

Direct Public Funding of Political Parties

Recommendations prepared for the Latvian Corruption Prevention and Combating Bureau

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Introduction

Public funding for political parties is a dominant feature of most established democracies and is increasingly utilized in many transition countries, yet Latvia is one of the few European countries without direct public funding. One of the key benefits of public financing is **the increased level of institutionalization** of political parties that results from transparent financing being made available to political parties. Furthermore, public financing for political parties has long been thought to foster increased political competition among political parties by channeling resources to parties for essential political activities, thereby **promoting a pluralistic party system** that can effectively channel diverse demands on the state. This benefit of public financing is crucial for transitional democracies.

In general, for most of the newly established democracies, public funding of parties and candidates (either in the form of reimbursement of electoral expenditures, or annual subventions) has been the only effort to diversify the sources of political money, and decrease the plutocratic influence in politics. Research in some countries where public financing for political parties has been introduced shows that it has provided many parties with the funds necessary to further party development.¹ In his case study of public financing in Uruguay, Kevin Casas finds that subsidies have enabled small parties to challenge traditionally dominant parties in the electoral arena.

¹ Jon Pierre, Lars Svasand, and Anders Widfeldt, 'State Subsidies to Political Parties: Confronting Rhetoric with Reality', *West European Politics*, 23/3 (2000), pp. 21-22.

As a general rule in transition countries, public funding has been supported by **opposition** parties and quietly opposed by parties in power with access to administrative resources. There is clear evidence that as a result of public funding opposition parties could maintain their organization and meet high costs of successful electioneering.

Designing an effective public funding system

Public subsidies to political parties are often perceived as one of the most important aspects of the relationship between parties and the state in established democracies. In countries where such subsidies were introduced they have provided the organizations with the funds necessary to further party development.² However, the current state of knowledge about public funding and its impact **does not allow easy answers** to some difficult and policy-relevant questions such as how to introduce a most effective public funding system and how to administer it properly.

The structure of public subsidies for party organisations and election campaigns is **far more complex** than is often assumed. There is a tremendous variation with regard to the state's financial support given to parliamentary groups, parties and electoral campaigns. There are at least **eight variables** separating public subsidies into different categories:

1. Recipients - various regimes have different rules for identifying which political entities (e.g. political parties and independent candidates) should be recipients of the subsidies.
2. Providers - depending on a regime, subsidies can be provided by different public bodies such as Ministries of Finance or Administration, Parliaments, Central Election Commissions, or even municipal bodies. To ensure a stable funding source for the public funds, there should be a guaranteed source for these funds.

² Jon Pierre, Lars Svasand, and Anders Widfeldt, 'State Subsidies to Political Parties: Confronting Rhetoric with Reality', *West European Politics*, 23/3 (2000), pp. 21-22.

3. Eligibility criteria - there is substantial difference among countries with regard to what qualifying criteria political entities should meet in order to receive public subsidies. The law needs to have clear, realistic, and objective thresholds for the receipt of public funds. These thresholds can be based on the amount of private money collected by a party, the number of members registered in the party, the number of votes received in certain elections, or the number of seats they hold in the national or local assemblies. At a minimum, compliance with the disclosure and other political finance regulations should be a requirement for receipt of public funds.
4. Level of funding - the levels of direct public funding in transition regimes differ considerably. There are different formulas for the allocation of public funding. The amount appropriated could either be an amount fixed by law indexed for inflation or an amount per capita or per voter.
5. Timing of payment - subsidies can be provided on annual, quarterly, or monthly bases, before or after elections. There should be a clear deadline for the distribution of the grants. These deadlines will allow the political parties to engage in proper budgeting. Further, periodic distributions of public funds can allow time to audit financial statements before the further distribution for this year. This adds teeth to the promise to withhold funds if full public disclosure has not been made or if a party has committed serious violations.
6. Spending restrictions - there are distinctions between countries regarding the purposes for what the public subsidies may be used.
7. Reporting obligations and monitoring - a growing number of countries require political entities to disclose publicly that subsidies have been spent transparently and according to the rules. In some cases, political finance regulators can perform strict control with regard to how the subsidies are used.

8. Sanctions effecting subsidies - one of the most effective ways to secure compliance with different political finance regulations is to limit or withdraw public funding from parties and candidates that do not take their obligations seriously. Furthermore, regulations should also address the issue of returning the illegally used public funds.

The effectiveness of a public financing system is dependent on the above multiple factors. The particular configuration of these design factors has a **significant impact on the effectiveness of a public finance system**, including the impact the public financing system may have in institutionalization of political parties and increasing transparency and accountability in funding of political parties.

