

Small Donors, Large Donors and the Internet: Campaign Finance Reform in New York after Obama

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Presentation at

The Rockefeller Institute of Government
State University of New York
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Thank you, Tom, for that introduction.

It is a pleasure for me to be back here, where I spent many years.

When I arrived in 1990, Dick Nathan was in his early days leading this institute. Dick wanted to bring the rigors of scholarship to bear in a timely and useful way on the most important structural issues of federal government. Today's panel can be seen in that context.

Just yesterday the New York State Senate's Committee on Elections held a hearing on public financing of state elections. Today I am going to bring my scholarly perspective to bear on that subject. That makes today's session only the latest among hundreds like this that have been held in this room over the years. Dick has a vision of what it takes to sustain a serious institute that maintains its intellectual credibility among peers while making real contributions to public life. Now that I run a smaller think tank I have a better understanding of how hard it is to hold on to that balance between independence and public use.

As many of you know, Dick recently announced that he'll be stepping back from his role. So I want to take the chance publicly today to offer my congratulations to Dick, as well as to Tom Gais and everyone else at the Institute, for what it has accomplished these past twenty years.

Now that I have set the bar, I'll need to stretch up to reach it. My talk will have three sections. In the first, I'll talk about small donors in the 2008 presidential elections. The second uses state data, including New York, to talk about the potential role for policy reform, including public financing. Finally, in the third section, I'll present my views about the three draft bills being discussed in the New York State Senate.

I. The 2008 Presidential Election

The year 2008 was a real turning point in the way many people think about money in politics. Suddenly, the role of the small donor and the Internet were dominating the public conversation. Much of the reason, of course, stems from the spectacular success of the Obama campaign's fundraising.

There is no doubt in my mind that after Obama, the campaign finance *debate* reached a decisive turning point. Many of the substantive issues are the same, but the issues are now being framed differently. I have been writing professionally about this subject for thirty five years. For most of that time, the main conversation has been about reducing corruption or the appearance of corruption. And the main tools used to serve those ends have been to limit contributions and spending.

It has become clear – painfully clear to some and joyfully clear to others – that there are limits to what you can accomplish through limits. I support contribution limits. But putting a limit on contributions, or even on spending by the candidates, does not and cannot limit spending.

But the real problem with the nearly exclusive focus on limits has been the tunnel vision it forces on the debate.

- The goal served by limits largely have been defined in terms of what they are trying to prevent -- corruption, the appearance of corruption, or undue influence.
- When CFI started the small donor project, we wanted to turn focus away from what bad things are we trying to prevent, toward what positive goals are we trying to accomplish.
- Political scientists traditionally talk about broad range of goals. I think of them as the four c's: limiting corruption is one. The other three c's are: competition, candidate emergence, and citizen participation.
- Of these four c's, my organization, the Campaign Finance Institute has focused on citizen participation -- specifically on promoting equality through enhanced participation.
- Equality requires more than squeezing down the top. Squeezing the top is intrinsically frustrating and marginal. The key, we suspected, was to promote equality by building up the bottom.

Notice the words, I said that "we suspected." but there was a lot we didn't know. So the next few years were spent with a three part research agenda that asked the following.

- First, is there enough of a difference between small and large donors for us to care whether there are more of them? The answer here from our survey research is they are different, but I won't take your time on that.
- Second, assuming they are different, is it plausible to imagine a large enough increase in small donor participation to have a noticeable impact on the system?
- Third, is the Internet likely to be enough by itself or is there still an important role for public policy to play?

To help answer these questions, I'd like to ask you all to look at some data with me. We'll consider the last question first, is the Internet enough by itself? And we'll do this by look at some of the presidential campaign numbers.

