Shaping a Legacy: Using a Public Choice Framework to Analyze the North Dakota Legacy Fund

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EXECUTIVE SUMMARY

The North Dakota Legacy Fund was established in 2010 to create a perpetual source of revenue derived from taxes on oil and gas activity in the state. The fund has been touted as a tool of fiscal responsibility, setting aside revenue to provide for North Dakota's needs when finite natural resources are no longer profitable. Since the Legacy Fund's principal and earnings became available for use, legislators and voters have put forth a number of proposals for consideration. These proposals showcase the different views North Dakotans have about the purpose of the fund. With the North Dakota Legislative Assembly's actions likely to set precedence for future use of the funds, we set out to further explore these proposals.

In this policy paper, we apply a public choice framework using political and economic analysis to categorize three types of proposals and to examine the institutional factors that are likely to guide politicians, bureaucrats, voters, and special interests. After reviewing the history of the North Dakota Legacy Fund and other sovereign wealth funds, we provide an overview of the institutional framework surrounding the fund. Finally, we suggest evaluating different approaches by considering a unified vision to guide the use of the Legacy Fund.

Based on our analysis, we conclude that legislators will face pressure to spend money on one-time or residual spending projects that provide short-term benefits for their constituents. We also note that legislators will be more likely to use the Legacy Fund as a budget stabilization tool during times of economic distress. These approaches will be weighed against the long-term benefits of reinvesting the fund to secure additional revenue for an uncertain future. We do not endorse a single approach, but instead outline a framework for policymakers and citizens to analyze current and future proposals.

INTRODUCTION

North Dakota voters approved a constitutional measure in 2010 for the creation of a "Legacy Fund."[1] The Legacy Fund would invest tax revenues from the oil and gas industry to create additional funding for the future. A decade later, competing visions for the fund and numerous proposals for its use have divided policymakers.

In this brief, we identify a framework to categorize three types of proposals related to the Legacy Fund. We apply a public choice perspective to analyze how decisions to use the fund's earnings will be made and what will drive those decisions. Using this approach, we explore two primary areas of interest. First, we analyze the types of proposals that have been put forth and determine their likely impact on the citizens of North Dakota. Second, we explore the political framework in which the budgetary process operates for the allocation of funds. This includes examining the process for getting a proposal approved and the incentives faced by politicians, bureaucrats, and special interests.

BACKGROUND

In 2009, the North Dakota Legislature passed House Concurrent Resolution No. 3054, or the Legacy Fund proposal, placing the question of the Legacy Fund on the 2010 North Dakota general election ballot. A previous ballot initiative, known as the "North Dakota Permanent Oil Tax Trust Fund Referendum" failed in 2008.[2] In 2010, Constitutional Measure 1, listed as the "North Dakota State Legacy Fund Establishment," passed with 63.6 percent of the statewide vote.[1] The Legacy Fund was instituted into law as Article X, Section 26, of the North Dakota Constitution[3]:

Article X, Section 26,
North Dakota Constitution

1. Thirty percent of total revenue derived from taxes on oil and gas production or extraction must be transferred by the state treasurer to a special fund in the state treasury known as the legacy fund. The legislative assembly may transfer funds from any source into the legacy fund and such transfers become part of the principal of the legacy fund.

2. The principal and earnings of the legacy fund may not be expended until after June 30, 2017, and an expenditure of principal after that date requires a vote of at least two-thirds of the members elected to each house of the legislative assembly. Not more than fifteen percent of the principal of the legacy fund may be expended during a biennium.

3. Statutory programs, in existence as a result of legislation enacted through 2009, providing for impact grants, direct revenue allocations to political subdivisions, and deposits in the oil and gas research fund must remain in effect but the legislative assembly may adjust statutory allocations for those purposes.

The state investment board shall invest the principal of the North Dakota legacy fund. The state treasurer shall transfer earnings of the North Dakota legacy fund accruing after June 30, 2017, to the state general fund at the end of each biennium.

