Building on Reform: A Business Proposal to Strengthen Election Finance

A Statement by the Research and Policy Committee of the Committee for Economic Development
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The Research and Policy Committee does not attempt to pass judgment on any pending specific legislative proposals; its purpose is to urge careful consideration of the objectives set forth in this statement and of the best means of accomplishing those objectives.

Each statement is preceded by extensive discussions, meetings, and exchange of memoranda. The research is undertaken by a subcommittee, assisted by advisors chosen for their competence in the field under study.

The full Research and Policy Committee participates in the drafting of recommendations. Likewise, the trustees on the drafting subcommittee vote to approve or disapprove a policy statement, and they share with the Research and Policy Committee the privilege of submitting individual comments for publication.

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The Committee for Economic Development set out on an uncharted course in 1999 when we released *Investing in the People’s Business: A Business Proposal for Campaign Finance Reform*. The passage of the Bipartisan Campaign Finance Reform Act (BCRA) by Congress, the signing of the law by President Bush, and the upholding of its major tenets by the Supreme Court, were vindication for all of the hard work of CED’s Trustees, both in drafting the report and in defending its findings in Washington and around the country. But the work of the business community is not complete.

BCRA was an important first step, but it was not intended to offer comprehensive reform. Party reliance on soft-money has been curbed. But so-called “527 committees” operated much like shadow parties in 2004, raising and spending hundreds of millions of unregulated dollars in much the same way the Democratic and Republican national committees once did. Despite this avalanche of new spending, the Federal Election Commission (FEC) seemed both unwilling and unable to act to curb these activities—activities that ran contrary to both the spirit and letter of the new law. Also, 2004 was the first presidential primary cycle that saw both eventual nominees opt out of the public funding system. CED continues to support a strong and vibrant public funding system for federal elections, but without additional reforms, the existing system is likely to continue its path toward irrelevancy.

All American citizens — and business communities in particular — need to take an active role in addressing the very real problems that remain in the way we finance elections in the United States. We have taken a major step forward with the BCRA, but we must continue to push for the necessary additional changes.

In this report, CED has presented the next steps that we feel need to be taken.

**Acknowledgements**

This policy statement is a continuation of the hard work of an excellent group of business, academic, and policy leaders (see page VI). We remain grateful for all of the hard work and focus that each put into the development of this report.

Special thanks go to the subcommittee’s co-chairs, Edward A. Kangas, Retired Chairman and CEO of Deloitte Touche Tohmatsu, and George P. Rupp, President of the International Rescue Committee, and the former President of Columbia University, for their sustained dedication, leadership, and insight.

We are also, once again, indebted to Anthony Corrado, the Charles A. Dana Professor of Government at Colby College and a nationally-renowned campaign finance scholar, who served as project director for the sub-committee.

We gratefully acknowledge Carnegie Corporation of New York and the Stewart Family Foundation for their continued support of this project and for CED’s ongoing work in this area.

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In the wake of the 2000 election, Congress passed and the President signed into law the Bipartisan Campaign Reform Act (BCRA), the most important piece of campaign finance legislation since the adoption of the Federal Election Campaign Act more than two decades before. The new law, more commonly known as McCain-Feingold, addressed the two most egregious problems in federal campaigns—party soft money and issue advocacy advertising—by banning party soft money contributions and establishing new restrictions on the sources of funding for broadcast advertisements that feature federal candidates. Soon after it was adopted, the United States Supreme Court reviewed the statute and, in a landmark ruling, upheld the constitutionality of all of the law’s major provisions. The Court found that soft money gifts and campaign advertisements financed with unregulated corporate and labor union contributions were corrupting the political process, and concluded that the act was an appropriate means of addressing this problem.

Congress’s decision to act and the Court’s subsequent ruling represent major victories in support of the cause of campaign finance reform. In the first national election conducted under BCRA, the law has had an immediate and positive effect. Corporate executives and other members of the business community are no longer being “shaken down” by elected officials and party leaders for soft money contributions in ever-increasing amounts. The flow of unregulated soft money gifts from corporations, labor unions, and other donors into party coffers at the behest of sitting officeholders has ended. Instead of raising hundreds of millions of dollars of unregulated contributions, parties have turned their focus to grassroots fundraising, soliciting contributions from hundreds of thousands of small donors—and raising records sums in response. And candidates are raising more money than ever before, in part due to the new law’s higher individual contribution limit. The new rules are achieving their major objectives and making a valuable contribution to the health of our democracy.

The success of BCRA, however, has been tempered by the concerted efforts of some political practitioners, including the federal regulators charged with enforcing the law, who have set out to undermine its effects. The actions of several nonparty political groups, known as 527 organizations, and the inaction of the Federal Election Commission in responding to the practices of these groups, have diminished the progress that has been made and threaten to recreate the soft money system at the national level. Such disregard for the decisions made by Congress and the Court should not be allowed to go unchallenged. The Committee for Economic Development (CED) believes that all appropriate steps must be taken, including reform of the Federal Election Commission, to ensure that these efforts to circumvent the law are not successful and that unregulated money does not, once again, become a principal means of financing campaign activity in federal elections.

CED commends the Congress for passing the Bipartisan Campaign Reform Act. In our 1999 policy statement, Investing in the People’s Business, we advocated reform of the campaign finance system and called for a ban on soft money and stricter regulation of so-called

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1 Senators John McCain, Republican from Arizona, and Russell Feingold, Democrat from Wisconsin, were the chief Senate sponsors of this bill. The chief sponsors of the companion bill in the House were Congressmen Christopher Shays, Republican from Connecticut, and Martin Meehan, Democrat from Massachusetts.
“issue” advertisements that were targeted to elect or defeat specific federal candidates. Having concluded that these reforms were necessary to protect the integrity of the political process and ensure that the monies used in federal campaigns came from regulated sources and were fully disclosed, we supported the provisions in the McCain-Feingold plan. We considered such changes to be among the essential first steps needed to restore public confidence in our representative institutions and revitalize citizen participation in the political process. We continue to hold this view.

Yet, while BCRA has helped to improve the campaign finance system, it was not meant to be a comprehensive attempt at reform. The law principally sought to restore the regulatory framework established by the Federal Election Campaign Act of 1974 (FECA). It was designed to reinforce and increase the efficacy of the contribution limits and disclosure requirements that had been undermined by the growth of soft money. It did little to address other serious flaws that have been clear to most observers for some time, including the deterioration of the presidential public funding system and the lack of adequate and effective enforcement authority.

Since the passage of BCRA, a number of major problems that were obscured in recent elections by the focus on soft money and issue advertising have been brought into high relief. The experience of the 2004 election, taken with the election four years ago, demonstrated that the presidential public funding system is in need of fundamental reform. Prior to 2000, candidates opting out of the public financing system were generally wealthy individuals who financed their own campaigns. But notably in 2000, Governor George W. Bush opted out in a campaign financed by outside contributions. And then in 2004, for the first time, both major party nominees opted out of the system during the primaries, and went on to raise an unprecedented $500 million prior to the party conventions – more than three times the amount raised by the two major party presidential nominees in 2000. This decision by both major candidates to forgo public funds indicated the inadequacies of the presidential system’s current incentives, as well as the impracticality of its current constraints.

The election was also characterized by new concerns about the rising role of certain political organizations, known as “Section 527 groups.” These organizations have been a common feature of the electoral landscape for many years, but in 2004 they took on a new aura—and a new twist. In this election cycle, a number of Section 527 groups were formed specifically for the purpose of using monies raised through unlimited contributions to influence the outcome of the presidential race. These groups, which first emerged on the Democratic side and then later on the Republican side, became a focal point of controversy and public criticism. They raised tens of millions of dollars, mostly from unregulated contributions and multi-million dollar gifts, and then used these funds to pay for television ads and voter mobilization efforts designed to elect or defeat Senator John Kerry or President George W. Bush in the race for the White House. The activities of these committees flouted the law and raised serious questions as to whether they were being conducted in violation of the ban on soft money. At a minimum, their tactics violated the spirit of the law, and demonstrated contempt for the recent actions taken by Congress and the courts. But despite a wave of regulatory proceedings, enforcement actions, and legal challenges, the Federal Election Commission (FEC) failed to take action against these practices until almost the end of the election season, and even then, after deadlocking on proposals for aggressive action, produced a regulation that had little effect on the 527 groups’ activities.

The 527 controversy was but the latest example of a problem that has been obvious for more than a decade: the Federal Election Commission, the agency responsible for administering and enforcing the law, is a toothless watchdog. Reform efforts will not be wholly successful, nor will the objectives of regulation be achieved, without the establishment of a more effective enforcement authority.

Accordingly, we have focused on three major reform issues that now confront the nation: first, how to ensure more effective enforcement of campaign finance law; second, how to best strengthen the ban on soft money with respect to the activities of Section 527 groups; and third, how to best improve the presidential public funding system. This policy statement presents our analyses and recommendations on each of these questions.

As in our previous deliberations, we have considered these issues mindful of certain basic principles that we believe should form the foundation of any system of
campaign finance regulation. These fundamental purposes can be summarized as follows.

- Regulation should protect the political system from corruption and the appearance of corruption.
- Reform should be consistent with constitutional principles.
- Regulation should ensure public accountability and full transparency of campaign financing.
- Regulation should encourage public participation in the political process and promote an informed citizenry.
- Regulation should promote electoral competition.

From our perspective as leaders in the business community, a campaign finance system that is designed to promote the fundamental objectives we have outlined is good for the nation, good for the economy, and good for business. Free, open and honest elections are the cornerstone of democratic government. Promoting an effective system of campaign funding, free of corruption and characterized by broad public participation, is one of the keys to ensuring public confidence and citizen engagement in the political process. A political process that promotes perceptions of corruption, or encourages the public to believe that government policies are open to the highest bidder, is not in accord with the basic tenets of democratic government. Nor is it conducive to a vibrant economy and strong business environment. Such perceptions corrode public confidence in government and business, and pressure business leaders to become more competitive and determined in their campaign giving. The business community wishes to compete in the marketplace, not in a political contributions arms race.

We recognize that reform of the campaign finance system is fraught with difficulties. Regulating political behavior is always a problematic and complex task, especially in such a dynamic area as political finance. But we feel strongly that the good that can result from reform justifies continued and strenuous efforts to improve the ways campaigns are funded.

**Summary of Recommendations**

**Ensuring Effective Enforcement**

Campaign finance rules will achieve their purposes only if they are properly administered and enforced. In this regard, CED sees a pressing need to reform the Federal Election Commission (FEC). In our view, the FEC has failed to carry out its responsibilities with the independence, impartiality, efficacy, and accountability that are essential to effective administration of the law. We therefore urge Congress to consider fundamental reform of this agency.

1. We have concluded that the FEC needs to be restructured and an appointment system established that will attract highly qualified individuals who are willing to make decisions independent of partisan politics and with the public interest in mind. We support an independent regulatory commission that consists of an odd number of members. One of the positions on this commission should be specifically designated for the chair of the commission. Terms should be staggered so that no two members are appointed at the same time. All positions on the commission would be appointed by the President with the advice and consent of the Senate with limited removal for cause. Members of the commission would be appointed for six-year terms. The chair would be appointed for a longer term with no eligibility for reappointment. We believe that such a single-headed agency will improve the agency’s capacity to act, and increase the independence and public credibility of the agency.

2. We also ask Congress to consider measures that would encourage a stronger pool of qualified candidates for nomination to the commission. One idea in this regard is to establish an independent nominating board that would be responsible for reviewing the credentials and qualifications of prospective nominees, and submitting a list of well-qualified candidates to be considered by the President and the Senate.
3. We also find it essential that the commission chair be given the authority and responsibility needed to manage and administer the FEC. One of the keys to attracting strong candidates to this position is to invest it with the power and resources needed to act. The chair should have the authority to establish the agency’s agenda, hire key staff, and set the agency’s budget.

4. Congress should also consider reforms that will provide the agency with greater capacity to enforce the law. Among these, we particularly support granting the FEC the authority to conduct random audits, as well as the authority to apply to federal district court for a temporary restraining order or preliminary injunction to prevent violations of law.

Strengthening the Ban on Soft Money

CED supported a ban on soft money and believes that it has served to reduce the risk of corruption in the political system. The ban also encouraged national party committees to increase their grassroots fundraising efforts, which has greatly expanded the role of individual donors in the financing of national elections. But the effect of the ban has been diminished by the activities of certain 527 groups. In order to strengthen the ban on soft money and further reduce the role of large donors in American politics, we suggest a number of changes.

1. CED firmly believes that political committees involved in federal elections should be bound by federal regulations and finance their activities solely with regulated (hard money) contributions. Congress should establish regulations to require all 527s to register as political committees with the FEC, except for those that raise and spend money solely in connection with nonfederal elections or selection processes.*

2. Congress should adopt regulations that specify that Section 527 groups that broadcast advertisements that promote, support, attack, or oppose a federal candidate are to be financed only with monies raised under federal contribution limits. No corporate or labor union contributions should be used for this purpose.

3. We recommend that Congress codify rules governing the use of monies by Section 527 committees that engage in activities that influence federal and nonfederal elections. Any group that is registered with the FEC and maintains federal and nonfederal campaign accounts to finance such activities as voter registration or turnout drives should be required to pay half of the costs of these activities with hard money contributions.

4. Any nonfederal funds used by a Section 527 committee to pay for activities that require a combination of federal and nonfederal funding should be raised from individual donors and the amount of the contribution that an individual may give should be limited.

Improving Presidential Campaign Finance

The presidential public funding system has been widely accepted by candidates and has proven to be an important source of funding in presidential campaigns. But the program is no longer as effective as it once was. The rules have not been substantially revised during the past thirty years. As a result, the system has not been adapted to accommodate the changes that have taken place in the presidential nomination process in recent decades. Nor has it been modified to acknowledge the changing dynamics and financial demands of presidential campaigns.

The major problem with the current system is that the tradeoff that forms the basis for the program—public money in exchange for agreeing to spending limits—is no longer regarded as an equitable exchange. The relative value of public funding has diminished, while the risks involved in accepting expenditure limits have grown. An increasing number of candidates are therefore concluding that the risks of accepting public money outweigh the benefits. This has placed the future of the system in serious jeopardy.

CED supports voluntary public financing as an alternative for campaign funding. In our earlier policy statement, Investing in the People’s Business, we advo-

*See memorandum by HARRY FREEMAN (page 43)
cated the creation of a voluntary program of public matching funds in congressional elections. Under our proposal, candidates who choose to participate in public financing would receive $2 in public funds for every $1 received in small donations from individuals. We continue to support this idea and encourage Congress to consider it.