PRESIDENTIAL

Leading Primary Candidates. 2004 and 2008: Percentage of Funds Received

	Amount Raised	From Contributions (<u>per transaction</u>) of . . .			From Individuals who gave <u>aggregate totals</u> of . . .		
		\$200 or less	\$201-\$999	\$1,000 +	\$200 or less	\$201-\$999	\$1,000 +
2008							
Obama	\$452,852,990	49%	18%	33%	26%	27%	47%
Clinton	\$210,901,574	33%	15%	52%	16%	21%	63%
Edwards	\$38,638,348	30%	15%	55%	15%	22%	63%
McCain	\$206,363,245	32%	15%	53%	21%	20%	59%
Romney	\$63,065,340	14%	11%	75%	14%	13%	73%
Giuliani	\$61,022,495	15%	9%	76%	15%	9%	76%
Paul	\$34,336,193	63%	15%	18%	39%	29%	32%
Thompson, F.	\$23,369,742	45%	13%	42%	38%	18%	44%
Huckabee	\$15,991,901	43%	17%	40%	29%	24%	47%
2004							
Kerry	\$215,915,455	37%	20%	44%	20%	24%	56%
Dean	\$51,360,995	60%	22%	19%	38%	30%	28%
Edwards	\$21,880,659	14%	16%	71%	7%	14%	78%
Bush	\$256,081,557	31%	12%	58%	25%	13%	60%

SOURCE: THE CAMPAIGN FINANCE INSTITUTE

- The numbers appear in two sets of columns. On the left we see the percentage of money coming from contributions or transactions of specific amounts. These are the numbers we usually saw reported during the campaign. In this column we see that 49% of Obama's contribution transactions were in amounts of \$200 or less, compared to Clinton's 33%. This is a very big difference. It accounts for much of Obama's financial advantage in the primaries.
- The next set of columns aggregates individual contributions by donor. To interpret this, when you see 26% in the line for Obama it means that 26% of Obama's money came from people whose total contributions came to \$200 or less.
- How did the 49% number drop to 26%? It simply means that he had an unusually large number of donors who gave more than once. They were about 200,000 of his 3 million primary donors. This was his activist core and included many of his volunteers.
- How should we interpret the difference 49% and 26%? The repeat donors are surely not fat cats. If you give \$500 or \$1,000, you are not buying a piece of the President. If your main policy goal is to dilute the role of fat cats, this is good enough.
- But if your goal is to increase participation down the ladder, this other column is the better one to look at. The average repeat donor who crossed the \$200 threshold gave about \$500. It's great that so many people were enthusiastic enough to do this, but even though they are not fat cats, and they are not typically what you would call "rich", neither are most of them people of average means.

When I look at Obama's numbers even in this aggregate donation column, they are pretty impressive compared to other presidential candidates. But when I look at them compared to a vision of the breadth of participation I'd like to see, I'd like to see a lot more.

But even though I might wish to see even more at the presidential level, it is important to emphasize that small donor participation in presidential politics is much higher than in other races.

U.S. HOUSE

Sources of Funds, 2008 General Election Candidates

	No. Candidates	Average Receipts per Candidate	From Individuals who gave aggregate totals of . . .			From PACs and Other
			\$200 or less	\$201-\$999	\$1,000 +	
Incumbents	399	\$1,430,613	6%	10%	34%	50%
Democrats	229	\$1,427,757	5%	10%	33%	52%
Republicans	170	\$1,434,460	7%	10%	36%	47%
Challengers	222	\$731,705	15%	15%	37%	33%
Democrats	123	\$766,739	13%	16%	39%	31%
Republicans	99	\$688,177	17%	13%	34%	36%
Open Seat	72	\$1,563,400	8%	12%	37%	42%
Democrats	36	\$1,638,117	9%	13%	35%	43%
Republicans	36	\$1,488,684	8%	11%	39%	42%
Total	693	\$1,220,516	8%	11%	35%	46%

SOURCE: THE CAMPAIGN FINANCE INSTITUTE

U.S. SENATE

Sources of Funds, 2008 General Election Candidates

	No. Candi- dates	Average Receipts per Candidate	From Individuals who gave <u>aggregate totals</u> of . . .			From PACs and Other
			\$200 or less	\$201-\$999	\$1,000 +	
Incumbents	30	\$7,758,342	10%	7%	41%	42%
Democrats	12	\$6,896,687	7%	7%	40%	46%
Republicans	18	\$8,332,779	12%	8%	41%	40%
Challengers	26	\$3,845,180	27%	9%	37%	27%
Democrats	17	\$5,173,841	28%	10%	36%	27%
Republicans	9	\$1,335,485	21%	7%	42%	30%
Open Seat	10	\$5,788,625	17%	10%	47%	26%
Democrats	5	\$7,209,193	15%	10%	52%	23%
Republicans	5	\$4,368,058	21%	9%	37%	33%
Total	66	\$5,918,351	15%	8%	41%	36%