According to the North Dakota State Treasurer's Office, the North Dakota Legacy Fund has total lifetime deposits of $6 billion and total lifetime distributions of $455 million (as of March 2021).[4]

Sovereign Wealth Funds

The North Dakota Legacy Fund is a sovereign wealth fund (SWF). Sovereign wealth funds are "government-owned investment entities set up for a variety of macroeconomic purposes."[5] The primary funding agents for SWFs worldwide include the taxation of commodity exports, transferred reserves from central banking institutions, and "budgetary surpluses, proceeds from privatization, or transfers from their government's main budget."[6] Arguably, the most prominent type of SWF concerns the taxation of commodity production and exports, similar to the North Dakota Legacy Fund. The first SWFs were permanent funds established in U.S. states, notably Texas and New Mexico, to invest proceeds generated from oil and gas production and finance public spending.[7]

SWFs can play an important role in the economic health of a state or nation. Research has demonstrated that SWFs serve three primary functions: "1) the stabilization of macroeconomic variables; 2) serving as a vehicle for the investment of accumulated public savings; and 3) the generation and diversification of fiscal income and national wealth."[7] In addition, they allow for the "… accumulation of savings for future generations in resource-rich countries to offset the future lack of natural resources."[8] Experts advocate for each fund to have a clear, established purpose. The defined purpose should determine the path for how the fund is used, invested, and allocated.

In the following section, we outline four examples of state-owned SWFs in the U.S. and abroad with revenues generated from commodity exports. In the U.S., we focus on funds in Alaska, Wyoming, and New Mexico. There are numerous SWFs abroad, but we chose to look at the Norwegian Pension Fund, the largest SWF in the world that takes its revenues from the same commodity as the North Dakota Legacy Fund—oil. These four funds were all mentioned in the Legacy Fund Earnings Study Background Memorandum, which was prepared by the North Dakota Legislative Council.[9]

Alaska. The Alaskan Permanent Fund is a state-owned corporation with a total value of more than $74 billion (as of February 2021).[10] The fund was established by a statewide general election ballot in 1976 to preserve Alaska's mineral and natural resource wealth. Greater than 25 percent of all mineral lease rentals, royalties, royalty sale proceeds, federal mining revenue sharing payments and bonuses received by the state are placed in the fund. All of the income from the permanent fund is deposited into the Alaska general fund. Much of the fund is invested in the stock market and other similar investments, though the portfolio includes bonds and real estate holdings as well.[11]

Alaska's SWF is unique in that it is used to support the Permanent Fund Dividend. This fund was established by the Alaska Legislature in 1980 "to generate political support for conservative management of the fund, [and] to increase the likelihood that the principal would be protected over time."[9] Since 1982, the fund has been paying out an annual equal dividend to every resident of Alaska.[12]

Wyoming. The Permanent Wyoming Mineral Trust Fund (PWMTF) is a SWF created by the Wyoming Legislature in 1974 to cushion the impact of boom-and-bust revenue cycles and act as an endowment to preserve the state's wealth. The fund is financed by severance taxes on mineral revenues extracted in the state,[13] with total assets of $7.96 billion (as of June 2020).[14] The primary spending tool for the fund is a 2.5 percent transfer from the PWMTF to the Wyoming general fund.[15] With the exception of the Alaska dividends, the PWMTF operates similarly to the Alaska Permanent Fund and the Severance Tax Permanent Fund in New Mexico.

New Mexico. The Severance Tax Permanent Fund (STPF) in New Mexico was created in 1973 (one year prior to the PWMTF), making it the oldest U.S. SWF reviewed here. The fund accumulates revenue from severance taxes on natural resource gains. Investment gains from the STPF are annually distributed into the New Mexico general fund at 4.7 percent of the fund's five-year average.[16] The value of the STPF is about $5 billion (as of 2018).[17]

Norway. The Norwegian Pension Fund was "set up to shield the economy from ups and downs in oil revenue. It also served as a financial reserve as a long-term savings plan so that both current and future generations get to benefit from oil wealth."[18] The fund is nearly identical to the North Dakota Legacy Fund in structure, as earnings from oil and gas production are transferred to the fund. However, the Norwegian Pension Fund does not give out consistent transfers, nor does it have a system of consistent payments. Rather, it is used to cover budget shortfalls in bad times.

