

April 2013

## Charities in Politics: A Reappraisal

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<https://scholarship.law.wm.edu/wmlr/vol54/iss5/3>

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## CHARITIES IN POLITICS: A REAPPRAISAL

BRIAN GALLE\*

### ABSTRACT

*Federal law significantly limits the political activities of charities, but no one really knows why. In the wake of Citizens United, the absence of any strong normative grounding for the limits may leave the rules vulnerable to constitutional challenge. This Article steps into that breach, offering a set of policy reasons to separate politics from charity. I also sketch ways in which my more precise exposition of the rationale for the limits helps guide interpretation of the complex legal rules implementing them.*

*Any defense of the political limits begins with significant challenges because of a long tradition of scholarly criticism of them. Critics of the limits suggest that the “market failures” that justify tax subsidies for charity also afflict group efforts to monitor politicians and organize politically, and thus the subsidy should extend to cover those activities. These claims, though, overlook a series of additional issues suggested by transaction cost economics and other aspects of economic theory.*

*Most significantly, even if lobbying and electioneering should be subsidized, it does not follow that these functions should be carried out by charities. I argue that combining politics with charity may produce a set of diseconomies of scope, including higher agency costs, diminished “warm glow” from giving, and greater inframarginality of deduction recipients. In addition, I argue that the economically ideal tools for reaching the socially optimal levels of charity and lobbying are incompatible with one another. Although there are also*

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\* Associate Professor, Boston College Law School. I'm grateful for helpful comments and suggestions from Ellen Aprill, Richard Briffault, Neil Buchanan, Roger Colinvoux, Tommy Crocker, Miriam Galston, Kent Greenfield, Ben Leff, Ray Madoff, Lloyd Mayer, Diane Ring, and attendees of presentations at Boston College Law School, South Carolina Law School and the Annual Meeting of the Law & Society Association. Melanie MacWilliams-Brooks provided excellent research assistance.

*offsetting gains from the combination, many of these gains further exacerbate the diseconomies.*

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## INTRODUCTION

As the Supreme Court has deregulated campaign finance over the past few years, money has poured into every crevice of politics, but maybe nowhere more so than in the nonprofit sector.<sup>1</sup> Most of the notorious “Super PACs,” including Karl Rove’s Crossroads GPS, are organized as nonprofits.<sup>2</sup> Federal tax law in theory prevents most nonprofits from devoting the bulk of their efforts to political campaigns and also limits the lobbying efforts of true charities, such as hospitals, schools, and churches.<sup>3</sup> But now that the Court has declared the pool open, even church leaders are diving in, with a coalition of ministers frankly daring the IRS to attempt to enforce its rules against them.<sup>4</sup>

Should we care? That is the central question for this Article. Legal limits on lobbying by charities have been around for a long time, but truly thorough explanations for why they exist have been slow to develop.<sup>5</sup> For about forty years, that was a problem mostly for academics, and perhaps for Congress.

Now, though, *Citizens United v. FEC* and the rest of the deregulatory wave of campaign finance decisions lend new urgency to identifying the government’s interest in regulating the political activities of charities.<sup>6</sup> Under federal tax law, charities cannot engage in more than a “substantial” amount of lobbying and cannot take part in campaigns for elective office at all.<sup>7</sup> The constitutional-

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1. See Ellen P. Aprill, *Regulating the Political Speech of Noncharitable Exempt Organizations After Citizens United*, 10 ELECTION L.J. 363, 363-64 (2011). For a description of the deregulatory movement, see Richard L. Hasen, *Lobbying, Rent-Seeking, and the Constitution*, 64 STAN. L. REV. 191, 195-97 (2012).

2. Michael Luo & Stephanie Strom, *Donor Names Remain Secret as Rules Shift*, N.Y. TIMES, Sept. 21, 2010, at A1; Jonathan Weisman, *Scrutiny of Political Nonprofits Sets Off Claim of Harassment*, N.Y. TIMES, Mar. 7, 2012, at A20.

3. David C. Vladeck, *Special Considerations for Lobbying by Nonprofit Corporations*, in THE LOBBYING MANUAL: A COMPLETE GUIDE TO FEDERAL LAW GOVERNING LAWYERS AND LOBBYISTS 319, 321-33 (William V. Luneberg & Thomas M. Susman eds., 3d ed. 2005).

4. See Stephanie Strom, *The Political Pulpit*, N.Y. TIMES, Oct. 1, 2011, at B1.

5. See Miriam Galston, *When Statutory Regimes Collide: Will Citizens United and Wisconsin Right to Life Make Federal Tax Regulation of Campaign Activity Unconstitutional?*, 13 U. PA. J. CONST. L. 867, 911-15 (2011).

6. See *id.* at 873; see also 130 S. Ct. 876 (2010).

7. I.R.C. § 501(c)(3) (2006).

ity of the two limits had been mostly settled by a series of Court decisions in the early 1980s.<sup>8</sup> Because government was not obliged to fund speech, the Court held, Congress could—with little justification or explanation—make abstention from politics a condition of its subsidies for the charitable sector.<sup>9</sup>

Those cases, however, depend on the assumption that a charity's stakeholders can still express themselves through the use of an affiliated, noncharitable nonprofit entity.<sup>10</sup> The *Citizens United* Court rejected, albeit in a somewhat different context, a very similar argument: the government had claimed that Citizens United was not burdened by campaign expenditure limits, because it could mitigate those limits by establishing a separate PAC.<sup>11</sup> The Court waived aside that alternative as too burdensome to sidestep First Amendment scrutiny.<sup>12</sup> And strict scrutiny, of course, demands that the government offer a compelling interest in support of its regulation.

Many other authors have also written on the connection between charity and politics, and in any literature as crowded as this one, any new contribution is necessarily incremental.<sup>13</sup> But prior authors have overlooked some fundamental economic concepts. For example,

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8. Galston, *supra* note 5, at 891-97.

9. See *Regan v. Taxation with Representation of Wash.*, 461 U.S. 540, 545-46 (1983).

10. See *infra* notes 44-45 and accompanying text.

11. See *Citizens United*, 130 S. Ct. at 897.

12. See *id.* at 897-98.

13. Important articles in the literature include the following: Johnny Rex Buckles, *Is the Ban on Participation in Political Campaigns by Charities Essential to Their Vitality and Democracy? A Reply to Professor Tobin*, 42 U. RICH. L. REV. 1057 (2008); Bruce Chapman, *Between Markets and Politics: A Social Choice Theoretic Appreciation of the Charitable Sector*, 6 GEO. MASON L. REV. 821 (1998); Laura B. Chisholm, *Exempt Organization Advocacy: Matching the Rules to the Rationales*, 63 IND. L.J. 201 (1988) [hereinafter Chisholm, *Matching*]; Laura Brown Chisholm, *Politics and Charity: A Proposal for Peaceful Coexistence*, 58 GEO. WASH. L. REV. 308 (1990) [hereinafter Chisolm, *Politics and Charity*]; Miriam Galston, *Lobbying and the Public Interest: Rethinking the Internal Revenue Code's Treatment of Legislative Activities*, 71 TEX. L. REV. 1269 (1993); Richard W. Garnett, *A Quiet Faith? Taxes, Politics, and the Privatization of Religion*, 42 B.C. L. REV. 771 (2001); Oliver A. Houck, *On the Limits of Charity: Lobbying, Litigation, and Electoral Politics by Charitable Organizations Under the Internal Revenue Code and Related Laws*, 69 BROOK. L. REV. 1 (2003); Benjamin M. Leff, "Sit Down and Count the Cost": A Framework for Constitutionally Enforcing the 501(c)(3) Campaign Intervention Ban, 28 VA. TAX REV. 673 (2009); Donald B. Tobin, *Political Campaigning by Churches and Charities: Hazardous for 501(e)(3)s, Dangerous for Democracy*, 95 GEO. L.J. 1313 (2007).

critics of existing political limits suggest that lobbying, at least, is consistent with the goals of the charitable contribution deduction.<sup>14</sup> The standard economic explanation for the deduction, though, is to encourage the production of goods the private market would otherwise fail to deliver.<sup>15</sup> To be sure, lobbying can be a tool for delivering services to the needy. But that implies that lobbying should be limited to lobbying in favor of delivering new public goods, not blocking or repealing them. This is a considerable oversight, given that political economists believe that the vast majority of effective lobbying is aimed at obstructing new legislation or regulation.<sup>16</sup>

Another gap that would surprise an organizational economist is the absence of any analysis of economies of scale and scope. Some opponents of the political limitations suggest plausibly that market failures also afflict efforts for underrepresented communities to unite for mutual political benefit.<sup>17</sup> Perhaps, then, lobbying should also be subsidized. Should the two tasks, lobbying and charity, be conducted together in the same organization, though? Are the two more effective when combined, or are there instead ways in which one might undermine the other? That seems like a key question, and so far it has gone unasked. Answering it will form the core of my analysis.

There are other omissions as well. Political scientists have already debated the best design for political subsidies.<sup>18</sup> The charitable contribution deduction, which is more generous for wealthier interests and allows for unlimited spending, is exactly the type of

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14. See Buckles, *supra* note 13, at 1115-16; Chisholm, *Matching*, *supra* note 13, at 267, 270-73; Houck, *supra* note 13, at 84; Dana Brakman Reiser, *Charity Law's Essentials*, 86 NOTRE DAME L. REV. 1, 61 (2011); John Simon et al., *The Federal Tax Treatment of Charitable Organizations*, in THE NONPROFIT SECTOR: A RESEARCH HANDBOOK 267, 286 (Walter W. Powell & Richard Steinberg eds., 2d ed. 2006).

15. See JOHN D. COLUMBO & MARK A. HALL, THE CHARITABLE TAX EXEMPTION 104-07 (1995); Harold M. Hochman & James D. Rogers, *The Optimal Tax Treatment of Charitable Contributions*, in THE ECONOMICS OF NONPROFIT INSTITUTIONS: STUDIES IN STRUCTURE AND POLICY 224, 231-32 (Susan Rose-Ackerman ed., 1986).

16. See *infra* notes 70-72 and accompanying text.

17. See, e.g., Buckles, *supra* note 13, at 1115-16; Mark Chaves et al., *Does Government Funding Suppress Nonprofits' Political Activity?*, 69 AM. SOC. REV. 292, 293 (2004); Chisholm, *Matching*, *supra* note 13, at 266-77; Galston, *supra* note 13, at 1314.

18. See, e.g., Richard L. Hasen, *Clipping Coupons for Democracy: An Egalitarian/Public Choice Defense of Campaign Finance Vouchers*, 84 CALIF. L. REV. 1, 20-35 (1996); see *id.* at 20-21 n.88 (describing earlier proposals of political scientists).

design that all the otherwise fractious political scientists can agree they would reject.<sup>19</sup> The finance and organizational-theory literatures offer a rich account of the perils of organizations that try to conduct two unrelated tasks at the same time: higher agency costs and managerial distraction are usually the result.<sup>20</sup>

In sum, there are potentially two distinct questions about the legal separation between charity and politics. First, should we subsidize political activity? If not, then we have an easy answer: the limits are simply targeting rules for government dollars, albeit with some potentially tricky questions about how to implement that targeting. Supposing that politics should sometimes get government support—and arguably it should—we then have the question of how to deliver that additional subsidy. This design problem, I will argue, is probably what best justifies the existing rules.<sup>21</sup>

As for the remainder of the Article, Part I offers more detailed background for readers not familiar with the tax rules governing charity or the constitutional law bearing on the validity of those rules. Part II begins the analysis by examining whether the rationales usually offered for government subsidies, such as in the case of the charitable contribution deduction, also justify a subsidy for lobbying, a subset of political activities. Although I find that these rationales offer less support than critics of the limits have acknowledged, the rationales do argue for subsidies at least for some people to engage in some kinds of lobbying. Part III therefore takes up the design question, asking whether charity and politics are wisely conducted together. Part IV plays out the legal implications of Parts II and III, offering suggested definitions of “lobbying” and “substantial,” and addressing other questions that currently vex lawyers in the field. Part V briefly applies the lessons of Parts II and III to charitable involvement in campaigns for elective office.

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19. *See id.* at 29-30.

20. *See, e.g.,* Bengt Holmstrom & Paul Milgrom, *Multitask Principal-Agent Analyses: Incentive Contracts, Asset Ownership, and Job Design*, 7 J.L. ECON. & ORG. 24, 33-43 (1991) (agency costs); Sucheta Nadkarni & Pamela S. Barr, *Environmental Context, Managerial Cognition, and Strategic Action: An Integrated View*, 29 STRATEGIC MGMT. J. 1395, 1397-1419 (2008) (distraction).

21. *See infra* Part III.

## I. BACKGROUND

To understand political limits on nonprofits, the reader must unfortunately take a brief tour of tax law. Federally recognized nonprofits can earn two distinct forms of tax benefits. Noncharitable nonprofits, such as labor unions and cooperatives, are exempt from the federal tax on corporate income.<sup>22</sup> Organizations meeting the tougher standards of § 501(c)(3), which I will somewhat loosely group together as “charities,” are entitled to this exemption and also are eligible to receive deductible contributions.<sup>23</sup> That is, individuals who donate to a qualified 501(c)(3) can reduce their taxable income by the amount of the contribution, subject to a series of technical limitations.<sup>24</sup>

The dollar value of this charitable contribution deduction (“the deduction”) is only a fraction of the money donated. Reducing taxable income by one dollar shrinks the size of the check the taxpayer has to write to the government in an amount equal to the taxpayer’s marginal rate multiplied by one dollar.<sup>25</sup> So, for example, if Louise makes a \$1,000 contribution and has a 28 percent marginal tax rate, she now pays the government \$280 less in taxes. In effect, the deduction is a matching grant from the government to the charity: for every dollar the donor contributes, the government gives back, say, 28 or 35 cents, which the donor can then also contribute. Studies suggest that the deduction is an important factor in encouraging donations.<sup>26</sup>

Because of its structure as an income tax deduction, federal support for charity is worth more for higher-income donors.<sup>27</sup> We have a progressive tax system, so higher-bracket donors get a larger matching grant.<sup>28</sup> Only itemizers, who are generally higher-income

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22. I.R.C. § 501(c)(4)-(7) (2006).

23. *See id.* § 501(c)(3); *see also id.* § 170(a)(1).

24. For a thorough exploration of the contribution rules, see BORIS I. BITTKER ET AL., *FEDERAL INCOME TAXATION OF INDIVIDUALS* ch. 25 (3d ed. 2002).

25. *See* COLUMBO & HALL, *supra* note 15, at 107-08.

26. *See* John Peloza & Piers Steel, *The Price Elasticities of Charitable Contributions: A Meta-Analysis*, 24 J. PUB. POL’Y & MARKETING 260, 264-65 & tbl.1, 267 (2005).

27. *See* STANLEY S. SURREY, *PATHWAYS TO TAX REFORM: THE CONCEPT OF TAX EXPENDITURES* 136 (1973).

28. *See* BITTKER ET AL., *supra* note 24, at 25-2.

households,<sup>29</sup> can claim the deduction at all,<sup>30</sup> and donors must have enough taxable income within a five-year span to offset their contributions.<sup>31</sup>

To qualify for their matching grant, nonprofit firms have to meet a series of legal requirements, including two separate limits on their political activities. For one, the organizations cannot engage in a “substantial” amount of “propaganda ... or otherwise attempt[] to influence legislation.”<sup>32</sup> I will call this the “lobbying limitation.” The organization also must not “participate in ... any political campaign on behalf of (or in opposition to) any candidate for public office.”<sup>33</sup> Notice the absence of the word “substantial” in this phrase. I will call this second rule the “electioneering ban.”

The other legal requirements for the deduction deal mostly with defining what kinds of firms are eligible for the subsidy. Generally speaking, commercial enterprises are not eligible, but churches, educational institutions, nonprofit hospitals, museums, zoos, and social service organizations are.<sup>34</sup> The key feature these purposes all share is that they suffer from market failure: because their consumers provide positive externalities to others, the private market will tend to undersupply them.<sup>35</sup> Entities that meet most of these requirements, but fail to comply with all of the political restrictions, can still be exempt from the corporate income tax under § 501(c)(4).<sup>36</sup> A (c)(4) can lobby and electioneer as long as electioneering is not the primary purpose of the organization.<sup>37</sup>

Taxpayers have repeatedly, and so far unsuccessfully, challenged the constitutionality of § 501(c)(3)’s political limitations.<sup>38</sup> The

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29. Ellen P. Aprill, *Churches, Politics, and the Charitable Contribution Deduction*, 42 B.C. L. REV. 843, 843-46 (2001).

30. I.R.C. § 63 (2006).

31. *Id.* § 170(d).

32. *Id.* § 501(c)(3). Nonchurch charities can also opt into a more detailed set of rules with explicit caps on certain forms of lobbying expenditures and more complex, although not necessarily more precise, definitions of several important terms. *Id.* § 501(h).

33. *Id.* § 501(c)(3).

34. See 26 C.F.R. § 1.501(c)(3)-1 (2012); ROBERT J. DESIDERIO, PLANNING TAX-EXEMPT ORGANIZATIONS §§ 7.01, .05, .08, 8.01 (2012).

35. See BRUCE R. HOPKINS, THE LAW OF TAX-EXEMPT ORGANIZATIONS 163 (9th ed. 2007).

36. See DESIDERIO, *supra* note 34, § 23.02(5)(c).

37. Vladeck, *supra* note 3, at 321.

38. In other words, the reader may now uncover her eyes: our journey through tax land is over. Okay, almost over.

leading case is still *Regan v. Taxation with Representation of Washington*, or “*TWR*.”<sup>39</sup> The *TWR* Court held that the deduction is a subsidy for charity and that the government is free to withhold that subsidy from activities it would prefer not to underwrite.<sup>40</sup> The Court declared that there is no right to government support even for constitutionally protected activities such as political speech.<sup>41</sup>

In cases after *TWR*, though, the Court grew more willing to scrutinize government spending decisions. Justice Blackmun’s concurring opinion in *TWR* had argued that a complete ban on all speech by a recipient organization went beyond the government’s goal of simply limiting the uses of its own dollars, because the ban also effectively penalized the organization for speech paid for with money that came from elsewhere.<sup>42</sup> Later cases adopted Blackmun’s concurrence as the more persuasive approach.<sup>43</sup> If a government grant is conditioned on limits to the recipient entity’s speech, the recipient’s members must have some other outlet for their expression.<sup>44</sup> In the case of nonprofits, the *TWR* concurrence acknowledged, this condition is usually met, because a 501(c)(3) organization is free to form an affiliated (c)(4), which its members can then use to do the bulk of their lobbying.<sup>45</sup>

Thus, until recently it seemed fairly settled that the lobbying limits and electioneering ban were constitutional, even though they arguably burdened protected speech, because of the (c)(4) option.<sup>46</sup> Many charities now also operate an affiliated noncharitable nonprofit which they use to conduct their political operations.<sup>47</sup>

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39. 461 U.S. 540 (1983).

40. *Id.* at 544-45.

41. *Id.* at 545-46.

42. *Id.* at 552 (Blackmun, J., concurring).

43. See *Rust v. Sullivan*, 500 U.S. 173, 196 (1991); *FCC v. League of Women Voters*, 468 U.S. 364, 400 (1984). For an overview of rules limiting government decisions to fund speech, see Eugene Volokh, *Freedom of Expressive Association and Government Subsidies*, 58 STAN. L. REV. 1919, 1928-38 (2006).

44. *League of Women Voters*, 468 U.S. at 399-400.

45. *TWR*, 461 U.S. at 552-53 (Blackmun, J., concurring).

46. See Galston, *supra* note 5, at 891-97, 903-06.

47. See Hasen, *supra* note 1, at 204; Lloyd Hitoshi Mayer, *What Is This “Lobbying” That We Are So Worried About?*, 26 YALE L. & POL’Y REV. 485, 546-47 (2008). For a helpful case study of these multientity structures, see Janelle A. Kerlin & Elizabeth J. Reid, *The Financing and Programming of Advocacy in Complex Nonprofit Structures*, 39 NONPROFIT & VOLUNTARY SECTOR Q. 802, 806-12 (2010).

