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**Financing of Political Parties in Latvia:  
Transparency, Regulation and State Subsidies**

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From 1985 to 1991, Dahl served as Executive Assistant to a member of the U.S. Federal Election Commission. He advised democratic development programs in Central and Eastern Europe for the International Republican Institute (IRI) during early post-Soviet elections. He served as the first project manager in Russia for the International Foundation for Election Systems (IFES) in 1993, and continued to advise IFES' Russia program in areas of election law revision, political finance regulation and complaint adjudication. Since June 1998, Dahl has worked on reform of election laws and election administration in Indonesia for IFES.

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**Part One: Introduction****PURPOSE**

This report has been prepared for the Corruption Prevention Council in the Ministry of Justice of the Republic of Latvia. The purpose of this study is to examine issues related to financing of political parties in the context of Latvian political development, and to describe best practices and international models that might be suitable for adaptation in Latvia.

Latvia is not alone in confronting problems of regulation and transparency of political party financing, or in considering public funding for political parties. Political finance issues are clearly a challenge in most all democracies. Scandals involving political party and election campaign funds have been well-publicized in the past two decades in Germany, France, Italy, Spain, Great Britain, Japan, the United States and in many other experienced democracies. New democracies of Central and Eastern Europe, and in East Asia, all face similar troubles with money and politics and efforts at regulation. A flow of books, articles, conferences and internationally funded programs attest to this widespread condition.

Latvia faces these issues at a crucial point in its democratic development. Latvia's first elections for Saeima following the regaining of independence took place in June 1993. Progress toward institutionalizing principles of democracy and transparency has since followed a course typical of new democratic systems, particularly in countries emerging from the former Soviet Union. Such progress – in elections, governance and economic activity – has been limited and uneven, and susceptible to being stalled. But incremental advances continue in Latvia, and commitment to further progress is encouraged by national aspirations to join organizations that are uniting the nations of Europe.

Ideals of democracy and transparency are endorsed in theory by the political culture in Latvia and are enshrined in new laws and in the creation of administrative and supervisory bodies. These ideals generally fail to be realized in implementation, however, because the laws and institutions are not fully capable or respected. The inadequacy of laws and institutions creates an environment of cynicism by political participants and disaffection by the general public. That environment undermines any further progress and encourages corrupt practices.

The current state of political party financing regulation and transparency in Latvia reflects this discouraging cycle. Ideals expressed through laws related to political party finance are not met in practice. Political participants in Latvia freely acknowledge widespread violations of legal restrictions upon donations and evasion of requirements for transparent disclosure of receipts and expenditures. Enforcement (and thus respect) for current laws is nil. Expectations for the effectiveness of further regulation are very low. This situation can only improve when laws and institutions begin to function effectively and compel changes in political practices in Latvia.

Despite this scenario, prospects for focused and practical reforms in political party financing in Latvia appear fairly good. The current attention given to political party financing in Latvia, initiated by the Prime Minister and Cabinet of Ministers, offers a chance to work for improving the legal framework and implementation in this area. This effort can produce significant reforms that will broadly enhance Latvia's political atmosphere and, ultimately, Latvia's international standing. But this opportunity can only be met with a sufficient commitment of political will, open public debate and strong support from the international community. Maximizing this opportunity requires devising a plan and taking specific action, to which this report will hopefully contribute.

Laws, institutions and practices relating to elections and political activity are often unique to the circumstances and political culture of each particular country. There are no perfect models or magic formulas in regulation of political party finance. Treating international examples as a 'menu' from which to pick ideas also runs the risk of an overly complex or internally inconsistent result. Policy-makers should seek a simple and coherent legislative package that is capable of full implementation and enforcement.

Perhaps Latvia will not only learn from international experience in dealing with difficulties of political finance, but will become an example of innovation and success. As demonstrated throughout the world, however, improvement in political finance regulation is generally an incremental and ongoing process. It is time for Latvia to start that process.

## **SCOPE & METHODOLOGY**

This report is based upon the following research:

- Review of current laws in Latvia relating to political parties and elections, and analysis of the draft Law on Financing of Political Organizations and their Associations developed by a Working Group established by the Prime Minister of Latvia;
- Discussions held in Riga in July 2001 with the Minister of Justice, members of the Saeima (parliament), political party leaders, election officials, government staff, academics and NGO representatives about political party financing and legal controls in Latvia; and
- Review of laws and practices from other democracies related to transparency, regulation and state subsidies in financing political parties and descriptive or analytical materials about such practices.

In order to give proper context to the discussion and recommendations, this report describes certain aspects of Latvia's current political environment and political or government institutions (as understood by the author). This paper does not, however, presume to present a comprehensive review of Latvian politics or political structures.

Similarly, numerous examples of approaches from other democracies are cited, but this report does not attempt to provide a comprehensive review of laws and practices internationally in the area of political party funding, regulation and transparency. Nor does this paper examine all academic literature on this topic or underlying concepts. Such information is widely available elsewhere and well known to Latvian policy-makers.

This paper focuses on: the proposed party financing law and its objectives; laws, institutions or practices in Latvia that relate to potential implementation of a new political party finance law; and international experience and models that can assist practical analysis and recommendations. This focus points to regulatory approaches, institutional commitment and specific action that would most effectively implement policies of state budget subsidies and enhanced regulation and transparency of political party financing in Latvia.

Issues of transparency, regulation and state subsidies in financing political parties are necessarily connected to financing of candidates and election campaigns. Rules and funding methods for candidates and campaigns should be coordinated and integrated with regulation of political party financing. The term 'political finance' is often used broadly to include all aspects in which money influences politics and elections, including political party financing. That general term is sometimes used in this report, particularly with reference to laws of other countries that may be broader in scope than only sources of and controls upon political party funding.

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Political party financing is also inherently related to a broader structure of anti-corruption regulation – all aspects of controls upon the influence of private interests and money on elections, governance and public policy-making.<sup>1</sup> That larger sphere of anti-corruption efforts is beyond the scope of this report.

The preparation by the Working Group of a new draft Law on Financing of Political Organizations and their Associations was prompted by interest in proposing state budget subsidies for political parties. Because of its central importance, the subject of public funding for parties is discussed prior to a review of technical issues raised by the Draft Law. Other policy issues of political party finance are discussed following that review.

## OVERVIEW OF RECOMMENDATIONS

Recommendations for action, described more fully in this report, reflect the following assumptions, conclusions or professional opinion of the author:

- Latvia's laws, institutions and practices regarding regulation and transparency of political party funding need revision and reform.
- Opportunity for significant reform in political party financing in Latvia is immediate and limited to a short and quickly diminishing time period. The Government, Saeima and political parties will be more reluctant to approve changes (particularly for adopting state budget subsidies for political parties) as October 2002 elections for Saeima draw nearer.
- Political agreement on reforming Latvia's system for financing political parties will require: 1) fair balancing of financial benefits and regulatory restrictions/obligations for parties; 2) compromise between political elements, particularly among larger, smaller and nascent political parties; and 3) substantial marshalling of domestic public support (and international pressure) for reform.
- The cornerstone of reform of political party financing is transparency: record-keeping, reporting and public disclosure of political party receipts and expenditures that is complete, accurate and honest. Regulation must strongly discourage 'off-the-books' financial practices by parties. This is achieved, not only through effective monitoring and enforcement, but by drafting rules that are reasonable and not overly restrictive.
- Significant state budget subsidies for political parties would encourage their institutional growth, stability and transparency. Public funding, coupled with stronger reporting and disclosure requirements, would probably lessen parties' reliance upon fund-raising from private sources (at least temporarily). However, public funding is not a substitute for private funding nor a cure for all political finance problems.
- State budget subsidies are probably an essential part of any package of regulatory reform that Latvian political parties would accept. There should be no political shame in striking such a compromise; if state subsidies are coupled with stronger controls and genuine transparency of political party funding, the Latvian people will be getting a good deal for their investment in democracy.

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<sup>1</sup> A complete regime of controls and transparency would include: sufficient public funding for legislators and legislative factions to perform their public responsibilities, and limitations upon private funding to legislators for such purposes, and other legislative ethics rules; complete personal financial reporting and disclosure by public officials, including legislators; and regulation of 'lobbying' by private interests. These subjects of regulation are not discussed in this paper, but should be reviewed in Latvia to determine if they are sufficient and complementary of political finance controls.