"Budget surpluses are transferred to the fund, while deficits are covered with money from the fund. In other words, the authorities can spend more in hard times and less in good times."[18] In addition, spending is limited to a rate of about 3 percent per year.[18]

Lessons. Other sovereign wealth funds in the U.S. and abroad provide useful examples for exploring the framework surrounding the North Dakota Legacy Fund and its use. Due to their similarities, many of the guidelines surrounding these four funds helped provide the foundational vision for the Legacy Fund. In fact, the Alaska Permanent Fund was continually brought up in discussions about how to structure the fund. Consultants were brought in to share their experience with implementing and administering the Alaska Permanent Fund and its dividend. They warned North Dakota, however, not to institute a dividend program to individuals.[19]

The Norwegian Pension Fund was also frequently sited as an example of how to model the Legacy Fund. As policymakers and citizens evaluate proposals for using the Legacy Fund, comparisons to other funds and their effects on the short-term and long-term economy are likely to continue.

Public Choice Framework

We apply a public choice framework to evaluate the institutional factors surrounding the North Dakota Legacy Fund. The public choice perspective of political and economic analysis "takes the same principles that economists use to analyze people's actions in the marketplace and applies them to people's actions in collective decision-making… [The] main motive, whether they are voters, politicians, lobbyists, or bureaucrats, is self-interest."[20] In other words, public choice looks at the systemic incentives that shape the actions of politicians and other decision-makers and their effects on the public policy process and outcomes.

NORTH DAKOTA LEGACY FUND

The principal and earnings of the Legacy Fund became available for use on July 1, 2018. Since then, there have been numerous proposals for use of the fund, including proposals to allow the fund to grow; proposals related to budget stabilization; and proposals for spending projects such as infrastructure, innovation and research, human services, and tax reductions. As the SWF literature shows, a sovereign wealth fund is generally guided by the institutional framework surrounding it and the vision, whether stated or implied, shared by policymakers and citizens.

Institutional Framework

Decisions about how to use the Legacy Fund will be made within a set of formal and informal institutions. The formal institutions include the North Dakota Legislature, the Legacy Fund Earnings Committee, Legislative Management and Legislative Council, the Retirement and Investment Office, the State Investment Board, and the Legacy Fund and Budget Stabilization Advisory Board.

Legislative assembly. Per Article X, Section 26, of the North Dakota Constitution, the North Dakota Legislative Assembly has the power to approve the use of the principal of the fund. Although the process for spending Legacy Fund earnings is not explicitly outlined, the budgeting and appropriation authority of the Legislature makes clear their primary role in governing the use of the Legacy Fund's principal and earnings. Despite this relative clarity, much uncertainty remains relating to the process for spending Legacy Fund earnings. Therefore, the Legacy Fund Earnings Committee was tasked with creating a proposal to outline how this spending would occur.[21]

Legacy Fund Earnings Committee. The Legacy Fund Earnings Committee was established during the 2019 legislative session through Senate Bill No. 2015 § 32. The committee was comprised of 11 members and charged to "study the potential uses of Legacy Fund earnings, including the use of earnings to provide tax relief, provide for reinvestment of Legacy Fund earnings, fund research and technological advancements, promote economic growth and diversification, and promote workforce development and career and technical education. The committee may consider public input on the use of Legacy Fund earnings and review the operation of other funds, such as Norway's sovereign wealth fund."[22]

The committee held public hearings throughout the state of North Dakota to receive proposals and suggestions for using the Legacy Fund earnings. In addition to their legislative votes, committee members are likely to have the most direct knowledge and input from experts and the public, giving them influence to make recommendations to the Legislature.

Legislative Management. Legislative Management is the group of legislators who manage the interim work between legislative sessions. This includes directing studies to be conducted and determining the membership of interim committees. When the Legislature is not in session, Legislative Management wields significant power. Legislative Management also "employs the Legislative Budget Analyst and Auditor who, with the assistance of a fiscal staff, provides technical expertise to budget and appropriation committees, reviews audit reports for the Legislative Audit and Fiscal Review Committee (LAFRC), and assists in conducting LAFRC studies designed to improve the state's fiscal practices."[23] In 1995, the North Dakota Legislature voted to give the Legislative Management authority to reconvene the legislative assembly.[23] Through these and other mechanisms, Legislative Management has a wide array of tools with which to impact decisions regarding use of the Legacy Fund.