The now-infamous *Citizens United* decision and a handful of cases immediately before and after it have unsettled the consensus that *TWR* remains good law.<sup>48</sup> The Supreme Court and courts of appeals have now struck down a series of state and federal limits on political expenditures.<sup>49</sup> The exact contours of the rules that have been invalidated are not important for my purposes here, but the rationale the courts have offered is. In *Citizens United*, for example, the Supreme Court struck down federal limits on certain political advertising paid for out of a corporation's general treasury funds.<sup>50</sup> The government argued in defense of the limits that corporations could still form a separately incorporated political action committee, or "PAC," which they could then use as vehicles for whatever advertising they wanted.<sup>51</sup> The Court rejected that argument, stating,

Even if a PAC could somehow allow a corporation to speak—and it does not—the option to form PACs does not alleviate the First Amendment problems with [the advertising limits]. PACs are burdensome alternatives; they are expensive to administer and subject to extensive regulations. For example, every PAC must appoint a treasurer, forward donations to the treasurer promptly, keep detailed records of the identities of the persons making donations, preserve receipts for three years, and file an organization statement and report changes to this information within 10 days....

...PACs have to comply with these regulations just to speak.... PACs, furthermore, must exist before they can speak. Given the onerous restrictions, a corporation may not be able to establish a PAC in time to make its views known regarding candidates and issues in a current campaign....

[The] prohibition on corporate independent expenditures is thus a ban on speech.<sup>52</sup>

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48. See generally *Citizens United v. FEC*, 130 S. Ct. 876 (2010). For the full story, see Aprill, *supra* note 1, at 365-75, 391-401, and Galston, *supra* note 5, at 882-84.

49. Hasen, *supra* note 1, at 213-16.

50. *Citizens United*, 130 S. Ct. at 913.

51. Supplemental Reply Brief for the Appellee at 6, *Citizens United*, 130 S. Ct. 876 (No. 08-205).

52. *Citizens United*, 130 S. Ct. at 897-98.

In other words, it appears that the burdens of setting up an alternative entity to speak for the organization can themselves create “a ban on speech.”

Commentators have been quick to point out the possible implications of passages like these for the *TWR* consensus.<sup>53</sup> Setting up a (c)(4) organization, like creating a PAC, requires an application form and regular reporting to the government.<sup>54</sup> Establishing that none of the 501(c)(3) entity’s resources are funneled to the (c)(4) requires detailed and careful accounting. If the logic of *Citizens United* applies, then the effort of setting up a (c)(4) workaround looks as though it could itself be a “ban” on speech.<sup>55</sup>

Of course, the fact that government regulations burden or ban speech does not necessarily mean that they are unconstitutional. Government always has the opportunity, even under the strictest constitutional scrutiny, to show that it is pursuing a compelling interest with the least restrictive means available.<sup>56</sup> Thus, the government’s interest in the 501(c)(3) political limits may be the key factor distinguishing the limits from those considered by *Citizens United* and its ilk. In *Citizens United*, the government’s goals were purely regulatory: it wanted to control the market for politics to avoid “corruption.”<sup>57</sup> The rationale for the political limits on charities may be different. Most of the existing explanations for those limits center on protecting the government’s investment in charity.<sup>58</sup>

Understanding charity, then, is at the center of the constitutional inquiry into the political limits placed on it. In what ways might lobbying or electioneering interfere with the underlying goals of

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53. See Aprill, *supra* note 1, at 391-401; Roger Colinvaux, *The Political Speech of Charities in the Face of Citizens United: A Defense of Prohibition*, 61 CASE W. RES. L. REV. 685, 721-23 (2012); Galston, *supra* note 5, at 903-11; Lloyd Hitoshi Mayer, *Charities and Lobbying: Institutional Rights in the Wake of Citizens United*, 10 ELECTION L.J. 407, 414-26 (2011); see also Adam Winkler, *The Corporation in Election Law*, 32 LOY. L.A. L. REV. 1243, 1259-60 (1999) (noting potential conflict of *TWR* and election law precedents prior to *Citizens United*).

54. I.R.C. § 6033(a) (2006); 26 C.F.R. § 1.6033-2 (2012).

55. Mayer, *supra* note 53, at 416-18, 423. *But see* Aprill, *supra* note 1, at 397-98 (suggesting that burdens of § 501(c) are lighter than the PAC regime condemned in *Citizens United*); Galston, *supra* note 5, at 907-11 (arguing that other case law may provide a basis for distinguishing *Citizens United*).

56. See *Citizens United*, 130 S. Ct. at 898.

57. *Id.* at 903.

58. *Cf. id.* at 899 (noting that the Court has allowed restrictions on speech to permit proper functioning of government institutions).

§ 501? That is the issue I will explore for the remainder of this Article.

## II. PRESERVING THE GOVERNMENT'S MONEY?

With that background out of the way, I turn now to attempting to determine whether there are any good explanations for the lobbying limits.<sup>59</sup> One obvious potential justification is that politics could be a wasteful diversion of charitable dollars. The charitable contribution deduction serves as a subsidy for charities, and tax exemption may further subsidize some organizations.<sup>60</sup> Perhaps limits on lobbying are simply ways for the government to channel those subsidies to their desired purposes. For any government-purpose analysis to be coherent, of course, we first have to agree on what purposes the deduction might be furthering. That is itself somewhat controversial. Thus the Sections that follow each lay out a possible set of rationales for the deduction and then consider whether lobbying activity is consistent with those justifications.

### A. Government Failure and Diversity Rationales

By far the most common modern justifications for the deduction rest on the claim that it helps society to produce goods that neither the market nor majoritarian government could.<sup>61</sup> Markets can fail to satisfy social demand for “public goods,” or other goods with a significant positive externality attached, because potential buyers do

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59. By “lobbying,” I mean efforts to achieve outcomes through political rather than private means.

60. Jeff Strnad, *The Charitable Contribution Deduction: A Politico-Economic Analysis*, in *THE ECONOMICS OF NONPROFIT INSTITUTIONS: STUDIES IN STRUCTURE AND POLICY*, *supra* note 15, at 265, 273. Dan Halperin explains that an exemption is a subsidy to the extent that the organization would not be able to offset all its revenues with deductions in the future. See Daniel Halperin, *Is Income Tax Exemption for Charities a Subsidy?*, 64 *TAX L. REV.* 283, 285, 292-94 (2011). Because political expenditures are not deductible business expenses, I.R.C. § 162(e) (2006), exempt entities are receiving a subsidy in the amount of lobbying and any untaxed campaign expenditures. *Cf. id.* § 527 (imposing a tax on exempt-entity expenditures related to electioneering activities, but only to the extent of an organization’s net investment income).

61. OFFICE OF MGMT. & BUDGET, EXEC. OFFICE OF THE PRESIDENT, *ANALYTICAL PERSPECTIVES: BUDGET OF THE UNITED STATES GOVERNMENT FISCAL YEAR 2008*, at 257-59 (2007).

not take into account the benefit their purchase would provide to others.<sup>62</sup> For-profit firms may also struggle to sell “credence” goods, whose quality is difficult for the purchaser to monitor; by promising not to divert profits, the nonprofit firm can help reassure consumers that it will not cheat them in order to pad the bottom line.<sup>63</sup> Although governments can use their taxing power to fill these gaps, government production might be limited to the policies that can command the support of a majority of the voting public.<sup>64</sup> The argument therefore is that government, too, fails to meet the needs of novel or unpopular causes, or of voters with unusually high demand for a service that the average voter desires in only modest amounts.<sup>65</sup>

Debate over whether this rationale is consistent with nonprofit lobbying has so far amounted to a fairly simple back-and-forth. Critics of lobbying by charities suggest that, because lobbying is not the production of services the market has failed to offer, use of subsidized charitable dollars for that purpose misallocates the government’s dollars.<sup>66</sup> Supporters respond that lobbying is simply an alternative way of getting society to create the underprovided goods.<sup>67</sup> They also argue that advocacy on behalf of those with few resources or political influence is itself a form of public good.<sup>68</sup> They

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62. Mark P. Gergen, *The Case for a Charitable Contributions Deduction*, 74 VA. L. REV. 1393, 1397-98 (1988).

63. See Henry Hansmann, *The Rationale for Exempting Nonprofit Organizations from Corporate Income Taxation*, 91 YALE L.J. 54, 68-70 (1981) (“With a nonprofit producer ... the patron has some assurance, by virtue of the nondistribution constraint, that all of the funds he turns over to the firm will in fact be used to produce the services that the firm holds itself out as providing.”).

64. See Burton A. Weisbrod, *Toward a Theory of the Voluntary Non-Profit Sector in a Three-Sector Economy*, in ALTRUISM, MORALITY, AND ECONOMIC THEORY 171, 175-83 (Edmund S. Phelps ed., 1975).

65. John G. Simon, *Charity and Dynasty Under the Federal Tax System*, in THE ECONOMICS OF NONPROFIT INSTITUTIONS: STUDIES IN STRUCTURE AND POLICY, *supra* note 15, at 246, 253-54; Weisbrod, *supra* note 64, at 175-78 & fig.1.

66. Ann M. Murphy, *Campaign Signs and the Collection Plate—Never the Twain Shall Meet?*, 1 PITT. TAX REV. 35, 80 (2003); see Leff, *supra* note 13, at 676 (summarizing this argument); see also Chapman, *supra* note 13, at 865 (claiming that lobbying by charities would exacerbate the political conflicts that the deduction is supposed to resolve).

67. See *supra* note 15 and accompanying text.

68. See Chisholm, *Matching*, *supra* note 13, at 266-77; Houck, *supra* note 13, at 84; see also Kelly LeRoux, *Nonprofits as Civic Intermediaries: The Role of Community-Based Organizations in Promoting Political Participation*, 42 URB. AFF. REV. 410, 411-12 (2007) (noting this point but not explicitly connecting it to the legal debate over the scope of lobbying

further claim that including these forgotten voices in the political conversation can transform the debate, which is perhaps yet another common benefit we all would enjoy.<sup>69</sup>

The combatants have not yet recognized, however, that each of these three counterclaims rests on factual assumptions that may not be well grounded. Increased lobbying expenditures might not in fact lead to greater social production of the goods sought. Advocacy may not actually improve the lives of the underrepresented. And subsidies for charity might not change the political climate or, if they do, might not change it for the better. Each of these possibilities needs some unpacking.

### 1. “Get Stuff”

Consider first the claim that lobbying might be another way to encourage production of goods that the market and government would otherwise fail to provide. A preliminary problem with this theory is that it does not really support many forms of lobbying activity. The theory, which I will call the “get stuff” premise, implies very significant restrictions on the permissible subjects charities could lobby for. A large fraction of U.S. lobbying expenditures are “defensive”—they are devoted to preventing changes to existing law.<sup>70</sup> Perhaps preserving an existing entitlement program is another way of ensuring that the program’s benefits continue to exist. Many other kinds of defensive lobbying, however, such as NIMBY-ish efforts to block or relocate a proposed public works project, opposition to new regulations of industry or human behavior, or calls for government austerity, could not plausibly rely on the “get stuff” theory. Similarly, efforts to repeal existing regu-

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restrictions). See generally JEFFREY M. BERRY WITH DAVID F. ARONS, *A VOICE FOR NONPROFITS* (2003) (developing an argument about the need for and role of the voluntary sector as an advocate for disenfranchised interests). As the advocates recognize, this rationale would not apply to private foundations. See Chisholm, *Matching*, *supra* note 13, at 285.

69. See NINA J. CRIMM & LAURENCE H. WINER, *POLITICS, TAXES, AND THE PULPIT* 122 (2011); Chisholm, *Politics and Charity*, *supra* note 13, at 349; Garnett, *supra* note 13, at 800-01; J. Craig Jenkins, *Nonprofit Organizations and Political Advocacy*, in *THE NONPROFIT SECTOR: A RESEARCH HANDBOOK*, *supra* note 14, at 307, 325; Steffen N. Johnson, *Of Politics and Pulpits: A First Amendment Analysis of IRS Restrictions on the Political Activities of Religious Organizations*, 42 B.C. L. REV. 875, 883-84 (2001).

70. See FRANK R. BAUMGARTNER ET AL., *LOBBYING AND POLICY CHANGE: WHO WINS, WHO LOSES, AND WHY* 233 & tbl.11.6 (2009).

lations, or to cut taxes or services, would seem the exact opposite of a “get stuff” rationale. Of course any lobbying for the production of “private” goods that the market could produce—which, by some accounts, is the bulk of all lobbying<sup>71</sup>—would fall outside the charitable-support framework entirely. Proponents of a “get stuff”-type argument have so far not acknowledged these logical limits on their position.<sup>72</sup>

Assuming that lobbying funds were spent on goals consistent with the purpose of the deduction, it is still unclear to what extent such expenditures would actually increase production of the goods sought. Injecting new funds into the system may simply contribute to an arms race in which all the actors spend more but do not get better results.<sup>73</sup> Further, it is likely that at least some portion of a lobbying subsidy would be captured as “rents” for public officials and professional lobbyists.<sup>74</sup> Political economists argue that the time, attention, and agenda space of public officials is limited.<sup>75</sup> Those who seek access must bid against each other, allowing the official to extract rents as payments for the opportunity to move up in line.<sup>76</sup> Intermediaries with relational capital invested in ongoing ties with officials may help provide access, but they, too, may claim rents in exchange for the scarce resource of their leverage with their

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71. See MANCUR OLSON, *THE LOGIC OF COLLECTIVE ACTION: PUBLIC GOODS AND THE THEORY OF GROUPS* 132-33 (1971).

72. Arguably, existing rules preventing charitable resources from being spent for the “private inurement” of a nonprofit’s insiders or for the “private benefit” of outsiders might limit lobbying for the production of private goods. Buckles, *supra* note 13, at 1120-21 & n.277. But, as Buckles acknowledges, these rules are nearly impossible for the government to invoke successfully in the lobbying context, because there will almost always be some colorable public-regarding purpose for any lobbying effort. *See id.* at 1121-22.

73. Shi-Ling Hsu, *What Is a Tragedy of the Commons? Overfishing and the Campaign Spending Problem*, 69 ALB. L. REV. 75, 109-11 (2005); Daryl J. Levinson, *Market Failures and Failures of Markets*, 85 VA. L. REV. 1745, 1747-48 (1999).

74. “Rent seeking is the socially costly pursuit of wealth transfers.” Robert D. Tollison, *Rent Seeking*, in *PERSPECTIVES ON PUBLIC CHOICE: A HANDBOOK* 506, 506 (Dennis C. Mueller ed., 1997).

75. BAUMGARTNER ET AL., *supra* note 70, at 42-44; *see* Hasen, *supra* note 1, at 219 (noting the critical role of personal contact in successful lobbying efforts).

76. *See* FRED S. MCCHESENEY, *MONEY FOR NOTHING: POLITICIANS, RENT EXTRACTION, AND POLITICAL EXTORTION* 124-31 (1997).

allies in office.<sup>77</sup> Helping groups to organize may simply facilitate the process of rent extraction.<sup>78</sup>

Funds devoted to lobbying may also be particularly vulnerable to diversion by a charity's own officers and employees. Commentators have recognized that, due to the difficulty of monitoring the quality of most public goods and the weak legal oversight mechanisms for most charities, it can be relatively easy for their employees to exploit the organization's resources for the employees' own ends.<sup>79</sup> Officers may pay themselves generous salaries, give only indifferent effort, or pursue purposes that satisfy their own preferences rather than those of donors.

These problems are more acute in the lobbying context because of a form of the team-production problem. When many actors collaborate together, it is difficult for monitors to judge each of their individual contributions.<sup>80</sup> Knowing this, participants may each feel free to pursue their own goals. Any lobbying to "get stuff" necessarily involves multiple actors—the charity's employees, the officials, the charity's outside lobbyists, and often a coalition of allied organizations.<sup>81</sup> Employees may take money to lobby and, when undesired outcomes occur, simply blame the officials. Or they may take money to "lobby" for an outcome that would have happened anyway.

More generally, as I have argued previously, lobbying is a costlier method of producing public goods than direct production by a charity, because it requires the efforts of two separate sets of agents.<sup>82</sup> We have just seen that when donors give money to a charity to produce a public good, some portion of their money and time will be lost to efforts at monitoring the charity's employees.

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77. See Hasen, *supra* note 1, at 219, 223 (describing the source of lobbyists' long-term influence); Samuel Issacharoff & Daniel R. Ortiz, *Governing Through Intermediaries*, 85 VA. L. REV. 1627, 1652-53 (1999).

78. See MCCHESENEY, *supra* note 76, at 151-52.

79. See Geoffrey A. Manne, *Agency Costs and the Oversight of Charitable Organizations*, 1999 WIS. L. REV. 227, 234-36; Dana Brakman Reiser, *Dismembering Civil Society: The Social Cost of Internally Undemocratic Nonprofits*, 82 OR. L. REV. 829, 859-60 (2003).

80. See Bengt Holmstrom, *Moral Hazard in Teams*, 13 BELL J. ECON. 324, 325 (1982).

81. See Thomas T. Holyoke, *Interest Group Competition and Coalition Formation*, 53 AM. J. POL. SCI. 360, 362-74 (2009) (reporting that working with legislators and coalition partners moves organizational lobbyists away from positions preferred by their group's members).

82. Brian Galle, *The Role of Charity in a Federal System*, 53 WM. & MARY L. REV. 777, 805-06 (2012).

Unless monitoring and control mechanisms are perfectly effective, some additional fraction is lost in rents paid to the charitable entrepreneurs.<sup>83</sup> If the charity is tasked with lobbying, then this process repeats again, as the charity's employees contract with second or even third sets of agents in the form of outside lobbyists and public officials.

Moreover, lobbyists and government officials may exploit nonprofit firms' vulnerability to holdups. For-profit firms are relatively resistant to managers who may be tempted to exploit the firm's dependence on them by demanding extra portions of the profits, because the size of these demands is limited to the firm's cost of replacing the manager.<sup>84</sup> Most shareholders can also respond to holdup attempts by simply selling their stock.<sup>85</sup> In contrast, many nonprofit stakeholders have deep and lifelong ties to their institution—say, the university's name on their resume.<sup>86</sup> These stakeholders can likely be repeatedly shaken down for rents by public officials who fund the institution or its mission, or by intermediaries who help to secure that funding.<sup>87</sup>

Even if all these various potential diversions do not wholly consume the value of the government's subsidy, they might still represent a reason to limit lobbying. If lobbying activities lead to a greater degree of waste and diversion than other methods for "getting stuff," limiting them could be a way to enhance the cost effectiveness of the government's dollars.

## 2. *Interest Representation*

Another way of justifying lobbying within a government failure framework for charity is to claim that the act of presenting the underserved groups' claims to government is itself one of the public

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83. See RUSSELL HARDIN, *COLLECTIVE ACTION* 35-36 (1982).

84. Cf. PAUL MILGROM & JOHN ROBERTS, *ECONOMICS, ORGANIZATION AND MANAGEMENT* 599 (1992).

85. See Issacharoff & Ortiz, *supra* note 77, at 1653-54 & n.85.

86. See Larry E. Ribstein, *The First Amendment and Corporate Governance*, 27 GA. ST. U. L. REV. 1019, 1045 (2011) (noting that donors are tied to nonprofits by moral commitment, geography, and social incentives).

87. The nonprofit sector as a whole faces this problem with respect to § 170. See, e.g., Nancy J. Knauer, *How Charitable Organizations Influence Federal Tax Policy: "Rent-Seeking" Charities or Virtuous Politicians?*, 1996 WIS. L. REV. 971, 1003-31.

goods society fails to provide.<sup>88</sup> Importantly, this vision of lobbying would seem to avoid both of my criticisms of the “get stuff” approach. For one, it would logically embrace a much wider set of permissible lobbying topics, such as defensive lobbying or efforts to repeal existing government programs, so long as the goals represented the interests of a group that would otherwise be unable to find purchase in the scramble for political influence. Representing the interests of others also might be a justifiable target for government subsidies even if lobbying dollars are relatively easily diverted. Because lobbying is itself the goal, the government can point to no alternative, more cost-effective method as a preferred target of its funds.

The interest representation theory relies on significant additional factual assumptions, however. For one, it is unclear that minority interests would be voiceless in the absence of a subsidy. As most readers likely know, public choice theory predicts that small and concentrated interests are exactly those that are most likely to succeed politically.<sup>89</sup> Even groups with few resources of their own can attract policy entrepreneurs to represent them, on the expectation that successful lobbying will bring later rewards for the entrepreneur.<sup>90</sup> Indeed, this argument would seem to undermine the premises of the government failure rationale for the deduction itself, as I have explained elsewhere.<sup>91</sup> Nonetheless, there would still be some groups—especially those that are poor, fairly numerous, and widespread—for whom public choice theory would suggest that subsidies might be needed, whether for lobbying or direct production of other public goods they prefer.<sup>92</sup>

Another question for the interest representation argument is whether it can remain coherent if lobbying is permitted by most charities. Again, it is widely accepted that access to public officials is limited.<sup>93</sup> Some, but likely not all, underrepresented interests will

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88. For accounts of lobbying as a public good outside the nonprofit context, see Issacharoff & Ortiz, *supra* note 77, at 1668.

