

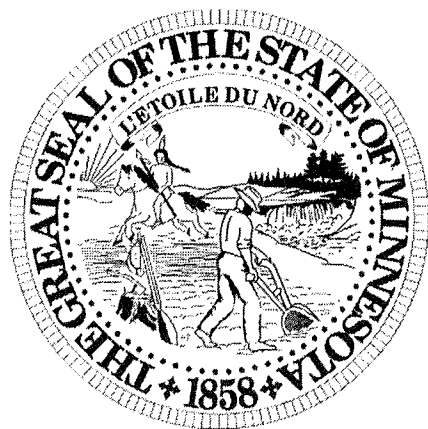
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CAMPAIGN FINANCE AND PUBLIC DISCLOSURE BOARD

Report to the Legislature

Funding Options for Board Operations

Report pursuant to:
Laws of Minnesota, Chapter 327, Section 28



January 15, 2011

**John Scanlon
Chair**

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Introduction

During the 2010 legislative session the legislature passed and the Governor signed a bill amending Minnesota Statutes Chapter 10A, the Campaign Finance and Public Disclosure Act. Included in the bill was a provision requiring the Campaign Finance and Public Disclosure Board to examine a funding option different from the usual biennial budget appropriation process.

The requirement, enacted in Laws of Minnesota, 2010, Chapter 327, Section 28, was as follows:

"CAMPAIGN FINANCE AND PUBLIC DISCLOSURE BOARD; FUNDING OPTION.

The Campaign Finance and Public Disclosure Board shall analyze the potential use of funds collected under Minnesota Statutes, section 10A.31, as the exclusive source of funding for the operations of the board.

The board must submit a report describing the board's findings and recommendations under this section to the chairs and ranking minority members of the legislative committees with jurisdiction over elections policy and finance no later than January 15, 2011."

Scope of This Report

This report will address the legislative mandate, which is to examine the use of funds collected under Minnesota Statutes, section 10A.31 as the exclusive source of funding for operations of the Board. Section 10A.31 is the statute providing for a system commonly referred to as the "State Elections Campaign Fund checkoff program".

In addition to the mandated scope of this report, the Board will comment on use of an alternative checkoff program, similar to the Nongame Wildlife Fund program. The Board will also comment on its 2004 study of the use of fees to fund Board operations and on other related subjects.

Campaign Finance Board Funding Needs

The Base budget for the Campaign Finance Board for fiscal years 2012-2013 is \$725,000 per year. With significant cuts in equipment and training and other cost-saving strategies, the Board hopes to be able to continue its current level of operations within this budget. Whether this funding level will result in staff reductions in FY 2013 will depend on the outcome of contract negotiations with the bargaining units representing state employees. If contracts result in significant personnel cost increases, a reduction in one position to less than full-time may be required.

It is important to note that the above paragraph states that the Board hopes to be able to maintain "its current level of operations". An important question is whether that current level of operations is satisfactory to the legislature and to the citizens of the state.

Minnesota's system of campaign finance and lobbying regulation relies significantly on the concepts of self-regulation and opponent or other interested party review of filed documents. By this is meant that in the first instance the Board relies on filers to know and understand the requirements of the law and to voluntarily comply with those requirements. When that doesn't happen, a second important aid in regulation and disclosure is the review of reports that is often carried out by opponents of the filer or other interested parties.

While the Board completes extensive computer analysis of receipts reported by filers, that analysis is able to detect only those violations that are disclosed in filed reports. It is an opponent's or other interested party's review of reports and knowledge of the events in the field that most often raises questions of violations not obvious from filed reports.

The Board's ability to be a stronger force in ensuring that money raised for political purposes is used appropriately is hindered by two facts. First, the Board does not have sufficient human resources to engage in a meaningful audit program and, second, the Board does not have jurisdiction over two statutes directly related to raising and spending political money: Section 211B.12, which governs how money raised for political purposes may be used and Section 211B.15 which regulates the use of corporate money for political purposes.

