annually to each of the three purposes, or about \$189 million total. This could grow to \$131 million each in 2025 and to \$222 million each in 2030. By 2040, funding could reach \$459 million annually to each of the three purposes.

Figure 1.9 Annual contributions to three purposes from 25 percent of annual earnings



The Legacy Fund clearly has the potential to contribute very significant amounts to state revenue with just a portion of its projected annual earnings. Not all of the revenue would necessarily have to be spent each year, and Legacy Fund Initiative participants were interested in estimating how a potential program fund might grow, if an annual contribution of earnings from the Legacy Fund were saved for a number of years. Three management scenarios for a theoretical infrastructure investment fund were used to illustrate this concept:

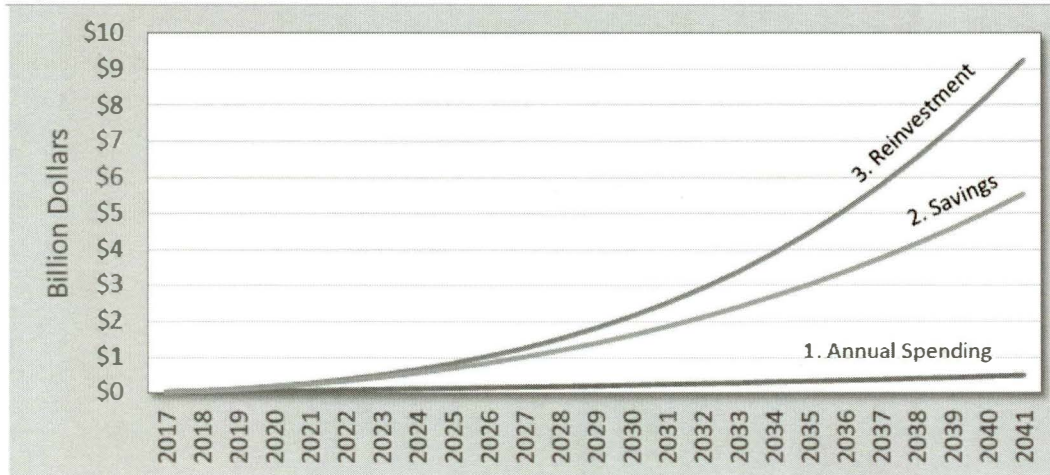
- In the first management scenario (1. Annual Spending), funds would be spent annually on applicable infrastructure projects.
- In the second scenario (2. Savings), funds would not need to be spent annually and could be carried over and saved over time.
- A third scenario (3. Reinvestment) would not only save the funds, but also reinvest them to grow the principal and allow for very significant infrastructure projects in the future.

Figure 1.10 shows the resulting amount of funds available to an infrastructure investment program depending on three scenarios for managing Legacy Fund contributions: 1. Annual spending of the funds and not saving, 2. Saving the funds, and 3. Saving and reinvesting the funds to yield earnings similar to the Legacy Fund (6.1 percent per year).

After 25 years, the contrast is apparent. Under the scenario in which funds are spent annually rather than saved, the infrastructure fund would have \$459 million available to it each year. Under the savings only scenario, the fund would have a total of \$5.5 billion available. Finally, if the funding were saved and

managed to earn a return on investment, the infrastructure fund could grow to a potential \$9.3 billion dollars.

Figure 1.10 Management scenarios for an infrastructure fund

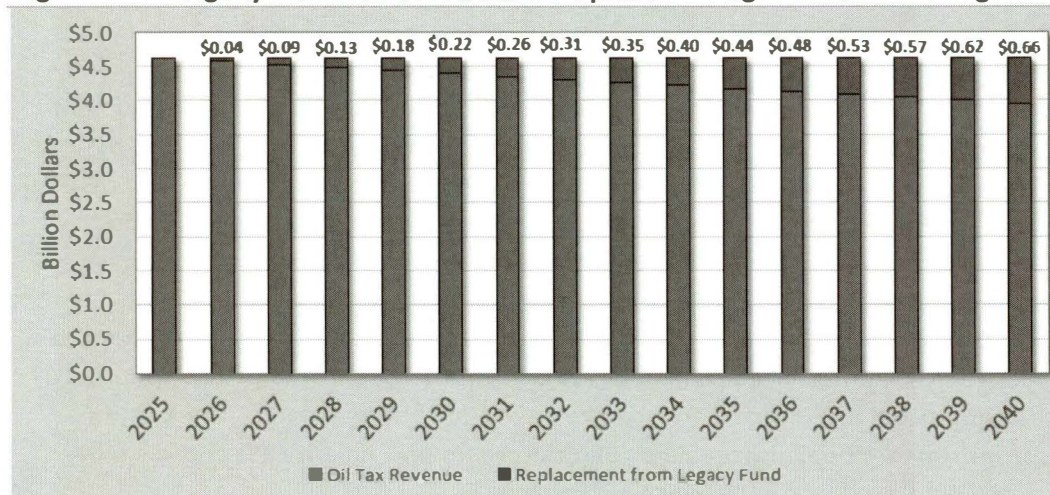


Preferred Scenario: Reinvest, Replace and Spend

The oil projections used for this scenario predict that peak production will occur between 2017 and 2025 (see figure 1.1), after which oil production will begin a slow but steady decline through the 2050s and probably further. With diminishing oil production comes falling tax revenue, but LFI participants' preferred scenario in this analysis illustrates a way to provide constant levels of revenue after production has peaked and begins to fall.

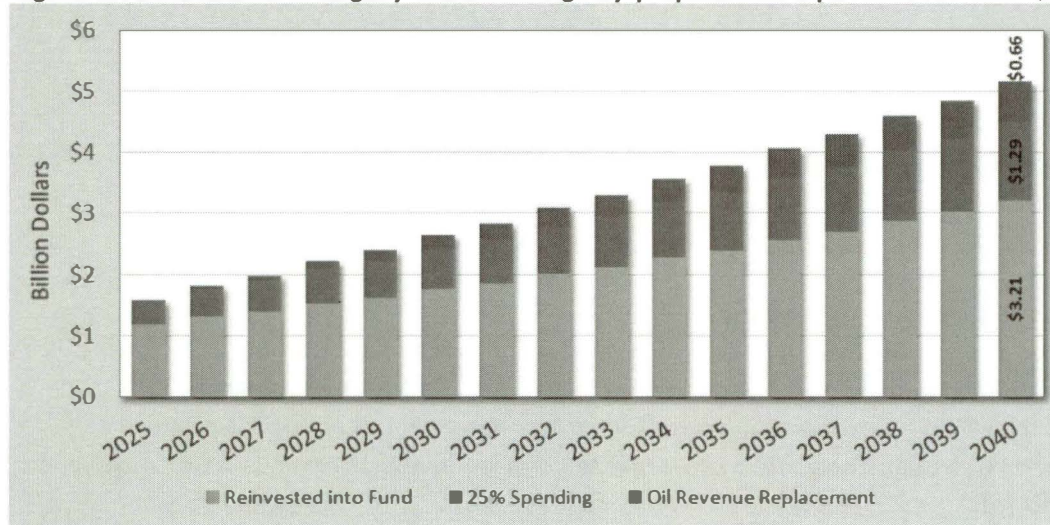
This Reinvest, Replace and Spend scenario features the same expenditure of 25 percent of annual earnings from the Fund as the previous scenario. This will result in similar levels of available funding as seen in figures 1.9 and 1.10. In addition, Fund earnings replace the amount of state revenue lost once oil production peaks and begins to fall. Figure 1.11 demonstrates the "wedge" of increasing levels of revenue to be replaced after projected oil production begins to decline in 2026.

Figure 1.11 Legacy Fund contributions to replace "wedge" of diminishing oil tax revenue



According to the P10 projection, the gradual rate of decline means that amount the Legacy Fund will need to replace is relatively small compared to the Fund's earnings. In 2026, under the preferred Spend, Replace, and Reinvest scenario, the Legacy Fund will need to make up for a projected \$44 million decline in oil tax revenue while also expending \$452 million of Fund earnings. Because the Fund is also projected to generate \$1.8 billion in earnings that same year, however, plenty of scope remains to continue growing the principal the Legacy Fund. Figure 1.12 compares the amounts of each use of annual Legacy Fund's earnings: reinvestment into the Fund, expenditure for specific purposes, and replacement of declining state oil revenue.