For instance, in terms of the eligibility criteria, there are two thresholds for receiving public funding in Central Eastern Europe. In Bosnia and Herzegovina, Estonia, and Slovenia, only parties with at least one seat in the legislature qualify for subsidies. Albania, Bulgaria, Croatia, Czech Republic, Lithuania, Macedonia, Russia, and Slovakia subsidies relate to voting support, and parties are required to obtain a minimum level of votes.³ Romania and Poland combine the two thresholds in either combination. Furthermore, the levels of direct public funding in the CEE differ considerably among countries like Russia⁴, the Czech Republic⁵ or Hungary⁶. This partly results from the dissimilar

³ The minimum level of national votes varies from as low as 1 per cent in Bulgaria to 3 per cent in Lithuania.

⁴ In the 1995 Russian State Duma elections, the total amount of direct public subsidies distributed among electoral blocs was little more than \$1 million, which constituted about 6 per cent of the total funds raised (approximately \$16 million). Thus, 43 registered electoral associations received about \$23,255 (approximately 115 million rubles each). See Central Electoral Commission, *Vybory 95: Electoralnaya Statistika* (Moscow: CEC, 1996). During the 1996 presidential elections, each of the 11 registered candidates received approximately \$60,000 (300 million rubles) of direct subsidies which accounted for only 4.46 per cent of the candidates' official income (73 977 million rubles). In the 1999 Duma Elections direct state subsidies to all political parties rose to US \$4.6 million (118,185,000 roubles). Even individuals received direct state subsidies amounting to a grand total of US \$38.91 each; this accounted for 0.06 per cent of their total spending allowance.

⁵ After the 1996 General Elections, Vaclav Klaus' ODS received about \$6 million (161 million KCS) from the state budget. Also, in the Parliamentary Elections of 1998, significant subsidies amounting to \$5,5 million (174 million KCS) were allocated to the victorious Social-Democrats.

⁶ Already in 1990 the proportion of state funding in the total Hungarian party budgets accounted for 93 per cent of the Independent Smallholders' Party budget, 88 per cent of the Christian Democratic People's Party budget, and 24 per cent in the case of the Hungarian Socialist Party. Well-documented records for 1995 only

regulatory frameworks for the systems of public funding in different post-Communist regimes.

Countries such as Bulgaria and Albania provide only nominal financial support, covering a tiny fraction of political expenditures. On the other hand, as a result of the most recent political finance reform, a system of considerable public financing has been introduced in Poland. According to the new election law, a political party whose election committee has participated in elections, or a political party that is a member of a coalition as well as the election committee of electors, has itself the right to a subsidy (called *subject allocation*) from the state budget for each mandate of a Deputy or Senator gained. The amount of the *subject allocation* is established by dividing the expenditure shown in the election reports of committees, which have at least one seat (mandate), by 560.⁷ The *subject allocation* is given to the amount shown in an election report (not exceeding expenditure limits). The *subject allocation* that is given to a member of an election coalition is divided proportionately among the parties that form the coalition, and is determined in an agreement while the election coalition is created. The allocation is paid 6 months after the announcement of the validity of the elections.⁸

In addition, Polish political parties that have formed their own election committee in the elections to the Sejm and have gained at least 3 per cent of valid votes in those elections, or are members of an election committee in the elections to the Sejm and have gained in those elections at least 6 per cent of valid votes, receive a state subvention for their statutory activities. The amount is determined in proportion to the valid votes gained for the constituency lists of candidates of a party or for an election coalition, according to the specially designed formula. Further, as a new initiative based on the experience of other countries, a small part of the subvention, from 5 per cent to 15 per cent, is

confirm significant state dependence in the cases of six parliamentary parties. Parties received from 18 per cent (Fidesz) to 90 per cent (Alliance of Free Democrats) of their total income in the form of state subsidies.

⁷ The number 560 is obtained by adding the nominal number of members of the Sejm [460] and of the Senate [100].

⁸ It is also granted to each mandate of a Deputy or a Senator gained in repeat elections to the Sejm and to the Senate, as well as in by-elections.

specified for the special party's know-how fund – dealing with the costs of legal, social, political and economic expertise and publishing activities.

The subvention is paid in quarterly instalments to a given political party throughout the Sejm's whole term. According to the initial regulations, the total amount of annual subvention to political parties for statutory activities is supposed to be 75,479,093.50 PLN (US \$18,869,773). Thus, during a four-year term of the parliament, the total subvention paid by the state budget to all the parties would amount to 301,916,374 PLN (US \$75,479,093).