The Board is aware of reports disclosing financial transactions that significantly deviate from expected patterns of campaign spending, suggesting the possibility of inaccurate reporting. Other reports suggest misappropriation or misuse of money raised for political purposes. Good

regulatory practice would result in these reports being investigated and the committees' financial records being audited. However, the two factors discussed above have prevented the Board from being proactive in these cases. A complex audit takes significant staff hours. It also requires a high-level staff member who has the knowledge and experience to conduct a complex and sensitive audit/investigation. At present, only the Executive Director and Assistant Executive Director of the Board possess that knowledge and experience. Second, in some cases, the most obvious violation suggested by a filed report is the misuse of campaign funds; a violation not under the jurisdiction of the Board. The result is that an investigation of a case where misuse of funds may have occurred will be investigated by the Board, if at all, as a case of improper reporting or false certification of a report.

The Board has recently investigated two matters where it made findings of false reporting. Although implicit in its analysis of these matters, the Board could not make findings that committee funds had been misused because it had no jurisdiction to do so. Additionally, if funds were misused, it was beyond the Board's authority to order return of those funds to the committee.

Each election cycle, Board staff answer hundreds of questions related to use of money raised by political organizations, use of corporate money, and inclusion of disclaimers on advertisements. Candidates and entities involved in elections would benefit if the Board had the authority to administer sections of Chapter 211B which directly relate to campaign finance and disclaimers for state candidates. The Board already fields questions in these areas and has established processes for issuing advisory opinions, administrative rules, and for handling complaints. As a result, this limited additional responsibility could be accepted without an increase in staff or budget. This change in statutory responsibility, however, would not improve the Board's capability to do audits and investigations without an additional staff member.

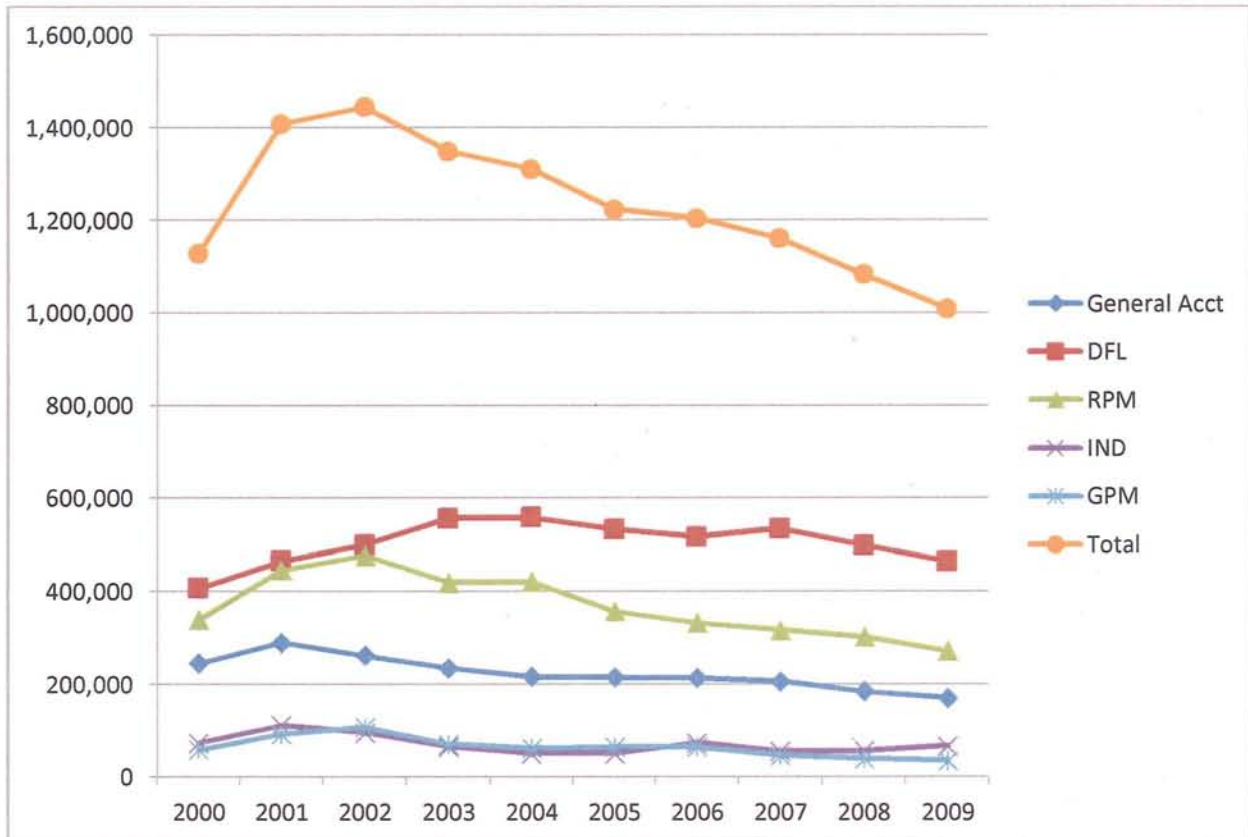
Weaknesses of Checkoff Program Funding for Board Operations