Figure 1.12 Allocation of Legacy Fund earnings by purpose under preferred Reinvest, Replace and Spend



By 2040, \$660 million dollars annually will be needed to make up for lost oil revenue after 15 years of decline. Meanwhile, \$1.29 billion dollars will be allocated to specific purposes, and \$3.21 billion in earnings will be retained and reinvested into the Fund. As Figure 1.12 shows, the Legacy Fund will still see sustainable growth, if moderate levels of annual earnings expenditure (25 percent proposed under preferred scenario) take place after 2017 and additional Fund revenue is used to make up the loss of revenue in the decades after oil production in North Dakota begins to decline.

Conclusion

This analysis was meant to illustrate a variety of management options for North Dakota's Legacy Fund. For consistency, these projections and scenarios hold many assumptions constant. Therefore, they do not reflect exact reality and cannot predict future political decisions that will impact budget amounts or revenue sources, especially as the projections extend out many years. A good methodology for analytical projection in an uncertain world is to determine those factors that can be decided by institutions and individuals making decisions, and to observe the effects of those decisions with all other factors held constant. Thus, from this analysis, the state of North Dakota clearly faces important decisions in how to manage the Legacy Fund in coming years. The results of the projections discussed in this report illustrate the dramatic differences between scenarios in which most or all of Legacy Fund earnings are spent early on, and scenarios in which a significant portion of earnings are saved for future growth. The analysis described in the previous pages amply demonstrates that allowing room and time for Fund growth in early years will result in a manifold payback in the decades to come.

APPENDIX B

Community Meeting and Online Survey Input Summary

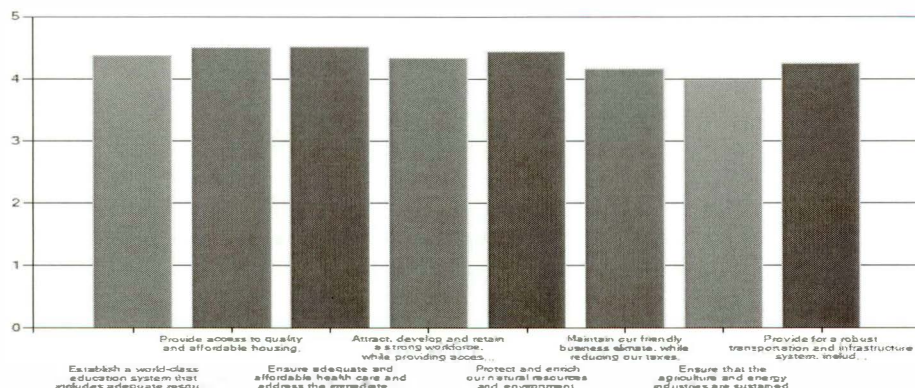
The Legacy Fund Initiative conducted public input outreach in May and June 2014 to gather input from North Dakotans on the draft vision, principles, goals and draft recommendations. An online survey was conducted in May across North Dakota's tribal college campuses. In June, four community input forums were held in Watford City, Velva, Grand Forks and Lisbon. An additional community input forum was held in Fargo in August. Approximately 180 citizens participated in the combined outreach activities of the Legacy Fund Initiative.

In the online survey, respondents were asked to provide their level of support and concurrence with the following list of current statewide needs compiled from the work and recommendations of the North Dakota Department of Commerce's 2020 and Beyond and USDA Rural Development North Dakota 2.0 statewide visioning processes:

- Establish a world-class pre-K through 12 and higher education system that includes adequate resources for early childhood education.
- Provide access to quality and affordable housing for all North Dakotans.
- Ensure adequate and affordable health care for all North Dakotans and address the immediate needs of our rural health care systems.
- Attract, develop and retain a strong workforce, while providing access to quality child care.
- Protect and enrich North Dakota's natural resources and environment to provide continued recreation and tourism opportunities.
- Maintain North Dakota's friendly business climate, while reducing North Dakotans' tax burden.
- Ensure that North Dakota's primary industries – agriculture and energy – are sustained for the long-term.
- Provide for a robust, long-term statewide transportation and infrastructure system, including water projects and flood control.
- Identification of current uses for the Legacy Fund to demonstrate near-term benefits and maintain public support for safeguarding the Fund for future generations.

Online survey respondents strongly agreed with all eight current needs identified:

North Dakotans, through two statewide visioning processes, have identified current needs and priorities that should be addressed in the state. Please indicate your level of agreement with the following list of current needs:



In addition, online survey respondents were asked to share their opinion on the use of Legacy Fund earnings that will be annually transferred into North Dakota's general fund beginning in 2017:

- 51 percent of respondents felt that Legacy Fund earnings should be utilized to support bold initiatives.
- 28 percent of respondents felt that Legacy Fund earnings should be spent on current state needs.
- 21 percent of respondents felt that Legacy Fund earnings should be reinvested back into the Legacy Fund.

Nearly 77 percent of survey respondents indicated that they supported the state addressing current needs with existing state resources before tapping into Legacy Fund earnings or principal.

Project stakeholders and staff facilitated each of the community forums and provided a background presentation on the project, including a snapshot of oil and gas production, the state budget, projections on growth of the Legacy Fund and the group's work to date.

Following the presentation, community input participants were asked: ***"Looking back twenty-five years from now, what would you like the Legacy Fund to have accomplished thanks to its wise management and use?"***

We received input in the following areas:

Accountability & Transparency

- There will need to be some strict standards for use of the Legacy Fund, otherwise ND may simply rely on the Fund to keep reducing taxes and still have poor infrastructure, underpaid teachers and an under-performing educational system.
- Transparency and accountability principles are needed across state government, in addition to the Legacy Fund.
- The governance recommendations provide a solid "foundation" to build public confidence in the management of the Legacy Fund.
- Affordable Housing/Child Care/Poverty Reduction/Trafficking.
- Affordable and sustainable housing is available for all North Dakotans.
- ND has a strong structure in place that helps eradicate human trafficking. ND has become a leader in anti-trafficking policy and enforcement.
- We have significantly reduced the number of hungry and homeless families in North Dakota.
- North Dakota has world-class, affordable child and elder care.

Education

- We have a world-class education system that is affordable and has a long-term, positive impact on students (pre-K through higher education), with increased quality and established niches for success. Tuition is reduced, and a fund is in place for scholarships.

Infrastructure & Public Services

- We have excellent, well-maintained infrastructure and have found productive uses for the infrastructure built to serve oil and gas development. We have a diversification plan in place. Infrastructure includes water, airports, roads, communications, rail, and pipelines and more.
- Infrastructure investments have been made that lead to improvements in people's quality of life (e.g., swimming pools).
- Establish a long-term, low interest, infrastructure fund (either whole or partial projects).
- Self-sustaining emergency responder services (911 centers, law enforcement, fire, EMS) are in place.
- Strong and innovative transportation systems are in place. High speed rail connecting Fargo, Grand Forks, Bismarck, and other population centers is available.

Natural Resources & Quality of Life

- North Dakota's natural resources are protected, preserved, and restored. There is a high value placed on preservation and protection with an eye towards tourism, hunting/fishing, and agriculture. Natural resources are accessible to the public for the purpose of increasing quality of life and for hospitality of guests/tourism.
- Strong investments have been made in energy conservation and renewable energy.
- North Dakota is a place where people want to live (quality of living, infrastructure, culture, education, etc.).
- ND (and especially Western ND) is a place where families want to move and stay (e.g., reasonable housing, health care, recreational activities—the full package of amenities that make up quality of life).
- We have more government capacity and services available locally to monitor and safeguard the region's water resources.

