Testimony of Michael J. Malbin
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Senate Committee on Rules and Administration, March 8, 2005

Chairman Lott and Members of the Committee:

I am grateful for your invitation to testify today on pending legislation concerning Section 527 organizations that are involved in federal elections. The Campaign Finance Institute is a nonpartisan policy research organization affiliated with George Washington University. For the committee's information: I am also a professor of political science at the State University of New York, Albany, as well as the executive director of CFI. Under the general supervision of CFI's Board, which includes members of major parties, academic experts, and representatives of civic groups, CFI provides information and analysis concerning the federal campaign finance system and its impact on our democratic political system. On occasion, our studies also lead us to advance policy recommendations, usually in the form of reports by broad-based Task Forces. We are not primarily a lobbying group

CFI has been engaged with Section 527 issues almost since our inception in 1999. Our first Task Force on Disclosure highlighted needs for improved disclosure, including electronic reporting by 527s to the Internal Revenue Service and web searchability of information in such reports. Last month, as part of our forthcoming book on the impact of the McCain-Feingold reform law on the 2004 elections, we released a draft chapter by CFI staff on the development of these organizations post-BCRA. I ask that you make a copy of this chapter part of your record. The subject of 527s also was recently discussed by our Task Force on the Financing of Presidential Nominations, which is about to set forth an updated proposal for fixing the broken public financing system.

527s: A Major Anomaly in the Campaign Finance Regime

In the post-BCRA world, candidates, political parties, and federal political committees that make contributions and/or expenditures, all have to scramble for limited, hard money contributions und the Federal Election Campaign Act (FECA). Section 527 tax-exempt political groups are defined by the Internal Revenue Code as organizations that have a primary purpose of influencing elections. 527 committees that are active in federal elections are the only federally active organizations that have electing candidates as their primary mission and can do so without limits on the contributions they receive. In our view, there is no clear rationale for this situation.

According to CFI's study, in 2004, Section 527 groups that were primarily or substantially involved in federal elections received $405 million in net contributions (after discounting for inter-group transfers). This was an increase of $254 million just since the 2002 cycle. The number of such groups rose from 42 in 2002 (not counting congressional leadership PACs since banned under BCRA) to 80 in 2004.

Unlike candidates, FEC-recognized political committees, and national, state and local political parties, 527s may raise contributions for federal elections from corporations and unions. They may also receive unlimited donations from individuals. Since candidate, political and party committees also fall under Section 527 of the Internal Revenue Code, the current campaign finance regime is more permissive toward certain types of 527s, and their donors, than to others.

Furthermore, in the last election, the beneficiaries of this distinction were mostly new 527s with little accountability to either large memberships or the general public. In post-election discussions, consultants for some of these groups, on both sides, publicly acknowledged that they gained an advantage from being less accountable than candidates and parties. They indicated that they were often able to sponsor harder-hitting, more emotional and more negative appeals than candidates and parties who might be effectively criticized for such ads. Thus, there is some evidence that the 527 anomaly is encouraging a coarsening of American political life.

Our research into $5,000+ business, labor union, and individual contributions to 527s in 2004 discovered that business (mainly corporations and their trade associations) gave $30 million and labor $94 million. However the majority of these donations -- $256 million -- came from individuals. As Table 1 shows the pattern of individual giving to 527s shifted dramatically towards the very biggest donors between 2002 and 2004. In 2002, 50% of individual contributions above-$5,000 came from donors who gave between $5,000 and $100,000. Instead of 50%, only 12% came from the $5,000-$100,000 donors in 2004. In contrast, 89% of the donations above $5,000 came from 265 individuals who gave at least $100,000. And 70% came from just 52 individuals who gave between $1 and $24 million. For a more detailed table showing these individuals, I refer you to the report to which I referred earlier, a copy of which is appended to this testimony.

We took a closer look at the 113 donors who gave at least $250,000 to federal 527s in 2004 (See appendix). We discovered that 73 (65%) were ex-soft money donors to the national parties. These individuals furnished a total of $50 million in soft money to national party committees during the 2000 and 2002 cycles combined. They were even more generous to 527s though in 2004. They gave them three times more -- $157 million -- in one cycle than they gave parties in the previous two cycles.

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Even taking into account the unusual passion and interest in the recent presidential election, we think there is reason to believe that 527s could play even larger roles in future congressional and presidential elections.

- There is a substantial base of 527 groups that have been active in at least the last two cycles and can therefore be regarded as having institutionalized 527 operations. These groups raised $154 million in 2004.

- Considering past trends in party soft money and convention host committee contributions, one may conclude that once the genie of huge donations is out of the bottle, it is unlikely to return. Beyond the 73 aforementioned former soft

money donors, the fundraising potential of ex-soft money donors, such as the 516 people who gave at least $100,000 in party soft money in 2000 alone, remains largely untapped.

- Republican 527s were slow in developing in the 2003-04 cycle mainly because the RNC and the Bush campaign resisted them until mid-May 2004. Partly for this reason, GOP-oriented 527s raised only $84 million compared to $321 for Democratic-oriented ones. Republicans might improve that ratio in 2006 and 2008.

In sum, the unregulated status of 527s concerning contributions is an anomaly. Other groups that are primarily focused on elections are subject to hard money requirements. The 527s also contribute to making politics less civil and accountable. And they are a large and growing phenomenon.