A checkoff mechanism for directing funding to the Board has desirable characteristics, including generating more engaged citizen participation in the Board's operations. However, checkoff funding using the model for the State Elections Campaign Fund program has significant weakness. The most important of those weaknesses is the fact that under a modified State Elections Campaign Fund checkoff program, the source of funds would still be the general fund of the state. While citizens would be directing money to the Board, this mechanism would not help reduce the Board's reliance on the general fund as its sole source of funding.

Additionally, the funding would remain under legislative and executive oversight and would remain vulnerable to fiscal pressures.

Analysis of Use of the State Elections Campaign Fund Checkoff Program

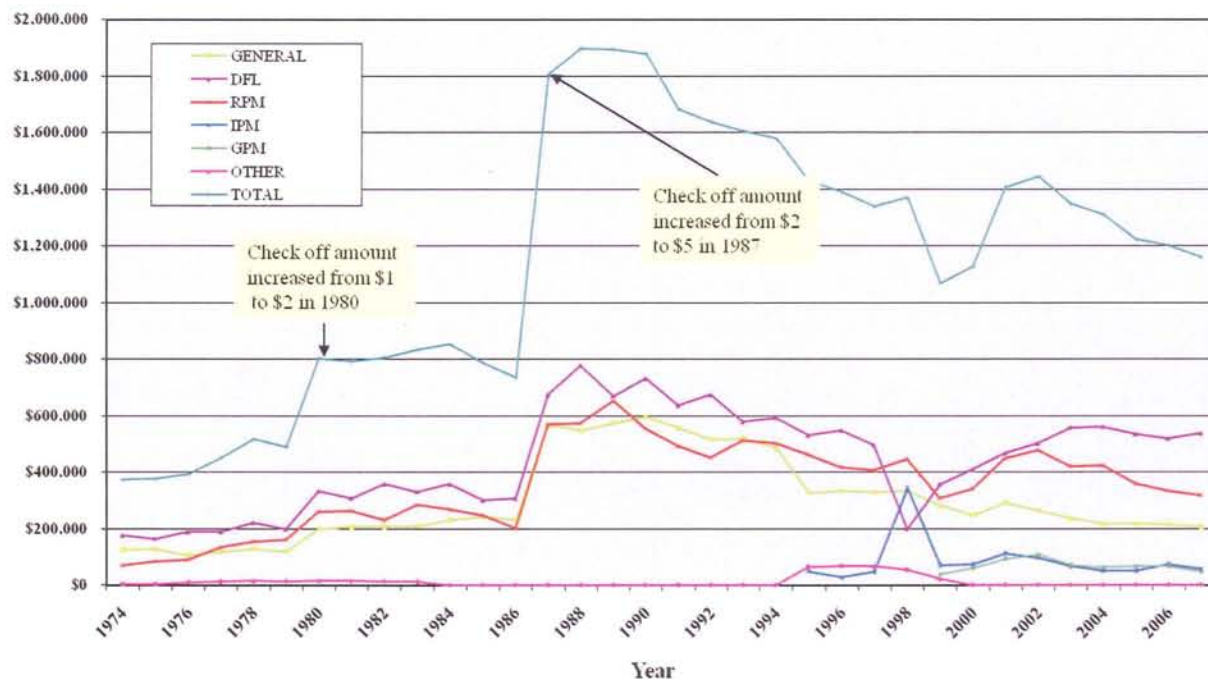
Public Subsidy Tax Checkoff – 2000 – 2009



The State Elections Campaign Fund checkoff program allows income tax filers and property tax refund filers to check a box on their tax form to designate \$5 for an individual or \$10 for a married couple filing jointly to be directed to the State Elections Campaign Fund.

The above graph shows the recent historic trend in the State Elections Campaign Fund checkoff program. As the graph indicates, the trend has been downward since 2002. The Board has no data on which to base a hypothesis regarding the reasons for this downward trend.