Our principal reason for endorsing the public matching fund alternative is our conclusion that this approach to public funding can serve as a powerful incentive for stimulating the participation of small donors in the financing of campaigns. It is a valuable mechanism for increasing citizen participation in the political process and reducing the risk of corruption.

Accordingly, we do not believe that the current presidential public funding system should be allowed to atrophy. We support a broadening of the current public funding benefits and other changes that will encourage greater candidate participation in the program.

1. We urge Congress to revitalize the presidential public funding program by expanding the incentives offered by the matching funds approach used during the presidential primaries. We recommend replacing the current $1-to-$1 public match on small amounts donated by individuals to a multiple dollar match on low-dollar amounts. At a minimum, we support a $2-to-$1 public matching ratio, and believe that a $4-to-$1 matching ratio is the best formula for stimulating small donor participation. This $4-to-$1 public match should be applied to individual contribution in amounts up to $250 per donor. In addition, the amount of a contribution eligible for public matching should be indexed for inflation in order to maintain the value of this incentive.

2. Congress should retain the basic grant approach currently used for public funding in the general election. Under the current law, candidates can receive a publicly funded grant equal to the amount of spending permitted by the law’s general election contribution limit. Candidates should continue to have the option to receive this support. The amount of the grant, however, should be increased substantially to provide candidates with a more realistic level of financing.

3. Eligibility for public funding should continue to be contingent on a candidate’s acceptance of certain restrictions, including limits on campaign spending and restrictions on the use of personal funds. In addition, we believe that eligibility for the general election funding should be contingent on the acceptance of public financing during the primary stage of the presidential selection process. Under the current rules, a candidate may refuse public funding and its accompanying spending limits during the primary phase of the presidential selection process, yet still be eligible to receive public funding in the general election. We have concluded that linking general election funding to the acceptance of public funding during the earlier part of the election would give candidates a powerful incentive to accept public funds at both stages of the process. This approach would ensure high levels of candidate participation in the matching funds program and thus give candidates additional incentive to solicit small contributions.

4. The expenditure ceilings that accompany public funding benefits need to be significantly revised. The amounts candidates are permitted to spend should be substantially increased. The limits must afford candidates a realistic and ample capacity to finance a campaign. Furthermore, we consider the current limits to be unnecessarily complicated. The ceilings should be streamlined and simplified to simply set the total amount a candidate is allowed to spend and give the candidate the autonomy to decide how best to allocate this sum.

5. CED supports measures designed to ensure fair competition between publicly funded candidates and high-spending, privately funded candidates. One of the factors that serves to discourage candidate participation in public funding systems is the strategic disadvantage that can result when facing a privately financed opponent. Because a publicly funded candidate is subject to spending restrictions,
such a candidate may be outspent substantially by an opponent who is not accepting public funds. In order to reduce this disincentive and ensure fairer competition among candidates, **CED supports alternatives that would allow publicly funded candidates to match the spending of privately funded opponents who spend more than the sum allowed by a spending limit.** In a party primary contest, publicly funded candidates should be eligible to receive a grant of supplemental public resources equal to the amount spent by a privately funded opponent in excess of the public spending limit. In competition across the parties, a publicly funded candidate should be allowed to rely on additional party support. Specifically, a party should be allowed to spend funds in support of and in coordination with its prospective nominee to match the spending of a privately funded prospective general election opponent, who is the nominee of the opposing party.

6. **CED has concluded that stronger safeguards are needed to protect against the risk of corruption from contributions to convention host committees.** In recent years, presidential nominating conventions have been financed with private funds in amounts that have been rising substantially. These contributions are received by convention host committees, which are established to help pay a large share of the costs related to the staging of a party convention. Currently, there are no restrictions on host committee contributions and the funds are poorly disclosed. **CED believes that host committee financing offers a means of circumventing the ban on party soft money contributions and poses a risk of corruption or the appearance of corruption in the political process. We therefore support greater regulation of host committee finances. First, we support rules that would prohibit elected officials and officeholders from soliciting unlimited contributions for these committees. Second, we believe that a limit should be placed on the amount a donor may give to a convention host committee. Third, greater transparency and disclosure of host committee finances is needed. These committees** should be required to file regular reports of their receipts and expenditures, and these reports should be made available to the public in a timely manner.
Effective enforcement is an essential component of any regulatory system. Regulations achieve their objectives only when they are implemented and administered in a timely, impartial and consistent manner that provides the regulated community with a clear understanding of the law. This has not been the case with federal campaign finance law.

The Federal Election Commission (FEC), the agency responsible for administering and enforcing campaign finance law, has proven to be a toothless watchdog. It has failed to uphold the laws as intended by Congress and the courts. The commission’s six members have often deadlocked and thus taken no action on crucial enforcement issues. All too often they have adopted permissive rules that undermine the efficacy of campaign finance restrictions. When they have taken action against violators, their decisions have been rendered long after the completion of the election in which the violation took place. As a result, the agency has done little to discourage circumvention of the law or to inspire public confidence in the campaign finance system. No effort to improve political finance will be wholly successful unless this agency is fundamentally reformed.

The failure of the FEC as a regulatory body is evident from recent developments in the campaign finance system. Partisans on both sides of the political aisle have expressed increasing frustration with the FEC and found it necessary to file lawsuits to try to force the agency to fulfill its responsibilities.

In 2004, for example, the congressional sponsors of BCRA filed suit against the FEC to overturn the regulations that were established to implement this new law. The lawmakers argued that the FEC’s regulations had failed to fulfill Congress’s intent in adopting BCRA and created major loopholes in the ban on soft money. Judge Colleen Kollar-Kotelly of the D.C. District Court agreed with this view, and struck down fifteen of the nineteen regulations the FEC had adopted. The court noted in its opinion that some of the FEC regulations “would create an immense loophole that would facilitate the circumvention of the Act’s contribution limits, thereby creating the potential for gross abuse.”

The court further held that one of the regulations ran “completely afoul” of settled law, “thereby undercutting FECA’s statutory purpose of regulating campaign finance and preventing circumvention of campaign finance laws.”

Similarly, in 2004, the FEC failed to clarify the regulations governing nonparty organizations known as Section 527 groups. As we note later in this report, the FEC had numerous opportunities to rule on the issue of 527 groups, but delayed action through most of the election year. Campaign finance reform groups filed a number of lawsuits against the agency to try to enforce the provisions of BCRA and get action on the issues posed by the activities of 527 groups. The Bush campaign filed two suits against the agency, noting that its failure to act on its complaints about Section 527 committees had caused “irreparable harm.” Yet, at the end of the election year, the FEC had still not addressed the central regulatory issues raised by the extensive election activities of these groups.

Rather than being known as an independent body capable of impartial judgment, the FEC has come to be known for its inaction and unwillingness to impose strict rules on members of the community it is supposed to regulate. Its inefficacy in part reflects the weakness of its design. Although ostensibly modeled
on more traditional independent regulatory agencies, the FEC has always been distinctive due to its even number of members and the partisan nature of its membership, which in practice consists of three Democrats and three Republicans, with four votes needed to take any action. Most other independent agencies, including the SEC, FCC, and FTC, have an odd number of members (five). The International Trade Commission has six members, but in that agency, if the Commission deadlocks on an enforcement matter, the investigation still goes forward. That is not the case with the FEC.

The FEC has also been hindered by a lack of autonomy and effective enforcement authority. These weaknesses reflect the agency’s unique position as an entity whose budget and statutory authority is determined by legislators who are subject to its regulations. A stronger, more independent agency is needed if improvements in the campaign finance system are to be accomplished.

A Flawed Appointments Process

The central problem with the FEC stems from the culture that has developed around its appointments process. The FEC consists of six voting members who serve staggered six-year terms of office. Two members are selected every two years. Members are appointed by the President with the advice and consent of the Senate. No more than three commissioners can be members of the same political party. The Commission has no appointed chair—each year, a member is selected on a rotating basis to serve as Chair and another is selected to serve as Vice-Chair. While this formal description of the selection process suggests that FEC members are chosen in a manner similar to that used for other federal regulatory commissions, the actual process is quite different. In practice, the members are selected in a way that gives great deference to the choices made by Congress and party leaders.

Soon after the FEC was established in the 1970s, an “informal” appointments process developed that has served to undermine the agency’s independence. Instead of leaving appointments to the President’s discretion, the parties in Congress began to defer to each other to ensure the selection of the individuals they would like to see appointed to “their” slots on the Commission. When a Democratic commissioner’s term ended, the Democratic leadership was allowed to choose a nominee and the Republicans would support his or her nomination. Similarly, when a Republican seat was open, the Democrats would reciprocate in kind. The President would routinely approve the nominees offered by the Congress, consulting with congressional and party leaders on the appointments to be made. In this way, each party was given leeway to appoint their preferred nominees. In those rare instances where the President has resisted a particular nominee, the Congressional leaders have generally insisted on their choice and succeeded in placing their preferred nominee on the Commission.

This informal practice of deferring to partisan candidates has helped Congress keep the FEC on a short leash and provided a safeguard against appointees who might act too independently if placed on the Commission. The individuals who have been appointed or reappointed to the Commission have typically been chosen from among members of the regulated community, or from among the attorneys who represent the regulated community. Unlike many other independent agencies, the FEC members have been drawn almost exclusively from the ranks of party loyalists. The FEC has thus often acted as a “captured agency.” Rather than enforcing the law in an impartial and effective manner, it has represented the interests of the major political parties or the parties’ candidates that it is supposed to be regulating.

Inadequate Enforcement Authority

When Congress established the FEC, it created an agency with minimal authority and power. The requirement that four of the six commissioners must vote in the affirmative for any action to be taken is but one of the restraints placed on the FEC’s exercise of administrative authority. Unlike many other administrative agencies, the FEC does not possess its own enforcement authority. The Commission cannot make its own findings that a violation has occurred and seek court injunctions to halt illegal activity while it is occurring. The FEC is also prohibited from investigating anonymous complaints, however well-founded they may be, and conducting random audits of campaigns.

Furthermore, what the FEC is allowed to do is encumbered by time-consuming procedural requirements.
When the FEC does conduct an investigation in an enforcement matter, it must undertake an elaborate procedure to determine whether there is “probable cause” (the FEC uses the term “reason to believe”) to suggest that a violation may have occurred. If a violation is found, the FEC can resolve the matter only by reaching a conciliation agreement with the alleged violator or by filing a civil lawsuit against an alleged violator to initiate an enforcement action in court. The court proceedings will ultimately determine whether a violation has occurred and, if so, the civil penalties or sanctions that are to be imposed. This process typically takes years to complete. Consequently, in those cases where conciliation agreements or court-imposed penalties have been reached, these results have come long after the election in which the violation had occurred.

The FEC’s procedural inefficiencies undermine timely and rigorous enforcement of the law, and thus reduce the capacity of the law to deter violations. This problem is exacerbated by Congress’s decision to grant the FEC exclusive civil jurisdiction over the enforcement of federal campaign finance law. Those who bring complaints alleging violations have no recourse other than to seek action from the FEC. The law bars complainants from seeking direct civil enforcement of the law through the courts.

To put the matter simply, the FEC lacks the basic enforcement powers needed to be an effective regulator, and those seeking enforcement of the law have no alternative but to cope with the FEC’s bureaucratic process.

**Recommendations**

CED believes that a new agency is needed to enforce the nation’s campaign finance laws. In our view, the FEC, as currently constituted, is incapable of acting in a manner that provides timely and effective enforcement of the law.

- A regulatory agency must be capable of acting in a manner that provides timely and effective enforcement of the law.
- It must be independent and nonpartisan, and consist of competent and truly objective administrators.
- It must be structured and function in a way that facilitates the objectives of the law and inspires public confidence.
- It must have adequate enforcement authority to encourage compliance with the law and be able to impose strict penalties on violators.
- It must be accountable for its actions, with appropriate external checks on its decisions.

We have concluded that the FEC does not fulfill these basic criteria. Unlike the Federal Reserve Board, the Securities and Exchange Commission, and the Financial Accounting Standards Board, it has not carried out its responsibilities in a manner that demonstrates independence or strength. We believe that the FEC needs to be restructured and an appointment system put into place that will attract highly qualified individuals with professional reputations who are willing to make decisions independent of partisan politics and with the public interest in mind.

As a first step, the FEC should be restructured to consist of an odd number of commissioners. One of the positions should be specifically designated Chair of the Commission, thereby ending the current practice of rotating the position of chair annually among members of the Commission. All positions would be appointed by the President with the advice and consent of the Senate with limited removal for cause. Members of the Commission would be appointed for six-year terms. These terms should be staggered so that no two members would be up for appointment at the same time. The Chair would be appointed to a longer term of office than those of the Commission members, with no eligibility for reappointment.

These changes will increase the agency’s capacity to act. An odd number of members will avoid the 3-to-3 partisan splits that often deadlock agency decision-making. The staggered terms will end the current practice of partisan pairing of appointments (one for the Democrats and one for the Republicans at the time of each
The designation of a chair as single head of the agency will improve the strength of the agency’s leadership. It will also promote stability and consistency in the interpretation of the law, and help remove the office from partisan politics. In addition, a highly visible, publicly credible chair would help to focus attention on the agency and its proceedings, and improve the prospects for effective, fair and accountable enforcement of the law.

We recognize that the creation of an odd-numbered regulatory body poses the possibility of one-party dominance (e.g., three Republicans and two Democrats) that might lead to partisan outcomes. However, we note that this possibility will provide the Senate with a powerful incentive to consider nominees with much greater scrutiny than is the case under the current system. In addition, Senate procedures, particularly the availability of the filibuster, will serve to protect the minority party’s interest and encourage the nomination of individuals who can achieve a certain level of bipartisan support.

This potential problem of partisan imbalance could further be addressed by considering measures that would encourage a stronger pool of qualified candidates. One idea in this regard is to establish an independent nominating commission to vet prospective nominees for commission positions. This nominating commission would be responsible for reviewing the credentials and qualifications of prospective nominees, and submitting a list of well-qualified candidates to be considered by the President and Senate. Our hope is that a nominating board, similar in role to those that have been used to review the qualifications of prospective candidates for judicial positions, would attract individuals of stature and reputation who would consider candidates with concern for the public interest, rather than simply partisan interests.

We also believe that it is essential that the Commission Chair be given the authority and responsibility needed to manage and administer the FEC. One of the keys to attracting strong candidates to this position is to invest it with the power and resources needed to act. The Chair should have the authority to set the commission agenda, hire the top staff, and manage the agency’s budget in the same way as most agency heads.