Tax Relief & Direct Payments to Citizens

- North Dakota is like Alaska and its Permanent Fund and the state makes annual payments to residents from the earnings of the Legacy Fund.
- North Dakota should make resources available to every resident (as Alaska does with its Permanent Fund) but the money should be tied to higher education and training. The money doesn't necessarily have to come from the Legacy Fund.
- The tax burden for our citizens has been greatly reduced.

Work Force Development/Job Creation/Future Industries

- Comprehensive affordability is established. Sustained wealth is created, and working North Dakotans can achieve a good living standard that meets basic needs and expenses.
- We have more financial products that make it possible for business start-ups (e.g., becoming a new young farmer). We are helping small businesses thrive, which helps diversify our economy in the process.
- We are investing research and development for other industries so that we are diversifying our industrial base beyond just oil and gas (for if/when that declines).

- North Dakota has an economy that allows us sustained growth in human resources.
- Thousands of high paying jobs are available through the efforts of long-term job creation.
- Rural areas are restored and experiencing robust growth.
- Economic mobility for future residents.

Input forum participants also offered suggestions on additional recommendations that the stakeholder group should consider prior to finalizing their work product.

Additional Recommendation Suggestions

- Need to incorporate support for **services, not just infrastructure**, especially with respect to **public safety**.
- In terms of the priority initiatives identified for potential near to medium-term expenditure of Legacy Fund earnings, there should be a fourth initiative that focuses on **environment and natural resources**.
- Would like to **increase emphasis on affordability of higher education** for ND students (in-state tuition costs, continued student loan program, and other institutional changes that would keep higher education generally affordable, not just scholarships).
- The 25% of "**overflow**" dollars (over and above the cap of \$300 million for the Strategic Investment & Improvement Fund) should be **made available to impacted communities at reduced interest rates**. This could replace and/or complement what the Bank of North Dakota was originally intended to do (the Bank has, over time, become more risk-averse and focused only on return).
- Spend some of the money on **medical research** (e.g., cancer and Alzheimer's).
- Emphasis should be on places where ND has a **strategic or comparative advantage**.
- ND has a world-class wind and biomass (bioproducts and biochemicals) and could position the state for a **more diversified economy longer-term**.

GOVERNMENT & VETERANS AFFAIRS COMMITTEE
North Dakota State Senate
Thursday, February 19 2015, 9:15 a.m.
Bismarck, North Dakota
TESTIMONY OF DINA BUTCHER

Chairman Dever and Members of the Committee:

I am Dina Butcher, a partner in WT Butcher & Associates, a private investigative agency in Bismarck, ND. I was fortunate enough to be a participant in the Legacy Fund Initiative and my testimony is in support of Senate SCR4014, a bi-partisan effort to study scenarios for the best investment of the interest of the Legacy Fund when it becomes the legislatures 'pot of revenue' in 2017. That 2017 legislature will set the precedent for how the interest from this constitutionally established fund is directed.

The Initiative members, who looked at various scenarios for investing the interest were a diverse group politically, demographically, and in my case, age and experience wise. We heard in depth presentations from states and countries with similar trust funds and considered various investment scenarios presented by consultants and investment experts. That diverse group came together unanimously in feeling that the bulk of the interest should be reinvested to maximize the benefits to future generations. And we also concluded that the conversation we began with the communities we visited and groups represented by Initiative members, needed to be broadened, which Senate Concurrent Resolution 4014 would do.

I have a daughter who moved to Alaska almost five years ago and have visited there several times. In informal 'focus groups' of their friends we have talked about "if they had it to do over again" how would they have structured their investment fund. And to

a person, in hind sight, they feel the individual payout has become an entitlement, a promise made, that cannot be kept without imposing taxes to shore up the economy as oil revenues decrease. This is just one anecdotal example of the discussion in which citizens of North Dakota need to be involved.

I am hopeful, that you have had the opportunity to review the Legacy Initiative report and the various editorial endorsements of the consensus reached to broaden this discussion..

Mr. Chairman and committee members, thank you for allowing me to testify on this study which may determine the steady course of North Dakota's governance long after all of us in this room have moved on to retirement or our "last call". I hope you will provide a "do pass" on this resolution.

PROPOSED AMENDMENTS TO SCR 4014

Page 1 line 19 after "WHEREAS," overstrike "seventy-five percent of annual legacy fund earnings from 2017 through 2039,"

Page 1 line 20 before "reinvested" insert "legacy fund earnings are"

Page 1, line 20 before "would" insert "the fund"

Page 1, line 20, after "grow" overstrike "the legacy fund"

Renumber accordingly

So it would read

"Whereas, if legacy fund earnings are reinvested into the fund, the fund would substantially grow to benefit future generations of North Dakotans; and"

GOVERNMENT & VETERANS AFFAIRS COMMITTEE

North Dakota State Senate

Thursday, February 19 2015, 9:15 a.m.

Bismarck, North Dakota

TESTIMONY OF Philip Boudjouk

#1 4014
3-19-15

Chairman Dever and Members of the Committee:

I am Philip Boudjouk, Professor of Chemistry and former Vice President of Research at North Dakota State University, my employer and professional home for 42 years.

It has been an honor and a pleasure to participate in the Legacy Fund Initiative and I am here today to offer my support of Senate SCR4014.

The goal of the initiative, to examine investment pathways for the earnings of the fund, which will be available for appropriation by the Legislature in July of 2017, was achieved through a bipartisan effort that included meetings of the members of the Initiative, webinars with decision makers of similar funds in other states, meetings with leaders in national sovereign funds, Norway for example, and community groups that we met with in cities around the state.

While the groups often brought forward different specific priorities, the consistent overall theme of all of them, whether international, national, or state, was that of building a better future for our successors through visionary leadership and transparent mechanisms. Common to these groups also, is the notion that the focus should be on spending earnings and avoid diminishing the principal. These ideas are incorporated in the work product of the Initiative.

The Initiative also concluded that the conversation we began with the communities we visited and groups represented by Initiative members, needed to be broadened, which Senate Concurrent Resolution 4014 would do.

Mr. Chairman and committee members, thank you for allowing me to testify on this study which may help illuminate the pathway to a still brighter future for our fellow citizens. I hope you will provide a "do pass" on this resolution.

NORTH DAKOTA'S LEGACY FUND:

Building a Bridge to the Future

*Harnessing Today's Oil Wealth to Build
a Positive Future for North Dakota*

NOVEMBER / 2014

RECOMMENDATIONS TO THE GOVERNMENT
AND CITIZENS OF NORTH DAKOTA



**GREAT PLAINS
INSTITUTE**

North Dakota's Legacy Fund: Building a Bridge to the Future

HARNESSING TODAY'S OIL WEALTH TO BUILD A POSITIVE FUTURE
FOR NORTH DAKOTA

LEGACY FUND INITIATIVE PARTICIPANTS

- **Nick Archuleta**, President, North Dakota United
- **Kelly Armstrong**, State Senator, District 36-Dickinson
- **Rod Backman**, Former Director, North Dakota Office of Management and Budget
- **David Borlaug**, President, Lewis and Clark Fort Mandan Foundation
- **Phil Boudjouk**, Professor of Chemistry and former Vice President for Research, Creative Activities and Technology Transfer, NDSU
- **Dina Butcher**, Former Director of North Dakota Division of Community Services and Former Deputy Agriculture Commissioner
- **Steve Burian**, CEO, Advanced Engineering and Environmental Services
- **Lorraine Davis**, Member, Mandan School Board
- **Maria Effertz-Hanson**, Owner, Black Butte Communications and Consulting
- **Mike Eggl**, Senior Vice President, Communications and Administration, Basin Electric Power Cooperative
- **Jon Godfread**, Vice President, Government Affairs, North Dakota Chamber of Commerce
- **Pete Haga**, Community/Government Relations Officer, City of Grand Forks
- **Eric Hardmeyer**, CEO, Bank of North Dakota
- **Terryl Jacobs**, Rancher and President, Slope Electric Board of Directors
- **Cynthia Lindquist**, President, Cankdeska Cikana Community College, Spirit Lake Nation
- **Jim Ringelman**, Former Director of Conservation Programs, Ducks Unlimited
- **Mac Schneider**, Senate Minority Leader, District 42-Grand Forks
- **Cody Schuler**, United Methodist Pastor
- **Larry Skogen**, Interim Chancellor, North Dakota University System
- **Rose Stoller**, Executive Director, Consensus Council, Bismarck
- **Karen Stoker**, Owner, Hotel Donaldson
- **Jessica Thomasson**, Vice President for Social Enterprise, Lutheran Social Services of ND
- **Dan Traynor**, Attorney, Traynor Law Firm
- **Gene Veeder**, Executive Director, McKenzie County Jobs Development Authority

ACKNOWLEDGEMENTS

This report and its consensus recommendations for the future of North Dakota's Legacy Fund represent the efforts and contributions of many people and institutions.