Public Subsidy Money Dedicated Through Check Off



The graph above is for the period from 1974, when the checkoff program was created, through 2006. This graph is instructional for its demonstration of the changes in total dollars checked off when the amount of each individual checkoff is increased by the legislature.

Underlying data on which this graph is based shows that in 1980 when the checkoff amount was doubled from \$1 to \$2, the total amount checked off went from \$489,813 to \$803,132. In 1987 when the checkoff amount was increased from \$2 to \$5, the total amount checked off went from \$735,086 to \$1,806,605.

It is instructive to note that in 1980, the checkoff amount was increased by 100% resulting in an increased in total funds checked off of only 64%. In 1987 the increase in the checkoff amount was 150% and the increase in the total funds checked off was 146%. These statistics suggest that a specific increase in the amount that may be checked off by an individual will not necessarily result in a corresponding increase in the total amount checked off.

Types of Checkoff Programs

Minnesota uses two distinct forms of checkoff on its tax returns. One form allocates general fund dollars to the subject program while the other results in a donation of taxpayer money to the subject program.

General fund allocation checkoff

The version of checkoff used for the State Elections Campaign Fund gives the taxpayer a direct voice in the use of general fund dollars. This checkoff appears near the top of the tax form before any calculations related to the filer's tax obligation are completed.

This version of the checkoff does not increase the filer's tax obligation or reduce any refund due to the filer. Rather, this checkoff is a direction by the taxpayer to spend money from the general fund of the State in a particular way.

The language used on the tax form is reproduced below:

State Elections Campaign Fund

If you want \$5 to go to help candidates for state offices pay campaign expenses, you may each enter the code number for the party of your choice. This will not increase your tax or reduce your refund.

Political party and code number:

Democratic Farmer-Labor	11	Green	14
Independence	12	General Campaign	
Republican	13	Fund	15

Your code:

Spouse's code:

The Board has noted over the years that even though the notice is clear: "This will not increase your tax or reduce your refund", some taxpayers still express an understanding that by using the checkoff option they are donating their own money to the State Elections Campaign Fund.

Taxpayer donation checkoff

The second version of checkoff is used for the Nongame Wildlife Fund program administered by the Department of Natural Resources. This checkoff appears in the body of the tax form where calculations of tax owed or refunds due are made. This is necessary because this checkoff allocates the individual taxpayer's money to the program. As a result it will increase the amount of tax owed or decrease the amount of any refund due to the taxpayer.

The Nongame Wildlife Fund checkoff has returned relatively stable amounts over the past ten years, yielding about \$1.1 million per year. The Department of Natural Resources reports that over the life of the program, the number of donors has decreased while the amount donated by each participant has increased.

Promotion of a Checkoff Program

The Department of Natural Resources is allocated \$100,000 from the Nongame Wildlife Fund checkoff each year to promote the checkoff program. Presumably this promotion is at least partly responsible for the core group of donors who, through their increased donations, have kept the program stable.

The Board is unaware of whether the party units promote the State Elections Campaign Fund checkoff to voters. It is possible that the lack of promotion is at least partly responsible for the steady decrease in program participation.

Effect on Existing Programs of Additional Checkoff Options

Good current data analyzing the effect of adding new checkoff programs to a tax form is not available. Other states have as many as 15 checkoff categories, but states vary widely in population and little quantitative information is readily available about the breakdown in funds raised by individual programs.

Research done by the Department of Natural Resources in the 1990's suggested that adding a second checkoff program to state tax returns would generate an increase of approximately 30% in total amounts checked off, but would also result in the diversion of about 25% of the original program's funds to the new program.

It is reasonable to expect that if a checkoff for Board operations was added to the body of the tax return, it would attract new taxpayer participation and increased total revenues. It is also likely that some revenue would be diverted from the existing Nongame Wildlife Fund program to any new checkoff program.

Fiscal Considerations

Any change in the tax form or in the processing of tax returns will result in a fiscal impact to the Department of Revenue for form design and for software design to process the new fields on the form.

Historical Funding for the Public Subsidy Program

Minnesota's Public Subsidy Program for candidates has been praised by commentators and is attributed with helping keep the costs of Minnesota elections relatively low. The program is

voluntary and uses payments of state general fund money to candidates as an incentive to encourage those candidates to agree to spending limits and to refrain from making independent expenditures.