SOURCE: THE CAMPAIGN FINANCE INSTITUTE

- It is obvious from Tables 2 and 3 that the role of small donors is much lower in House and Senate elections than presidential. House candidates raised 8% of their money from candidates who gave \$200 or less in the aggregate. That drops to 6% for House incumbents. For Senate candidates the \$200-and-under percentage comes to 10% for the incumbents and 15% for all candidates.
- These contrasts points to an important fact: small donor fundraising depends upon name recognition or visibility. That comes more easily in races at the top of the ticket than further down.

The importance of visibility becomes clear within a single race becomes clear when we look at fundraising over time during presidential primaries. This table goes back to contributions or transactions, not aggregated by donor.

Large and Small Contributions Over the Primary Season

Leading Candidates' Fundraising, Jan. 2007 - Aug. 2008
(Contributions **Not** Aggregated by Donor)

	Amount Raised From Individuals (\$ millions)	In Contributions of \$200 or less (%)	In Contributions of \$1,000 or more (%)
OBAMA			
Jan. - Sep. 2007	74.7	28%	60%
Oct. - Dec. 2007	22.5	46%	33%
Jan. - Feb. 2008	87.4	52%	26%
Mar. - May 2008	91.4	62%	18%
Jun. - Aug. 2008	134.7	62%	21%
CLINTON			
Jan. - Sep. 2007	61.6	13%	78%
Oct. - Dec. 2007	22.4	16%	69%
Jan. - Feb. 2008	45.3	47%	43%
Mar. - May 2008	51.1	61%	19%
McCAIN			
Jan. - Sep. 2007	28.0	22%	67%
Oct. - Dec. 2007	6.3	38%	39%
Jan. - Feb. 2008	21.1	22%	62%
Mar. - May 2008	53.2	25%	63%
Jun. - Aug. 2008	94.4	39%	43%

SOURCE: THE CAMPAIGN FINANCE INSTITUTE

As you can see, all of the candidates depended on large contributions at first, and then developed their small donor fundraising base over time. This was even true for Obama, who raised 28% of his money from contributions of \$200 or less. These were the nine months when he established himself as the alternative to the front runner. He established himself largely on the basis of his fundraising, and that was mostly fundraising of the old fashioned kind, with checks of \$1,000 or more. His small contributions did not reach the high 40s until the fourth quarter of 2007.

From all of this I conclude, first, that the Obama phenomenon will not be easy to replicate, especially in legislative or lower visibility races. Second, I conclude that small donor fundraising presupposes some kind of a launching pad or starting point. Even with the Internet, you cannot go to mass fundraising until enough people know who you are. To do that requires a campaign that has already gotten some traction.

With these data now in front of you, I'll turn to the next major section of my talk. If we do not believe the Obama phenomenon will be replicated easily – and I do not believe it – than are there some effective ways for public policy to help promote participation?