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- Fund-raising from private sources by political parties should continue to be permitted and not too tightly restricted. Market forces of supply and demand for such money will continue regardless of regulation. Controls should seek to limit, channel and disclose private donations to political parties (and their candidates) through a lawful and 'above-board' system. Rules should be realistic and encourage legal compliance, particularly as to requirements for accurate reporting and full disclosure of party receipts and expenditures.
  - Political parties' compliance with transparency requirements should be facilitated and specifically funded by the State.
  - Primary responsibility for supervising political party financial controls and transparency should be assigned to the independent Central Election Commission. CEC should be assisted by appropriate State bodies with expertise and capacity, particularly as to auditing responsibility. If CEC is given expanded responsibilities under revised political party financing laws, CEC must be guaranteed greater funding for administrative and personnel costs, and salaries of CEC commissioners should be increased commensurate with their important duties.
  - Enforcement mechanisms will be difficult to effectively implement. Investigation and prosecution of offenses will require cooperation between CEC and other State bodies with legal authority and capacity; an effective arrangement may require temporary solutions and ongoing development.
  - Sanctions and penalties for violations of political finance regulations should be serious – sufficiently severe to deter illegality. Punishment for violations should also be serious in that they are realistic – reasonable and appropriate to the gravity of the violation, so as to be capable of being imposed by election authorities and courts.
  - Regulation and transparency of political party funding is unavoidably linked to and dependant upon controls on political parties' (and their candidates') election campaign financing. Saeima elections will occur in October 2002, prior to any expected implementation of amendments to political party financing laws (or, at least, prior to any state budget subsidies for parties). Changes in regulation regarding campaign funding may be needed in the Saeima election law in advance of the 2002 elections.

- All aspects of political finance regulation should be integrated now to provide coherency, to properly initiate transparency practices, and to avoid undermining public support for political party funding reforms in advance of their implementation. One transitional solution is to enact post-election state budget subsidies for political parties under an amended party financing law (as contemplated by the new draft law), but to enact funding restrictions and disclosure requirements within the Saeima Election Law for the 2002 election campaign. Another option is to provide a separate subsidy to qualified political parties for the 2002 election campaign, or (as recommended below) to increase free broadcast time to qualified parties, but couple that benefit with a limitation upon purchasing more broadcast time.

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**Part Two: Legal Framework****CURRENT LAW****Constitution**

The Constitution of the Republic of Latvia was adopted by the Constitutional Assembly of Latvia on 15 February 1992. Chapter VIII, on "Fundamental Human Rights," guarantees:

- Right to freedom of thought and freedom of expression (including distribution of information);
- Right to participate in the activities of the State and of local government;
- Right to "form and join associations, political parties and other public organizations";
- Freedom to engage in peaceful meetings and demonstrations; and
- Right to petition State or local government and receive responsive reply.

**Current Latvian Laws Related to Elections and Political Parties**

- The Law on Public Organizations and their Associations was enacted in 1992. Chapter One sets out basic registration procedures and organizational requirements for all public organizations. The Ministry of Justice administers registration of public organizations and their associations; termination 'for cause' is decided by courts. Public organizations and their associations are obligated to submit annual reports on income and expenditures to the State Revenue Service (Article 21).

Chapter Two prescribes regulation of particular types of organizations; Section IX adds provisions on establishing, registering and operating political organizations (parties).<sup>2</sup> Parties must be founded by no less than 200 Latvian citizens (Article 43).<sup>3</sup> Article 44 contemplates further regulation of political parties by other laws and official acts, and Article 47 states that procedures for financing political organizations (parties) shall be regulated by a specific law.

- The Law on the Central Election Commission was first enacted in 1994 and amended in 1996 and 1998. The Commission (CEC) is composed of nine members, who are appointed for four-year terms within six months of each convening of a new Saeima. The Chairperson and seven members are named by the Saeima, and one member, a judge, by the Supreme Court.

The law sets forth CEC powers, duties and procedures with respect to administering elections, but does not grant CEC authority for regulating political parties or political finance. CEC is specifically responsible for ensuring application and enforcement of (and must act in accordance with) the Saeima Election Law, the law on local elections and the law on referenda and initiatives (Articles 4 & 8); the CEC law makes no reference to the Law on Financing of Political Organizations.

Article 12 grants CEC the power to annul election results at particular polling stations if flagrant violations of the law have been committed that would affect the election results, and to refer over individual persons responsible for such violations to state or local

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<sup>2</sup> Article 2 in Chapter I describes an association of public organizations as "founded by two or more public organizations by mutual association and by establishing a common management institution for the coordination of activities." Section IX in Chapter 2, particularly regulating political organizations (parties), makes no separate reference to an association of political organizations.

<sup>3</sup> In October 1999, the President of Latvia vetoed amendments to the law passed by the Saeima that would have raised the required minimum members of parties from 200 to 1000, saying this change was an unnecessary restriction upon the legal rights of Latvian citizens.

authorities. Article 13 provides that decisions of CEC may be appealed “in accordance with the procedure set by law.”

- The current Saeima Election Law was enacted in 1995 (and was in effect for elections in 1998). The law sets out an electoral system for Saeima elections based on party list voting and proportional representation using five multi-member constituencies (Articles 7, 8 & 38). Legally registered political organizations and associations thereof are entitled to submit their lists of candidates nominated for election; such lists shall only be registered if the party or association makes a security deposit of 1000 lats (approx. 1600 USD) to the Central Election Commission (Articles 9 & 12).
- The current Law on Financing of Political Organizations was enacted in 1995 and has not since been amended. The following overview is only a summary of key points and not comprehensive:

Objective. This law regulates the funding of political organizations and their associations – essentially ‘political parties’ (Article 1(1)).<sup>4</sup> The law’s stated purpose is to ensure transparency and legality of the operation of political parties, consistent with parliamentary democracy (Article 1(2)).

Funding sources. The law permits political parties to receive funding from membership fees, donations from individuals and entities, and income from business activity; it includes a ‘catch-all’ provision for other financial resources not otherwise prohibited by law (Article 2). Donations to a political party from individuals or entities are limited to 25,000 lats (approx. 40,000 USD) per calendar year (Article 4(2)).

Prohibited donations. The following are prohibited from donating to political organizations: state and municipal governments (except as otherwise provided for by law); entities and enterprises in which state or municipal capital exceeds 50%; foreign institutions, enterprises and citizens; and religious organizations (Article 6(1)). It is prohibited to fund parties through an intermediary, or for parties to establish special foundations or other intermediary entities to fund party operations (Article 6(3&4)). Anonymous donations are prohibited; the law sets up a rather cumbersome method for such donations to be forfeited to a state account and then redistributed to parties according to their number of Saeima deputies (Article 7(4)).

Transparency. Once a year, no later than March 1, political organizations are required to submit a Declaration of Financial Activities, signed by the party’s leader, to both the Ministry of Justice and the State Revenue Service (Article 8(1)). The law specifies donations and other receipts, and bank loans, that must be disclosed, as well as purchases of real estate, vehicles or other property exceeding 1000 lats in value (Article 8(2)). Financial reports of parties are to be available for review by persons qualified to donate and by “any journalist of the mass media” (Article 9). The law requires parties to have their finances audited by an independent audit company (at parties’ expense) at least once a year, and attach such audit report to their annual Declaration of Financial Activities (Article 11).

Legal Compliance. If a political organization fails to timely submit its annual Declaration of Financial Activities, or its Declaration does not contain the information required by law, the Minister of Justice is obligated within two weeks to first warn such organization and, if the situation is not rectified, to then institute legal action to force the organization to cease its activity (Article 10). Leaders of political parties are responsible for transfer of anonymous contributions to the state account and for submitting financial reports (Article 12(1)). The Minister of Justice is responsible for implementing the public disclosure and enforcement provisions (Article 12(2)).

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<sup>4</sup> Hereafter, this report will generally use the term ‘political party (or parties)’ to mean ‘political organizations and associations thereof’ within the meaning of Latvia’s laws, except as particularly noted.

## WORKING GROUP DRAFT LAW ON FINANCING OF POLITICAL ORGANIZATIONS

A new Cabinet of Ministers in Latvia was appointed in May 2000. The Cabinet's declaration for future activities addressed the need to combat corruption, and included a commitment to provide state funding for political organizations. On 27 September 2000, the Prime Minister established a Working Group tasked with drafting a law to provide for direct state funding for political organizations. A new draft Law on Financing of Political Organizations and their Associations (*Draft Law*) was submitted to the Cabinet of Ministers in April 2001 (unofficial translation: [Attachment 1](#)). The *Draft Law* is expected to receive Cabinet consideration in late 2001.