A Potential Constitutional Issue and Relevant Evidence of the 2004 Election

As indicated above, under existing federal campaign finance law, an organization that makes "independent expenditures," which employs "express advocacy" (e.g. "vote for" or "vote against") in behalf of a candidate can spend as much as it likes. But it may not accept any corporate or union contributions or more than $5,000 a year from an individual. Before *McConnell v. FEC*, which upheld BCRA, representatives of 527s asserted that they could not be regulated under the campaign law, as interpreted by federal courts, because they did not conduct express advocacy. Those wishing to regulate argued that the requirement of express advocacy did not apply to groups having a "major purpose" of influencing elections. The thrust of the Court's explanation of its BCRA decision was to undermine the use of express advocacy as a basis for standing outside the system. The Supreme Court now regards the distinction between public communications that "promote, attack, support and oppose" candidates and express advocacy as "functionally meaningless." Therefore, there would appear to be no obstacle in current law to prospective FEC or congressional action to end the 527 anomaly, as S. 271 would.

Nevertheless, some legal scholars have observed that, the Supreme Court has never ruled on the *constitutionality* of limiting individual contributions to committees that *only* spend independently of candidates and parties. (That includes PACs doing express advocacy as well as 527s.) Under the reigning legal anti-corruption justification for contribution limits, the *constitutional* issue would be, "Can Congress reasonably perceive a threat of corruption, or the appearance of such a threat, in individual contributions to 527s that spend independently of candidates and parties?" Should Congress pass S. 271 or similar 1egislation, it might be contested in federal court, just as BCRA was. And if that happened, the judges would surely, as in the BCRA case, look to real world political analysis for critical evidence and insight concerning the potential existence or appearance of "undue influence." The following findings support our general position in favor of contribution limits:

1) With almost all of the 527s associating themselves with the two major parties and their candidates, and with the great majority of contributions coming from donors giving in the millions, rather than thousands or even tens of thousands of dollars, big 527 donors today are positioned to garner more attention and consideration from parties and candidates than those who give the maximum direct contribution of $2,000-$25,000.

2) Many of the organizations sponsoring 527 groups concurrently sponsor separate Political Action Committees (PACs) that provide or channel hard money contributions to candidates and parties. Twenty-nine of the eighty groups we studied in 2004 had such PACs; examples included the Club for Growth, New Democratic Network, and Emily's List. In these cases, it is unrealistic to assume that candidates and officeholders will regard the sponsor's 527 and its donors as "independent" of and disassociated from the same sponsor's PAC contributions.

3) Individuals who were closely associated with the Democratic and Republican parties and presidential campaigns established, managed and raised money for five 527 groups in 2004. These groups, the largest of which by far were America Coming Together, The Media Fund and Progress for America, accounted for nearly half of total 527 contributions in 2004. We have no reason to believe that the people who worked with these organizations violated the FEC's restrictions with respect either to parties' soliciting soft money or to an independent group's coordinating its political communications with candidates or parties. Nevertheless the organizations' activities and methods were conducive to fostering a nexus of reciprocity between parties, campaigns and many donors. In some way, the major 527s become institutionalized during 2004 as quasi-party surrogates. (Some prominent ones like Progress for America and The Media Fund are currently involved or considering involvement in mobilizing donations to participate in the partisan battle over Social Security reform). Over time, this creates a risk that 527s will re-create a barely one-step-removed version of the party soft money system.

In its forthcoming report, CFI's broad-based Task Force on Financing Presidential Nominations concludes that "The public credibility of hard money limitations on contributions to candidates and parties is diminished by soft money contributions to, and unlimited outlays by, 527 groups in the candidates' behalf." The Task Force therefore sees "no reason why 527 groups spending money to influence federal contests should be wholly exempt from contribution limitations." While this conclusion does not lead CFI to make specific recommendations about the precise limits and definition in the bill now before, it does lead us to endorse the concept of reasonable limits for 527 political committees.

Consequences of 527 Regulation for 501c Groups in Federal Elections

The contribution limits in S. 271 apply to certain 527s that play a role in federal elections. The legislation states it is not to be construed to affect the designation of any 501(c) group as a political committee subject to contribution limits. Nevertheless, leading representatives of certain tax-exempt 501(c)s have expressed concern that greater regulation of 527s could be a harbinger of future efforts to curb their own political activities.

Specifically, 501(c)(4) advocacy groups, 501(c) (5) labor unions and 501(c)(6) trade associations may engage in political activities as long as they do not constitute their primary purpose. Some 501(c) s participated in the 2004 election -- most notably the U,S. Chamber of Commerce, the AFL-CIO, Americans for Job Security and United Seniors' Association. But they did so on a much smaller scale than 527s.

Thus far, both Congress and the Courts have been reluctant to regulate the 501(c)s' subsidiary political activities for fear of intruding upon and discouraging their primary advocacy missions. Generally speaking, these groups constitute less attractive vehicles for electioneering than 527s. Since they cannot make elections their primary or exclusive mission, most of their contributions are used to pay for non-political activities. Individual donations to 501(c)(4) organizations, unlike those to 527s, may be subject to steep gift taxes on the donors. And the 501 (c)s alone are subject to a 35% tax on the lesser of their political expenditures or investment income. These groups have one advantage in comparison with 527s: they do not have to reveal their contributors except when they pay for certain broadcast, cable or satellite "electioneering communications" shortly before federal elections and use funds from individuals.

We do not know whether or not these less efficient vehicles for political giving will become a new focus of unregulated political giving or new public policies should contributions to 527 groups be limited. Much will depend on the willingness of such groups to lend themselves to such uses. In turn, this will partly depend upon the Internal Revenue Service's willingness to be clear in defining what it considers political activities (an area in which it has made recent progress with its 2004 Revenue Ruling regarding political advocacy communications) and to enforcing the related reporting requirements on political expenditures in Form 990 (here there has been no progress). In any case, this issue is not before the Committee at this time, and does not need to be.

I would be pleased to answer your questions.