89. See DANIEL A. FARBER & PHILIP P. FRICKEY, *LAW AND PUBLIC CHOICE: A CRITICAL INTRODUCTION* 23-24 & n.52 (1991).

90. KAY LEHMAN SCHLOZMAN & JOHN T. TIERNEY, *ORGANIZED INTERESTS IN AMERICAN DEMOCRACY* 72-74 (1986).

91. Galle, *supra* note 82, at 804.

92. See Hasen, *supra* note 1, at 226-27.

93. See *supra* note 75 and accompanying text.

be able to attract charitable organizations to fight on their behalf.<sup>94</sup> Subsidies for represented groups may bid up the cost of access to officials, meaning that it will become even more costly for groups that do not have representation.<sup>95</sup> Subsidized lobbying might therefore amplify some voices by drowning out others. These new outsiders are already likely to be especially marginal, given their inability to draw even private policy entrepreneurs into their corner.

Similarly, a lobbying deduction might simply amplify existing disparities in resources and influence.<sup>96</sup> Wealthy and powerful donors, too, can form organizations to lobby on their own behalf. And the current structure of the deduction provides much greater benefits to top-bracket donors than to the bottom 50 percent of households, magnifying, rather than narrowing, disparities in the groups' political access.<sup>97</sup> Better-financed interests could also use these additional resources to bid up the costs of access, further reducing the access of poorer groups.

For these reasons, commentators weighing the design of a possible lobbying subsidy overwhelmingly favor vouchers or other rewards that are identical in size for each individual, rather than a matching grant.<sup>98</sup> Even if crowding out is not a problem, the possibility that already-successful interests could claim the deduction

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94. See THEDA SKOCPOL, DIMINISHED DEMOCRACY: FROM MEMBERSHIP TO MANAGEMENT IN AMERICAN CIVIC LIFE 211-15 (2003) (arguing that modern interest groups "privilege the already-educated and already-politicized"); Hasen, *supra* note 18, at 30 (suggesting that voucher systems might advantage better-organized and wealthier groups); Jennifer E. Mosley, *Organizational Resources and Environmental Incentives: Understanding the Policy Advocacy Involvement of Human Service Nonprofits*, 84 SOC. SERV. REV. 57, 72 (2010) (finding survey evidence that "small, isolated organizations" are not successful at lobbying and that this disparity may diminish the "diversity of voices advocating for clients").

95. Cf. Issacharoff & Ortiz, *supra* note 77, at 1658 (observing that groups that can afford more effective lobbyists will become yet more powerful than those with weak representatives).

96. For arguments why this would be undesirable, see JOHN RAWLS, POLITICAL LIBERALISM 327-30 (1993); Edward B. Foley, *Equal-Dollars-Per-Voter: A Constitutional Principle of Campaign Finance*, 94 COLUM. L. REV. 1204, 1220-50 (1994).

97. Gregg D. Polsky, *A Tax Lawyer's Perspective on Section 527 Organizations*, 28 CARDOZO L. REV. 1773, 1776-78 (2007) (offering this as a reason the tax system limits lobbying with deductible dollars); see Galston, *supra* note 13, at 1317. It is also possible that wealthier interests will not significantly increase their lobbying in response to the subsidy. But they will surely claim the deduction anyway, meaning the government will spend money for nothing.

98. See, e.g., Richard Briffault, *Ballot Propositions and Campaign Finance Reform*, 1 N.Y.U. J. LEGIS. & PUB. POL'Y 41, 63-67 (1997); Hasen, *supra* note 18, at 29-31; Spencer Overton, *The Donor Class: Campaign Finance, Democracy, and Participation*, 153 U. PA. L. REV. 73, 106-08 (2004).

means that the deduction would not be a very cost-effective support for the underserved; only a small fraction of each dollar spent by the government would go to the targeted groups.<sup>99</sup>

Some proposals would diminish these tax-driven differences by converting the deduction to a credit that would give all donors an equal dollar value for each dollar donated.<sup>100</sup> But that structure would still allow wealthy donors to claim a government subsidy to lobby. Because for-profit firms and the wealthy can spend much more than poorer households, they would still claim a considerably larger pile of government dollars.<sup>101</sup>

The crowding-out point would be less worrying to the extent that, as some suggest, there are diminishing marginal returns from lobbying expenditures.<sup>102</sup> If returns diminish quickly within the range likely occupied by existing powerful organizations, then the subsidy might usefully increase the representation of less powerful groups: a dollar given to each group would produce greater returns for the low-powered group than for the high-powered one. It also seems plausible, though, that the returns curve is S-shaped, in that lobbying by already-influential groups likely commands particular attention from officials, until at some point the official is fully captured and further expenditures have little effect. Figure 1 illustrates this possibility and others.

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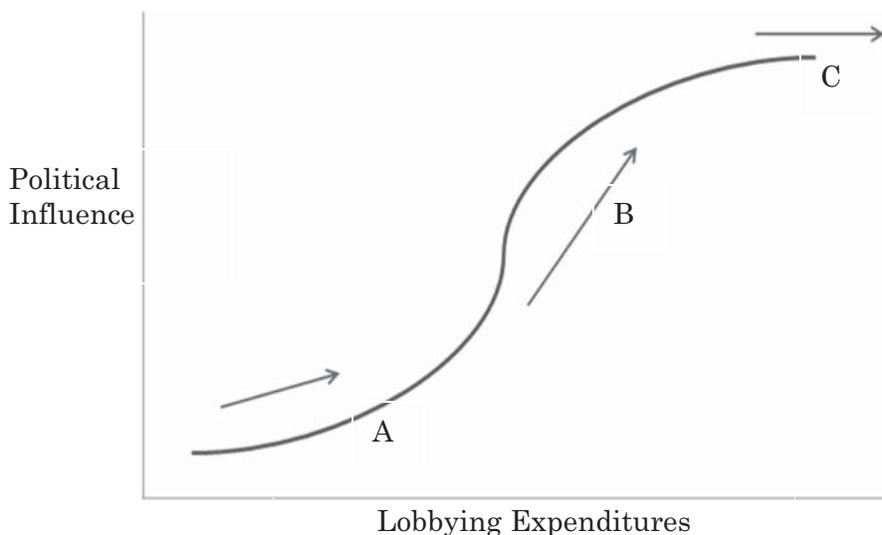
99. Cf. Overton, *supra* note 98, at 112-13 (noting that wealthy donors are likely to be inframarginal).

100. See, e.g., NAT'L COMM'N ON FISCAL RESPONSIBILITY & REFORM, THE MOMENT OF TRUTH 31 fig.7 (2010), available at [http://www.fiscalcommission.gov/sites/fiscalcommission.gov/files/documents/TheMomentofTruth12\\_1\\_2010.pdf](http://www.fiscalcommission.gov/sites/fiscalcommission.gov/files/documents/TheMomentofTruth12_1_2010.pdf).

101. See John M. de Figueiredo & Elizabeth Garrett, *Paying for Politics*, 78 S. CAL. L. REV. 591, 644-45 (2005) (pointing to historical evidence that this was the case for the federal campaign contribution tax credit); Gergen, *supra* note 62, at 1405-06 (arguing that even a credit system will give wealthy donors control over how to allocate government dollars).

102. See, e.g., Hasen, *supra* note 1, at 229.

Figure 1: A Possible Relationship Between Expenditures and Influence



In this graph, the impact of lobbying subsidies depends on where existing powerful interests fall on the graph. Each arrow represents a possible boost in expenditures represented by subsidies. By assumption, underrepresented interests are at the arrow labeled *A*: subsidies amplify their voice, but the return on expenditures is only moderate. Whether this represents a net gain depends on whether more powerful interests are mostly at the arrow labeled *B* or arrow labeled *C*. If the most influential are at arrow *C*, the subsidy these winners claim does not produce much greater influence, because they have already bought all the influence that can be bought. In that scenario, subsidies available to all, on net, increase the voice of the poor. If the powerful are at point *B*, however, the voiceless are net losers: the subsidy buys more influence per dollar for those who already have some. Of course, wealthier interests can also spend more dollars.

Although many of these objections could be overcome if lobbying were limited to only a select group of charities, that approach faces significant challenges. Given that this theory does not clearly identify which interests are underrepresented, government line-

drawing rulings could be difficult, contentious, and politically fraught.<sup>103</sup> As with the question of eligibility for the deduction generally, a danger exists that government officials might selectively favor the organizations with which they are ideologically aligned.<sup>104</sup> I have suggested elsewhere some mechanisms for cabining this problem, but they do not translate perfectly to the lobbying context.<sup>105</sup>

It is also possible that the problem of crowd out and competition from better-funded groups could be alleviated with tools short of strict limits on lobbying by all charities. A sensible campaign finance regime, separate and apart from the tax system, might help to ensure a level playing field for all. If it were really effective, though, then the need for lobbying subsidies might itself wilt. Sticking to regulations of charities per se, caps on the amount of lobbying that could be carried out by any one organization—or group of related organizations—would tend to limit the ability of already-powerful groups to consume all the available political oxygen. I have argued elsewhere that the current law’s restriction of charities to an insubstantial amount of lobbying, if properly understood, already constrains the amount of influence any one entity can wield without losing its exemption.<sup>106</sup> The interest representation rationale, then, may be consistent with these existing limits, if not a more dramatic constraint.

### 3. *Political Pluralism*

A final way in which government failure theorists explain lobbying by nonprofits is to argue that lobbying on behalf of under-represented groups benefits not only the groups but also society at large. Incorporating competing views into major political discussions

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103. See Mayer, *supra* note 47, at 549.

104. Cf. Chisholm, *Matching*, *supra* note 13, at 244 (noting several examples of when the “IRS has ... taken advantage of definitional leeway in the tax provisions to suppress unpopular ideology”).

105. See Galle, *supra* note 82, at 848-50. In brief, the translational problem is that it is not obvious how to design a “costly screen” to exclude organizations that do not really “need” a lobbying subsidy.

106. See Brian Galle, *The LDS Church, Proposition 8, and the Federal Law of Charities*, 103 NW. U. L. REV. COLLOQUY 370, 376-78 (2009), available at <http://www.law.northwestern.edu/lawreview/colloquy/2009/10/LRColl2009n10Galle.pdf>.

enriches the debate, they argue, challenging old verities and offering innovative new alternatives.<sup>107</sup> These arguments face many of the same questions as interest representation theories: Would subsidies actually amplify the voices of the underrepresented or instead crowd them out? Would charities really offer an independent voice, or would the prospect of an unlimited federal matching grant tempt managers and outsiders to divert charity to other purposes?<sup>108</sup>

In addition, even if it proves the case that subsidies for lobbying by charities significantly increase the influence of underrepresented interests, a serious question remains as to whether such voices in fact enrich politics rather than polarize it. Evidence suggests that deliberation among individuals of differing views contributes to better, more inclusive, and more legitimate-seeming government.<sup>109</sup> When, however, politics consists not of conflict among individuals, but among interest groups, these benefits of deliberation apparently diminish.<sup>110</sup> Membership in a homogenous group—such as most voluntary associations<sup>111</sup>—often appears to harden the views of the group's members, leaving them predisposed to doubt even basic factual propositions that would challenge their existing worldview.<sup>112</sup> As more extreme sets of beliefs come into contact, they struggle to agree on these basic facts, leading to gridlock and bitter partisan-

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107. See sources cited *supra* note 69 and accompanying text.

108. For more consideration of this point, see *infra* Part III.A.5.

109. See CARLOS SANTIAGO NINO, *THE CONSTITUTION OF DELIBERATIVE DEMOCRACY* 117-28 (1996); Stefan Schulz-Hardt et al., *Biased Information Search in Group Decision Making*, 78 *J. PERSONALITY & SOC. PSYCHOL.* 655, 658 (2000).

110. See Cass R. Sunstein, *Deliberative Trouble? Why Groups Go to Extremes*, 110 *YALE L.J.* 71, 105-08 (2000).

111. Pamela A. Popielarz & J. Miller McPherson, *On the Edge or in Between: Niche Position, Niche Overlap, and the Duration of Voluntary Association Memberships*, 101 *AM. J. SOC.* 698, 698-99, 704 (1995).

112. See Elisabeth S. Clemens, *The Constitution of Citizens: Political Theories of Nonprofit Organizations*, in *THE NONPROFIT SECTOR: A RESEARCH HANDBOOK*, *supra* note 14, at 207, 208, 211-12; Marc Hooghe, *Voluntary Associations and Democratic Attitudes: Value Congruence as a Causal Mechanism*, in *GENERATING SOCIAL CAPITAL: CIVIL SOCIETY AND INSTITUTIONS IN COMPARATIVE PERSPECTIVE* 89, 106 (Marc Hooghe & Dietlind Stolle eds., 2003); Sunstein, *supra* note 110, at 85-96; cf. DIANA C. MUTZ, *HEARING THE OTHER SIDE: DELIBERATIVE VERSUS PARTICIPATORY DEMOCRACY* 3 (2006) (describing the author's research finding that heterogeneity of political views in groups reduces political engagement by their members); Matthew C. Stephenson, *Information Acquisition and Institutional Design*, 124 *HARV. L. REV.* 1422, 1468-71 (2011) (arguing that members of ideologically diverse groups have stronger incentives to acquire new information).

ship rather than deliberation and compromise.<sup>113</sup> Subsidies that channel citizen participation into these kinds of outlier organizations might add some voices to public debate at the cost of making our public debate more toxic overall.<sup>114</sup>

Another way that lobbying subsidies can contribute to polarized debate is by channeling political conversations into narrowly focused organizations. Most entities do not represent their stakeholders' global interests but instead focus on one or two goals or issues.<sup>115</sup> As Samuel Issacharoff and Daniel Ortiz argue, these entities are often bound contractually to their vision and must "argue[] without compromise" rather than represent the more nuanced views of their principals.<sup>116</sup>

To sum up, the government failure rationale does not necessarily offer support for nonprofit lobbying. Although there is still a case to be made, a number of unresolved empirical questions about the way lobbying works might undermine that case severely.

### *B. Privatization Rationale*

Although most of the debate over lobbying restrictions has so far centered on the traditional rationales for charity, there are also other grounds for the deduction. One of these is the claim that the deduction helps to transfer the production of public goods from the

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113. See, e.g., BILL BISHOP WITH ROBERT G. CUSHING, *THE BIG SORT: WHY THE CLUSTERING OF LIKE-MINDED AMERICA IS TEARING US APART* 171, 176-81 (2008) (describing how the self-selection of Americans into churches with like-minded people correlated with increased polarization between the denominations along partisan lines); TIMUR KURAN, *PRIVATE TRUTHS, PUBLIC LIES: THE SOCIAL CONSEQUENCES OF PREFERENCE FALSIFICATION* 16-21 (1995).

114. See Morris P. Fiorina, *Extreme Voices: A Dark Side of Civic Engagement*, in *CIVIC ENGAGEMENT IN AMERICAN DEMOCRACY* 395, 396 (Theda Skocpol & Morris P. Fiorina eds., 1999); see also MARY DOUGLAS, *HOW INSTITUTIONS THINK* 1 (1986) (arguing that in-group bonds may lead to intergroup conflict); Margaret Levi, *Social and Unsocial Capital: A Review Essay of Robert Putnam's Making Democracy Work*, 24 *POL. & SOC'Y* 45, 47-48 (1996) (book review) (same); cf. Shannon Weeks McCormack, *Taking the Good with the Bad: Recognizing the Negative Externalities Created by Charities and Their Implications for the Charitable Deduction*, 52 *ARIZ. L. REV.* 977, 1024 (2010) (arguing that allowing deductions for "organizations that ... promote particular viewpoint[s] on ... which there is reasonable disagreement" contributes to social conflict over the meaning of "the good" life).

115. See Issacharoff & Ortiz, *supra* note 77, at 1655-56.

116. *Id.* at 1656; see also Hasen, *supra* note 18, at 35-36 (noting incentives of subsidy recipients to concentrate contributions in single-issue groups).

government to the private sector.<sup>117</sup> Some argue that this relocation is helpful because the private sector outperforms government,<sup>118</sup> whereas others simply hail the opportunity to reduce the coercive power of the state.<sup>119</sup> My own view is that both of these claims are mistaken, for reasons I explain elsewhere.<sup>120</sup>

For my purposes here, I only want to point out that, if one accepts the privatization rationale, strong limits on lobbying would seem to follow. Since the point of the deduction, in this view, is to substitute private production for government production, lobbying the government to “get stuff” is antithetical to the deduction’s purpose.<sup>121</sup> Defensive lobbying or lobbying to repeal programs and cut taxes of course would be more palatable, although it is unclear why this should be a function of the nonprofit sector.<sup>122</sup>

Further, the rules for enforcing any such regime would be difficult to implement. Defeating one piece of legislation may leave another preexisting one in place. Deciding which set of laws better represents privatization’s values would be a controversial task for which government bureaucrats seem especially poorly suited.

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117. See Helmut K. Anheier & Lester M. Salamon, *The Nonprofit Sector in Comparative Perspective*, in *THE NONPROFIT SECTOR: A RESEARCH HANDBOOK*, *supra* note 14, at 89, 92. Lloyd Mayer’s recent arguments for nonprofit “autonomy” may also fall in this category. Lloyd Hitoshi Mayer, *The “Independent” Sector: Fee-for-Service Charity and the Limits of Autonomy*, 65 *VAND. L. REV.* 51, 75-76 (2012).

118. See, e.g., Saul Levmore, *Taxes as Ballots*, 65 *U. CHI. L. REV.* 387, 406-07 (1998); David M. Schizer, *Subsidizing Charitable Contributions: Incentives, Information, and the Private Pursuit of Public Goals*, 62 *TAX L. REV.* 221, 262 (2009).

119. See, e.g., Kenneth Prewitt, *Foundations*, in *THE NONPROFIT SECTOR: A RESEARCH HANDBOOK*, *supra* note 14, at 355, 358-59.

120. Galle, *supra* note 82, at 782.

121. Some privatization advocates base their preference for nonprofits in part on the superior information of nonprofit donors. See Levmore, *supra* note 118, at 409-10; Schizer, *supra* note 118, at 260-62. These theorists might embrace lobbying for government services, so long as the end products of government were guided by the better-informed choices of donors and managers. Considering the many limits on government discretion, and the many other voices that likely guide any policy choice, though, it is unlikely that government production would embody the preferences of donors and managers as clearly as a nonprofit under the control of donors would. Cf. Galston, *supra* note 13, at 1323-24 (noting that lobbying organizations may no longer be able to capitalize on their differences from government). So Levmore and Schizer should probably oppose nonprofit lobbying. See Galle, *supra* note 82, at 783-84 n.15.

122. See *supra* notes 70-72 and accompanying text.

*C. Government Complement Rationale*

Finally, I have argued at length in prior work that none of these other rationales are fully satisfying, and that instead the best justification for subsidizing nonprofits is that nonprofits are a useful complement to a multitiered system of government.<sup>123</sup> Although in theory governments in a federal system are forced to compete with one another for, in Alexander Hamilton's term, the "affection" of their citizens,<sup>124</sup> in reality interjurisdictional competition is often congested by citizens' inability to move to the jurisdiction they think is performing the best.<sup>125</sup> Nonprofits can fill in this gap, offering a rival source of services citizens can use as an alternative to, or as a yardstick for measuring the quality of, other governments.<sup>126</sup> The credible threat of these alternatives may itself improve the quality of government.<sup>127</sup> Additionally, sometimes intergovernmental competition is too severe, as when states "race to the bottom" to curtail redistributive spending.<sup>128</sup> Here, too, nonprofits perhaps can supply services when federalism fails.

For the federalism complement rationale to function, governments and nonprofits must likely compete with each other on something like an even footing.<sup>129</sup> This implies that nonprofits should be relatively free from government controls and vice versa. A government that can hamstring its rival would not feel pressure to perform. At the same time, a nonprofit that can strongly influence the behavior of its government rival would not provide true comparative information to the public, perhaps resulting in public decisions to privatize even when government could have outperformed the charity.<sup>130</sup>

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123. Galle, *supra* note 82, at 790-835.