The *Draft Law* includes noteworthy changes in political finance policy from the current Law on Financing of Political Organizations (*Current Law*):

Role of CEC. The *Current Law* preceded amendments to other laws that strengthened the authority of the Central Election Commission (and, as discussed later, also preceded laws that increased the role and capacity of the State Audit Office). The *Current Law* requires parties to file their annual Declaration of Financial Activity with the Ministry of Justice and the State Revenue Service. The *Draft Law* provides that the CEC will:

- Manage arrangements for state funding of qualified political parties (Article 9);
- Receive submissions of annual Declarations of Financial Activity of political parties (and accounting surveys for disbursements by the State Treasury) (Articles 21 & 9);
- Control and supervise all aspects of transparency and compliance in the financial operations of political parties under this and other laws (Article 20);
- Provide for public disclosure and opportunity for examination of parties' Declarations of Financial Activity (Article 23);
- Be empowered, through its chairman, to monitor parties' compliance with obligations to submit annual Declarations of Financial Activities and accounting surveys; if parties' submissions are not made, or are incomplete or inaccurate, CEC is to first warn parties in violation and then, if not satisfied, to propose that those parties have their operations terminated pursuant to legal procedure.<sup>5</sup>

Business activity of political parties. In Article 2, the *Draft Law* omits the provision under *Current Law* that allows parties to generate funds from "entrepreneurial and other business activity." Eliminating the opportunity of political parties to combine business and political activity follows general international practice. Political parties should be viewed as non-profit associations performing quasi-public functions, particularly in nominating candidates for general elections. Business activity is inconsistent with this role and only invites corruption.<sup>6</sup> Ownership and operation of

<sup>5</sup> A discussion of monitoring and enforcement bodies is in Part Seven of this report; a discussion of sanctions and penalties for violations of political finance laws in Part Eight of this report.

<sup>6</sup> The Political Parties Act of Estonia provides that parties may not engage in economic activities, except for distribution and sale of materials related to a party's promotional activities, small merchandise having the insignia of the party, and lotteries (parties are also not permitted to be a partner or a shareholder of a company or own securities). Similarly, in the United States, parties are not allowed to engage in profit-making businesses, but are permitted to sell items promoting the party or candidates, such as coffee mugs or T-shirts; the proceeds of such sales are viewed in their entirety as donations from the buyer of

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profit-making businesses by political parties is a throwback to Latvia's socialist past (and is apparently of little practical importance today). The propriety of mixing business activity with politics becomes even more suspect if state budgetary subsidies are provided to parties.

State funding of political parties. Most significantly, the *Draft Law* provides for state budget subsidies to be provided to qualified political parties. This policy is to commence following the next Saeima elections in October 2002; i.e., beginning in 2003. Under the proposal, political organizations that received three percent or more of the total vote in the election, or associations of political organizations receiving four percent or more, are entitled to state budget subsidies. (This encompasses, of course, all political organizations or associations reaching the five percent threshold for gaining seats in the Saeima.) The *Draft Law* provides for these subsidies to be given annually (in quarterly installments) at the rate of 60 santims per vote for the four-year period through the next round of elections.

Limitations on Donations. The *Draft Law* significantly reduces the amount that is permitted to be donated to political parties by any one donor in a calendar year. Article 11 provides: natural persons may donate no more than one thousand lats (approx. 1600 USD) in money or property per year; legal entities may donate no more than five thousand lats (approx. 8000 USD) per year.

Thus, the *Draft Law* of the Working Group represents a solid effort to incorporate proposals for state funding of political parties with provisions to encourage transparency in their operations. The *Draft Law* also provides a focal point for public discussion of political finance policy in Latvia and an opportunity to build popular support for reform.

Part Four of this report reviews technical problems in the *Draft Law* and related policy and implementation issues.

### **Part Three: State Funding for Political Parties**

#### **IMPORTANCE AND ROLE OF POLITICAL PARTIES**

Strong, competitive and participatory political parties are vital to a healthy democracy under almost all electoral systems. Political parties are private associations that play a special intermediary role between citizens and government. Political parties may be suspect in the eyes of voters, however, who may see parties as selfish, divisive and simply partisan, and as instruments of favor-seeking and favor-granting (patronage and corruption) rather than instruments of public will.

Parties perform a quasi-public function by organizing and expressing the political will of citizens and, most importantly, in nominating candidates for general elections. Parties are generally the organizing basis for legislative factions and, often, for a coalition executive cabinet. Because of these functions, parties usually have a more formalized and interdependent relationship with government than other private associations within civil society. Thus, political parties are subject to greater government regulation. A balance must be struck between: protecting the public's legitimate interest in political party operations that affect the integrity of the political process, and preserving the independence and vitality of political parties as private, voluntary associations.

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the goods, regardless of the intrinsic value of the goods (the same is true for proceeds of dinners or other fund-raising events, regardless of the value of food, beverages or entertainment provided at events).

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## POLICY CONSIDERATIONS

Public funding (state budget subsidies) for political parties and/or candidates has become increasingly prevalent in modern democracies. Michael Pinto-Duschinsky, a political scientist and expert in political finance practices, recently observed that no fewer than 39 of the 49 democracies he was studying provided some direct public funding for political parties or election campaign activity.<sup>7</sup> That figure represents nearly a doubling in the number of countries giving such electoral assistance since a survey by another eminent scholar in this field a little more than a decade ago.<sup>8</sup> The expansion of state funding for political activity in particular countries has often followed political finance scandals and public frustration with money and politics.

Proponents of public funding of party and candidate activity argue such financing will relieve pressure upon parties and candidates to raise funds from private sources and, thus, reduce undue influence and corruption by 'special interests.' Some advocates say public funding will help 'level the playing field' by providing parties that are less capable of raising private funds (especially 'opposition' parties) an ability to compete more effectively, or at least provide a reliable 'floor' of funding for smaller parties.

Also, when public funds are provided for election campaign expenses and coupled with limits upon campaign expenditures, it is argued that public funding can lower overall political spending, which appears otherwise to be rising dramatically in every election. Finally, when provided for routine organizational costs of parties, public funds are seen as an investment in political parties as institutions, which will strengthen their role in democracy.

Enacting a program of public funding for parties has some downside risks. Subsidies may simply increase parties' appetites for spending money and for raising even more from private sources. Funding or other political support may instead be provided through nominally independent sources – 'off-the-books' – despite expenditure limits. Recent political finance scandals in Germany, France, Spain, Italy and Japan demonstrate that a public funding system does not guarantee compliance with laws or an end to corruption.

Moreover, public funding may 'lock in' the status quo and discourage small or new political parties. State involvement in financing parties may undermine the voluntary and participatory nature of political parties, diminishing parties as independent associations of persons motivated by shared civic ideals.

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**Viewpoint:** Peter Ware, Professor of Politics at the University of Oxford, recently observed<sup>9</sup>:

Public funding was unknown in the first half of the twentieth century but has become common in the second half. Many of the established liberal democracies have some form of public funding, and some of the newer democracies, notably in those in eastern Europe, have embraced this approach. Well-financed parties can provide linkage with mass electorates; a wholly publicly funded system would prevent the distortion of party priorities in the direction of fund-raising; and even partly publicly funded systems might reduce the inequalities in resources between parties and candidates. ... Viewed in this way it looks like a panacea for all the problems of party financing. However, in practice it is not.

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<sup>7</sup> "Political Finance and Democracy: Major Challenges for Reformers and Scholars," paper presented at Conference on Political Finance and Democracy in East Asia, Seoul, Korea, June 28-30, 2001.

<sup>8</sup> "Money and politics: rethinking a conceptual framework," Herbert E. Alexander, Comparative Political Finance in the 1980's, Herbert E. Alexander, editor (Cambridge University Press, 1989), p.12.

<sup>9</sup> "Conclusion," Funding Democratization, Peter Burnell and Alan Ware, editors (Manchester University Press; 1998), pp. 242-3.

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Public funding is expensive. In a country, such as South Africa, where the initial elections in the democratizing regime have been costly, replacing private funding with a wholly public funded system would lead to the displacement of other public policy priorities and may be difficult to sell to many sectors of the electorate. On the other hand, if public funding operates alongside private funding, scandals involving links between parties and organized interests may well occur anyway, just as they do in wholly privately funded regimes. Public funding does not always drive out the adverse effects of private funding. Germany, the first European state to introduce public funding, is a case in point, and among the more recently democratized regimes Spain provides another example. ... More generally the point can be made that public funding can give a false appearance of fairness and legitimacy in the funding of political parties when, in reality, there is unequal access to private funds for which public funding does not compensate. ...

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**Viewpoint:** Lively debate over the question of public funding for political parties continues in Great Britain even after legislative reforms were adopted in 2000 following the report of the Neill Committee on Standards in Public Life. Those reforms ultimately did not include significant public funding of political parties or election campaigns. An overview of 'quotable' policy arguments is offered in one recent commentary:<sup>10</sup>:

Prime Minister Tony Blair (Labour Party): "I think I probably speak for any political leader of any political party when I say that I would be delighted if we never had to raise a single penny piece in political funding. But I don't think the support is there from the public."