In addition to the money checked off on tax returns the program is funded by an appropriation of \$1,020,000 for each general election. This statutory appropriation was originally established in 1993 in the amount of \$1,500,000 per general election. In 2005, the base appropriation was reduced to \$1,250,000. Other reductions to provide funding for the Office of Administrative Hearings and for Board operations resulted in the current appropriation amount.

The checkoff money itself was affected by a 1992 statutory change that directed that 3% of all funds checked off shall be retained in the general fund of the state for administrative expenses.

These reductions, along with decreased taxpayer participation in the checkoff program, have left the public subsidy program with substantially less money to allocate to candidates than when the program was at its peak. However, the Board believes that the recent decrease in candidate participation in the public subsidy program is more likely related to candidates' unwillingness to agree to spending limits than to the amount of public subsidy available.

The public subsidy program is an important component of the state's overall campaign finance system. It is the Board's position that the public subsidy program should not be further compromised to provide adequate funding for Board operations.

Options for Using a Checkoff Program to Fund Board Operations

1. Add a check box in the State Elections Campaign Fund section of tax returns for Board operations without changing the program structure in any other way.

The checkoff program results in about \$1,000,000 annually being dedicated to the State Elections Campaign Fund by tax return filers. Research related to checkoff programs funded by individual taxpayer donations suggests that adding additional option box to a checkoff program is likely to divert some dollars from the existing categories but may also increase overall participation. Unless participation in the program nearly doubles as a result of the Board option checkbox, the drain on the public subsidy program by diverting checkoff money to the Board would likely be significant.

2. Add a check box to the State Elections Campaign Fund section of tax returns for Board operations and increase the amount that an individual may check off.

Past history with the checkoff program suggests that increasing the amount of the checkoff by a specified percentage will increase the overall amounts checked off, but that the percentage of increase may not closely track the percentage of increase of the individual checkoff amount. Because the Board's programs are related to campaign finance, a subject of some public interest, there is also the possibility that regardless of any increase in the checkoff amount, the net proceeds to the State Elections Campaign Fund for the public subsidy program would decrease because more people choose to support the Board than to support candidates' campaigns.

3. Add a check box to the State Elections Campaign Fund section of tax returns and allow filers to check the Board box and one other box of their choice.

Prediction of the effect of adding a Board check box while still allowing taxpayers to checkoff for a party of their choice is difficult. Based on experience of others it is likely that overall amount of money dedicated by the checkoff would increase as savvy filers recognize that they can have more direct input into state spending and can fund an agency that provides oversight of tens of millions of dollars in campaign spending each election cycle. To be effective, this approach may require promotional outreach to inform tax payers of the option and of the reasons for directing money to the Board.

4. Allow promotion of the checkoff program for Board operations.

Programs such as the Nongame Wildlife Fund program may be appropriate subjects for solicitation of public support and are clearly aided by ongoing outreach efforts. However, the Board believes that ensuring the integrity of Minnesota's campaign finance systems is so integral to the functioning of state government that it would be damaging to the Board's status to require the Board to directly solicit citizens to check off money to support the Board's operations.

5. Develop a new checkoff where citizens contribute their own money rather than dedicating general fund money to support Board operations.

A new checkoff program similar to the Nongame Wildlife Fund checkoff would have the advantage of removing the Board's funding from the general fund of the state. However,

such a checkoff would almost certainly reduce the amount of funding going to the Nongame Wildlife Fund.

Additionally, unless the new checkoff was promoted the total return could be minimal. The experience of the Nongame Wildlife Fund, the Public Subsidy Checkoff Program, and of other states suggests that it would be difficult to raise sufficient money through a new checkoff to fully support the Board's operations without significant promotion. It is also likely that the addition of a new donation-style checkoff would not receive support from the Department of Natural Resources or from organizations interested in nongame wildlife issues.

The Board believes that a legislatively mandated program of regulation and disclosure, created in the public interest, should be fully funded by the legislature.

Other Options

Statutory appropriation

One concern of the Board and others is that the Board's funding is, like most state funding, subject to the biennial budget process and pressures to control and reduce state spending. As a result, the Board has never had the funds it would require to be an aggressive watchdog over campaign finance matters. Instead, the Board is more reactive than proactive in its enforcement approach, particularly with respect to audits and potentially complex investigations. To change that posture, it would be necessary for the Board to have at least one additional staff position, a high-level auditor-investigator, and stable funding.

