

TESTIMONY ON DARK MONEY AND CAMPAIGN FINANCE REFORM
SENATE COMMITTEE ON RULES AND ADMINISTRATION

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Mr. Chairman and members of the Committee, it is both an honor and a privilege to testify before you today on the challenges of money in politics. In my testimony, I want to raise two larger concerns generated by the multiple recent moves that have knocked the pins out from under the regulatory regime that has long operated in American politics, going back at least to the Tillman Act in 1907. First is the corrosive corruption caused by removing the modest limits on money that have existed. Second is the many efforts to limit disclosure and enable huge flows of dark money to enter the system without the accountability necessary in a democratic political system.

There are many who believe there should be no regulations on campaign finance, requirements for disclosure of contributions and spending, or limitations on contributions. This is not a new question in American politics. Concerns about corruption-- the understanding that money in campaigns can be a corrosive force, both from well-heeled individuals and groups seeking influence in government and from government actors shaking down individuals and groups to raise money-- were present quite early in our country's history.

The concerns were real. Periodically, scandals would engulf the system, leading to a backlash and a drive for reform. The scandals occurred, of course, because a wide open system, where anything goes, provided ample room for that corruption. Government has power-- power to provide jobs, via a spoils system; power to provide opportunities for individuals and interests to make huge sums of money via government contracts, tax breaks, regulations or rights of way, and in many other ways. And the power of government can be used to extract money from those seeking favor or afraid of punishment. This is not a problem unique to America; it is a cancer afflicting societies across the globe, a danger to free governance and systemic legitimacy everywhere.

The history of American politics and political money shows that for at least 150 years, and arguably for more, concerns about corruption and the appearance of corruption often triggered by scandal, led to efforts to balance First Amendment freedoms by putting modest and reasonable restrictions on campaign fundraising and contributions, to push for more disclosure as a disinfectant, to find ways to limit the overweening influence of monied interests, including corporations and labor unions. Attempts to prohibit parties from shaking down government employees for contributions began in 1837. Historian John Lawrence has noted, Abraham

Lincoln warned that concentrated capital had become “enthroned” in the political system and he worried about an era of “corruption in high places ... until the Republic is destroyed.” The first actual restriction on campaign funding came after the Civil War, with an 1867 provision prohibiting the solicitation of contributions from naval yard government employees. The very modest change did not have any appreciable impact on the overall system.

Corruption in the administration of Ulysses S. Grant led to more calls for reform, culminating in the Pendleton Act in 1883, which resulted in the end of the patronage system and assessments. The end of the spoils system led to the rise in influence of corporations, which filled the vacuum in party and campaign funding. A backlash against huge corporate and business contributions, including allegations of outsized corporate influence on President Theodore Roosevelt, led Roosevelt to lead a new reform movement in 1905 and 1906; that led to the Tillman Act of 1907. The Tillman Act made it illegal for “any national bank, or any corporation organized by authority of any laws of Congress” to make a contribution relating to any election for federal office. In 1910, the Federal Corrupt Practices Act required national party committees and congressional campaign committees to disclose their contributions and expenditures after each election.

Scandal continued to spur reform efforts and reform. The Teapot Dome scandal resulted in the Federal Corrupt Practices Act of 1925, which expanded disclosure and adjusted the spending limits upward. Reports of abuse of federal employees working for the re-election of Speaker of the House Alben Barkley in 1938 led to passage of the Hatch Act in 1939, a revision of the 1883 Pendleton Act, which prohibited partisan political activity by most federal employees and also banned solicitation of contributions from workers on federal public works programs.

Labor’s increasing political activity during the presidency of Franklin D. Roosevelt led to several efforts to limit labor’s contributions, like those of corporations. In 1947 the Republican Congress made a ban on labor contributions to campaigns permanent, as part of the Taft-Hartley Act.

The Watergate scandal spurred the Federal Election Campaign Act of 1974, which was substantially revised by the landmark Buckley v Valeo decision in 1976. The Bipartisan Campaign Reform Act of 2002 was spurred by scandals over soft money fundraising and the misuse of the funds from corporations and unions for electioneering communications.

Then came Citizens United. The longstanding concerns about corruption, or its appearance, were brushed aside; Justice Kennedy’s opinion suggested that campaign activity and money raised or spent independently could have neither a corrupting influence nor the appearance of corruption, unless there was a direct quid pro quo. But Citizens United also upheld vigorously the importance of disclosure. By 8 to 1, the Court otherwise deeply divided on the issues upheld disclosure requirements for corporations, including nonprofit corporations, making independent expenditures, saying “With the advent of the Internet, prompt disclosure of

expenditures can provide shareholders and citizens with the information needed to hold corporations and elected officials accountable for their positions and supporters.”

Now comes McCutcheon. And here I want to paraphrase from a column I wrote recently on this most recent and most destructive Supreme Court decision. Many analysts have written a lot about the decision, with a natural focus on its direct implications for campaigns. Those are huge and important. But they are, I believe, overshadowed by the impact of the decision on corruption in America.