MP Malcolm Bruce (Liberal Democratic Party): "Political donations must be open to scrutiny to avoid the suspicion of buying influence. Going a step further and introducing state funding for political parties would put an end to the culture of sleaze surrounding donations."

'Shadow' Cabinet Minister Andrew Lansley (Conservative Party): "We are opposed to large-scale state funding of political parties. What the state pays for, it tends to control and it would be a barrier to new political parties."

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Thus, public funding of political parties (or election campaign activity) is politically controversial and a significant policy decision. It can be a responsible policy choice if expectations are not too high that it will cure politics of self-interest and political influence. Public funding may be best viewed as a potential component of electoral reform, complementing and facilitating a reform package, rather than as a sole or primary reform itself.

Enacting a state budget subsidy program for parties in a newly developing democracy such as Latvia can be justified as a means of diminishing parties' reliance upon private funding and of encouraging growth of political parties institutionally. Moreover, public funding may be an essential ingredient in reaching political consensus and support for a package of reforms regarding regulation and transparency of political parties in Latvia. This is not to say political parties in Latvia should be 'bought' by promises of public funding in order to enact needed reforms. But new legal restrictions and obligations, coupled with credible enforcement, may be more palatable to parties if they see some obvious benefit too.

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**Recommendation:** A system for providing annual state budget subsidies for political parties should be adopted in Latvia, in order to:

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<sup>10</sup> *Public Finance*, a journal of The Chartered Institute of Public Finance and Accountancy, January 2001, article by Paul Gosling. See: [http://www.cipfa.org.uk/publicfinance/news\\_details.ihtml?news\\_id=7590](http://www.cipfa.org.uk/publicfinance/news_details.ihtml?news_id=7590).

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- Support and strengthen the role of political parties in Latvia's democratic development;
  - Lessen parties' reliance upon private funding sources; and
  - Encourage parties' acceptance of and compliance with stronger regulation and effective disclosure.

Recommendations about specific implementation issues for public funding are presented later in this report.

This recommendation is premised on public funding for political parties' operational, administrative and institutional expenses, rather than for election campaign expenses (discussed in the next part of this report). This approach is more consistent with treating public funding as a component of a reform package for political party financing.

Since this important issue is viewed as part of a comprehensive reform program, Government officials, Saeima members and political party leaders should seek public input and broad-based political consensus. They should encourage vigorous discussion among civil society, academia, news media and the general public about the merits of a political finance reform package and the legitimate role of public funding of political parties in reform legislation. State budget subsidies for parties will increase public cynicism if enacted without strengthened regulatory and disclosure provisions.

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## THRESHOLD ISSUES

### Qualification Standards

Public funding systems face difficult questions regarding qualification standards (eligibility requirements) for political parties to receive state budget subsidies. Most countries that provide public funding base eligibility upon either, or both, electoral performance (votes received in an earlier election) or seats held in legislatures (which is a less precise measure of electoral performance, depending upon the electoral system). Usually, but not always, public funding based on electoral performance is associated with financing of election campaign expenses (often by post-election reimbursement), while funding based on seats is associated with ongoing institutional support for parties. With either approach, qualification standards inevitably end up favoring more established parties.

Germany's system has fairly complicated qualification standards (and distribution formulas) for public funding of political parties; one standard for qualification is 0.5% in last prior federal election (Germany is discussed more fully below). Other election performance thresholds include: France (5%), Australia (4%), Japan (2% or over 5 members), Sweden (2.5%) and Israel (based on number of seats, or parties receiving more than 1% of the vote but no seats). Further examples are as follows:

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**Example:** Section 17 of the Electoral Act of 1997 of Ireland provides for a fund of one million pounds that shall be distributed among qualified political parties annually; the fund is periodically increased in amount according to increases in remuneration for civil service employees. Section 16 defines a 'qualified' political party as a party registered to contest *Dail* (parliamentary) elections and whose candidates received not less than 2% of the total first preference votes obtained by all candidates at the most recent *Dail* general election (June of 1997).

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**Example:** Political parties in Hungary which gain at least 1% of votes cast in the parliamentary election are entitled to support from the national budget. But 25% of the total funds provided by the national budget for the support of political parties must be distributed equally among parties that hold seats in Parliament (see: discussion of 'equity' principle, below). The remaining 75% of funds are

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distributed to parties on the basis of votes gained by the parties or their candidates in the first lawful round of parliamentary elections.<sup>11</sup>

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**Example:** In the Czech Republic, political parties or coalitions which obtain three percent or more of the total number of valid votes cast in elections for the national Chamber of Deputies may receive a post-election payment from the national budget of 90 Kc per each vote received.<sup>12</sup>

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**Example:** The Political Parties Act of Estonia entitles only parties represented in the *Riigikogu* (national parliament) to receive annual allocations from the state budget, proportional to their respective seats. Allocations to parties are transferred to a bank account of the political party.

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**Example:** Canada provides two separate categories of post election subsidies: for individual parliamentary candidates and for national party organizations. National party organizations are entitled to a reimbursement of 22.5% of their total election campaign expenses if they: 1) field at least 50 candidates; 2) obtain at least 2 percent of the total valid votes cast in a general election, or 5 percent in constituencies where they have candidates, and 3) adhere to a spending limit (but have expenditures at least 10% of that limit). Candidates who are elected or receive at least 15 percent of the valid votes cast in their constituency (and adhere to a spending limit) are entitled to a reimbursement of 50 percent of election-related expenses actually paid (to a maximum, obviously, of 50 percent of the election spending limit in the constituency).<sup>13</sup>

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Thus, international models demonstrate a variety of qualification thresholds that have been adopted to implement public funding of political parties. As with many political finance elements, this decision represents a policy choice based on political culture and circumstances of each country.

The *Draft Law* developed by the Working Group proposes a qualification standard for state budget subsidies of three percent or more of the total vote in Saeima elections for political organizations and four percent of the vote for associations of political organizations. Since the Saeima Election Law requires parties to win five percent of the vote in order to be awarded seats, these proposed qualification standards are reasonably generous in encouraging and rewarding competitive parties.<sup>14</sup>

A further challenge to drafting public funding legislation is to provide a fair (but not too lenient) method for new parties to qualify for funds, even between election campaign periods (in advance of a new election). This objective is of less consequence for a funding scheme of annual institutional support of parties, which can proceed from one election to the next. If, however, subsidies are provided to parties for election campaign

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<sup>11</sup> In Hungary, state subsidies cannot exceed 50% of a party's income; parties must refund excess funds if it is determined that state funds exceed 50% of that party's income. See: §5(3) of Law No. XXXIII of 1989, On the operation and financial functioning of political parties, as modified by Law No. LXII of 1990.

<sup>12</sup> Article 85, Chapter Four, Act No. 247 on Elections to the Parliament of the Czech Republic, enacted September 27, 1995.

<sup>13</sup> All candidates are entitled to a full refund of their \$1000 deposits if they comply with reporting and financial requirements of the Canada Elections Act.

<sup>14</sup> However, the setting of separate standards for 'political organizations' and 'associations thereof' is of dubious policy value (see: discussion of associations, below).

expenses during the election campaign (including free broadcast time or other ‘indirect’ subsidies), prior electoral performance may not reflect changes in strength of parties or the rise of new political parties. The law would need to provide a means for parties to show current popular support, perhaps connected to candidacy certifications, or through ‘signature petition’ requirements or a universally accepted polling mechanism; thresholds would still need to be sufficiently high to discourage frivolous, extremist or money-seeking parties.

### **Distribution Formula: Equity and Proportionality Principles**

The formula for distribution of state subsidies to qualified political parties must also be determined in the law. This decision also depends upon policy objectives and political circumstances, since funding approaches may have significant impact upon parties and the political structure. The policy choice for a distribution formula generally involves choosing between values of equity and proportionality – although public funding systems often try to reach a balance between the two values (e.g., Hungary and Sweden).

Equity principles prefer treating parties equally, so that smaller or newer parties can compete and the advantage of bigger and established parties is not perpetuated and exaggerated by the subsidy program.<sup>15</sup> Equity considerations view parties as deserving an equal chance to gain popular support in election campaigns regardless of private fundraising ability or, if subsidies are for institutional purposes, equal footing organizationally.

Proportionality principles prefer basing subsidies on political party performance (or some measure of current popular support), as both a reward and as a measure of each party’s strength and organizational needs. Proportionality considerations view ‘equity’ approaches as inexact. Giving every party the same level of subsidy over-rewards small parties that just pass the qualification threshold and fails to give bigger parties significant or sufficient resources to discourage their private fundraising or to justify additional regulation. Thus, most political finance systems employ some form of proportionate measure in distributing public subsidies.

