Toward a Small Donor Democracy:

The Past and Future of Incentives for Small Political Contributions

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Written by Thomas Cmar
Edited by Adam Lioz

U.S. PIRG Education Fund

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Written by Thom Cmar, U.S. PIRG Education Fund Legal Analyst. Edited by Adam Lioz, Senior Democracy Advocate for the National Association of State PIRGs and the U.S. PIRG Education Fund.

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U.S. PIRG Education Fund
Attn: Reports
218 D Street, SE
Washington, DC 20003
(202) 546-9707

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EXECUTIVE SUMMARY

Long before voters register their preferences on Election Day, the flow of political money determines which candidates are able to mount viable campaigns for federal office. Providing public incentives for small political contributions could help average Americans play a more meaningful role in influencing who has the resources to run effective campaigns and win public office.

Most modern political campaigns are funded predominantly by a small number of large donors rather than a cross section of the American public. Congressional candidates in 2002, for example, collected more than half of the money they raised from individuals in contributions of at least $1000—from just 0.09% of the voting age public.

Our current campaign finance system grants these contributors disproportionate influence over who runs for office and who wins elections—and thereby who dictates public policy. Grassroots candidates who take positions that do not appeal to wealthy donors have difficulty competing with well-funded opponents. Finally, many ordinary citizens are alienated from the process as they perceive that their contributions—and even votes—matter less than the large donations that define the political field of play.

Reform advocates frequently discuss setting contribution limits at levels that average Americans can afford to give, establishing spending limits to dampen the fundraising "arms race," and providing direct public financing of candidate campaigns as potential solutions to the problem of big money dominance in politics. Another solution that has received significantly less scholarly and public attention is providing public incentives to encourage small contributions. By leveraging the power of the Internet and harnessing promising recent fundraising trends, it may be possible to encourage a wave of small contributions that will help balance out the undue influence of large donors.

This paper provides a thorough canvass of existing knowledge about small contribution incentive programs at the federal level and throughout the five states that feature similar initiatives—Arkansas, Minnesota, Ohio, Oregon, and Virginia. Our conclusion is that—especially in the new age of Internet fundraising—a well-designed program can play a significant role in increasing the role of small contributors in our democracy and serve as a helpful tool for grassroots candidates seeking to run campaigns geared towards average voters, not wealthy donors. We make several recommendations about how to best design a contribution incentive program to accomplish these goals. Our most significant findings are outlined below.

TYPES OF PROGRAMS

Three main types of contribution incentive programs have been proposed and/or enacted:

- Vouchers: Citizens are provided with vouchers in advance that they may allocate to candidates, parties, or political organizations of their choice. The primary advantage of vouchers is that they allow all eligible recipients to participate in financing campaigns without regard to income or tax liability.

- Refunds: A refund program, operated outside the tax system, reimburses citizens for approved contributions. Minnesota currently operates this type of program and provides refunds within four to six weeks of making a political contribution.

- Tax credits/deductions: A tax credit or deduction allows citizens to credit their contributions against their total tax liability or deduct the contribution from their taxable income. Arkansas, Oregon, Ohio, and Virginia currently offer credits and/or deductions.

EXISTING PROGRAMS

Several contribution incentive programs currently exist throughout the United States.

Federal Program

> ***"It is essential to broaden the base of financial support for candidates and parties. To accomplish this, improvement of public understanding of campaign finance, coupled with a system of incentives for solicitation and giving, is necessary."***
>
> **President John F. Kennedy, supporting a tax credit in 1962**

- A federal tax credit for small political contributions was first proposed in Congress in the 1950s and ultimately passed by a bipartisan 82-17 vote in 1971.

- From 1972 to 1974, taxpayers could choose to claim a 50% tax credit for an individual's donations to federal, state, and local candidates and party organizations up to a limit of $12.50 (or $25 for a married couple filing jointly), or they could choose to take a 100% deduction off their adjusted gross income for their first $50 of federal, state, or local contributions (or $100 for married couples filing jointly). For the tax year 1975, both of these tax incentives were doubled, creating a 50% tax credit of up to $25 for individuals and $50 for joint returns, and a 100% tax deduction of up to $100 for individuals and up to $200 for joint returns. A few years later, Congress doubled the tax credit again while repealing the tax deduction.

- At peak participation, more than 7% of eligible filers took advantage of the credit. This compares with the estimated 2% of Americans who currently contribute to political campaigns. Unfortunately because of data limitations, it is not possible to determine how successful the credit was in increasing the number of small donors or in boosting their clout relative to donors making large contributions.

- The federal tax credit was repealed as part of the Tax Reform Act of 1986. The credit was largely swept up in a movement to simplify the tax code. Even while most credits were being abandoned, the House of Representatives voted 230 to 196 to save and improve the credit for political contributions. The provision, however, did not survive a House-Senate conference.

- At peak participation, the federal tax credit cost just $270 million in 1980. The American Enterprise Institute has estimated that a new federal tax credit would cost less than $1 billion per year, or 1/20 of one percent of the annual U.S. budget. This compares with $39 billion spent by the government on individual tax credits in 2002.

State Program Highlights

- Arkansas, Minnesota, Ohio, Oregon, and Virginia currently employ tax credit or refund programs that allow participants to contribute directly to candidates, parties and/or political action committees (PACs).

- Minnesota's Political Contribution Refund (PCR) program has helped significantly boost the clout of small donors. In open seat races, the program helped increase the percentage of campaign money that came from small donors from 34% to 69% between 1990 and 1998. Overall, contributions below $100 increased from 34.3% to 39.2% of the average candidate's budget during that time period—a 14% increase.

- Minnesota's PCR program, which provides prompt refunds for contributions, appears to have largely eliminated income as a significant factor for participation.

- Oregon has the nation's oldest incentive program (dating back to 1969), which has had the highest participation rate of any program in the country largely because taxpayers may make credit-eligible contributions to candidates, parties, or PACs.

LESSONS LEARNED

- A voucher is likely to be the most effective program. Voucher programs minimize opportunity costs and make desire to participate, rather than ability to give, the primary factor in determining who is able to contribute to campaigns.

- Outreach efforts by eligible recipients drive participation in contribution incentive programs. To maximize participation and encourage diverse forms of political expression, contributions to candidates, parties and PACs should be eligible for incentive programs.

- An effective tax credit should be a full (100%) credit to maximize incentive value; of significant size to make a difference in campaigns; yet accessible to average Americans to prevent subsidizing large contributions.

- Incentive programs should include public education efforts to inform citizens and potential recipients about the program. Recipients and potential contributors must know about a contribution incentive program in order to take advantage of it. More than 20% of Ohioans surveyed by the Campaign Finance Institute reported they would have been more likely to contribute if they had known about the tax credit.

- Contribution incentive programs are most effective when combined with other reforms. Vouchers, refunds, or tax credits work to complement low contribution limits, spending limits, and public financing and are most effective in the context of a system that provides meaningful incentives for fundraisers to reach out to small donors.

CONCLUSIONS

- A well designed program can increase the clout of small donors. Minnesota's PCR program significantly boosted the impact of small contributors—especially in open seat races where fundraising matters most. Oregon's experience has shown that PACs aggressively solicit credit-eligible contributions and can serve as a useful conduit for aggregating the political influence of average Americans—even in the absence of a public financing system or refund program.

- A properly designed program can provide an essential tool for grassroots candidates. Governor Jesse Ventura was able to use Minnesota's PCR program to mount a competitive gubernatorial campaign as an independent candidate, nearly equaling his major party opponents in PCR fundraising. Governor Howard Dean and General Wesley Clark demonstrated the promise of the Internet as a tool for generating small contributions during the 2004 presidential primaries. A contribution incentive program would likely make similar candidates' grassroots fundraising appeals even more effective.

- Contribution incentive programs are worthwhile investments in a healthy democracy. Experience at the federal level and throughout several states shows that a contribution incentive program can produce significant public benefits at relatively minimal cost. In the short term, a new federal tax credit for small political contributions could produce sufficient benefits to justify its estimated cost of less than $1 billion per year—or just 1/20 of one percent of the annual U.S. budget.

RECOMMENDATIONS

1. A new federal tax credit for political contributions should be enacted immediately, as an incremental step on the road to more comprehensive reforms. The credit should be a 100% credit for an amount that is significant but also not out of the reach of most Americans, such as $100 (or $200 for joint returns).

2. The tax credit should be available for contributions to candidates, parties, and PACs.

3. The tax credit program should encourage small donor PACs by making credit money available only to those PACs that agree to abide by low contribution limits.

4. The tax credit should be accompanied by public education efforts to inform the public of its existence.

5. Voucher systems and other ways to administer political contribution incentives more effectively outside of the tax code should be explored.

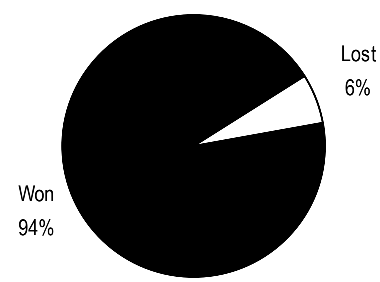
6. Contribution limits should be lowered for candidates, parties, and PACs to a level that is within the reach of most Americans.

7. Other forms of public financing linked with voluntary spending limits should be offered to supplement political contribution incentives.

INTRODUCTION

Money is the lifeblood of electoral politics. A political campaign is almost never successful unless its resources are comparable to those of its opponents – and the most important of these resources is money. As Alexander Heard described it, political money "is a universal, transferable unit infinitely more flexible in its uses than the time, or ideas, or talent, or influence, or controlled votes that also constitute contributions to politics."[1]

Electoral Success of Biggest Fundraisers in 2002 Congressional General Elections



Money has always been crucial to political success, but for modern campaigns it has taken on a singular, overriding importance. In the 2002 congressional elections, 94% of the candidates who raised the most money won their races.[2] Winners out-raised losers approximately four to one.[3] The overwhelming correlation between fundraising success and electoral victory exists even in primary elections, where the partisan makeup of the district does not give any candidate an inherent advantage. The biggest fundraisers won primary elections in 2002 more than 90% of the time.[4] Incumbency plays an important role in these statistics: 92.7% of House incumbents and 85.7% of Senate incumbents who ran in 2002 won re-election.[5] The high re-election rate of incumbents, however, is due in no small part to their ability to raise large sums of money; in 2002, the average incumbent out-raised his or her opponent by a ratio of 4.5-to-1.[6]

The primacy of television advertising as a modern campaign tactic has increased the importance of money. Federal candidates, parties, and PACs spent more than $1 billion on television advertising in 2002.[7] More than any other factor, television spending has contributed to an "arms race" mentality within political campaigns, steadily escalating from election cycle to election cycle without regard to the ads' consequences for democracy.[8] Rather than being a testament to the value of free speech, the modern campaign practice of raising millions of dollars in contributions from the privately wealthy and spending

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[1] ALEXANDER HEARD, THE COSTS OF DEMOCRACY 90 (1960). Alexander Heard authored this work shortly before his tenure as chairman of President Kennedy's Commission on Campaign Costs. *See infra* text accompanying notes 31 – 34.
[2] U.S. PIRG EDUC. FUND, THE ROLE OF MONEY IN THE 2002 CONGRESSIONAL ELECTIONS 14 (2003), *available at* http://www.uspirg.org/reports/roleofmoney2003.pdf.
[3] *Id*. at 14.
[4] U.S. PIRG EDUC. FUND, THE WEALTH PRIMARY 6 (2002), *available at* http://www.uspirg.org/reports/WealthPrimary10_02.pdf.
[5] U.S. PIRG EDUC. FUND, *supra* note 2, at 31. The percentage of victorious House incumbents includes those incumbents whose districts were eliminated through re-districting, but who successfully sought re-election in another district. *Id.* at 31 – 32.
[6] *See id.* at 32 ("The average incumbent participating in the 2002 general election raised $1,230,151, compared with $270,491 for the average challenger.").
[7] Alliance for Better Campaigns, *Record Political Ad Spending on Television Tops $1 Billion*, POL. STANDARD, Nov.-Dec. 2002, *available at* http://www.bettercampaigns.org/standard/display.php?StoryID=270.
[8] *See, e.g.*, JOE TRIPPI, THE REVOLUTION WILL NOT BE TELEVISED: DEMOCRACY, THE INTERNET, AND THE OVERTHROW OF EVERYTHING 39 (2004) ("Each year, TV advertising becomes more dominant, more ubiquitous, and more expensive, at the same time it becomes less effective. That's why in politics we've become caught in a self-defeating cycle.") (emphasis in original).

most of them on a large number of short, repetitive television advertisements undermines the societal interest in open and informed debate that is protected by the Constitution's First Amendment.[9]

Voters collectively decide who represents them in elected office. The nature of the voters' decision, however, is determined by innumerable smaller decisions that precede it. These decisions – such as which candidates decide to run in the first place, and which candidates receive the opportunity to communicate their messages effectively to the electorate – are heavily influenced by the flow of political money.[10] By essentially determining which candidates are able to make it onto a given primary or general election ballot, donors help to define the field of possibility in American politics.

Despite the importance of monetary participation to the viability of political campaigns, the current federal system of campaign finance regulation creates huge obstacles to the equal participation of grassroots candidates of all parties and ideologies and the small donors who might support them. The 2004 presidential campaign has shown that, in an election perceived to be of great historical significance, campaigns' growing use of the Internet to reach out to small donors can result in large numbers of small contributions to political campaigns.[11] In most successful political campaigns for federal office, however, small donors play only a marginal role. Although congressional election campaigns reported more than $1 billion in total receipts for the 2002 election cycle,[12] only 24% of the money raised from individuals came in contributions under $200, accounting for less than 14% of candidates' total receipts.[13] By contrast, 55.5% of the money raised from individuals came in contributions of $1,000 or more.[14] These large contributions came from only approximately 202,245 donors – less than .09% of the U.S. population.[15]

In these races, it is the wealthy who are making the crucial early-stage choices of which candidates will receive the resources they need to run viable campaigns. Wealthy donors have political preferences and concerns that are distinct from those of other Americans,[16] yet generally only those candidates who appeal to wealthy donors' concerns are able to amass sufficient resources to compete effectively. Because current federal campaign finance laws allow individual contributions to candidates of up to $2,000 per election,[17] candidates who could potentially have broad popular appeal but are unable to attract the support of wealthy donors find it very difficult to compete.[18] Meanwhile, most of the American people themselves

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[9] *Cf.* Colo. Republican Fed. Campaign Comm. v. Fed. Election Comm'n, 518 U.S. 604, 650 (1996) (Stevens, J., dissenting) ("It is quite wrong to assume that the net effect of limits on contributions and expenditures – which tend to protect equal access to the political arena, to free candidates and their staffs from the interminable burden of fund-raising, and to diminish the importance of repetitive 30-second commercials – will be adverse to the interest in informed debate protected by the First Amendment.").

[10] *See generally* U.S. PIRG EDUC. FUND, LOOK WHO'S NOT COMING TO WASHINGTON: QUALIFIED CANDIDATES SHUT OUT BY BIG MONEY (2003) (profiling forty-nine unsuccessful congressional candidates whose campaigns were severely handicapped by their failure to match their opponents' fundraising), *available at* http://www.uspirg.org/reports/lookwhosnot1_03.pdf.

[11] *See* Linda Feldmann, *In politics, the rise of small donors*, CHRISTIAN SCI. MONITOR, June 28, 2004 (quoting Virginia Professor Larry Sabato as stating that there are "always . . . increases in small gifts when people feel very strongly in an election"), *available at* http://www.csmonitor.com/2004/0628/p01s01-uspo.html.

[12] U.S. PIRG EDUC. FUND, *supra* note 2, at 10 n.e. Total receipts include contributions from individuals, parties, and PACs, as well as personal money and interest earned on campaign accounts. *Id.*

[13] *Id.* at 16, 18.

[14] *Id.* at 16.

[15] *Id.* at 15.

[16] *See* JOHN GREEN, ET AL., INDIVIDUAL CONGRESSIONAL CAMPAIGN CONTRIBUTORS: WEALTHY, CONSERVATIVE AND REFORM-MINDED (1998) (finding that large-dollar contributors as a group tend to be significantly more conservative than the general public).

[17] Bipartisan Campaign Reform Act of 2002, Pub. L. No. 107-155, § 307, 116 Stat. 81, 102 – 03 (to be codified at 2 U.S.C. § 441a).

[18] *See generally* U.S. PIRG EDUC. FUND, *supra* note 10.

are marginalized in this "wealth primary," robbing them of the opportunity to have the same voice as wealthy donors in choosing which candidates are able to campaign successfully and ultimately win their elections.[19]

The wealth primary takes place in the early stages of the American political process where political agendas are set and candidates first decide to run for office. The disproportionate level of influence and access that large-dollar contributors acquire through the wealth primary is partly responsible for wealthy Americans being more likely to make their voices heard in government and to have their interests represented there.[20] Meanwhile, over the last forty years, voter turnout in federal elections has significantly decreased.[21] Because the wealth primary prevents average Americans from having an equal say in who represents them in government, Americans feel less and less invested in the democratic process.

When federal campaign contribution limits allow the wealthiest Americans to give far more money than most potential donors can afford, many candidates, parties and political action committees ("PACs") lack compelling reasons to pursue small-dollar contributions – and in the absence of a contest that is perceived to be of such singular importance as the 2004 presidential race, most Americans lack sufficient incentive to give them.[22] In the absence of such a particularly important and/or closely fought election, it is only rational for the average American to perceive that his or her small contribution does not count for much against the contributions of wealthy donors who can afford to give thousands of dollars at a time.[23]

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[19] *See generally* Jamin Raskin & John Bonifaz, *Equal Protection and the Wealth Primary*, 11 YALE L. & POLICY REV. 273, 273 – 332 (1993) (arguing that the decisive role of private wealth in federal elections rises to the level of a de facto primary that deprives excluded candidates and citizens of their right to equal protection of the laws under the Fourteenth Amendment to the Constitution).

[20] *See* AM. POL. SCI. ASS'N TASK FORCE ON INEQUALITY & AM. DEMOCRACY, AMERICAN DEMOCRACY IN AN AGE OF RISING INEQUALITY 5 (2004) ("Those who enjoy higher incomes, more occupational success, and the highest levels of formal education, are the ones most likely to participate in politics and make their needs and values known to government officials."), *available at* http://www.apsanet.org/inequality/taskforcereport.pdf.

[21] *See id.* at 6 – 7 (arguing that "a number of ongoing trends discourage voting and reinforce inequalities in voter turnout," including rising economic inequality, felon disenfranchisement laws, and the tendency of major political parties to focus their mobilization efforts on those who are already political active and able to make political contributions). The most recent peak in voter turnout in a presidential election was in 1960, when 62.8% of voting-aged Americans participated in the race between John F. Kennedy and Richard Nixon. CTR. FOR VOTING & DEMOCRACY, PRESIDENTIAL ELECTION VOTER TURNOUT: 1924-2000, *at* http://www.fairvote.org/turnout/preturn.htm (last visited Aug. 26, 2004). Official turnout for the 2000 presidential election was 105,586,274 voters, which was 51.3% of the voting-aged population. FED. ELECTION COMM'N, VOTER REGISTRATION AND TURNOUT 2000, *at* http://www.fec.gov/pages/2000turnout/reg&to00.htm (last visited Aug. 26, 2004). Perhaps even more tellingly, more people watched the Kennedy-Nixon debates in 1960 than the Bush-Gore debates in 2000, even though America had 100 million fewer people then. THOMAS E. PATTERSON, THE VANISHING VOTER: PUBLIC INVOLVEMENT IN AN AGE OF UNCERTAINTY (2002).

[22] *See* Press Release, Campaign Fin. Inst., CFI Analysis of the Presidential Candidates' Financial Reports Filed June 20 (June 20, 2004) (finding that small contributions to the 2004 presidential candidates were triple and large contributions were double the number made in 2000), *available at* http://www.cfinst.org/pr/063004.html.

[23] *See, e.g.*, U.S. PIRG EDUC. FUND, *supra* note 10, at 37. One powerful example of this phenomenon is an anecdote told by Victor Morales, the public school government teacher and city councilman for 22 years who was the Democratic nominee for Senator in Texas in 1996:

> [Morales] secured 44% of the vote against [incumbent Republican Senator] Phil Gramm despite being vastly outspent. Morales raised approximately $900,000 in the last four months of his campaign, 87% of which he estimates came from contributions less than $100. . . . "During my 1996 campaign," he [says], "I ran into two of my former students walking out of the post office. They said[,] 'Mr. Morales, we're so proud of you. When we see you on TV, we say – that's our government teacher. We were going to send you $25 each, but we didn't because we thought 'what's $25, he needs millions.'"

Id.

Two campaign finance reforms that have been prominently advocated in recent years address the problem of political equality: low contribution limits and public financing. Lowering campaign contribution limits makes sense as a matter of basic fairness: contribution limits should be set at a level that average Americans can afford so that wealthy donors are not allowed to systematically outspend average Americans and buy for themselves a greater say in which candidates are able to run successful campaigns. Public financing addresses a related concern, giving candidates who qualify a source of funding that is independent of donations made from the private wealth of individuals. Ideally, these two reforms would be established alongside one another, reducing the influence of wealthy donors while ensuring that candidates are able to run their campaigns on a level playing field.