The data analysed for Poland suggest that the introduction of public subsidies to the political parties **did not delay the emergence of new parties**. The results of the 1997 and 2001 elections clearly illustrated that the system of public funding had not prevented the emergence of new political forces and the freezing of the existing party system. The existing rules for state funding did not discriminate against new parties as some scholars have suggested.⁹ Moreover, recent parliamentary elections show that there is no relationship between party system stability and introduction of public funding. In fact, direct subsidies can even galvanize the emergence of new political parties rather than obstructing it.

The empirical research shows that newly emerged parties tend to use indirect subsidies, mainly free broadcasting, to run successful media campaigns. As a result they can gain seats in parliament and qualify for significant public subsidies. A number of successful new parties in Poland, like the Solidarity Election Action in the 1997 election, or the Self-Defence Party, Law and Justice and Civic Platform in the 2001 election, confirm this development. In addition, public funding might be more important for newly formed parties than for established organizations in the post-election period. The case of the Law and Justice party and the Self-Defence party confirms that new parties can often win elections without strong grass-roots organization, receive public subsidies and only then start building a regular party organization. Considering this, public subsidies make a positive rather than a negative difference.

⁹ Szczerbiak (2001), p. 241.

In Western European democracies, in general, ‘subsidisation has passed through three structurally similar but overlapping stages of implementation’.¹⁰ In the first stage of ‘**experimentation**’, governments make cautious steps towards introducing subsidies. In the second stage of ‘**enlargement**’, the amount and scope of the subsidies is increased. This is usually followed by the stage of ‘**adjustment**’, which generally involves the institutionalisation of the subsidy system and takes account of inflation.

However, among the arguments against increasing public funding that are worthy of consideration, the one most widely accepted is that public subsidies divert parties from seeking small donations. Public funding does not, however, appear to have had a significant impact on the process of decline of party membership in Western democracies.¹¹ Still, despite low levels of income from membership subscriptions in the CEE regimes, there are no regulations to galvanize the parties into expanding their membership base – state subsidies are tied only to electoral performance and parliamentary representation. In all CEE countries small donations are not encouraged in the form of tax credits¹², matching grants or tax relief¹³ on small political donations. Thus, the current Polish subsidy’s model, based largely on the number of seats in parliament (subject allocation) and valid votes (annual subvention), means that election results play a fundamental role in terms of the party’s overall financial situation. The obvious economic incentive for parties would be to win votes rather than to gain or keep

¹⁰ For Nassmacher, the first step (1954-1974) was the ‘stage of experimentation’; then the Western democracies (West Germany, Austria, Sweden, Italy) entered the second phase (1967-1982) the ‘stage of enlargement’. The last stage (1982-) has been the ‘stage of adjustment’. See Nassmacher (1989), pp. 238-241.

¹¹ According to Pierre, Svasand and Widfeldt, the patterns indicate ‘a very limited impact of the subsidies; party families which had experienced a declining membership prior to the introduction of public subsidies largely continued to do so once they were implemented, and parties with increasing membership also continued to increase after the subsidy programmes had been enacted.’ Pierre, Svasand, and Widfeldt (2000), p. 18.

¹² Tax credits are used in Canada. Taxpayers are given a deduction from their income-tax bill for contributions to a political party or a candidate.

¹³ A system of tax relief for political donations is similar to the system of tax relief on giving to charities in Poland and in Britain. In fact, the Committee on Standards in Public Life recommended income-tax relief on small political donations in 1998. See the Fifth Report of the Committee on Standards in Public Life (1998), p. 95.

members. Such developments would make the parties, in effect, abandon efforts to raise money at grassroots.

Recommendations:

1. The KNAB should conduct rigorous, comparative research to gain the necessary confidence with which to make policy recommendations regarding public funding of political parties and election campaigns. The research should take into consideration 8 variables discussed above presenting different scenarios (there are at least 50 models which could be taken into consideration) to the policy makers.
2. Any reform introducing public funding should be introduced as a result of wider political consensus rather than
3. There ought to be a clear and comprehensive set of rules and strict control over public funds. In transition democracies, political finance regulations should be introduced with the intention of encouraging a climate of open, free and fair competition.
4. As a result of the introduction of the public funding the whole system of spending limits should be revised to reflect additional resources allowing parties to run more expensive campaigns
5. Latvia, just like other established democracies, will pass through three stages of implementation of the public funding system. In the first stage of 'experimentation', Latvia should make cautious steps towards introducing modest but well regulated subsidies.
6. Proper auditing both prior to and after the distribution of the public funds is necessary. The KNAB should be allowed to review periodic disclosure (e.g. bi-annual rather than annual reports) to ensure the parties are complying with the law and rules. Every claim for matching funds must be accompanied by adequate documentation before any public funds are paid. Otherwise parties might falsify their reports to receive more funding than they are entitled to.