124. THE FEDERALIST NO. 17, at 120 (Alexander Hamilton) (Clinton Rossiter ed., 1961).

125. Galle, *supra* note 82, at 815.

126. *Id.* at 817-18.

127. *Cf.* Thomas S. Dee, *Competition and the Quality of Public Schools*, 17 ECON. EDUC. REV. 419 (1998) (reviewing evidence finding that the threat of private schools improves some measures of public school output).

128. Galle, *supra* note 82, at 826-27, 840.

129. *Id.* at 851.

130. *Cf.* Lucian A. Bebchuk & Robert J. Jackson, Jr., *Corporate Political Speech: Who Decides?*, 124 HARV. L. REV. 83, 90-91 (2010) (noting that firm managers may lobby to enact rules that favor themselves).

The even-footing principle therefore probably implies at least some partial restrictions on lobbying. Although nonprofits should be limited in their ability to lobby the government with which they compete, they would still be free to lobby others. Lobbying on topics that could not plausibly affect the nonprofit's relationship with rival public providers should also be permissible, although that line could be challenging to draw in close cases.

The even-footing story may be less cogent for nonprofits that do not compete with government. The competition story makes sense for educational institutions: when a private school opens, political support for high-quality local schools falls.<sup>131</sup> On the other hand, churches and other institutions of worship obviously have no public competitors for their central mission.<sup>132</sup> There is no rival government service that should be shielded from church influence. Similarly, organizations whose membership and operations are scattered widely across many jurisdictions might compete with the public sector but could not easily focus their lobbying on one rival government, limiting the need to protect government from their efforts.<sup>133</sup>

At the same time, the government complement approach to charity also offers some reasons to welcome lobbying. Lobbying could be a way to "get stuff" that excessive interjurisdictional competition would discourage governments from otherwise providing.<sup>134</sup> It is also a potential tool for reforming low-quality governments.<sup>135</sup>

On balance, the potential gains from lobbying under this rationale, and the complexity of drawing distinctions between helpful and less helpful political participation, probably make a strong prohibition unwise. But perhaps a brightly delineated limit on lobbying against the provision of services similar to those offered by the charity could be administered easily enough, and is important enough to this rationale for the deduction, that it would be worth the challenges.

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131. JONATHAN GRUBER, PUBLIC FINANCE AND PUBLIC POLICY 295-97 (3d ed. 2011). For a discussion of evidence of crowding out in other public goods, see *id.* at 198-99.

132. See U.S. CONST. amend. I.

133. See Galle, *supra* note 82, at 822.

134. See *id.* at 826-27.

135. See *id.* at 814.

*D. An Initial Assessment Proves Incomplete*

So far I have focused on the internal logic of the charitable contribution deduction. I have asked whether, given the underlying rationales for the deduction, the government might be justified in limiting lobbying in order to preserve taxpayer dollars for their intended purposes. In resolving that question, the unsettled basis for the deduction has turned out to be a problem. One possible reason the deduction is so popular is because it can appeal to both ends of the ideological spectrum, offering the possibility of redistribution and social empowerment to liberals while giving the promise of privatization and smaller government to conservatives.<sup>136</sup> This incompletely theorized consensus breaks down, however, when it comes to writing lobbying rules, as the two currently accepted theories seem to give diametrically opposite results. Diversity rationales would likely disallow lobbying in opposition to government, whereas privatization theorists would allow *only* lobbying in opposition.

Another obstacle for lobbying under any of the theories is that none of them, standing alone, explains why lobbying must be done by charitable organizations. For instance, diversity proponents claim that minority interests will be disappointed by the political process.<sup>137</sup> To the extent this claim is true, that failure can be overcome simply by bolstering the political power of minority groups. That bolstering could be in the form of subsidies to nonprofits that represent these groups, but it could also come in the form of subsidies for individual lobbying efforts, or money directed to a separate organization that only lobbies.<sup>138</sup> The next Part considers the pros and cons of these various approaches.

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136. See Knauer, *supra* note 87, at 1063-66.

137. See *supra* text accompanying note 88.

138. Indeed, the “get stuff” rationale arguably favors lobbying subsidies over nonprofit subsidies. There is some evidence that lobbying at the federal level by for-profit firms can yield returns of more than 100:1. Hasen, *supra* note 1, at 233. Even if one assumes, as one surely should, that the lobbying expenditures these firms are willing to publically admit to are considerably lower than their actual expenses, these numbers still represent impressive returns on investment.

### III. LOBBYING CHARITIES OR A SUBSIDY FOR LOBBYING?: ECONOMIES AND DISECONOMIES OF SCOPE

So far I have argued that the internal logic of most rationales for the charitable contribution deduction appears open to at least some degree of lobbying, although that consensus erodes when we attempt to identify which forms of lobbying should be permissible. Assuming that this dissensus could be overcome, we still face the question whether lobbying subsidies must necessarily be combined with subsidies for charitable activities. None of the arguments I have surveyed so far clearly explain why the two activities should or should not be carried out at the same time by the same entities.

There is, however, an extensive economic literature devoted to the optimal design of organizations.<sup>139</sup> In this literature, managers of firms and governments must decide which activities to combine together and which to spin off under separate management.<sup>140</sup> A key factor in these decisions is whether some activities complement each other when conducted together, such as when control over one facilitates production of the other.<sup>141</sup> These kinds of combinations are known as “economies of scope.”<sup>142</sup> The opposite is also possible: some combinations are worse off for one or both halves. A classic example is the branding problems faced by a conglomerate that tries to produce both pesticides and baby food: “Raid Products: Deadly for Bugs, Great for Your Kids!”<sup>143</sup> These are diseconomies of scope. My argument here is that in many cases, combining charitable endeavors with lobbying produces diseconomies of scope that exceed any likely economies, and that avoiding these unwanted combinations

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139. See, e.g., Colin F. Camerer & Ulrike Malmendier, *Behavioral Economics of Organizations*, in *BEHAVIORAL ECONOMICS AND ITS APPLICATIONS* 235, 235-72 (Peter A. Diamond & Hannu Vartiainen eds., 2007).

140. See generally Oliver E. Williamson, *The Logic of Economic Organization*, in *THE NATURE OF THE FIRM: ORIGINS, EVOLUTION, AND DEVELOPMENT* 90 (Oliver E. Williamson & Sidney G. Winter eds., 1993).

141. Sanford J. Grossman & Oliver D. Hart, *The Costs and Benefits of Ownership: A Theory of Vertical and Lateral Integration*, 94 *J. POL. ECON.* 691, 710-18 (1986) (using the insurance industry to illustrate that vertical integration may be optimal in these types of situations).

142. John C. Panzar & Robert D. Willig, *Economies of Scope*, 71 *AM. ECON. REV.* 268, 268 (1981).

143. True story! See Rev. Rul. 2003-110, 2003-2 C.B. 1083 (using this combination as an example of a firm that has good business reasons for a tax-free split up).

could justify government restrictions on nonprofit lobbying, whatever our rationale for the deduction.

### A. *Diseconomies*

Combining lobbying with other charitable activity can reduce social welfare in five distinct ways. One of these is already familiar from debates over the separation of church and state. Commentators since before James Madison have argued that politics can potentially distract private sector enterprises from their original purposes.<sup>144</sup> I review that debate briefly here and add some new evidence from the management literature. I also raise four other ways in which combining the two functions may reduce the cost effectiveness of either. Combined organizations can increase the inframarginality of the government's subsidies, raise donor and government agency monitoring costs, and reduce the "warm glow" that empowers the charitable sector. In addition, I argue that the economically ideal tools for reaching the socially optimal levels of charity and lobbying are incompatible with one another.

#### 1. *Agency Costs*

First, conducting charity and lobbying under one roof exacerbates the social costs of controlling nonprofit employees. Of course, when one set of people performs tasks for another, there is always some degree of slack, or divergence between the preferences of the principal and the performance of the agent.<sup>145</sup> Principals must invest time and resources in monitoring their agents to reduce these slippages.<sup>146</sup> It is a familiar point that this problem is especially acute in the nonprofit sector.<sup>147</sup> Nonprofit outputs are hard to evaluate,

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144. See JAMES MADISON, MEMORIAL AND REMONSTRANCE AGAINST RELIGIOUS ASSESSMENTS (1785), reprinted in 5 THE FOUNDERS' CONSTITUTION 82 (Philip B. Kurland & Ralph Lerner eds., 1987); Andrew Koppelman, *Corruption of Religion and the Establishment Clause*, 50 WM. & MARY L. REV. 1831, 1849-53 (2009) (describing, for example, John Milton's corruption argument against establishment).

145. George P. Baker, *Incentive Contracts and Performance Measurement*, 100 J. POL. ECON. 598, 599-600, 606 (1992).

146. ARTHUR LUPIA & MATHEW D. MCCUBBINS, THE DEMOCRATIC DILEMMA: CAN CITIZENS LEARN WHAT THEY NEED TO KNOW? 8, 17-18 (1998).

147. SCHLOZMAN & TIERNEY, *supra* note 90, at 131-33; Ribstein, *supra* note 86, at 1045. *But*

and stakeholders tend to free ride on one another's efforts at monitoring the officers of the firm, lack many legal tools for compelling accountability, and have no ownership shares they can distribute to managers to align managers' incentives with their own.<sup>148</sup> Churches do not even have to file tax returns, making their finances particularly opaque.<sup>149</sup>

This is not to say that nonprofit managers are wholly unresponsive to outside incentives. Managers legally can be, and often are, rewarded for good performance with bonuses, additional donations, greater authority, or other perks.<sup>150</sup> Studies find that managers do respond both to explicit incentives, such as cost-cutting targets at hospitals, and also to implicit incentives, such as their perception of potential donors' preferences.<sup>151</sup>

One well-known problem with these kinds of goal-oriented incentives is that they can be imprecise; if not carefully designed, they can severely distort desired managerial behavior. For example, when managers have multiple tasks, but their incentives measure one task more precisely, managers will tend to devote much more effort to hitting the better-measured target.<sup>152</sup> The manager's lack

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see CRIMM & WINER, *supra* note 69, at 122 (asserting, without explanation, that churches "can protect themselves from being inappropriately co-opted").

148. Avner Ben-Ner, *Who Benefits from the Nonprofit Sector? Reforming Law and Public Policy Towards Nonprofit Organizations*, 104 YALE L.J. 731, 754-55 (1994) (reviewing WHO BENEFITS FROM THE NONPROFIT SECTOR? (Charles T. Clotfelter ed., 1992)); James R. Hines Jr. et al., *The Attack on Nonprofit Status: A Charitable Assessment*, 108 MICH. L. REV. 1179, 1198 (2010); Manne, *supra* note 79, at 234-36. Social cohesion, groupthink, and outright trading of favors also make nonprofit insiders poor monitors of one another. Melanie B. Leslie, *The Wisdom of Crowds? Groupthink and Nonprofit Governance*, 62 FLA. L. REV. 1179, 1198-201, 1205-09 (2010).

149. I.R.C. § 508(c)(1)(A) (2006); see Tobin, *supra* note 13, at 1341-42 (noting the possibility that this opacity offers for diverting funds into campaign activity).

150. See Hines et al., *supra* note 148, at 1194-95; Myron J. Roomkin & Burton A. Weisbrod, *Managerial Compensation and Incentives in For-Profit and Nonprofit Hospitals*, 15 J.L. ECON. & ORG. 750, 765, 772 (1999) (distinguishing and comparing bonus incentive schemes in for-profit and nonprofit hospitals).

151. James A. Brickley & R. Lawrence Van Horn, *Managerial Incentives in Nonprofit Organizations: Evidence from Hospitals*, 45 J.L. & ECON. 227, 246 (2002) (concluding that explicit managerial incentives in nonprofit hospitals in some ways mirror explicit incentives in for-profit hospitals); see Ranjani Krishnan et al., *Financial Disclosure Management by Nonprofit Organizations 1-2* (July 19, 2002) (unpublished manuscript), available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=319581](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=319581) (finding that nonprofit managers manipulate reporting of expenses to attract donors).

152. See Daron Acemoglu et al., *Incentives in Markets, Firms, and Governments*, 24 J.L. ECON. & ORG. 273, 274 (2008); Holmstrom & Milgrom, *supra* note 20, at 23-33. For evidence,

of effort on the alternate task is easy to overlook or cover up, allowing her to focus on the task that she prefers or that will earn her rewards.<sup>153</sup>

Overcoming the distorting effects of mismatched incentives can be costly. The principal can attempt to mitigate the multiple-task problem by writing more detailed incentives. The principal and agent must then bear the costs of drafting the more-detailed incentives, negotiating them, and measuring success or failure in meeting them.<sup>154</sup> Wealthier interest groups may be better able to invest in monitoring, further exacerbating the disparities of a lobbying subsidy.<sup>155</sup>

Monitoring in multitask firms becomes more complex if the tasks would pull managers in different directions.<sup>156</sup> For instance, CEOs of large firms serve at least two sets of investors: shareholders and creditors. Shareholders want the CEO to take risks; bondholders typically want the opposite.<sup>157</sup> Providing the CEO with a set of incentives that simultaneously satisfy both is difficult; firms often resort to complex legal agreements with their creditors, granting the

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see Michael Cragg, *Performance Incentives in the Public Sector: Evidence from the Job Training Partnership Act*, 13 J.L. ECON. & ORG. 147, 161-62 (1997) (finding in the study that more intensive incentives in the Job Training Partnership Act lead to “creamskimming”), and Brian A. Jacob & Steven D. Levitt, *Rotten Apples: An Investigation of the Prevalence and Predictors of Teacher Cheating*, 118 Q.J. ECON. 843, 844 (2003) (noting research that has shown “instances of manipulation, including documented shifts away from nontested areas or ‘teaching to the test’”).

153. See AVINASH K. DIXIT, *THE MAKING OF ECONOMIC POLICY: A TRANSACTION-COST POLITICS PERSPECTIVE* 96 (1996); Oliver Hart et al., *The Proper Scope of Government: Theory and an Application to Prisons*, 112 Q.J. ECON. 1127, 1136-41 (1997).

154. Mathias Dewatripont et al., *Multitask Agency Problems: Focus and Task Clustering*, 44 EUR. ECON. REV. 869, 876 (2000) (discussing the costs of optimal task clustering).

155. Cf. Chisholm, *Matching*, *supra* note 13, at 281 (noting that “powerless” groups also cannot control their agents).

156. Avinash Dixit, *Power of Incentives in Private Versus Public Organizations*, 87 AM. ECON. REV. 378, 378-79 (1997); cf. George G. Triantis, *Organizations as Internal Capital Markets: The Legal Boundaries of Firms, Collateral, and Trusts in Commercial and Charitable Enterprises*, 117 HARV. L. REV. 1102, 1148 (2004) (noting agency problems in nonprofit firms in which different donors have different priorities).

157. See Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305, 334-35 (1976); Charles K. Whitehead, *Creditors and Debt Governance*, in RESEARCH HANDBOOK ON THE ECONOMICS OF CORPORATE LAW 68, 71-72 (Claire A. Hill & Brett H. McDonnell eds., 2012).

creditor extensive power to investigate and even control the firm's behavior.<sup>158</sup>

My claim, then, is that combining lobbying and charitable functions within one nonprofit firm creates these kinds of tensions and costs. Asking managers to pursue both lobbying and charity seems to present both problems associated with incentivizing multiple goals: each goal is hard to incentivize accurately and the two are sometimes in tension. Monitoring agents who lobby is even more difficult than monitoring the direct production of charitable services.<sup>159</sup> Managers might prefer to overemphasize lobbying, because that would allow them greater rents and lower accountability.<sup>160</sup> Further, lobbying may conflict with other nonprofit goals, such as maintaining independence from government.<sup>161</sup> And defining "success" for the production of public goods is, as I have noted, difficult.

Nonprofits lack the tools other firms can employ to overcome the multiple-task problem. A for-profit firm might force managers to internalize the costs of their divided loyalty by giving managers an ownership stake in the firm.<sup>162</sup> Nonprofits cannot employ that option, however, so it may instead be optimal simply to prohibit managers from lobbying or to split the tasks between two entities.<sup>163</sup>

It is worth noting that conflicts between incentives to lobby and incentives to carry out other functions can arise even if charity supporters do not encourage managers to lobby. Lobbying offers managers opportunities for private gains, such as vindication of

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158. Douglas G. Baird & Robert K. Rasmussen, *Private Debt and the Missing Lever of Corporate Governance*, 154 U. PA. L. REV. 1209, 1226-28 (2006); Robert E. Scott, *A Relational Theory of Secured Financing*, 86 COLUM. L. REV. 901, 926-27 (1986).

159. See *supra* text accompanying notes 79-83; see also Murphy, *supra* note 66, at 81 (noting that donors cannot prevent an organization's use of funds for unintended political purposes).

160. Cf. Bebchuk & Jackson, *supra* note 130, at 90-92 (arguing that for-profit managers may lobby to enact state rules favoring their interests over those of shareholders).

161. Tobin, *supra* note 13, at 1337.

162. See Holmstrom & Milgrom, *supra* note 20, at 40-41.

163. See Bengt Holmstrom, *The Firm as a Subeconomy*, 15 J.L. ECON. & ORGS. 74, 90-99 (1999) (offering an argument similar to Holmstrom's earlier articles but with more math); Holmstrom & Milgrom, *supra* note 20, at 42-48 (arguing that prohibiting managers from engaging in some activities or dividing tasks between teams may be the second-best result if outputs cannot be measured and incentive pay is weak).

personal ideological preferences or political ties that may facilitate outside career advancement.<sup>164</sup>

Allowing lobbying also increases monitoring costs for the government. For one, donors primarily rely upon state organizational law and federal tax law to protect their interests in the nonprofit firm. Therefore court time and other government-funded litigation expenses will rise as principals' need for monitoring increases.

Further, the government will likely monitor to protect its own interests in seeing its subsidies properly spent. The government, too, wants managers to work hard and not simply collect their salaries and pretend to serve charitable interests. More importantly, no theory of the deduction would grant unlimited license to organizations to lobby on any subject.<sup>165</sup> Any lobbying by nonprofits would therefore still be subject to oversight to ensure that the organization engages only in permissible lobbying. That task is greatly complicated in an organization that carries out multiple tasks, because it is relatively easy to transfer value from one activity to another off the books.<sup>166</sup> An e-mail list that is supposedly compiled to send around the church newsletter can also be used to encourage members to call their member of Congress or to vote against a ballot initiative.<sup>167</sup>

It might be argued in response to my claims so far that, although greater agent autonomy does frustrate the goals of principals, it does not necessarily reduce social welfare. Agents, after all, are people too, and if they get what they want we should count that as a gain for society. This response is unpersuasive for two reasons. For one, principals will typically respond to increased slack by spending more on monitoring, which is mostly deadweight loss: hours spent filling out time sheets and verifying them are hours

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164. Issacharoff & Ortiz, *supra* note 77, at 1653-54; Faith Stevelman Kahn, *Pandora's Box: Managerial Discretion and the Problem of Corporate Philanthropy*, 44 UCLA L. REV. 579, 615-19 (1997).

165. See *supra* Part II.D.

166. See Leff, *supra* note 13, at 708-10 (using the allocation of a minister's paid time as an example); see also Kahn, *supra* note 164, at 656 (suggesting that the IRS cannot detect these kinds of transfers).

167. See Galle, *supra* note 106, at 374-75; see also Mosley, *supra* note 94, at 62 ("E-mail, in particular, facilitates advocacy activity [by nonprofits]."). For a detailed analysis of other transfers between 501(c)(3)s, (c)(4)s, and PACs, see Kerlin & Reid, *supra* note 47, at 810-18.

both sides could have spent doing more productive tasks.<sup>168</sup> For another, many of the gains for agents are private gains, whereas the losses to principals are public goods. In other words, it is not just donors to charity who are losing but also all beneficiaries as well. Donors will likely not invest the socially optimal amount of effort into increased monitoring, because by definition they do not fully internalize the benefits of the public good for society.<sup>169</sup> Admittedly, sometimes nonprofit officers will use their slack to accomplish their own vision of the public good, but they may also use it to enjoy leisure time, to pursue esoteric personal goals, or to leverage their own social or political standing.<sup>170</sup>

## 2. *Effects on Warm Glow*

Another possible, but empirically open, question about political activity by nonprofits is whether it may suppress the personal satisfaction, or “warm glow,” of donors and other charitable supporters. Warm glow is an important potential explanation for the success of the nonprofit sector.<sup>171</sup> American voluntary contributions to the purchase of public goods far exceed the amounts that could be explained easily by classic economics or the effect of the deduction.<sup>172</sup> Perhaps donors are “pure” altruists who internalize the well being of others and who would give even if they experienced no rewards for themselves from their gift. A more psychologically realistic alternative is that many of us are “impure” altruists, and we give because being seen as generous carries public esteem and gratitude, sends a signal of wealth and power, makes us feel we are good people, or relieves a sense of moral or social obligation.<sup>173</sup> It is

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168. See generally RICHARD A. POSNER, *ECONOMIC ANALYSIS OF LAW* (8th ed. 2011).