A third campaign finance reform approach that addresses the problem of political equality is the creation of government-sponsored incentive programs to promote small political contributions. Proposals for such programs typically call for the creation of a tax credit for political contributions, but they could also involve means outside of the tax code such as a contribution refund or campaign finance voucher program. Although the concept of political contribution incentives has been around for decades, the programs have been subject to surprisingly little scholarly study.

Proponents of political contribution incentives argue that they will bring into the political process new, small-dollar contributors who would otherwise not be able to afford to contribute. Political contribution incentives also would open up the "wealth primary" by giving small donors a stronger voice in the American political process and rewarding candidates who conduct grassroots, issue-driven campaigns. Moreover, political campaigns' growing use of the Internet as a cost-effective means to reach out to small donors makes political contribution incentives more viable today than ever before.

Opponents of political contribution incentives object chiefly on the grounds that experience with the programs shows that they will not work as advertised. The federal government offered a tax credit (and, briefly, a tax deduction) for small political contributions from 1972 to 1986. This tax credit program enjoyed modest success but did not bring about large increases in small-dollar contributions. Several states currently maintain political contribution incentive programs, allowing for the study of how different credit programs operate in different legal contexts. Some of the state tax credit programs that have operated in tandem with different campaign finance laws than the federal program have enjoyed greater success.

A careful study of experiences at both the state and federal levels reveals that the structure of a contribution incentive program plays a significant role in determining its success. State programs structured similarly to the federal tax credit program have largely replicated the federal experience. Meanwhile, more successful state programs have made it easier for people to claim the incentives and made them available for contributions to a wider variety of political actors, including candidates, parties, and PACs. Moreover, the structure of other laws that regulate campaign fundraising has important effects on the success of an incentive program. A political contribution incentive program will be successful at bringing in new small donors only if potential recipients of contributions actively solicit those donors and encourage them to participate in the incentive program.

Successful state programs have made it easier for people to claim the incentives and made them available for contributions to a wider variety of political actors, including candidates, parties, and PACs.

A campaign finance voucher program is the most potent, and thus the most promising, form of political contribution incentive program. Tax credits or refund programs require individuals in effect to float an interest-free loan to a candidate, party, or PAC while they wait for their contribution to be reimbursed. A voucher program would provide individuals with an equal amount of money to make small contributions up front. An individual's ability to give would not be contingent on whether or not he or she owed taxes or had sufficient disposable income. In the process, individuals participating in a voucher program would do so as members of a democracy with an equal status not based on private wealth. Instead of raising money by coddling individual wealthy donors, a voucher program would force political actors to compete for its funds through effective communication of political ideas.

Congress is unlikely to consider a voucher program in the short-term. An intermediate yet important step to encourage small donor participation would be a new federal tax credit for political contributions. As with any contribution incentive program, the tax credit should be structured to directly target small donors, provide a strong incentive for small donors to contribute, and encourage maximum participation.

This paper will review the history of political contribution incentive programs in the United States and conclude that the programs can play an important role in a pragmatic reform strategy to give small donors a central role in the financing of political campaigns. Campaign finance voucher systems and other ways to administer political contribution incentives outside the tax code should be explored as part of a long-term strategy of creating a "small donor democracy." Additional reforms, such as low contribution limits and public financing, will also be necessary to any comprehensive solution to the problem of political equality in campaign finance. A reform strategy centered on political contribution incentives places the power to choose which candidates receive public funding in the hands of individual small donors. These donors can only participate on truly equal terms with one another, however, if wealthy donors are prevented from turning private wealth into disproportionate political influence.

BACKGROUND: POLITICAL CONTRIBUTION INCENTIVE PROGRAMS

LEGISLATIVE HISTORY OF THE FEDERAL TAX CREDIT FOR POLITICAL CONTRIBUTIONS

1972-1974	50% credit to federal, state, local candidates, parties up to $12.50 ($25 for married couple) *or* 100% deduction for first $50 individual/$100 joint
1975-1978	50% credit for $25 individual, $50 joint; 100% deduction for $100 individual/$200 joint
1979-1986	50% credit for $50 individual/$100 joint; no deduction
1986	Credit repealed

The federal government offered targeted tax incentives for political contributions between 1972 and 1986. From 1972 to 1974, taxpayers could choose to claim a 50% tax credit for donations to federal, state, and local candidates and party organizations up to a limit of $12.50 (or $25 for a married couple filing jointly), or they could choose to take a 100% deduction off their adjusted gross income for their first $50 of federal, state, or local contributions (or $100 for married couples filing jointly).[24] For the tax year 1975, both of these tax incentives were doubled, creating a 50% tax credit of up to $25 for individuals and $50 for joint returns, and a 100% tax deduction of up to $100 for individuals and up to $200 for joint returns.[25] A few years later, Congress doubled the tax credit again while repealing the tax deduction.[26]

In 1986, Congress reversed course and repealed the political contribution tax credit as part of a sweeping simplification of the tax code that eliminated a large number of tax credits and deductions.[27] Targeted tax incentives still survive as a means for the government to promote what it considers socially beneficial activities, however, and since 1986 Congress has added many new tax incentives to the code.[28]

Debate and passage of a federal tax credit for political contributions

A federal tax credit for political contributions was first proposed in Congress in the 1950s.[29] In 1957, the Senate Committee on Rules and Administration reported favorably a bill that would have created a 50% tax credit for the first $20 of political contributions to federal candidates, or an alternative 100% tax deduction for up to $100.[30] In October 1961, President Kennedy appointed a bipartisan Commission on Campaign Costs to study ways to increase public participation in the financing of campaigns.[31] The Commission recommended tax incentives as a central aspect of its report, calling for the creation of a system where taxpayers could choose either a 50% tax credit for their first $20 in contributions or a tax deduction for up to

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[24] Revenue Act of 1971, Pub. L. No. 92-178, § 701, 85 Stat. 497, 560 – 62.
[25] Tariff Schedules Amendments, 1975, Pub. L. No. 93-625, § 12, 88 Stat. 2108, 2120.
[26] Revenue Act of 1978, Pub. L. No. 95-600, § 113, 92 Stat. 2763, 2778.
[27] Tax Reform Act of 1986, Pub. L. No. 99-514, § 112, 100 Stat. 2085, 2108 – 09.
[28] *See infra* text accompanying notes 84 – 89.
[29] HEARD, *supra* note 1, at 394.
[30] *Id.* at 448.
[31] President John F. Kennedy, Letter to the President of the Senate and to the Speaker of the House Transmitting Bills To Carry out Recommendations of the Commission on Campaign Costs (May 29, 1962), *available at* http://www.presidency.ucsb.edu/site/docs/print_pppus.php?admin=035&year=1962&id=219. For more information on the President's Commission on Campaign Costs, see generally HERBERT ALEXANDER, MONEY IN POLITICS (1972). Herbert Alexander, who went on to write numerous works on campaign finance, was executive director of the Commission.

> ***"It is essential to broaden the base of financial support for candidates and parties. To accomplish this, improvement of public understanding of campaign finance, coupled with a system of incentives for solicitation and giving, is necessary."***
>
> **President John F. Kennedy, supporting a tax credit in 1962**

$1,000 in contributions.[32] According to President Kennedy, "it is essential to broaden the base of financial support for candidates and parties. To accomplish this, improvement of public understanding of campaign finance, coupled with a system of incentives for solicitation and giving, is necessary."[33] President Kennedy and former Presidents Truman and Eisenhower, as well as their campaign opponents, endorsed the Commission's report.[34] White House advocacy for these and similar reforms continued during the Johnson administration,[35] but attempts to create a political contribution incentive as part of a broader package of electoral reforms faltered in Congress. Nevertheless, both Republicans and Democrats supported tax incentives as a means of broadening the base of contributors to campaigns.[36]

Championed by Senator Edward Kennedy (D-Mass.), tax credits for political contributions were once again a topic of debate during the Nixon administration. Senator Kennedy attempted to attach a package of election reforms that included creation of a tax credit to the Tax Reform Act of 1969; his amendment was tabled by a 50 to 45 vote.[37] Senator Kennedy pursued a similar tactic two years later, this time proposing an amendment to the Revenue Act of 1971 that provided for tax credits alone.[38] This amendment was never acted upon, however, as Senator John Pastore (D-R.I.) successfully offered his own campaign finance amendment, a more comprehensive proposal that added two titles to the Revenue Act: one title that created both tax credits and deductions, and another title that created a tax check-off to establish a system of partial public financing for presidential campaigns through the Presidential Election Campaign Fund.[39] Debate on the Pastore Amendment dragged on for several days, with most of the attention focused on the more controversial public funding provisions.[40] Meanwhile, the creation of tax incentives for

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[32] Kennedy, *supra* note 31. In recommending the Commission's proposal to Congress, President Kennedy reduced the amount proposed for the tax deduction from $1000 to $750. *Id.* Additionally, the proposed tax incentives would only have applied to contributions to national and state political committees. *Id.*

[33] *Id.*

[34] *Id.*

[35] *See* President Lyndon B. Johnson, Special Message to the Congress on Election Reform: The Political Process in America (May 25, 1967) (calling for Congress to reconsider the Kennedy Commission's report, as well as alternative proposals for public financing of campaigns), *available at* http://www.presidency.ucsb.edu/site/docs/print_pppus.php?admin=036&year=1967&id=236.

[36] *See, e.g.*, Associated Press, *G.O.P. Calls for Tax Incentives to Spur Political Contributions*, N.Y. TIMES, June 8, 1967, at 32 (quoting a Republican spokesman arguing in favor of Democratic proposals for tax incentives for political contributions as opposed to proposals for public funding of campaigns).

[37] Warren Weaver, *Senate Backs Retirement at 60 on Benefits of 66%*, N.Y. TIMES, Dec. 10, 1969, at 1.

[38] S. AMDT. 643, 117 CONG. REC. 40,688 – 89 (1971) (providing for a 50% tax credit of up to $12.50 for individuals or $25 for joint returns). Senator Kennedy did not include a tax deduction in his proposal because he wanted specifically to target low- and middle-income citizens. *See* 117 CONG. REC. 40,688 (1971) (statement of Sen. Kennedy).

[39] S. AMDT. 692, 117 CONG. REC. 41,758 – 61 (1971). The Presidential Election Campaign Fund was originally established by the Presidential Election Campaign Fund Act of 1966, Pub. L. No. 89-809, 80 Stat. 1539. The following year, however, Congress passed a law stating that the Fund could not go into effect until further implementing guidelines were adopted. Act of June 13, 1967, Pub. L. No. 90-26, 81 Stat. 57.

[40] *See, e.g.*, 117 CONG. REC. 41,764 (1971) (statement of Sen. Pastore) ("I think the time has come . . . when something has to be done about the idea that a man who runs for President has to be either personally wealthy or has to become beholden to a lot of people with vested interests."); *id.* at 41,770 (statement of Sen. Howard Baker (R-Tenn.)) ("This is not the time for the

political contributions enjoyed strong support from both parties.[41] Ultimately, both titles of the Pastore Amendment passed the Senate. While the public funding provisions passed by a narrow margin of 52 to 47, the tax incentive provisions passed by a vote of 82 to 17.[42] President Nixon signed the bill into law, but only after convincing the House-Senate conference committee to delay the effect of the public funding provisions until after the 1972 election.[43]

Effects of federal tax incentives for political contributions from 1972 to 1986

When Congress enacted the tax credit and deduction for political contributions in 1971, it had little way of knowing how the programs would affect political campaigning. Apparently, Congress believed that simply limiting the credit to a small amount of contributions was sufficient to target its effects toward small donors.[44] Hence, the legislation lacked several design features that would likely have encouraged greater citizen participation. The tax incentives were not accompanied either by a public education campaign to encourage their use or any mechanism to guarantee that the programs were not simply rewarding those who were already giving anyway. Perhaps most importantly, Congress gave no special consideration to creating incentives for candidates to solicit credit-subsidized contributions actively rather than to continue pursuing large contributions from wealthy donors.

Throughout the 1970s, debate over the best policy approach for addressing citizen participation and political equality concerns in political campaigns continued. As in the debate over the Revenue Act of 1971, the two competing policy alternatives before Congress were tax incentives and public financing. Though Congress ultimately rejected more expensive proposals for direct public financing and even greater expansions of the tax credit,[45] Congress twice doubled the amounts of the tax credit "to further expand individual participation in the electoral process . . . through the encouragement of political contributions."[46]

Participation rates for the federal tax credit for political contributions between 1972 and 1986 show that the program was a modest success in its later years. In 1972, 3.5% of those filing tax returns took advantage

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Congress of the United States to say that the American political system has become so incestuous that we are going to provide money from the public funds for our own perpetuation in office.").

[41] *See, e.g.*, *id.* at 42,381 – 82 (statement of Sen. Jack Miller (R-Iowa)). According to Senator Miller, a tax credit for political contributions had a history of support from both parties:

> [T]here has always been strong support on this side of the aisle . . . for a limited tax deduction or a tax credit on the income tax return for political contributions . . . . I have done so in order that people in general can join in financing the campaigns of political candidates and political parties, and let the chips fall where they may. I see no reason why a tax credit, for example, should not work with equal favor to the members of both parties.

Id.

[42] *Id.* at 42,632 – 33.

[43] *See* Revenue Act of 1971, Pub. L. No. 92-178, §§ 801 – 802, 85 Stat. 497, 562 – 74.

[44] *See* SEN. RPT. 95-1263, at 59 (1978) ("[S]ince the credit is small, it probably has the greatest incentive effect with respect to contributors of moderate amounts.").

[45] *See, e.g.*, *Increased Tax Credits for Contributions to Candidates for the U.S. Senate: Hearings on S.1471 Before the Subcomm. on Taxation and Debt Management of the Senate Comm. on Finance*, 95th Cong. 29 (1977) [hereinafter *Tax Credits Hearings*] (debating proposals that would have provided either direct public financing for Senate candidates or a 75% tax credit for contributions up to $100 to a Senate candidate's campaign).

[46] SEN. RPT. 95-1263, at 59 (1978). At the same time as Congress doubled the tax credit for the second time in 1978, it also repealed the tax deduction, stating that it "add[s] complexity to the law without serving any significant purpose" given that tax credits are a more direct means of encouraging greater political participation. H. RPT. 95-1445, at 5 (1978).

of either the tax credit or deduction, costing the federal treasury a total of $78.8 million.[47] After Congress doubled the value of the incentives in 1975, participation that year was only 2.7%, with a total of $99 million in credits and deductions claimed.[48]

At the height of the federal tax credit, 7.2% of eligible filers took advantage of it.

For the year 1979, the first year after Congress doubled the amount of the tax credit again while repealing the tax deduction, it is possible to calculate participation as a percentage of taxpayers who were eligible to claim the credit – i.e., taxpayers who actually owed tax liability prior to claiming any tax credits.[49] In 1979, 5.5% of eligible filers claimed the credit at a cost of $193.5 million.[50] This number rose to a high of 7.2% of eligible tax filers claiming $269.8 million during the presidential election year of 1980,[51] but ultimately dipped back down and settled at a rate of 5.3% of eligible tax filers claiming $241.7 million for the credit's last year of existence in 1986.[52]

The participation rates of the federal tax credit for political contributions suggest that the credit had at least a marginally positive effect on the number of contributors to political campaigns. In fact, one recent study of the federal data concludes, with 99% confidence, "that an increase in the level of a tax credit for political contributions will increase the number of people participating in the program for the observed levels of the credit ($12.50 to $50.00)."[53] Nevertheless, because the Federal Election Commission ("FEC") did not begin documenting contributions until 1976, and until 1989 only itemized contributions of more than $500,[54] it is impossible to know the exact effect that the tax credit for political contributions had on small donor participation and influence between 1972 and 1986.

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[47] Joseph E. Cantor, *Campaign Financing in Federal Elections: A Guide to the Law and Its Operation* 29 (CRS Report for Congress, Congressional Research Service, 1993).

[48] *Id.*

[49] This percentage is a more accurate measure of participation rates, because it does not count those whose lack of tax liability left them with no need for a tax incentive. Even this percentage is in some senses underinclusive, however, because it fails to count those who gave a political contribution that was claimed under the credit but did not file their own tax return – i.e., because they were included in a joint return. This percentage also does not include those who would have claimed a tax credit for political contributions but did not need to because their tax liability was exhausted after claiming other tax credits.

[50] *See* Cantor, *supra* note 47, at 29 (reporting that 4.4% of total taxpayers claimed the credit in 1979 at a cost of $193.5 million); 2 INTERNAL REVENUE SERV., STATISTICS OF INCOME BULLETIN 44 (summer 1982) (reporting that in 1979, 74,243,824 owed taxes prior to claiming tax credits out of 92,694,302 tax filers).

[51] *See* Cantor, *supra* note 47, at 29 (reporting that 5.8% of total taxpayers claimed the credit in 1980 at a cost of $269.8 million); 5 INTERNAL REVENUE SERV., STATISTICS OF INCOME BULLETIN 80 (fall 1985) (reporting that in 1980, 76,135,819 owed taxes prior to claiming tax credits out of 93,902,469 tax filers).

[52] *See* Cantor, *supra* note 47, at 29 (reporting that 4.5% of total taxpayers claimed the credit in 1986 at a cost of $241.7 million); 10 INTERNAL REVENUE SERV., STATISTICS OF INCOME BULLETIN 104 (fall 1990) (reporting that in 1986, 86,975,883 owed taxes prior to claiming tax credits out of 103,299,601 tax filers).

[53] John de Figueiredo and Elizabeth Garrett, PAYING FOR POLITICS, USC and Cal Tech Center for the Study of Law and Politics Working Paper Number 34, at 56 (August 2004), *available at* http://lawweb.usc.edu/cslp/pages/papers.html.

[54] FED. ELECTION COMM'N, YOUR GUIDE TO RESEARCHING PUBLIC RECORDS, *at* http://www.fec.gov/pubrec/prguide1.htm (last visited July 1, 2004). In 1989, the FEC began tracking itemized contributions of $200 or more. *Id.* Because of this, even today the number of small donors to campaigns is only an estimate. Exact numbers are only knowable if the campaign self-reports.

Repeal of the tax credit for political contributions

Congress repealed the tax credit for political contributions as part of the Tax Reform Act of 1986 ("TRA").[55] The TRA was the result of a bipartisan compromise between the Reagan Administration and Democratic leaders in Congress. The stated intent behind the Act was to reduce burdens for the majority of individual taxpayers by simplifying the tax code to eliminate loopholes through which more sophisticated taxpayers were avoiding payment of the full percentage rate for their income class.[56] The TRA's supporters also argued that targeted tax incentives had caused serious unintended consequences, distorting free market incentives in ways that produced economically harmful effects.[57] The theory behind the TRA was that all taxpayers would benefit from a simpler tax code; in reducing administrative burdens and opportunities for tax avoidance, the government could afford to tax at lower rates across all income classes. Many of the Act's supporters thus argued that it was designed to favor the interests of average Americans over those of the wealthy and large corporations.[58]

The tax credit for political contributions was repealed in a larger movement to simplify the tax code.

The tax credit for political contributions was swept up in this larger movement to simplify the tax code. The tax legislation that emerged from the House Ways and Means Committee repealed the credit along with a variety of other tax preferences.[59] The *New York Times* reported that even lawmakers who otherwise supported political contribution incentives "were reluctant to challenge the President and [Ways and Means Committee Chairman Dan Rostenkowski (D-Ill.)] on such a relatively minor topic."[60] While the bill was pending in the House, however, Representatives Matthew McHugh (D-N.Y.) and Thomas Tauke (R-Iowa) introduced a proposal that would have replaced the 50% tax credit for contributions to federal, state and local candidates with a 100% tax credit that applied only to contributions to congressional candidates from the candidate's home state up to $100 (or $200 for married couples filing jointly).[61] Although the McHugh Amendment was rejected by the Ways and Means Committee, Democrats in the Rules Committee succeeded in allowing for

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55 Pub. L. No. 99-514, 100 Stat. 2085 (1986) (codified as amended in scattered sections of 26 U.S.C.).

56 *See* David E. Rosenbaum, *Tax Revision Bill Wins Passage in the House on Shift in G.O.P. Votes*, N.Y. TIMES, Dec. 18, 1985, at A1.

57 *See* H. RPT. 99-426 (1985). The House Ways and Means Committee's report argued that

> [t]ax incentives, even if individually designed to promote desired objectives, collectively cause significant economic distortions and increase the burden of the tax system in other sectors of the economy. Incentives designed to encourage investment and increase productivity often have unintended results, such as the substitution of less productive, but tax-favored, assets for more productive investments. . . . In many cases, such investments are made only because they produce large deductions and credits that may be used to offset other income, and, importantly, not because there is a market demand for the services provided by these investments.