North Dakota Governor. Beyond the legislative assembly, several other institutional actors are able to influence how the Legacy Fund is managed and used. The most prominent executive actor is the governor. As the most visible statewide elected official and head of the executive agencies, the governor wields substantial agenda-setting abilities. Part of that agenda-setting power can be exerted through the governor's proposed budget each biennium. By bringing public attention to certain issues and establishing a vision for the fund, the governor can influence legislative discussion and public opinion.

State Retirement and Investment Office. The North Dakota State Retirement and Investment Office was established in 1989 to coordinate the activities of two agencies: the State Investment Board (SIB) and the Teachers' Fund for Retirement (TFFR). North Dakota Century Code Section 54-52.5-02 states, "The state investment board shall govern the state retirement and investment office."[24] Moreover, the SIB "is charged with implementing policies and asset allocation and investing the assets of the legacy fund in the manner provided in Section 21-10-07."[25] The SIB manages the Legacy Fund's investments and controls the goals, objectives, and asset allocation for the fund.

Advisory board. In addition to the SIB, the Legacy and Budget Stabilization Fund Advisory Board (known as "advisory board") is charged with the responsibility of recommending policies on investment goals and asset allocation of the Legacy Fund.[26] The advisory board is comprised of four legislators. Although the SIB and advisory board do not have independent power to determine how funds should be spent, they do influence how the Legacy Fund's investments are allocated and the availability of funds in a given year.

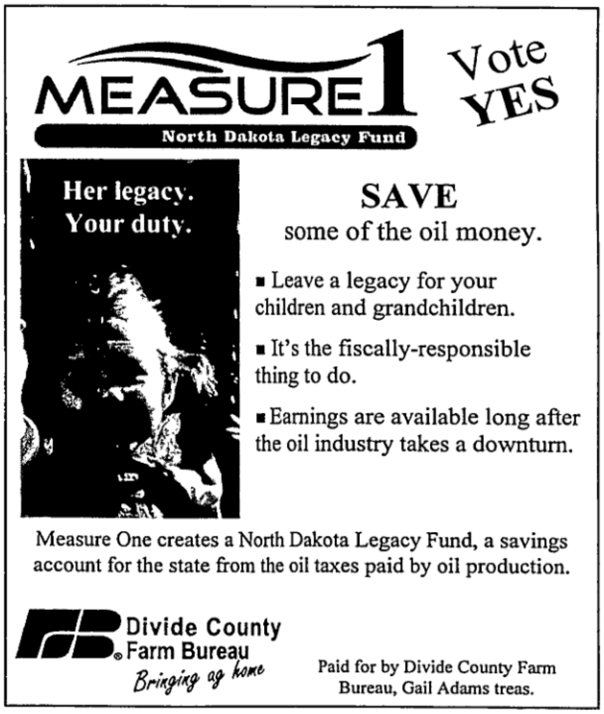
Competing Visions – Then and Now

The Legacy Fund was promoted as a way for the state to prudently invest and save revenues from the cyclical oil boom in western North Dakota. Members of the Legacy Fund Founders Committee stated, "The Legacy Fund would secure North Dakota's financial future by providing a consistent state revenue stream for our children and grandchildren, long after the oil industry takes a downturn."[27] In a 2010 op-ed, proponents argued, "It's prudent we put some money away when we're making the big bucks on the oil field… This isn't going to last forever."[28]

The intent to secure funds for the future is clear. However, visions and plans differed for guiding the use of the funds after the seven-year mandatory freeze. In fact, four prominent North Dakota newspapers supported the creation of the Legacy Fund, but each endorsed it for different reasons. *The Forum of Fargo-Moorhead* touted "a brighter economic picture for future generations," while The Bismarck Tribune focused on limiting government spending to avoid future tax increases.[29]

An advertisement appearing in multiple North Dakota newspapers encouraged voters to support the measure for a variety of reasons, including: "Leave a legacy for your children and grandchildren;" "It's the fiscally responsible thing to do;" and "Earnings are available long after the oil industry takes a downturn."