We are grateful for the dedication of our Legacy Fund Initiative participants who volunteered their time over the course of seven meetings, several webinars and many conference calls. It has been an inspiration and privilege to work with a group of people who care deeply about the future of our state.

We also thank the many citizens across our North Dakota who took the time to participate in our community meetings and online survey. Their input helped shape these recommendations. Special thanks are due to the North Dakota Association of Tribal Colleges for their assistance in preparing and delivering our online survey to gather citizen input.

Officials from North Dakota, federal agencies, other states, and the country of Norway gladly provided information and presentations to Legacy Fund Initiative participants that informed their recommendations. We want to acknowledge contributions from a number of state and federal agencies, including the Bank of ND, ND Department of Commerce, Office of Management and Budget, ND Public Finance Authority, ND University System, and USDA Rural Development. We also recognize representatives of state natural resource funds in New Mexico and Wyoming who generously shared their own experiences and Norwegian officials and colleagues who helped inspire this project in the first place. We thank Peter Beck for allowing the use of his photo on the front cover of this report.

Finally, none of this work would have been possible without the Northwest Area Foundation, North Dakota Natural Resources Trust and the Consensus Council in partnership with the Bush Foundation. We extend our thanks and appreciation for their generous financial support of this project.

~ Patrice Lahlum and Brad Crabtree, Great Plains Institute

EXECUTIVE SUMMARY

For the first and perhaps only time in our state's history, we can meet the needs and opportunities of the present and steward the development of an extraordinary and permanent resource for the future.

In November 2013, the Great Plains Institute convened a diverse group of North Dakota public, private, community and nonprofit leaders and citizens to develop a consensus vision and policy recommendations to guide the purposes, governance, investments and future expenditures of the state's oil and gas Legacy Fund.

North Dakota's Legacy Fund is special. It differs from other constitutional and state special funds in that North Dakota voters established the Legacy Fund to safeguard a portion of oil and gas revenue and grow it for the future. With 30 percent of oil and gas tax revenue flowing into the Fund, the balance of the Legacy Fund has grown substantially and now stands at more than \$2.2 billion. Legislative forecasts predict that the Legacy Fund balance will grow to at least \$6 billion by 2017.

Under the state's Constitution, the earnings from the Legacy Fund become available for expenditure by North Dakota's legislature in 2017. State officials estimate the earnings from the Fund will be at least \$300 million annually by 2017, and those earnings will be deposited into the state general fund. After July 1, 2017, the state legislature can spend up to 15 percent of the principal balance of the Legacy Fund per biennium, if two-thirds of each house of the legislature agrees to the spending.

North Dakota stands at a critical juncture. There has not yet been a broad public conversation in North Dakota about the future of the Legacy Fund since its inception.

Legacy Fund Initiative participants studied national sovereign wealth funds and state-level natural resource funds to gain insight into the purposes and management of various funds. In addition, project participants considered a number of scenarios for the management of North Dakota's Legacy Fund in coming decades.

Identifying a common vision and principles upon which to formulate recommendations for the Legacy Fund was one of the first steps taken by participants in the process:

Vision for the Legacy Fund

North Dakota's Legacy Fund will provide a permanent, sustainable resource for future generations that fosters self-sufficiency, creates opportunity and enhances quality of life for all citizens.

Guiding Principles

- Implement the highest standards and practices of governance, accountability and transparency to guide Fund policies, procedures, decisions and actions.
- Make long-term, sustainable investments in North Dakota's future through the responsible stewardship of revenue generated from a finite natural resource.
- Foster and reinforce core values of hard work, self-sufficiency, innovation, equity, and stewardship.

Priority Number One: Governance, Accountability and Transparency

In their deliberations, LFI participants have consistently emphasized the fundamental importance of managing the Legacy Fund according to the highest standards and practices of governance, accountability and transparency in policies, procedures, decisions and actions. Therefore, LFI participants have developed a "Best Practices" checklist for this report to enable North Dakotans to compare the governance, accountability and transparency of the Legacy Fund against a set of best practices drawn from guiding principles and codes of conduct for other sovereign and state wealth funds. They also recommend that state policy-makers consider modifying the current governance of the Legacy Fund as it grows in scale and importance.

Scenarios for the Future

With a vision and principles in place, project participants analyzed various revenue scenarios for the Legacy Fund over time. The revenue scenarios were developed utilizing oil production projections published by the North Dakota Department of Mineral Resources at the time of writing, as well as data on recent and historical revenue and fund balances.

Project participants ultimately selected a preferred 25-year scenario on which to base their goals and recommendations in this report. It offers state policy-makers a pragmatic middle ground between spending everything and spending nothing. The preferred "Reinvest, Replace and Spend" scenario achieves a balance for the Legacy Fund of \$230 billion by 2060, while providing North Dakotans important benefits in the near to medium term. Under the scenario, the Legislature would spend 25 percent of annual earnings from 2017-2039 and reinvest the remaining 75 percent back into the Legacy Fund until oil production peaks and begins to decline (currently projected for the latter half of the next decade). At that point, the Legislature would still spend 25 percent of annual earnings, but use a portion of the remaining 75 percent of earnings to replace diminishing state oil and gas revenue, while reinvesting the rest into the Fund.

At a time of rapidly growing oil production and state revenues, but also growing concern over the recent decline in oil prices, the "Reinvest, Replace and Spend" scenario represents a responsible approach to the future that relies on conservative projections for oil production and price. It also appropriately balances benefits for North Dakotans today and for future generations.

Having selected a preferred scenario, participants established goals for the future of the Fund. These goals build on one another and will require prudent, intentional management to grow the Legacy Fund's principal over a 25-year timeframe:

Goals for the Legacy Fund

- *Provide a resource of last resort in times of exceptional need.*
- *Provide for a significant portion of the state's future needs by compensating for the reduction in revenues once oil and gas production begins to decline.*
- *Beginning in 2017, invest in bold, visionary, and transformative actions that build assets and enhance quality of life for North Dakota citizens today and in the future.*

The Legacy Fund goals described above can only be accomplished through the power of compounding interest. Turning potential into reality will require citizens and their elected representatives to sustain a commitment to wise management of the Fund over time.

Fortunately, given North Dakota's present fiscal strength—with billions of dollars in oil and gas, sales tax and other revenue flowing into and overflowing out of multiple state funds—we have abundant alternatives to the Legacy Fund to meet the current spending priorities in our state.

Building upon the vision, principles and goals, this report outlines a broad strategy to manage the Legacy Fund over the next quarter century that meets our obligations to future generations, while contributing meaningfully to the lives of North Dakotans today.

Legacy Fund Strategies

- *Reinvest 75 percent of annual Legacy Fund earnings from 2017 through 2039 to grow the Fund principal, after inflation, to benefit future generations of North Dakotans.*
- *Use existing state resources to address critical needs and priorities of citizens and communities today, rather than drawing on the Legacy Fund.*
- *Allocate 25 percent of annual Legacy Fund earnings from 2017 through 2039 to bold and visionary purposes that build a bridge to a future.*

In order to achieve the strategies outlined above, the report includes detailed recommendations for the proposed allocation and use of 25 percent of the annual Legacy Fund earnings from 2017 through 2039.