Id.

58 *See, e.g.*, 131 CONG. REC. 35,836 (1985) (statement of Rep. Pete Stark (D-Cal.)) ("A vote for the bill is a vote for [the] citizen taxpayer. . . . If you have billions of dollars in a sector rich in tax shelters, then you are against the bill.").

59 *See* H. RPT. 99-426 (1985). Among other changes, the bill repealed the regular investment tax credit, partially repealed the tax credit for fuels from non-conventional sources, and abolished a variety of "tax shelters" such as the two-earner deduction for couples and tax exclusions for the first $100 in dividends. *Id.*

60 David E. Rosenbaum, *Panel Votes to End Political Tax Credit*, N.Y. TIMES, Oct. 10, 1985, at D6.

61 131 CONG. REC. 37,374 – 75 (1985).

its consideration on the floor, and it passed by a vote of 230 to 196.[62] The Senate, however, did not include a similar proposal in its version of the bill,[63] and the provision did not survive the House-Senate conference.

The legislative history of the Tax Reform Act of 1986 reveals that Congress had three primary motives for repealing the tax credit for political contributions. First, many congressional supporters of the Act felt it inappropriate to retain the credit on the one hand while on the other hand eliminating many credits and incentives for other activities.[64] Some members of Congress even argued that retaining the credit (or expanding it through the McHugh Amendment) would smack of self-dealing and corruption.[65] Second, TRA proponents questioned the efficacy of the credit as a means of encouraging new, small-dollar contributions, given that IRS data suggested that political contribution incentives were used disproportionately by wealthy taxpayers.[66] Finally, proponents of the repeal questioned whether giving a small credit ($50 under the law at the time) was worth the administration and verification costs to the IRS.[67]

The McHugh Amendment was designed to respond to some of these concerns. Its congressional proponents argued that it was an important (if incremental) campaign finance reform measure and not simply a tax preference for members of Congress.[68] Though opponents of the amendment argued that providing a credit only for congressional candidates (and not state or local candidates) was tantamount to self-dealing, Representative McHugh presented it as a way to narrow the scope of the credit as a cost-saving measure in an effort to keep the provision roughly revenue-neutral.[69] At the same time, the McHugh Amendment doubled the dollar value of contributions claimable under the credit and made it into a full 100% credit, thus strengthening its incentive value and addressing the charge that the credit was too small to justify IRS expenditures on administration and verification.[70] Even as experience with the federal credit suggested that it was not performing as well as its creators intended, the McHugh Amendment represented a reasonable effort to strengthen the credit in response to criticism.

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[62] Rosenbaum, *supra* note 56.

[63] *See* SEN. RPT. 99-313 (1986).

[64] *See id*.

[65] *See, e.g.*, *Tax Reform Act of 1986: Hearings on H.R. 3838 Before the Senate Comm. on Finance*, 99th Cong. 68-73 (1986) [hereinafter *TRA Hearings*] (statement of Rep. Bill Frenzel (R-Minn.)) (calling the McHugh Amendment "a terrible case of greed and selfishness on the part of Congress"). Representative Frenzel had previously been a proponent of tax credits, arguing that unlike direct public funding schemes, tax credits encourage civic participation. *See Tax Credits Hearings*, *supra* note 45 (statement of Rep. Frenzel). Nine years later, however, Frenzel expressed serious doubts about the efficacy of tax credits, and stated that three quarters of contributions claimed under the tax credit went to incumbents. *See TRA Hearings*, *supra*, at 68 ("[I]f we are all going to sacrifice by giving up some tax preferences, it seems to me Congress ought to be willing to give [some] up too.").

[66] *See* SEN. RPT. 99-313 (1986). For a discussion of the IRS data, see Guy Lincoln Smith, A Third Way in Campaign Finance Reform: Political Contribution Credits and Their Role in Increasing Political Equality 81 – 84, unpublished Harvard University senior thesis (2001) (on file with author, used with permission).

[67] *See* SEN. RPT. 99-313 (1986).

[68] *See* 131 CONG. REC. 35,949 (1985) (statement of Rep. McHugh) ("[W]e are offering a modest, but very important proposal, which will give a meaningful incentive to candidates for congressional office in the House or the Senate to go out and get more participation from small contributors."). The Democratic Study Group ("DSG"), a partisan think tank, was one of the original proponents of the idea to increase the tax credit to 100% to encourage small-donor participation and to counter the increasing role of political action committees ("PACs") in political fundraising. Thomas B. Edsall, *PACs Outpacing Individuals; Study Says Small Donors Disappearing From Politics*, WASH. POST, Oct. 24, 1985, at A8.

[69] *See id.*

[70] *See supra* text accompanying notes 61 and 67.

Nevertheless, opposition from some unexpected quarters raised obstacles to the inclusion of the McHugh Amendment in the TRA. In a move that divided campaign reform advocates on the Act, Common Cause President Fred Wertheimer and longtime campaign reform advocate Representative David Obey (D-Wisc.) spoke out against the McHugh Amendment before Congress.[71] Wertheimer and Obey both argued that the McHugh Amendment's expansion of the tax credit for political contributions, if enacted on its own, would only aggravate what they saw as the greater problem, the disproportionate political influence of PACs. According to their argument, the practice of PACs "bundling" individual contributions to candidates – i.e., encouraging individuals to write checks to particular candidates, and then collecting those individual contributions and delivering them together – would be subsidized by expanding the credit without enacting additional reforms.[72] Supporters of the McHugh Amendment argued that its provisions addressed the bundling issue by limiting the credit to in-state contributions and through an additional provision that made contributions through a third party ineligible for the credit.[73] With the campaign reform community unable to present a united front on the merits of a tax credit for political contributions, the credit ended up a casualty of legislative maneuvering over the TRA.

The federal tax code today

Though the most ardent proponents of tax simplification sought to remove all forms of targeted tax incentives from the tax code in 1986,[74] the TRA was only a small step in this direction. Even as it eliminated tax incentives such as the tax credit for political contributions, the Act retained and even strengthened other tax incentive programs such as the Earned Income Tax Credit, the tax deduction for charitable contributions, and the tax credit for rehabilitation of historic structures.[75]

The next step for congressional supporters of the elimination of tax incentive programs was the passage of the Budget Enforcement Act of 1990 ("BEA").[76] The BEA placed restrictions on Congress' ability to legislate through the tax code, requiring that tax changes resulting in revenue loss be offset by tax increases or the elimination of other tax preferences in order to keep any such changes revenue-neutral.[77] These "pay-as-you-go" or "PAYGO" requirements were intended to prevent the enactment of new tax incentives from undermining the simplification of the tax code accomplished by the TRA.[78]

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[71] Richard E. Cohen, *Giving Their All*, NAT'L J., Dec. 14, 1985, at 2886.

[72] In testimony before the Senate Finance Committee, Wertheimer argued that the McHugh Amendment would make bundling a more effective tool for PACs, but that could be a valuable piece of a broader package of reforms. *TRA Hearings*, *supra* note 65, at 175-183 (1986) (statement of Fred Wertheimer, Pres., Common Cause). Representative Obey made similar arguments to his Democratic colleagues, but also played on partisan fears, claiming that Republicans would be able to use bundling and other sophisticated fundraising techniques to take better advantage of an expanded tax credit. Cohen, *supra* note 71.

[73] *See* Cohen, *supra* note 71 (quoting Richard P. Conlen, executive director of DSG). For the text of these provisions, see 131 CONG. REC. 37,374 – 75 (1985).

[74] *See, e.g.*, 131 CONG. REC. 37,446 (1985) (statement of Rep. Bill Archer (R-Tex.)) (arguing that tax credits for political contributions "put[] us even farther away from a return-free system").

[75] *See* H. RPT. 99-841 (1986).

[76] Omnibus Budget Reconciliation Act of 1990, Pub. L. No. 101-508, §§ 13001 – 13501, 104 Stat. 1388, 1388-573 – 1388-630 (codified as amended in scattered sections of 2 U.S.C.).

[77] *See id*. The Office of Management and Budget was required to monitor congressional compliance with the BEA requirements. 2 U.S.C. § 902(b) (2000). If at the end of the session congressional tax changes resulted in a net loss to the government, the Office was required to "sequester" (i.e., eliminate) certain expenditures according to a pre-established formula in order to eliminate the deficit increase. *See id.* § 902(b).

[78] *See* Cheryl D. Block, *Pathologies at the Intersection of the Budget and Tax Legislative Processes*, 43 B.C. L. REV. 863, 884 (2002) (arguing that "[c]odification of the PAYGO rules in 1990 was an indication that Congress did not trust itself" to remain true to the spirit of tax simplification underlying the TRA).

Even with the budgetary restrictions, however, in the early 1990s the amount of money that the government spent through tax credits and other "tax expenditures" quickly rose back toward the level it had been at prior to the TRA.[79] In the late 1990s, federal budget surplus projections often induced Congress to bypass or waive the BEA requirements on an ad hoc basis.[80] The politics of a budget surplus made "pay as you go" seem less necessary, and Congress allowed the BEA requirements to expire for most categories of expenditure in October 2002.[81] Since then, the return of federal budget deficits has led many in Congress to call for the reinstatement of PAYGO requirements, but the politics surrounding the issue make it unlikely that Congress will revive the requirements in the foreseeable future.[82]

Despite continuing criticism from some members of Congress that the use of targeted tax incentives is harmful to the economy,[83] the federal government uses tax credits and similar tax preferences in many areas to promote what it considers socially beneficial activities. In the years following the passage of the BEA, many new tax incentives were added to the tax code, including tax credits that benefit the disabled,[84] the environment,[85] and education.[86] In 2002, more than 40.6 million American taxpayers claimed tax credits on their individual returns, in amounts totaling $39 billion.[87] Of this money, the vast majority went to finance three tax credits: the Child Tax Credit, which cost the government $21.6 billion; the Foreign Tax Credit, which cost the government $5.2 billion; and the various education tax credits, which cost the

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[79] GEN. ACCOUNTING OFF., REP. NO. GAO/GDD/AIMD-94-122, TAX POLICY: TAX EXPENDITURES DESERVE MORE SCRUTINY 35 – 37 (1994). *See also* David E. Rosenbaum, *Favoring Tax Cuts and Tolerating Deficits*, N.Y. TIMES, June 10, 2004, at A4 ("[O]ne of the guiding principles of [President] Reagan's tax policy, simplifying the tax code by eliminating narrow tax breaks, was abandoned by subsequent presidents of both parties who preferred to use tax preferences to meet various social and economic goals and satisfy special interests.").

[80] *See* EXEC. OFF. OF THE PRES., OFF. OF MGMT. & BUDGET, BUDGET OF THE UNITED STATES GOVERNMENT, FISCAL YEAR 2002: ANALYTICAL PERSPECTIVES 243 (2001) ("With the arrival of budget surpluses in 1998, Congress and the [Clinton] Administration began to skirt the budget enforcement mechanisms.").

[81] EXEC. OFF. OF THE PRES., OFF. OF MGMT. & BUDGET, BUDGET OF THE UNITED STATES GOVERNMENT, FISCAL YEAR 2004: ANALYTICAL PERSPECTIVES 315 (2003).

[82] During debate over the 2005 budget, a budget amendment creating a new version of the PAYGO requirements narrowly passed the Senate over the objections of the Bush Administration and congressional leadership. Richard A. Oppel, Jr., *Senate Raises Bar to Enact New Tax Cuts; Rebuff to Bush*, N.Y. TIMES, Mar. 11, 2004, at A24. A resolution supporting the change failed to pass on a tie vote in the House. Richard A. Oppel, Jr., *Bush Plans For Tax Cuts Barely Avert House Setback*, N.Y. TIMES, Mar. 31, 2004, at A18. President Bush and congressional leaders have resisted reviving the "pay-as-you-go" principle that changes to the tax code should be revenue-neutral because it would make it virtually impossible to make permanent major tax cuts passed in 2001 and 2003. Edmund L. Andrews, *Mutiny by 4 Republicans Over Bush's Tax Cutting Forces Delay on Budget Vote*, N.Y. TIMES, May 21, 2004, at A18.

[83] *See, e.g.*, U.S. CONG. JT. ECON. COMM., INEFFICIENCY OF TARGETED TAX POLICIES (1997) (arguing that targeted tax incentives artificially lower the costs of some activities in ways that distort the free market and cause unintended consequences that frequently undermine their incentive value).

[84] *See* Omnibus Budget Reconciliation Act of 1990, Pub. L. No. 101-508, § 11611, 104 Stat. 1388, 1501 – 03 (codified at 26 U.S.C. § 44 (2000)) (establishing the Disabled Access Credit).

[85] There are multiple tax credits designed to encourage environmentally friendly activities, including credits for qualified electric vehicles and the production of energy from renewable sources. *See* Energy Policy Act of 1992, Pub. L. No. 102-486, §§ 1913(b)(1), 1914(a), 106 Stat. 2776, 3019 – 20 (codified as amended at 26 U.S.C. §§ 30, 45 (2000)) (establishing tax credits for qualified electric vehicles and energy production from certain renewable sources).

[86] *See* Taxpayer Relief Act of 1997, Pub. L. No. 105-34, § 201, 111 Stat. 788, 799 – 806 (codified at 26 U.S.C. § 25A (2000)) (establishing the Hope Scholarship Credit and the Lifetime Learning Credit).

[87] INTERNAL REVENUE SERV., INDIVIDUAL INCOME TAX RETURNS: SELECTED INCOME AND TAX ITEMS FOR SPECIFIED TAX YEARS, 1985 – 2002 (2004), *at* http://www.irs.gov/pub/irs-soi/02in01si.xls (last visited June 30, 2004). This data is preliminary data only, revised by the Internal Revenue Service as of May 2004. *Id.*

government $4.9 billion.[88] By comparison, the cost of the tax credit for political contributions was only $269.8 million in its peak year of 1980.[89]

POLITICAL CONTRIBUTION INCENTIVES AT THE STATE LEVEL

The design of the original federal tax credit for political contributions limited its effectiveness. Experience with political contribution incentive programs, however, is not limited to the federal level. Many states have implemented their own version of a tax credit for political contributions, including Oregon, Arkansas, Ohio, and Virginia. Meanwhile, Minnesota takes a slightly different approach, operating a Political Contribution Refund ("PCR") program outside of its tax system.[90] Recent experience with incentive programs for small-dollar political contributions at the state level suggests several ways in which the design of an incentive program can be tailored to promote small-donor participation in political campaigns more effectively.

Details of the state programs

Oregon has the oldest of the current state political contribution incentive programs, having provided a tax credit for political contributions in some form since 1969.[91] The Oregon tax credit also has had the highest participation rate of any state's political contribution incentive program, with an average of 4.5% of its taxpayers participating per year during the 1990s.[92] After the TRA repealed the federal tax credit in 1986, Oregon increased the coverage of its credit from 50% to 100% for contributions up to $50 (or $100 for joint returns) to federal, state, and local candidates, parties, and PACs.[93] In 1994, Oregon voters passed Measure 9,[94] a ballot initiative championed by OSPIRG and other reform groups that set low contribution limits for state candidates, parties, and PACs[95] and made tax credits for contributions available only for candidates who agreed to abide by voluntary spending limits.[96] The Measure 9 provisions were in effect for only a few years before the Oregon Supreme Court struck down its contribution limits because they violated

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[88] *Id.* Not included amongst these numbers is the Earned Income Credit, which unlike most tax credits offered by the federal government is refundable – i.e., claimants are entitled to a refund of any credit amount in excess of the claimant's tax liability. *See id.*

[89] *See supra* text accompanying note 51. At that time, the political contributions credit was only a 50% tax credit for the first $50 of an individual's contributions ($100 for joint returns). *See supra* text accompanying notes 24 – 26.

[90] Arizona also has a tax credit for political contributions, but unlike those discussed here, the credit is not available for contributions to candidates, but instead only applies to contributions made to the state's nonpartisan Clean Elections Fund. For a discussion of the Arizona credit, see David Rosenberg, *Broadening the Base: The Case for a New Federal Tax Credit for Political Contributions* 56 – 60 (American Enterprise Institute, 2002).

[91] Rosenberg, *supra* note 90, at 24. For a discussion of the creation of Oregon's tax credit in 1969, see ALEXANDER, *supra* note 31, at 194.

[92] Rosenberg, *supra* note 90, at 26.

[93] 1987 Or. Laws 470 – 71.

[94] 1995 Or. Laws 1 – 11.

[95] *Id.* at 3. Measure 9 limited individual and PAC contributions to $500 for candidates for statewide office and $100 for candidates for the state legislature, parties, and PACs. *Id.*

[96] *Id.* at 9 – 10. Measure 9 set different voluntary spending limits for the primary and general election. *Id.* at 5. In the primary, candidates for governor could spend no more than $500,000; candidates for other statewide office could spend no more than $200,000; candidates for state senator could spend no more than $30,000; and candidates for state representative could spend no more than $20,000. *Id.* The limits were set at double these amounts for each office in the general election. *Id.* In addition to being ineligible for tax credit-reimbursed contributions, candidates who did not agree to limit their spending had a statement to that effect placed next to their names in the official voter pamphlet. *Id.* at 6 – 7.

the "free expression" clause of the Oregon Constitution.[97] The absence of contribution limits undermined participation in the tax credit program as many candidates chose to decline credit-eligible contributions to avoid consenting to spending limits.[98] In response to the Oregon Supreme Court's decision, the state legislature restored the tax credit's availability for the first $50 (or $100 for joint returns) of contributions to all federal, state, and local candidates, parties, and PACs.[99]

In 1996, Arkansas voters passed Initiated Act 1, establishing a tax credit that reimburses 100% of an individual's first $50 ($100 for joint returns) in contributions to state candidates, parties, and PACs.[100] The Act also established a series of low contribution limits for state campaigns – $300 for statewide executive offices such as governor and secretary of state and $100 for state legislative and judicial offices – and empowered local governments to set low contribution limits for their own races.[101] The low contribution limits applied both to contributions from individuals to ordinary PACs and to contributions from ordinary PACs to candidates.[102] Perhaps the most innovative provision of Initiated Act 1, however, was its creation of a new kind of political entity, the small donor PAC.[103] Small donor PACs, which could also accept credit-eligible contributions, operated under a different set of rules than regular PACs; in return for only accepting contributions from individuals of $25 or less, small donor PACs could give up to $2,500 in contributions to a candidate.[104] Initiated Act 1's low contribution limits, tax credits for political contributions, and favorable treatment of small donor PACs were clearly designed to give average Americans a greater opportunity to participate in political campaigns and to force candidates to engage in a style of campaigning that was more responsive to grassroots constituencies from across the political spectrum.

Opponents of Initiated Act 1, including the Associated Industries of Arkansas PAC, challenged its provisions in federal court.[105] In 1998, the Eighth Circuit Court of Appeals issued a decision that struck down the Act's contribution limits as well as a pre-Act contribution limit of $200 for contributions from

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[97] VanNatta v. Keisling, 931 P.2d 770 (Or. 1997). The Oregon Supreme Court's holding was on independent state law grounds, as the Court interpreted the state constitutional guarantee in an even stricter fashion than the United States Supreme Court has interpreted the First Amendment. *See id.* at 775 – 76 (rejecting *Buckley v. Valeo*'s holding that restrictions on contributions are less threatening to freedom of expression than restrictions on expenditures). The Court rejected, however, a similar claim that Measure 9's voluntary spending limits violated the "free expression" clause. *Id.* at 787 – 89. The Court found that neither the linkage of tax credit eligibility to acceptance of the spending limits nor the voter pamphlet statement of candidate compliance with the limits was sufficiently coercive as to place an impermissible burden on candidates' speech. *Id.*
[98] *See* Smith, *supra* note 66, at 79 – 80. In 1996, when Measure 9's contribution limits were still in effect, 95.8% of primary election candidates and 83.75% of general election candidates agreed to spending limits. *Id.* In 1998, after the Oregon Supreme Court had struck down the contribution limits, only 61.4% of primary election candidates and 10.31% of general election candidates agreed to spending limits. *Id.* These statistics demonstrate that the success of Measure 9's voluntary spending limits depended on its low contribution limits to give candidates a reason not to opt out of the system. Evidently, the lure of raising and spending campaign funds in unlimited amounts was too great for 89.69% of Oregon's candidates in the 1998 general election.
[99] S.B. 369, 1999 Or. Laws 2464, 2477 – 78 (codified at OR. REV. STAT. § 316.102 (2001)).
[100] ARK. CODE § 7-6-222 (2000).
[101] Rosenberg, *supra* note 90, at 51.
[102] Ark. Ethics Comm'n, Advisory Op. No. 98-EC-017 (Aug. 27, 1998), *available at* http://www.arkansasethics.com/opinions/98-EC-017.htm.
[103] Rosenberg, *supra* note 90, at 51. According to a survey of state campaign finance laws done by the National Conference of State Legislatures, the only other state that creates a special classification for small donor PACs is Colorado. NAT'L CONF. OF STATE LEGIS., LIMITS ON PAC CONTRIBUTIONS TO CANDIDATES, *at* http://www.ncsl.org/programs/legman/about/PACCand.htm (last visited Aug. 24, 2004).
[104] *Id.*
[105] Russell v. Burris, 146 F.3d 563 (8th Cir. 1998), *cert. denied*, 525 U.S. 1001 (1998), *cert. denied*, 525 U.S. 1145 (1999).

individuals to PACs.[106] The court reinstated the state's prior limit of $1,000 for contributions from individuals and PACs to candidates and also reduced the contribution limit for small donor PACs from $2,500 to $1,000 to align it with that of ordinary PACs.[107] As a result, individuals are no longer limited in the amount that they can give to ordinary PACs, and while small donor PACs still exist, they can no longer contribute more to candidates than can ordinary PACs.