Figure 1: An advertisement by the Divide County Farm Bureau published in a local newspaper on October 27, 2010



With few legal constraints on how legislators can use the funds, the number of proposals has grown. Numerous interests have begun to engage the process since 2017, garnering significant discussion and opposing viewpoints. Public officials have endorsed a wide variety of approaches for using the Legacy Fund. For example, North Dakota Governor Doug Burgum has frequently discussed his vision for the Legacy Fund in his State of the State address.

Governor Burgum. In his 2018 State of the State presentation, Gov. Burgum discussed the budget shortfalls for the upcoming biennium: "We may have to use [Legacy Fund earnings] again to get us through this period of time where we're just using it to fund government. But certainly, all the young people who are here, in your lifetime, there's going to be an opportunity to use the Legacy Fund earnings for something that is really transformative."[30] Burgum did not elaborate on specific policies except to say that he opposed spending the principal of the fund.

The next year, in his 2019 address, Gov. Burgum advocated for a variety of specific spending projects using the Legacy Fund earnings, such as funding for career academies, scholarships, a new hospital, and infrastructure. He stated, "This – and all of our Legacy Fund proposals – will have lasting impacts beyond our current generation."[31]

In his 2020 State of the State Address, Gov. Burgum declared, "Our number one priority should be protecting ourselves and future generations from these downturns [in oil revenues], which can occur from market forces and world events beyond our course." Burgum further indicated that until oil is no longer a source of revenue for the state, "… we should never put ourselves in a position where legacy funds are funding core government because then we're going to be in a huge bind down the road."[32]

These remarks demonstrate the variable and evolving views officials have toward the Legacy Fund based on the political and economic realities of a given year.

North Dakota state senator Rich Wardner, vice chairman of the Legacy Fund Earnings Committee, explained his vision of the Legacy Fund: "[The] purpose of the Legacy Fund was to provide a revenue stream to the state general fund when oil production and oil tax revenue ended in North Dakota without raising any taxes. Therefore, legislators are not interested in spending the principal unless there would be an extreme emergency."[21]

Others. Sen. Wardner's comments indicate that he and other legislators view the Legacy Fund as a revenue replacement tool when oil extraction subsides on a permanent basis. (These comments echo some of the sentiments expressed by Gov. Burgum while also revealing a competing vision with Burgum's desire for "transformational" projects.) This view contrasts with a variety of proposals made by citizens at hearings around the state. These competing narratives reflect the myriad of visions held by elected officials and members of the public. Importantly, the Legislature's actions will likely set a precedent for future use of the funds.

EVALUATING APPROACHES

Evaluating proposals for using the Legacy Fund is a complex process with political ramifications. We suggest that any analysis of different approaches should address these three questions:

1. What was the initial intended purpose for which the Legacy Fund was established?
2. What are the best uses for the Legacy Fund's earnings, and perhaps for the principal, in achieving its purpose?
3. What are the political constraints surrounding approaches to using the fund?

As previously discussed, there appeared to be some initial consensus on the purpose of the fund, though it was not universal. The intent of the Legacy Fund founders was to create a fund to preserve resources generated from the current oil boom and provide for future generations. This intent, and the precedents set by the Legislature's actions, will likely govern the long-term decision-making process.

THREE TYPES OF PROPOSALS

Guided by the questions above, we reviewed the various proposals and identified three main categories of Legacy Fund proposals:

1. Reinvesting the earnings into the Legacy Fund
2. Using the earnings as a budget stabilization fund
3. Using the earnings on novel projects to transform government

Our analysis focuses on proposals related to the Legacy Fund's earnings. We view the use of the fund's principal as unlikely. Still, our framework can be applied to the principal with the understanding that there is a higher threshold for agreement, thus making decisions to use the principal less likely to occur.