169. On the general theory of externalities, see GRUBER, *supra* note 131, at 122-29.

170. Cf. Theda Skocpol, *Advocates Without Members: The Recent Transformation of American Civic Life*, in *CIVIC ENGAGEMENT IN AMERICAN DEMOCRACY*, *supra* note 114, at 461, 492-504 (developing an extended argument that free riding by members of interest groups allows their agents to pool resources for the agents' own, often extreme, political views).

171. James Andreoni, *Impure Altruism and Donations to Public Goods: A Theory of Warm-Glow Giving*, 100 *ECON. J.* 464, 464-65 (1990).

172. See *id.*; Lise Vesterlund, *Why Do People Give?*, in *THE NONPROFIT SECTOR: A RESEARCH HANDBOOK*, *supra* note 14, at 568, 572.

173. Andreoni, *supra* note 171, at 464.

this second set of motives that—following a large social science literature—I describe as warm glow.<sup>174</sup>

Extensive evidence now points to warm glow as a larger component of the public's reasons for giving than pure altruism.<sup>175</sup> Laboratory and real-world studies both confirm the intuition of fundraising professionals that public acknowledgment of donors increases giving.<sup>176</sup> Another important piece of evidence is donors' response to the news that some other entity has already spent money pursuing the donors' goals.<sup>177</sup> If donors are pure altruists, this news should reduce their own spending, because they should care only about the beneficiaries' welfare. Instead, donors do not reduce much, and in some cases even increase their giving, suggesting that it is important to donors that *they* be the ones to support the cause.<sup>178</sup> Warm glow motivation by charitable employees seems to lower the salary they demand, and this fact in turn may motivate donors to choose the charitable form as an especially cost-effective tool.<sup>179</sup>

Returning to politics, we might hypothesize two competing warm glow effects of greatly expanded lobbying activity by charities. One possibility is that introducing politics will result in a kind of brand dilution for the nonprofit sector. I have argued previously that allowing for-profit firms to conduct charitable works would diminish the luster of charity by confusing donors and other observers.<sup>180</sup>

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174. *E.g.*, Susan Rose-Ackerman, *Altruism, Nonprofits, and Economic Theory*, 34 J. ECON. LITERATURE 701, 712 (1996).

175. For reviews, see Vesterlund, *supra* note 172, at 572-81 (discussing warm glow in the context of other private benefits), and B. Douglas Bernheim & Antonio Rangel, *Behavioral Public Economics: Welfare and Policy Analysis with Non-Standard Decision Makers* 57-60 (Nat'l Bureau of Econ. Research, Working Paper No. 11,518, 2005), available at <http://www.nber.org/papers/w11518>.

176. Vesterlund, *supra* note 172, at 578.

177. David C. Ribar & Mark O. Wilhelm, *Altruistic and Joy-of-Giving Motivations in Charitable Behavior*, 110 J. POL. ECON. 425, 427 (2002); Vesterlund, *supra* note 172, at 573-74.

178. See Ribar & Wilhelm, *supra* note 177, at 428; Vesterlund, *supra* note 172, at 573.

179. Brian Galle, *Keep Charity Charitable*, 88 TEX. L. REV. 1213, 1223 (2010); see GERALD MARWELL & PAMELA OLIVER, *THE CRITICAL MASS IN COLLECTIVE ACTION: A MICRO-SOCIAL THEORY* 61-63 (1993) (hypothesizing that donors are attracted to firms in which they can leverage the value of other contributions).

180. Galle, *supra* note 179, at 1222-25; see also William M. Landes & Richard A. Posner, *Salvors, Finders, Good Samaritans, and Other Rescuers: An Economic Study of Law and Altruism*, 7 J. LEGAL STUD. 83, 99 (1978) (suggesting that pay for good acts obscures the social

Society would no longer be able to easily recognize which organizations were nobly sacrificing gain for the greater good and which were trying to make a buck. Employees who gave up cash rewards in exchange for public recognition of their virtue would find the noncash portions drying up, leading to convergence between nonprofit and for-profit salaries.<sup>181</sup> That, in turn, might lead donors who sought to leverage below-market nonprofit salaries to turn elsewhere.

One could tell a similar, and perhaps even broader, story about political activity. The public may realize that narrow private interests can more easily summon lobbying support<sup>182</sup> and interpret charitable lobbying accordingly. There would be no ready way for the public to verify that a charity's lobbying is more public spirited, and few observers would have incentives to investigate on their own.<sup>183</sup> Further, because lobbying in pursuit of a shared goal would be susceptible to free riding across groups, lobbying by any one of those groups alone could be a signal that the firm is instead pursuing some private purpose.<sup>184</sup>

Organizations could not necessarily preserve their reputation by avoiding lobbying. Although actual donors might take the trouble to read the firm's tax return to verify its reported lobbying expenditures, casual observers will provide the bulk of the general goodwill prized by warm-glow-motivated employees, and the general public will be rather unlikely to be able to distinguish between firms that lobby and those that do not.<sup>185</sup> Even if only some firms lobby, all

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rewards of altruism).

181. See Galle, *supra* note 179, at 1224-25.

182. See OLSON, *supra* note 71, at 132-33. For a review of the evidence on either side of Olson's hypothesis, see Gary M. Anderson et al., *The Economic Theory of Clubs*, in 2 ENCYCLOPEDIA OF PUBLIC CHOICE 175-80 (Charles K. Rowley & Friedrich Schneider eds., 2003).

183. See Jill Nicholson-Crotty, *Does Reported Policy Activity Reduce Contributions to Nonprofit Service Providers?*, 39 POL'Y STUD. J. 591, 596 (2011) (explaining the cost of understanding organizational expenditures).

184. See Hsu, *supra* note 73, at 123-24 (suggesting that lobbying can be a signal of private benefit); cf. JACK L. WALKER, JR., MOBILIZING INTEREST GROUPS IN AMERICA: PATRONS, PROFESSIONS, AND SOCIAL MOVEMENTS 43, 46 (1991) (describing theories in which production of what looks like public goods may depend on efforts of individuals who have a taste for personal political power); *id.* at 53-54 (arguing that most interest groups are supported by large institutional players or wealthy individuals).

185. Cf. Stephanie Moulton & Adam Eckerd, *Preserving the Publicness of the Nonprofit Sector: Resources, Roles, and Public Values*, 41 NONPROFIT & VOLUNTARY SECTOR Q. 656, 671

might suffer a reputational hit. Additionally, the branding effects of lobbying could reduce the warm glow of all potential donors, not just employees.<sup>186</sup> Partisan politics, as others have suggested, may carry a taint or air of conflict that the nonprofit sector has until now largely avoided, diminishing the perceived returns of being known as a charitable benefactor.<sup>187</sup>

On the other hand, there certainly are existing charities with a sharply defined ideological position, and the fact that these organizations sometimes thrive suggests a possible offsetting gain of increased politicization.<sup>188</sup> Sociologists suggest that at least a portion of warm glow is likely related to donors' feelings that they have personally participated in achieving their self-defined public policy goals.<sup>189</sup> That sense of ideological accomplishment can also help to explain voting and nondeductible contributions to political campaigns, both of which should be rare under a classic economic framework.<sup>190</sup>

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& tbl.5 (2012) (reporting results of a survey of 100 organizations, in which those more dependent on individual donations were less inclined to political advocacy).

186. *See id.*

187. *See* Houck, *supra* note 13, at 85; Hsu, *supra* note 73, at 106, 116-20 & tbl.7 (offering evidence of this effect).

188. *See* Nicholson-Crotty, *supra* note 183, at 596 (arguing that lobbying activity may be attractive to some donors). Nicholson-Crotty reports that increased lobbying activity is correlated with higher donations in her sample. *Id.* at 592. There are a number of econometric questions about that finding. Most significantly, Nicholson-Crotty does not appear to have accounted adequately for potential endogeneity problems—that is, rather than lobbying causing donations, it may be that a common unobserved factor causes both. In particular, if demand for public goods is increasing, we should expect demand for both charity and government services to rise, which in turn would likely be reflected both in more donations and more lobbying. Her findings could also simply be evidence that charities sold the value of their donation. For example, her observation that firms that lobbied more in 2000 received more donations in 2001, *id.* at 597-600 & tbl.2, could imply that organizations lobbied in exchange for a pledge to contribute money in future years. Finally, the years 2000 and 2001 were an unusual period for charitable giving because of the vast amount of stock market wealth in the hands of donors. Tax law greatly favors donations by owners of appreciated stock. Joseph J. Cordes, *Re-Thinking the Deduction for Charitable Contributions: Evaluating the Effects of Deficit-Reduction Proposals*, 64 NAT'L TAX J. 1001, 1002 (2011). Therefore, Nicholson-Crotty's results could be driven in part by the fact that stock owners happened to prefer organizations with greater inclination to lobby. *Cf. id.* (providing a statistical summary of differing donation preferences of wealthy and middle-class donors).

189. David Knoke, *Incentives in Collective Action Organizations*, 53 AM. SOC. REV. 311, 326 (1988).

190. *See* HARDIN, *supra* note 83, at 108-12.

It is possible that both models could exist simultaneously in different pools of organizations.<sup>191</sup> Some classes of entities will try to present a staid, apolitical image: think of museums and performing arts centers. Others, such as environmental groups or antiabortion organizations, might embrace the more politically engaged image. An important question would be to what extent the activities and image of one group spill over onto the other, or if some groups that cannot clearly shape their own image for the public will be pooled together, getting the benefits of neither extreme. As I said, these all seem like plausible theoretical possibilities; further field work is needed to sort out which effects are the most important.<sup>192</sup>

### 3. *Regulatory Mismatch*

Another potential negative consequence of combining lobbying and charity in one entity is that different regulatory tools are optimal for each, and in many instances, cannot be simultaneously employed. In particular, political markets should arguably be regulated with sticks whereas charity should be regulated with carrots. As I have explained in prior work, subsidies to encourage good behavior can potentially be replaced with a punishment for those who fail to do good.<sup>193</sup> Both options have similar effects on the marginal incentives of donors.<sup>194</sup> Whether donors are rewarded, or nondonors fined, giving an additional dollar saves donors money relative to not giving.<sup>195</sup> However, the two mechanisms vary in a number of other important ways. Which option is the better choice for a particular policy depends largely on these other factors.<sup>196</sup>

Except in unusual circumstances, sticks are the more efficient tool for reining in the social overproduction of some negative externality-laden good.<sup>197</sup> Sticks earn the government money,

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191. See Nicholson-Crotty, *supra* note 183, at 596-97.

192. Some studies report that political activity does not diminish contributions to the lobbying nonprofit. See *id.* at 592. But the studies do not consider whether there are reputational externalities—whether lobbying by some firms affects giving to others.

193. Brian Galle, *The Tragedy of the Carrots: Economics and Politics in the Choice of Price Instruments*, 64 STAN. L. REV. 797, 848-50 (2012).

194. POSNER, *supra* note 168, at 10.

195. *Id.*

196. Galle, *supra* note 193, at 814-24.

197. For development of the points in this paragraph, see *id.*

whereas carrots drain the treasury, wasting hard-won tax revenues. Carrots give producers more resources to create the unwanted good and may even increase their demand for it, a phenomenon known as the “income effect.”<sup>198</sup> Carrots are wasteful if producers plan to cut back on their activities anyway. And overproducers who know they will be paid a carrot to curtail their activities in the future have an incentive to begin overproducing, whereas the opposite is true of sticks.

In contrast, carrots are more defensible for encouraging the production of a good with positive externalities, for which we would expect social underproduction.<sup>199</sup> In that case, the fact that carrot recipients have more resources is desirable, because we want them to produce or demand more of the good. On the other hand, it is still the case that the expectation of future carrots has unwanted incentive effects, encouraging producers to delay producing the good until the government agrees to pay them. Carrots also remain costlier, especially when factoring in the possibility that some might produce the good altruistically without subsidy.<sup>200</sup> Thus, even though carrots are less clearly dominated by sticks in the positive externality setting, a question remains whether they are worth the cost.

On this account the subsidy for contributions to charity is at least plausibly efficient. The central question would be whether the increased donations we see as a result of donors’ greater wealth from receiving carrots is worth the cost of the subsidy. As part of this cost, we would also have to consider the extent to which many donors would be willing to give even without government reward; again, data suggest that personal motives for giving are widespread and quite substantial.<sup>201</sup>

At the same time, these factors suggest that failures in the political market should probably be corrected with sticks.<sup>202</sup> As we saw earlier, spending money on lobbying is like driving a care: it is

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198. GRUBER, *supra* note 131, at 36.

199. See Galle, *supra* note 193, at 831-32.

200. See *id.* at 819-20.

201. Vesterlund, *supra* note 172, at 569-78.

202. Cf. David S. Gamage, Note, *Taxing Political Donations: The Case for Corrective Taxes in Campaign Finance*, 113 YALE L.J. 1283, 1288-321 (2004) (arguing that a corrective tax is superior to campaign spending limits under some assumptions).

a great way to get somewhere if no one else is on the road, but at rush hour, you might be better off walking.<sup>203</sup> More technically, lobbying is likely subject to congestion, in which use of a shared resource creates negative externalities for other users.<sup>204</sup> Of course, lobbying also provides positive externalities to those with similar goals as the lobbyists.<sup>205</sup> It therefore represents a hybrid good, falling somewhere between pure positive externality and pure negative externality goods. As such, the argument for political carrots is tenuous. Carrots would enrich donors to lobbying organizations, leading to more lobbying. More lobbying contributes both to congestion and political expression for the organizations' other supporters. Theory thus does not clearly predict whether the net income effect from enriching donors would increase social welfare. Given that the income effect is the primary argument in favor of carrots, this point significantly weakens the case for lobbying carrots.

This mismatch between the regulation of charity and lobbying is a reason to separate the two functions. Granting carrots to some of an organization's donors and imposing sticks on others would be prohibitively difficult. Donors would have to earmark the purpose of their money, but because money is fungible, this earmarking would not actually be meaningful in most cases. Even if it were, enforcement would be challenging, because money can buy resources—such as staff time and office space—that can be shared between purposes easily and invisibly.<sup>206</sup> Segregating lobbying and charity therefore better enables society to choose the more efficient regulatory tool for each activity.

Finally on the mismatch issue, even if lobbying and charity would both be best regulated with the same tool, they may have different marginal values. That is, it is very unlikely that both would happen to be underproduced by the same amount. For reasons I just noted, it would be difficult to subsidize one more than the other. As a result, if they are bound together, subsidizing one to an optimal degree means over- or undersubsidizing the other.

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203. Cf. Hsu, *supra* note 73, at 95-96 (analogizing traffic to campaign spending).

204. *Id.*

205. See Galle, *supra* note 193, at 831-32.

206. See Leff, *supra* note 13, at 707-08.

#### 4. *Inframarginality of the Deduction*

Next, allowing charities to lobby may reduce the cost effectiveness of subsidies for charitable activities by increasing the portion of inframarginal recipients of the subsidy. The efficacy of any subsidy is limited by the possibility that some of those who will receive it might have undertaken the desired activity anyway.<sup>207</sup> These recipients are inframarginal: they are not among the group of beneficiaries whose choice is tipped over the edge from inaction to action by a bonus payment. Dollars given to inframarginal recipients are wasted, from the government's perspective, because—aside from possible income effects—each dollar spent in that way increases the subsidized activity by \$0.<sup>208</sup>

If subsidized nonprofits can lobby, then they can also drive up the inframarginality of their donors. To explain this point, I first have to offer some background on why so many donors to charity are marginal. Inframarginality depends to a significant degree on a donor's menu of options. As I have argued, some nonprofits compete directly with governments.<sup>209</sup> When acting alone, however, individual donors would typically have little influence over government policy. Thus, as other studies have found, public spending crowds out private alternatives.<sup>210</sup> Would-be donors to private institutions know they cannot also reduce the taxes they will pay for the competing public institution, so they are willing to accept a less-than-ideal government substitute rather than pay the entire cost of

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207. Maureen L. Cropper & Wallace E. Oates, *Environmental Economics: A Survey*, 30 J. ECON. LITERATURE 675, 680-81 (1992).

208. Even if income effects are significant, dollars given to inframarginal donors will still very likely be less cost effective than money for marginal donors, because the latter will experience *both* income and substitution effects. Only in the improbable event that income effects are systematically larger for inframarginal donors than for marginal donors would the inframarginal subsidy be more efficacious. A more plausible scenario in which the usefulness of the two dollars would be comparable is if the substitution effect for the subsidized good is very small, such as when demand is highly inelastic.

209. See WALKER, *supra* note 184, at 46 (explaining that donors join groups for increased material benefit).

210. Bruce R. Kingma & Robert McClelland, *Public Radio Stations Are Really, Really Not Public Goods: Charitable Contributions and Impure Altruism*, 66 ANNALS PUB. & COOPERATIVE ECON. 65 (1995) (summarizing other findings and reporting authors' own study); A. Abigail Payne, *Does the Government Crowd-Out Private Donations? New Evidence from a Sample of Non-Profit Firms*, 69 J. PUB. ECON. 323 (1998).

a charitable rival that might be only a bit better.<sup>211</sup> As a result, in the presence of government competition, many potential donors are marginal: they would not give unless they received a subsidy.<sup>212</sup>

Subsidies for lobbying change this calculus, allowing charities to reduce government competition and therefore increase the inframarginality of their donors.<sup>213</sup> Though individual donors are likely to free ride on one another's efforts to offset competing government services, the lobbying subsidy would be designed to overcome exactly this obstacle.<sup>214</sup> Once government services are reduced, many donors would be willing to contribute without any subsidy.<sup>215</sup> Allowing the charity to help direct the efforts of their lobbying compatriots against government competitors would also waste some of the resources that the lobbying wing of the organization could have devoted to its own priorities.<sup>216</sup>

##### 5. *Entanglement and Executive Attention*

Finally, the long-standing claim that politics distracts nonprofit managers and distorts their goals can be understood as a diseconomy of scope argument. Madison believed that the irresistible

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211. See, e.g., GRUBER, *supra* note 131, at 295-97.

212. See Galle, *supra* note 82, at 821.

213. Admittedly, not all charities compete with the government. I have argued that competition should be the key feature for eligibility, see *id.* at 813-35, but my view is not current law. And churches, I acknowledge, simply fill a gap that the government constitutionally cannot. *Id.* at 813-14.

214. A privatization theorist might welcome even inframarginal spending on the deduction, because at a minimum, such spending reduces the size of government. But this would be a mistake. Treasury money lost through the deduction does not necessarily reduce other spending programs; the deduction might simply be offset through a higher tax rate. Because higher marginal tax rates result in greater deadweight loss, GRUBER, *supra* note 131, at 594-95, this is a bad outcome even for the privatization advocate: government is no smaller, and society is poorer.

215. One might think that reducing duplicative services should be a social gain. But the government services exist because voters did not want the quantity or kind of services the charity offers. By changing the government's choices, lobbying reduces welfare for those voters. For example, parochial school parents may vote to lower public school quality, which obviously is not welfare increasing for public school families. *Cf. id.* at 295-97.

216. In theory nonprofit law could respond to this problem by reducing the amount of the subsidy directed to organizations whose donors are more likely to be inframarginal, but that solution has serious practical problems. See Louis Kaplow, *A Note on Subsidizing Gifts*, 58 J. PUB. ECON. 469, 471 (1995).

temptation of political power would corrupt churches.<sup>217</sup> Modern commentators echo that concern for the nonprofit sector in general, worrying that managers will bargain away aspects of their own goals in exchange for greater power or money to achieve others, or to pay off hold-ups by officials who want their support.<sup>218</sup> Because independence from majoritarian government decisions is key to all the rationales for the deduction,<sup>219</sup> this problem is an existential threat to the sector.<sup>220</sup> It is especially perilous when combined with the problem of agency costs. Managers may trade their organization's goals for personal advancement or their own ideological aims, and most stakeholders will be relatively powerless to stop them.<sup>221</sup> Even politics that align perfectly with the organization's mission can distract managers from their other tasks.<sup>222</sup>

Some have argued that if these were serious concerns, organizations would simply self-commit not to engage in politics.<sup>223</sup> In fact,

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217. MADISON, *supra* note 144, at 82-83.