The *Draft Law* developed by the Working Group proposes a subsidy distribution formula for political parties based purely upon proportionality principles: 60 santims per vote in the prior Saeima election. The effects of that approach, and alternatives, are discussed in the next part of this report.

## **CASE STUDIES**

Examples from different parts of the world, instituted at different times and in different circumstances, illustrate different regulatory approaches. These examples demonstrate the need for a public funding system to be comprehensive and coordinated with other political finance regulation.

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**Example:** Germany was a pioneer in the policy of public funding for political parties, beginning such support in 1959. These funds are provided annually, and may be used by parties for routine

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<sup>15</sup> “To some extent, this ‘the rich get richer’ aspect to public subsidy is unavoidable: how else could states give public money; public funds could hardly be given to candidates because they promised to do well at election time. Even so, access to state subsidy, and rules governing the same, affect the flow of resources to candidates and – if resources matter – can affect the outcome and conduct of elections.” Shaun Bowler, Elisabeth Carter and David M. Farrell, “Studying Electoral Institutions and Their Consequences: Electoral Systems and Electoral Laws”, based on a paper presented at the XVIIth World Congress of Political Science, Quebec City, August 1-5, 2000.

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organizational costs and other functions assigned to them by the Basic Law and specified in the Law on Political Parties.

The state subsidy system is currently implemented through extensive provisions in the Law on Political Parties. The German public funding system uses two methods to provide subsidies to parties, and uses a separate qualification/allocation standard for each method. These two measures determine whether parties are qualified by popular support to receive public funding and their respective funding allocation.<sup>16</sup>

The first measure is parties' performance in the most recent European, Bundestag (federal [national]) and Landtag (state [local]) parliamentary elections. Parties must have received at least 0.5% of the valid votes in the last prior European or Bundestag elections, or 1% in prior Landtag elections, to be entitled to partial public funding.<sup>17</sup> Each qualified party receives an annual subsidy of DM 1.3 per vote up to five million votes and DM 1 per vote for additional votes above five million.

The second measure is total membership subscriptions and donations from natural persons. Qualifying political parties receive a matching grant of DM 0.5 for each DM 1 received by the party from contributions from natural persons, up to a limit for matching of DM 6000 per person annually. These 'matchable' donations must be identified separately on the parties' annual Statements of Account.

The German public funding system also has two limitations upon state subsidies. The Federal Constitutional Court of Germany ruled in April 1992 that the country's constitution prohibited political parties from being "predominantly" financed by the state. German law was amended, effective in January 1994, to provide that the amount of public funds could not exceed the party's own annual income from membership fees and private donations. Thus, a party's allocation of state funding is limited to no more than the amount of funds raised from private sources (called the "relative limit"). To facilitate implementing this limit, political parties are required to include in their annual Statement of Account the total amount of contributions they have received.<sup>18</sup>

As a budget matter, the law also stipulates an "absolute limit" upon the allocation of state funds to all parties combined, raised from DM 230 million (approx. 106 million USD) to DM 245 million (approx. 113 million USD) per year by amendments to the law in 1999. The actual calculation of total amounts of state subsidies to which parties are entitled routinely exceeds this budgetary limit, however. The amounts of state funds paid to all parties are then reduced proportionately.

Thus, parties do not actually receive full subsidy amounts per vote and per donation pursuant to the allocation methods. Together, these two limits set fairly complicated parameters that change the amounts received by each party annually because of the interactive nature of the formulas.<sup>19</sup>

In order to receive state funding, parties are required to submit a written application for their share of state funds, and to submit their statements of account that comply with legal requirements, including reporting of the total amount of private contributions received. Parties may apply to receive advance payments on 15 February, 15 May and 15 August; such payments may not exceed 25% of the total

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<sup>16</sup> The web-site for the German Bundestag describes these measures: "The yardstick for the distribution of public funds is the extent to which the parties are established within society." See: [www.bundestag.de](http://www.bundestag.de).

<sup>17</sup> Special provision is made so that parties that were not permitted to present a full candidate list for elections may receive public funding if they received at least 10% of the vote in a constituency.

<sup>18</sup> Germany's Law on Political Parties permits natural persons to claim income tax deductions for contributions to political parties. Deductions are limited to 6000 DM annually; contributions above that amount are permissible, but deductible only up to 6000 DM. Contributions from legal persons are not tax deductible.

<sup>19</sup> See: [http://www.bundestag.de/htdocs\\_e/datab/finance/finance\\_2.htm](http://www.bundestag.de/htdocs_e/datab/finance/finance_2.htm).

amount allocated to the party for the preceding year. These payments are then deducted from the amount to which such parties are determined to be entitled on 1 December.

Eighteen political parties were entitled to public subsidies in Germany in 2000. Land (state) governments provided about 38 million DM (approx. 15%) and the federal government provided about 207 million DM (approx. 84.4%) of total public funding.<sup>20</sup> Parties' total income from private sources for 1999 was approximately 561 million DM (approx. 258.7 million USD); thus, public funding of 245 million DM provides 30% of party receipts.<sup>21</sup>

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**Example:** The Constitution of South Africa requires national legislation to provide for "equitable and proportional" funding for political parties "to enhance multi-party democracy." The Public Funding of Represented Parties Act was adopted in 1997 to implement this principle.

Under the Act, a political party is entitled to an allocation from the Fund in a financial year in which it is represented in either (or both) the National Assembly or any provincial legislature (but not parties represented only in municipal councils or not represented in any legislative body). Ten percent of the Fund is distributed on an 'equity' basis, although based on whether parties are represented in each of the provinces, so not actually equal per party; ninety percent is based upon number of seats held by parties in both national and provincial legislatures. The absence of public funding opportunities for new parties, not represented in legislatures, is a continuing political controversy in South Africa.

The Fund is administered by the Independent Electoral Commission (IEC). The Chief Electoral Officer, the Commission's administrative head, has responsibility as the Fund's accounting officer and manager. Payments to qualifying political parties are made quarterly each fiscal year.<sup>22</sup> During its first year of operation, fiscal year 1998 (1 April 1998 to 31 March 1999), the Fund distributed 52,103,000 ZAR (currently, approx. 6.3 million USD) to eight parties.

Section 5(1)(b) of the Act provides that allocations from the Fund may be used "for any purposes compatible with [a party's] functioning as a political party in a modern democracy" including promoting democratic choice, influencing public opinion, political education, and encouraging political activism. Parties may not use allocated funds to:

- pay any direct or indirect remuneration or benefit of any kind to any elected representative or government official/employee;
- finance or contribute to any cause or event that contravenes any parliamentary code of ethics;
- directly or indirectly, start a business or acquire financial interests in any business;
- directly or indirectly, acquire or maintain a financial interest in immovable property, unless used solely for ordinary political party purposes;

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<sup>20</sup> Annual subsidies are disbursed to party organizations at both the federal and state level. Local party organizations receive their funds from Land budgets. However (adding another complicating implementation feature), local parties take priority in the funding program, receiving DM 1.00 per vote based on most recent Landtag elections, irrespective of ceilings and other caps operating at the federal level. National level parties receive their party's remaining entitlement to public funds, if any, from the Federal budget; parties only represented at the Land (state) level receive any additional funds to which they are entitled from the Federal budget as well.

<sup>21</sup> See: [http://www.bundestag.de/htdocs\\_e/datab/finance/finance\\_2.htm](http://www.bundestag.de/htdocs_e/datab/finance/finance_2.htm).

<sup>22</sup> Hungary also provides for disbursing public funds to qualifying political parties from the state budget on a quarterly basis, on the first day of each quarter. See: §5(4) of Law No. XXXIII of 1989, On the operation and financial functioning of political parties, as modified by Law No. LXII of 1990.

- pay for anything else incompatible with a political party's functioning in a modern democracy.

Parties may not carry over to the next fiscal year more than fifty percent of their allocated funds. Political parties must account for spending of their allocation from the Fund according to these classifications: personnel expenditures; accommodation (office); travel expenses; arrangement of meetings and rallies; administration; and promotions and publications.

Parties receiving funds are required to:

- keep a separate account with a bank in South Africa, into which money allocated from the Fund must be deposited;
- appoint an official within the party as accounting officer, who is responsible for money in the bank account and for compliance with the requirements of the Act, and who must keep separate books and records for this money as prescribed by law;
- maintain an income and expenditure statement, disclosing for what purposes the money was spent; the statement must be audited annually, and the auditor must express an opinion as to whether any allocated money was spent for purposes not authorized by the Act;
- annually submit (by accounting officer) the financial statement and the auditor's report to the Commission, within three months of the close of the fiscal year.