In eliminating these advantages over ordinary PACs, the Eighth Circuit seriously undermined the ability of states to provide for small donor PACs that empower small donors vis-à-vis the large-dollar contributors who have historically dominated campaign finance.[108] In addition, Initiated Act 1's tax credit for political contributions no longer serves the same purpose. Whereas the tax credit was originally intended to provide an incentive for a larger number of small donors to make contributions to increase the pool of money available to candidates as a complement to the Act's low contribution limits,[109] it now may be used to reimburse portions of contributions to candidates that may run as high as $1,000, or contributions to ordinary PACs that can be for any amount.

Ohio and Virginia also offer tax credits for political contributions, but neither state's credit program includes parties, PACs, or federal candidates. Ohio provides a 100% tax credit for the first $50 (or $100 for joint returns) in contributions to state candidates.[110] Ohio law limits individual and PAC contributions to candidates to $2,500; individual and PAC contributions to parties to $5,000 for county parties and $15,000 for state parties; and individual contributions to PACs to $5,000.[111] Virginia offers a 50% credit on the first $25 (or $50 for joint returns) of contributions to state and local candidates during the year they are up for election.[112] Virginia law does not limit contributions to candidates or PACs.[113]

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[106] *See id.* (holding that there was insufficient evidence to support a finding that low contribution limits were necessary to support Arkansas' interest in preventing corruption and the appearance of corruption). The Eighth Circuit's interpretation of the First Amendment was later seriously undermined by the Supreme Court's decision in *Nixon v. Shrink Mo. Gov't PAC*, which upheld a similar initiative passed in Missouri that established low contribution limits. *See* 528 U.S. 377 (2000) (upholding Missouri contribution limits of $1,000 for constitutional offices and $250 for other offices, indexed for inflation). Thus, if Arkansas were to enact Initiated Act 1's low contribution limits again today, a federal court would likely find them constitutionally acceptable.

[107] *Russell*, 146 F.3d at 568 – 72. The court reasoned that the Equal Protection Clause of the Fourteenth Amendment required parity between the amount an ordinary PAC and a small donor PAC were allowed to contribute to candidates, even though after the court's decision ordinary PACs were able to receive unlimited contributions from wealthy donors while small donor PACs would still exist as entities that collected contributions in amounts of $25 or less. *Id.* at 572.

[108] *See* Zach Polett, *Empower Citizens*, BOSTON REV., Apr./May 1997 (describing the aims of Initiated Act 1's proponents), *available at* http://bostonreview.net/BR22.2/polett.html. According to the director of national political operations for the Association of Community Organizations for Reform Now ("ACORN"), one of the groups whose organizing and lobbying efforts helped to pass Initiated Act 1,

> What makes the small-donor PAC particularly effective as a campaign finance reform tool is its combination with the contribution limits of the initiative. Under the initiative, regular PACs and individuals can contribute no more than $100 per election to a candidate (or $300 for a statewide race) while small-donor PACs are allowed to contribute up to $2,500. Thus small-donor PACs empower small donors while decreasing the power of traditional, large-donor PACs. They also have the advantage of putting more money into the system, thus answering one of the objections raised to relatively low contribution limits.

Id.

[109] *See id.*

[110] OHIO REV. CODE ANN. § 5747.29 (2002).

[111] *Id.* § 3517.102.

[112] VA. CODE ANN. § 58.1-339.6 (2000).

[113] Rosenberg, *supra* note 90, at 61.

In 1992, Minnesota created its PCR program, which offers refunds for 100% of contributions up to $50 per person to political parties and candidates who agree to abide by spending limits.[114] The program is administered outside of the tax system, with refunds issued typically within four to six weeks after the contributor submits an official receipt to the state's Department of Revenue.[115] The Minnesota legislature enacted the contribution refund program as a supplement to its system of partial public financing, which had been in existence since 1974.[116] Participation in the public funding system in Minnesota is high, and public funds represent a significant portion of total campaign funds used by candidates; in 2002, approximately 25% of all candidate funds came from direct public financing.[117] Like PCR money, these public funds are available to candidates only if they abide by spending limits.[118] The spending limits are adjusted periodically for inflation; in 2002, spending limits were set at $27,380 for candidates for State Representative; $54,740 for candidates for the State Senate; $182,350 for candidates for Secretary of State and State Auditor; $364,690 for candidates for Attorney General; and $2,188,090 for candidates for Governor and Lieutenant Governor.[119] First-time candidates receive a 10% increase in their spending limit.[120] Candidates who win in a contested primary election may spend 120% of their spending limits.[121] In non-election years, spending limits are set at 20% of election-year limits.[122] Studies have suggested that Minnesota's system of campaign finance regulation has resulted in more competitive elections in the state than would have taken place under a system of regulations patterned after the federal model.[123]

Comparing effects of different state programs

As Justice Louis Brandeis wrote in the first half of the twentieth century, "It is one of the happy accidents of the federal system that a single courageous state may, if its citizens choose, serve as a laboratory, and try novel social and economic experiments without risk to the rest of the country."[124] Brandeis' laboratory

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[114] MINN. STAT. § 290.06(23) (2002).
[115] Rosenberg, *supra* note 90, at 36.
[116] *See* Graham P. Ramsden & Patrick D. Donnay, *Impact of Minnesota's Political Contribution Refund Program on Small-Donor Behavior in State House Races*, 33 STATE & LOCAL GOV'T REV. 32, 33 (2001) (detailing history of PCR's enactment).
[117] *See* MINN. CAMPAIGN FIN. & PUB. DISCLOSURE BD., 2002 CAMPAIGN FINANCE SUMMARY (reporting total contributions and total public subsidies received by state candidates in 2002), *at* http://www.cfboard.state.mn.us/Summary02/CFSUMM2002.pdf (last visited June 22, 2004).
[118] MINN. STAT. § 10A.322 (2002).
[119] *Id.* § 10A.25(2). In 2004, only members of the Minnesota House of Representatives are up for election. The 2004 spending limit for candidates for this office is $28,400. MINN. CAMPAIGN FIN. & PUB. DISCLOSURE BD., 2004 CONTRIBUTION AND EXPENDITURE LIMITS, *at* http://www.cfboard.state.mn.us/campfin/CONTLTEY.htm (last visited June 22, 2004).
[120] MINN. STAT. § 10A.25(2)(d) (2002). Minnesota law defines a first-time candidate as "a candidate who is running for that office for the first time and who has not run previously for any other office whose territory now includes a population that is more than one-third of the population in the territory of the new office." *Id.*
[121] *Id.* § 10A.25(5). A candidate qualifies for the contested primary spending bonus if the candidate "received fewer than twice as many votes as any one of the candidate's opponents in [the] primary . . . ." *Id.*
[122] *Id.* § 10A.25(6). Contributions limits in Minnesota are similarly structured. Individual contribution limits during election years are $500 for state legislative campaigns, $1,000 for the Attorney General's campaign, and $2,000 for campaigns for Governor and Lieutenant Governor. *Id.* § 10A.27. During non-election years, these limits are set at $100, $200, and $500, respectively. *Id.* Any contribution or expenditure over $100 from a corporation or other association must come from a segregated political fund. *Id.* § 10A.12.
[123] *See* Patrick D. Donnay & Graham P. Ramsden, *Public Financing of Legislative Elections: Lessons from Minnesota*, 20 LEGIS. STUD. Q. 351, 351 – 64 (1995) (finding that the Minnesota system of public financing helps challengers more than incumbents in state legislative elections, making them more competitive); Kenneth R. Mayer, Public Financing and Electoral Competition in Minnesota and Wisconsin 17 (Citizens Res. Found., U. of So. Cal., 1998) (arguing that the Minnesota system has resulted in "state legislative elections . . . [that] are vigorously contested, with voters offered viable alternatives in nearly every race").
[124] New State Ice Co. v. Liebmann, 285 U.S. 262, 311 (1932) (Brandeis, J., dissenting).

metaphor is apt for a discussion of political contribution incentives. In particular, the Minnesota and Oregon political contribution incentive programs serve as instructive case studies that suggest ways in which a new federal incentive program for political contributions might be structured.

Those states that have offered tax credits without any additional reforms have largely replicated the federal experience. Ohio, Arkansas, and Virginia all have credits that essentially stand on their own as methods of encouraging citizen involvement in political campaigns, and though their relatively recent enactment means that data are limited, the three states' programs have all experienced modest participation rates. The programs' effects on small donor participation are less clear. In the early years of the Ohio tax credit, the program's participation rate has never exceeded 0.5%, and the number of small-dollar contributions has changed only slightly.[125] Data from Arkansas and Virginia tell similar stories, though these states have newer credit programs that preclude drawing state-specific conclusions. As with the old federal credit and the Ohio credit, political contribution incentives in these two states have shown modest participation rates.[126]

Unlike other political contribution incentive programs, the structure of the Minnesota PCR program encourages parties and candidates to solicit small-dollar contributions actively. The state gives official receipt books to candidates and parties, who then offer the receipts to donors to submit with their refund applications.[127] With refunds issued year-round, candidates can promise prospective donors a refund in a matter of weeks, enhancing their fundraising efforts.[128] Moreover, since the contribution refunds are only available for donations to those candidates who abide by spending limits and receive a large portion of their campaign budget from public funds,[129] candidates whose appeal is primarily to grassroots constituencies – regardless of party or ideology – have more of an opportunity to compete on a level playing field.

Because the Minnesota PCR program operates as a refund rather than as a traditional tax credit, it reduces an eligible donor's costs of making a political contribution to a greater degree than traditional tax credits do. In studying what motivates individual donors to make political contributions, political scientists have found strong evidence that the likelihood that an individual will make a political contribution is almost entirely dependent on his or her family's income level.[130] Even more so than a traditional tax credit, a program like Minnesota's that is designed to reimburse small donors for their political contributions within weeks after they are made has the potential to make an individual's likelihood to contribute to a campaign less dependent on his or her ability to do so.

One recent study by a Harvard University student suggests that contributions to candidates made under the Minnesota PCR program are not predominantly determined by the income level of the candidate's

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125 Rosenberg, *supra* note 90, at 48 – 49. In the four-year cycle following the introduction of Ohio's tax credit for political contributions, contributions of $50 or less to campaigns for statewide offices rose less than 5%. *Id.* More recent data on the efficacy of the Ohio tax credit has been gathered by the Campaign Finance Institute, which surveyed Ohio citizens and found that public education about the program could lead to a substantially greater participation rate. *See infra* text accompanying notes 221 – 223.

126 *See* Rosenberg, *supra* note 90, at 53 (finding that "[t]he Arkansas tax credit is getting more popular but remains . . . a minor piece of the campaign finance system" that has not had a significant impact on state elections); *id.* at 63 (finding that the Virginia credit has had only "a tiny impact on campaign finances" and has had no demonstrable effect on small-dollar contributions).

127 *Id.* at 36.

128 *See id.* at 42 – 43.

129 MINN. STAT. § 290.06(23) (2002).

130 *See* SIDNEY VERBA, ET AL., VOICE AND EQUALITY 361 (1995) ("[I]n accounting for the volume of contributions to politics, family income is, overwhelmingly, the dominant factor. To give money one needs money and, apparently, little else.").

supporters.[131] Based on a detailed analysis of contribution refund program data,[132] the study found that the income level of some candidates' districts actually showed a slight negative relationship to the candidates' ability to raise PCR program funds.[133] According to the study, the data show that characteristics of the candidate, rather than characteristics of the district, are the crucial determinants of a candidate's PCR fundraising ability.[134] For example, a candidate's status as an incumbent and success at raising non-PCR funds show strong relationships to his or her success at raising PCR donations.[135] In other words, the study suggests that Minnesota PCR donations depend almost entirely on a candidate's own efforts to solicit contributions rather than on the income level of the candidate's supporters. Further study of the Minnesota experience is necessary to clarify the effects that the refund program has had on political giving in the state.

Minnesota's political contribution refund program helped boost the proportion of candidates' funds raised from small contributions by more than 14% between 1990 and 1998.

The Minnesota PCR program was introduced to supplement a system of public financing that had already shown moderate success in enabling more competitive elections. Studies on the effects of the contribution refund on small-donor participation in Minnesota suggest that the refund program has had a similarly moderate, but measurable, effect on donor behavior. Between 1990 and 1998, contributions of less than $100 increased from 34.3% to 39.2% of the average candidate's budget, with effects being particularly pronounced in open-seat races.[136] In open-seat races, contributions of less than $100 rose from 28.9% to 48.9% of the total receipts of Democratic-Farmer-Labor candidates, and from 30.9% to 41.3% of the total receipts of Republican candidates.[137]

Despite these measurable effects, the contribution refund program's overall participation rate is still relatively low. One study suggests that participation averages slightly less than 4% of potential donors during election years and slightly less than 3% during off years.[138] Even as participation rates have remained flat, however, the amount of money paid out by the state through the program has increased

131 Smith, *supra* note 66, at 97 – 118.

132 More detailed conclusions about patterns of donor behavior are possible for Minnesota's PCR program than for federal or state tax credits because in operating the contribution refund program outside of its tax system, Minnesota tracks a different set of credit usage data than does the IRS or most other states. Instead of recording the income class of those who take advantage of the credit, Minnesota maintains data on which candidates and parties are recipients of the funds, and in what amounts. *Id.* at 73 – 74. This more detailed set of data allows for more sophisticated analyses of donor behavior than are possible using only aggregate taxation statistics. *Id.* at 108 – 18.

133 *See id.* at 115 (finding that in the 1996 election cycle, the income level of a State Senate candidate's had a negative correlation with the amount of PCR money they raised). This was the case even though in Minnesota, Republicans (generally assumed to be the party favored by the wealthy) have taken much fuller advantage of the contribution refund program than Democrats in their mobilization efforts. Rosenberg, *supra* note 90, at 39 – 42.

134 Smith, *supra* note 66, at 112.

135 *Id.* at 116. Party affiliation also plays a major role, as the Republican Party in Minnesota has been much more effective than the Democratic Farmer-Labor Party at mobilizing its donor base to take advantage of the contribution refund program. *Id.* at 107 – 08.

136 *See* Ramsden & Donnay, *supra* note 116, at 38.

137 *Id.* at 39.

138 *See* Smith, *supra* note 66, at 97 (estimating contribution refund participation rates for the years 1994 to 1999). The author estimates that contribution refund participation was 3.73% in 1994, 2.86% in 1995, 4.05% in 1996, 2.76% in 1997, 3.79% in 1998, and 2.97% in 1999. *Id.*

steadily as the average size of the refund has increased, rising from $7.5 million in the 1996 election cycle to more than $9 million in the 2000 election cycle.[139]

Perhaps the most notable "success story" for the Minnesota PCR program – and indeed, for political contribution incentive programs generally – was the election of Reform Party candidate Jesse Ventura as Governor of Minnesota in 1998. Governor Ventura's success was widely attributed to the effectiveness of his appeal to grassroots supporters.[140]

The contribution refund program was instrumental to this appeal. Even after he was elected governor, Ventura promoted participation in the program actively throughout his fundraising efforts with such slogans as "Help Fund the Governor's Grass Roots Volunteer Organization and Get Your Money Back!"[141] Governor Ventura argued that the contribution refund program was essential to his fundraising efforts because he refused to accept PAC donations: "The underlying goal of the publicly funded PCR program is to make it unnecessary for candidates to accept large contributions from individual donors and lobbying groups by providing candidates with enough small contributions to adequately finance their campaigns."[142] Ventura's promotion of the Minnesota contribution refund program was particularly prominent on his web site, where he devoted most of his main fundraising page and an entire additional page to the refund.[143]

Governor Ventura's emphasis on PCR contributions was not simply rhetoric, as during his 1998 campaign he was able to raise PCR funds at a comparable rate to that of his major party opponents. Ventura raised $177,658 in PCR funds in 1998, which was only slightly less than the $181,089 raised by Democratic candidate Skip Humphrey, and actually exceeded the $175,937 raised by Republican Norm Coleman.[144] This fundraising success, when combined with the operation of Minnesota's other election laws such as voluntary spending limits and direct public funding[145] – as well as access to debates[146] – enabled Governor Ventura to overcome obstacles to competing with the major party candidates and ultimately to win his election.

The unique history of political contribution incentives in Oregon provides additional insight into ways in which lawmakers can design a more effective political contributions incentive program. Oregon's brief experience with linking its tax credit for political contributions to voluntary spending limits reveals some of the effects that different regulatory structures can have on the efficacy of political contribution incentives. During the brief period when Measure 9's low contribution limits and voluntary spending limits were both in effect, political contribution incentive program participation rates for the wealthiest income classes fell

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[139] Rosenberg, *supra* note 90, at 38.
[140] *E.g.*, Dane Smith & Robert Whereatt, *Ventura Wins; Populist Campaign Brings Out Throngs of Young Voters*, MINN. STAR-TRIB., Nov. 4, 1998, at 1A.
[141] Rosenberg, *supra* note 90, at 42 – 43.
[142] *Id.* at 43.
[143] *Id.*
[144] Peter S. Wattson, How Minnesota's Campaign Finance Law Helped Elected a Third-Party Governor 10, Paper Presented at Council on Governmental Ethics Laws Annual Conference (Dec. 8, 1999), *available at* http://www.senate.leg.state.mn.us/departments/scr/treatise/cogel-jesse.pdf.
[145] *See id.* at 9 – 12 (arguing that restrictions spending limits placed on Ventura's opponents, access to general account public funding available to all candidates who received over 5% of the vote, and permissive election laws that made it easier for minor party candidates to access the ballot and for new voters to register on election day were all necessary factors in Ventura's election).
[146] *See* Smith & Whereatt, *supra* note 140, at 1A (reporting that Ventura, as a "plain speaker of homespun wisdom," was "by consensus, the star of most of the debates").

sharply, while participation rates for the two lowest income classes rose slightly.[147] This effect suggests that, as in Minnesota, adoption of a system that combines low contribution limits with political contribution incentives linked to voluntary spending limits creates a political environment that is more open to candidates whose strength lies in appealing to large numbers of small donors. Oregon's data set is too limited to draw any definite conclusions– only in the 1996 election was there a high level of participation in Measure 9's voluntary spending limits – but at the same time, the data are in some ways more instructive than Minnesota's data in that one can witness the effects of a change in the governing law.

Oregon's tax credit has had the highest participation rate of any state's political contribution incentive program.

Oregon has the highest participation rate in the country for a political contribution incentive program, and in large measure this is due to the state providing the credit for contributions to PACs as well as candidates and parties.[148] Many PACs solicit credit-eligible contributions aggressively, promoting the credit as a central aspect of their fundraising appeal.[149] The result is that in recent electoral cycles, a substantial portion of contributions on which a tax credit was claimed went to PACs rather than to parties or candidates.[150] These results are consistent with data from Minnesota's contribution refund program. Both cases suggest that political contribution incentive programs are more likely to be successful in changing donor behavior if the backdrop of campaign finance regulations against which they operate also includes incentives for potential contribution recipients to promote the credit's usage. More study is needed to clarify why PACs in Oregon are so much better positioned than candidates and parties to solicit credit-eligible contributions.[151] Clearly, however, Oregon's higher participation rate is driven by the mobilization efforts of contribution recipients.