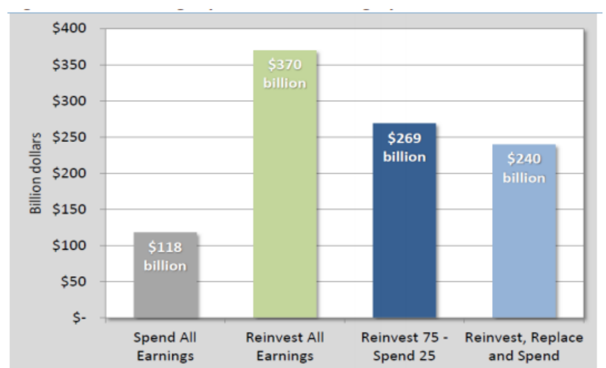
Reinvesting the Legacy Fund

The first type of proposal focuses on reinvesting all or part of the Legacy Fund's earnings. This may occur as a deliberate policy action or as the result of inaction. If the Legislature does not allocate funds to be spent from the Legacy Fund, they are automatically reinvested. This was the case during the 2019 Legislative Assembly.

Calls to reinvest the Legacy Fund's earnings and allow the fund to grow have been popular since the fund was instituted. This option has many potential long-term benefits.

A 2014 Great Plains Institute report titled "Recommendations of the North Dakota Legacy Fund" studied this issue by meeting with key North Dakota stakeholders to discuss policy recommendations. The report featured projections under different scenarios of spending and reinvestment. According to their projections, spending 100 percent of the earnings would yield just under $50 million by 2039; reinvesting 100 percent of the earnings (spending zero percent) would yield over $100 million by 2039; and reinvesting 75 percent of the earnings while spending 25 percent would yield approximately $90 million.[33] Though the exact rate of return is not guaranteed, these projections give an estimate of the likely difference in returns under different strategies.

Figure 2: Overall value of the fund in 2060, given different investment scenarios; projections made by the Great Plains Institute in 2014



The Legacy Fund Earnings Committee released its own projections in November 2019 under three different scenarios: transferring 100 percent of the earnings to the General Fund; 50 percent of the earnings to the General Fund; and zero percent of the earnings to the General Fund. Their projections were lower across-the-board than the projections released by the Great Plains Institute in 2014. For example, returning 100 percent of the earnings back to the Legacy Fund was predicted to generate a balance of $48.33 billion by 2041.[34] These lower projections are the result of a decrease in the price of oil. At the start of 2014, the Brent crude oil price was just over $100 per barrel. In 2019, it started at about $55 and continued to decline.[35]

Despite the unpredictability of oil markets, these projections help show the long-term advantages of reinvesting the earnings to grow the total principal of the Legacy Fund. The difference in the size of the fund between the different scenarios should give policymakers pause in spending the earnings. Preserving the funds for the future could have a much greater impact on the state.

Using the Legacy Fund as a Budget Stabilization Tool

The second type of proposal focuses on using the earnings to fill budgetary shortfalls, similar to a budget stabilization fund. Budget stabilization funds, also known as rainy day funds, "allow states to set aside surplus revenue for times of unexpected revenue shortfall or budget deficit."[36] Using the Legacy Fund as a budget stabilization fund would allow the state to maintain consistent spending levels.

North Dakota created a Budget Stabilization Fund in 1987 to limit revenue shortfalls. The guidelines for funding the Budget Stabilization Fund state: "The State Treasurer is required to transfer any funds in the General Fund exceeding $65,000,000 at the end of each biennium [...] to the Budget Stabilization Fund to achieve the fund's maximum balance. If there is not enough in the General Fund to meet the cap, then the Budget Stabilization Fund will retain its earnings until the cap is met. Once the cap is met the earnings are deposited in the General Fund."[37]

The primary revenue stream for North Dakota's Budget Stabilization Fund, besides transfers from the General Fund, are oil and gas production taxes. Using the Legacy Fund as a budget stabilization tool would duplicate an existing fund in both the source of its funds and its purpose. Legislators should be mindful of using the earnings in this way as it could lead to a perpetual reliance on the Legacy Fund for this purpose, transforming the short-term and long-term goals of the fund.