South Africa's law also permits parties to raise funds from private sources: from members and from donations from individuals, businesses or civil society groups. Regulation of private fund-raising is very weak. Donations from foreign sources are not prohibited. Political parties are not required to report or disclose information about their raising or spending of private money – not even to identify sources of funds.

As noted above, parties' unspent balances of public funds at the end of a financial year may be forwarded to the next financial year up to 50% of the prior allocation. However, for the June 1999 elections, all political parties who received public funds were required to close their books and return all unspent funds to the IEC 21 days prior to the election; new allocations were made after the results of the new elections were declared. Thus, public funds are not permitted to be used for election campaign purposes and are only available for ongoing administrative use by political parties.

All monies spent by parties' during the pre-election campaign period were from private sources (and parties' receipts/donations and expenditures for the pre-election campaign were not reported or disclosed). South African parties were reported to anticipate compiling 50 to 90 percent of their funds for the 1999 elections from businesses and large individual donors, including foreign sources. A prominent NGO, the Institute for Democracy in South Africa (Idasa), announced in February 2001 that it would lead a drive for public support for regulation of private funding of political parties, including disclosure requirements.

**Example:** After years of considering reform proposals, and following well-publicized scandals, France adopted new political finance laws in 1988 and 1990. Previously, the political finance system in France used little public funding and almost no rules concerning donations and election expenditures, nor for reporting and disclosure. The public funding system in France provides annual grants to political parties, and also reimbursements to candidates for certain campaign expenses – cost of paper, printing and distribution of approved brochures and posters. The new laws also:

- impose a limit on campaign expenses by candidates but not political parties, and added limits on donations to candidates;
- increase tax deductions for contributions and reimbursements to candidates for campaign expenses; and
- require candidates and parties accepting public funds to designate an agent to maintain campaign accounts and to submit reports to a national commission.

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Public funding policies adopted in France in 1988 and 1990 seem clearly premised on the assumption that parties and candidates will have less incentive to seek illicit financing under a system of substantial state subsidies.

As one expert observer noted<sup>23</sup>:

The reformed system is intended to ensure regular financing of political parties and candidates. However, unlike the system at the federal level in Canada, the French system has contribution limits, rigid controls on advertising, no spending limits on parties and only partial disclosure requirements.

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**Example:** Sweden has provided public funding to political parties at the national level since 1966 and subnational level since 1976. Parties represented in national and/or subnational parliamentary bodies receive an annual grant. Public funding is estimated to constitute 50-75% of party income. No conditions are placed upon use of subsidies by parties, and no public audit of their expenditure is required.

State funds are provided at the national level in two forms: 'party support subsidies' (which account for about three-fourths of public funding) and 'secretariat subsidies.' A party is eligible for 'party support subsidies' if it received at least one seat in parliament or 2.5% of the votes throughout the country in either of the previous two general elections. These subsidies are allocated in proportion to party share of parliamentary seats (or, if the party has won no seats, based on their share of the vote). A party qualifies for 'secretariat subsidies' if it won one seat in the Parliament in the last election or received at least 4% of the vote throughout the country in either of the previous two elections. "Secretariat subsidies' are distributed equally among parties represented in the parliament, but with a 50% bonus for 'opposition' parties.

Parties qualify for public funding at the sub-national level by receiving at least 3% of the regional vote; funds are distributed according to parties' share of seats in county and municipal government bodies.

Campaign expenditures are unrestricted. Parties receive free media time during election campaigns, but no public funding is provided for campaign expenses (except a small reimbursement for parties that win 2.5% or more of the nationwide vote but no seats).

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The common method of public funding for political parties sends the money to the central party organization. That increases central head-quarter's control and influence over local party branches and further encourages a tendency toward centralization. But public funding through the national party is simpler, and permits holding central party leaders responsible and accountable for record-keeping and reporting of spending of the funds.

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**Example:** A system for public financial support of political parties in Denmark was first established in 1965 and then expanded with a second element enacted in 1986. The first element is an annual grant based upon party share of seats in the national parliament. The second element bases an annual grant upon votes received in national, county and municipal level elections; the subsidy amount per vote is increased annually for inflation. To qualify, parties must have received a minimum of 1000 votes in the prior election for national parliament.

The system is administered by the Ministry of the Interior. Funds are distributed to the central party organization. Parties receiving public funds submit a declaration to the Ministry of Interior each year

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<sup>23</sup> "Comparative Studies in Electoral Reform and Party Finance: France," by Don Padget, in compendium edited by F.L. Seidle and published by the Royal Commission on Electoral Reform and Party Financing in Canada in 1992 (p. 80).

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stating that the amount has been used for political purposes within Denmark and that such activities are ongoing. Since 1990, parties must submit with this declaration a copy of an annual accounting of how the funds were spent. Since 1996, this accounting must include the names of donors of contributions who have given more than 20,000 DKr (approx. \$2500 US) to the central party organization.

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**Example:** The two major political parties in the United States are highly institutionalized and regulation of political parties is often fairly comprehensive at the individual state level. However, the federal and state governments of the U.S. generally do not subsidize parties as institutions from public funds (although a few states have a tax 'checkoff' system for donations to party accounts). And public funding for candidate campaigns is very limited and uncommon in the U.S., as described more fully below in the discussion of 'expenditure limits.'

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The examples and case studies described above demonstrate how public funding systems vary widely in approach and complexity. Total amount of political party subsidies requires a policy judgment as to the level of funding that parties need and the amount of state budget expenditures for this purpose that the Government can afford.

The draft Law on Financing of Political Organizations and their Associations developed by the Working Group avoids over-complicating this policy effort. However, elements of the *Draft Law* raise a number of policy and technical issues. Thus, discussion and recommendations about specific implementation aspects of public funding are presented in the next part of this report.

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## Part Four: Policy and Technical Issues in the Draft Law

### STATE BUDGET SUBSIDIES FOR POLITICAL PARTIES

#### Organizational Support or Election Campaign Financing?

As demonstrated above, funding policies in other democracies take different approaches on whether to provide political parties with election campaign financing or routine financial support outside the election period, or both. The Working Group's draft Law on Financing of Political Organizations and their Associations (*Draft Law*) reveals uncertainty on this fundamental policy issue. The *Draft Law* contains a basic inconsistency between procedures for funding political parties and restrictions upon use of such funds.

At the end of the *Draft Law*, transitional rules stipulate that state budget subsidies for political parties will not begin until after the next Saeima elections (to be held in October 2002). Article 3(2) describes the state budget subsidy to parties as yearly. Article 3(4) refers to qualified political parties receiving state budget subsidies each year in the course of four years until the next election of Seima. Article 9 provides that state subsidies for parties will be allocated annually in the state budget and paid out to parties in quarterly installments. Article 21 provides that parties' annual Declarations of Financial Activities shall include disclosure of funds received through state budget subsidies. Article 3(6) of the *Draft Law* provides that direct state funding to political organizations is stopped in case of premature dismissal of the Saeima, presumably in anticipation of new elections.

Thus, the processes described in the *Draft Law* (and general expectations for the proposal) envision annual funding of political parties from the state budget to begin in 2003 (with parties' share of funds based upon 2002 election results). Such a system seems clearly designed to help fund ongoing, routine administrative operations of political parties, and not particularly intended to finance parties' periodic pre-election campaigning.

However, Article 5 of the *Draft Law* states that political parties may use state budget subsidies only for carrying out pre-election campaign activities. And Article 6 specifically prohibits political organizations from using state budget subsidies for routine administrative expenses, including office rent, telecommunication costs or employee compensation.

This contradiction in the *Draft Law* between funding procedures and restrictions upon parties' spending of state budget subsidies may signal concerns by the Working Group about the propriety of policies that would subsidize certain types of party expenses. Perhaps there are political objections to state budget subsidies for parties' administrative expenses, out of fear public funds may go towards exorbitant salaries, 'sweetheart deals' or other self-dealing by political party leaders. Perhaps subsidies for pre-election campaign costs are favored as most needed, or as a means of reducing parties' reliance on private donations during the pre-election campaign. Maybe this is seen as a way to direct subsidies back to the State Treasury through party expenditures for State Television during the pre-election campaign (discussed in next section). Regardless of its reasons, the conflict in policy directions in the *Draft Law* must be resolved.

The concern evident in the *Draft Law* about the possible spending practices of political parties is misdirected:

- Problems of corruption and self-dealing should be heavily discouraged by full reporting and disclosure of expenditures by parties (backed up by strong enforcement);
- Regulations can be enacted to prohibit the worst possible financial abuses; and

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- Public sensibilities would likely be equally offended by parties' spending practices for and during the election campaign.