Participants propose the establishment of a North Dakota Legacy Foundation to involve the legislative and executive branches of government to administer Legacy Fund initiatives and guide the use of annual Fund earnings, subject to oversight by the Legislature. The Legacy Foundation's role would include gathering public and expert input, identifying priorities for recommendation to the Governor and Legislature, and coordinating state agencies and private sector entities in planning and undertaking initiatives.

LFI participants recommend that the Governor and Legislature identify a critical priority for the state each biennium and charge the Legacy Foundation with developing a program of action to address that priority with Legacy Fund earnings and other state and private resources. They envision that priorities chosen each biennium will span a wide range of important issues as future governors and Legislatures respond proactively to the changing circumstances of our state over time.

Based on their own discussions and input from citizens, LFI participants strongly encourage the Governor and Legislature to choose the development of a comprehensive strategy and action plan for building a world class pre-K through 20 education system as the first Legacy Foundation priority for the 2017-19 biennium.

Additionally, project participants recommend that the Legacy Foundation focus on a few key priorities for impact. Three ongoing initiatives are proposed in education scholarships, innovation and infrastructure that the Foundation could coordinate. By 2020, the Legacy Fund could provide about \$63 million to each of the three initiatives, or about \$189 million total. This could grow to \$131 million in 2025, \$222 million in 2030 and \$459 million annually in 2040 to each of the three recommended initiatives:

INITIATIVE #1: ENDOW A HIGHER EDUCATION SCHOLARSHIP PROGRAM IN NORTH DAKOTA

As part of developing and implementing the broader strategy and action plan for pre-K through 20 educational excellence recommended in this report, LFI participants encourage state legislators to continue exploring how Legacy Fund resources could be utilized to endow a higher education scholarship program.

INITIATIVE #2: FOSTERING INNOVATION THAT BUILDS A BRIDGE TO THE FUTURE

LFI participants recommend that a “Genius Initiative” be established to foster transformative private and public sector innovation that builds a bridge to the future by leveraging our current success in energy and agriculture to expand and accelerate economic diversification and increase our state’s productive potential.

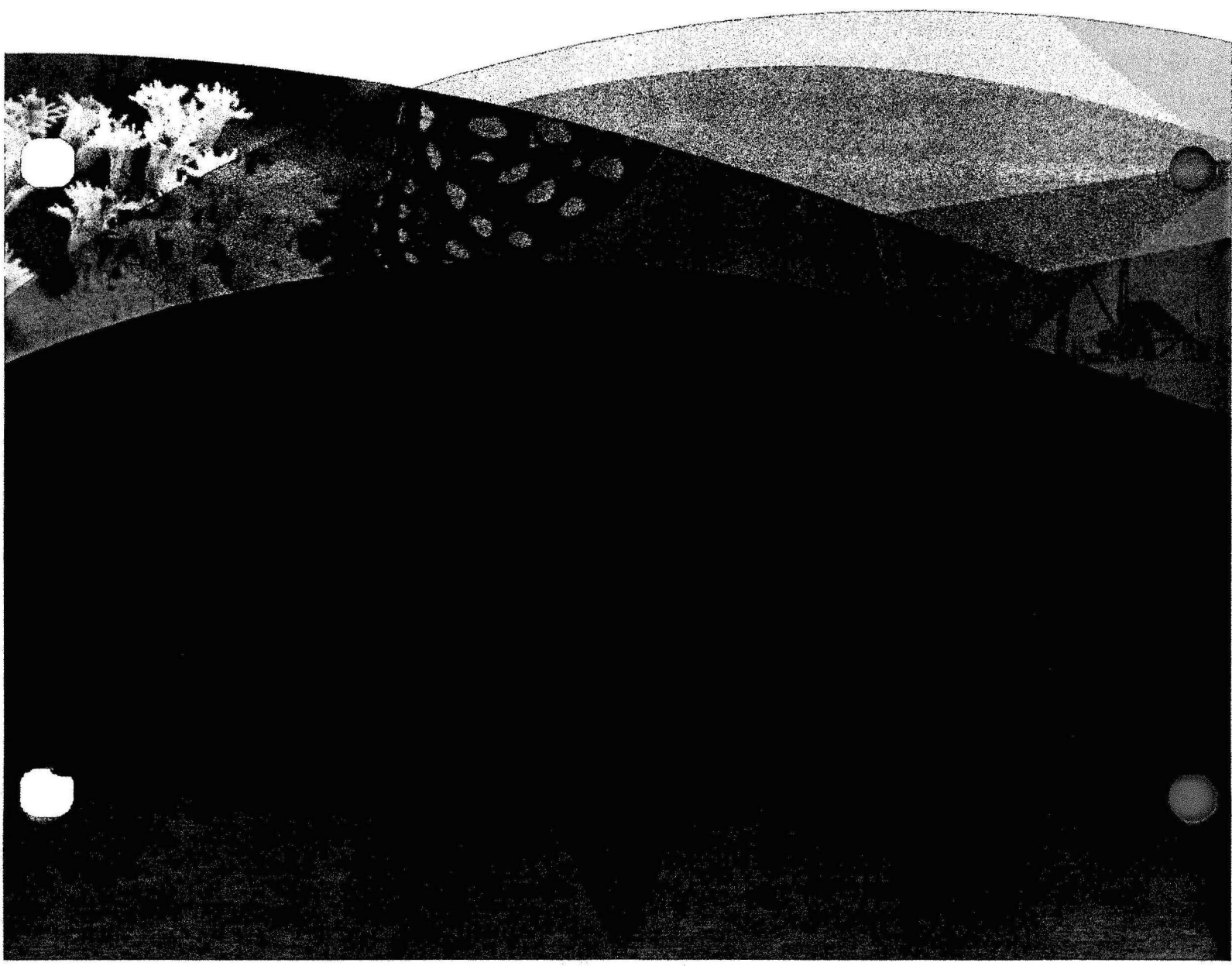
Funded by a portion of annual Legacy Fund earnings not reinvested, the proposed Genius Initiative would support applied research, development and demonstration of technologies and best practices, program and service delivery, and public-private partnerships that have significant potential to increase prosperity, create opportunity and enhance quality of life for citizens today and generations to come.

INITIATIVE #3: INVESTING IN 21ST CENTURY ECONOMIC AND COMMUNITY INFRASTRUCTURE

The LFI participants encourage state policy-makers to dedicate a portion of annual Legacy Fund earnings not reinvested after 2017 toward long-term economic and community infrastructure investments that are bold, visionary and transformative and that provide returns or allow for repayment of principal to the Fund. They specifically recommend investing rather than spending Fund earnings on infrastructure in order to leverage the impact over time.

LFI participants do not advocate appropriating Legacy Fund earnings for traditional infrastructure purposes. North Dakota’s infrastructure needs in the near term are enormous and driven to a large extent by oil and gas development. These needs will exceed available proceeds from Legacy Fund earnings by a large margin in the early years.

In offering these consensus recommendations for consideration by state policy-makers and citizens, LFI participants believe that we as North Dakotans today are blessed with an extraordinary bounty of oil and gas resources, which most states and countries will never share, and that is available to us for a limited time. We have an obligation through the Legacy Fund to take advantage of this window of opportunity to build a bridge to a future that provides our children and grandchildren with opportunities and options similar to those we enjoy today.





\$260 billion by 2060: Group outlines goals, uses for ND Legacy Fund

By Mike Nowatzki on Nov 13, 2014 at 8:56 p.m.

B ISMARCK – A voter-approved trust fund that has socked away more than \$2.4 billion in North Dakota oil and gas tax revenue since 2011 could balloon to \$230 billion by 2060 under a scenario outlined Thursday by a group that spent the last year developing a road map for the fund.

The Legacy Fund Initiative, led by the Minneapolis-based nonprofit Great Plains Institute with participation from 24 leaders in the public, private and nonprofit sectors, released its 44-page report during a news conference at the Capitol.

The purpose of the Legacy Fund has been a source of debate since North Dakota voters approved a constitutional amendment in 2010 to set aside 30 percent of the state's revenue from taxes on oil and gas production and oil extraction, initiative co-director Brad Crabtree said.