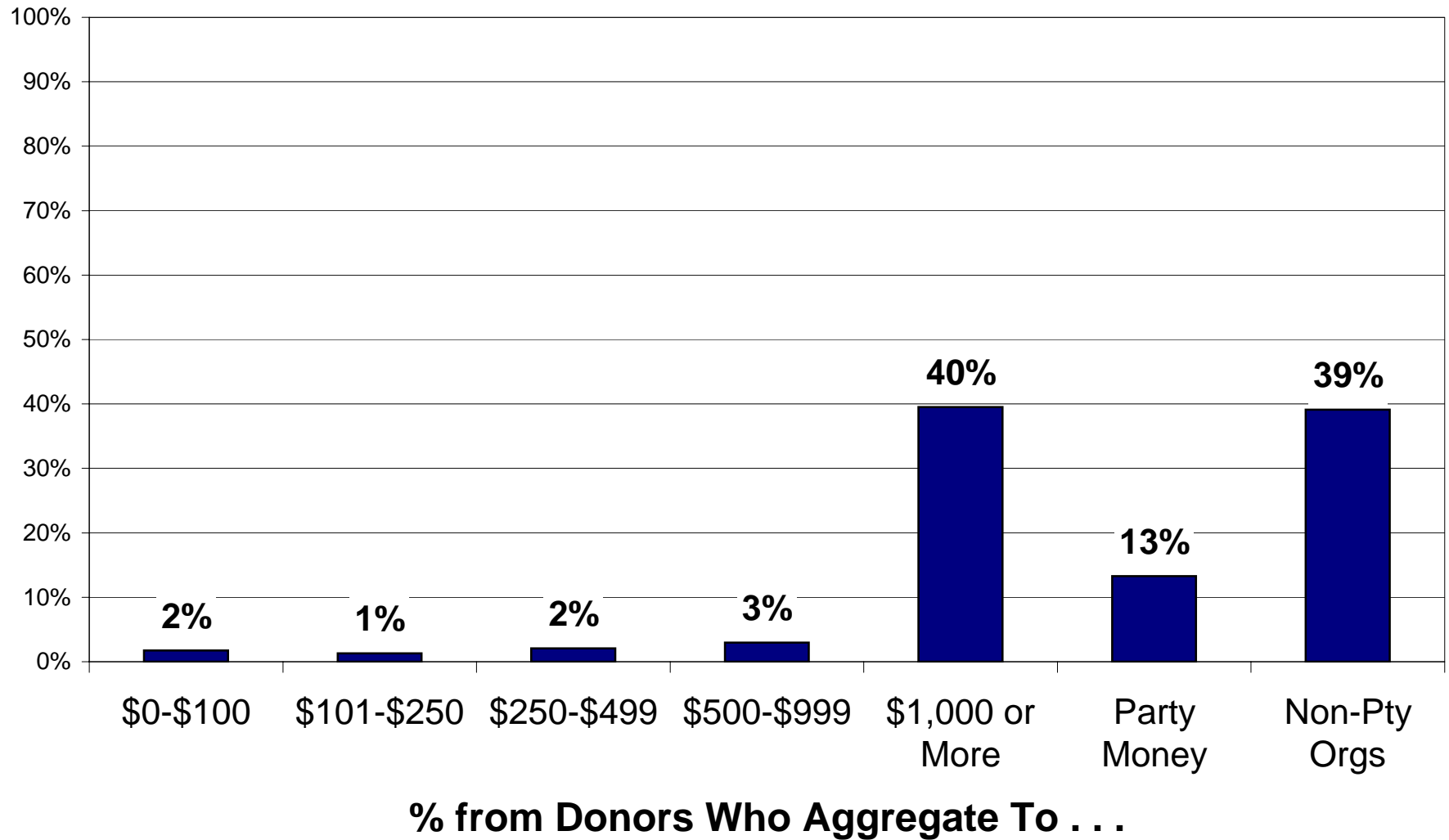
II. Modeling the States

To answer the policy questions, I shall refocus my attention to the work CFI has been doing in the states.

In the next figure, I use bar charts for states to give you some of the same information I showed you in tables for federal elections. These charts are from a series we are developing for all fifty states.

The first chart shows the sources of candidates' funds in New York State in 2006. We are still crunching the numbers for 2008 but should have them fairly soon.