Moreover, the examples of public funding in other democracies cited in the previous part of this report show that direct subsidies for election campaign expenses are generally in the form of reimbursements after the election. These funds are essentially then used by parties for administrative expenses after the (except, perhaps, to pay off remaining debts or loans), or to raise private funds for ongoing party activity.

The approach in the Draft Law would require that political parties set aside and save their annual subsidies for the next election campaign. or the payment process would need to be changed to provide for subsidies to be paid closer to the election. Unfortunately, direct cash subsidies to political parties immediately prior to an election might be politically awkward. And such a system would necessarily require some means of qualifying new or newly revitalized parties that would not qualify for subsidies based upon prior election results.

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**Recommendation:** The purpose of state budget subsidies for political parties should be to provide qualified parties a basic level of resources to support their administrative operations and facilitate greater institutionalization and professionalism. Instructions for permissible and impermissible use of public funds in the *Draft Law* should be reversed: annual grants to political parties should be used for parties' expenses for administrative and organizational operations, not for expenditures related to pre-election campaigns. (State support for campaign expenses, if desired, could be separately adopted through the Saeima Election Law. [see next recommendation]) Use of public funds for routine operational expenses of parties would serve the purpose of building political parties as democratic institutions, and would correlate properly with the funding procedures in the *Draft Law*.

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### **Direct vs. Indirect State Funding**

A related problem arises in Article 4 of the *Draft Law*. In addition to direct state budget subsidies for political parties, Article 4(1) proposes indirect state funding for parties by granting free airtime for election campaigning on National Broadcasting and Television of Latvia (as in previous Saeima elections). Article 4(2), however, states that political parties that have received direct state funding shall not be entitled to indirect state funding.<sup>24</sup>

The motive for imposing this restriction may simply be a sense that the generosity of public subsidies has its limits, particularly since Article 5 contemplates direct subsidies for pre-election campaign expenses only. That element is removed if direct state budget subsidies are intended for institutional support of political parties, outside the election campaign period, as recommended above. Or, again, this restriction may show an interest in having state subsidies directed back to the State Treasury through expenditures on state television by parties (and state television relieved of having to provide so much free airtime). But economic interests or problems of State Television should not dictate political finance policy.

The either/or approach of the Draft Law regarding State support for political parties is arbitrary and misguided. It undermines the basic policy objective of supporting parties and reducing their dependence on private funding.

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<sup>24</sup> This provision is inconsistent with Article 2(1), which states that political organizations shall be entitled to direct and indirect state funding (not 'or').

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Moreover, implementation would be complicated by the differences in timing between annual direct subsidies to parties and periodic indirect support (broadcast time) during the election campaign period. In practice, parties would not forego immediate funding for a promise of free airtime in the next election campaign, rendering the offer of indirect funding only valid for parties newly qualifying for the next election. Acceptance by parties of entirely different forms of state support – direct annual grants or indirect campaign assistance – should not be conditioned on foregoing the other.

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**Recommendation:** Forcing political parties to choose between direct and indirect state funding should be eliminated from the Draft Law. A better approach in this area would be to condition availability of free broadcast media time on a party's agreement to not purchase (and not permit other persons or groups to buy on its behalf) additional media time for political advertisements beyond prescribed limits. An appropriate limitation may be to prohibit those parties that accept free broadcast time from purchasing an amount greater than (or more than twice than) their free allocation.

Combining free broadcast time with constraints upon buying additional time may be an effective way to implement some campaign spending limits. Campaign expenditure limits are generally difficult to enforce, but media expenditures are easier to monitor. To be successful, however, such a policy would require a more expansive (and flexible) allocation of media time on National Broadcasting and Television of Latvia for political parties during the election campaign period than in prior elections. And Latvian State Television should not bear the costs of political reform. State Television should be appropriately compensated from the State budget for allocations of airtime to political parties.

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#### **Distribution Formula: Equity and Proportionality Principles**

The *Draft Law* developed by the Working Group proposes a qualification standard for state budget subsidies of three percent or more of the total vote in Saeima elections for political organizations and four percent of the vote for associations of political organizations. The Saeima Election Law requires parties to win five percent of the vote in order to be awarded seats; thus, the proposed qualification standard is reasonably generous. The setting of separate standards for 'political organizations' and 'associations thereof' adds unnecessary complexity, however (see discussion below).

Determining the formula for distribution of state budget subsidies to qualified political parties depends upon policy objectives and political circumstances, since funding approaches may have significant impact upon parties and the political structure. As described above, the policy choice for a distribution formula generally involves choosing between values of equity and proportionality – although most public funding systems try to reach a balance between the two values.

The *Draft Law* provides that political organizations and associations that qualify for state budget subsidies are to receive an annual grant of sixty santims per vote received in the prior Saeima election. This approach is based purely upon proportionality: the amount of funds each political party receives is determined by and proportionate to its performance in the prior election. Thus, the distribution formula does not otherwise seek to advance 'equity' values to diminish advantages of larger parties, and will actually reinforce those advantages. Reliance upon parties' vote percentages will almost certainly create significant disparities in subsidy amounts.

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**Illustration:** By its terms, the *Draft Law* would not be implemented until after the October 2002 Saeima elections, and distribution of state subsidies to political parties would be based upon those new election results. However, for purposes of examining potential consequences of the *Draft Law's*

proposal, it is instructive to see how the successful parties competing in the 1998 Saeima elections would have fared in annual state subsidy distribution, based upon 60 santims per vote<sup>25</sup>:

| <u>Party</u>  | <u>1998 Vote</u> | <u>Subsidy (lat)</u> |
|---|------------------|----------------------|
| Popular Party – Tautas Partija  | 21.30% 122,151   |                      |
| Alliance “Latvia’s Way” – Savieniba “Latvijas Cels”                                 | 18.15% 104,052   |                      |
| Alliance “For Homeland and Freedom”/LNNK –<br>Apvieniba “Tevzemei un Brivibai”/LNNK | 14.73% 84,464    |                      |
| National Harmony Party – Tautas Saskaņas Partija                                    | 14.20% 81,420    |                      |
| Latvian Social-Democratic Alliance –<br>Latvijas Sociāldemokrātu Apvienība          | 12.88% 73,834    |                      |
| New Party – Jauna Partija   | 7.35%            | 42,128               |
| Latvian Farmers’ Union – Latvijas Zemnieku Savienība                                | 2.48%            | 0                    |
| Alliance: DP/LKDS/LZP   | 2.30%            | 0                    |

No political party received between three and five percent in the 1998 elections; thus, no party would have qualified for state budget subsidies that was not awarded seats in the Saeima. The six political parties that won seats in 1998 (and would have qualified to receive funding under the formula of the *Draft Law*) represented 88.6% of the vote. At 60 santims per votes of qualified parties, annual subsidies to parties would have been just over a half million lats.

If the *Draft Law's* rules had been in effect after the 1998 election, the party receiving the least state budget subsidy would have received about a third of the funds distributed to the party receiving the most subsidy. However, if a political party had received 3.1% of the 1998 vote (approximately 28670 votes), it would have been entitled to 17,200 lat, or approximately 14% of the funds for which the most successful party in 1998 would have qualified (assuming all other factors constant). Whether these levels of disparity in political party funding would be desirable as a policy matter (or politically acceptable) in future application of a state budget subsidy system is a decision for Latvian politicians. Clearly, however, political dissension could arise if differences in public funding were as much as a seven to one ratio. The public could see such a system as unfair.

**Recommendation:** Alternatives should be considered that would provide some balance between equity and proportionality principles. One option is to set a minimum ‘floor’ and a maximum ‘ceiling’ for state budget subsidies to parties. Setting a minimum assumes a basic level of necessary operational expenses for every qualified party. Setting a maximum assumes that those operational costs do not grow arithmetically with parties’ size or success and can be capped.

- The minimum could be set at 25,000 lats for any political party that qualified for state budget subsidies with 3% (or 4%) or more of the vote. In 1998, at 60 santims per vote, that would be equivalent to having received 41,667 votes (4.36% of the vote), not significantly higher than the threshold qualification. Any qualified party getting more votes than needed to deserve the minimum amount of subsidy (in 1998, more than 4.36%) would, of course, receive a subsidy at a higher level according to its vote percentage.
- The maximum could be set at 100,000 lats. In 1998, only two parties would have exceeded that amount based on their vote percentage.

Thus, under this approach, no party would receive state budget subsidies that were more than four times the minimum that the smallest parties receive.

<sup>25</sup> Total vote: 955,581. Vote results from [www2.essex.ac.uk/elect/electer/latvia\\_er\\_nl.htm](http://www2.essex.ac.uk/elect/electer/latvia_er_nl.htm).