With input from public meetings and an online survey, the bipartisan initiative group crafted a set of principles, strategies and priorities for the fund's management and future use.

"It looked into what I believe is probably the largest long-term public policy issue facing North Dakota lawmakers, and that is how we take this one-time harvest of natural resource revenue and make it a permanent investment in our people," said Senate Minority Leader Mac Schneider, D-Grand Forks.

State officials predict the Legacy Fund will grow to at least \$6 billion by 2017, earning \$300 million annually in interest and investment income.

Lawmakers may start appropriating money from those earnings before June 30, 2017, but the funds can't actually be spent until after that date. Any spending of the fund's principal requires a two-thirds vote of both houses of the Legislature.

The idea for the Legacy Fund Initiative arose after the Great Plains Institute led a delegation of North Dakota leaders to Norway in June 2012 to study the Norwegian energy system. The trip included a briefing by officials from Norway's Government Pension Fund Global, which was created in 1990 as a way to ensure present and future generations benefit from the country's petroleum wealth. The fund currently stands at about \$893 billion.

The group studied various scenarios for the Legacy Fund, ultimately basing their goals and recommendations on a preferred 25-year scenario that offers state policymakers a "pragmatic middle ground between spending everything and spending nothing," the report states.

Under the preferred "Reinvest, Replace and Spend" scenario, the Legislature would spend 25 percent of the fund's annual earnings from 2017 to 2039 and reinvest the remaining 75 percent back into the Legacy Fund until oil production peaks and starts to decline. At that point, lawmakers would use a portion of the 75 percent to replace diminishing state oil and gas revenue.

"I think it's a prudent approach," said Rod Backman, a member of the group and former director of the state Office of Management and Budget.

Officials said the scenario uses conservative oil production projections from the state and assumes a crude oil price of \$80 per barrel and no changes in the existing oil and gas tax formula.

The group recommends the governor and Legislature identify a spending priority for the fund in each biennium, suggesting that the first priority for 2017-19 be to develop a plan for building a "world class" pre-kindergarten to college education system.

Participants also recommend three ongoing spending initiatives: a higher education scholarship endowment, infrastructure investments and a “genius initiative” to foster innovation in the agriculture and energy sectors.

Sen. Kelly Armstrong, R-Dickinson, said the next step is to present the report to lawmakers for feedback. There’s no timeline for implementing the group’s recommendations, “but the discussion needs to start now,” he said.

Schneider said he can’t foresee any active opposition to the recommendations.

The initiative was funded with \$168,000 in grant funding from the Northwest Area Foundation, North Dakota Natural Resources Trust and the Consensus Council in partnership with the Bush Foundation, Crabtree said.

Legacy leaders

Participants in the North Dakota Legacy Fund Initiative:

- Nick Archuleta, president, North Dakota United
- State Sen. Kelly Armstrong, R-Dickinson, an attorney
- Rod Backman, former director of the North Dakota Office of Management and Budget
- David Borlaug, president of the Lewis & Clark Fort Mandan Foundation
- Phil Boudjouk, chemistry professor and former vice president for research, creative activities and technology transfer at North Dakota State University
- Dina Butcher, former director of the North Dakota Division of Community Services and former state deputy agriculture commissioner
- Steve Burian, CEO of Advanced Engineering and Environmental Services Inc.
- Maria Effertz-Hanson, owner of Black Butte Communications and Consulting
- Mike Eggl, senior vice president of communications and administration at Basin Electric Power Cooperative, Bismarck
- Jon Godfread, vice president of government affairs for the Greater North Dakota Chamber

- Pete Haga, Grand Forks community/government relations officer
- Eric Hardmeyer, CEO of the Bank of North Dakota
- Terryl Jacobs, rural Regent rancher and president of the Slope Electric Cooperative board of directors
- Cynthia Lindquist, president of Cankdeska Cikana Community College, Spirit Lake Nation
- Bob Mau, president of MW Industries Inc., Kenmare
- Jim Ringelman, former director of conservation programs, Ducks Unlimited
- State Sen. Mac Schneider, D-Grand Forks, Senate minority leader and an attorney
- Cody Schuler, a United Methodist pastor from Fargo
- Larry Skogen, interim chancellor of the North Dakota University System
- Rose Stoller, executive director of the Consensus Council, Bismarck
- Karen Stoker, owner of the Hotel Donaldson, Fargo
- Jessica Thomasson, vice president for social enterprise for Lutheran Social Services of North Dakota
- Dan Traynor, attorney from Devils Lake
- Gene Veeder, executive director of the McKenzie County Job Development Authority

Mike Nowatzki

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OUR OPINION: A master class in N.D. politics

By Tom Dennis Today at 5:00 a.m.

The Legacy Fund's creators put the proposal on the right track. That's why the fund exists in North Dakota today.

Clearly, the Legacy Fund Initiative's backers have learned those lessons, too. The backers put together an impressive coalition, which in turn crafted an impressive proposal.

The proposal is sure to get a good hearing by the governor and Legislature.

Some parts of it are very likely to become law.

If that happens, then anyone who'd like to make big changes in North Dakota should study these episodes, because they'll amount to a textbook description of how it's done.

Start with the Nov. 4 election: Eight measures were on the North Dakota ballot. Voters rejected seven of them, passing only a ban on a certain kind of tax.

It was enough to make copy editors recall the Herald's famous headline of Dec. 6, 1989, which captured voters' even deeper skepticism of eight other ballot measures: "No, no, no, no, no, no, no, no."

So, are North Dakota reformers doomed to failure at the polls?

Absolutely not. Consider the Nov. 2, 2010, election, in which nearly 64 percent of voters said Yes to amending the North Dakota Constitution to create the

Legacy Fund.

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Why did that effort succeed where so many others have failed?

In our view, success stemmed from two things: First, the care with which supporters drafted the measure; second, the wide range of endorsements that the supporters secured for their campaign.

Remember, a 2008 effort to create a Legacy Fund had failed by the same 2-1 margin. Clearly, supporters learned from that failure and tailored their 2010 proposal with the comments and criticisms from two years earlier in mind.

As important, the supporters worked hard to get the blessing of a diverse lineup of key groups, many of which had opposed the 2008 proposal.

So, as the 2010 campaign developed, supporters won the backing of the state teachers union, the Greater North Dakota Chamber, the North Dakota Farm Bureau, newspaper editorial boards and a wide range of Democratic and Republican elected officials.

Such diverse support lends a statewide sense of consensus and legitimacy to a political cause. And in North Dakota, that makes all the difference on Election Day.

More recently, the Great Plains Institute took pains to craft a similarly broad-based foundation of consensus and goodwill. The institute assembled an all-star cast to craft the Legacy Fund Initiative, a lineup that again features notables from all walks of North Dakota life.

The result is both a strong and a strongly backed proposal. The initiative is off to a great start, and we're confident North Dakota lawmakers will give it the attention it deserves.

Rod Backman: The preferred scenario: Benefits now, plus long-term growth

By Rod Backman Today at 5:15 a.m.



Rod Backman

Through wise management, North Dakota's Legacy Fund has the potential to provide a truly permanent, sustainable resource for future generations.

The fund, established in 2010 by constitutional measure, has a current balance exceeding \$2.4 billion and is projected to grow much larger in coming years. The question is: how much money can and should the Legacy Fund hold in the future?

Beginning in 2017, the earnings from the Legacy Fund become available for expenditure by North Dakota's Legislature. State officials estimate the earnings from the fund will be at least \$300 million annually by 2017, and those earnings will be deposited into the state general fund.

The Legislature will have the option of either spending that money funds, reinvesting the earnings back into the fund or a combination of both.

In order to think strategically about the future of the Legacy Fund, participants in the Legacy Fund Initiative analyzed various scenarios for the fund based on conservative assumptions of oil production and price. They found that if all earnings are spent starting in 2017, the Legacy Fund may reach a projected maximum balance of about \$77 billion dollars by 2060.