Congress should also consider reforms that will provide the agency with a greater capacity to enforce the law. Among these, we particularly support the idea of granting the FEC the authority to conduct random audits. The agency should also be given the authority to apply to federal district court for a temporary restraining order or preliminary injunction to prevent violations of law.
When Congress adopted the ban on soft money, some legislators and policy analysts voiced concerns that this step would weaken the role of party organizations in American politics, since it would deprive the national parties of a substantial source of their funding. In both 2000 and 2002, the Democratic and Republican parties received a combined total of close to $500 million from soft money donations, which represented more than 40 percent of their total funds.\(^1\)

The parties have quickly adjusted their strategies and adapted to the new law, shifting their emphasis to concentrate on individual donors, and expanding their outreach to solicit contributions from their broad bases of support among the electorate. As a result, they have had notable success in replacing the amounts previously received from unregulated donations with limited individual contributions, particularly from donors of small amounts.

However, a relatively small group of political operatives and nonparty organizations have reacted to the ban on soft money by searching for ways to circumvent the law. These practitioners have established political committees, commonly known as Section 527 groups, to solicit unregulated contributions for use on activities meant directly to influence the voting in the presidential race. This practice has been encouraged by the Federal Election Commission’s ineffectual response to these actions. The agency has taken no meaningful steps to prevent such groups from using unregulated monies in federal elections, despite a number of opportunities to do so in rulemaking proceedings or in response to regulatory requests. The agency is now facing lawsuits seeking to force regulatory action from complainants representing both sides of the political aisle.

The parties’ response to the ban on soft money is encouraging, and we laud their efforts to increase the participation of average citizens in the financing of political campaigns. But we are convinced that the FEC should bring 527 groups whose major purpose is to influence federal elections under the restrictions of federal law. In our view, the activities of 527 groups that have been specifically designed to channel unlimited contributions into presidential and congressional elections represent a breach of Congress’s purpose in adopting the Bipartisan Campaign Reform Act (BCRA). The efforts of these groups reflect a disdain for the decisions reached by our national political leaders and the judgment issued by the Supreme Court.

This section reviews the changes in party fundraising taking place under BCRA and offers recommendations for strengthening the ban on soft money and its application to nonparty groups.

**Party Fundraising After BCRA**

BCRA banned soft money at the national level by prohibiting federal elected officials and candidates, as well as national party leaders and their agents, from soliciting, raising, spending, transferring, controlling, or directing any funds that are not subject to federal contribution limits. To prevent circumvention of these restrictions, the law prohibits federal officeholders or candidates, and national party leaders or party staffs, from raising soft money for other organizations that conduct activities related to federal elections. For example, federal elected officials and national party committees, as well as state and local party committees, are specifically barred from soliciting funds or otherwise financially supporting tax-exempt organizations that
are engaged in activities such as voter registration and mobilization programs that are carried out in connection with federal elections. Similarly, they are banned from raising soft money for certain organizations that operate under Section 527 of the Internal Revenue Code. Put simply, federal officeholders, candidates, party officials, and their agents are restricted to raising money that is permitted under federal contribution limits. They may solicit and use only “hard money” for their political activities.¹

CED supported a ban on soft money because we concluded that unregulated contributions, especially when solicited by sitting officeholders, increased the risk of corruption in government. That the soft money ban has helped to reduce the potential for corruption can be discerned from the changes already taking place. Members of Congress and national party officials are no longer pressuring major corporations, labor unions, and individuals to give large contributions to party committees or offering preferential treatment in exchange for such gifts. Million dollar contributions to national party committees have become a thing of the past. The White House is no longer being used as a reception facility for coffee klatches and other special events designed to provide special access for soft money donors. Moreover, for the first time since 1980, all of the monies raised by national party committees have come from limited contributions. In these ways, BCRA is altering the fundraising environment in Washington and enhancing the integrity of the political process.

Even before BCRA went into effect, the national party committees”¹¹ had begun to reorient their fundraising approaches to conform to the new law. Both parties invested heavily in small donor solicitation programs. They also developed programs to capitalize on the higher individual contribution limits contained in BCRA, which increased the amount an individual may give to a national party committee from $20,000 per year to $25,000 per year, with a maximum limit on the total amount an individual could contribute to party committees of up to $57,500 every two years.

The national parties were highly successful in adjusting to the new rules. Spurred by the highly competitive presidential race and a deep partisan divide in public attitudes, party fundraising reached new heights. In fact, the national party committees raised more money in hard dollars alone in the 2004 election cycle than they raised in hard and soft money combined in previous cycles. Moreover, they did so by adding substantial numbers of new donors to their fundraising rolls.

By the end of November 2004, the national party committees had raised more than $1.2 billion, or about $150 million more than they had raised in hard and soft money combined at a comparable point in the 2000 election cycle. In other words, they replaced all of the soft money they received in 2000 with new hard dollar donations.

Although most observers predicted that the Republicans would have a dominant financial advantage over the Democrats in the hard money world mandated by BCRA, the Democrats were more financially competitive in 2004 than they had been in any election since the adoption of the FECA in the early 1970s. By the end of November, the Republicans had collected $632 million in hard money contributions, as compared to $580 million for the Democrats. In comparison, the Republicans raised $611 million in hard and soft money combined at a comparable point in 2000, while the Democrats raised $458 million. Thus, with a month of fundraising left to go, the Democrats had increased their receipts by more than $130 million as compared to four years ago, while the Republicans increased their receipts by about $20 million. Moreover, the DNC raised more money than the RNC for the first time in recent memory.

¹ The law does allow some exceptions for specific circumstances. For example, a federal elected official who is seeking state or local office (e.g., a member of Congress running for governor) may raise money permitted under state law, including contributions larger than those allowed under federal rules, so long as allowed by state law and so long as these funds are used solely for activities that refer solely to a state or local candidacy. An exemption also allows a federal candidate or officeholder to raise money from individuals, but not corporations or labor unions, in amounts up to $20,000 for certain tax-exempt charitable organizations, provided that these organizations do not conduct voter registration and turnout programs as their principal purpose.

¹¹ There are six national party committees that have been established by the Democratic and Republican parties. Each party has a National, Senate, and House committee. These are: Democratic National Committee (DNC), Republican National Committee (RNC), Democratic Senatorial Campaign Committee (DSCC), National Republican Senatorial Committee (NRSC), Democratic Congressional Campaign Committee (DCCC), and National Republican Congressional Committee (NRCC).
Thus, contrary to fears expressed by some, BCRA has not proved to be a tool of partisan advantage. Both parties have demonstrated considerable financial strength in the aftermath of a ban on soft money. Both parties amassed ample resources to wage competitive campaigns on behalf of their candidates. They were able to do so largely as a result of their success in recruiting and involving hundreds of thousands of new small donors in the political process.

Party fundraising in 2004 was characterized by a dramatic surge in the number of party donors. While this expansion of participation was in part a reflection of the competition and level of voter interest in this year’s election, it also reflected party efforts to reach out to new donors. By stripping parties of their ability to rely on unlimited contributions from a very small pool of donors, BCRA gave parties a strong incentive to expand their bases of financial support and place greater emphasis on the recruitment of small donors. Both par-

### Table 1

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<tr>
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<th>2000</th>
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<th>2004</th>
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<td>Soft</td>
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</table>

Source: Federal Election Commission data. The figures for 2000 are through year end. The figures for 2004 are through December 7, 2004. Figures include adjustments for transfers among committees.

### Figure 1
National Party Committee Fundraising: 2000 and 2004 Cycles

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ties responded in the way supporters of the ban hoped they would—and with impressive results.

Republicans and Democrats alike experienced notable success in broadening their grass-roots support and numbers of small donors. The Republican National Committee added more than one million new contributors to its rolls by the start of the election year. By the spring of 2004, the Democratic National Committee had recruited more than 800,000 new small donors through direct mail alone, tripling its number of direct mail givers from 400,000 in 2001 to more than 1.2 million. By the end of the election cycle, the number of direct mail donors had surged to 2.7 million, an almost seven-fold increase as compared to 2000. Similarly, the National Republican Senatorial and Congressional Committees have recruited a combined total of more than 700,000 new contributors. The Democratic Congressional Campaign Committee has added more than 230,000 donors, more than double the 100,000 new donors it recruited in the 2002 cycle. And, although exact numbers have not been released, the Democratic Senatorial Campaign Committee reports that the breadth of its donor base has “increased significantly.”

The parties are replacing their soft money receipts with hard money from millions of new donors. More important, most of these donors are individuals who are giving small amounts. The role of small donors has been enhanced by the ban on soft money and, by participating in great numbers, these individuals are making a major contribution to the financial life of the parties. After the first eighteen months of the 2004 cycle, small donors making contributions of $200 or less had provided the national party committees with almost $272 million in funding. This total was more than twice the $135 million that the parties had received from small givers during the comparable period four years ago.

The parties have adapted well to the ban on soft money and have done so in a way that offers the prospects of continued fundraising strength in the future. They are now raising money in a manner that serves to promote citizen involvement and elevate the role of small donors. The ban on soft money is making a difference.

The 527 Controversy

The major issue that has emerged in the aftermath of BCRA concerns the role of so-called “527 organizations” and their use of unregulated political contributions in federal elections. The activities of these organizations were a focal point of debate in 2004, particularly with respect to the presidential election, and highlighted some of the key issues that need to be addressed in order to strengthen the ban on soft money in federal campaigns.

The attention given to 527 committees led to a common misimpression that all of these committees represent some form of structural innovation spurred by BCRA. Most 527s are not new, and the controversy in 2004 was sparked by the activities of a relatively small group of committees, most of which were formed in anticipation of the 2004 election with a primary objective of influencing the outcome of the presidential race, and most of which relied on a relatively small group of donors for a sizable share of their funding.

Section 527 groups are political committees that are collectively identified on the basis of the provision of the Internal Revenue Code under which they are organized. Section 527 of the Code provides tax-advantaged status to certain types of political committees that are formed for the primary purpose of influencing federal, state or local elections. Committees with 527 status pay no tax on the contributions they receive or expenditures they make. Further, because these organizations are exempt from federal taxation, they may receive gifts of more than $11,000 without being subject to the federal gift tax.

There are more than 20,000 political committees registered with the Internal Revenue Service under Section 527. These encompass various types of political organizations, including candidate campaign committees, party committees, political action committees, and some nonparty political organizations. Some of these committees are active only in federal elections, some only in state or local elections, and some in both.

The provisions of this part of the tax code were originally intended to cover federal political committees that are registered with and report to the FEC, or state and local committees that register and report to state campaign finance authorities. Years before the pas-
sage of BCRA, in response to court rulings that made a distinction between “express advocacy” and “issue advocacy,” the IRS incorporated this distinction into its interpretation of Section 527, and recognized the possibility that an organization could be engaged in activities that “seek to influence the outcome of federal elections” without engaging in express advocacy and thus being subject to FECA restrictions or disclosure requirements. This understanding opened the door to the possibility that a political committee focused on federal elections could be organized under Section 527, but, by limiting its activities to “issue advocacy” communications, claim to be exempt from the requirement to disclose its finances to the FEC.

Section 527 first became a matter of public attention in the 2000 Republican presidential primaries, when an independent political entity unaffiliated with a candidate or party committee, called Republicans for Clean Air, gained national news coverage for the controversial advertisements it broadcast against Senator John McCain in a number of key primary contests. When the television ads were first broadcast, little was known about the group or the sources of its funding. Subsequent media investigations determined that the committee was formed by a couple of supporters of Governor George W. Bush, who were seeking to help Governor Bush after his loss to Senator McCain in the New Hampshire primary. Republicans for Clean Air spent an estimated $2.5 million on ads critical of Senator McCain in an effort to help Governor Bush win the Republican presidential nomination.

Republicans for Clean Air and similar groups became a major source of controversy early in the 2000 election because their financial activities were not publicly disclosed. The Internal Revenue Code made no provision for disclosure, because it was assumed that the committees operating under Section 527 would already be disclosing their finances with the FEC or some other established reporting agency. The groups that avoided registering with the FEC claimed that they were involved in “issue advocacy,” not “express advocacy,” and thus were not engaged in federal election activity that required registration with the FEC or public disclosure of their finances. Congress quickly addressed this problem, passing a bill in June 2000 that required Section 527 groups to file disclosure reports with the IRS. The law required all Section 527 groups with annual receipts of more than $25,000 to disclose all contributors of $200 or more per annum and all expenditures of more than $500 to any one entity per annum.10

Section 527 organizations once again became a source of controversy in 2004. The dispute began in response to the activities of a relatively small number of primarily Democratic-leaning organizations that were formed after the adoption of BCRA specifically to participate in the presidential race. The most prominent of these groups included the Media Fund, run by former Clinton aide Harold Ickes, which was organized to mount advertising campaigns targeted at defeating President Bush; Americans Coming Together (ACT), led by Ellen Malcolm, who formed the progressive women’s PAC, EMILY’s List, and Steve Rosenthal, former political director of the AFL-CIO, which focused on registering and turning out voters supportive of “progressive” issues; and Joint Victory Campaign 2004, a joint fundraising committee affiliated with the Media Fund, ACT and other progressive groups. Another organization, MoveOn.org, an Internet-based political group that was formed during the Clinton impeachment trial, was also among the most active groups, financing a number of television and newspaper advertisements in the early stages of the election.

These pro-Democratic groups were established to raise tens of millions of dollars to spend on the presidential race. They sought to compensate for what was expected to be a major resource gap between the prospective party nominees. At the time these committees were formed, most practitioners assumed that President Bush would refuse public funds during the primaries, as he did in 2000, and thus be free to raise an anticipated $200 million for his uncontested re-nomination campaign. The prospective Democratic nominee was expected to accept public funds and thus be limited to spending no more than $50 million prior to the Democratic national convention. In addition, given the ban on soft money, it was expected that the Republican Party—as it had in the past—would raise substantially more money than the Democrats. The 527 entities hoped to make up some of the anticipated disparity by spending millions of dollars on television advertisements against President Bush and by financing voter registration and mobilization efforts to turn out “progressive” voters who were likely to favor Democratic candidates.
These committees aggressively pursued their objectives and began to amass substantial sums of money by relying on large individual contributions and some labor union support. By the end of March, less than a month after Senator John Kerry had wrapped up the Democratic presidential nomination, the top new Democratic groups—Media Fund, Americans Coming Together, MoveOn.org, Joint Victory Committee 2004, and America Votes—had raised more than $47 million. Club for Growth, a leading conservative group, had taken in more than $5 million. More important, the pro-Democratic groups had by this time already spent more than $20 million on advertising critical of President Bush and had pledged to raise more than $200 million to defeat the President.