218. Chisholm, *Politics and Charity*, *supra* note 13, at 338; Clemens, *supra* note 112, at 215; Steven Rathgeb Smith & Kirsten A. Grønberg, *Scope and Theory of Government-Nonprofit Relations*, in THE NONPROFIT SECTOR: A RESEARCH HANDBOOK, *supra* note 14, at 221, 227; Tobin, *supra* note 13, at 1320-24, 1329-30.

219. *See supra* Part II.A-C.

220. *Cf.* Tobin, *supra* note 13, at 1337 (arguing that opportunities to campaign would compromise nonprofit independence).

221. *See* Jenkins, *supra* note 69, at 315 (noting that the political interests of managers "constrain[]" their other values). For qualitative evidence of the phenomenon, see Galston, *supra* note 13, at 1327-29 (reporting findings of the Filer Commission and other studies suggesting that increased government control through funding resulted in organizational agenda shifts to match the relevant government body's agenda); Frederick C. Harris, *Black Churches and Civic Traditions: Outreach, Activism, and the Politics of Public Funding of Faith-Based Ministries*, in CAN CHARITABLE CHOICE WORK? COVERING RELIGION'S IMPACT ON URBAN AFFAIRS AND SOCIAL SERVICES 140, 153-54 (Andrew Walsh ed., 2001); and Debra C. Minkoff & Walter W. Powell, *Nonprofit Mission: Constancy, Responsiveness, or Deflection?*, in THE NONPROFIT SECTOR: A RESEARCH HANDBOOK, *supra* note 14, at 591, 595-98.

The role of managers also explains why, contrary to Buckles, *supra* note 13, at 1094, the Establishment Clause does not mitigate the temptation problem for churches. Although the government cannot easily give direct rewards to churches, nothing in the First Amendment prevents political actors from rewarding church officers, especially if the reward is paid out through policy success or prestige rather than cash. *See, e.g.*, Harris, *supra*, at 153-54.

222. *See* Ellen P. Aprill, *Lessons from the UBIT Debate*, 45 TAX NOTES 1105, 1108 (1989) (making this point about the rule against substantial commercial activity); *cf.* Eleanor Brown & Al Slivinski, *Nonprofit Organizations and the Market*, in THE NONPROFIT SECTOR: A RESEARCH HANDBOOK, *supra* note 14, at 140, 149-50 (noting that commercial activities divert scarce organization resources).

223. *See, e.g.*, Buckles, *supra* note 13, at 1096; *cf.* HENRY N. BUTLER & LARRY E. RIBSTEIN, THE CORPORATION AND THE CONSTITUTION 25-27 (1995) (suggesting that shareholders can

any 501(c)(3)'s organizational documents prohibit electioneering or substantial lobbying, because that is a requirement for eligibility.<sup>224</sup> But few nonprofits would self-limit if they were not required to do so. Many nonprofits compete in the policy arena with other firms; why would they unilaterally disarm?<sup>225</sup> Drafting, monitoring, and enforcing individualized contractual terms is also expensive.<sup>226</sup>

What is more, organizational resources and the government's subsidy dollars are commons shared by the firm's founders and their successors. Thus, each stakeholder with influence over the firm actually has incentives to divert organizational resources to their own ends before other managers do so.<sup>227</sup> Though these tragedies of the commons are pervasive, not many resolve themselves without government assistance; why nonprofits would be different is not obvious.<sup>228</sup> Among other problems, the benefits of solving the collective action problem are good for the firm in the long run, but present managers will not be around to collect those benefits; they therefore are prone to overweight their own present opportunities for rents.<sup>229</sup> Endowment effects, framing, and over-optimistic belief in the founders' own ability to avoid problems may contribute to this

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contract with management to prevent unwanted political activities).

224. 26 C.F.R. § 1.501(c)(3)-1(b)(3) (2012).

225. Cf. Hines et al., *supra* note 148, at 1195-96 (discussing competition among nonprofits).

226. See Hsu, *supra* note 73, at 125 ("[P]rohibitive transaction costs of cooperation ... include the costs of enforcement.").

227. Cf. Barry R. Weingast et al., *The Political Economy of Benefits and Costs: A Neoclassical Approach to Distributive Politics*, 89 J. POL. ECON. 642, 658-59 (1981) (explaining the incentives of public officials to spend expected revenues before other officials use them up).

228. Hsu, *supra* note 73, at 125. Scholars of the commons problem report many instances in which small communities have used norms and other forms of interpersonal commitment to constrain overuse of common resources. ELINOR OSTROM, GOVERNING THE COMMONS: THE EVOLUTION OF INSTITUTIONS FOR COLLECTIVE ACTION 35-37, 88-89, 205-07 (1990); Robert C. Ellickson, *Property in Land*, 102 YALE L.J. 1315, 1390-91 (1993). But these kinds of interactions cannot easily arise when the players are spread across time rather than space; there is no ready sanction of shaming or exclusion that today's managers can use to punish future managers.

229. Cf. Gary A. Wagner, *Political Control and Public Sector Savings: Evidence from the States*, 109 PUB. CHOICE 149, 150 (2001) (finding this effect among state officials); Michael Wolkoff, *An Evaluation of Municipal Rainy Day Funds*, PUB. BUDGETING & FIN., June 1987, at 52, 61 (articulating the same point with regard to municipal officials). See generally GEORGE AINSLIE, PICOECONOMICS: THE STRATEGIC INTERACTION OF SUCCESSIVE MOTIVATIONAL STATES WITHIN THE PERSON 63-80 (1992) (describing evidence that humans excessively discount future benefits).

miscalculation.<sup>230</sup> Participants may also worry that they will unfairly be bound by any shared commitment to refrain when others get away with cheating.<sup>231</sup> This seems like a reasonable concern for nonprofits, for whom oversight by outsiders is particularly difficult.<sup>232</sup>

In this respect, organizational self-commitments against lobbying are similar to more general constraints on managerial self-dealing. It is possible some organizations would write such rules themselves. Because of the higher transaction costs a diffuse group of members faces in organizing to limit the behavior of their agents, however, default rules should in general be set to protect members against opportunistic manager behavior.<sup>233</sup>

### *B. Economies*

On the other side of the ledger, there are some clear and well-recognized cost advantages of combining lobbying and charity together in one organization. I will argue, though, that this cost advantage may actually cut against nonprofit politics, as it exaggerates some of the dangers I have already mentioned.

#### *1. Cost Advantages of Combined Activities*

Staff who are already expert in delivering charitable services are likely to be particularly knowledgeable lobbyists. They have direct experience serving their target population, have learned close-up the key problems or issues facing their clientele, and may have hard-earned information about which solutions work and which do not.<sup>234</sup> Nonprofit staff can also help government to coordinate its

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230. Cf. Barton H. Thompson, Jr., *Tragically Difficult: The Obstacles to Governing the Commons*, 30 ENVTL. L. 241, 256-62 (2000) (discussing the influence of these factors in an individual's miscalculation of common natural resources).

231. See, e.g., Hsu, *supra* note 73, at 127-28.

232. See *supra* note 79 and accompanying text.

233. See Bebchuk & Jackson, *supra* note 130, at 103-04 (making this point about for-profit shareholders).

234. See Mayer, *supra* note 47, at 539 (noting the benefits of interest groups include the ability to supply "valuable information and advice to governmental decision makers").

efforts with their own, perhaps avoiding wasteful duplication or allowing one program to build on the strengths of another.<sup>235</sup>

Sharing personnel between lobbying and direct charitable activities also makes for more effective lobbying. Obviously, expert lobbyists are often more credible. Beyond that, though, shared staff may be more cost-effective lobbyists because of warm glow and personal connection to the organization's mission.<sup>236</sup> Although this warm glow would presumably dissipate for some workers if they had to spend all of their time lobbying, a charity could attract top talent at bargain prices and then "lend" such talent to its lobbying efforts on a part-time basis.

More generally, overlapping lobbying and charity allows each activity to leverage the resources that staff and supporters have contributed for one purpose to the service of the other. Some are fairly tangible, such as office space, e-mail and phone lists, and well-trained volunteers.<sup>237</sup> Others are more abstract. For example, political theorists believe that a key source of lobbyist influence is the threat, often implicit, that the lobbyist can mobilize her constituency to vote against the official she is lobbying, or at least to contribute to the official's political opposition.<sup>238</sup> A charity offers the lobbyist a built-in grassroots constituency she can use in this way, saving her—and, if she is subsidized, the government—the costs of building a separate organization.<sup>239</sup>

Relatedly, a long-established charity likely has a substantial store of goodwill and public reputation it can use to sway officials or rally

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235. The tax definition of lobbying excludes testimony or simple responses to legislative inquiries, I.R.C. § 4911(d)(2)(B) (2006), which allows a fair amount of information to flow between lobbyists and legislators irrespective of other limits.

236. See *supra* note 179 and accompanying text.

237. Leff, *supra* note 13, at 707-08 (discussing the fact that an "organization may use expenditures made with subsidized funds to support its campaign-intervention activities, but without making any marginal expenditures"). On the usefulness of voter lists, see Stephen K. Medvic, *Political Management and the Technological Revolution*, in *ROUTLEDGE HANDBOOK OF POLITICAL MANAGEMENT* 98, 104, 108 (Dennis W. Johnson ed., 2009).

238. See BAUMGARTNER ET AL., *supra* note 70, at 12; JEFFREY M. BERRY & CLYDE WILCOX, *THE INTEREST GROUP SOCIETY 90-94* (4th ed. 2007) (discussing the influence of nonfinancial and financial support by PACs and interest groups).

239. See Kenneth T. Andrews & Bob Edwards, *Advocacy Organizations in the U.S. Political Process*, 30 ANN. REV. SOC. 479, 489-90 (2004) (describing studies that argue for the importance of preexisting resources and membership for successful advocacy groups); Jenkins, *supra* note 69, at 319 (discussing the importance of effective mobilization by advocacy groups and suggesting ways to achieve it).

the public behind a lobbying campaign.<sup>240</sup> Donors may prefer to purchase both charity and lobbying from the same organization, because they have invested effort in verifying the quality or trustworthiness of that entity.<sup>241</sup> Perhaps lobbying organizations could build similar reputations, but presumably that would be a long and expensive process. And perhaps lobbying organizations, standing alone, could never equal the influence of charities. Many charities can draw on a long tradition of relative nonpartisanship, as well as the broad social consensus in favor of charity, giving them special weight when they choose to speak.<sup>242</sup> Of course, if that is an important factor, it suggests that charities and their subsidizers should want to limit the sector's political adventures, lest it spend down its hard-won store of public goodwill.

Finally, combining what might otherwise be two or more sets of organizations allows for economies of scale as well as scope.<sup>243</sup> If donors would tend to split contributions to charities and lobbying firms, or if either half of the combined entity can attract donors that the other could not, then the whole will be greater than either of its two parts. Donors may also give more when they know that their dollars will benefit from economies of scope.<sup>244</sup> Additionally, many charities have very significant sources of revenue independent of donors. For example, hospitals derive less than 5 percent of their revenues, on average, from donations.<sup>245</sup>

## 2. *The Downside of Cost Advantages*

At the same time that economies of scale and scope may benefit donors to lobbying charities, they may also threaten to create yet more social headaches or to exacerbate problems I have already identified. First, and probably most importantly, the two economies

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240. Mayer, *supra* note 47, at 535-36.

241. Cf. Robert G. Harris & Thomas M. Jorde, *Antitrust Market Definition: An Integrated Approach*, 72 CALIF. L. REV. 1, 25-26 (1984) (noting that having multiproduct sellers allows consumers to save on search costs).

242. See Tobin, *supra* note 13, at 1319-20.

243. Economies of scale are simply savings that result from producing goods in quantity. BLACK'S LAW DICTIONARY 590 (9th ed. 2009).

244. See MARWELL & OLIVER, *supra* note 179, at 61-63.

245. MOLLY F. SHERLOCK & JANE G. GRAVELLE, CONG. RESEARCH SERV., R40919, AN OVERVIEW OF THE NONPROFIT AND CHARITABLE SECTOR 19 fig.5, app. at 60 (2009).

magnify the political power of wealthy donors. As other commentators have recognized, because of the upside-down nature of § 170, letting donors who wish to lobby tap into the charitable contribution deduction would direct a larger government matching grant to donors who are already rich and politically powerful.<sup>246</sup> If combining the two activities in fact is cost effective, the inequality of the subsidies would be magnified even further.<sup>247</sup> Low-income donors would benefit from the dollar-multiplying effect of economies of scale and scope, but those who can afford to donate more would also see that advantage multiplied, potentially further crowding out the voices of the less powerful.<sup>248</sup>

Greater returns on lobbying expenditures also heighten the danger of capture and entanglement for charities. As charities become more potent tools for effecting political change, political actors' incentives for influencing, and even co-opting, charity grow.<sup>249</sup> Donors with only tenuous connections to the mission of the organization may also seek to purchase a portion of the surplus created by the economies of scale and scope, making more plausible the possibility, which I alluded to in Part III.A.5, that lobbying can become a distracting profit center for the firm.

Further, the problems of inframarginality and agency costs grow when nonprofit lobbying becomes more cost effective. The better charities are at driving down government competition, the less necessary the subsidy for charity becomes—and the less genuine the competition between the two sectors. Managers, like the tenuously connected donors of the last paragraph, are also more tempted to use the organization's resources for their own ends when those resources are a better bargain than spending the managers' own money.

Money derived from interest on an endowment or fees paid by customers can be yet more tempting for managers than donated

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246. See Tobin, *supra* note 13, at 1326-27; see also *supra* notes 96-101 and accompanying text.

247. As I noted earlier, and will take up again later, this problem can also be addressed with campaign finance regulations or caps on organizational spending. See *supra* Part II.A.2 and *infra* Part IV.B.

248. Again, it is worth noting that the crowd-out result depends to some extent on the shape of the marginal-returns-on-lobbying curve. See *supra* Figure 1 and text accompanying note 102.

249. See Tobin, *supra* note 13, at 1322.

funds. As I argued earlier, even donors who are relatively attentive to the uses of their contributions may have difficulty detecting when managers' political choices begin to stray from the donors' own.<sup>250</sup> Hospital patients and museumgoers have no authority over the board, have strong incentives to free ride on other monitors, and have no legal authority over nonprofit managers' political choices, giving managers with access to the revenue streams a freer hand to pursue their own personal or ideological interests.

Taken to an extreme, managerial lobbying threatens the meaningfulness of the firm's supposed nonprofit status, especially in firms with significant nondonative revenue. The nondistribution constraint—that is, the promise that a nonprofit will remain not-for-profit—is supposed to assure customers that managers will not cut corners on quality in order to line their own pockets.<sup>251</sup> As Henry Hansmann argues, customers cannot observe or easily measure that quality. Thus, without the promise of limited profiteering, customers would likely be unwilling to contract with the firm.<sup>252</sup> If, however, managers can lawfully derive personal consumption from the firm's funds, they will again have incentives to shortchange customers on quality in order to maximize their opportunity to spend on their own goals. In other words, lobbying can become profits in disguise.

To some extent "profits in disguise" are always a possibility when revenue-driven organizations carry out some functions that please the firm's employees but do not fully satisfy customers.<sup>253</sup> Nonprofit law does prohibit organizations from devoting resources to the private goals of their managers.<sup>254</sup> But no rule prevents managers from shifting resources from one permissible public purpose to another. If lobbying were permissible, managers could freely spend customers' money on lobbying, rather than on quality services. As

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250. See *supra* notes 79-83, 159-64 and accompanying text.

251. See Henry B. Hansmann, *Reforming Nonprofit Corporation Law*, 129 U. PA. L. REV. 497, 501 (1981).

252. See *id.* at 506-07.

253. See Evelyn Brody, *Agents Without Principals: The Economic Convergence of the Nonprofit and For-Profit Organizational Forms*, 40 N.Y.L. SCH. L. REV. 457, 463 (1996); cf. Mayer, *supra* note 117, at 109-11 (describing ways in which management may be able to resist the preferences of consumers, but claiming that it is a good outcome because it preserves the charity's public benefit goals).

254. I.R.C. § 4958 (2006).

I argued earlier, lobbying is especially likely to create these opportunities for managerial rent taking.<sup>255</sup>

Finally, economies of scope and scale also worsen the problem of regulatory mismatch. Recall that subsidizing lobbying contributions probably increases crowding in the political marketplace, which implies that sticks are more likely to be the better choice than carrots for charitable contributions.<sup>256</sup> Suppose that it were possible for donors to earmark their contributions for the two purposes very clearly, that firms could not shift money around to offset that earmarking, and that government could perfectly monitor uses of the earmarked funds. The two functions could then be combined in one firm, and the two different regulatory tools could be applied to the two different kinds of donations, without much conflict. Economies from combining the two into one firm would spoil that utopia, however, because contributions to the charity side of the house would also allow for more lobbying output per dollar spent on lobbying. Lobbying donors might be taxed, and so might donate less, but each dollar would go farther, contributing to crowding.

### C. Summary

Overall, combining politics and charity together in one organization looks like it would seriously water down the benefits of the nonprofit sector. Together, the two can reduce the efficacy of social incentives for charitable behavior, increase the costs of monitoring the resulting organization, distort its outputs, and perhaps degrade their quality. That savings can be found, too, may simply worsen these problems, because the savings make the combined form especially tempting for politically motivated donors and managers.

It could be argued that we should simply leave to donors the decision whether, on net, combined organizations are worth their costs.<sup>257</sup> Indeed, as I have mentioned, one of the stated goals of the

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255. See *supra* notes 79-83, 159-64 and accompanying text.

256. See *supra* Part III.A.3.

257. See Brakman Reiser, *supra* note 14, at 61; Mark Totten, *The Politics of Faith: Rethinking the Prohibition on Political Campaign Intervention*, 18 STAN. L. & POL'Y REV. 298, 307 (2007); cf. BUTLER & RIBSTEIN, *supra* note 223, at 25-27 (making this argument about for-profit firms).

deduction is to permit private decisions about the most effective way to get things done.<sup>258</sup>

The problem, again, is externalities. Many of the costs of combined entities are borne mostly by people who are not their donors. Damage to the independence and zest of the sector, political crowding, reduced warm glow, decreased marginal efficacy of the government's subsidy dollars, and increased monitoring effort by the government—all of these burden the entire charitable sector, if not all of society.<sup>259</sup> Even donors' agency costs are an externality, as individual donors do not directly internalize the increased agency costs of *other* donors. Thus donors will be drawn to the combined form by the fact that it makes their own dollars go further while neglecting the harms those dollars do.

We could tell much the same story about letting nonprofit managers decide the most efficient organizational structure. Rationally self-maximizing managers would have little reason to choose separate firms for lobbying and charity. To the contrary, because combined organizations probably allow managers more autonomy and therefore more rents, they likely prefer combinations, all else equal.

To be sure, not everyone is a rational self-maximizer who ignores all externalities, and probably very few of us really are. Again, the nonprofit sector depends on our collective willingness to do good for one another. Surely some causes are more important and more salient to us than others, though. We should not expect the environmental advocate to turn down the most effective instrument for preserving wetlands because that instrument will result in greater deadweight loss from taxation.<sup>260</sup> The data confirm this intuition, finding that personal ideology matters in giving; donors give to what is most important to *them*.<sup>261</sup>

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258. See *supra* Part II.B.

259. See *supra* Part III.A; cf. Hsu, *supra* note 73, at 110-11.

260. See Gergen, *supra* note 62, at 1412-14 (suggesting donors do not account for the negative fiscal externality of deduction).