The state is currently facing a difficult economic situation with the price of oil remaining low and businesses and individuals still recovering from the coronavirus pandemic. During difficult budgetary cycles, proposals to use the Legacy Fund to alleviate shortfalls will become increasingly attractive.

Using the Legacy Fund to Transform Government

The third and final type of proposal focuses on allocating some or all of the earnings for specific spending projects. Spending proposals have received significant attention from elected officials and the public.

This type of proposal has the largest short-term benefit because it allows the funds to be put to immediate use. However, any proposal requires a majority vote by the Legislature. During the 2019 Legislative Assembly, legislators failed to pass several spending proposals (see Figure 3). These proposals also face budgetary constraints. Biannual earnings are placed in the General Fund at the beginning of each session, but the amount transferred is finite and varied.

These proposals have assumed a variety of forms (see Figure 4) but can broadly be narrowed into two categories:

1. Using the earnings to reduce income or property taxes for residents of North Dakota
2. Using the earnings to support appropriations for increases in government spending

Each category has distinct features, and we will discuss them separately in the sections that follow.

Figure 3: A list of failed proposals related to appropriating Legacy Fund dollars for new projects in 2019

HB 1484	would have appropriated $275 million from the General Fund derived from Legacy Fund earnings for various purposes, including a transfer of $100 million to a health and human services stabilization fund.
HB 1504	would have deposited a portion of the Legacy Fund earnings into the General Fund with the remainder transferred to a legacy earnings fund; the amount deposited in the General Fund would have been equal to five percent of the four-year average of Legacy Fund assets.
HB 1509	would have transferred $5 million from the General Fund derived from Legacy Fund earnings to a paid family medical leave fund
HB 1523	would have transferred excess state agency fund balances to the Legacy Fund after August 2021.
HB 1530	would have transferred 50 percent of Legacy Fund earnings to a legacy income tax reduction fund to provide income tax rate reductions.
SB 2141	would have provided a funding allocation to each child at birth managed by the Bank of North Dakota and would have deposited unspent funding in the Legacy Fund.
SB 2276	would have expanded the investments of the Legacy Fund to include investments in state programs
SB 2282	would have transferred 15 percent of Legacy Fund earnings to an economic diversification research grant fund.
Senate Concurrent Resolution 4005	proposed constitutional amendment to create a fund for grants and loans to political subdivisions for infrastructure projects; the amendment would have transferred 15 percent of the principal of the Legacy Fund and 15 percent of the earnings to the fund.

Figure 4: A list of the most common suggestions for spending Legacy Fund earnings; provided by North Dakota Majority Leader Senator Rich Wardner

Transportation infrastructure funding
Capitalize low interest revolving infrastructure loan fund for cities
Capitalize a low interest revolving loan fund for school building construction
20 percent funding assistant to school construction for school districts that qualify
Fund more career and technology programs
Funding for behavioral health programs
Increase funding to research and innovation
Funding for homeless programs
Property tax reduction through state K-12 funding
Income tax reduction

Reducing Taxes.

Some of the more popular proposals relating to the Legacy Fund have focused on using the fund's earnings to offset reductions to the state income tax or property tax collections. Proponents of these proposals argue that lower taxes will lead to in-migration and economic growth. However, potential issues could emerge from using the Legacy Fund in this way. We explore a proposal to lower the income tax rate to highlight these issues.

Reducing or replacing the state's income tax with revenues from the Legacy Fund is possible, especially as the fund continues to grow. During the 2017-2019 biennium, North Dakota collected $781,710,694 in individual income tax revenue, which was roughly 8.9 percent of the total net collections during that period. This represents a proportionally small amount of the state's income. Oil and gas taxes accounted for more than $4.6 billion (about 52.7 percent of the state's total income), and sales and use taxes were more than $1.9 billion (about 22.4 percent).[38] The total revenue generated from income tax collections is relatively small, but the expected economic benefits are similarly small.