NY: 2006 Donors (Actual): All Offices Combined



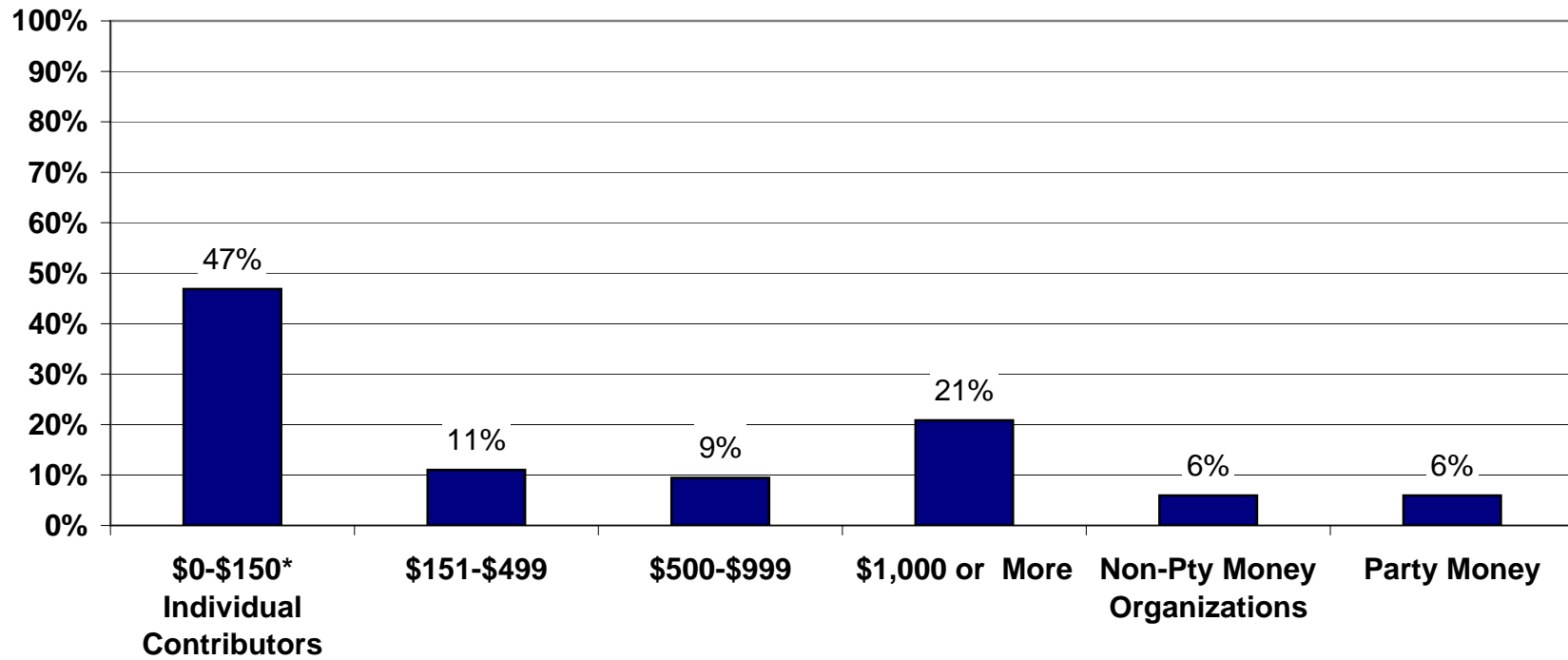
As you can see, the candidates in New York received even less of their money from small donors [2-3%] than candidates for the US House [8%]. Only one-half of one percent of the adults in New York gave any money at all to any of the candidates that year. That includes an estimate for the unitemized small donors who gave less than \$100. 99.5% of the adult population in New York gave nothing at all in 2006.

This is a remarkably low participation rate. Of the 44 states we have calculated so far, New York is second from the bottom. For most other states, the number looks more what we saw for the US House.

But the general shape of the chart is not that all that different from other states. Most of the money came from the major donors and organizations at the right hand side of the chart.

The next chart does the same thing for Minnesota.

Minnesota Actual (2006)