261. Rene Bekkers & Pamala Wiepking, *A Literature Review of Empirical Studies of Philanthropy: Eight Mechanisms that Drive Charitable Giving*, 40 *NONPROFIT & VOLUNTARY SECTOR Q.* 924, 941-42 (2010). Even if the observed variation in giving results from differences in donor information, see *id.* at 930-32, not ideological beliefs or other preferences, that would still support my argument. Donors are unlikely to even be aware of many of the social costs identified here, and certainly not with the degree of precision needed to compare them

## IV. LEGAL IMPLICATIONS

So far, I have focused on the fairly general question of whether charitable organizations should also lobby. Translating these principles into legal rules requires a bit more effort. For example, even if in the abstract we would prefer that charities not lobby, defining “lobbying” in practice is difficult, especially in the case of organizations whose charitable mission is to educate the public—an activity that looks a lot like lobbying. Another example is the question of how far lobbying limits should reach: Should they apply to the entire organization or just to the use of money the organization raises through deductible contributions? In the absence of a clear theory about why we would want to prohibit some kinds of conduct and not others, these kinds of line-drawing exercises are challenging, not to mention the fact that the results are often confusing, frustrating, and hard to predict.<sup>262</sup> Now that our theory is clearer, though, the legal task of definition and administration should be easier. To illustrate—and also because it might be useful—this Part plays out some of the more important legal details that follow from the theory so far.

*A. Defining Lobbying*

Although the basic meaning of lobbying is straightforward, some difficult borderline cases do arise. Borderline cases are not necessarily rare or unimportant. If organizations can easily change their behavior to toggle back and forth across a legal border as necessary, then what begins as a rare exception can quickly become the norm. It is therefore worthwhile to consider the limits of what we mean by “lobbying.”

My working definition of lobbying to this point has comprised efforts to achieve outcomes through political rather than private means. Or, put another way, lobbying seeks to extend an organization’s control from the use of its own funds to the direction of

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meaningfully against the benefits of contributing.

262. See Tobin, *supra* note 13, at 1356-58 (noting that unclear rules make IRS enforcement actions difficult to predict).

taxpayer dollars. That distinction also matches fairly well my suggested policy rationales for limiting lobbying by charities.<sup>263</sup> Influence over the federal treasury allows organizations to reduce the inframarginality of donations, and that influence most strongly tempts the entity and its officers to change their mission in exchange for greater resources. The scramble to leverage the government's scarce resources may generate resentment towards and political friction for the nonprofit sector, and regulating that scramble may require tools that would be incompatible with tools for encouraging the private production of public goods.

This logic suggests two significant legal implications, one of which is contrary to current law. For one, notwithstanding existing IRS regulations authorizing administrative lobbying,<sup>264</sup> lobbying limits should extend to efforts to influence regulations. Admittedly, § 501(c)(3)'s plain text focuses on "propaganda" or other efforts to affect "legislation."<sup>265</sup> Many regulations have long been held to be the equivalent of "law" for most purposes,<sup>266</sup> though, and the term "propaganda" on its face is broad enough to include administrative lobbying. As a policy matter, regulation can direct the uses of public resources as effectively as legislation,<sup>267</sup> raising the dangers of distraction, agency costs, warm glow diminishment, and inframarginality. Although the size of most agencies is not usually constitutionally limited, the size of bureaucracies is practically determined by their budgets,<sup>268</sup> so their time and attention, like a legislature's, are subject to crowding. Routine interactions with low-level bureaucrats may not raise these concerns as sharply, and so perhaps, as Mayer proffers, lobbying might be restricted only when contacts are with the political leadership of an agency.<sup>269</sup>

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263. See *supra* Part III.A.

264. Treas. Reg. § 56.4911-2(d)(3) (1990).

265. I.R.C. § 501(c)(3) (2006).

266. See Thomas W. Merrill & Kathryn Tongue Watts, *Agency Rules with the Force of Law: The Original Convention*, 116 HARV. L. REV. 467, 493-570 (2002).

267. See *id.* at 546-48.

268. See Peter Raven-Hansen & William C. Banks, *Pulling the Purse Strings of the Commander in Chief*, 80 VA. L. REV. 833, 834-36 (1994) (describing the importance of agency budgets as a control mechanism); Charles Tiefer, *Congressional Oversight of the Clinton Administration and Congressional Procedure*, 50 ADMIN. L. REV. 199, 212-14 (1998) (same).

269. Mayer, *supra* note 47, at 554.

My analysis also suggests, consistent with existing law, that efforts to sway the outcome of ballot initiatives and referenda are lobbying.<sup>270</sup> Again, there is some linguistic ambiguity in whether these kinds of law making would fall within the literal ambit of the terms “propaganda” or “legislation.” Again, too, it is clear that when voters control government outcomes directly there are significant opportunities for nonprofit involvement to lead to temptation, infra-marginality, and politicization.<sup>271</sup> A number of studies also confirm that voter attention in advance of a referendum, as well as tools for reaching voters—such as television advertising time—are scarce resources,<sup>272</sup> so the crowding arguments are still important. On the other hand, the agency cost problem is likely less than when nonprofits lobby government directly, because unlike a phone call, back-room meeting, or handshake agreement, the organization’s efforts at changing public opinion cannot easily be hidden from its stakeholders. But on balance the policy case for regulating charitable involvement in direct democracy still seems quite strong.

Direct democracy does raise more sharply an issue that all lobbying restrictions face: how to identify when communications aimed at the general public, rather than directly at policymakers, should count as lobbying. Under current law, this form of grassroots lobbying can sometimes count as the equivalent of a direct communication.<sup>273</sup> Whether any given communication counts as lobbying depends on a set of balancing tests, with the exact content of the test varying depending on which of several possible legal regimes the organization is subject to.<sup>274</sup>

Because public opinion is a key lever for moving government officials, at least some grassroots communications must count as lobbying for any lobbying limits to be meaningful. As popular opinion changes, democratically accountable officials are likely to

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270. Treas. Reg. § 1.501(c)(3)-1(c)(3) (as amended in 2008). *But see* Mayer, *supra* note 47, at 562 (arguing that efforts to influence referenda should not be regulated as lobbying).

271. *See supra* Part III.A.

272. *See* Shaun Bowler et al., *Ballot Propositions and Information Costs: Direct Democracy and the Fatigued Voter*, 45 W. POL. Q. 559 (1992); Stephen P. Nicholson, *The Political Environment and Ballot Proposition Awareness*, 47 AM. J. POL. SCI. 403, 403-04 (2003); *see also* Elizabeth Garrett, *Money, Agenda Setting, and Direct Democracy*, 77 TEX. L. REV. 1845, 1870-72 (1999) (arguing to this effect).

273. Vladeck, *supra* note 3, at 326-27.

274. *See* HOPKINS, *supra* note 35, at 640-61.

change positions, too, making grassroots lobbying a powerful, if indirect, tool for accomplishing social change.<sup>275</sup> Charitable organizations are key players in developing public opinion because rationally ignorant voters often rely on credible intermediaries for their information.<sup>276</sup> Organizations' advertising and other political communications can also manipulate the framing and emotional content of a political message to shape voter opinion.<sup>277</sup>

Interest groups' power to shape opinion calls into question the current definition of grassroots lobbying, which is limited to communications that urge the public to contact an official.<sup>278</sup> Direct contact between officials and the public is important but is not the only pathway to grassroots influence. Officials do often depend on their contacts with lobbyists or more active constituents to get a sense of their constituency's leanings.<sup>279</sup> But given the efficacy of interest groups' messaging to their constituents, officials can also get a general sense of possible shifts in public opinion simply by observing the communications from the organization to the public. That makes most grassroots lobbying a kind of indirect message to officials.

Even grassroots lobbying aimed only at members of the organization or those with close ties to it can impact officials' decisions.<sup>280</sup> As I have mentioned, lobbyists derive a good measure of their power

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275. See JOHN W. KINGDON, *AGENDAS, ALTERNATIVES, AND PUBLIC POLICIES* 149-51, 162-63 (2d ed. 1995) (describing how the use of public communications influences officials); James A. Stimson et al., *Dynamic Representation*, 89 *AM. POL. SCI. REV.* 543, 557-60 (1995) (reporting authors' evidence that electoral constraints tie officials to public preferences).

276. See Christopher Weber et al., *It's All in the Name: Source Cue Ambiguity and the Persuasive Appeal of Campaign Ads*, 34 *POL. BEHAV.* 561 (2012); Richard E. Wagner, *Pressure Groups and Political Entrepreneurs: A Review Article*, 1 *PUB. CHOICE* 161, 164-67 (1966) (reviewing MANCUR OLSON, JR., *THE LOGIC OF COLLECTIVE ACTION* (1965)).

277. See RICHARD M. PERLOFF, *THE DYNAMICS OF PERSUASION: COMMUNICATION AND ATTITUDES IN THE 21ST CENTURY* 287-359 (4th ed. 2010); Lynda Lee Kaid, *Political Advertising*, in *HANDBOOK OF POLITICAL COMMUNICATION RESEARCH* 155, 160-75 (Lynda Lee Kaid ed., 2004) (discussing research on how the content of candidates' political campaign ads affects the behavior of voters); Adam F. Simon & Jennifer Jerit, *Toward a Theory Relating Political Discourse, Media, and Public Opinion*, 57 *J. COMM.* 254, 257-58 (2007) (discussing how political entrepreneurs and journalists use framing to produce public discourse, which in turn affects the judgment of citizens).

278. See *Treas. Reg.* § 56.4911-2(b)(2) (1990).

279. See Peter H. Aranson et al., *A Theory of Legislative Delegation*, 68 *CORNELL L. REV.* 1, 38-39 (1982).

280. Galston, *supra* note 13, at 1349-50.

from their ability to whip the individual members of the coalition they represent.<sup>281</sup> Because it is costless for any given lobbyist to claim that she represents a powerful and easily motivated coalition, all lobbyists presumably would do so. In order to distinguish themselves, intermediaries who actually represent real interests must be able to demonstrate that the troops can be mobilized.<sup>282</sup> Calls to action from the organizer to the coalition, even if not public, are therefore at the heart of effective lobbying. The proposal by some commentators to exempt from regulation all internal communications from the organization to its members<sup>283</sup> would accordingly weaken most meaningful lobbying restrictions.

At the same time, any lobbying regulation regime has to acknowledge that information is a public good separate and apart from any political consequences.<sup>284</sup> Organizations that seek to understand the world or to share existing understandings with a wider public are therefore at the core of almost any rationale for a nonprofit subsidy.<sup>285</sup> Knowledge, of course, can also motivate the public to change its mind about what the law should be. Even an objective observer might therefore have trouble distinguishing lobbying from public education. And, as courts have recognized, the government officials who have to make this distinction are not always objective.<sup>286</sup>

Existing law seems to have evolved to a reasonable compromise. Organizations can escape the lobbying label by following a particular procedure for how they inform the public.<sup>287</sup> Grassroots communications are not lobbying if they are “educational”—that is, if they are based in fact, offer contrary evidence when appropriate, and avoid claims based purely in emotion.<sup>288</sup> To be sure, these rules

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281. See sources cited *supra* note 238 and accompanying text.

282. BERRY & WILCOX, *supra* note 238, at 116-17.

283. See, e.g., Keith S. Blair, *Praying for a Tax Break: Churches, Political Speech, and the Loss of Section 501(c)(3) Tax Exempt Status*, 86 DENV. U. L. REV. 405, 435-36 (2008); Mayer, *supra* note 47, at 561-62; Totten, *supra* note 257, at 321-22.

284. See Mayer, *supra* note 47, at 561.

285. See Chisholm, *Matching*, *supra* note 13, at 288.

286. See, e.g., *Big Mama Rag, Inc. v. United States*, 631 F.2d 1030, 1036-37, 1040 (D.C. Cir. 1980).

287. Rev. Proc. 86-43, 1986-2 C.B. 729. For a cogent description of the procedure and its interpretation, see Daniel L. Simmons, *An Essay on Federal Income Taxation and Campaign Finance Reform*, 54 FLA. L. REV. 1, 57-64 (2002).

288. Rev. Proc. 86-43, 1986-2 C.B. 729; see Treas. Reg. § 56.4911-2(c)(1) (1990) (stating that an “independent and objective exposition of a particular subject matter” is “educational” and

likely allow for a fair amount of what is functionally considered lobbying under my proposed definition. But the price of being allowed to lobby is that the organization must often provide society with genuine public goods—real, honest-to-goodness facts. The added costs of having to verify its claims and avoid using manipulative advertising serve effectively as taxes on the crowding effects of the lobbying communication.<sup>289</sup>

Indeed, current law could probably go further in the direction of requiring organizations to substantiate their arguments so as to increase the size of this tax and to heighten the value of the information that society receives. For example, the amended rule might oblige organizations to disclose any reasonable factual evidence contrary to their public statements, even for statements that do not include a “call to action.” Studies of deliberation suggest that having to craft a message that acknowledges opposing opinions would also have the side benefit of moderating the extremity of an organization’s positions.<sup>290</sup> That could mitigate the tendency of lobbying subsidies to polarize the political debate.

### B. “Substantial”

From what I have said so far, it should be clear that no test that seeks to separate lobbying from education is going to be exact. If we want to avoid deterring a significant amount of activity that could be close to the line, there should likely be room for organizations to

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does not constitute lobbying). Alternatively, grassroots communications are educational if they simply comment in a roundabout way about legislation without directly calling on the public to act. See Treas. Reg. § 56.4911-2(b)(2) (defining “grassroots lobbying” as communications aimed at the public that identify specific legislation, reflect a view on the legislation, and encourage recipients to take appropriate action). I argued earlier that this standard is probably too loose.

289. There is an analogy here to tax shelter regulation. Government often restricts socially wasteful tax sheltering activity by imposing formal requirements that must be met before the shelterer can prevail—what David Weisbach calls “backflip[s].” David A. Weisbach, *Ten Truths About Tax Shelters*, 55 TAX L. REV. 215, 222-23 (2002). Weisbach’s point is that meeting the formal requirements is itself wasteful for the shelterer, so it is ambiguous whether such requirements actually improve total welfare on net. *Id.* In the case of the education requirements, though, the backflip also produces a public good, making it rather more likely that the distortive effect of the educational requirement actually betters society overall.

290. See Schulz-Hardt et al., *supra* note 109. See generally CASS R. SUNSTEIN, WHY SOCIETIES NEED DISSENT 209-13 (2003).

make some mistakes before they are seriously penalized. That brings us to the question of how much lobbying activity should be permissible. Historically, courts have refused to revoke an organization's 501(c)(3) status for conducting nonexempt activities unless those activities were "substantial."<sup>291</sup> Congress has now codified the substantiality rule for lobbying.<sup>292</sup> More recently, Congress has also added penalties short of revocation for certain kinds of organizations.<sup>293</sup>

Both of these approaches make sense as ways of balancing the deterrence of grassroots lobbying against the encouragement of education. Balancing can also make sense even in the case of direct communications with officials because society will often want government to use the knowledge gathered by nonprofits.

Although my theory here does not by itself tell us exactly where to draw the line that constitutes too much lobbying, it does at least help to clarify how to go about drawing that line. Most commentators assume that the portion of the organization's time or resources devoted to lobbying determines whether its lobbying is "substantial."<sup>294</sup> For example, observers of the Mormon Church's multimillion dollar efforts in support of Proposition 8 in California suggested that even \$10 million in expenditures would be a tiny fraction of the Church's annual revenues, and so were not "substantial."<sup>295</sup>

This view of "substantial" is too narrow to fit with most justifications for the lobbying limits. As I have argued in abbreviated form elsewhere, substantial lobbying should likely also include efforts that have a significant real-world policy impact, even if as small as a fraction of an organization's budget.<sup>296</sup> Almost all of the rationales for lobbying limits make more sense if they are measured by

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291. Galle, *supra* note 106, at 372-73.

292. I.R.C. § 501(c)(3) (2006).

293. *Id.* § 4955. Private foundations are always subject to monetary penalties for some kinds of political activity. *Id.* § 4945(d). Most public charities, other than churches, can also opt in to an intermediate sanction regime. *Id.* § 501(h). The opt-in is attractive because it also expressly limits when organizations can lose their exemption. Vladeck, *supra* note 3, at 322-23.

294. See, e.g., HOPKINS, *supra* note 35, at 642-43.

295. Janet I. Tu, *Mormon Church's Role in Prop. 8 Fight Debated*, SEATTLE TIMES, Nov. 14, 2008, at A12; John D. Columbo, *LDS Church, Proposition 8, and the Lobbying Limitation*, NONPROFIT L. PROF BLOG (Nov. 18, 2008), <http://lawprofessors.typepad.com/nonprofit/2008/11/llds-church-prop.html>.

296. See Galle, *supra* note 106, at 374-79.

lobbying's real policy impact. For example, an organization's total expenditures, not the fraction of its budget spent on lobbying, determine how much it congests the political market.

Consider also the temptation, warm glow, and entanglement issues. A charity willing to shape legislative outcomes single handedly is going to be an important political player. Officials will often put considerable pressure on the managers to conform to the politicians' views, and managers will be sorely tempted to use their power for their own goals.<sup>297</sup> Similarly, public perceptions of charities as political rather than charitable are likely to depend on the organization's impact on the political scene. If the Gates Foundation decided to spend \$500 million to push for a carbon tax, it is doubtful that any view of them as partisan would be dampened by the fact that the Foundation still had another \$39.5 billion to throw around.

Even the arguments that critics of the lobbying limits offer seem to counsel for limits on a charity's overall policy impact. Recall that a central problem for the interest representation and political pluralism claims was that more powerful or traditional interests could also benefit from the deduction, and their magnified voices could then crowd out, or even counteract, less influential groups.<sup>298</sup> This problem could be curtailed if each organization faced some kind of cap on its lobbying activities.<sup>299</sup> The cap could not increase significantly as the size of the entity grew, because if it did, powerful interests would still be able to drown out others. We thus would want something like what I have just suggested: a limit, or perhaps a soft cap along the lines of the luxury tax model common in professional sports, on the influence any one interest group could exert.

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297. *See id.* at 378.

298. *See supra* Part II.A.2-3.

299. Of course, the limits would have to treat all related entities as a single unit; otherwise the caps could be easily evaded by creating strings of subsidiaries. *Cf.* Donald B. Tobin, *Campaign Disclosure and Tax-Exempt Entities: A Quick Repair to the Regulatory Plumbing*, 10 *ELECTION L.J.* 427, 444 (2011) (noting need for antiabuse rules if regulations are based on the amount of donations to an organization).

*C. Donations or Organizations?*

Although current law is clear that limits on lobbying apply to all of a § 501(c)(3) organization's activities, no matter the source of the funds expended, several commentators argue that this interpretation is mistaken.<sup>300</sup> For example, Laura Chisholm argues that the rationale for the limitations should apply only to donations that have benefitted from the government's subsidy.<sup>301</sup> According to Chisholm, revenues from other sources, such as paying customers, or presumably even nondeductible contributions, should not face any limits.<sup>302</sup> Her claim, essentially, is that the only reason to limit lobbying is to prevent government subsidies from supporting political activities.<sup>303</sup> Thus, organizations should be able to spend their unsubsidized funds freely. These kinds of arguments sidestep the economies of scope and scale issues<sup>304</sup> but otherwise seem reasonable given their premise.

But what if the purpose of the lobbying limits is much broader than simply cordoning off the government's subsidy? The diseconomy of scope rationales I have offered,<sup>305</sup> if persuasive, require that lobbying limits apply to the entire organization. Nearly all of the diseconomies result from the simple fact that the two purposes are conducted by a single organization. Whether *lobbying* dollars are subsidized by the government does not affect whether monitoring costs are higher, whether warm glow diminishes, or whether the inframarginality of the deduction declines.

Indeed, lobbying in firms that do not depend much on subsidized donations also suggests a more fundamental challenge to the rationale of the *Citizens United* antiregulatory regime. The premise of *Citizens United* appears to be that spending by organizations represents political expression by the organization's members,

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300. See Chisholm, *Politics and Charity*, *supra* note 13, at 328, 352; Totten, *supra* note 257; see also Buckles, *supra* note 13, at 1122-23 (suggesting government could achieve its purpose by recapturing the economic value of deductible contributions spent on politics).

301. Chisholm, *Politics and Charity*, *supra* note 13, at 352.

302. See *id.* at 328.

303. See *id.* at 352.

304. That is, they neglect the possibility that any subsidy for the organization could benefit all of its activities, even those not funded directly. See Leff, *supra* note 13, at 707-08; Volokh, *supra* note 43, at 1942-43.

