

# **Broadening the Base**

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## **The Case for a New Federal Tax Credit for Political Contributions**

**David Rosenberg**

With a Foreword by Norman J. Ornstein

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## FOREWORD

In the spring of 2002, the Bipartisan Campaign Reform Act (BCRA), commonly known as McCain-Feingold, was enacted into law. It was the most significant campaign reform legislation passed in a quarter century. The changes to the political system will be significant, notably the banning of soft money and the regulation of issue advertisements. But BCRA was not meant to be the last word on campaign reform, and its authors admitted that it was an incremental step along the way toward more durable and comprehensive change in the campaign finance system.

Nearly six years ago, I convened a group of campaign finance experts from across the political spectrum to reach a consensus on basic principles of reform. We published “Five Ideas for Practical Campaign Finance Reform.” The five ideas were: a soft-money ban, sensible regulation of issue advocacy advertising, improved enforcement of campaign finance laws, a broadcast bank allowing candidates the resources to deliver messages on television, and a tax credit to encourage small donations. The first two ideas were largely incorporated into BCRA. The third is the subject of a major effort now underway by Senators John McCain (R-Arizona) and Russell D. Feingold (D-Wisconsin) and Representatives Christopher Shays (R-Connecticut) and Martin T. Meehan (D-Massachusetts), the four chief authors of BCRA. The fourth and fifth ideas, a broadcast bank for television time and a tax credit, are the next issues on the campaign reform agenda.

The small donation tax credit is the subject of David Rosenberg’s excellent study. It is a significant part of a larger reform agenda. McCain-Feingold attempted to change the nature of fundraising and the kinds of resources channeled into campaigns. Unlimited soft money for federal campaigns, actively solicited by lawmakers and policymakers, was blocked. Individual contribution limits of so-called hard money to candidates and political parties, set in 1974, were raised. Those increases, from \$1,000 to \$2,000 for contributions to federal candidates, did not even compensate for twenty-five years of inflation and were necessary steps. Substantial resources are required to operate a campaign system in a democracy, and that means a substantial number of donors able and willing to give candidates \$1,000 to \$2,000.

But they should not be the only—or even the principal—sources of funds for candidates. A healthy democracy works best when lots of people contribute to campaigns, even if the amounts they give are small. BCRA, however, left undone any plan to broaden the base of donors. This is where a tax credit for small donations is important. Finding a way to get an increase in the number and scope of donations less than \$200 could compensate for the ban on enormous checks coming into campaigns without creating the conflicts and question marks that the large donations engender. The result would be campaigns that have sufficient funding to get their message out and to develop grassroots support, that attract a wide base of financial support rather than rely on a few, and that do not provide the same appearance of a quid pro quo being exchanged—money for legislative favors—that have been dominant themes in Congress over some years.

There was, of course, a credit for small contributions in place in our federal tax code before 1986. It was taken out, along with most other credits, as part of the “base broadening”

undertaken by the sweeping tax reform of 1986. Rosenberg shows that the credit that we had had value and that some innovative experiments with such tax credits in the states hold promise. Clearly, a way exists to increase small donations at a relatively modest cost and without creating a large bureaucracy to administer the program. In addition, a tax credit for small donations would have appeal across the political spectrum. Over the past few Congresses, representatives of both parties have introduced bills advocating a form of a tax credit for small donations. Given the enthusiasm for campaign finance reform that led to the passage of McCain-Feingold and given that the tax credit is a bipartisan issue, prospects for that type of reform are good.

Rosenberg's report will be a guide to reform at the federal level. Not only does it lay out possible variations implemented in the states, but it also alerts us to some of the dangers ahead. Most of all, it reminds us that the battle to add more small donors to the base of those who contribute to our campaigns is a worthy one to join.

Norman J. Ornstein  
Resident Scholar  
American Enterprise Institute  
for Public Policy Research

## EXECUTIVE SUMMARY

If elections are the engine of American democracy, money is its fuel. The Constitution guarantees our right as Americans to the free exchange of ideas and free election of political leaders, but it takes money—and lots of it—to disseminate and promote those ideas and the candidates who espouse them. In fact, according to the Federal Election Commission, candidates for federal office and the national party organizations spent approximately \$3 billion on campaigns in the 2000 election cycle. And this figure excludes significant spending by labor unions and other outside interest groups, as well as spending on myriad state and local campaigns.

Most politicians and political observers agree that the ideal way to finance American political campaigns is through a broad base of constituent donors, each providing a relatively small contribution. But the harsh economic realities of modern-day campaigning force politicians and parties to spend a tremendous amount of time soliciting funds from a concentrated group of large donors. The potential for corruption, or at least the appearance of quid pro quos, is significant.

While most campaign finance reform efforts have focused on limiting the impact of “big money,” certain reforms have been designed specifically to enfranchise small donors. Most notably, from 1972 to 1986, the federal government offered a 50 percent tax credit for political contributions. The credit provided an explicit incentive for average Americans to contribute to campaigns in small amounts while simultaneously encouraging politicians to solicit donations from a broad swath of contributors. The credit was repealed during the Reagan-era tax reforms, and today, as campaign costs skyrocket and public antipathy toward politicians remains strong, the absence of an explicit tax incentive only reinforces a growing focus by candidates and parties on large contributors.

Six states currently offer their own tax credits for political contributions. These state-level credits differ in form, style, process, and impact, but all share the same goal of encouraging average Americans to join in the funding of our political system. This report summarizes findings from an analysis of the six state-level credits as well as the old federal tax credit and draws lessons that may be applied in the creation of a new federal tax incentive for small contributions.

Our analysis indicates that a well-crafted tax credit for political contributions can be a cost-effective and sound method for helping balance the influence of big money donors in the American electoral process. We find that tax credits for political contributions not only invite middle-class Americans to become active participants in the political process, but also encourage many candidates to seek the small, local contributions that are almost universally valued in our political system.

The varied experiences in the states offer valuable lessons for the design of a potential new tax-credit law. On the basis of our analysis, we strongly encourage Congress to reintroduce a federal tax credit for political contributions, with the following recommendations:

1. The credit should provide a 100 percent refund on eligible contributions to candidates.

2. The credit should provide a meaningful refund, not a token amount.
3. The credit should be targeted to middle- and working-class contributors.
4. The credit should apply to federal candidates only.
5. Congress should consider applying the tax credit to parties as well as to candidates.

We estimate that a new federal tax credit for political contributions will cost approximately \$3.1 billion over four years. In this scenario, the number and percentage of small donations represent a significant increase over current levels and reverse a decline in small contributions seen since the late 1990s. We believe that a new federal tax credit for political contributions would go a long way toward enfranchising more Americans in a vital part of the political process while respecting the realities of federal budget constraints in today's political and economic environment.