If the higher participation in the Oregon tax credit is largely attributable to the mobilization efforts of PACs, why has the Arkansas credit not shown similar effects? Like Oregon, Arkansas allows PACs (including small donor PACs) to receive credit-eligible contributions. Anecdotal evidence suggests, however, that the Arkansas credit is the victim of a widespread lack of awareness, even among political insiders.[152] While Oregon's tax credit has been around since 1969, Arkansas' credit was only enacted in 1996. Moreover, the Arkansas credit was enacted as part of a much broader initiative, most of which was struck down as unconstitutional by the courts.[153] Indeed, the very PACs that might otherwise have been early supporters of the tax credit were opponents of Initiated Act 1 because it subjected them to low contribution limits.[154] According to the author of Initiated Act 1, after large portions of the Act were struck down, the tax credit's

[147] Smith, *supra* note 66, at 142 – 43.
[148] Rosenberg, *supra* note 90, at 29 – 32.
[149] *See id.* at 30 – 31 (quoting literature from Oregon Right to Life and Oregon Gun Owners' Political Victory Fund).
[150] *See id.* at 29 ("Comparing tax credit data from the Oregon Department of Revenue and contribution data from the National Institute for Money in State Politics, it appears that the most tax credits are being claimed on contributions to organizations besides candidate and party campaigns.").
[151] For a discussion of some reasons why PACs may have stronger incentives to use the tax credit to solicit small-dollar contributions, see *infra* text accompanying note 194.
[152] *See* Rosenberg, *supra* note 90, at 54 – 55 ("The Arkansas political establishment has not embraced or, in some cases, even acknowledged the credit for political contributions as a viable fundraising mechanism."). One political party leader was not even aware that the credit applied to donations to political parties. *See id.* at 54 (citing a personal interview with State Senator Percy Malone (D-Arkadelphia)).
[153] *See supra* notes 106 – 107 and accompanying text.
[154] *See supra* text accompanying notes 105 – 108.

focus on small contributions was undermined.[155] While campaign literature often refers to the credit, these references are mainly limited to "small print disclaimers."[156]

The turbulent history surrounding the enactment of the Arkansas credit seems to have handicapped its early success in increasing the role of small donors in state and local politics. More study of the differences between the Arkansas and Oregon credits and the role of PACs in Arkansas and Oregon is needed to clarify why PACs in Oregon have mobilized around tax credits for political contributions so effectively.

Minnesota and Oregon have provided useful "laboratories" for examining the effects of political contribution incentive programs under different circumstances.[157] In the next section, the state PIRGs will propose a structure for a new federal incentive program for political contributions that builds on this experience.

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155 *See* Rosenberg, *supra* note 90, at 55 (quoting Scott Trotter, former Executive Director of Common Cause Arkansas).

156 *Id.* (internal quotation marks omitted).

157 Another valuable source of data on political contribution incentive programs is Canada, which offers a 75% tax credit for contributions to political parties. *See* CAMPAIGN FIN. INST., PARTICIPATION, COMPETITION, ENGAGEMENT: REVIVING AND IMPROVING PUBLIC FUNDING FOR PRESIDENTIAL NOMINATION POLITICS 80 – 82 (2003), *available at* http://www.cfinst.org/presidential/report/index.html. Canada has offered a tax credit for political contributions since 1974. *Id.* In 2003, the Canadian Parliament passed legislation that raised the amount of the credit from $500 to $650. An Act to Amend the Canada Elections Act and the Income Tax Act, ch. 19, S.C. 2003 (Can.). Although a comprehensive comparative study of Canada's campaign finance system is beyond the scope of this paper, the Campaign Finance Institute's research suggests that Canada's tax credit has significantly increased the role of small donors in funding political parties. *See* CAMPAIGN FIN. INST., *supra*, at 82 (finding that since the tax credit was introduced, political parties' average contributions has generally declined while the numbers of both individual contributors and claimants of the tax credit increased). Further study of the Canadian experience is needed to determine what lessons Americans should draw from it.

STORIES FROM MINNESOTA AND OREGON

Eric Lipman, State Representative, Minnesota

Eric Lipman is a Republican state representative from Minnesota in his second term whose entry into politics was inspired by his view that the way government works should be changed. "I am particularly interested in tax and spending issues in the high-tax state of Minnesota," he said. Believing the government should trim its spending and give citizens a wider range of choices, the attorney who had served as Deputy Secretary of State threw his hat in the ring in 2000, winning a seat in the state House.

Speaking from his campaign experience, Representative Lipman argues that the Minnesota refund program makes elected office "more accessible to a wider range of folks. Ordinary people can compete in elections, and it makes our part-time legislature possible." He noted that the refund facilitates fundraising. "It's a much easier ask for a candidate," he pointed out. "I could raise a lot of money in small amounts of $100 or less." Having worked on a federal Senate campaign, he can attest to the fact that the contrast between fundraising for his own campaign and for one outside the refund program is that of "night and day." Under the refund program, however, "you can run a campaign as a family operation."

Representative Lipman emphasized that the refund works best in the context of a system of voluntary spending limits; if candidates agree to abide by the limits, they can offer potential donors the option of a $50 refund (or $100 for a couple). A program designed in this way, he said, drives down the cost of campaigns and ensures high candidate compliance with spending limits.

Even better, the program is well known and loved among Minnesotans. "The refund program has great popular support," observed Representative Lipman, "and candidates who don't participate in the program are negatively perceived."[158]

Phil Barnhart, State Representative, Oregon

Dr. Phil Barnhart is the Assistant Democratic Leader in the Oregon House of Representatives. With a background as a practicing psychologist, an attorney, and a professor, he decided to enter politics when a fifth grade teacher he knew was laid off because of school budget cuts. The school was forced to scale back its budget, he said, after the passage of an initiative that reduced property taxes. "People get involved in politics because of something that *shakes* them," Dr. Barnhart said. "In my case, my objective was to repair school funding and ensure that it was stable."

Having promoted the Oregon tax credit extensively while campaigning, Dr. Barnhart believes that the credit allows people who have not been involved in the political process to become involved. "It's a way to break

[158] Personal communication between Representative Lipman and Dana Mason of the National Association of State PIRGs, June 29, 2004.

the ice with people," he pointed out. "I have a number of people who give more because of the credit; it increases their comfort level."

And then there are those who wouldn't donate at all without the credit. "Some people say, 'I'm dividing the tax credit between you and another candidate,'" Dr. Barnhart said. "These are people who are living very close to the earth." Many of his contributors are small-dollar donors; he estimates that between one-third and one-half of his contributions come in amounts of $100 or less.

He has seen direct evidence that Oregonians are spurred to donate because they know they will receive the credit on their taxes. In September 2003, he sent out a fundraising letter to previous donors soliciting contributions for his upcoming campaign. Some responded right away, but he observed a spike in donations four months later, in the last week in December—13% of those who donated made sure to contribute before the end of the year. Dr. Barnhart believes they were contributing in time to receive their tax credit for 2003.

According to Dr. Barnhart, the tax credit is valuable for increasing citizen participation. "In terms of involving people in the political process, the tax credit is an important tool," he noted. "I would be far less likely to get a new person involved without it."[159]

[159] Personal communication between Representative Barnhart and Dana Mason of the National Association of State PIRGs, February 20, 2004.

CONTRIBUTION INCENTIVE PROGRAMS AS PART OF LONG-TERM, COMPREHENSIVE CAMPAIGN FINANCE REFORM

VOUCHERS: ONE POSSIBLE FUTURE

A political contribution incentive program can only empower individuals to participate on equal terms in the funding of political campaigns if participation in the program is determined solely by individual choice, so that donors are not forced to bear opportunity costs that lower-income citizens will be less able to afford. One way to construct such an ideal program would be to administer political contribution incentives through a voucher system.

The idea of creating a voucher system to distribute public funding to candidates is not new. Senators Lee Metcalf (D-Mont.)[160] and Russell Long (D-La.)[161] each proposed a campaign finance voucher program in 1967. Both proposals were introduced in response to criticism of the Presidential Election Campaign Fund Act of 1966.[162] That Act had established a tax check-off for public financing of presidential campaigns, but Congress had subsequently voted to delay the Act's implementation while it considered further proposals for reform.[163] Both voucher proposals considered in the Senate in 1967 would have retained the element of a tax check-off that allowed taxpayers to earmark $1 for financing political campaigns, but would have given individuals a more potent political contribution incentive by having the government send them a voucher that they could remit to the candidate of their choice (instead of their $1 going into a general fund for all candidates, as under conventional tax check-off programs).[164] The voucher proposals were thus like tax check-off proposals, because individuals would not have been required to lay out any of their own money up front, but they were also like tax credits, because individuals would have been given the power to choose the recipients of the funds.

The Metcalf and Long proposals differed both in scope and accessibility. Senator Metcalf's plan would have expanded both the scope and effect of the tax check-off, giving taxpayers the choice to receive two $1 vouchers: one each for use in congressional and presidential campaigns.[165] The Metcalf vouchers would not have been accessible to all Americans at all times, however, as they would only have been available to those taxpayers who had sufficient tax liability in the year preceding the election for which the voucher would have been issued.[166]

Compared to the Metcalf proposal, the Long proposal on the one hand was more limited in scope, but on the other hand was more progressive. Senator Long's bill would have created "Presidential Election

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[160] Federal Elections Campaign Financing Act, S. 1390, 90th Cong. (1967). *See also* DAVID W. ADAMANY & GEORGE E. AGREE, POLITICAL MONEY: A STRATEGY FOR CAMPAIGN FINANCING IN AMERICA 189 (1975) (evaluating Metcalf's proposal).
[161] Presidential Election Campaign Assistance Act, S. 1698, 90th Cong. (1967).
[162] Pub. L. No. 89-809, 80 Stat. 1539.
[163] *See* Act of June 13, 1967, Pub. L. No. 90-26, 81 Stat. 57; *Political Campaign Financing Proposals: Hearing Before the Senate Comm. on Finance*, 90th Cong. 60 – 63 (1967) [hereinafter *Campaign Financing Proposals Hearings*] (summarizing 10 proposed reforms before the Senate Finance Committee in 1967).
[164] *See* ADAMANY & AGREE, *supra* note 160, at 189.
[165] S. 1390 § 2.
[166] *Id.* Thus, during presidential off-years only congressional vouchers would have been issued. *Id.*

Campaign Certificates" but made no provision for congressional races.[167] Under Senator Long's plan, however, the government would have automatically sent vouchers to all individuals who filed taxes in the year preceding the election and made a voucher available to any other individual (including resident aliens) who requested it.[168] Thus, while it applied only to presidential campaigns, Senator Long's proposal was the first legislative attempt to enact political contribution incentives outside of the tax code, making them potentially available to all Americans.

Ultimately, however, the Senate acted on neither 1967 voucher proposal. Some Senators who supported vouchers in principle raised questions about how easily they could be administered, and political momentum at the time was clearly behind first creating some form of tax incentive.[169] After several years of additional debate and legislative maneuvering, the tax credit and tax check-off each became law separately as the two titles of the Pastore Amendment to the Revenue Act of 1971.[170]

Although Congress has not considered a campaign finance voucher proposal since 1967, the concept has remained alive in academic circles. In their seminal 1975 text *Political Money*, David Adamany and George Agree used the Metcalf plan as a starting point for developing their own proposal for a voucher system that applied to both presidential and congressional elections.[171] In recent years other proposals for using a voucher system for the public financing of federal elections have circulated through legal academia.[172] The

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[167] S. 1698 § 102.

[168] *Id.*

[169] *See, e.g.*, *Campaign Financing Proposals Hearings*, *supra* note 163, at 242 – 264 (1967) (statement of Sen. Robert F. Kennedy (D-N.Y.)) (arguing, inter alia, that tax credits were easier to administer than the proposed Metcalf voucher system).

[170] *See supra* text accompanying notes 39 – 43. *See also* 117 CONG. REC. 41,947 (1971) (statement of Sen. Russell B. Long (D-La.)) (arguing that the Pastore Amendment's presidential tax check-off should be extended to non-taxpayers through a voucher system).

[171] ADAMANY & AGREE, *supra* note 160, at 189 – 99. In their discussion of voucher proposals, Adamany and Agree ultimately decided to modify their voucher plan so that it was no longer a true political contribution incentive program. Instead of each voucher being worth a certain amount of money that would be given to the candidate chosen by each citizen, under the Adamany and Agree plan citizens would first donate their vouchers to candidates, then a complicated formula would be applied to determine how much public money each candidate would be given based on the number of vouchers the candidate had collected. *Id.* at 196 – 99. The formula's most salient feature was a ceiling of 38% of total popular support; any percentage of total vouchers a candidate received above this threshold would not have resulted in additional funds. *Id.* at 196 – 98. Adamany and Agree adopted this formula to prevent a lopsided distribution of campaign subsidies. With the 38% ceiling, even presidential candidates Barry Goldwater and George McGovern, who suffered landslide defeats to Lyndon Johnson and Richard Nixon, respectively, would have received the same amount of public funding as their opponents (assuming, somewhat questionably, that the voucher distribution would have tracked general election results). *Id.* at 200. Adamany and Agree argued that designing a system that would provide rough parity in funding among major candidates was essential to guarantee to voters "a full and fair presentation of alternatives." *Id.* at 190. Adding a complicated formula for how funds are distributed, however, is directly contrary to the principles that support the creation of a system of political contribution incentives; political contribution incentives empower individual acts of participation by linking the distribution of funds directly to popular support. Moreover, attempts to second guess the public by allowing it only an indirect say over how public funds are distributed leave open many of the same opportunities for major party entrenchment that plague the existing system of direct grants of public money to presidential campaigns. *See, e.g.*, *Tax Credits Hearings*, *supra* note 45, at 57 (statement of Prof. Roy Schotland, Georgetown Univ. Law Ctr.) (arguing that forms of public funding other than political contribution incentives necessarily involve formulae for distributing the funds that will unfairly discriminate against some group of candidates). *See also* Richard L. Hasen, *Clipping Coupons for Democracy: An Egalitarian/Public Choice Defense of Campaign Finance Vouchers*, 84 CAL. L. REV. 1, 7 (1996) (arguing that "the voucher plan does a better job of both minimizing the impact of wealth on the political system and of empowering those individuals lacking political capital" than other forms of public financing).

[172] *See* Hasen, *supra* note 171, at 29 – 44 (arguing that a voucher system would create a more equitable political order and that it would have a realistic chance of becoming law and passing constitutional muster); Edward B. Foley, *Equal-Dollars-Per-Voter: A Constitutional Principle of Campaign Finance*, 94 COLUM. L. REV. 1204 (1994) (arguing that a constitutional principle of equal-

most compelling of these proposals was put forward by Yale Law Professors Bruce Ackerman and Ian Ayres in their recently published book, *Voting With Dollars: A New Paradigm for Campaign Finance*.[173]

In *Voting With Dollars*, Ackerman and Ayres propose to send to all registered voters an ATM-like "Patriot card" containing fifty "Patriot dollars" that would be transferable to the candidate(s) of their choice.[174] Of that money, $10 would be set aside for House races, $15 for Senate races, and $25 for the presidential race.[175] Donations to parties and PACs would also be allowed; the authors see these political agents as "brokers" whom individuals may choose to entrust with their Patriot dollars so that they can be put to their most effective use.[176]

Ackerman and Ayres postulate that, even as market forces create more competitive elections by channeling Patriot dollars to where they are most in demand, the operation of the market will have the secondary effect of fostering a more active and engaged citizenry. Once citizens are given a stake on equal terms within the Patriot voucher program, "Americans will be giving renewed social meaning to their self-understanding as free and equal citizens, engaging in democratic deliberation."[177]

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dollars-per-voter should be established – either by amendment or reinterpretation – that would require a closed system of campaign funds such as a voucher plan).

173 BRUCE ACKERMAN & IAN AYRES, VOTING WITH DOLLARS: A NEW PARADIGM FOR CAMPAIGN FINANCE (2002). Professor Ackerman had discussed his ideas for creating a voucher system of public financing in previous works, but *Voting With Dollars* is the first detailed elaboration of his proposal. *See* Bruce Ackerman, *The Patriot Option*, BOSTON REV., Apr./May 1997, *available at* http://bostonreview.net/BR22.2/ackerman.html; Bruce Ackerman, *Crediting the Voters: A New Beginning for Campaign Finance*, AM. PROSPECT, Spr. 1993, at 71.

174 ACKERMAN & AYRES, *supra* note 173. The "new paradigm" referred to in the work's title includes both the voucher proposal and a proposal that contribution limits be greatly increased but that all contributions be made anonymously. *See id.* at 9. The common thread between these two proposals is an analogy to the voting booth. In the authors' view, the voucher system guarantees political equality among all citizens – analogous to constitutional principles of one person, one vote – while the anonymity rules address corruption concerns by creating an "anonymous donation booth" analogous to the secret ballot. *See id.* at 25. Although the authors treat the two aspects of their proposal as if they were crucially linked, many commentators have argued that the two proposals should be evaluated separately. *See, e.g.*, Pamela S. Karlan, *Elections and Change Under Voting With Dollars*, 91 CAL. L. REV. 705, 705 (2003) ("If . . . Voting With Dollars . . . were an Olympic event, it would be the biathlon . . . [which] combines two sports that are usually quite distinct from one another . . . ."). Moreover, once one defines political equality as the primary concern of campaign finance reform, measures such as anonymity for all private contributions that are aimed at fighting corruption become less necessary. After all, bribery statutes and related laws already make actual corruption illegal. *See* 18 U.S.C. §§ 201 – 19 (2000) (defining crimes of bribery, graft, and conflicts of interest for public officials). Although fears that the appearance of corruption harms the American political process are real, such fears are often exaggerated by those who argue that the regulation of deals between legislators and their constituents, rather than political equality, should be the central concern of campaign finance reform. *See infra* text accompanying notes 187 –199. In defining the problem of campaign finance reform as one of political equality, this paper focuses solely on the voucher proposal of Professors Ackerman and Ayres while ignoring their proposed anonymity requirements.

175 ACKERMAN & AYRES, *supra* note 173, at 76 – 78. The authors further provide that when an incumbent president is running for reelection, the presidential money pool must be split with $10 for the primary and $15 for the general election; no similar provisions are made for congressional or open-seat presidential elections. *Id.* at 79 – 82.

176 *See* Bruce Ackerman & Ian Ayres, *Why a New Paradigm?*, 37 U. RICH. L. REV. 1147, 1176 – 77 (2003) ("The activities of these 'Patriotic brokers' will vastly increase the number of effective challenges to vulnerable incumbents.").

177 ACKERMAN & AYRES, *supra* note 173, at 15. Of course, under Ackerman and Ayres' proposal citizens would still be on unequal terms with regard to private contributions made outside of the Patriot voucher program. While Ackerman and Ayres would require private contributions to be made anonymously to address corruption concerns, *see supra* note 173, they also call for raising individual contribution limits to "a stratospheric height that will be practically insignificant to all but the very richest Americans." ACKERMAN & AYRES, *supra* note 173, at 48. The authors are clearly relying on what they see as the "transformative" effects of the Patriot voucher program to address the problem of political equality, *see infra* note 178 and accompanying text, but combining the Patriot program with significantly higher contribution limits will severely undermine Patriot's beneficial effects. A political contribution incentive program can only establish meaningful equality among individual donors if it is combined with low

In contrast to proposals that would limit the total money available to candidates, Ackerman and Ayres predict that the net result of their proposal would be to double the total money available in the system.[178] With such a large infusion of public money into the campaign system, the authors argue that their proposal will have "transformative" effects on campaign finance:

> Empirical study of the existing marketplace doesn't provide a clue about the way politicians will respond to such a massive shift in the financial playing field. Perhaps some will continue relying almost exclusively on private funds. But they will have to contend with a host of rising politicians who will learn to appeal to the interests of Patriot holders.[179]

Ackerman and Ayres also provide two additional mechanisms to guarantee that substantial amounts of Patriot money flow through the system in any given election. First, Patriot dollars would be adjusted for inflation so that their real value does not diminish over time.[180] Second, the authors would give the Federal Election Commission ("FEC") power to intervene in the operation of the Patriot system in the event that the overall funds available to candidates dipped too low or the ratio of private-to-Patriot dollars became too high.[181] Ultimately, though, the authors feel that this emergency mechanism will not be necessary, as the Patriot system will create "a wave of enthusiastic citizen engagement" that over time will grow to exceed voter turnout rates.[182]

Critics of voucher systems argue that candidates must expend more effort to raise money from small donors, and therefore engage in excessive amounts of fundraising.[183] This criticism is misguided, however,

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contribution limits that prevent private wealth from being translated into disproportionate political influence. *See infra* text accompanying notes 201 – 203.

[178] *See* Ackerman & Ayres, *supra* note 176, at 1152 ("About $3 billion in private dollars were contributed to all federal candidates during the 2000 election cycle. We predict that private giving will decline under the [anonymous] donation booth regime to the $1 to $2 billion range, while Patriot giving will yield approximately $5 billion."). The authors' estimate of the amount of Patriot dollars that will actually be expended, however, is based on the controversial assumption that participation rates in the program will initially approximate voter turnout in general elections. *See* ACKERMAN & AYRES, *supra* note 173, at 4 – 5 (stating that if "100 million Americans who came to the polls in 2000 had also 'voted' with their patriot cards during the campaign, their combined contributions would have amounted to $5 billion . . . ."); *id.* at 31, 51 (assuming that Patriot participation will equal $5 billion). Many reviewers of *Voting With Dollars* have argued that this estimate is exceedingly optimistic. *See, e.g.*, Guy-Uriel E. Charles, *Mixing Metaphors: Voting, Dollars, and Campaign Finance Reform*, 2 ELECTION L. J. 271, 274 – 76 (arguing that basing estimates of participation on presidential primary turnout is a more reasonable approach, one which provides a figure of $1.8 billion).

[179] Ackerman & Ayres, *supra* note 176, at 1152.

[180] ACKERMAN & AYRES, *supra* note 173, at 218.