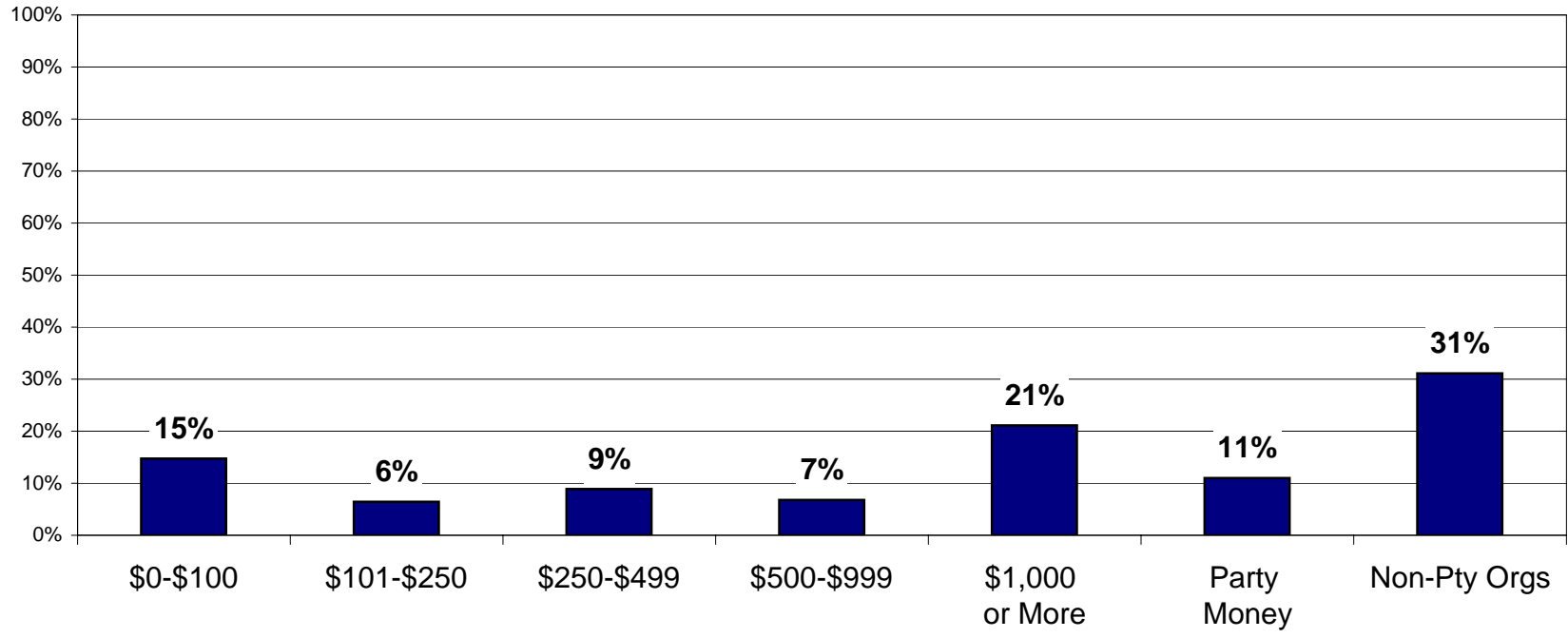


As you can see, the basic shape of this chart is radically different from New York's. What makes Minnesota different? For many, the first answer might be that people are just different in Minnesota. But that answer won't do. It turns out that states neighboring Minnesota, with similar cultures, have charts more like New York's than Minnesota's. But Minnesota does have different campaign finance laws. It has low contribution limits, it gives donors up to a \$50 state rebate for contributions, and it offers partial public funding to candidates. With this combination, about 5% of the people in Minnesota contribute to candidates -- that's 5%, not 0.5%.

Next we looked at what some policy options could do to the bar charts.

This chart shows the impact of the public matching fund proposal that passed the New York Assembly last year. As you may know, the Assembly bill would have given a four-for-one public match for the first \$250 from every donor, and it would have limited contributions to \$2000. Here is what that chart would have looked like, if superimposed on the 2006 donors.