Some have suggested that McCutcheon was not a terribly consequential decision—that it did not really end individual-contribution limits, that it was a minor adjustment post-Citizens United. Others have said that it may have a silver lining: more money to parties, more of the money disclosed. I disagree on both counts. Justice Stephen Breyer's penetrating dissent to the decision pointed out the many methods that campaigns, parties, and their lawyers would use to launder huge contributions in ways that would make a mockery of individual limits. Chief Justice John Roberts pooh-poohed them as fanciful. And, of course, they started to emerge the day after the decision.

As for disclosure, the huge amounts that will now flow in through political parties will be channeled through joint committees, state and local party committees, and others in complex ways that will make real disclosure immensely difficult, if not impossible.

More significant, in any case, were Roberts's sweeping conclusions about corruption and the appearance of corruption in the decision. The chief justice took the shaky conclusion reached by Justice Anthony Kennedy in the Citizens United decision—that money given "independently" of campaigns could not involve corruption or its appearance—and applied it in an even more comprehensive fashion to money given directly to candidates and campaigns. Thanks to McCutcheon, only quid pro quo corruption is sufficient to trigger any restrictions on campaign contributions—meaning, direct bribery of the Abscam or American Hustle variety, presumably captured on videotape for the world to see. The appearance of corruption? Forget about it. Restrictions on elected officials soliciting big money? Forget about them, too.

To anyone who has actually been around the lawmaking process or the political process more generally, this is mind-boggling. It makes legal what has for generations been illegal or at least immoral. It returns lawmaking to the kind of favor-trading bazaar that was common in the Gilded Age.

With intense competition between parties over election outcomes, with the stakes incredibly high over who will capture majorities in a polarized era, and with money everywhere and intense competition for dollars, the trade of favors for money—and the threat of damage for the failure to produce money—will be everywhere. Access to lawmakers, presidents, their aides, and subordinates is precious, including when they are actually marking up legislation. In the aftermath of Roberts's decisions, this precious access will be sold to the highest bidders.

I remember well the pre-reform era where there were "Speaker's Clubs" and "President's Clubs" with menus for soft-money donors: for \$10,000, lunch with key committee chairs and a day hobnobbing with important lawmakers and committee staffers; for \$25,000, all that and a small breakfast or lunch with the speaker; and so on. Those will be back, with the dollar amounts higher and the access more intimate. Big donors will make clear to party leaders that multimillion-dollar donations are one step away—and will be forthcoming if only the leaders will understand the legislative needs of the donor. McCutcheon not only made all that legal but also gave it the Supreme Court's seal of approval.

On disclosure, I have already noted the full-throated endorsement of full disclosure of campaign donors in Citizens United and McCutcheon. Of course, it was always going to be a priority for high-priced campaign lawyers to try to find ways around the system, to hide donors where they could. In that sense, the dynamic is no different than high-priced tax attorneys looking for loopholes to enable their wealthy clients to avoid paying taxes. We count on aggressive regulators to keep them honest, and to keep the integrity of the system intact.

It is clear that when it comes to disclosure, the direct and manifest intent of both Congress in Buckley and BCRA and the Supreme Court in Citizens United and McCutcheon has been repeatedly undermined by a feckless set of commissioners at the Federal Election Commission, and by the failure to implement the clear intent of the tax law by the IRS.

Trevor Potter, in his compelling testimony, details how the FEC, through the Republican members of the Commission, worked actively to undermine the language and intent of the law, and has chosen to narrow the disclosure requirements regarding electioneering communications to a point where they are almost meaningless. A Public Citizen report in 2010 showed the impact of the FEC's action on disclosure:

- While most groups making electioneering communications in 2004 and 2006 reported their sources of funding, by 2010 only 1 out of 3 did.

- In 2004, 47 groups reported expenses, 46 of which reported their donors (98%);
- In 2006, 31 groups reported expenses, 30 of which reported their donors (97%);
- In 2008, 79 groups reported expenses, only 39 reported their donors (49%);
- In 2010, 53 groups reported expenses, only 18 reported their donors (34%). The top 10 spenders reported spending \$63 million, but reported only \$6.9 million in contributions—or about 1 out of every 9 dollars.
- Of the 308 groups—excluding party committees—that reported spending money on the 2010 elections, only 166 (54%) provided any information on the sources of their funding. These groups spent \$136 million in 2010, which was almost double the total amount spent by all groups (\$69 million) active in the 2006 midterm election.

It is not only the FEC that has been derelict here. So too has the IRS, which now is trying finally to provide clarity under the law for nonprofit groups that have misused tax categories, namely those under Section 501(c)4, as a means to channel dark money through the system. As I wrote in a column in the Atlantic, tax law has many provisions for nonprofit organizations, including 29 under Section 501(c) in the Internal Revenue Code. Federal credit unions, for example, are under 501(c)1, business trade associations are under 501(c)6, mutual insurance companies are under 501(c)15, black-lung benefit trusts are under 501(c)21, and so on. Most of what we think of as nonprofits—religious, educational, scientific, and charitable organizations—are under Section 501(c)3.