One means of making funding slightly more stable is through a statutory appropriation rather than a biennial budget appropriation. However, this solution is, of course, not immune to legislative modification as demonstrated by the \$1,500,000 statutory appropriation for the public subsidy program, which now stands at \$1,020,000.

A statutory appropriation approach would require a mechanism to accommodate increases in the Board's two largest expenditure categories: personnel costs and rent.

Imposition of fees on regulated individuals and entities

In January, 2004, the Board completed a study of the feasibility of charging fees to entities regulated by the Board. Copies of that study are available from the Board upon request.

During the development of this legislatively mandated fee proposal, the Board examined the percentage of its resources that were devoted to each program and developed a fee structure that would recover from each program only its share of the Board's operating expenses. This approach was mandated by case law that suggested that fees could not be charged to lobbyists, for example, that would pay for campaign finance programs. The basis of these cases was that charging lobbyists more to register than the cost of maintaining the lobbyist programs amounted to an infringement on the lobbyists right to free speech.

Under the 2004 analysis, 28% of the fees would be allocated to lobbyists, 65% to the campaign finance program and the balance to other programs. Due to technology changes since 2004, it is anticipated that the percent of program costs attributable to lobbying has decreased and the percent attributable to campaign finance has increased.

The 2004 fee study was designed to provide 100% of the Board's operating budget. The study concluded that to reach that goal lobbyists would pay a fee of \$75 per association represented. Political committees or associations with political funds would pay between \$25 and \$15,000 depending on their level of financial activity. Party units would pay between \$30 and \$25,500 depending on their level of financial activity. Candidates' principal campaign committees would pay a \$100 registration fee. Fees to file for office would double with 50% going to Board operations. Candidates would also pay an additional fee during each election year. That fee was set at approximately \$800 per election year for House of Representatives candidates and approximately \$1,600 per election year for Senate candidates. Higher fees would be required of constitutional office candidates.

During development of the report, comments were solicited and received from every regulated group. Many comments opposed fees outright. Many others were concerned about the effect of fees imposed on individuals or organizations that do not have significant financial resources. It is safe to say that virtually none of the comments fully supported a fee system for funding the Board's operations.

Board Recommendations

1. The Board recommends against modification of the existing State Elections Campaign Fund checkoff program so that it could serve as the primary source for funding the Board's operating budget for the reasons set forth below.
 - a. The checkoff program is a diversion of general fund dollars. Diverting those dollars through a checkoff program rather than by means of a direct or statutory appropriation does not change the *source* of funding and, thus, does not relieve budgetary stresses.
 - b. Diversion of checkoff money to Board operations would likely have a detrimental effect on the public subsidy program, which is an important tool in containing the cost of elections in Minnesota.
 - c. In order to be successful, a modified checkoff program would probably require promotion. The Board does not feel that it should be put in a position where it is required to advocate directly to citizens for its funding.

2. The Board recommends against adding a new taxpayer donation checkoff similar to the Nongame Wildlife Fund for the reasons set forth below.
 - a. The addition of new categories of checkoff in which the taxpayer donates a portion of his or her tax refund to the new program tends to diminish the amount of money donated to existing programs. The Board anticipates that the Department of Natural Resources and nongame advocates would not support the addition of a checkoff for Board operations.
 - b. In order to be successful, a new donation checkoff would benefit from promotion. The Board does not feel that it should be put in a position where it is required to advocate directly to citizens for its funding.
 - c. The Board also believes that a legislatively mandated program of regulation and disclosure created in the public interest should be fully funded by the Legislature.

3. The Board continues to recommend against implementing a system of fees to generate its operating budget. This option was thoroughly reviewed in 2004 and the Board's position and analysis has not changed. However, if the legislature elects to impose a fee structure, the Board recommends that the design developed in 2004 serve as the basis for the program with modifications based on shifting program workloads.

4. The Board recommends that the legislature enact stable Board funding into statute with built-in mechanisms to accommodate personnel and rent increases.
5. The Board recommends that at some time in the future its funding be increased so that it can add an auditor/investigator to its staff. The Board recognizes that the current biennium is not the time to consider such a request, but the need exists when funds are available.

This report adopted by resolution of the Campaign Finance and Public Disclosure Board at its regular meeting of January 10, 2011.

Signed: /s/ John Scanlon
 John Scanlon, Chair