NY: 2006 Donors Under Assembly Plan



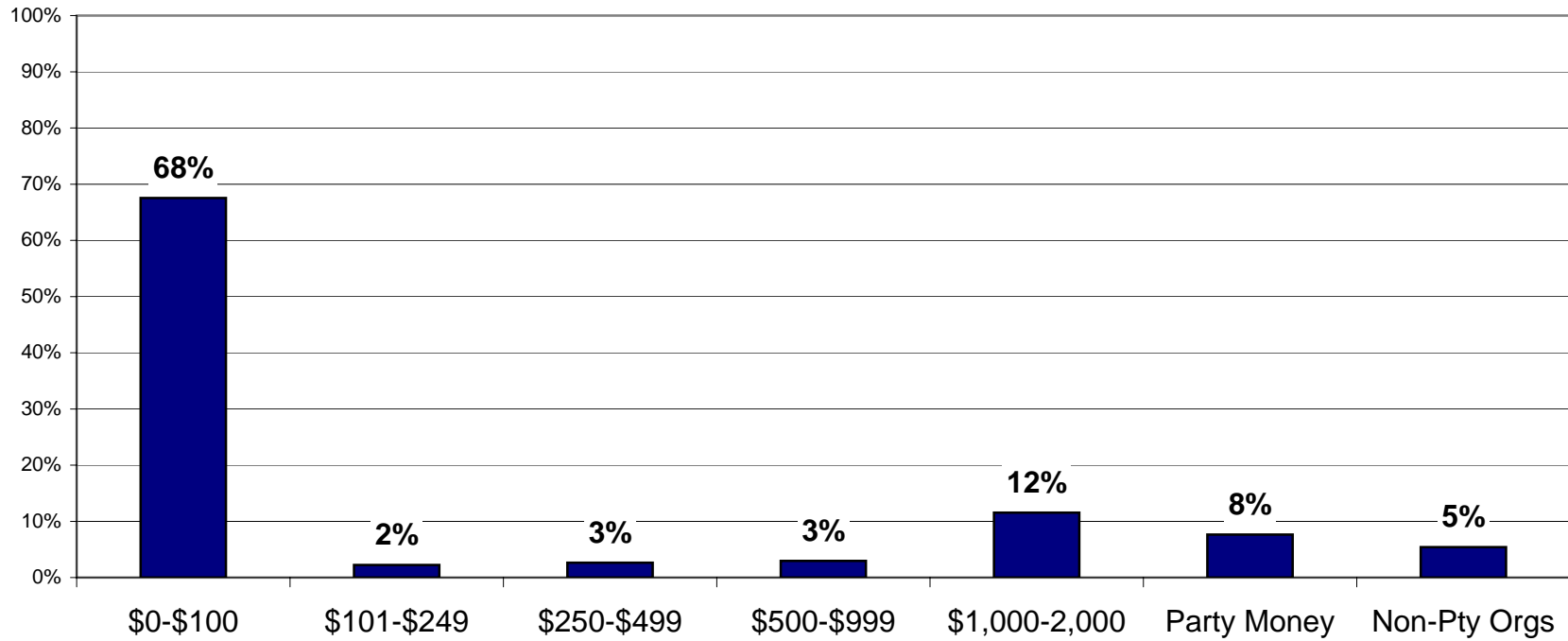
- NOTE: we added the value of the public matching money to whatever bar was responsible for generating it. In the Assembly bill, you could give any amount and still generate public money, so we added the right amount of money to each bar. We also reduced the top bars to account for the lower contribution limits.

As you can see, this bill would have a noticeable effect on the shape of the bar. The proportional role of small donors would come to look like somewhere between the US Senate and John McCain. That is significant, but it is not up to the level of Obama, let alone the whole state of Minnesota.

Next we created a series of hypothetical scenarios. In each of the 50 states, we look at the potential effect of three kinds of changes to the status quo. First, we look at \$2000 contribution limits. Next we look at the impact of public matching funds, but instead of \$250, as in the New York Assembly bill, we give a 5 for 1 match only for the first \$50. Finally, we asked what would happen if some combination of policy plus technology could shift the candidates' incentives enough to get 3% of the people to give \$50 each. We do not think 3% is overly optimistic. It is about half of Minnesota's rate. It's also about the same as in the 2008 federal elections without any public money incentive. And since we are looking for 3% in a year with a gubernatorial election, we not think a 3% goal is overly optimistic.

When our online tool is launched, you will be able to look at the effects of each of these changes individually, or in any combination of two or three in any of the states. There are about a dozen possibilities per state. I am only going to show you the most spectacular one, which is what happens when you combine all three at all three of the options once. Here is the combination table for New York.

NY: More Small Donors (3%) with a Lower Contribution Limit and Small Donor Matching



As you can see, building up the participation rates from the bottom like this could have a huge impact. And public policy -- including rebates, tax credits or matching grants -- can be structured to help make this happen.

The key lessons are first, that policy choices can change the situation radically and, second, that there is more than one way to reach the same goal. So it is important, when you talk about campaign finance reform, to think about what it is you're trying to get *to*, not just what you're trying to get away from.

I would argue that one of the key goals is to get more people involved in the process. We know that getting more small donors involved also means more volunteers; we have good reason to believe there is two-way feedback between giving and doing. Getting people involved is valuable for its own sake, so it's important when formulating campaign finance policy to think carefully about how best to encourage this goal.

III. Current Approaches in New York

That gets to my final topic: What do I think of the three public financing bills now before the New York legislature? All provide public resources to candidates and I think that's good. Each of them suffers, however, from one or more substantial flaws that I hope will be corrected.