These early efforts in the presidential race immediately generated a controversy over whether the 527 groups involved in federal elections should be required to register with the FEC and be subject to federal contribution restrictions. In February 2004, the FEC issued an advisory opinion in response to a request from Americans for a Better Country, a political committee registered with the FEC. In that opinion, the FEC ruled that a 527 registered with the FEC as a federal political committee is subject to the contribution limits and disclosure requirements of federal law, and, citing the provisions of BCRA, further noted that such a committee must finance any public communications that “promote, support, attack or oppose” a federal candidate with hard money. The opinion also noted that any voter registration or mobilization activities that include messages urging voters to support a specific federal candidate must be financed with hard money. The Commission, however, did not determine at what point or under what circumstances a 527 committee that is not registered with the FEC is required to register as a federal committee and comply with the restrictions of the law.

The FEC’s opinion had no effect in prohibiting the use of unregulated funds by the Media Fund and other 527s involved in federal elections. The decision applied to a 527 already registered with the FEC as a federal political committee. But the Media Fund and the other 527s set up to participate in the presidential race had not registered with the FEC as federal political committees, even though their purpose was to conduct activities in federal elections. Thus, the central issue in the 527 controversy is this: when is any political committee required to register with the FEC and abide by the contribution limits, disclosure requirements, and other restrictions imposed on political committees by federal law? This is an issue that gained renewed prominence in 2004, but is not new. Rather, it is one that the FEC has failed to address for almost thirty years.

Ever since the adoption of FECA, federal law has defined a “political committee” as a committee that has as its “major purpose” the influencing of elections, and that spends at least $1,000 in connection with federal elections. The Supreme Court in its 1976 Buckley decision construed this definition to apply to organizations that are “under the control of a candidate or the major purpose of which is the nomination or election of a candidate.” The FEC, however, has never effectively implemented this requirement. The Commission has never established standards for implementing the “major purpose” test or defined what the requirement means. The Commission did initiate a rulemaking procedure in 2001 to define this standard and develop regulations for determining when a committee should have to register and abide by federal rules, but it produced no result.

In May 2004, the Commission faced the issue again in a rulemaking procedure triggered by the soft money activities of Section 527 groups. By this time, the Congressional sponsors of BCRA, the Bush presidential campaign, the Republican National Committee, and others had filed a variety of formal legal complaints with the FEC against the activities of the pro-Democratic groups involved in the presidential campaign. The Commission, however, again failed to offer a solution, defeating on a four-to-two vote a proposal offer by two of the commissioners that was designed to bring clarity to the law and place regulations on 527 financing in federal elections. Instead, the agency decided to delay action until August. At that time, the agency established allocation rules that specified that certain 527 activities, including certain types of voter mobilization programs, must be partially funded with hard money. But the matter of standards for determining a group’s status as a federal political committee subject to federal contribution limits was left in limbo.
The FEC’s failure to bring clarity to the law served to encourage 527 activity. Groups aligned with progressive or Democratic causes proceeded to implement their strategies without pause. Groups associated with conservative or pro-Republican causes, whose principal objective was to defeat Senator John Kerry, quickly began to organize and seek out large contributors of their own. The most prominent among these pro-Republican committees was Progress for America Voter Fund (PFA), a group led by two pro-Bush political consultants, and Swift Boat Veterans for Truth (later Swift Boat Veterans and POWs for Truth), which was organized by a group of Vietnam veterans opposed to Senator Kerry. These pro-Republican groups quickly launched aggressive fundraising efforts of their own, taking in almost $63 million in the third quarter alone, as compared to $36 million by their Democratic counterparts.13

By the end of November, there were an estimated 97 Section 527 groups whose activities focused on federal elections, 69 of which had been formed after the adoption of BCRA.14 Most of these committees, 68 in all, were Democratic-oriented groups. These 97 groups reported total expenditures of $323.4 million. In addition, 527 committees associated with the 12 major labor organizations reported expenditures of $100 million. Democratic-oriented committees spent about $226 million, or more than twice the $96.7 million disclosed by Republican-oriented groups. If the labor spending is added to these totals, the spending advantage held by Democratic-oriented groups was close to three-to-one.

Most of this $323 million in spending, about $245 million or 75 percent of the total, was due to the efforts of eight groups. On the Democratic side, ACT spent about $76 million; Media Fund, $54 million; MoveOn.org, $21 million; and the New Democrat Network, $12 million. On the Republican side, PFA spent $35 million; Swift Boat Vets (SBVT), $22 million; and Club for Growth and Club for Growth.net, a combined $13 million. Moreover, a large share of the funding came from individuals who gave substantial sums to these organizations. According to data compiled by the Center for Responsive Politics based on IRS filings, the top twenty-five individual donors to federal 527 groups contributed a total of more than $146 million to these committees, which represented about 44 percent of their total funds. Almost all of these gifts were made to the small number of groups that were most active in the presidential race. An analysis conducted by the Washington Post in October 2004 estimated that eight out of every ten dollars received by the leading pro-Democratic groups, and nine out of every ten dollars received by the leading pro-Republican groups, came from donations of $250,000 or more.15

### Table 2

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<th>Financials of Selected Section 527</th>
<th>Receipts* ($ millions)</th>
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<td><strong>Republican-Oriented Committees</strong></td>
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<td>Club for Growth.net</td>
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Source: Based on data compiled by PoliticalMoneyLine and the Center for Responsive Politics from IRS filings as of December 8, 2004.

*Under IRS rules, 527 committees only need to report contributions of $200 or more and expenditures of $500 or more. Due to these disclosure rules, groups that receive large numbers of small contributions, such as MoveOn.org, have a significant share of their receipts that are not reported.

This funding allowed these 527 groups to play an active role in the presidential race. For example, by mid-October, the Media Fund had spent more than $43 million on television and radio advertisements.16 ACT was reporting that its more than 4,000 employees had registered 450,000 voters, and that it planned to organize 45,000 persons to turn out voters on Election Day in presidential battleground states.17 On the pro-Republican side, PFA had already spent at least $7 million on anti-Kerry ads in swing states, and planned an additional $12 million in television advertising during the final two weeks of the campaign.18 From mid-August through early October, Swift Boat Veterans for Truth...
spent more than $5 million on ads that drew substantial media attention due to their attacks on Senator Kerry’s honesty and Vietnam War record.  

**Recommendations**

The role of 527s in the 2004 election demonstrates that the FEC’s failure to fulfill its regulatory responsibilities is promoting the re-creation of a soft money system in federal elections. This development is contrary to the spirit of the recent legislation and the spirit of the Supreme Court’s rulings on campaign finance. CED does not wish to see the return of a soft money arms race. We firmly believe that federal campaign activities should be financed with monies that are regulated by federal law and fully disclosed. We urge Congress to take swift action to address the federal regulatory issues raised by Section 527 groups to ensure that this loophole does not become a vehicle for undermining the progress being made under BCRA.

CED applauds the companies and business leaders who are resisting efforts from political fundraisers to contribute to those 527 groups that are designed merely to circumvent the ban on soft money. As the Wall Street Journal reported in September 2004, corporations and major companies have not been a significant source of funding for the 527s active in the presidential campaign. Similarly, an analysis conducted in mid-October by PoliticalMoneyLine, a nonpartisan disclosure organization, found no Fortune 500 companies or major publicly held corporations among the top donors to these groups. The refusal of the business community to be drawn into the tactics of these 527s demonstrates a desire to adhere to the law and stands as further testament to our desire to compete in the marketplace, rather than the political arena. We encourage business leaders to continue these voluntary actions to prevent the resurrection of the soft money system.

We firmly believe that political committees involved in federal elections should be bound by federal regulations and finance their activities solely with hard money contributions. We therefore urge Congress to establish regulations that would require all 527s to register as political committees with the FEC, except for those that raise and spend money solely in connection with nonfederal elections or selection processes, including candidate elections, ballot initiatives, and the nomination or confirmation of non-elected officeholders. The regulations should require that Section 527 groups that broadcast advertisements that promote, support, attack, or oppose a federal candidate are financed only with monies raised under federal contribution limits. No corporate or labor union contributions should be allowed for this purpose. This approach will serve to strengthen the ban on soft money and place nonparty groups under similar restrictions to those now placed on party advertisements. In order to avoid the possibility of placing an unnecessary regulatory burden on small grass-roots groups, the registration requirement should be applied only to political committees that meet an established financial threshold that serves as a trigger for registration. The current reporting threshold of $25,000 contained in the IRS Section 527 disclosure rules would be a reasonable level for this purpose.

We further recommend that the Congress codify rules governing the use of monies by Section 527 committees that engage in activities that influence federal and nonfederal elections. Any group that is registered with the FEC and maintains federal and nonfederal accounts to finance such activities as voter registration programs or voter turnout drives should be required to pay 50 percent of the costs of such activities with hard money contributions, if a federal candidate is mentioned in these efforts. In addition, we believe strongly that any nonfederal monies raised to pay for activities that require joint federal/nonfederal funding should be limited. These funds should only come from individual donors and a limit should be placed on the amount an individual is allowed to donate.

The party soft money system was established as a result of FEC decisions that allowed party committees to raise unlimited contributions for what were originally a defined set of restricted purposes. The FEC’s actions eventually led to the development of a campaign finance system characterized by hundreds of millions of dollars in unregulated gifts that had a corruptive effect on the political system, made a mockery of the law, and alienated many citizens from their own government. In 2002, a bold step was taken to address these problems. Now, Congress should not allow the FEC to make the same mistake again.
In 1974, Congress established a voluntary system of public financing in presidential elections. This system was designed to reduce the risk of corruption in the political process by offering candidates the option of public money as a source of funding for their campaigns. It also sought to expand citizen participation in campaign financing by increasing the role of small contributors, while reducing the relative importance of large donations. At the time public financing was adopted, it was heralded as the most innovative change in federal campaign finance law in American history. It remains so to this day.

Since the first publicly financed election in 1976, this optional program has been well-received by presidential candidates. Almost all of the major contenders who have sought the Oval Office, whether a sitting President or a challenger, Republican or Democrat, have used public funds to help finance their campaigns. Every major party presidential nominee has chosen to finance a general election campaign with public resources, and both major parties have used public funds to help pay for their national nominating conventions.

While public funding has been a popular and important source of presidential campaign funding, the program is no longer as effective as it once was. The rules have not been revised in thirty years. The system has not been adapted to accommodate the dramatic changes that have taken place in the presidential nomination process in recent decades. Nor has it been modified to acknowledge the changing dynamics and financial demands of presidential campaigns. Consequently, candidates have found it increasingly difficult to conform to the public funding rules—particularly the outdated caps on spending attached to the acceptance of public money—and still meet the financial and strategic demands of a modern campaign.

The strategic problems caused by the current rules are encouraging candidates, especially those most likely to win a party’s nomination, to concentrate on large donors or opt out of the program altogether, at least during the primary stage of the election. In 2000, Governor George W. Bush became the first major party nominee to win his party’s presidential nomination without accepting public matching funds and the spending limits that accompany this decision. In 2004, both of the major party nominees, President George W. Bush and Senator John Kerry, decided not to take public money during the primaries, as did Governor Howard Dean, the early frontrunner in the Democratic race. Their decisions will undoubtedly encourage future candidates to follow their lead.

The major problem with the current system is that the tradeoff that forms the basis for the program—public money in exchange for agreeing to spending limits—is no longer regarded as an equitable exchange. The relative value of public funding has diminished, while the risks involved in accepting expenditure limits have grown. An increasing number of candidates are therefore concluding that the risks of accepting public money outweigh the benefits. This has placed the future of the system in serious jeopardy.

Public Funding in Presidential Elections

In the eight presidential elections from 1976 through 2004, candidates and party committees have received more than $1.3 billion in public financing. The pro-
gram has distributed about $342 million to candidates seeking party presidential nominations, $152 million to party committees for convention funding, and $839 million to general election contenders. As these figures suggest, public resources have been a major source of campaign funding.

Candidates can qualify to receive public funds at each stage of the presidential election process. The monies to pay for this benefit come from a tax-checkoff option on individual federal income tax forms, which allows taxpayers to designate a deposit to the Presidential Election Campaign Fund, a separate account administered by the Department of the Treasury, from which all public funding payments are made. Individual taxpayers are allowed to contribute $3 to this account, or $6 if filing jointly. The amount of the checkoff does not affect the amount of an individual’s tax liability or tax refund.

In primary elections, candidates who choose to accept public funding are eligible to receive “matching” payments on low-dollar contributions made by individuals. Under the terms of the program, candidates who meet certain eligibility requirements can receive public money on a dollar-for-dollar basis on the first $250 given by each individual donor. So, for example, an individual’s contribution of $50 is matched with $50 in public money, thus generating $100 in campaign funds. If an individual donates more than $250, only the first $250 is matched. An individual contribution of $2,000 would generate $250 in matching funds, providing a candidate with a total of $2,250 in campaign money. The program thus offers an incentive to candidates to pursue small donations and increases the relative importance of small donors in presidential campaigns. It encourages candidates to expand their bases of support and promote citizen involvement in the electoral process.

In the general election, candidates are eligible to receive full public funding. Each of the major party candidates may choose to accept a public grant that provides the total amount a publicly funded candidate is allowed to spend. This approach frees a candidate from the demands of campaign fundraising and diminishes the potential for corruption by replacing private sources of funding with public resources. In 1974, the amount of the general election grant was set at $20 million, with adjustments for inflation. By 2004, this amount had increased to $74.6 million. Minor party or independent candidates can qualify for a proportionate share of this subsidy by winning at least 5 percent of the vote in the previous presidential race.

Presidential candidates who participate in the public funding program are subject to the same financial disclosure requirements and contribution limits as those applied to other federal candidates. Prior to 2004, a presidential candidate may receive a maximum of $1,000 per election from an individual donor and $5,000 per election from a PAC. In 2002, the Bipartisan Campaign Reform Act increased the individual limit to $2,000, with adjustments for inflation, and kept the $5,000 limit on PACs. The 2004 election is the first presidential race conducted under these new limits.

To be eligible to receive public funds, a candidate must agree to limit personal spending on his or her own campaign to $50,000 and agree to abide by campaign spending limits. Publicly funded general election candidates are also prohibited from raising any additional private contributions for their campaigns, with the exception of monies used to pay for the legal and accounting expenses incurred to comply with the law. Any funds raised for legal and accounting costs must come from limited contributions.

\[\text{The amount of the tax checkoff was initially}$1$ for individual filers and $2$ for married couples filing jointly. In 1993, Congress raised the amount to $3$ for individuals and $6$ for joint filers.\]
The presidential public financing system was established by the Federal Election Campaign Act of 1974. The law created a voluntary program of partial public funding in primary elections and full public funding in general elections, as well as a subsidy for national party committees for the purposes of financing national nominating conventions. The law set forth detailed provisions that determined the eligibility requirements to qualify for public funding and the terms of the program.