305. See *supra* Part III.A.

shareholders, and donors.<sup>306</sup> The money that the entity spends, the Court assumes, is a proxy for speech by its financial supporters.<sup>307</sup> As others have noted, that assumption is problematic in most nonprofits, where monitoring and oversight of managers who make spending decisions is sporadic and weakly enforced.<sup>308</sup> The Court itself had at one time recognized that the speech-proxy assumption is especially improbable for organizations with revenues not derived from donations.<sup>309</sup> When hospitals lobby, they are not focusing the pooled time and money of a community of like-minded individuals; they are spending a portion of fees from paying customers.

The same is true of most for-profit firms. But at least directors of those firms are, in theory, bound by their obligations to shareholders who can vote them out of office or, in some states, bring suit for breach of duty. Many revenue-supported nonprofits have no members at all; their boards are “self-perpetuating,” subject only to the choices of the existing members of the board.<sup>310</sup> If the board or the officers breach their duties, they often can be sued only by the entity itself, another board member, or the attorney general of the state.<sup>311</sup> Therefore the assumption that revenue-rich nonprofit corporations’ speech is the product of stakeholder “democracy” seems especially thin.

## V. ELECTIONEERING

At this point, having read so much about lobbying, the reader may have forgotten that charities also face a nominal ban on any involvement in campaigns for public office. Fortunately, much of what I have said about lobbying also applies to the electioneering ban, in many cases even more so.

To review, the ban on electioneering permits the IRS to revoke exemption for any participation in a campaign for elected office,

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306. See *Citizens United v. FEC*, 130 S. Ct. 876, 904-08 (2010).

307. See *id.* at 899, 904, 911 (describing an entity’s communications as “speech” controlled by shareholder “democracy”).

308. See, e.g., Ribstein, *supra* note 86, at 1044-45.

309. See *Austin v. Mich. Chamber of Commerce*, 494 U.S. 652, 660 (1990), *overruled by Citizens United*, 130 S. Ct. 876.

310. Brody, *supra* note 253, at 466-67.

311. MARION R. FREMONT-SMITH, *GOVERNING NONPROFIT ORGANIZATIONS: FEDERAL AND STATE LAW AND REGULATION* 324-28 (2004).

however insubstantial.<sup>312</sup> In reality, though, the government permits a fair amount of involvement in campaigns by defining some campaign-related activities as something other than impermissible electioneering. For example, organizational leaders can endorse candidates and identify themselves with the organization, so long as they are not acting in an “official capacity.”<sup>313</sup> Charities can comment on issues that are related to an ongoing campaign, as long as on balance the issue-related observations are not tied too closely to candidates.<sup>314</sup> Organizations can hold candidate forums on the condition that the invitation is extended to all major candidates—even if the organization knows that the candidates who expect to be booed will not show.<sup>315</sup> And a charity can present nonpartisan voter guides evaluating how officeholders have stood on issues important to the organization, but only if the organization makes no particular effort to connect the evaluation to an ongoing campaign.<sup>316</sup>

My analysis of the previous three Parts suggests these limits are defensible in both directions—that is, good nonprofit policy reasons support a limit on substantial electioneering by a charity. There are also good reasons to have some exceptions to the limits, and the principles implicit in the exceptions I mentioned are sensible. Or, at least, they would be sensible if the funding stream for nonprofits were more transparent. Each of these points needs a bit more explanation.

#### *A. Defending the Electioneering Ban*

In many ways the case against combining charity and electoral politics is stronger than the case against nonprofit lobbying. For one thing, as earlier commentators have recognized, the connection between electioneering and the purposes of the deduction is attenuated.<sup>317</sup> Electing sympathetic candidates can be one way for

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312. See *supra* note 33 and accompanying text.

313. See Rev. Rul. 2007-41, 2007-1 C.B. 1421.

314. See *id.*

315. Rev. Rul. 86-95, 1986-2 C.B. 73.

316. Rev. Rul. 80-282, 1980-2 C.B. 178.

317. See Chisholm, *Politics and Charity*, *supra* note 13, at 349-50; Tobin, *supra* note 13, at 1337-38.

a coalition to “get stuff,” including public goods. The promise of electoral support can be a lever to strengthen lobbying efforts.<sup>318</sup> But in the American duopolistic political system, candidates run on broad slates of many issues bundled together.<sup>319</sup> Electing a candidate who will produce more of one good in the bundle may also mean less of many of the others, reducing net utility per subsidy dollar for both donors and their opponents. Further, bundling implies that government subsidy dollars will often be on both sides of an election, which hardly seems like the most efficient way to use tax dollars for the production of public goods.<sup>320</sup>

Public support for campaign contributions might give more voice to poorer voters, but as with lobbying, the design of the charitable contribution deduction is ill fitted to that purpose. Proponents of campaign contribution subsidies favor vouchers in a fixed amount, often in combination with caps on individual and corporate contributions.<sup>321</sup> Others recommend tax credits but only with a very low cap on the available credit.<sup>322</sup> As all of these commentators recognize, with unlimited matching, public support could simply be hijacked by already-powerful interests who would use the money to further entrench their own influence.<sup>323</sup>

Several diseconomies of scope also seem worse in the electioneering context. Agency problems are more severe because of the issue-bundling problem. An organization’s mission could encompass issues that do not line up perfectly with candidate positions, leaving the entity’s managers freedom to choose which issues and candidates to favor. The Catholic Bishops Association’s apparent electoral

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318. See Simon et al., *supra* note 14, at 288, 298 n.86.

319. The IRS has pointed to this difference as a reason to distinguish between lobbying and electioneering, although without any particularly deep explanation as to why the difference matters. See I.R.S. Gen. Couns. Mem. 34,233 (Dec. 3, 1969).

320. Cf. Norman J. Ornstein & Thomas E. Mann, *Conclusion: The Permanent Campaign and the Future of American Democracy*, in *THE PERMANENT CAMPAIGN AND ITS FUTURE* 219, 225 (Norman J. Ornstein & Thomas E. Mann eds., 2000) (contrasting “zero-sum” expenditures on campaigns with constructive use of resources spent achieving policy).

321. See BRUCE ACKERMAN & IAN AYRES, *VOTING WITH DOLLARS: A NEW PARADIGM FOR CAMPAIGN FINANCE* 14 (2002); Thomas Cmar, *Toward a Small Donor Democracy: The Past and Future of Incentive Programs for Small Political Contributions*, 32 *FORDHAM URB. L.J.* 443, 449-50 (2005); Hasen, *supra* note 18, at 20-27.

322. See de Figueiredo & Garrett, *supra* note 101, at 640-43, 661-66; Overton, *supra* note 98, at 107-08.

323. See, e.g., de Figueiredo & Garrett, *supra* note 101, at 644-45.

preference for candidates who focus on reproduction and family structure, rather than those who accord with the Church's views on immigration and poverty, is one of many possible prominent examples.<sup>324</sup> Of course, managers might well choose the exact balance that contributors would, but given the challenges of effective monitoring, they will also face temptations to choose based on self-serving factors.<sup>325</sup>

Electioneering also may exacerbate the effects of politics on warm glow. Electioneering seems more likely than lobbying to send a signal that managers are self-serving. Candidates generally represent a broader array of interests than any one issue organization. There are therefore greater opportunities for supporters of a candidate to free ride, so that a rational observer would conclude that campaign contributors are more likely pursuing some purely self-serving interest. Indeed, the literature on campaign contributions suggests that to overcome the free-rider problem, candidates strive to create private benefit for their donors.<sup>326</sup> The broader array of positions a candidate takes also increases the chance that the charity's choice will contradict the preferences of some of its potential donors.<sup>327</sup> More generally, voters seem to have a limited tolerance for political advertising, in part because they seem to resent the culture of bargained exchange it represents.<sup>328</sup>

This latter point suggests that combined charity and electioneering entities also present a regulatory mismatch problem. Unlike lobbying, campaign expenditures are not aimed at a small group of people whose composition is limited by the Constitution and whose staff resources are limited. So there is not a crowd-out problem in

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324. See Vaughn E. James, *Reaping Where They Have Not Sowed: Have American Churches Failed to Satisfy the Requirements for the Religious Tax Exemption?*, 43 CATH. LAW. 29, 49-55 (2004).

325. See *supra* Part III.A.5.

326. See TERRY M. MOE, *THE ORGANIZATION OF INTERESTS: INCENTIVES AND THE INTERNAL DYNAMICS OF POLITICAL INTEREST GROUPS* 222-23 (1980); Jenkins, *supra* note 69, at 319. See generally WALKER, *supra* note 184, at 46 (examining motivations for interest group participation).

327. Cf. Tobin, *supra* note 13, at 1338-39 (noting that supporting political candidates might make fundraising more difficult for charities).

328. See Cmar, *supra* note 321, at 446-47; Hsu, *supra* note 73, at 109; see also Thomas Stratmann, *Some Talk: Money in Politics. A (Partial) Review of the Literature*, 124 PUB. CHOICE 135, 137 (2005) (summarizing evidence that voters distrust messages paid for by "special interests").

the same sense. But campaign expenditures do seem to give rise to other negative externalities. One, as I just mentioned, is that as expenditures rise, their marginal efficacy diminishes because of public campaign fatigue. Additionally, when one side in a campaign spends, the other side usually must respond or lose.<sup>329</sup> So spending by either side has a double-negative effect, both triggering an arms race and also upping the cost of effective competition in the race. Whether there are any strong positive externalities associated with most campaign spending remains unclear; many campaign ads are aimed at viewer emotions and offer little new informational content.<sup>330</sup> The optimal price instrument for campaign spending, therefore, is probably a stick, not the carrot that charities currently collect.

### *B. Defending Exceptions to the Electioneering Ban*

On the other hand, charities can play a socially important role in gathering and sharing information about public officials. As is well known, interest groups allow voters to overcome their individual rational ignorance of politics, mainly through the device of agents who are paid to collect that information and share it with the group.<sup>331</sup> Of course group members also attempt to free ride on

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329. See Mark Paul Gius, *An Analysis of the 2006 Congressional Elections: Does Campaign Spending Matter?*, 15 APPLIED ECON. LETTERS 703, 705 (2010); see also Cmar, *supra* note 321, at 443-44 (noting an “overwhelming correlation between fundraising success and electoral victory”). As is well known, there are serious endogeneity problems—that is, possible reverse-causality issues—with measuring the effects of spending on campaign outcomes; for example, being perceived as the likely winner can attract donations. See Stratmann, *supra* note 328, at 138. Modern studies using instrumental variables techniques confirm, though, that outspending rivals increases electoral success. Kenneth Benoit & Michael Marsh, *The Campaign Value of Incumbency: A New Solution to the Puzzle of Less Effective Incumbent Spending*, 52 AM. J. POL. SCI. 874, 888 (2008).

330. See TED BRADER, *CAMPAIGNING FOR HEARTS AND MINDS: HOW EMOTIONAL APPEALS IN POLITICAL ADS WORK* 13-16 (2006); see also Alan S. Gerber et al., *How Large and Long-Lasting Are the Persuasive Effects of Televised Campaign Ads? Results from a Randomized Field Experiment*, 105 AM. POL. SCI. REV. 135, 148-49 (2011) (suggesting their results are more consistent with the emotional than the informational view of advertising). But see Paul Freedman et al., *Campaign Advertising and Democratic Citizenship*, 48 AM. J. POL. SCI. 723, 725-35 (2004) (arguing that political advertising contains “some” information and that its emotional content encourages voters to learn more). It is worth noting that the “information” Freedman et al. find evidence of consists mostly of voters’ ability to name the candidates. *Id.* at 729.

331. Issacharoff & Ortiz, *supra* note 77, at 1649-50; see Andrews & Edwards, *supra* note

others' willingness to pay their agents. Subsidies for agents who will monitor government on behalf of the public, or at least on behalf of a group large enough to experience free riding, therefore make sense as a way of overcoming market failures.

Charities are especially well positioned to play this monitoring role. Their issue-specific expertise allows charitable employees to gather information about good public policy cheaply, often as a sideline to their main mission.<sup>332</sup> That same expertise, and the at least nominal loyalty of the charity to its mission, rather than to outsiders, makes the information it releases especially credible. Credibility is key to useful information gatherers,<sup>333</sup> because it is easy to imagine that those subject to monitoring would set up bogus or captive monitors. And the social ties the charity can foster among those committed to its mission help to ensure that participants also pay for their share of the added costs of monitoring.<sup>334</sup>

With these benefits come the now-familiar caveats. Charities' efficacy at tracking elected officials makes them especially tempting targets for officials and their foes. Managers, too, might be tempted to take advantage of the unique position their control of a credible charity would offer in pursuit of their personal ideology or rewards from outsiders.

There may be ways to disentangle the public good from the private misappropriations of it. A possible dividing line falls between pure information and active endorsement. One suspects that those who hijack a charity for their own political ends will rarely be content with a simple statement of the facts of a candidate's record. Instead, the temptation will be to push the audience to draw voting conclusions from the facts and to leverage the charity's other resources to spread the combined information and advocacy message. Drawing the line at some kind of active advocacy therefore rules out subsidies for many would-be misappropriators. Note also that from society's perspective the informational value of a charity's endorsement is much lower than a simple voter scorecard reporting whether

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239, at 498 (explaining the importance of professional staff in monitoring complex modern regulation).

332. See Yael Tamir, *Revisiting the Civic Sphere*, in FREEDOM OF ASSOCIATION 214, 223 (Amy Gutmann ed., 1998).

333. See Leff, *supra* note 13, at 713.

334. See Robert D. Tollison, *Rent-Seeking: A Survey*, 35 KYKLOS 575, 590 (1982).

a candidate has performed well on the issues that matter to the charity.<sup>335</sup> The charity has expertise related to its own issues. It is not expert on the separate question of whether on balance the officeholder has enough other good or bad qualities, relative to the opposition, to outweigh her performance on the scorecard.

Many of the current law's definitions of impermissible electioneering roughly track this line. Scorecards, candidate fora, and discussions of issues are, as I noted earlier, all currently permissible in some circumstances and all permit charities to share a significant amount of their knowledge with the public.<sup>336</sup> Each of these activities then tip into violations when used more directly as advocacy tools, especially when they seem to allow candidates to make use of the organization's financial resources on an unequal basis. The voter scorecard revenue rulings, for example, emphasize that organizations that blast out thousands of copies of their card near an election risk their exempt status.<sup>337</sup> Endorsements by leaders acting in their individual capacity are harder to explain as purely informational, but at least they do not typically consume much of the entity's tangible resources.

Obviously the exact balance between these interests and the corresponding line between permissible and impermissible is hard to state with precision. Information is itself persuasive; that is why it is valuable to the electorate. Building credibility itself takes a serious resource commitment. Probably, then, the better approach would be to mirror the lobbying rules and to more officially recognize that organizations can commit insubstantial missteps without losing their exemption.<sup>338</sup> Existing money penalties for political expenditures will help discourage abuse of this leeway.<sup>339</sup>

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335. On the significance of scorecards to low-information voters, see L. SANDY MAISEL & MARK D. BREWER, *PARTIES AND ELECTIONS IN AMERICA: THE ELECTORAL PROCESS* 133-36 (5th ed. 2010).

336. See *supra* notes 331-34 and accompanying text.

337. Rev. Rul. 80-282, 1980-2 C.B. 178; Rev. Rul. 78-248, 1978-1 C.B. 154, at Situation 4.

338. See Buckles, *supra* note 13, at 1077 (suggesting adding a "substantiality" exception or other intermediate sanctions for electioneering).

339. See I.R.C. §§ 527, 4955, 4958 (2006).

*C. Transparency as a Precondition for the Exceptions*

I should note one important qualification to my argument of the last Section. A key assumption I made was that charities would at least sometimes genuinely be independent of politicians or their allies. The problem is that it will not be easy for the public to observe when that is the case. It is a well-known feature of reputation markets that, in the absence of some way to credibly sort posers from objective opinion makers, the market unravels and no one's reputation is worth much.<sup>340</sup> Technologically savvy readers may recognize this as the “Yelp” problem: it is hard to tell if someone with no “user rating” who has reviewed a restaurant is a satisfied customer or the owner.<sup>341</sup> If much of the education offered by charities is not useful to the public, the case for carving out an exception for “educational” communications appears weak.

It thus seems crucial that the public have information about who funds nonprofits that are opining about politics.<sup>342</sup> Political scientists report that voters can and do use data about who paid for a political message to draw inferences about its reliability.<sup>343</sup> Obviously, not all donations would have to be made public. The identity of many small donors is less important than the fact that they exist at all: widespread public support can serve as evidence for voters that others believe in the expertise of the organization, just as user ratings of Yelp reviewers helps to confirm their credibility. But relatively large donations can clearly impact the objectivity of the organization, and so that information is properly relevant for the voting public, under my informational theory.<sup>344</sup>

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340. That is, unless there is some costly, and therefore credible, signal that objective raters can offer to separate themselves from the pool of fakers, observers will not be able to distinguish the two. See Keith Weigelt & Colin Camerer, *Reputation and Corporate Strategy: A Review of Recent Theory and Applications*, 9 STRATEGIC MGMT. J. 443, 448-49 (1988).

341. For an example of Yelp's reliability problem, see Jim Handy, *Think Yelp is Unbiased? Think Again!!*, FORBES (Aug. 16, 2012, 12:35 AM), <http://www.forbes.com/sites/jimhandy/2012/08/16/think-yelp-is-unbiased-think-again>.

342. *But see* Issacharoff & Ortiz, *supra* note 77, at 1664 (doubting that information about individual donors would be useful).

343. See, e.g., Arthur Lupia, *Shortcuts Versus Encyclopedias: Information and Voting Behavior in California Insurance Reform Elections*, 88 AM. POL. SCI. REV. 63, 63 (1994).

344. See *supra* notes 284-85 and accompanying text.

I therefore agree, albeit for different reasons, with those who have called for more transparency in the nonprofit sector.<sup>345</sup> Organizations that do not want to avail themselves of the information and education safe harbor from the electioneering ban need not disclose their donors. But any organization that wants to rely on a claim that it is informing the public should have to acknowledge who is paying for its information.

### CONCLUSION

Economic theory explains the lobbying limits and electioneering ban more thoroughly than any prior approach has. Although subsidies may be justified to overcome collective action problems in information gathering and political representation for group interests, theory also suggests that extending the charitable contribution deduction to include politics is a poor design for such a subsidy.

I have limited my discussion to nonprofit policy, and have not addressed the Constitution. For example, I do not dispute here the suggestion that government funding decisions seriously impair liberty and can only be justified, if at all, by very good reasons.<sup>346</sup> I am instead interested in identifying what those reasons might be.

My arguments also may counsel for closing the “(c)(4) loophole.” As I have noted, many charities routinely avoid legal scrutiny of their political activities by shunting those tasks to an affiliated (c)(4) organization.<sup>347</sup> Given that the boundary between the two firms may exist only on paper, the multifirm structure will likely not mitigate many of the diseconomies of scope I have mentioned. Until now it has appeared that the (c)(4) outlet is constitutionally required. Permitting the (c)(4) structure, though, merely allows the government to escape strict scrutiny.<sup>348</sup> If strict scrutiny is inevitable in the wake of *Citizens United*, as many commentators believe,<sup>349</sup> then the (c)(4) loophole no longer has any function. Further, given that my

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345. *E.g.*, Aprill, *supra* note 1, at 403-04; Tobin, *supra* note 299, at 440-44; Ciara Torres-Spelliscy, *Hiding Behind the Tax Code, the Dark Election of 2010 and Why Tax-Exempt Entities Should Be Subject to Robust Federal Campaign Finance Disclosure Laws*, 16 NEXUS 59, 92-93 (2011).

346. *E.g.*, CRIMM & WINER, *supra* note 69, at 292.

347. *See supra* note 47 and accompanying text.

348. *See supra* text accompanying notes 42-47.

349. *See supra* note 53.

arguments imply that the existing regulations can potentially survive strict scrutiny, my arguments also suggest the loophole may not need to stay open.

As for free-standing (c)(4)s and other noncharitable nonprofits, at least some of my analysis also extends to them. Exemption, I have noted, is a subsidy in the sense that similar U.S. entities would usually pay taxes on the money used to fund their political expenditures.<sup>350</sup> Exemption therefore magnifies the resources wealthier interests have available for politics and contributes to crowding of the political marketplace. On the other hand, because it is unclear whether noncharitable nonprofits get any other subsidy, few of the diseconomies of scope I have described seem to apply to them, although some economies do. Thus, my analysis probably prescribes at least some limits on lobbying and electioneering for these organizations but not a total ban. Electioneering subsidies for noncharitable nonprofits also likely should be accompanied by disclosure requirements, for the reasons I have described.

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350. *See supra* note 60.