First, each of the bills sets a spending limit on the candidates. Spending limits have proven to be fatal flaws in the presidential system as well as in many states. Under federal constitutional law, public financing programs with spending limits must be voluntary. We have been learning in recent years that if a candidate thinks that a spending limit will hurt his chances to win, the candidate will say "no thanks" and opt out. Candidates cannot control how much an opponent will spend, let alone how much the parties or interest groups will spend in unlimited, constitutionally protected speech. You cannot expect a candidate to commit political suicide just to get public funds.

Many states responded by giving extra bonus money to participating candidates if their opponents opt out, or if an outsider makes an independent expenditure. This idea is in the New York Clean Money bill, as well as in law in Arizona, Maine and Connecticut. I see two problems with this approach.

- First, these provisions have become constitutionally suspect after the Supreme Court down the so-called "Millionaire's Amendment" in federal law.
- Second, recent Supreme Court rulings on issue advertising means that a great deal of politically relevant speech will fall outside of any permissible

definition of independent spending. There is no way to compensate for this financially.

As a result, it is inevitable that hard and fast spending caps over time will come to be seen as death traps by many candidates. The candidates eventually will choose not to participate and when that happens, the whole purpose of public financing will fall by the wayside.

But there are even more fundamental issues in question. We need to ask what is the real purpose of a spending limit? I understand that if you are going to give the candidate public money, you want to get something back. But why should the "give back" take the form of a spending limit? If the goal is to reduce the power of special interests, what is wrong with allowing small contributions of \$100 or \$200? Most people don't even become aware of a campaign until late. What is the point of turning them off? Small contributions fuel volunteer activity and vice versa. This is good for democracy, not bad.

To my mind, the spending limit is the main problem with the Assembly's matching fund bill, although I also have problems with details of the matching provision.

The Clean Money full public funding bill has the same spending limit problem, with a twist. Clean Money gives candidates a large flat grant early, after they qualify. In its pure version, the only private money comes very early as a qualifying contribution. Early grant money does help with candidate recruitment and with competition, but in my view there are two big problems with the pure Clean Money approach:

- First is that there is a lot riding on getting the qualifying provisions exactly right. If qualifying is too easy, you waste a lot of public money. But if you make it too hard to qualify, you'll be keeping people out who ought to be in. Matching fund systems are a lot more forgiving in this respect.
- The second problem with the pure system is that the complete absence of private money means you lose an important lever for building up enthusiasm among average supporters, who tend to come into the process later.

For these reasons, I tend to be a fan of properly designed matching fund systems.

But Clean Money advocates can at least improve their products and get around both the spending limit and enthusiasm problems with a well designed hybrid. The draft hybrid for New York starts off with matching funds and then goes to a flat grant with no more money after the grant. In my view, this gets it backwards.

By contrast, the latest bill just introduced by Sens. Durbin and Specter for congressional public financing reverses the sequence in a way that I would recommend people in New York should consider. In the federal bill's sequence, qualifying contributions come first, then a flat grant, and then matching funds. Candidates who participate have to live with a \$100 contribution limit. This money gets matched, four to one, and the money keeps getting matched to a high enough level so candidates don't have to worry about an opponent who does not participate. And even after the matching funds are finished, there is still no hard and fast spending limit. Candidates may continue to raise unmatched funds as long as it comes from people who give \$100 or less.

The new presidential bill, not yet introduced, will embrace a slightly different approach. It will continue use matching funds for the primaries, as the system does now. As I said, using matching funds in the primaries takes the big risk out of the qualifying thresholds: if you let a too many candidates in, it's not a big deal. The system then moves to a flat grant for the general. But for both primaries and the general, candidates will be able to raise and spend unlimited amounts from small donors who give \$200 or less.

In my mind, this is an intellectual paradigm shift. Instead of stopping and restricting, the new emphasis is on empowering and enabling. This new emphasis has been energized by the Internet and small donors, but the technology alone is not enough. Technology needs to be supplemented by incentive, and policy can help create those incentives. Many policies will help us get where we want to go. The fascinating point is that the policy community is rethinking the destination. This is a welcome change. While legislative majorities will not come easily in the short term, I look forward to where the new paradigm may lead in the end.