**Primary Election**

- **Eligibility:** In the prenomination or primary phase of the election, candidates are eligible for public matching funds if they fulfill certain fundraising requirements and agree to certain financial restrictions. To qualify, a candidate must raise at least $5,000 in contributions of $250 or less in at least twenty states. A candidate must also agree to abide by aggregate and state-by-state spending ceilings, and agree to limit personal spending in support of a campaign to no more than $50,000. Once these eligibility requirements are met, public funds are granted on a $1-to-$1 basis on the first $250 contributed by each individual donor. The maximum amount of the subsidy a candidate may receive is a sum equal to one-half of the base primary spending limit.

- **Payments:** Only contributions received by eligible candidates after January 1 of the year before the election can be matched with public funds. The first payments to candidates are made on January 1 of the election year. FEC regulations state that a candidate who fails to garner 10 percent of the vote in two consecutive primaries is no longer eligible to receive matching funds. This rule was adopted to ensure that the availability of matching funds does not encourage a candidate who is unlikely to win to remain in the race. The FEC has interpreted this regulation to mean two consecutive primaries in which a candidate is entered on the ballot, rather than two consecutive primaries as determined by the primary calendar. To restore eligibility for funding, a candidate needs to garner 20 percent of the vote in a subsequent primary.

- **Minor Party or Independent Candidates:** Candidates who compete in parties that do not hold state primaries or caucuses, such as the Green Party and Natural Law Party in 2000, may qualify for matching funds by meeting the basic eligibility requirements.

- **Aggregate Spending Limit:** The law imposes a ceiling on the aggregate amount a publicly financed candidate may spend. This aggregate ceiling, which limits the total amount a candidate may spend, is based on a number of component parts. The aggregate spending cap was set in 1974 at a base limit of $10 million, plus an additional 20 percent for exempted fundraising costs, with adjustments for inflation. This fundraising “exemption,” which is simply an added amount for fundraising expenditures, was included in the law to recognize the higher costs that would be incurred to raise funds from the smaller contributions required by contribution limits and encouraged by the matching fund incentives. There are also exemptions for legal and accounting expenses incurred to comply with the law. In 2000, the FEC adopted regulations that limit these compliance costs to 15 percent of the base limit while the campaign is still active. Thereafter, once a campaign is over and winding down, all payments for salaries and overhead are considered exempt and do not count against the aggregate limit.

In 1976, a candidate was allowed to spend a total of $13.1 million on a presidential nomination campaign. By 2000, this overall ceiling had increased to about $45.6 million, with the new rules on compliance costs included. In 2004, the overall limit is $44.8 million, or almost $50 million when compliance funds are included.

- **State Spending Limits:** In addition to the aggregate ceiling, candidates must also abide by state-by-state spending limits. The amount a candidate may spend in each state is based on a formula established in 1974 that allows the higher amount of 16 cents times a state’s
voting-age-population, plus adjustments for inflation, or a minimum of $200,000, adjusted for inflation. In 2004, these state limits ranged from a minimum of $746,200 in a low population state such as New Hampshire to $15.6 million in California. Over the years, FEC regulations designed to ease the accounting burdens on candidates have exempted a variety of campaign activities or expenditures from the accounting associated with state ceilings, so long as they are included in the aggregate spending limit.

**General Election**

- A candidate who does not accept public financing in the primary election may choose public financing in the general election, so long as that candidate meets the qualifying requirements and conditions.

- **Major Party Candidates:** Major party nominees (defined in the law as a nominee of a party that received at least 25 percent of the vote in the previous election) can receive a full public grant equal to the total amount of the general election spending limit. The amount of this grant was set in 1974 at $20 million, plus adjustments for inflation. By 2004, this grant had grown to $74.6 million. As a condition of receiving this funding, candidates must agree that they will not raise or spend additional private contributions on their campaigns, with the exception of monies to finance general election legal, accounting and compliance costs. These compliance funds are subject to federal contributions of $2,000 per individual and $5,000 per PAC.

- **Non-Major Party Candidates:** A non-major party candidate or independent candidate can receive a proportionate share of the amount provided by the general election grant based on the share of the vote the party or candidate received in the previous presidential election, as compared to the average vote received by the major parties. To qualify, such a candidate or party has to receive at least five percent of the national vote. For example, in 1996, Ross Perot, the Reform Party nominee, received about $29.1 million in general election public fund-

- **Newly Qualified Candidates:** New parties or candidates can also qualify for post-election funding. As in the case of non-major party candidates, these candidates can receive a proportionate share of the general election grant, so long as the presidential nominee of the party receives at least five percent of the national vote. In 1980, John Anderson of the National Unity Party garnered more than five percent of the vote and was granted $4.2 million in public money after the election to help defray the costs of his presidential campaign.

**Convention Funding**

- **Major Parties:** The national party committees of the major parties have the option of accepting a public grant to finance their respective national presidential nominating conventions. Each major party can receive a grant that was originally set in 1974 at $2 million, plus adjustments for inflation, and subsequently increased to a base amount of $3 million in 1979 and $4 million in 1984. With adjustments for inflation, the total amount of this grant reached $14.9 million in 2004.

- **Non-Major Parties:** A non-major party whose presidential nominee received at least five percent of the vote in the previous presidential election can qualify for a proportionate convention subsidy. As with general election funding, the amount is based on the share of the vote received by the candidate as compared to the average vote received by the major parties. In 2000, the Reform Party qualified for $2.5 million in convention financing based on Ross Perot’s share of the vote in 1996.
The Benefits of Matching Funds

Every major party presidential nominee since 1976, including President George W. Bush and Senator John Kerry in 2004, has accepted public financing in the general election. Until recently, so did every serious contender for the major parties' nominations.

Republicans and Democrats alike have relied on public funds as a means of financing their campaigns, with a greater number of Democrats receiving primary matching funds due to the greater number of contested Democratic nomination contests in the past thirty years. Even so, Democratic candidates and their national party committee have received about $646 million in public support since 1976, as compared to $628 million for Republican candidates and their national party committee. Relatively few of the non-major party candidates who have run for president have qualified for public support. Those who have received a total of only $59 million from the program. Two-thirds of this amount, approximately $42 million, represents the partial general election funding given to the Reform Party nominee in 1996 and 2000 as a result of the support garnered by Ross Perot in the 1992 and 1996 elections.

Presidential aspirants have chosen to participate in the matching program because it is an effective means of generating campaign money and enhancing the value of small contributions. Candidates who emphasize the solicitation of small contributions, or who lack a developed base of large donor support, can rely on matching funds as leverage to promote donor participation and garner the resources needed to wage a viable campaign. Most presidential contenders, including many who did not win the party's nomination, have recognized this benefit.

In the first few publicly funded elections, winning candidates capitalized on the availability of matching funds, engaging large numbers of small donors in their campaigns and raising a substantial portion of their campaign monies from low-dollar contributions. In 1976, 40 percent of the monies President Gerald Ford received from individuals came from donors of $200 or less. Similarly, 38 percent of the contributions received by the eventual Democratic nominee, Jimmy Carter, came from small donors. In 1980 and 1984, Ronald Reagan raised half—47 percent and 46 percent respectively—of his individual contributions in the form of small donations, and in 1984, became the first and only presidential candidate to ever receive the maximum amount of public matching money permitted by the law. Even former Vice President Walter Mondale, who ran for the Democratic nomination in 1984 with a well-established base of financial support, relied on small donors for almost a third of his total campaign contributions from individual supporters.

Lesser-known candidates realized an even greater relative benefit from public financing. The availability of matching funds allowed these candidates to build on their comparatively small bases of donor support and raise the sums needed to communicate their views to voters. For many of these challengers, matching funds were a vital source of funding at crucial points in the campaign, particularly in the critical early primary states. In these instances, public funding not only helped to promote greater participation, but also expanded the choices available to voters, thus making their ballot decisions more meaningful.

As political scientist Michael Malbin, director of the Campaign Finance Institute, has recently noted, examples of candidates who, without public funds, would have lacked the resources to compete in primaries can be found in every election. Many of those who mounted strong, but unsuccessful, challenges for a party's presidential nomination, including Ronald Reagan in 1976, George H.W. Bush in 1980, Gary Hart in 1984, Paul Tsongas and Patrick Buchanan in 1992, and Senator John McCain in 2000, would have found it difficult to sustain their campaigns without the infusions of money they received from matching funds at critical junctures in a race. Public funding gave these contenders an opportunity to have their voices heard and left it to the voters to decide the outcome of the race.

The value of public funding in enhancing competition and the choices available to voters was once again demonstrated in the 2004 Democratic primaries. The contests in Iowa and New Hampshire were highly competitive and attracted substantial voter interest. But at least four of the major challengers who competed in those elections—Wesley Clark, John Edwards, Richard Gephardt, and Joseph Lieberman—would not have remained viable candidates without the more than $3 million in matching funds that each received at the beginning of January. Senator John Edwards, who waged a strong campaign in the early states, was virtually out
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**Overall Totals** | **645.6** | **628.0** | **58.7** | **1332.3**

of money at the end of 2003, and would not have had the resources needed to campaign in Iowa and New Hampshire without the benefit of public support.4

Yet, while public funding has continued to be widely accepted by candidates, its efficacy in promoting low-dollar donor participation has declined. In recent elections, candidates have altered their fundraising strategies, and attempted to meet the rising financial demands of the process by focusing on large contributions. This shift reflects changes that have occurred in the presidential selection process, as well as the diminishing value of the public funding incentive. As a result, the relative importance of small donors is decreasing.

The financial demands of a presidential campaign have intensified as a result of changes in the formal selection process. Beginning in the mid-1980s, a growing number of states began to schedule their presidential primaries or caucuses earlier and earlier in the election year, a phenomenon known as “front-loading.”5 In 1976, when the public funding program first went into effect, the New Hampshire primary was held in the last week of February and candidates faced only six other state primaries over the course of the following eight weeks. In 2004, New Hampshire held its primary at the end of January and nine other states held primaries in the next two weeks. By the end of the first week of March, the majority of the delegates to the 2004 national conventions had already been chosen.

This front-loading of the process has increased the pressure on candidates to raise money early. It has also made it increasingly difficult for candidates to finance a campaign by raising the funds needed to contest one state and then rely on a good showing—and a few weeks’ time—to raise money for the next. Instead, candidates now face the reality of having to amass the funds needed for the contests in Iowa and New Hampshire, as well as a number of other states, even before the voting has begun. This strategic dictate has elevated the prominence given to early fundraising as a measure of a candidate’s viability, in effect creating a “money primary” in the months leading up to the first election in Iowa. Candidates have responded by starting to campaign earlier and earlier in the pre-election year, which increases the length and expenses of a run for office.

Candidates have also adapted to the demands of frontloading by placing greater emphasis on donors capable of giving larger amounts. While a few candidates have continued to embrace the incentives offered by matching funds and focused on small donors, most candidates, especially well-established candidates and prospective frontrunners, have chosen instead to focus on those willing to give the maximum amount allowed by the law. Consequently, in the most recent elections, candidates, especially party nominees, have received a majority of their individual contributions from $1,000 donors (then the maximum contribution).6

- In 1996, 45 percent ($42.7 million) of the monies raised by presidential candidates from individual donors ($94.6 million) came from donors who gave $1,000. Donors who gave $1,000 were responsible for 56 percent of the total amount President Clinton received from individual supporters and 51 percent of Senator Robert Dole’s total individual receipts.

- In 2000, 55 percent ($121.4 million) of the total amount taken in by all presidential candidates from individual donors ($220.6 million) came from $1,000 donors. Vice President Al Gore raised 63 percent of his individual receipts from those who gave the maximum allowed, while Governor George W. Bush raised 67 percent of his receipts from this source.

- In 2004, despite the success of Governor Howard Dean in mobilizing thousands of new small donors and a quadrupling of the total amount contributed by small donors, 51 percent ($293.1 million) of the monies received from individuals by all presidential contenders as of July 31, 2004 ($580.2 million) came in contributions of $1,000 or more (the limit having been raised to $2,000). More than half of this amount ($197 million out of the $293.1 million) came from donors who gave the new maximum of $2,000. President Bush received 60 percent ($142.5 million) of his individual contributions in amounts of $1,000 or more. Senator John Kerry received 44 percent ($91.5 million) in donations of $1,000 or more.

These figures indicate the shift taking place in the financing of presidential campaigns. Instead of inciting candidates to invest in efforts to attract small contributions, matching funds now tend to be regarded by
candidates primarily as a supplement to large contributions. Candidates are concentrating on a relatively small pool of donors, and are not undertaking the types of broad-based fundraising efforts that can promote the involvement of a larger share of the electorate in the financing of campaigns. Furthermore, by emphasizing large donations, candidates may discourage participation among small donors by sending the signal that low-dollar gifts are not important, thereby reinforcing feelings of political inefficacy and alienation that undermine the vitality and health of representative government. We believe that our democracy is best served by a financial system that encourages all candidates to reach out to average citizens and expand the scope of participation in the financing of campaigns. This is one way to promote well-funded and robust campaigns, a more engaged electorate, and stronger political participation.

We recognize that the 2004 election has been characterized by an extraordinary surge in small donor participation. The early success of Governor Howard Dean’s campaign, the emergence of the Internet as a major conduit for small donor activity, and the unprecedented fundraising success of the two presidential nominees stand as testaments to the fact that the 2004 election has engaged average citizens in a way unlike any in recent memory. We are encouraged by these developments and would like to see such high levels of citizen engagement in future elections. Indeed, we hope that future candidates will have as much—if not more—success in attracting small donor support.

We note, however, that the experience in the 2004 election does not in fact ensure a broader role for small contributors in the future. Although small contributions more than quadrupled in the 2004 presidential primary race, growing from a total of $53 million for all candidates four years ago to more than $205 million in this cycle, much of this money was received after the presidential nominations were already decided, and reflects the unprecedented sums raised by the two de facto nominees. Because President Bush and Senator Kerry chose not to accept matching funds, they were allowed to spend as much as they could raise in limited contributions. By the time of the conventions, which constitute the end of the primary campaign fundraising period, the President had raised $260 million, while Senator Kerry took in more than $248 million. Such sums were unprecedented, and represented about five times more than the amounts each of these candidates would have been able to spend under the public funding spending caps. President Bush and Senator Kerry alone received a combined total of more than $157 million from donations of less than $200, with each of these candidates raising more than $78 million in gifts of $200 or less. Small contributions to these two candidates constituted 75 percent of the small donor total achieved by all of the candidates.