[181] *Id.* at 89 (arguing that the FEC should be empowered to exercise "swamping control" over the Patriot scheme so that public funds always constitute at least two-thirds of all campaign money). Ackerman and Ayres' calculation of how many Patriot dollars will be necessary to maintain their desired two-thirds ratio depends on both their expectations for relatively high rates of participation in the program and their assumption that the program's anonymity element of their proposal will reduce private donations between one half and two thirds. *See supra* note 178.

[182] *Id.* at 90 – 91. Reviewing *Voting With Dollars* in the Election Law Journal, Professor Guy-Uriel Charles argues that regardless of how powerful incentives to contribute are made, "the incidence of voting will always surpass contributions as a form of political participation" because "voting is the highest form of participation . . . as both a descriptive and normative matter." Charles, *supra* note 178, at 276. As evidence for his argument, Charles cited data showing the participation rate in Minnesota's contribution refund program to be 8% for the 2000 elections. *See id.* (stating that "Minnesota's campaign financing scheme . . . is the most analogous comparison to Patriot extant"). *But see* ACKERMAN & AYRES, *supra* note 173, at 262 – 63 n.3 (arguing that the Minnesota system is far less user-friendly than Patriot).

[183] *See* Richard Briffault, *Reforming Campaign Finance Reform: A Review of Voting With Dollars*, 91 CAL. L. REV. 643, 674 (2003) ("[T]he voucher plan both diverts a significant portion of public money into fundraising and will require that candidates devote a significant portion of their campaign time and effort to fundraising.").

because it ignores important values that are served by bringing the small-dollar contributions of average Americans into the political process. With fundraising linked directly to popular support through a voucher system such as Patriot (or even somewhat imperfectly through a well-designed tax credit program), campaigning and fundraising no longer have to be separate activities. Instituting a well-funded voucher system as the principal means of funding campaigns[184] would force candidates to appeal to large portions of the electorate in order to mount viable campaigns. Exclusive black-tie dinners would become less effective than community barbeques. Personal phone calls to local elites would become less effective than door-to-door canvassing. To attract large numbers of vouchers, candidates would have to take distinctive positions that set them apart from their rivals and are popular with grassroots constituencies from across the political spectrum. Ackerman and Ayres summarize it best: "In short, the best fundraising strategy will be effective political communication."[185]

A campaign finance voucher system such as the one proposed by Professors Ackerman and Ayres would provide the most potent form of political contribution incentive program. All Americans, regardless of their tax status or their income level, would receive an equal opportunity to participate in the voucher program alongside their fellow citizens. As Ackerman and Ayres suggest, such a program would have the potential to change the face of American politics by empowering average Americans to become small donors. Past experience with political contribution incentive programs suggests, however, that such programs are only effective when the potential recipients of political contributions have an incentive to use the program to solicit contributions and when the public has been educated about the existence of the program.

ENCOURAGING MAXIMUM PARTICIPATION FROM SMALL DONORS

One way to increase participation in a political contribution incentive program is to provide the incentive for contributions to a broad range of political agents, especially those who have a high demand for small-dollar contributions. As front-line participants in electoral contests, candidates are the most obvious beneficiaries of the program, but parties have a strong claim as well. Contributions to political parties are qualitatively different from contributions to candidates. Parties are generally in a much better position than individual donors to know where contributions will be used to the greatest competitive effect, giving parties an important role in promoting competitive elections.[186] Moreover, parties have more of a long-term interest than candidates in developing a base of small donors who regularly participate in the funding of campaigns. As repeat players in the political market, parties benefit much more from the associative value of receiving small contributions from donors who come to feel that they are among the "party faithful."

It is not likely a coincidence that Oregon's tax credit for political contributions has the highest participation rate of any political contribution incentive program in the country and that it includes both state and federal entities, including PACs, in its coverage.[187] Some campaign finance reform advocates wrongly point to PACs as a principal problem with the current federal campaign finance system because PACs engage in

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[184] *See supra* note 178.
[185] Bruce Ackerman & Ian Ayres, *The New Paradigm Revisited*, 91 CAL. L. REV. 743, 753 (2003).
[186] *See* Daniel Hays Lowenstein, *On Campaign Finance Reform: The Root of All Evil is Deeply Rooted*, 18 HOFSTRA L. REV. 301, 350 – 54 (1989) (arguing that parties should be the primary mechanism for allocating public campaign funds). Lowenstein also argues, inter alia, for low individual contribution limits for candidates, parties, and PACs. *Id.* at 357 – 59.
[187] *See supra* text accompanying notes 91 – 99.

"bundling."[188] A "bundler," who may represent a PAC or be an individual fundraiser, solicits contributions on behalf of a candidate or party and arranges that they be delivered in a way that identifies the entire "bundle" of contributions with the bundler who solicited them.[189] According to the critics of bundling, PACs are able to use this practice to win disproportionate influence for the "special interests" that they represent.[190] This same school of thought led some reformers to oppose the McHugh Amendment, which would have strengthened the federal tax credit for political contributions in the 1986 TRA instead of repealing it; critics of bundling argued that expanding the federal tax credit for political contributions would only subsidize this practice.[191] These opponents of including PACs in a political contribution incentive program would likely point to the experience in Oregon to make their case. PACs have become the primary beneficiaries of Oregon's tax credit, such that most credit claims received by the state are made on contributions to "special interests."[192]

There are several problems with this analysis. First, the predominant role of PACs in taking advantage of the tax credit must be understood in tandem with another crucial aspect of Oregon's campaign finance laws: the lack of any limits on individual contributions to candidates. In the absence of regulatory incentives that compel candidates to solicit small-dollar contributions by promoting the use of the tax credit, credit-subsidized contributions to candidates are likely to take place at a low rate.[193] PACs, on the other hand, tend to be issue-oriented or otherwise more narrowly focused in their fundraising appeals than candidates; as such, many depend on small-dollar contributions for their existence and are likely to have much stronger incentives to organize a fundraising campaign around political contribution incentives.[194] Thus, the disproportionate benefits derived by PACs from Oregon's tax credit are likely explained in large part by the incentive structures created by the state's campaign finance laws, rather than anything inherent in the credit's coverage of contributions to PACs.

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[188] *See, e.g.*, Jim Motavalli, *Chasing the Money: Everyone Talks About Campaign Finance Reform, But Grassroots Groups Are Making It Happen*, E, Sept.-Oct. 1996 (quoting Ellen Miller, executive director of the Center for Responsive Politics, arguing that low contribution limits are ineffective reforms because "they don't deal with the bundling issue"), *available at* http://www.emagazine.com/september-october_1996/0996feat12.html.

[189] Traditionally, a bundler had to gather physically the checks of a group of individual donors and deliver them together in order to get "credit" from the recipient for his or her bundling. In 1999, however, campaign operatives for then-Governor George W. Bush developed a system of virtual bundling whereby individual fundraisers were assigned tracking numbers that contributors could write on their checks to identify the fundraiser who had successfully solicited their contribution. CHARLES LEWIS & THE CENTER FOR PUBLIC INTEGRITY, THE BUYING OF THE PRESIDENT 2004 8 (2004). Using these tracking numbers, the Bush campaign gave the honorary title of "Pioneer" to fundraisers who raised over $100,000 for the campaign; in 2004, the campaign added the title of "Ranger" for fundraisers who raised over $200,000. *See id.* at 8 – 9 ("What is unusual about the Pioneer system is the unabashed directness of the transaction: You help us and we'll credit you and remember your loyalty and support later. . . . [S]uch exceptionally well organized bundling violates the spirit of limiting the size of contributions . . . .").

[190] *See, e.g.*, Ian Ayres & Jeremy Bulow, *The Donation Booth*, BOSTON REV., Dec. 1997/Jan. 1998 (stating that "two of the biggest influence abuses" in campaign finance are "PAC bundling and soft money"), *available at* http://www.bostonreview.net/BR22.6/ayres.html.

[191] *See supra* text accompanying note 72.

[192] *See supra* note 150 and accompanying text.

[193] *See, e.g.*, *supra* note 134 and accompanying text.

[194] In fact, it depends on the PAC. Some PACs are financed almost entirely by small donations, while others receive substantial amounts of money from large contributions by wealthy donors. *See, e.g.*, Press Release, Oregon Follow the Money Money in Politics Research Action Project, Heavy Hitters on Opposite Sides of the Tax Credits Debate Collect Cash from Mirror-Image Donors (Aug. 8, 2003) (comparing the contribution profiles of two major Oregon PACs), *available at* http:// www.oregonfollowthemoney.org/Press/aug0803.pdf. The Oregon Education Association's People for Improvement of Education PAC raised 99.4% of its contributions in amounts of $200 or less from an estimated 18,107 contributors. *Id.* The Associated Oregon Industries' Center for Citizen Leadership PAC raised 97.9% of its contributions in amounts of $1000 or more from an estimated 47 contributors. *Id.*

More importantly, tailoring campaign finance regulations toward minimizing the influence of PACs "solves" the wrong problem. "Special interest" PACs are perceived to be a problem to the extent that they are able to gain disproportionate influence over legislative outcomes in ways that distort the political process. PACs that have an intense interest in legislative outcomes on particular issues can use their resources to conduct carefully targeted advocacy to lobby candidates on the merits of legislative proposals, with the promise to support those candidates whose positions align with their own.[195] The perception that PAC influence is in itself undesirable rests on the flawed assumption that there is something inherently wrong with legislative deal-making between representatives and their constituents. In singling out the deal-making aspect as the problem, this assumption focuses on concerns over quid pro quo corruption while ignoring the real problem, which is the political inequality that results when political actors of any kind are able to turn large sums of private wealth into legislative influence.[196]

A deal made between a legislator and a PAC – i.e., that the PAC gives the legislator contributions that encourage him or her to look out for its interests on particular issues – should only raise concerns to the extent that those Americans with significant private wealth are able to use their wealth as a means of exercising disproportionate influence over the political process. The primary concern should thus be political equality, not corruption or its appearance. The problem with PAC contributions is the same as the problem with other forms of hard money. Individual contribution limits to PACs are currently set at $5,000,[197] which is a level of political spending far beyond the means of all but the wealthiest Americans. High contribution limits functionally guarantee that only a narrow segment of the population is able to play a meaningful role in the funding of campaigns.[198]

Legislative deal-making would not be cause for concern if all citizens had an equal opportunity to influence the legislative process. A comparison to voting is instructive here. Candidates make deals with particular groups of constituents all the time in return for their votes. This sort of deal-making is not seen as illegitimate, however, because all citizens have a right to vote on equal terms. When a PAC is able to wield disproportionate influence on the legislative process, the deal itself is not the issue; on the contrary, the real issue is that the PAC is able to bring its disproportionate access to private wealth to bear in the first place.

When groups of citizens join together to advocate on an issue about which they care deeply, they are engaging in an activity that is fundamental to the democratic process. PACs such as the Sierra Club and the NRA represent groups of citizens who care about particular issues intensely enough that they are willing to donate money to see that their views on those issues are given a full hearing in the public

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[195] *See* Lowenstein, *supra* note 186, at 309 (arguing that it is rational for issue-oriented PACs seeking particular legislative outcomes to give contributions to more candidates than those who agree completely with their position, "[s]ince the legislative strategist is interested in the change that the group's contribution may induce in the candidate's policy views, rather than in the absolute location of those views").

[196] For a discussion of this argument in the context of proposals for a voucher system of public financing, see David A. Strauss, *What's the Problem? Ackerman and Ayres on Campaign Finance Reform*, 91 CAL. L. REV. 723, 732 – 33 (2003) ("If quid pro quo deals are a problem only because people with more resources will get unfair advantages, then the real issue is inequality, not the deals themselves.").

[197] *See* 2 U.S.C. § 441a(a)(2)(A) (2000).

[198] U.S. PIRG EDUC. FUND, *supra* note 2, at 17 ("According to a nationwide survey funded by the Joyce Foundation during the 1996 congressional elections, 81% of those who gave contributions of at least $200 reported annual family incomes greater than $100,000. This stood in stark contrast to the general population at the time, where only 4.6% declared an income of more than $100,000 on their tax returns." (citing JOHN GREEN, ET AL., INDIVIDUAL CONGRESSIONAL CAMPAIGN CONTRIBUTORS: WEALTHY, CONSERVATIVE AND REFORM-MINDED (1998))).

discourse. Indeed, this kind of political association is precisely the kind of intermediate organization that theorists of American democracy have long argued is necessary for individual citizens to overcome collective action problems and organize according to communities of interest.[199]

Political contribution incentives do not negate the ability of PACs under a system of high contribution limits to turn private wealth into legislative influence. So long as incentive programs are narrowly tailored so that their funds are only available to those who make small contributions, however, their effect will likely be to raise the percentage of campaign funds that come from small donors. This will make PACs that rely primarily on small contributions more viable and also bolster the influence of small donors within PACs of all kinds.

COMBINING INCENTIVE PROGRAMS WITH ADDITIONAL REFORMS

The effectiveness of a political contribution incentive program can only be understood when considered as part of the larger system of campaign finance law within which it operates. In Minnesota, candidates have an incentive to seek out small donors because the contribution refund program operates as part of a system that includes moderately lower contribution limits than the federal system and also provides candidates of established parties with direct grants of public funding linked to voluntary spending limits.[200] A focus on raising money from small donors is likely to have significant secondary benefits for a candidate's campaign. Unlike appeals to wealthy donors, who represent only a tiny percentage of the electorate, candidates who are able to rely on small-dollar contributions are free to appeal to the people for votes and contributions simultaneously. Freed from the demands of large-dollar fundraising, a candidate's entire style of campaigning is likely to be different. Instead of attending exclusive fundraisers and making telephone calls to wealthy donors, a candidate will have time for more direct communication with average Americans through such activities as neighborhood barbeques and door-to-door canvassing. Establishing policies that will engender a widespread switch to this style of campaigning, however, will require far-reaching reforms that go well beyond the enactment of political contribution incentives.

Relying on candidates and other political agents to promote a political contribution incentive program would be the most efficient approach, because these actors have the most to gain from promoting the tax credit or voucher program's usage. As experience with state programs shows, however, candidates and political agents will only promote the program to the extent that the campaign finance laws are structured so that they have an incentive to seek out small contributions. Because the old federal tax credit operated under the rubric of the Federal Election Campaign Act ("FECA"),[201] little such incentive existed for contribution recipients. During the years the tax credit was in effect, FECA set individual contribution limits to

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199 *See, e.g.*, ALEXIS DE TOCQUEVILLE, DEMOCRACY IN AMERICA 193 – 94 (George Lawrence trans., Perennial 2000) (1848) (stating that in America citizens organize into political associations "to show their numbers and to lessen the moral authority of the majority, and . . . by stimulating competition, to discover the arguments most likely to make an impression on the majority, for they always hope to draw the majority over to their side").

200 *See supra* text accompanying notes 114 – 123.

201 Federal Election Campaign Act of 1971, Pub. L. No. 92-225, 86 Stat. 3 (codified as amended at 2 U.S.C. §§ 431 – 455). The original FECA legislation was passed in the same Congress as the creation of the tax credit for political contributions. Supporters of the Pastore Amendment saw well-funded methods of public financing, both direct and indirect, as a necessary complement to the limits that FECA placed on contributions and, before they were struck down as unconstitutional, expenditures. *E.g.*, 117 CONG. REC. 41,762 (1971) (statement of Sen. Pastore).

candidates at $1,000 (or $2,000 for joint returns).[202] Meanwhile, even at their most generous, the tax credits only reimbursed individuals for 50% of their first $100 of contributions. In the absence of low contribution limits or a system of public funding that counterbalances the impact of large contributions, FECA resulted in a political fundraising "arms race," with candidates compelled to raise as many large-dollar contributions as possible in order to compete with their opponents.[203] Those donors who were already giving anyway were in the best position to take advantage of the credit, and the credit contained no mechanism to encourage candidates to target small donors with their solicitations.

Enacting additional reforms along with a new political contribution incentive program could help stem the "arms race" effect of current law and give candidates and other political actors greater incentive to focus their attentions on average Americans. Lowering contribution limits to levels that average Americans can afford would give those citizens an opportunity to participate in the financing of campaigns on an equal footing with the small percentage of Americans who are able to give large donations.[204] Providing public financing in forms other than political contribution incentives (and other than the current system of partial public funding available to presidential candidates[205]) would create additional opportunities for grassroots-driven campaigns. George Washington University Law School Professor Spencer Overton has proposed that a tax credit for political contributions be linked to matching funds that enhance the value of small contributions at a 4-to-1 rate.[206] Another approach to reform would link political contribution incentives and other forms of public funding to voluntary spending limits that would directly limit a candidate's ability to engage in the campaign finance "arms race" if he or she wanted to receive public funds.[207]

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[202] *E.g.*, 2 U.S.C. § 441a (1982). With the recent passage of the Bipartisan Campaign Reform Act, contribution limits have been raised to $2,000 (or $4,000 for joint returns). Bipartisan Campaign Reform Act of 2002, Pub. L. No. 107-155, § 307, 116 Stat. 81, 102 – 03 (to be codified at 2 U.S.C. § 441a).

[203] *See Constitution and Campaign Reform: Hearings Before the Senate Comm. on Rules and Administration*, 106th Cong. (2000) (statement of Derek Cressman, U.S. PIRG) [hereinafter "Cressman Testimony"] (arguing that low contribution limits allow candidates to spend less time coddling individual donors and more time competing in the marketplace of ideas), *available at* http://pirg.org/democracy/democracy.asp?id2=5999&id3=CFR& (last visited August 14, 2004). The "arms race" effect of high contribution limits was compounded by the Bipartisan Campaign Reform Act's doubling of individual contribution limits to candidates. U.S. PIRG EDUC. FUND, *supra* note 2, at 36. In the 2002 congressional elections, 94% of candidates who raised the most money won their elections. *Id.* at 14. 55.5% of individual contributions to candidates came in at or above $1,000. *Id.* at 16. While it is impossible to know exactly how many donors who previously gave the maximum will now increase their giving up to the new limit of $2,000, the higher individual contribution limits are likely to increase the proportion of campaign funds that come from large-dollar contributions. *See* Clyde Wilcox & John Green, et al., *Raising the Limits*, PUB. PERSPECTIVE, May-June 2002, at 11 (finding that "'increased giving is likely to exacerbate the upper status character of the donor pool'").

[204] *See, e.g.*, Cressman Testimony, *supra* note 203 (citing evidence that in states which adopted low contribution limits in the 1990s, the total amount of funds raised by candidates declined only slightly, while small donor participation increased to make up for most of the money lost through elimination of large contributions).

[205] *See* 26 U.S.C. §§ 9001 – 9042 (2000) (providing a voluntary system of matching funds for primary election campaigns and a block grant for general election campaigns, each of which are linked to spending limits).

[206] Spencer Overton, *The Donor Class: Campaign Finance, Democracy, and Participation*, 152 U. PENN. L. REV. (forthcoming 2004). Like the state PIRGs, Professor Overton proposes that the tax credit be available for contributions of $100 or less, so that under his program "if a contributor gives $100 to a candidate, the candidate would receive another $400 in public funds, producing a total contribution worth $500 to the candidate." *Id.*

[207] Voluntary spending limits are a central element of Minnesota's campaign finance system. *See supra* text accompanying notes 114 – 123. If campaign expenditure limits are not voluntary, they may run afoul of the Supreme Court's decision in *Buckley v. Valeo*, which struck down expenditure limits in the Federal Election Campaign Act because the Court held that they were not narrowly tailored to further the government's compelling interest in eliminating corruption. 424 U.S. 1, 45 – 59 (1976). In August 2004, the Second Circuit Court of Appeals held that campaign expenditure limits enacted in Vermont would be constitutional under *Buckley*'s strict scrutiny if they are found to be the least restrictive means of furthering the state's compelling interests in "safeguarding Vermont's democratic process from (1) the corruptive influence of excessive and unbridled fundraising and (2) the effect that perpetual fundraising has on the time has on the time of candidates and elected officials." Landell v.

As a practical matter, efforts to enact wholesale reforms such as these will likely require extended legislative battles spanning multiple congressional sessions. The next section discusses how enacting a federal tax credit for political contributions could be a useful incremental step toward greater reforms.

Sorrell, No. 00-9159, slip op. at 7 (2d Cir. Aug. 18, 2004). Voluntary expenditure limits, which further the same interests, would not face the same strict scrutiny because the government has greater power to attach voluntary conditions to the receipt of government funds than it does to regulate primary conduct. *See* VanNatta v. Keisling, 931 P.2d 770, 789 (Or. 1997) ("The legislative choice to encourage certain behavior by tax policy violates no right of any potential recipient of contributions, because the recipient had no constitutional right to the contributions-with-tax-credits in the first place."). *See also* Buckley v. Valeo, 424 U.S. 1, 57 n.65 (1976) (upholding presidential public financing scheme's voluntary spending limits); Rosenstiel v. Rodriguez, 101 F.3d 1544, 1550 – 51 (8th Cir. 1996) (upholding Minnesota's linkage of public funding to acceptance of spending limits).

