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FISCAL IMPACT REPORT

SPONSOR: Gonzales DATE TYPED: 1/31/03 HJR 16

SHORT TITLE: Permanent School Fund Distribution, CA SJR _____

ANALYST: Smith

REVENUE

Estimated Revenue		Subsequent Years Impact	Recurring or Non-Rec	Fund Affected
FY03	FY04 or FY05			
	47,528.0 (Timing Uncertain)		Recurring	General Fund
	(57,263.0) (Timing Uncertain)		Recurring	Land Grant Perma- nent Fund
	9,735.0 (Timing Uncertain)		Recurring	Other Beneficiaries

(Parenthesis () Indicate Revenue Decreases)

Duplicates SJR6

SOURCES OF INFORMATION

Responses Received From

State Investment Council
DFA
Legislative Council Service
LFC Files

SUMMARY

Synopsis of Bill

House Joint Resolution 6 proposes to amend the New Mexico Constitution to increase the annual distribution from the Land Grant Permanent Fund (LGPF) from 4.7% to 5.5% of a five-year average market value.

Significant Issues

The land grant permanent fund (LGPF) was established by the Ferguson Act of 1898 and confirmed by the Enabling Act for New Mexico of 1910. Together, these acts transferred approximately 9.2 million surface acres of federal lands and 13.1 million acres of federal mineral interests to the territory of New Mexico. These lands were to be held in trust for the benefit of public schools and 19 other state institutions.

The LGPF consists of proceeds from the sale of state lands, royalties from natural resource production, and five percent of the proceeds from the sales of federal public lands in the state. Rental, bonus, and other public land income are also distributed to trust beneficiaries. The common school fund (a subset of the general fund) is the beneficiary of around 83 percent of trust income. The market value of the fund as of June 30, 2002 was \$6.7 billion.

FISCAL IMPLICATIONS

The revenue table notation reflects the uncertainty about the date of the election. The \$47.5 million is the full year impact for FY04.

A 1994 constitutional amendment mandates that 4.7 percent plus administrative expenses of a 5-year average of the fund's year-end market valuations shall be distributed to the beneficiaries.

Investment consultants look at permanent funds as an endowment, not a "rainy day fund". This is an important distinction because it implies the current generation is obligated to pass the fund on to future generations intact. This notion is often referred to as "inter-generational equity". Specifically, it means the inflation adjusted purchasing power of the distributions should not be diminished. Alternately, it means the present value (a way of adjusting for the time value of money) of the funds' corpus and distributions should not be impaired. Implicit in this standard is the assumed trade-off between the value of a dollar today and in the future (known as the discount rate). A lower rate makes future dollars more attractive; conversely, a higher rate implies that today's distributions have a higher value than tomorrow's increased fund balances. Experts note that the discount rate in these studies has typically ranged from a high of 15 percent to a low of 5 percent.

The State Investment Council contracts with New England Pension Consultants (NEPC) to review the appropriateness of the permanent funds' distribution policy. The following table summarizes the results in a 2002 study. Please note that NEPC analyzed a slightly different proposal. The results for a 5.5 percent distribution would be roughly the same magnitude.

Inflation and Time Adjusted Effects of Different Spending Scenarios

(Dollars in millions) **Inflation and Time Adjusted Effects of Different Spending Scenarios**

(Dollars in millions)

Spending Level	4.70%	5.45%
Real Value of Fund (Year 20)	\$6,955,947	\$6,106,340
Net Present Value of Spending Policy	\$10,368,973	\$10,168,870

The first row shows the inflation adjusted value twenty years into the future assuming an inflation rate of 3.25 percent. Unsurprisingly, the real value of the fund is greater with a lower spend-

ing policy. More significant is the row marked “Net Present Value of Spending Policy”. It shows the time adjusted effects of different spending policies. Its purpose is to put the future value of the corpus of the funds (a stock) on an “apple to apples” basis with a set of annual distributions over time (a flow) by using the financial concept of the time value of money, or “present value”. This figure is the sum of discounted distributions and the initial corpus value. As shown in the table, the higher spending policy actually results in a slightly lower present value.

TECHNICAL ISSUES

- The Legislative Council Service has noted that an election could be scheduled so that the distribution would be effective in FY04.
- The language in Section 3 appears to be unnecessary. The Council Service believes that the state would not have to seek congressional approval for a distribution rate change.

OTHER SUBSTANTIVE ISSUES

By far the most important value judgment underlying the spending policy analysis is the supposition that the maintenance of the endowment is of greater good to society than any alternative investment. As a recent Wall Street Journal article shows, many trustees have and do question this principle. The article’s most poignant argument for the spend-it-all approach comes from 1913; Julius Rosenwald, chairman of Sears, Roebuck and Co., declared, "Permanent endowment tends to lessen the amount available for immediate needs, and our immediate needs are too plain and too urgent to allow us to do the work of future generations. "The article goes on to note that “In the first half of the century, Mr. Rosenwald's fund gave away the equivalent of more than \$700 million in today's dollars. Among many other projects, Mr. Rosenwald contributed to the construction of nearly 5,400 schools for black children in the South. In the years following World War I, an estimated 60% of American blacks who had completed primary school had been educated in Rosenwald schools”.

The point here is that the quantitative measures presented in these studies are still governed by subjective influences; they are not “scientific” nor are they sufficient information on which to make an informed judgment. The investments that depleted the Rosenwald endowments had dramatic returns to society but would probably fare quite poorly by the present value and inflation statistics presented in the NEPC study. In the end, policy makers must make their own judgments as to what expenditures have the highest return for society.

SS/njw/ljs