Figure 2
Breakdown of Individual Contributions to Presidential Candidates

![Breakdown of Individual Contributions to Presidential Candidates](image)

2004 Presidential Primary

- $1,000 and Up: 23%
- $200-$999: 57%
- Less than $200: 21%

2000 Presidential Primary

- $1,000 and Up: 33%
- $200-$999: 16%
- Less than $200: 51%

Source: Campaign Finance Institute, based on contributions as of July 31, 2004.
Table 4  
Presidential Primary Campaign Finance, 2000 and 2004

<table>
<thead>
<tr>
<th></th>
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<tbody>
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<td>Total Receipts*</td>
<td>Total Disbursed</td>
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<td>John Kerry</td>
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<td>Steve Forbes</td>
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<td>48.4</td>
<td>Joe Lieberman</td>
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<td>Alan Keyes</td>
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<td>John McCain</td>
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<td>Al Sharpton**</td>
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<td><strong>Republican</strong></td>
<td></td>
<td></td>
<td>George W. Bush</td>
<td>242.0</td>
<td>209.5</td>
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<table>
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<tr>
<th></th>
<th>2004</th>
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<tr>
<td>Democrat Total</td>
<td>101.7</td>
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<td>Republican Total</td>
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<tr>
<td>Total</td>
<td>650.2</td>
<td>567.3</td>
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</table>

* Includes contributions, loans, federal matching funds, transfers from other political committees, offsets, and other items.

** Al Sharpton has been declared ineligible for matching funds and may be forced to return the $100,000 he received.

Totals may not add up due to rounding.

Most of this increase in small donor giving occurred once the Democratic nominee had emerged and the general election was essentially under way. At the end of February, as the Democratic nomination process was moving into its last few meaningful primaries, the financial picture looked very different. At that point in the election, the recent historical trend towards large contributions was continuing with little abatement, and the percentage of candidate receipts from small donors and public funds was down sharply. In fact, of the major contenders, only Governor Howard Dean, who raised almost 60 percent ($29.9 million) of his individual receipts from donations of less than $200, relied on small donors as the principal source of his campaign money. Through February, the President had raised 75 percent ($117.3 million) of his funds from donors of $1,000 or more, including more than $95 million from donors of $2,000. Senator Kerry had 66 percent of his individual receipts from donors of $1,000, and these donors made up more than 70 percent of the individual monies raised by the other major contenders—Edwards, Gephardt, and Lieberman. Overall, without Governor Dean included, about 63 percent of the money raised from individuals by Democrats came from donors of $1,000, and only 19 percent from small donors. The corresponding percentages with Governor Dean included are 49 percent from large donors and 32 percent from small donors. These statistics highlight the dramatic difference in the way Governor Howard Dean’s campaign was financed as compared to most other major contenders in recent elections.

That larger contributions made up a higher percentage of the early money raised in 2004 as compared to 2000 or 1996 is not surprising given the higher contribution limits established by BCRA. BCRA doubled the individual contribution limit, increasing it to $2,000, without making any corresponding change in the rules governing matching funds. The law, in effect, reduced the relative value of the matching fund benefit by half: instead of matching the first $250 on a maximum donation of $1,000, the program now matches the first $250 on a maximum donation of $2,000. Furthermore, BCRA indexed the individual limit for inflation, but did not make a corresponding change in the amount of a matchable contribution. This means that the relative value of the matching subsidy will continue to decline in the future. This imbalance will offer future candidates an additional incentive to concentrate on larger gifts, rather than small donations.

### The Problem of Spending Limits

Candidates are refusing to accept public funds not because of the decline in the value of the match, but due to the outmoded constraints imposed by the program’s spending limits. The expenditure allowances established for publicly funded candidates are woefully inadequate. This is especially the case with respect to the caps placed on pre-convention spending. The primary campaign expenditure ceilings fail to reflect the changes that have taken place in the presidential selection process, the practical costs of modern campaigns, and the complicated financial dynamics of competitive presidential contests. As a result, a growing number of candidates, particularly frontrunners or prospective nominees, are concluding that the strategic risks incurred in accepting these limits are too high to justify the benefits that public funding offers.

One problem with the current limits is evident from the various provisions that govern the ceilings: they do not allow candidates the freedom to choose how best to allocate the sums they are allowed to spend. Instead of establishing a straightforward, overall spending ceiling, the rules set forth complicated formulas that compel candidates to engage in unnecessary accounting, and in innovative practices designed to circumvent particular restrictions.

The primary spending limits are particularly complex. The total amount a candidate is allowed to spend is determined by adding up a number of sub-limits, including a base limit that was originally set at $20 million in 1974 and adjusted for inflation, an amount equal to 20 percent of the adjusted base limit that can be used to pay fundraising expenses, and, beginning in 2000, an additional amount equal to up to 15 percent of the base limit for legal and accounting costs. The total of these three sub-limits is the aggregate amount a candidate is allowed to spend under the aggregate ceiling on expenditures. In 1976, this calculation produced a spending ceiling of about $13 million; in 2004, the ceiling had grown to close to $50 million.

In addition, publicly funded primary candidates are required to adhere to limits on the amount they may
spend in each state. These state-by-state ceilings vary on the basis of population and range from a low of about $746,000 in New Hampshire to more than $15 million in California. The incoherence in the current system is exemplified by the fact that the total amount of spending permitted under these state caps, when all 50 states are added up, is about three times as much as the amount allowed by the aggregate limit. Moreover, since these caps are based on population, they do not reflect the realities of the presidential nominating process. Iowa, the first state in the presidential selection process, has a relatively low spending limit. New Hampshire, the state that holds the most important primary, has the lowest limit. The FEC has tried to ease this problem by allowing candidates to allocate a variety of expenditures against the aggregate limit rather than the state caps. Even so, candidates must pursue innovative practices and often travel a complex and winding route through a forest of legal technicalities to spend the sums they want to spend in the early state contests.

A more fundamental—and alarming—problem is easily discerned from the spending patterns that have been evident since the mid-1980s. In each subsequent election cycle, the candidate who emerges from a contested nomination campaign has reached the expenditure ceiling at an increasingly early point in the election. Thus, the law, as it now stands, no longer provides candidates with the spending capacity needed to adequately finance a nomination campaign.

In the 1980s, the leading candidates, including Governor Reagan in 1980, Vice President Mondale in 1984, and Vice President Bush and Governor Dukakis in 1988, tended to come within reach of the overall cap on spending (factoring in forward costs to get through the nominating convention) by early June or late May. All of these candidates had to limit their campaigning in the weeks prior to the convention, but they were able to spend enough money to campaign throughout the primary season. In recent elections, this has not been the case. Candidates who have won the nomination in competitive primary races have run out of "spending

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### Table 5

**Presidential Primary Spending Limits ($ millions)**

<table>
<thead>
<tr>
<th>Year</th>
<th>Base Primary Spending Limit</th>
<th>Additional Fund-Raising Exemption</th>
<th>Overall Limit*</th>
<th>Sum of State-by-State Limits</th>
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</thead>
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<tr>
<td>1980</td>
<td>14.7</td>
<td>2.9</td>
<td>17.7</td>
<td>48.9</td>
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<td>1984</td>
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<td>4.0</td>
<td>24.2</td>
<td>67.2</td>
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<td>1988</td>
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<td>1992</td>
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<td>1996</td>
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<td>6.2</td>
<td>37.7</td>
<td>102.7</td>
</tr>
<tr>
<td>2000</td>
<td>33.8</td>
<td>6.8</td>
<td>40.6</td>
<td>113.8</td>
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<tr>
<td>2004</td>
<td>37.3</td>
<td>7.5</td>
<td>44.8</td>
<td>146.0</td>
</tr>
</tbody>
</table>

* NOTE: The overall limit does not include money spent to comply with the law. As of 2000, candidates may spend up to 15 percent of the overall limit on compliance costs during the primary campaign.
room” as early as the end of April or middle of March. In short, they have essentially disbursed the amounts they were allowed to spend three or four months before the party nominating conventions. These candidates were therefore left in a precarious position, particularly when facing prospective general election opponents who were nominated without major opposition.

The inadequacies of the current limits were made plain in the 1996 and 2000 elections. In 1996, Senator Robert Dole captured the Republican nomination after winning a hard-fought nomination contest against a number of challengers, including Malcolm “Steve” Forbes, who largely self-financed a campaign with millions of his own dollars and thus was not constrained by spending limits. By the time Senator Dole emerged as the likely nominee in April, he had already essentially reached the pre-convention spending cap. His prospective general election opponent, President Bill Clinton, faced no challenge for the Democratic nomination, and still had more than $20 million left to spend on what was basically a general election campaign. Senator Dole, however, continued to be restricted by the spending limit until after the Republican convention.

Early in the 2000 election cycle, Governor George W. Bush, facing the prospect of having to run against Steve Forbes in the primaries and perhaps an incumbent Vice President in the general election, decided to avoid Dole’s dilemma by opting out of the public funding program. This decision freed him of the spending limits, and he went on to raise and spend more than twice the amount permitted a publicly financed candidate. Senator John McCain accepted public funds and mounted a strong challenge against Governor Bush. But Senator McCain’s primary bid ended in the first week of March after he was defeated in a couple of key primary contests. Had Senator McCain achieved another primary victory and been in a position to continue his quest for the nomination, he would have been unable to continue his aggressive campaigning because he was already facing the spending limit. He would have either had to violate the rules or grind his campaign to a halt, at the very time that the broader electorate was starting to take interest and become involved in the race.

Thus, in 2000, it was Vice President Al Gore who found himself in Senator Dole’s position. After defeating Senator Bill Bradley for the Democratic nomination, Vice President Gore had relatively little room left to spend money under the cap. Consequently he was outspent by his prospective general election opponent, Governor George W. Bush, by a substantial margin. Accordingly, in 2004, President Bush refused public funding once again, and Governor Howard Dean decided to opt out of the program to avoid being in Vice President Gore’s position. Soon after, Senator John Kerry decided to forgo public funds so that he could spend millions of dollars of his own money on his faltering campaign. This decision was a key to his nomination victory and his ability to compete financially throughout the rest of the pre-convention period.

As this recent experience indicates, the current expenditure limits do not reflect the practical realities of the presidential selection process. They do not acknowledge changes in the primary system. They do not allow candidates to spend the sums needed to wage a competitive campaign and engage in active campaigning right through to the party conventions. They do not recognize the additional financial demands that candidates may face when running against a self-financed opponent, or an opponent who is not accepting public funds. Nor do they consider the prospect of active campaigning by well-funded political groups. If they are not reformed, presidential hopefuls will continue to have no choice but to opt out of the public funding program.

The Tax Checkoff

The presidential public funding system is financed through a tax checkoff provision on individual federal income tax forms. A question placed near the top of the tax form offers taxpayers the option of designating $3 (individual filers) or $6 (joint filers) to the Presidential Election Campaign Fund (PECF), a separate account maintained by the U.S. Treasury, which was established for the purpose of financing the public funding program. The exercise of this checkoff option does not affect the amount of an individual’s tax payment or refund. The funds deposited into PECF are used to pay for the general election subsidies, convention subsidies, and matching fund payments. Under the terms of the law, monies needed for the general election and convention payments are set aside first, with any remaining monies available for matching payments.
Since 1992, the checkoff system has been under strain, and, in most recent elections, has barely been able to provide the funding needed to meet the financial requirements of the public financing program. While the early years of the checkoff were characterized by rising taxpayer participation and increasing annual revenues, these trends peaked in 1981, when almost 29 percent of individual tax returns designated a contribution to PECF for an annual deposit of $41 million. From that point, individual participation and revenues began to decline, falling by 1993 to about 19 percent participation and less than $28 million in annual deposits. At the same time, the financial demands of the program were continuing to grow, due in large part to the inflation adjustments built into the general election and convention subsidies. By 1992, the system had reached a point where it was operating on the brink of insolvency.

Congress sought to address these financial concerns by tripling the amount of the checkoff in 1993, raising it from the original sum of $1 to its current level of $3 (or $2 to $6 in the case of joint filers). This change bolstered the resources available to the program, but participation rates and annual deposits have continued to drop. Participation rates fell from 14.5 percent in the first year of the $3 checkoff to about 11 percent in recent years, while annual deposits have slid from about $71 million in 1993 to $62 million in 2002. Consequently, in both 1996 and 2004, the monies available for matching funds at the time the initial payments were made were inadequate to meet candidate demand. In 1996, candidates received 60 cents on the dollar in their first payments; in 2004, the February payments provided only 46 cents on the dollar. The difference in the amount owed to the candidates was subsequently paid from deposits received from incoming tax filings. In the interim, candidates gained access to the money they had accrued by taking out loans against these forthcoming matching fund payments.**

Why taxpayer participation has declined is a matter of debate, and most likely reflects a number of different factors. Some observers contend that the participation rate serves as a measure of public support for the program and shows that a substantial majority of Americans oppose public financing. Public opinion polls, however, indicate much higher levels of support for public funding than the levels suggested by checkoff participation. Further, the millions of individuals who do contribute through the checkoff are far higher than the number of individuals who make a financial contribution to candidates or political committees through other means. Some observers therefore claim that the decline reflects a lack of public awareness of the checkoff and its role. These analysts note that only a small portion of the electorate understands the checkoff and that no major public education effort has been undertaken to increase awareness in at least a decade. Others cite the increase in the number of individual returns prepared by paid preparers or relying on software programs that often default to “no” on the checkoff question. Finally, another factor, which specifically affects the amount of money deposited into PECF, is the growth in the number of individual filers who have no tax liability. Under the terms of the checkoff program, individuals who have no tax liability are ineligible to participate in the program. These filers may mark the checkoff, but $3 is not deposited into PECF as a result of this action. More than 20 percent of individual tax filers now fall into this category.

Whatever the reasons for the changes that have taken place, recent experience suggests that the current checkoff system does not guarantee the resources needed to fund a robust program of public financing marked by broad candidate participation. In 2000 and 2004, the system averted serious financial shortfalls principally because some of the leading candidates opted out of the matching funds program. This is not a recipe for the long-term health and solvency of a meaningful system of public finance.

**In those instances where candidates have not received 100 percent of the matching funds they have accrued, the payments in full have been made in the following month. The monies needed to meet the payments come from the new deposits made into PECF from tax forms being filed in advance of the April 15 tax deadline.