DESIGNING AN EFFECTIVE FEDERAL TAX CREDIT FOR SMALL POLITICAL CONTRIBUTIONS

Yale Law Professors Bruce Ackerman and Ian Ayres argue that a well-funded campaign voucher program is qualitatively superior to imperfect versions of political contribution incentives because it would reconstitute campaign finance under a whole new paradigm and in so doing transform American politics.[208] The professors are betting that making a radical change in the system will empower individuals to participate in new and meaningful ways. The original supporters of a federal tax credit for political contributions had similarly high hopes that their programs would foster widespread citizen participation in campaign fundraising.[209] As with tax credits, the biggest problem with vouchers is uncertainty over the practical effects they will have on campaigns once they are enacted.[210] Because vouchers are a much more dramatic and expensive undertaking than tax credits, it will be difficult to convince legislators to enact such a proposal without some preliminary evidence that it will actually work. Tax credits are an intermediate step between no public subsidies for campaigns and a fully-funded voucher system. If a tax credit is put into place and enjoys at least modest success, a powerful argument could then be made that the program should be taken out of the tax code and expanded into a voucher system, which would provide political contribution incentives that are more potent and available to more people.

STRUCTURING A TAX CREDIT TO MAXIMIZE ITS EFFECTIVENESS

For a tax credit program to further the long-term goals of the campaign finance reform movement, it must be structured so that it is effective even in the absence of wholesale reform. The credit must be potent enough to provide a significant incentive to its beneficiaries to promote it to potential donors. As with other political contribution incentive programs, the credit should be available to a broad range of political agents, including candidates, parties, and PACs. The credit should be narrowly tailored so that it is only available for small contributions. Finally, the enactment of the credit should be accompanied by independent public education efforts to encourage the credit's use as part of a larger civic strategy of encouraging small donor participation in politics.

Offering a 100% tax credit that is both significant in size and available only for small contributions will provide a potent incentive targeted toward small donors

For any political contribution incentive program to further its underlying purposes, it must provide an incentive of a large enough size that it can have a significant aggregate impact on election campaigns. One criticism of the old federal tax credit was that its amount was so small that its benefits were not even worth the administrative and monitoring costs to the IRS to enforce it.[211] If the federal government is to create a new tax credit for political contributions and expect it to have an impact on political fundraising,

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208 *See supra* text accompanying notes 174 – 182.
209 *See, e.g.*, *supra* text accompanying note 33.
210 *See* Briffault, *supra* note 183 at 673 (arguing that with candidates' funding entirely dependent on voters casting their vouchers, "challengers and political newcomers" will face "uncertainty . . . [that] may discourage some candidates from entering races and thus diminish electoral competitiveness").
211 *See supra* text accompanying note 66.

then the credit cannot be for a token amount.[212] As the object of the credit is to encourage grassroots campaigns that appeal to small donors, however, the credit should have an upper limit that is within the reach of average Americans.[213] A credit that applies to an individual's first $100 of contributions, or $200 for joint returns, would best strike this balance.

A 100% credit will maximize the incentive value to prospective donors.[214] Even some critics of the old federal tax credit claimed that a more potent tax incentive would have given candidates sufficient incentive to mobilize small donors.[215] A full credit is the most effective tool for candidates to use in their solicitation efforts, where they are able to promise prospective small donors that they will get all of their money back.

The best way for Congress to enact a new federal tax credit for political contributions would be to combine it with low contribution limits for the same amount.[216] Under this system, every American would have an incentive to give at a level that most Americans could afford, and no American would be able to give more and thus wield disproportionate influence simply because he or she had a greater ability to give.

As a practical matter, however, Congress may only enact a tax credit without also lowering the limits on all individual contributions. Even if the tax credit for political contributions is forced to stand on its own, Congress can still target the tax credit more closely toward small donors by making it claimable only for small contributions. For a donor to be eligible for the tax credit, his or her total contributions in the given election cycle to the candidate, party, or PAC to which he or she claims to have made credit-eligible contributions should not exceed the maximum amount of the credit.[217] This provision is the most effective way to target the tax credit at small donors, because it focuses directly on whether the credit is being claimed for small contributions rather than trying to discriminate among the donors themselves. Moreover, this limitation will no doubt make the tax credit proposal much less costly by not subsidizing those who are already giving large-dollar donations. Evaluating the effect that limiting the tax credit to small donors would have on both participation and cost is an important area in which further study is needed.

The tax credit should be provided for contributions to candidates, parties, and PACs

In order for a tax credit for political contributions to encourage as many small donors to contribute to campaigns as possible, the credit should be available for contributions to candidates, parties, and PACs. As experience with Oregon's tax credit demonstrates, smaller issue-oriented PACs may have a much greater incentive to organize small donors to take advantage of the credit.[218] Although these PACs are frequently derided as "special interests," their political activity is just as fundamental to American democracy as that of any other political actor.[219] The tax credit for political contributions could thus play an

[212] *See* Rosenberg, *supra* note 90, at 16 (calling for a credit of $200 per person, or $400 for joint returns).
[213] Indeed, one reason Congress initially created such a small tax credit was so that it would provide a significant incentive only for contributors who would otherwise be unable to afford to give. *See supra* note 44 and accompanying text.
[214] *See* Rosenberg, *supra* note 90, at 16 (calling for a 100% credit).
[215] *E.g.*, *Tax Credits Hearings*, *supra* note 45, at 79 (statement of George E. Agree, Chairman, Comm. for the Dem. Process).
[216] *See* Cressman Testimony, *supra* note 203 (arguing that low contribution limits allow candidates to spend less time soliciting contributions from individual donors and more time running issue-driven campaigns, leading to substantial increases in small donor participation).
[217] This provision would necessarily be enforced largely through voluntary reporting, as are most aspects of our tax code.
[218] *See supra* text accompanying notes 150, 194.
[219] *See supra* text accompanying notes 193 – 199.

important role in encouraging PACs to bring small donors into the political process who might not otherwise participate.

Public education efforts are necessary to inform the public of the credit's existence

Simply passing a tax credit or other contribution incentive program will not magically bring large numbers of non-participants into the political fundraising process. As a threshold matter, members of the public must know that the program exists and how to take advantage of it. Even in states with well-established tax credit programs, there has never been a widespread, non-partisan effort to educate the public about the programs. In Minnesota, where the contribution refund program is considered a success, a recent study suggested that public education efforts would raise the program's participation rate even further.[220] A more detailed survey performed by the Campaign Finance Institute in 2002 found that only 27% of Ohioans were aware of their state's tax credit for political contributions,[221] though it had at the time been in existence for eight years.[222] More than 20% of those surveyed said that they would have been more likely to give if they had known about the tax credit.[223] The Campaign Finance Institute is also in the process of conducting a field experiment to test whether a public information campaign could lead to additional contributions to campaigns. The Institute mailed non-partisan brochures explaining the tax credit for political contributions to a random sample of Ohioans and will publish findings on the extent to which this mailing resulted in additional citizen participation in the tax credit program.[224] Additional research is needed in other states and with other forms of public education.

A new federal tax credit for political contributions should be accompanied by public education efforts in order to build awareness and counteract incentives within the current federal system of campaign finance law that focus candidates' solicitation efforts away from small political contributions. Even though the proposed new credit is more potent in various ways than the old credit, it would still have to operate in a system of high contribution limits similar to the system that existed at the time of the original federal tax credit.[225] As occurred with the original federal tax credit, candidates would have a limited incentive to use the credit to solicit contributions from small donors when the law allows them to solicit large contributions from wealthy donors instead.[226] Indeed, a candidate's incentive to solicit from small donors is even further reduced following the passage of the Bipartisan Campaign Reform Act, which increased the amount that an individual is allowed to contribute to a candidate from $1,000 to $2,000 per election.[227] If the object of a new federal tax credit for political contributions is to increase the involvement of small donors in American politics, Congress cannot simply rely on candidates, parties and PACs to promote the credit and inform the public of its existence if other aspects of campaign finance law give them little incentive to do so. In the absence of congressional consensus to adopt wholesale reforms of the campaign finance laws, any

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220 Ramsden & Donnay, *supra* note 116, at 39.
221 ROBERT G. BOATRIGHT & MICHAEL J. MALBIN, CAMPAIGN FIN. INST., POLITICAL CONTRIBUTION TAX CREDITS AND CITIZEN PARTICIPATION 12 (2003).
222 *Id.* at 10.
223 *Id.* at 28. 4.7% said that they would have been "very likely" to give, while 17.5% said that they would have been "somewhat likely" to give. *Id.*
224 *Id.* at 23.
225 *See supra* text accompanying notes 201 – 203.
226 *See id.*
227 Bipartisan Campaign Reform Act of 2002, Pub. L. No. 107-155, § 307, 116 Stat. 81, 102 – 03 (to be codified at 2 U.S.C. § 441a).

legislation that proposes a new tax credit for public contributions should include a special earmark to the IRS to publicize the credit.

NEW FEDERAL TAX CREDIT: BENEFITS FOR DEMOCRACY OUTWEIGH COSTS

Even if the tax credit were to cost a full $1 billion, it would still be less than one twentieth of one percent of the federal government's 2003 expenditures.

The fundamental objection of members of Congress who voted in 1986 to repeal the tax credit for political contributions was that its benefits did not outweigh its costs.[228] In its peak year of 1980, when 7.2% of eligible filers took advantage of the tax credit for political contributions, the program's total cost was only $269.8 million.[229] The American Enterprise Institute has estimated that a new federal tax credit for political contributions to candidates and parties would cost less than $1 billion per year.[230] An August 2004 study employs three different methodologies to estimate the cost of a similar proposal, concluding that the annual lost treasury revenue is unlikely to exceed $1.2 billion per year and may be significantly less.[231] Further study is needed of the costs of a new federal tax credit for political contributions. Nevertheless, even if the tax credit were to cost a full $1 billion, it would still be less than one twentieth of one percent of the federal government's expenditures in 2003.[232] Compared to the $39 billion that the federal government spent on tax credits in 2002,[233] these preliminary estimates suggest that the credit would involve relatively modest new expenditures of federal funds.

Moreover, structuring a new federal tax credit in ways that have proven successful in the states will strengthen the credit program and make it a more cost-effective investment in our democracy. Narrowly tailoring the tax credit so that it provides a direct incentive to small donors to participate should result in a measurable increase in small contributions to political campaigns. A new federal tax credit for political contributions will also facilitate candidates' use of the Internet to mobilize the donations and support of grassroots constituencies from across the political spectrum. If and when political contribution incentive

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[228] SEN. RPT. 99-313 (1986).
[229] *See supra* text accompanying note 51. At that time, the political contributions credit was only a 50% tax credit for the first $50 of an individual's contributions ($100 for joint returns). *See supra* text accompanying notes 24 – 26.
[230] Rosenberg, *supra* note 90, at 19, 66 – 67. The American Enterprise Institute estimated the costs of four alternative designs for a tax credit. *Id.* at 66 – 67. The Institute estimates that a 100% tax credit of $200 for individual and $400 for joint returns, with an income cap of $100,000 (i.e., no taxpayer could claim the credit whose income exceeded $100,000), would cost $998.4 million in the fourth year after it was enacted. *Id.* at 66. The Institute estimates that the same credit with an income cap of $50,000 would cost $529.9 million in the fourth year. *Id.* at 67. If the amount of the credit is reduced to $100 for individual and $200 for joint returns, the Institute estimates that the credit would cost $499.2 million in its fourth year with an income cap of $100,000 and $265 million in its fourth year with an income cap of $50,000. *Id.* The state PIRGs recommend a 100% tax credit of $100 for individual and $200 for joint returns, with eligibility for the credit limited to contributions that do not exceed those amounts. *See supra* text accompanying notes 211 – 227. The state PIRGs recommend limiting the tax credit to small-dollar contributions rather than establishing an income cap in order to target the incentive directly toward encouraging small political contributions of all kinds rather than arbitrarily targeting the incentive toward contributors who have a particular income in a given year. *See supra* text accompanying note 217. Unlike the American Enterprise Institute, the state PIRGs recommend extending the eligibility of the tax credit to PACs. *See supra* text accompanying notes 218 – 219.
[231] Figueiredo and Garrett, *supra* note 53, at 63-65.
[232] *See* CONG. BUDGET OFF., CBO'S CURRENT BUDGET PROJECTIONS, *at* http://www.cbo.gov/showdoc.cfm?index=1944&sequence=0 (last visited July 1, 2004) (reporting that the federal government spent $2.158 trillion in fiscal year 2003).
[233] *See supra* text accompanying note 87.

programs are proven to work, the debate can then shift to their potential value to society. By enabling more small donors to participate in funding campaigns, a new federal tax credit for political contributions will increase the voice of average Americans in deciding which candidates are able to run viable campaigns for elected office.

In its 2002 Ohio survey, the Campaign Finance Institute found that the more than 20% of respondents who said that a tax credit would make them more likely to make a political contribution were closer to the general public in age, income, political affiliation and other characteristics than were the 3.9% who identified themselves as current campaign contributors.

Increasing the role of small donors in funding campaigns will force candidates, parties, and PACs to articulate political agendas that have a greater appeal to average Americans. In its 2002 Ohio survey, the Campaign Finance Institute found that the more than 20% of respondents who said that a tax credit would make them more likely to make a political contribution were closer to the general public in age, income, political affiliation and other characteristics than were the 3.9% who identified themselves as current campaign contributors.[234] Political contribution incentive programs make a small donor's willingness to make a political contribution less dependent on his or her financial ability to make that contribution.[235] By bringing small donors into the campaign finance system who would otherwise be unable to participate in the "wealth primary," a tax credit for political contributions would empower small donors to play a more meaningful, substantive role at the early stage when crucial decisions are made concerning which candidates choose to run for office and whether or not those candidates are able to run viable campaigns.

A well-designed federal tax credit for political contributions could play an important role in encouraging new donors to participate in the funding of campaigns. The Campaign Finance Institute's 2002 Ohio survey indicated that those most receptive to becoming new donors in response to a tax credit were young adults who did not already have strongly formed political beliefs.[236] As political participation is significantly influenced by habits formed early in life, political contribution incentive programs could create a "ripple effect" that promotes progressively greater levels of citizen participation over time.[237] While a new federal tax credit for political contributions would not likely lead to a sharp increase in the number of campaign contributors, a well-designed program could have significant cumulative effects over a period of years. As more and more donors develop a sense of ownership over their democracy, public interest and civic engagement are likely to increase.

A new federal tax credit for political contributions also could help encourage a new and promising trend in American politics: using the Internet as a tool for generating small contributions and encouraging citizen participation in grassroots campaigns.[238] This phenomenon became prominent during the race for the

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[234] BOATRIGHT & MALBIN, *supra* note 221, at 13 – 15. The 3.9% figure is likely to be an exaggerated number. Data from the Ohio Secretary of State suggests that only 0.6% of Ohioans gave contributions to state candidates in 2002. *Id.* at 10 n.9.
[235] *See* Smith, *supra* note 66, at 119 – 55 (arguing that political contribution incentives programs weaken the correlation between an individual's income and the likelihood that he or she will make a political contribution).
[236] *Id.* at 22.
[237] *Id.* at 3.
[238] It is important to note, however, that the Internet is not a panacea – it is simply a new tool for facilitating political communication and participation. Because wealthy, white, well-educated Americans have a disproportionate amount of access to the Internet and make disproportionate use of it, the Internet is unlikely to overcome existing political inequality within

2004 Democratic presidential nomination. Presidential candidates' historical dependence on wealthy donors largely remained true in the 2004 Democratic primary campaign.[239] Two relative political outsiders bucked this trend, however, and enjoyed surprising success using the Internet to attract small-dollar contributions and organize grassroots supporters. The Internet activities of these candidates – former Vermont Governor Howard Dean and General Wesley Clark – made them surprisingly strong contenders in the months before the 2004 primary season. Though the campaigns of both candidates fizzled during the primaries themselves, their use of the Internet enabled them to emerge from the "wealth primary" as viable candidates with legitimate chances to win their party's nomination.[240]

During the 2004 Democratic presidential primary campaign, the ten major candidates raised a total of $160.6 million in individual contributions through March 1, 2004.[241] Of this money, 49% came through contributions in amounts of $1,000 or more, while only 32% came through contributions in amounts of less than $200.[242] The disparity between large-dollar and small-dollar contributors becomes much larger, however, once the effects of Governor Dean's substantial small-donor fundraising are factored out of the totals. Dean led the candidates in fundraising, raising $50.6 million in individual contributions.[243] 59% of Dean's money came in amounts less than $200, while only 19% came in amounts of $1,000 or more.[244] Of the $110 million in individual contributions raised by the other nine candidates, 63% was collected in amounts of $1,000 or more and only 19% came in amounts less than $200.[245] The fundraising percentages of these candidates were similar to those of the 2000 Democratic primary campaign, where Vice President Al Gore and former New Jersey Senator Bill Bradley raised a total of $60 million in individual contributions, with 65% collected in amounts of $1,000 or more and only 15% collected in amounts less

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American society on its own. AM. POL. SCI. ASS'N TASK FORCE ON INEQUALITY & AM. DEMOCRACY, *supra* note 20, at 8. Moreover, because of the Internet's decentralization and sheer size, those who are not already politically attuned are unlikely to be drawn into political involvement simply because the Internet is available to them. *See id.* at 8 ("In short, the Internet may 'activate the active' and widen the disparities between participants and the politically disengaged by making it easier for the already engaged to gain political information, to make political connections, and [to] contribute money.").

239 Here, the "2004 Democratic primary campaign" includes both 2003 pre-primary campaign fundraising and electioneering (i.e., the period in which the wealth primary takes place, *see supra* text accompanying notes 16 – 21) and the contested primary season, which ended on March 2, 2004 when Senator John Kerry (D-Mass.) became the de facto Democratic presidential nominee following victories in nine of ten "Super Tuesday" primaries. Adam Nagourney, *Kerry in Big Victories Across the Nation; Edwards Will Quit Race, an Aide Says*, N.Y. TIMES, Mar. 3, 2004, at A1. The Democratic campaign fundraising data reported here represents totals as of February 29, 2004.

240 *See* Susan Page & Richard Benedetto, *Clark Closes in on Dean in Poll*, USA TODAY, Jan. 7, 2004, at 1A (reporting that in national polls taken two weeks before the Iowa Caucuses, Dean led all Democratic presidential candidates with 24%, but Clark was gaining ground and came in second with 21%). The race for the nomination changed dramatically, however, when Senator Kerry pulled off a dramatic come-from-behind victory in the Iowa Caucuses. *See* Adam Nagourney & Edward Wyatt, *After Iowa, New Hampshire Just Doesn't Look the Same*, Jan. 21, 2004, at A22 (reporting that Kerry's victory in Iowa derailed Dean's nomination strategy and undermined Clark's plan to skip Iowa and focus on New Hampshire).

241 CAMPAIGN FIN. INST., 2004 PRESIDENTIAL FUNDRAISING FROM INDIVIDUAL CONTRIBUTIONS AS OF FEBRUARY 29, 2004 [hereinafter 2004 PRESIDENTIAL FUNDRAISING], *at* http://www.cfinst.org/pr/pdf/Table1_Feb.pdf (last visited June 24, 2004). The ten major candidates for the 2004 Democratic presidential nomination were General Clark, Governor Dean, Senator John Edwards (N.C.), Congressman Richard Gephardt (Mo.), Senator Bob Graham (Fla.), Senator Kerry, Congressman Dennis Kucinich (Ohio), Senator Joe Lieberman (Conn.), former Senator Carol Moseley Braun (Ill.), and Reverend Al Sharpton. *Id.*

242 *Id.* By comparison, over the same period President George W. Bush raised $155.8 million in individual contributions. *Id.* 75% of Bush's contributions came in amounts of $1,000 or more, while only 17% of his contributions came in amounts less than $200. *Id.*

243 *Id.*

244 *Id.*

245 *Id.*

than $200.[246] Thus, while the totals for the 2004 Democratic presidential primary campaign are significantly different than they were in 2000, these differences were mostly due to the Dean campaign's success raising money from small donors over the Internet. Using this approach, Dean's ratio of small-dollar to large-dollar contributions was almost the mirror image of the combined ratio of the other candidates.[247]

The Dean campaign also made effective use of the Internet as a tool for grassroots organizing.[248] The campaign used the Internet to organize its operations under a decentralized model and coordinate with self-organized networks of volunteers in places where it had no formal organizational presence.[249] Unlike most campaigns, which are run from the top down with tight controls on their message and activities, the Dean campaign made efforts to mobilize supporters who acted independently on behalf of the campaign.[250] The campaign proved itself responsive to suggestions from these grassroots activists, with whom it communicated via Internet web logs.[251] While no study has yet been done of the number of active Dean volunteers who also supported the campaign through small-dollar contributions, the overlap was likely substantial. The Dean campaign successfully engaged large numbers of citizens at the grassroots level by making use of the Internet to solicit small donations and encourage active participation in campaign events.[252] Although the Dean campaign was not itself successful in turning grassroots enthusiasm into victories at the polls, politicians of all stripes have sought to incorporate the successful aspects of Dean's Internet strategy into their own campaigns.[253]

General Wesley Clark declared his candidacy for the 2004 Democratic presidential nomination in late September 2003, just two weeks before the end of the third fundraising quarter.[254] In those two weeks, the Clark campaign reported that it quickly raised $3.5 million in contributions in amounts averaging $175 per donor.[255] Two thirds of Clark's contributions were raised online.[256] Once Clark established himself as a serious contender for the Democratic nomination, his fundraising practices evolved into those of a more traditional candidate.[257] Clark raised a total of $17.3 million in individual contributions in the 2004

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246 CAMPAIGN FIN. INST., 2000 PRESIDENTIAL FUNDRAISING FROM INDIVIDUAL CONTRIBUTIONS AS OF FEBRUARY 29, 2004, *at* http://www.cfinst.org/pr/pdf/Table1_Feb.pdf (last visited June 24, 2004).