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By contrast, reinvesting all earnings could yield a balance of \$448 billion by 2060 – a nearly six-fold increase – but without any public benefit from or use of the fund.

Understanding the minimum and maximum potential for the fund, we developed a preferred scenario – “Reinvest, Replace and Spend” – that provides a responsible middle ground on which to base our recommendations.

Under the scenario, the Legacy Fund balance grows to \$230 billion by 2060, while providing North Dakotans important benefits in the near to medium term and fully replacing state oil and gas revenue once production peaks and eventually starts to decline.

This scenario has the potential to provide future North Dakotans with twice as much in annual earnings (inflation adjusted) from the fund as we are receiving today in oil tax revenue.

Under this preferred scenario, the Legislature would spend 25 percent of annual earnings and reinvest the remaining 75 percent back into the Legacy Fund until oil production peaks and begins falling.

At that point, the Legislature still would spend 25 percent of annual earnings, but use a portion of the remaining 75 percent of earnings to replace diminishing state oil and gas revenue, while reinvesting the rest into the fund.

At a time of rapidly growing oil production and state revenues, but also growing concern over the recent decline in oil prices, the “Reinvest, Replace and Spend” scenario represents a responsible approach to the future. It also appropriately balances benefits for North Dakotans today and for future generations.

Having selected a preferred scenario, participants established goals for the future of the fund. These goals build on one another and will require prudent, intentional management to grow the Legacy Fund’s principal over a 25-year

timeframe.

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The goals for the Legacy Fund are to provide a resource of last resort in times of exceptional need; provide for a significant portion of the state's future needs by compensating for the reduction in revenues once oil and gas production begins to decline; and beginning in 2017, invest in bold, visionary and transformative actions that build assets and enhance quality of life for North Dakota citizens today and in the future.

These Legacy Fund goals can be accomplished only through the power of compounding interest (earnings), which will grow the fund's principal today to generate significant earnings permanently and sustainably in the future. Turning this extraordinary potential into reality will require citizens and their elected representatives to sustain a commitment to wise management of the fund over time.

Fortunately, given North Dakota's present fiscal strength – with billions of dollars in oil and gas, sales tax and other revenue flowing into and overflowing out of multiple state funds – we have abundant alternatives to the Legacy Fund to meet the current spending priorities in our state.

By embracing a sound 25-year strategy, we can advance bold and visionary ideas that provide benefits now, while building a bridge to our future. It is our hope that our recommendations and projections offer a prudent starting point for legislative and citizen debate about the future of North Dakota's Legacy Fund.

Backman, an accountant, served for 10 years as state budget director under Govs. Ed Schafer and John Hoeven. He was a participant in the Legacy Fund Initiative and submitted this on behalf of the other participants.

Steve Burian: Fund's earnings can finance 'bold and transformative strategies'

By Steve Burian Today at 5:10 a.m.



Steve Burian

GRAND FORKS – Here are important questions for all North Dakotans to consider: Looking back 25 years from now, what do you hope has been accomplished through North Dakota's Legacy Fund? What do we, as a state, want to accomplish?

What do we want our legacy to be?

Those very questions were posed in the first meeting of the Legacy Fund Initiative – a diverse group of North Dakota public, private, community and nonprofit leaders and citizens who came together to develop consensus recommendations on the purposes, governance, investments and future expenditures of our state's oil and gas Legacy Fund.

We recently released our recommendations as a proposed roadmap for the future. We believe that the Legacy Fund can serve both as an engine of opportunity and quality of life for North Dakotans today and a sustainable resource for future generations.

Our Legacy Fund is special. It differs from other constitutional and state special funds in that North Dakota voters established the Legacy Fund to safeguard a portion of oil and gas revenue and grow it for the future.

With 30 percent of oil and gas tax revenue flowing into it, the Legacy Fund has

grown substantially and now stands at more than \$2.4 billion. Legislative forecasts predict that the fund's balance will grow to at least \$6 billion by 2017.

Under the state's constitution, earnings from the Legacy Fund become available for expenditure by the North Dakota Legislature in 2017. State officials estimate that earnings from the fund will be at least \$300 million annually by 2017, and those earnings will be deposited into the state general fund.

Projections we developed show that the Legacy Fund balance could reach \$230 billion by 2060, even while using 25 percent of annual fund earnings.

That's why we recommend that the Legislature reinvest 75 percent of annual earnings for the next quarter century to grow the principal of the Fund and its earnings potential for future generations, while offsetting declining state revenues once oil production begins to fall.

Meanwhile, we encourage the Legislature to spend the remaining 25 percent of annual earnings, starting in 2017, to carry out bold and transformative strategies for North Dakota's future that also provide clear benefits to citizens today.

We recommend establishing a North Dakota Legacy Foundation to involve the legislative and executive branches of government with the private sector in guiding the use of a portion of annual Legacy Fund earnings, subject to oversight by the Legislature.

Under the North Dakota Legacy Foundation model, the Legislature would establish a critical priority every biennium for long-term study, statewide planning and action. The group recommends a comprehensive strategy and action plan for building a world class pre-K through 20 education system as the first Legacy Foundation priority in the 2017-19 biennium.

We also propose three ongoing initiatives for the Legacy Foundation:

- Endowing a higher education scholarship program in North Dakota, as part of developing and implementing the broader strategy and action plan for pre-K through 20 educational excellence.
- Fostering innovation that builds a bridge to the future, by establishing a “Genius Initiative” to spur transformative private and public sector innovation that leverages our current success in energy and agriculture to expand and accelerate economic diversification and increase our state’s productive potential.
- Investing in 21st century economic and community infrastructure that is bold, visionary, and transformative and provides returns or allows for repayment of principal to the fund. We specifically recommend investing rather than spending fund earnings on infrastructure in order to leverage the impact over time.

Allocating 25 percent of Legacy Fund earnings could provide approximately \$190 million for these recommended priorities by 2020. This amount could grow to roughly \$390 million in 2025, \$670 million in 2030, and \$1.44 billion annually in 2040.

We, as North Dakotans, today are blessed with an extraordinary bounty of oil and gas resources that is available to us for a limited time. We have an obligation through the Legacy Fund to use this window of opportunity while building a bridge to a future that provides our children and grandchildren with opportunities and options similar to those we enjoy today.

Burian is CEO of AE2S, a Grand Forks-based consulting firm that specializes in civil and environmental engineering. He was a participant in the Legacy Fund Initiative and submitted this on behalf of the other participants.

our OPINION

OUR OPINION: Too soon to spend N.D.'s Legacy Fund money

By Tom Dennis Today at 5:00 a.m.

Five thousand dollars is a lot of money. That's how much every North Dakota newborn would get for college tuition and other purposes if lawmakers approve Senate Bill 2165.

But \$448 billion is a lot of money, too. And that's how much the North Dakota Legacy Fund could be overflowing with by 2060, if the state reinvests rather than spends the fund's earnings between now and then.

Which means the two numbers may well be mutually exclusive. In other words, only one of them may be able to come true. We can have a \$5,000 account for

every newborn starting in 2017, or we can have nearly half a trillion dollars in the Legacy Fund in 2060.

But we may not be able to have both, because the money for the \$5,000 accounts would come from the earnings on the Legacy Fund. And spending that money now obviously means it wouldn't be reinvested in the fund.

That's the choice that confronts North Dakotans. It's vital to remember, because it will underlie every proposal to spend the Legacy Fund's earnings or principal for as long as the fund is around.

And in our view, that's the reason why the Legacy Fund Initiative deserves more of a hearing than it's getting in Bismarck. For the initiative by the nonprofit Great Plains Institute laid out the Legacy Fund's various "futures" in clear and convincing detail.

So, what do North Dakotans want:

A Legacy Fund that grows unencumbered for decades, until it expands to truly astonishing size?

A Legacy Fund that grows much more modestly, because state leaders choose to spend the earnings on such projects as the \$5,000-for-every-newborn initiative?

Or something in between?

Rather than commit to new spending programs, however attractive, the North Dakota Legislature should debate and settle on a plan - an approach to how the Legacy Fund's earnings will be used.