Recommendations

The question confronting national policymakers is whether to reform the presidential campaign finance system or allow it to continue on its present path. CED believes that the presidential public funding system should not be left to atrophy. Indeed, we consider reform of the system long overdue. If the status quo prevails, the beneficial effects of public incentives will
continue to diminish. Public confidence in the electoral process will further deteriorate. And public perceptions of the nation’s highest office as being open to the highest bidder will become even more predominant. A growing portion of the electorate will thus become convinced that their individual actions will make little difference, and the vitality of our electoral process will decline.

CED supports voluntary public financing as an alternative for campaign funding. We have concluded that the availability of public incentives can have a valuable and salutary effect in reducing the risk of corruption and strengthening participation in our democracy. As we noted in a previous policy statement on campaign finance reform, “The improvement of our campaign finance system is a public benefit, and it should therefore be publicly funded. It is an investment in the people’s business.” We continue to affirm this view.

We have concluded that the presidential public financing system is in need of fundamental reform. The major provisions of the law must be changed to provide stronger incentives to candidates to participate in the program, and most importantly, stronger incentives to small donors to become involved in the financing of campaigns. Reform must also ensure that candidates who choose the public option have the capacity to run well-funded campaigns, and have an opportunity to compete against non-publicly funded opponents. In other words, the incentives offered by the public financing system must be restructured, or the benefits of public incentives that we find so compelling will not be achieved.

Strengthen Citizen Participation by Increasing Public Matching Incentives

CED has previously called for the creation of a voluntary program of public matching funds in congressional elections. Under our proposal, candidates who choose to participate in public financing would receive $2 in public money for every $1 received from an individual donor, up to a maximum of $400 for each individual contributor of up to $200. We recommended that the costs of such a program be financed through federal budget appropriations.

In advancing this proposal, we noted that a multiple dollar matching approach on low-dollar donations can have a substantial leveraging effect that would provide candidates with a strong financial incentive to seek out large numbers of small donations. At the same time, it would give small donors a greater sense of empowerment that would encourage them to become more involved in the financing of political campaigns. This approach would increase the resources available to candidates while reducing the relative influence of larger donors and private contributions that might be linked to special interests. We reaffirm our support of this proposal, and once again suggest that Congress establish such a system.

Accordingly, we support the adoption of a similar approach in the presidential public funding system. We recommend that Congress increase the public matching incentives on small contributions to presidential primary candidates by replacing the current $1-for-$1 public matching ratio with a multiple-dollar match on contributions of low-dollar amounts. At a minimum, we support a $2-to-$1 match on the first $250 of individual contributions. But given the costs of a presidential campaign and our desire to stimulate small donor participation, we would prefer a higher match rate where candidates would be eligible for matching on a $4-to-$1 basis on individual contributions of up to $250, a proposal similar to that recently submitted to Congress by Senator John McCain. Under this higher rate, candidates who choose to participate in the program would receive $4 in public funding for every $1 received from an individual contributor, up to a maximum of $1,000 in public money for each individual’s contribution of up to $250. This increase would quadruple the amount of public money a candidate may receive from individual contributions of $250 or less. In addition, the amount of a contribution eligible for public matching should be indexed for inflation, with the dollar amount of eligible contributions rounded to the nearest $10 increment.

In the general election, we recommend that the current approach be retained. Candidates who choose public financing in the general election would receive a public grant that provides full financing for a campaign. A full public subsidy would be available to major party candidates, as defined by current law. Others could qualify for partial subsidies by receiving
at least five percent of the national presidential vote, as determined by current law.

A two-to-one matching rate on the first $250 of individual contributions would restore the relative value of public funding that was lost as a result of BCRA’s increase in the contribution limit. Whereas the matching subsidy formerly provided $250 in public money on the maximum donation of $1,000, it now provides $250 on the maximum individual donation of $2,000. Under our $4-to-$1 proposal, $1,000 in public money would be provided on a $2,000 contribution. Because BCRA also indexed the individual contribution limit for inflation, the amount of a contribution eligible for public matching should also be indexed to safeguard against a future reduction in the relative value of the public benefit. If the maximum contribution limit of $2,000 is adjusted in the next election cycle and increased by 10 percent, the amount of an individual contribution eligible for public funding should also be increased by 10 percent.

Under a multiple match approach, a greater share of campaign resources will come from public funds than is the case under the current system. Both Republicans and Democrats, well-established and less well known contenders, will benefit, albeit in slightly different ways. In general terms, established candidates with broad bases of support and extensive donor bases are expected to receive more money than lesser known candidates, but lesser known candidates are likely to receive a greater portion of their total campaign resources from public sources so they will realize a greater relative benefit.

For example, according to analyses conducted by the Campaign Finance Institute, if a $4-to-$1 match rate on the first $250 was operative in the 2000 election, Senator John McCain would have received $49.9 million in matching funds instead of $14.6 million; Senator Bill Bradley, $48.5 million instead of $12.5 million; and Vice President Al Gore, $58.1 million instead of $15.5 million. Matching funds would have constituted about 55-58 percent of the primary funds available to each of these major contenders. Republican Gary Bauer would have received $13.8 million in matching funds instead of $4.9 million, while Patrick Buchanan, who ran for the Reform Party nomination, would have received $16.4 million instead $4.4 million. Matching funds would have represented an estimated 64 percent of Bauer’s campaign money and 75 percent of Buchanan’s total funds.\textsuperscript{11}

The potential of multiple dollar matching as a mechanism for stimulating small donor participation can be discerned from the recent experience with public funding in New York City municipal elections. New York City first established a publicly funded matching funds program in 1988. Under the original terms of this program, participating candidates were eligible to receive a dollar of public money for every one dollar received from each individual donor, up to a maximum amount of $1,000. Thus, a candidate who raised $1,000 from an individual donor could receive $1,000 in public matching money for a total of $2,000 in campaign receipts. The law was subsequently amended to establish a multiple match benefit focused on small contributions.

The New York City program now offers a $4-to-$1 matching fund subsidy to candidates who choose public financing in city elections. This public option is available to candidates running for mayor, citywide elective office, or city council. A participating candidate may receive four dollars of public money for every one dollar received from individual city residents on contributions of up to $250. Thus, an individual contribution of $250 made to a participating candidate is matched with $1,000 of public money, providing the candidate with a total of $1,250 in campaign receipts. A contribution of $50 triggers $200 of public money, providing a candidate with a total of $250.

This multiple match subsidy has had a powerful effect in stimulating small contributions, and dramatically changed the scope of individual participation in the financing of city elections. According to the New York City Campaign Finance Board, the number of contributions to candidates who have decided to participate in the program nearly doubled between 1997 (when the multiple match was first established) and 2001, rising from 71,600 in 1997 to 139,400 in 2001.\textsuperscript{12} In the most recent elections held in 2003, 84 percent of the contributions received by candidates came from small donors of $1 to $250. Overall, more than 17,000 individuals gave $100 or less to a participating candidate, as compared to 900 who gave more than $1,000. The largest share of the monies raised by candidates came from donors of $50 or less, who represented nearly 40 percent of all contributors.\textsuperscript{13}
The relatively small expenditure of public resources required by such a program would have a substantial effect in leveraging the contributions made by small donors, thereby enhancing their role in political campaigns. This approach would empower individual citizens and promote their involvement in the electoral process. It would also provide participating candidates with more funding than they can receive under the current system, which will spur participation in the program and lead to better-financed and more competitive presidential contests.

Candidates who choose to accept public matching funds would have to meet certain eligibility requirements to be certified to receive this support. To qualify, candidates should have to raise a threshold amount of money from individual contributions of $250 or less. In this way, the qualifying process would require candidates to demonstrate a certain level of popular support. It would also serve as another means of empowering small donors. The qualifying threshold should not be set so high that it discourages broad participation from a wide range of candidates. But it should be set high enough to discourage frivolous candidacies or the granting of public resources to candidates who are incapable of demonstrating a credible level of support among voters.

Eligibility should also be contingent on other requirements, as is the case in the current system. At a minimum, candidates should have to agree to abide by limits on campaign spending and limit personal expenditures on a campaign to $50,000. Candidates who decide to accept public financing in the general election should be prohibited from raising additional private contributions for their campaigns.

We also support the idea of making eligibility for the general election grant contingent on the acceptance of public financing during the primaries. Under the current system, candidates are able to refuse the public funding option during the primaries, yet still be eligible to accept public financing for the general election campaign. Thus, in 2004, President George W. Bush and Senator John Kerry each refused public funds prior to the general election, but then accepted the substantial sum of public money offered for the fall campaign. This tactic allowed them to raise and spend an unlimited amount of money, right up to the time of their respective conventions, and then receive a large sum from public sources to spend from the time of their formal nominations at the conventions through Election Day. That both of these candidates chose public funding for the general election, despite having raised far more than the amount of the public grant in private contributions during the primaries, indicates the value that candidates place on the general election subsidy and their understanding of the monetary and strategic benefits it offers. Thus, linking the eligibility for general election funding to participation in the primary public matching fund program would give candidates a powerful incentive to accept public funds during the primaries. This approach would ensure high levels of candidate participation in the matching funds program, and give candidates further incentive to solicit small contributions.

Finally, candidates should begin receiving public financing payments as soon as they qualify. One of the ways that public subsidies can help to improve competition is by making the public money accrued by candidates available on a timely basis. The current regulations for primary matching funds stipulate that any individual contribution raised by a participating candidate after January 1 of the year prior to the election year is eligible for public matching. But the rules also state that the first matching payments are to be made to candidates on January 1 of the election year. We believe that little purpose is served by restricting the release of payments. Candidates who qualify for public funding in the primaries should be able to receive matching funds before the start of the election year. In this way, public monies would be available when they are needed most—in the earliest stages when candidates are engaged in the task of launching a campaign.

We note, however, that some timetable restrictions are necessary to ensure that the regulations do not promote a greater lengthening of presidential campaigns by encouraging candidates to start raising money well in advance of the beginning of the election year. The simplest approach would be to retain the present rule on the timetable for eligible contributions (January 1 of the year before the election) and make matching fund payments available to a candidate as soon as he or she meets the eligibility requirements and is certified to receive public funds.
Reduce Constraints that Discourage Participation

Beyond enhancing incentives for participation, reform must also address the features of the current system that serve to discourage participation. In this regard, the most important changes concern the limits on spending.

Generally, we consider reasonable limits on spending to be an acceptable and necessary requirement that presidential candidates must accept in exchange for the use of public resources. Expenditure allowances provide a safeguard against excessive levels of spending that may serve to create the impression among the electorate that the White House is up for sale. They also help to level the financial playing field, which facilitates greater electoral competition.

But expenditure ceilings are only effective—and only serve the basic objectives of a public funding system—when they provide candidates with a realistic and ample capacity to finance a campaign. Stringent spending limits simply serve to convince candidates to eschew public funds, or, even worse, to encourage financial practices and tactics designed to circumvent restrictions and the provisions of the law. More important, such constraints fail to serve the objectives of free and democratic elections, since they overly restrict the scope of campaigning, often forcing candidates to reduce their electioneering in the midst of a campaign, or—as has been evident in recent presidential primaries—just as the electorate is becoming engaged in a race.

Any spending allowances imposed on publicly funded candidates must provide these contenders with the capacity to spend the monies needed to wage a competitive and well-funded campaign. They should also give candidates the freedom to determine how best to allocate their resources and conduct their campaigns. Limits should not be designed to try to govern or manage the types of expenditures made in election campaigns.

The current spending limits established for publicly funded presidential primary campaigns fail to meet the basic criteria we have just outlined. In our judgment, the spending ceilings are unnecessarily complicated and unrealistic. A number of major changes must be made to produce a more workable system.

First, the primary election ceilings should be streamlined and simplified. Instead of a ceiling constructed out of a base limit with various exemptions and adjustments, the law should establish a unified, aggregate ceiling on expenditures. In other words, the approach used in primaries should be similar to that used in the general election: establish the sum that may be spent and leave it to the candidate to decide how to spend it.

Second, the state-by-state expenditure ceilings should be eliminated. These restrictions have relatively little effect on spending and, for the most part, are nothing more than an accounting nuisance for candidates. To the extent that these ceilings have influenced candidate strategies, their role has been limited to constraining some expenditures in Iowa, New Hampshire, and a few other early contests. For years, the FEC has recommended to Congress that these limits be abolished. We agree.

Third, the spending allowances for primary campaigns and general election campaigns should be substantially increased. The current limits do not provide candidates with an adequate capacity to manage the costs of a contested nomination campaign. Although the general election ceiling has not proven to be a major problem to date, we believe that it should also be raised to a level at least commensurate with any increase in the primary ceiling.

Promote Fair Competition Among Participating and Non-Participating Candidates

The U.S. Supreme Court has ruled that expenditure limits may be applied only to candidates who accept them voluntarily as a condition attached to the receipt of a public benefit. Candidates who finance their campaigns solely with private contributions, or those who rely on personal resources to pay for a campaign, are free to spend money without limit. Consequently, presidential hopefuls who decide to participate in public financing may face a strategic disadvantage when facing high-spending, nonparticipating opponents, because they can be outspent by substantial amounts. This potential disadvantage is one of the concerns that acts as a disincentive to candidate participation in public funding programs.
One of the advantages of higher expenditure allowances is that this reform would do much to mitigate this potential problem. If publicly financed candidates are allowed to spend ample amounts, they will have a greater capacity—assuming that they can raise the necessary funds—to advocate their views effectively even against high-spending, nonparticipating opponents. Higher ceilings give participating candidates a fairer opportunity to compete against non-participants.

Higher ceilings alone, however, may not be enough to quell this concern. This is especially the case in instances where prospective contenders face the possibility of running against a wealthy competitor willing to spend large sums from his or her own wallet, or an established incumbent with a broad, well-established base of financial support, capable of raising significantly more than the amount allowed by public funding spending limits. CED has therefore concluded that steps should be taken to promote a more level playing field between participating and nonparticipating candidates.

In a party presidential nominating contest, campaign finance regulations should allow publicly funded candidates to match the spending of a nonparticipating opponent whose spending or fundraising exceeds the amount that a participating candidate is allowed to spend. Once a nonparticipating candidate has surpassed the established public financing spending allowance, a publicly financed candidate should be eligible to receive supplemental grants of public money to match a nonparticipating opponent’s expenditures. For example, if a privately financed candidate for a party’s presidential nomination raises or spends $5 million more than the amount of the spending limit applied to a publicly funded opponent, the publicly funded opponent should be eligible to receive a public grant equal to $5 million to match his or her opponent’s resources. Subsequent monies raised or spent by a privately funded candidate would be matched with additional grants of public money to the participating challenger. To ensure timely and effective application of this approach, the nonparticipating candidate should be required to file a “trigger report” with the FEC within 24 hours of reaching the limit imposed on publicly financed challengers, either in terms of expenditures made or contributions received.