247 Representative Kucinich actually raised a higher percentage of his funds from small donors than Dean (68%) and a lower percentage of his funds in contributions of $1,000 or more (13%). 2004 PRESIDENTIAL FUNDRAISING, *supra* note 241. Kucinich only raised $6 million, however. *Id.*

248 For a more detailed discussion of the Dean strategy, see generally TRIPPI, *supra* note 8.

249 *See* Jim Drinkard & Jill Lawrence, *Online, off and running: Web gains clout on campaign front*, USA TODAY, July 15, 2003, at 1A (reporting that "Dean . . . is rewriting the playbook on how to organize, finance and mold a presidential campaign").

250 *See id.* (reporting that groups of Dean supporters have independently organized activities such as letter-writing campaigns and community service projects with the blessing of the campaign).

251 *Id.*

252 *See* Liz Marlantes, *Web May Revolutionize Fundraising*, CHRISTIAN SCI. MONITOR, July 31, 2003, at 2 ("One aspect that makes the Internet particularly intriguing as a campaign tool is that, unlike television – the main political medium for a half-century – it gives people a heightened sense of connection to campaigns and even a degree of empowerment.").

253 *See* Susan Page, *While losing, Dean transformed race, politics*, USA TODAY, Feb. 9, 2004, at 1A ("Now [other candidates] have copied the techniques that worked, from telethon-like fundraising challenges to chatty candidate 'blogs' detailing their day. The Internet fundraising blueprint devised by the Dean campaign is likely to be followed by presidential candidates contemplating races in 2008 and beyond.").

254 Adam Nagourney, *Clark Makes it 10, Roiling Democratic Race*, N.Y. TIMES, Sept. 18, 2003, at A1.

255 Press Release, Clark for President, General Clark Raises Nearly $3.5 Million in Two Weeks (Oct. 15, 2003), *available at* http://clark04.com/press/release/021/.

256 *Id.*

257 *See* Joanna Weiss, *Clark Aides Say Recent Donations Net $10.4 Million, Matching Funds*, BOSTON GLOBE, Jan. 2, 2004, at A7 (reporting that "traditional Democratic fundraisers who watched Clark stumble in the early days of his campaign . . . opened their wallets when they saw him improving in appearances and gaining traction in the polls").

Democratic presidential primary campaign, with 49% coming in amounts of $1,000 or more and 31% coming in amounts less than $200.[258] Nevertheless, Clark's early reliance on Internet fundraising from small donors made his candidacy possible.

Clark's success with Internet fundraising coincided with the manner in which he began his campaign. For months prior to the official declaration of his candidacy, Clark supporters – without any direct contact with the general – organized the "Draft Wesley Clark" movement, a grassroots political movement aimed at setting up a rudimentary campaign organization for the general and convincing him to run.[259] Prior to Clark's entry into the race, the movement had generated more than $1 million in pledges for campaign contributions and recruited volunteers and operatives in all 50 states.[260] Like the Dean campaign, the Draft Wesley Clark movement showed that the Internet has opened up tremendous new possibilities for grassroots candidates who are funded by small donors.

With both Dean and Clark using Internet fundraising and organizing efforts to establish themselves as viable candidates for the 2004 Democratic primaries, it is clear that the Internet has already started to change the face of political campaigns. The Internet provides an exciting new way for campaigns to tap large pools of potential small donors, and it could help make a federal tax credit for political contributions more significant to a grassroots political campaign than was ever previously possible. Much as Minnesota Governor Jesse Ventura was able to take advantage of the PCR program in fundraising appeals on his web site,[261] the fundraising drives of federal candidates could feature on their campaign websites a prominent display reading "Contribute Here…For Free" or "Support [Candidate] and Get Your Money Back." Experience with political contribution incentive programs in the states suggests that participation in a political contribution incentive program is chiefly dependent on the efforts of candidates and other political agents to promote the program in their fundraising efforts.[262] The style of campaigning employed by Dean and Clark – using the Internet to appeal directly to small donors and organize volunteers – is well-suited to encouraging donor participation with the help of a tax credit for political contributions. It is not surprising, then, that Howard Dean – who made campaign finance reform an important focus of his campaign – called for a 100% tax credit for the first $100 of every individual contribution to a federal candidate.[263]

If there had been a federal tax credit for political contributions on the books during the 2004 Democratic primary campaign, the Dean campaign's phenomenal Internet fundraising success would undoubtedly have been even greater. The Dean campaign became known for its constant, creative use of email solicitation to encourage its supporters to make small contributions whenever they could afford them.[264] This steady stream of email into Dean supporters' inboxes made it very easy for them to contribute whenever they were inclined to do so.[265] Yet if the Dean campaign also had been able to promote a tax credit for political

[258] 2004 PRESIDENTIAL FUNDRAISING, *supra* note 241.
[259] Michael Janofsky, *General is Said to Want to Join '04 Race*, N.Y. TIMES, Aug. 28, 2003, at A29.
[260] *Id.*
[261] *See supra* text accompanying notes 141 – 144.
[262] *See, e.g.*, *supra* text accompanying note 134.
[263] DEAN FOR AMERICA, "TAKE BACK OUR DEMOCRACY": AN AGENDA FOR REAL CAMPAIGN REFORM (2003). In Dean's proposal, the tax credit would only be available to Americans earning $50,000 or less per year ($100,000 for joint returns). *Id.*
[264] *See* Page, *supra* note 253, at 1A.
[265] *See, e.g.*, Paul Boutin, *Howard's Web: The Internet couldn't save Dean, but it could still help Kerry*, SLATE, Feb. 18, 2004, *at* http://slate.msn.com/id/2095707 (last visited June 7, 2004) ("According to contribution charts at fundrace.org, Dean's campaign did particularly well at drawing repeat donations from large numbers of people dispersed over a wide range of ZIP codes.

contributions as part of its fundraising appeal, the knowledge that they would receive $100 of their contributions back at tax time would have made it substantially easier for Dean's supporters to give. Although Howard Dean fell short of his goal of raising $200 million by attracting $100 contributions from two million Americans,[266] a $100 tax credit could have made this a much more attainable goal.

Moreover, as the fundraising successes of General Wesley Clark and Governor Jesse Ventura demonstrate, the benefits of a political contributions incentive program are not limited to candidates of any one party or ideological affiliation. Prospective small donors will come in all ideological shapes and partisan sizes, and contribution incentives will benefit any candidate who can effectively reach out to small donors and persuade them to contribute.

VOUCHER SYSTEM: A MORE EFFECTIVE WAY TO ADMINISTER POLITICAL CONTRIBUTION INCENTIVES

The tax code is a frequently used vehicle for federal policy making. The Internal Revenue Service administers a complex system of regulations; adding one additional tax credit to the system will create only marginal administrative costs. Nevertheless, creating a political contribution incentive in the tax code has two major disadvantages. First, using the tax code weakens the incentive by making it more complicated to claim and making reimbursement less immediate. Second, a significant percentage of the population, particularly those with low incomes, will not have the tax liability necessary to take advantage of a tax credit. Because of these disadvantages, a federal tax credit for political contributions is only a short-term solution to the problem of small-donor participation in campaign finance. Once the tax credit is enacted, campaign finance reform advocates should press for its expansion into a comprehensive campaign finance voucher system such as that advocated by Professors Ackerman and Ayres.

Many citizens do not even file tax returns, and of those who do many do not have sufficient tax liability to take advantage of a new tax credit. The estimated voting-age population for the 2002 election was 215,139,087.[267] In 2002, Americans filed a total of 130,201,415 tax returns representing 181,730,902 adults.[268] Those adults who had no reason to file taxes at all would be unable to take advantage of a new tax credit. Of those who did file tax returns, only 102,479,207 owed income tax prior to claiming any tax credits.[269] After taking advantage of existing tax credits, only 91,078,178 still had additional tax liability.[270] While some taxpayers may be able to structure their behavior differently in response to the addition of a new tax credit, a significant percentage of tax filers will have no use for it. One way to address this problem is to make the tax credit refundable, so that individuals are fully reimbursed whether they have tax liability or not. While this change would raise the cost of the credit to the public treasury, it would do so in a way that makes participation accessible to more Americans.

Sounds like a classic example of the Internet's reach and convenience. . . . A friend surprised me yesterday by admitting he's given $150 to Dean in several batches, in part because 'they made it so easy.'").

[266] Thomas Edsall, *Dean Declines Public Funds for Campaign*, WASH. POST, Nov. 9, 2003, at A06.

[267] MICHAEL MCDONALD, VOTING AGE POPULATION AND VOTING ELIGIBLE POPULATION ESTIMATES, *at* http://elections.gmu.edu/VAP_VEP.htm (last visited Aug. 26, 2004).

[268] *See* INTERNAL REVENUE SERV., *supra* note 87 (reporting total number of returns and joint returns for 2002). This data is preliminary data only, revised by the Internal Revenue Service as of May 2004. *Id.*

[269] *Id.*

[270] *Id.*

For citizens who can take advantage of a traditional tax credit, participating in the credit program requires that they in effect float an interest-free loan to a candidate or other political agent that the government will ultimately repay. Even for credits that provide 100% reimbursement, the donors must lay out their own money and bear the opportunity costs between the time of the contribution and the time their taxes are processed.

These obstacles to full participation in a tax credit program make it worthwhile to explore means to administer political contribution incentives outside of the tax code. The Minnesota contribution refund program provides one model. Though the contribution refund program is administered by the same state agency that oversees the state's income tax system, applications for refunds are processed year-round and are in no way linked to whether the donor files a tax return or has tax liability.[271] The Minnesota contribution refund program makes political contribution incentives available to all citizens, not just those with tax liability, and by offering reimbursement in the short term it creates a stronger incentive to contribute. Nevertheless, the contribution refund program does not completely eliminate all opportunity costs that discourage full participation by new contributors, for it still requires contributors to lay out their own money and wait several weeks for their refund to be processed.

Administering political contribution incentives through a campaign finance voucher system is the most effective long-term way to encourage small donor participation. A federal tax credit for political contributions is an important, and perhaps even a necessary, step toward that long-term goal. While a new federal tax credit would not provide an incentive to all Americans, it has significant potential to encourage those it does reach to give small contributions to political campaigns. As the effects of political contribution incentive programs are proven over time, they can be expanded into more comprehensive programs.

[271] *See* Smith, *supra* note 66, at 72 – 73. For a detailed discussion of the Minnesota contribution refund program, see *supra* text accompanying notes 127 – 146.

Conclusion

Political contribution incentive programs are a highly promising approach to the challenge of increasing the voice of small donors in political campaigns. The programs empower small donors while also bringing new dollars into the campaign fundraising process that balance to some extent the dominant role played by the small percentage of Americans who can afford to give large donations. Political contribution incentive programs bolster the viability of candidates who direct their campaigns primarily toward grassroots constituencies. The success of Governor Jesse Ventura in Minnesota – due in part to his active solicitation of contributions through the contribution refund program – shows that political contribution incentive programs can actually work to level the political playing field if enacted as part of a more comprehensive package of reforms such as low contribution limits or public financing, or both. Meanwhile, presidential candidates Howard Dean and Wesley Clark demonstrated the potential of the Internet as an organizing tool for small donors on a national scale. A political contribution incentive program at the federal level would provide an even greater boost to dynamic campaigns as diverse as those of Jesse Ventura, Howard Dean, and Wesley Clark that seek to engage average Americans from across the political spectrum and promote popular participation in politics.

In order to be effective, political contribution incentive programs must cover contributions to a broad range of political agents and be potent enough that both contributors and recipients have an incentive to use them. The background of laws and regulations upon which the program is placed also can enhance or undermine its effectiveness. Ultimately, participation in incentive programs is driven more by the activities of the recipients of contributions than by the circumstances of the donors. To maximize participation, incentive programs should apply to donations to PACs as well as candidates and parties. In the current federal system, where contribution limits are high and other forms of public financing of campaigns are limited, a tax credit may only have modest effects on the demand of candidates and parties for small-dollar contributions. Many PACs, however, are likely to have a high demand for small-dollar contributions; making them eligible for the credit could greatly increase credit participation rates and foster issue-centered political activity that is important to a healthy, well-functioning democracy.

A tax credit for political contributions is not a panacea, but it may be an important step toward more comprehensive reforms. The cost of the tax credit is a small investment in democracy that could yield substantial dividends in increasing the voice of average Americans and possibly also lead to greater long-term citizen involvement. A tax credit would encourage citizens to make small annual investments in politics that would give them a sense of ownership over their democracy. Proposals for a tax credit also could be linked with other important reform measures, such as those that provide public funding to match small donor contributions. More importantly, even a modestly successful tax credit could furnish important evidence that political contribution incentives work to reduce political inequality in the campaign finance system. If this evidence proves persuasive, then the principles underlying political contribution incentives could be feasibly expanded into a system of voucher-based public financing. Such a system would give all citizens opportunities for full and equal participation in political campaigns and would completely redefine the way campaigns are conducted. A well-funded voucher system would create a new kind of political market, one in which significant private wealth does not enjoy disproportionate influence. In this new market, a candidate's most effective means of campaigning would be to communicate his or her ideas to the voting public.

Recommendations

1. A new federal tax credit for political contributions should be enacted immediately, as an incremental step on the road to more comprehensive reforms. The credit should be a 100% credit for an amount that is significant but also not out of the reach of most Americans, such as $100 (or $200 for joint returns). Anything less than a full credit for a non-trivial amount will provide candidates with insufficient incentive to solicit credit-eligible contributions actively. If the credit is raised to a level out of the reach of most Americans, however, it will be used primarily by those who can already afford to give and will subsidize the large contributions that distort the political process.

2. The tax credit should be available for contributions to candidates, parties, and PACs. The new federal tax credit should act to increase the relative voice of small donors and encourage citizen participation in the full range of political campaign activities. Also, as seen in Oregon, opening the credit up to PACs would greatly increase the demand for credit-eligible contributions, thereby boosting participation in the program.

3. The tax credit should only be available for small contributions. The tax credit should only be available to individuals who make $100 or less in contributions to the candidate, party, or PAC in the election for which they are claiming the credit. This limitation directly aims the credit's incentive at small donors while holding down its costs by preventing the credit from subsidizing large-dollar contributors who are likely to make their contributions with or without a tax credit.

4. The tax credit should be accompanied by public education efforts to inform the public of its existence. Research from the Campaign Finance Institute and other sources suggests that tax credit participation rates will be much higher if the public is made well-informed of its existence. Any proposal for a tax credit for political contributions should include a reasonable earmark of funds to the IRS to publicize the credit.

5. Voucher systems and other ways to administer political contribution incentives more effectively outside of the tax code should be explored. For a political contribution incentive program to be most effective at encouraging the participation of new small donors, it must be administered outside of the tax code. The voucher proposals described above fully articulate the principles underlying political contribution incentives. A fully funded, well-designed voucher system would directly link the distribution of funds to popular support for a candidate, party, or PAC, creating a new kind of market for political contributions, one not based on private wealth.

6. Contribution limits should be lowered for candidates, parties, and PACs to a level that is within the reach of most Americans. Tax credits for political contributions have had historically low-to-moderate participation rates because candidates and parties have had insufficient incentives to mobilize significant numbers of small donors. Combining meaningful incentives for small donors to participate with low contribution limits that enable them to participate on a more equal footing with those who are already giving would change the conduct of campaigns. Furthermore, although PACs are frequently attacked as a principal evil of the current campaign finance system, PAC influence is only a problem to the extent that high contribution limits cause PACs to become conduits of influence for the fraction of Americans who have significant private wealth.

7. Public financing and additional reforms should be adopted to supplement political contribution incentives. Professor Overton's proposal that tax credits be accompanied by matching funds at a 4-to-1 rate to enhance the value of small contributions should be explored. Additional lessons can be learned from Minnesota's contribution refund program, which has been able to achieve success in increasing small donor participation because its system of low contribution limits, public financing, and voluntary spending limits provides additional opportunities for grassroots candidates to compete with candidates who are able to attract large-dollar contributions.

SUGGESTIONS FOR FURTHER STUDY

Knowledge of tax credits for political contributions, as well as other possible forms of political contribution incentives, is still limited. The following are just a few of the areas where more research is needed to gain a better understanding of the potential of political contribution incentives as a policy tool.

CANADA

Canada has had a 75% tax credit for contributions to political parties since 1974. In 2003, Parliament voted to increase the value of the credit from $500 to $650. As noted in the footnotes above, the Campaign Finance Institute recently published an analysis of Canada's tax credit. According to their analysis, since the tax credit was adopted, the average contribution to a political party has generally declined while the number of both donors and claimants of the tax credit has increased. These promising results suggest that a more comprehensive comparative study is needed that explores the differences between the Canadian and American systems of government and campaign finance to determine what lessons Americans should draw from the Canadian experience.

COST ANALYSIS

While it is impossible to construct a perfect model of how a prospective tax credit will operate in practice, a more detailed cost analysis is needed to understand the implications of the proposal, to support its passage, and to provide a menu of alternatives that will facilitate legislative deal-making. This cost analysis should look carefully at how different structural features of a credit proposal, such as including PACs in its coverage or limiting credit eligibility to in-state or in-district contributions, might affect its bottom line. Having such a cost analysis available will prove invaluable to policymakers as they contemplate the various tradeoffs between cost and participation while drafting legislation to create the credit. Moreover, if legislators seek compromise over some aspect of the credit's design in order to secure its passage, they will need forecasts of how a given compromise might affect the credit.

FURTHER ANALYSIS OF MINNESOTA PCR DATA

Minnesota's contribution refund program is the only existing state program that offers political contribution incentives outside of the tax code. Moreover, because the administrators of the program monitor contributions by the candidate or party to which they are sent, rather than by the income data of the donor, data from the program provide a unique look at donor behavior that has been heretofore unavailable for traditional tax credit programs. Further analysis of this valuable data source is essential to understand better why political contribution incentives have enjoyed modest success in Minnesota. Pioneering researchers should devise ways to hold different elements of the Minnesota campaign finance system constant in order to test the role such features as spending limits, direct public financing, and other outside variables have played in influencing participation in the contribution refund program. Many questions remain unanswered, such as why the Republican Party has had significantly more success than the Democratic Party in raising PCR contributions; why average PCR contributions have risen while participation rates have remained relatively flat; and to what extent variables such as an incumbent candidate or demographic characteristics of the candidate's district influence PCR contribution patterns.

PAC PARTICIPATION IN OREGON

Oregon has the highest participation rate of any political contribution incentive program in the country, and the majority of those who claim its tax credit do so to reimburse PAC contributions. This paper suggests reasons why PAC contributions have come to dominate credit solicitation efforts – but a better picture is needed of what kinds of PACs are the most successful fundraisers, and why they are so much more successful than candidates at encouraging their donors to take advantage of the tax credit. The PACs with the most success in encouraging donors to take advantage of the tax credit may be representative of PACs in the state generally, or they may not. Determining which characteristics of PACs correlate with fundraising success could prove instructive in understanding what drives tax credit participation rates.

OTHER COMPARATIVE STUDIES

Researchers also should find ways to take full advantage of the various data currently available on state and federal tax credit programs by engaging in comparative studies. Some useful comparative studies would include the following: studies of the differences between 50% and 100% credits, particularly in Oregon, which changed its credit from 50% to 100% after the repeal of the federal credit in 1986; studies of how credits operate in systems with different contribution limits; and studies of how tax credit participation correlates with the competitiveness of elections. One specific comparison that might be made is between Minnesota's contribution refund program and the Oregon tax credit as it operated under Measure 9. Though there are of course important differences between the two campaign finance regimes, both combined low contribution limits with political contribution incentives that were linked to voluntary spending limits.

PUBLIC EDUCATION

The Campaign Finance Institute's recent studies in Ohio suggest that informing the public about tax credits for political contributions could result in a significant number of contributions from new donors. The studies also suggest that these donors are likely to be more representative of the general public than the very small percentage of Americans who are currently giving. A comprehensive study of every state with a political contribution incentive program would make it possible to understand the relationship between public awareness of the program and the program's effectiveness.