Several studies have been conducted to examine how reducing income taxes affects economic growth and other variables. Unfortunately for advocates, there is little conclusive evidence to link lowering income taxes with real, consequential impacts on economic outcomes.[39] Moreover, North Dakota's income tax burden is already relatively low compared to other states.[40]

Opposition to this proposal has emerged from Gov. Burgum's administration. In the 2019 legislative session, a bill was proposed to "… divert half of the Legacy Fund earnings each two-year budget cycle to an 'income tax rate reduction fund,' as long as the transfer is at least $50 million."[41] In reference to this bill, Burgum said the proposal is not "good policy" because, "You're taking tax revenue from one industry and then spreading it out to everybody." Burgum has stated a preference for using the Legacy Fund on one-time projects instead of residual spending proposals.[42]

Spending Proposals.

Several interesting proposals have been put forth by Gov. Burgum, elected officials, and the general public to spend the Legacy Fund's earnings on diverse projects. Proposals have ranged from research advancements and workforce development to spending on infrastructure and health and human services. Other proposals have focused on funding narrow programs that represent a small group of stakeholders. Due to the wide scope of these proposals, we will not explore each one in detail. Overall, this category of proposals seeks to increase total government spending by allocating additional funds based on the availability of Legacy Fund earnings.

A proposal was put forth during the 2019 legislative session to create a new fund, with an initial allocation of $275 million from the Legacy Fund's earnings, to finance a variety of projects.[43] Although the bill failed, this approach is potentially popular among elected officials because it would allow different proposals to access a bucket of funds.

If legislators decide to use the fund in this way, it could lead to a shift in the purpose of the Legacy Fund. Functionally, a portion of the Legacy Fund's earnings would be added to the total revenue taken into the North Dakota General Fund each biennium.

DISCUSSION AND CONCLUSIONS

The question of how best to use the Legacy Fund's principal and earnings is complex and politically fraught. We sought to apply the lessons of public choice economics to study this dynamic issue. Given the institutional constraints surrounding the use of the Legacy Fund, public choice dictates that "… legislators, officials, and voters [will] all use the political process to advance their private interests, just as they do in the marketplace."[44] Those private interests may be financial or electoral. For example, elected officials will consider two questions: 1) *Is this good policy?* and 2) *How will my constituents feel about this policy during the next election?*

With self-interest at play, legislators will most likely face some pressure to spend money on one-time or residual spending projects that help their constituents. These projects are beneficial in the short-term and allow politicians to tout claims of progress and material betterment. This is true generally regarding the interests of politicians. However, the specific politics of North Dakota may push legislators to favor more fiscally conservative approaches.

With many voters in the state opposed to increased government spending, some legislators have instead focused on strong anti-tax sentiments among the electorate. Although these proposals are attractive to voters, the impact of these decisions remains uncertain and tax reductions—while popular in the short-term—may become problematic during periods of economic decline.

As a result of the ongoing coronavirus pandemic and the associated economic downturn, there has been growing interest among officials and the public to use Legacy Fund earnings as a budget stabilization tool. With legislators hesitant to cut programs or raise taxes, it becomes increasingly attractive to tap into the Legacy Fund as an available source of revenue during times of economic distress.

Special interests will also attempt to use the Legacy Fund's earnings to support their causes and preferred policy outcomes. The impact of these groups through direct campaign support, indirect public influence, and other avenues is likely to help steer policy discussions.

All of these issues interplay with the electoral and political realities faced by individual actors. The issue is further complicated by the knowledge that pursuing one vision for the Legacy Fund will likely foreclose opportunities to pursue other uses.

With these factors in mind, it appears that the most likely policy outcomes are the second and third proposals: using the fund's earnings for budget stabilization or spending the earnings to transform government. However, the alternative course – to reinvest the earnings for the future – may be favored by legislators and officials considering the long-term benefits for themselves and the state. Understanding that the current oil revenues will eventually run out, these institutional actors may favor an approach that stabilizes North Dakota's future.

What will be the legacy of North Dakota's Legacy Fund? Determining the right course is a decision for the elected representatives and the people of North Dakota. We do not suggest or recommend a proposal here. Instead, we have endeavored to examine the potential advantages and disadvantages of each approach and to provide a framework for evaluating their feasibility, efficacy, and likely outcomes.

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