To be eligible to receive this supplemental public funding, a publicly financed candidate should have to meet a fundraising threshold. There are often a number of candidates competing for a party’s nomination. This supplemental funding should not automatically be made available to every candidate, including those who have raised relatively small amounts or those who are unlikely to be major competitors for the party standard. In order to ensure that supplemental public funds are not granted to credible candidates who are unlikely to raise the maximum amount of money permitted by the spending limit, only those candidates who have raised a substantial portion of the amount allowed by the spending limit and are thus highly likely to reach the spending ceiling should be eligible for supplemental funds.

Similar measures that allow publicly funded candidates to gain access to additional resources to match the spending of nonparticipating opponents have been used effectively in state public financing programs in Maine and Arizona. In these states, which provide full public financing to participants, candidates are allotted additional public funds to match the resources of high-spending, privately financed candidates. These supplemental public funding provisions have been upheld in court as constitutionally permissible measures under the First Amendment, since their purpose is not to “chill” the speech of nonparticipating candidates, but rather to permit additional speech by publicly funded contenders.  

Our proposal for supplemental public funding addresses one of the strategic concerns that can discourage candidate participation in the public funding program: the prospect of being outspent by a privately funded opponent within the party in a presidential nomination contest. But there is another concern that can also serve as a powerful disincentive to participation: the prospect of being significantly outspent by a privately funded challenger from the opposing party. This was the situation Vice President Al Gore faced in 2000. After accepting public funds and wrapping up his party’s nomination in early March, he then faced months of competition against his prospective general election challenger, Governor George W. Bush, who had not accepted matching funds and spending limits, and thus was capable of outspending Vice President Al Gore by a substantial margin in the months leading up to the party nominating conventions. Democrats had to face a similar scenario in 2004, since it was expected that President Bush would not take public money during
the primaries and raise three to four times more than the amount permitted a publicly funded candidate. Accordingly, Governor Dean and Senator Kerry each decided to forgo public funding in part to avoid ceding a substantial financial advantage to President Bush in the months leading up to the party conventions.

In this circumstance, where a publicly funded nominee of one party faces a privately funded nominee of the other, we recommend that the party be given the opportunity to make up the difference. If the prospective nominee of one party is accepting public funds and the accompanying spending limit, and the prospective nominee of the other party is not accepting public funds and is raising or spending more than the amount permitted by the spending limit, the party of the publicly funded challenger should be allowed to spend funds in support of and in coordination with their candidate, up to the amount expended by the opposing party’s nominee who has surpassed the public funding expenditure allowance.

Strengthen the Safeguards and Transparency of Convention Finances

As part of the presidential public financing program, the Federal Election Campaign Act established an optional public funding grant for national party committees to subsidize the cost of their presidential nomination conventions. Under the terms of the law, each major party can receive a public grant, which is adjusted for inflation, to finance convention costs. A non-major party that received at least five percent of the national vote in the previous presidential election can receive a proportionate, partial subsidy for its convention. In 2004, the amount of the grant given to each of the major parties was $14.9 million. No other parties qualified for funding.

This public grant was originally intended to cover all of the costs a party incurred to conduct its national convention. It was established in response to charges of corruption associated with certain contributions made in connection with the financing of the 1972 Republican National Convention. Its purpose was to reduce the potential for corruption by providing parties with public monies and thus eliminate the need to seek contributions from private sources to finance a national convention.

But soon after public financing was put into place, cities hosting presidential conventions began to establish convention “host committees” or “municipal funds” that supplemented party resources. These funds promote the convention city and its commerce and defray some of the expenses associated with the convention. The items financed by host committees or municipal funds cover a wide range of purposes and activities, including advertising efforts designed to promote the city as a tourist destination, local transportation for convention participants, welcoming receptions and entertainment, the costs of constructing and modifying convention facilities, and police and emergency worker overtime pay.

Host committees for presidential nominating conventions are typically registered as tax-exempt charitable organizations under Section 501(c)(3) of the Internal Revenue Code. Donors to these organizations are therefore able to deduct their contributions from their taxable income. There are no federal restrictions on the amount that an individual, corporation, labor union, or political committee may contribute to a convention host committee.

The financial activities of host committees are governed by regulations established by the FEC. Under the provisions of the Federal Election Campaign Act, the major national party committees that accepted public funding for their conventions were prohibited from making any expenditures on a nominating convention that exceeded the amount of the public funding grant. However, the FEC soon undermined this prohibition. In 1979, the Commission exempted local, nonprofit host committees from this restriction, treating them as entities separate from party committees. The regulations established by the Commission allowed host committees to accept contributions in any amount, since these contributions were given for the assumed purpose of promoting economic activity and good will of the host city, rather than for political purposes. Originally, only local businesses, unions, organizations, and individuals were permitted to make contributions to host committees. Over time—specifically as a result of rulings issued in 1994 and 2003—the FEC eased this requirement in recognition of the complexities created by branches, local offices, chapters, or affiliates of state or national businesses, unions, or organizations. Today, contributors to host committees are no longer required to have a local presence or be related...
to a business's expectation of an economic return from convention activity.

Since 1992, the role of host committees or municipal funds in the financing of nominating conventions has grown dramatically, reaching the point where the private donations raised by these entities represent a majority of the monies spent on national conventions. In 1996, for example, each of the major party committees received a public grant of $12.4 million to pay the costs of a convention. In contrast, the host committees of the two convention cities raised a combined total of $38 million from private donors. In 2004, each of the parties received a public grant of $14.9 million. The convention host committees established in New York City for the Republican convention and Boston for the Democrats raised a combined total of more than $138 million, which represented more than twice the amount of private donations made in the previous election. A substantial portion of this sum was donated by major corporations and business organizations, many of which contributed amounts of $100,000 or more.

### Table 6

**Sources of Convention Funding, 1980-2004 ($ millions).**

<table>
<thead>
<tr>
<th>Year</th>
<th>Convention</th>
<th>Public Grants to Party Committees</th>
<th>Private Contributions*</th>
<th>Local and State Government Funding**</th>
<th>Total Convention Contributions</th>
</tr>
</thead>
<tbody>
<tr>
<td>1980</td>
<td>R Detroit</td>
<td>4.4</td>
<td>0.7</td>
<td>2.0</td>
<td>7.1</td>
</tr>
<tr>
<td></td>
<td>D NYC</td>
<td>4.4</td>
<td>0.4</td>
<td>4.5</td>
<td>9.3</td>
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<tr>
<td>1984</td>
<td>R Dallas</td>
<td>8.1</td>
<td>4.3</td>
<td>1.3</td>
<td>13.7</td>
</tr>
<tr>
<td></td>
<td>D San Francisco</td>
<td>8.1</td>
<td>2.4</td>
<td>7.6</td>
<td>18.1</td>
</tr>
<tr>
<td>1988</td>
<td>R New Orleans</td>
<td>9.2</td>
<td>1.8</td>
<td>6.7</td>
<td>17.7</td>
</tr>
<tr>
<td></td>
<td>D Atlanta</td>
<td>9.2</td>
<td>1.7</td>
<td>15.8</td>
<td>26.7</td>
</tr>
<tr>
<td>1992</td>
<td>R Houston</td>
<td>11.0</td>
<td>2.2</td>
<td>7.3</td>
<td>20.5</td>
</tr>
<tr>
<td></td>
<td>D NYC</td>
<td>11.0</td>
<td>6.2</td>
<td>21.1</td>
<td>38.3</td>
</tr>
<tr>
<td>1996</td>
<td>R San Diego</td>
<td>12.4</td>
<td>18.0</td>
<td>12.8</td>
<td>43.2</td>
</tr>
<tr>
<td></td>
<td>D Chicago</td>
<td>12.4</td>
<td>20.0</td>
<td>15.0</td>
<td>47.4</td>
</tr>
<tr>
<td>2000</td>
<td>R Philadelphia</td>
<td>13.5</td>
<td>20.1</td>
<td>41.8</td>
<td>75.4</td>
</tr>
<tr>
<td></td>
<td>D Los Angeles</td>
<td>13.5</td>
<td>36.1</td>
<td>35.8</td>
<td>85.4</td>
</tr>
<tr>
<td>2004</td>
<td>R NYC</td>
<td>14.9</td>
<td>84.2</td>
<td>27.0</td>
<td>126.1</td>
</tr>
<tr>
<td></td>
<td>D Boston</td>
<td>14.9</td>
<td>54.4</td>
<td>10.0</td>
<td>79.3</td>
</tr>
</tbody>
</table>

* Private contributions are through host committees and "municipal funds."

** Local and state government funding is direct and through host committees.

Source: Campaign Finance Institute, and 2004 disclosure reports of host committees.
The growth of host committee funding is a matter of great concern to many advocates of campaign finance reform. These advocates contend that donors to host committees make these contributions as a means of gaining influence in the political process, and that the opportunity to contribute to host committees is a means of circumventing the ban on soft money donations. We considered the issues very carefully and discussed the questions raised by host committee finances. We share the concerns raised by advocates of reform, and recognize that the political parties increasingly rely on host committee support to finance many of the activities that were formerly financed by the parties themselves, such as the construction and reconfiguration of the convention hall or receptions and galas for attending delegates and political leaders. We also agree that the demand for host committee contributions raises the risk of political officials placing pressure on the business community and other prospective donors to make convention contributions.

But we also see merit in the argument that a national nominating convention brings prestige and notable economic benefits to a host city. Also, there are traditional costs associated with attracting a major convention to a city and sponsoring such an event. We believe that it is appropriate for businesses, unions, and others to participate in the financing of these national civic events, if they choose to do so. It is one of the ways that the business community and other private sector organizations fulfill their duty of civic responsibility.

Strong safeguards are needed to protect the political system from any potential risk of corruption, or the appearance of corruption, that might accompany donations to host committees. At a minimum, the regulations governing host committee finances must prohibit elected officials and officeholders from being allowed to solicit unlimited contributions on behalf of host committees, municipal funds, and other entities established for the purpose of financing convention-related expenses. This restriction would reinforce the soft money ban established by BCRA and ensure that its prohibitions incorporate convention financing. It would also ensure that state and local elected officials are not influenced by host committee donors. Further, we would even support an extension of this prohibition to state and local elected officials and officeholders. Those in office should not be allowed to solicit unlimited gifts on behalf of host committees. This is the best way of guarding against the risk of corruption.

We also support limits on contributions to host committees or municipal funds. The potential for corruption is greatest when the amounts a donor may give are not limited. Appropriate limits on the amount a donor may give to a host committee will help to protect the integrity of the process, and also prevent the host committee “option” from serving as a vehicle for evading the ban on soft money gifts to parties.

Finally, greater transparency and disclosure of host committee finances are needed. Under current law, host committees are required to file a report of their receipts and expenditures, but these filings are not required until 60 days after the end of a nominating convention. There is no requirement mandating regular and timely pre-convention reporting. In 2004, the Boston and New York host committees did voluntarily disclose some information about their donors and sources of funding, but these voluntary website postings were far from complete and failed to offer the kinds of information that should be available to the public to guarantee full transparency and appropriate public scrutiny.

We urge Congress to pass rules to ensure full and timely disclosure of the financial activities of convention host committees and municipal funds. At a minimum, host committees should be required to file a report disclosing their receipts and expenditures at the end of the pre-election year and thereafter on a monthly basis. These reports should be made available to the public, and filed by electronic means. In our view, full, timely, and effective public disclosure is an essential means of safeguarding against corruption, encouraging compliance with the law, and ensuring accountability. Host committees, given their role in convention funding, should not be exempt from such an essential requirement.
V. Conclusion

The value of endeavors to improve the campaign finance system was demonstrated in the 2004 election. The new rules established by BCRA ended the risk of corruption created by party soft money contributions and spurred a major restructuring of national party finance. Instead of soliciting large gifts from businesses and donors with interests in legislation, the national parties embarked on major grassroots fundraising efforts that led to millions of new small donors being added to the party rolls. CED believes that additional reforms will further promote the participation of individuals in the financing of campaigns, and thereby reduce the potential for corruption and increase public confidence in the political system. But the experience with BCRA in 2004 has also shown that reforms will fully achieve their purpose only if the law is adequately enforced. Efforts to improve the campaign finance system should therefore be focused on the best means of creating a new regulatory body to ensure fair, impartial, and effective administration of the law.
Notes


4. Ibid., pp. 45-46.

5. See Section III below.


8. Ibid.


18. Public Law 106-230, 114 Stat. 477. This statute was signed into law by President Bill Clinton on July 1, 2000.


22. The data in this section are based on a CED analysis of the information contained in the disclosure reports filed by Section 527 committees with the IRS, as compiled by Political-MoneyLine, the Center for Public Integrity and the Center for Responsive Politics. Data are based on totals reported as of December 8, 2004.


27. Gordon, “Large Donors Fueling Ad Blitz.”


35. The data that follows are based on analyses of contributions made in the 1996 and 2000 elections by Anthony Corrado of Colby College, and of the 2000 and 2004 elections by the Campaign Finance Institute.


I approve the excellent CED statement and vote in favor. However, I have lingering doubts over whether 527 entities, as they have been run, are protected by the First Amendment. I believe they are protected, even though I also think there has been moral abuse of this exception.

I continue to believe that the best role for CED is to try and broker a group of like-minded corporations to “take the pledge” not to make any political contributions whatsoever. I understand some corporations have done so. Such a feat must be done with a number of corporations simultaneously so that one company does not bear an unequal rap. CED is in a unique position to take a shot at some kind of initiative like this.
For more than 60 years, the Committee for Economic Development has been a respected influence on the formation of business and public policy. CED is devoted to these two objectives:

To develop, through objective research and informed discussion, findings and recommendations for private and public policy that will contribute to preserving and strengthening our free society, achieving steady economic growth at high employment and reasonably stable prices, increasing productivity and living standards, providing greater and more equal opportunity for every citizen, and improving the quality of life for all.

To bring about increasing understanding by present and future leaders in business, government, and education, and among concerned citizens, of the importance of these objectives and the ways in which they can be achieved.

CED’s work is supported by private voluntary contributions from business and industry, foundations, and individuals. It is independent, nonprofit, nonpartisan, and nonpolitical.

Through this business-academic partnership, CED endeavors to develop policy statements and other research materials that commend themselves as guides to public and business policy; that can be used as texts in college economics and political science courses and in management training courses; that will be considered and discussed by newspaper and magazine editors, columnists, and commentators; and that are distributed abroad to promote better understanding of the American economic system.

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