The volunteers who put together the Legacy Fund Initiative got the ball rolling. They suggested a 25/75 split: that is, spend 25 percent of the fund's earnings,

while putting 75 percent back into the fund.

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This would create a revenue stream to serve North Dakota's most important needs, while also harnessing the magnificent power of compound interest to grow the fund. And to review the numbers the Initiative released in November, this would result in a fund balance of \$279 billion in 2060, vs. \$448 billion if all the earnings are reinvested, and \$77 billion if all the earnings are spent.

Of course, these numbers are estimates, and they're based on various assumptions, including predictions about the price of oil. But the point about the effect on the fund's balance of spending the earnings vs. saving them is indisputable, in any scenario and under any conditions.

Let's be clear: Creating the \$5,000 accounts might be the right choice. But North Dakota will be a lot better off if it settles on an approach to Legacy Fund spending before it starts doling out the cash.

Right now, the account-for-every-newborn idea has the advantage of being the first proposal out of the starting gate. But would it be the best use of the fund's revenue stream? That's an open question, and it ought to be answered not only in light of other ideas, but also in the context of a formal Legacy Fund plan.

Tom Dennis

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The Bismarck Tribune

Legacy Fund report merits serious look

November 19, 2014 2:00 am • Tribune editorial

The Legacy Fund Initiative last week released what could be a road map for using money from the Legacy Fund.

The fund, approved by voters in 2010, reached \$2.4 billion in September. Thirty percent of all oil and gas production and extraction tax revenue goes into the Legacy Fund, which can't be accessed until June 30, 2017.

The Legacy Fund is expected to have approximately \$6 billion by 2017, according to Brad Crabtree of the Great Plains Institute, and the fund principal could be at \$230 billion by 2060.

A two-thirds vote of both chambers of the Legislature is needed to spend any of the fund's principal, capped at 15 percent per biennium. Earnings after June 30, 2017, are to be deposited into the state general fund at the end of each biennium by the state treasurer.

Crabtree headed the Legacy Fund Initiative committee composed of business leaders, officials with nonprofits, legislators and educators. Both political parties were represented on the committee.

After a year of work, members offered recommendations that involve the creation of a world-class state education system, a higher education scholarship program and long-term infrastructure investments.

They also suggested a "Genius Initiative" using a portion of earnings to foster public-private partnerships as well as support research and development of new technologies.

The committee should be commended for the work. It's well reasoned with a focus on building a strong foundation for the future of North Dakota. At the same time, it provides benefits for North Dakotans of today.

But it will be difficult to follow the same path for so many years. The economy, the legislative power structure and many other factors could change over the years. Those changes could alter how much the Legacy Fund grows and is used.

The committee's report, coming two years before the fund can be tapped, provides an opportunity for dialogue in the Legislature and the community.

During the 2013 legislative session, bills failed that would have used Legacy Fund money for students to attend college.

It's apparent the fund and how to use it is on the minds of lawmakers. Any discussion on using fund dollars should involve a broad discussion, and the committee's work offers a good starting point.

We are not suggesting the committee's work should be adopted as presented, but it merits a serious review.

Crabtree summed up the importance of dealing correctly with the Legacy Fund:

"For the first and perhaps only time in our state's history, we can meet needs and opportunities of the present and steward the development of an extraordinary and permanent resource for the future."

#2 4014
3-19-15

GOVERNMENT & VETERANS AFFAIRS COMMITTEE

North Dakota State House

Thursday, March 19, 2015

Bismarck, North Dakota

TESTIMONY OF DINA BUTCHER

Chairman Kasper and Members of the Committee:

I am Dina Butcher, a partner in WT Butcher & Associates, a private investigative agency in Bismarck, ND. I was fortunate enough to be a participant in the Legacy Fund Initiative and my testimony is in support of Senate SCR4014, a bi-partisan effort to study scenarios for the best investment of the interest earned on the Legacy Fund when it becomes one of the legislature's "revenue bucket" in 2017. That 2017 legislature will set the precedent for how the interest from this constitutionally established fund is directed.

The Initiative members, who looked at various scenarios for investing the interest were a diverse group politically, demographically, and in my case, age and experience wise. We heard in depth presentations from states and countries with similar trust funds and considered various investment scenarios presented by consultants and investment experts. That diverse group came together unanimously in feeling that the bulk of the interest should be reinvested to maximize the benefits to future generations. And we also concluded that the conversation we began with the communities we visited and groups represented by Initiative members, needed to be broadened, which Senate Concurrent Resolution 4014 would do.

I have a daughter who moved to Alaska almost five years ago and have visited there several times. In informal "focus groups" of their friends we have talked about "if they

had it to do over again" how would they have structured their investment fund. And to a person, in hind sight, they feel the individual payout has become an entitlement, a promise made, that cannot be kept without imposing taxes to shore up the economy as oil revenues diminish. This is just one anecdotal example of the discussion in which citizens of North Dakota need to be involved.

I am hopeful, that you have had the opportunity to review the Legacy Initiative report and the various editorial endorsements of the consensus reached to broaden this discussion..

Mr. Chairman and committee members, thank you for allowing me to testify on this study which may determine the steady course of North Dakota's governance long after all of us in this room have moved on to retirement or our "last call". I hope you will provide a "do pass" on this resolution.

#3 4014
3-19-15

**Testimony of
Rod Backman,
Legacy Fund Initiative Participant
in support of
SCR 4014
to the
House Government & Veterans Affairs Committee
Rep. Jim Kasper, Chairman
Thursday, March 19 – 9:00 am**

Chairman Kasper and committee members, my name is Rod Backman and I'm offering this testimony in support of Senate Concurrent Resolution 4014, which directs legislative management to study potential reinvestment scenarios for the Legacy Fund.

This legislation is based on recommendations that were developed through the year-long Legacy Fund Initiative - a diverse group of North Dakota public, private, community and nonprofit leaders and citizens brought together to develop a consensus vision and policy recommendations to guide the purposes, governance, investments and future expenditures of the state's oil and gas Legacy Fund.

Your committee has been provided a copy of the recommendations, including a detailed appendix that takes an in-depth look at the various Legacy Fund earnings reinvestment scenarios we studied as part of the project.

We analyzed various revenue scenarios for the Legacy Fund over time. The revenue scenarios were developed utilizing oil production projections published by the North Dakota Department of Mineral Resources at the time of writing, as well as data on recent and historical revenue and fund balances.

Project participants ultimately selected a preferred 25-year scenario on which to base the goals and recommendations. The preferred "Reinvest, Replace and Spend" scenario achieves a balance for the Legacy Fund of \$230 billion by 2060, while providing North Dakotans important benefits in the near to medium term.

Under the scenario, the Legislature could reinvest 75 percent of Legacy Fund earnings, with the option to spend 25 percent of annual earnings, from 2017-2039, until oil production peaks and begins to decline. At that point, the Legislature would still spend 25 percent of annual earnings,

but use a portion of the remaining 75 percent of earnings to replace diminishing state oil and gas revenue, while reinvesting the rest into the Fund.

At a time of growing concern over the recent decline in oil prices, the "Reinvest, Replace and Spend" scenario represents a responsible approach to the future that relies on conservative projections for oil production and price. It also appropriately balances benefits for North Dakotans today and for future generations.

We view these projections and scenarios as a starting point for discussion by the Legislature. Given the variable nature of oil production and price and the importance of our Legacy Fund to the state's future, I encourage you to pass SCR 4014 so that Legislative Management can further study potential reinvestment scenarios for the Legacy Fund in advance of the 2017 legislative session.

Looking forward, it will be prudent to develop a broad strategy to manage the Legacy Fund over the next quarter century that meets our obligations to future generations.

Mr. Chairman and members of the committee, I fully recognize the policies and management of the Legacy Fund is a Legislative decision, but believe this diverse group of North Dakotans have created a well thought out and valuable report for the Legislature to consider as it makes those decisions.

Mr. Chairman and committee members, thank you for the opportunity to testify in support of SCR 4014.