Section 501(c)4 applies to “social-welfare organizations,” nonprofits that promote social welfare through public-education campaigns, including some lobbying. What about nonprofits that aim to influence elections and engage in campaigning as their primary activity? Those entities organize under Section 527 of the code. That includes political parties, PACs, and other related groups. The law clearly and unequivocally defines 501(c)4s as *exclusively* social-welfare organizations. But for decades, in direct contradiction to the clear language of the law, the IRS has used regulations that define 501(c)4s as *primarily* social-welfare organizations. Why did the IRS do this? Tax experts in this area tell me that this is a convention used at times by the agency to give it a tiny bit of flexibility to avoid rigid characterizations and applications of the law—meaning that if an organization accidentally or unknowingly used an insubstantial portion of its resources in ways that were not within the rubric of social-welfare organizations, the agents or auditors would not be forced to throw the book at it.

Groups classified as 501(c)4s do not have to disclose the identity of their donors. Before 2000, 527s did not have to disclose their donors either—outside organizations used 527s to run ads clearly designed to elect or defeat candidates, but they were called “issue ads” because they did not explicitly say “elect” or “defeat” Candidate X or Y. These outside groups gravitated to

527s to escape disclosure and run their campaigns in secret—and to avoid contribution limits. But after Congress changed the rules in 2000, the new way to avoid disclosure became the 501(c)4s. Following the *Citizens United* decision in 2010—which opened the door to corporations, including nonprofit groups, to make direct expenditures in federal elections—enterprising and aggressive lawyers pushed the envelope. They used the IRS’s application of “primarily” in its regulatory approach to social-welfare organizations to mean 50.01 percent of the organizations’ activities, and encouraged the newly formed groups to spend a fortune on political ads during a campaign, and then afterward run so-called “issue ads”—many of which were in fact barely disguised campaign ads—to meet their 50.01 percent standard.

For a group intent on influencing the outcome of elections, there was only one reason to create a 501(c)4 instead of turning to a 527 or simply forming an independent super PAC—[secrecy](#). For many groups, that was explicit: When Karl Rove and his colleagues formed Crossroads GPS to operate alongside his super PAC, American Crossroads, the communications to potential donors made it clear that if they wanted to remain anonymous, the GPS route would enable them to do so.

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For a federal revenue service that is understaffed and deeply sensitive about getting in the middle of a political dispute, the easiest way out was the passive one: Accept the standard that flew directly in the face of the law but was insisted upon by aggressive political consultants and their consiglieri to inject huge amounts of dark money into federal races. When the IRS publicly announced that it would consider applying gift taxes to donors to these groups that went over the line, the organized and concerted campaign of intimidation by the pols forced the agency to back off.

After *Citizens United* and another related appeals-court decision, *SpeechNow*, we saw an explosion of super PACs and of outside money flooding into campaigns, and an explosion in groups trying to get 501(c)4 status. Many clearly did not deserve it—if you are a “Tea Party” group, with a direct goal of influencing elections, you belong as a 527. The same is true of many organizations aimed at influencing elections with the word “party” in the name, or even of others using words like “progressive” or “occupy.” Faced with a flood of applications, and recognizing, thanks in part to efforts by reform groups and lawmakers, that their handy interpretation of “primarily” in the regulations had exploded into a gaping loophole, the IRS began its ham-handed and overreaching efforts to screen groups.

Now, appropriately and commendably, the IRS is trying to write new and clear regulations that meet the test of complying with the explicit language of the law, as the Supreme Court itself, in decisions like *Better Business Bureau v. the United States*, has said means exactly what it says: Exclusively means exclusively. A very modest amount of political activity can fit under the rubric of social-welfare organizations, and the IRS is trying to make it easy for organizations by defining both what those political activities are and what proportion of the organization's budget can be applied.

Not surprisingly, opponents are going to DEFCON 1—for one reason, and one reason only: They want to keep secret the hundreds of millions in dark, undisclosed money to run attack ads and muddy the waters. This attack on the IRS, by lawmakers like Mitch McConnell, Darrell Issa, and Dave Camp, and by their outside political hacks and counselors, is all about muzzling the IRS to maintain secrecy and avoid the disclosure that the Supreme Court has wholeheartedly and overwhelmingly endorsed.

What can Congress do? First, despite the steeply uphill battle to enact any reasonable laws these days, it should make every effort to pass the DISCLOSE Act. Second, the Senate should hold probing hearings on the dysfunctional Federal Election Commission and look to reform it to make it into a reasonably functional body that acts to enforce the law and not to thwart it. Third, for every hearing in the House highlighting the purported “scandal” at the IRS, the Senate should hold a hearing on the real meaning of social welfare organizations and the need to clarify in IRS regulations what the law specifically intends. Fourth, the Senate should pass a rule amending its ethics code to make it a violation for senators or senior staffers to solicit the large contributions for party committees now allowed under McCutcheon. Fifth, Congress should begin serious consideration of a broader reform of the campaign finance system, one that would empower small donors as a counterweight to the oligarchs, having it ready for the day when, as John McCain has predicted, the next huge scandal creates a new momentum for reform. Before that happens, I fear that deep damage will be done to the fabric of the American political system.