A second option would be to have a two-tiered formula (as in Germany). That formula could involve subsidies for political parties of 1.0 lat per vote up to a certain level of votes in the prior election, and 40 santims per vote above that level. This approach would also provide a floor of funding for smaller qualified parties and lessen disparities in subsidies between large and small parties.

## TERMINATION, MERGER OR SEPARATION OF POLITICAL PARTIES

Laws providing for a system of state budget subsidies for political parties should anticipate situations where parties terminate, merge (combine), or separate (divide). These possibilities are of special concern in a relatively new democracy in which parties and coalitions are still in dynamic transition. The Working Group's *Draft Law* gives considerable attention to these issues.<sup>26</sup>

This report will discuss below the drafting problems arising in the *Draft Law* from attempting to distinguish between political organizations and their associations. Obviously, these aspects are compounded in the *Draft Law* by setting two different qualification standards for public funding for political organizations (3%) and for associations (4%), which must be considered in the context of merger and separation.

The *Draft Law* properly determines that a political organization or association that terminates its operation loses its right to public funding. The idea of combining subsidy amounts in the case of merger of political parties is also satisfactory.<sup>27</sup> However, the law

<sup>26</sup> Provisions relating to party funding qualification, and termination, merger or separation, include:

- Political organizations [not associations] shall have a right to state budget subsidies if they gained at least three percent of total number of votes in the Saeima election (Article 3(3));
- A political organization that terminates its operation, or is dissolved because of failure to observe legal requirements, loses its right to a state budget subsidy (Article 3(5));
- Direct state funding of political parties is stopped if the Saeima is prematurely dismissed (Article 3(6));
- State budget subsidies given to political organizations are combined in the event organizations merge (Article 7(1));
- In case of separation of political organizations that previously gained at least five percent of total number of votes [thus awarded seats in the Saeima], state budget subsidies shall be redistributed proportionally according to the number of members of the [newly separate] political organizations in the Saeima (Article 7(2));
- In case of separation of political organizations that previously gained at least three percent of total number of votes, but did not gain seats in the Saeima, state budget subsidies shall be redistributed proportionally according to the number of registered members of the [newly separate] political organizations (Article 7(3));
- Associations of political organizations shall have a right to state budget subsidies if they gained at least four percent of total number of votes in the Saeima election (Article 8(1));
- In case of separation of associations of political organizations that previously gained at least five percent of total number of votes [thus awarded seats in the Saeima], state budget subsidies shall be redistributed proportionally according to the number of members of the [newly separate] associations of political organizations in the Saeima (Article 8(2));
- In case of separation of associations of political organizations that previously gained at least three percent of total number of votes, but did not gain seats in the Saeima, state budget subsidies shall be redistributed proportionally according to the number of registered members of the [newly separate] associations of political organizations (Article 8(3));
- An association of political organizations that terminates its operation loses its right to a state budget subsidy (Article 8(4)).

<sup>27</sup> **Example:** The issue of the effect of 'amalgamation' (merger) of political parties upon public funding arose recently in Ireland, when the Democratic Left merged into the Labour Party in 1999. By terminating

should not permit small parties that did not qualify for public funding (not having reached the vote threshold) to combine after the election (or combine with a qualifying party) in order to receive a state budget subsidy. And merger becomes more complicated if the system involves minimum and maximum subsidies (discussed above).

It is more difficult to set a formula for redistribution of state budget subsidies in the event of separation of political parties<sup>28</sup>, especially if a political party qualified for public funding but not represented in the Saeima separates into two or more entities. The solution in both Articles 7 (political organizations) and 8 (associations) of the *Draft Law* – to redistribute according to the number of “registered members” – is unrealistic, arbitrary and subject to manipulation. Again, it is further complicated if the system involves minimum and maximum subsidies (discussed above).

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**Recommendation:** The law should adopt a general presumption that when any party separates into two or more parties, each new party will be deemed to have gained an equal share of votes in the prior election and shall be qualified (or not qualified) to receive state budget subsidies accordingly – unless the new parties agree to a different disposition. This approach may permit parties to separate to maximize their subsidy if the law provides for a minimum ‘floor’ or maximum ‘ceiling’ or a two-tiered approach; however, political consequences of separation should discourage such maneuvering.

If the program for state budget subsidies for political parties involves minimum and maximum levels of subsidies, or a two-tiered approach, the law should provide in the case of a merger of political parties:

- No additional subsidy shall be provided if a political party, not itself qualified to receive public funding, joins with one or more other political parties;
- A combination of political parties already qualified to receive public funding shall be entitled to at least the minimum subsidy provided by law, but no more than the amount of their combined Saeima vote times the subsidy rate – minimum subsidies are not combined;
- Total subsidies of merged political parties shall be subject to the maximum limit of state budget subsidies.

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## POLITICAL ORGANIZATIONS AND ASSOCIATIONS THEREOF

The Working Group's *Draft Law* illustrates practical problems arising from the concept of an ‘association of political organizations.’ These problems are evident in the *Current Law* but become more troublesome with regard to proposed state subsidies.

### Legal Status

The legal status of associations of political organizations as ongoing entities is unclear under Latvian law. Article 2 of the Law on Public Organizations and their Associations generally provides: “An association of public organizations shall be founded by two or

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its registration as a party, the Democratic Left lost its qualification to further public subsidies. A bill is now pending to amend the Electoral Act of 1997 (which introduced public funding for political parties) to provide that when one or more parties join another, or two or more parties form a new party, the subsidy for the resulting enlarged or new party (if it qualifies for funding) will be based on “the total number of first preference votes obtained by every candidate of each former party ...” (Ireland uses a ‘preferential’ voting system for its parliament.) Unfortunately, the proposed amendments in Ireland do not address the more difficult problem arising when an existing (qualified) party separates into two or more parties.

<sup>28</sup> **Example:** In Hungary, political parties which break up into new parties are to decide themselves about distribution of property. See: §7 of Law No. XXXIII of 1989, On the operation and financial functioning of political parties, as modified by Law No. LXII of 1990.

more public organizations by mutual association and by establishing a common management institution for the coordination of activities.” Additional and specific provisions for political organizations are contained in Chapter Two, Section IX (Articles 43-49). This section repeatedly uses the expression “political organizations (parties)” – equating the two – and does not mention associations of political organizations anywhere. Compare Section XII in Chapter Two, containing additional provisions for public sports organizations and, specifically, their associations.<sup>29</sup>

Thus, associations of political organizations seem to be generally permitted, but not specifically contemplated, by the basic law on public organizations. Associations of ‘political parties’ are actually the creation of the Saeima Election Law and the Law on Financing of Political Organizations (and also the Law on Election of City, County and Pagasts Councils).

This development is not necessarily wrong; election laws in other countries provide for associations or ‘blocs’ of political parties to combine for purposes of nominating candidates and meeting vote thresholds to receive legislative seats.<sup>30</sup> But these combinations undermine an effort to institutionalize parties on a long-term basis, and complicate a system of state budget subsidies that treats parties and associations of parties differently.

As mentioned above, the Latvian law regarding public organizations provides that associations of public organizations should establish a common management institution to coordinate their activities. The two associations of political organizations that earned seats in the 1998 elections operate in Saeima in the same manner as political parties, including rights to committee assignments and staffing and other resources. Thus, the distinction between political organizations (parties) and associations thereof appears to be in name only after elections. It may not be worth maintaining this distinction if it causes problems in ongoing application of political party finance laws.

### Law Drafting Problems

Problems with law drafting that arise from maintaining the concept of an association of political parties are shown in the Working Group’s *Draft Law*. Article 1(1) (as in the *Current Law*) states that the term “political organization” shall “hereinafter” refer to both political organizations and associations thereof. That drafting convenience is quickly abandoned in the draft, however.

- Article 3(3) states that the right to receive state budget subsidies shall be granted to any political organization that receives at least three percent of the total number of votes in the Saeima elections; Article 3(4) repeats that general qualification threshold for state funding in another context. But Article 8(1) later states that the qualification threshold for state funding for associations of political organizations is different: having received at least four percent of the total vote in Saeima elections.
- Article 3(5) states that political organizations that terminate operations or fail to fulfill legal requirements lose their right to receive state budget subsidies. Article 7 states that political organizations that merge shall receive their combined state subsidies (and also addresses separation of political organizations). Article 8 later says that associations of political organizations that terminate lose their right to state budget subsidies, but does not mention that consequence for failure to fulfill legal

<sup>29</sup> As with Section IX regarding political parties, Section X (additional provisions for foundations), Section XI (additional provisions for professional associations) and Section XI-1 (additional provisions for organizations of creative professions [artists]), also do not mention associations of these groups. The law seems to distinguish which organizations can appropriately or reasonably combine into associations.

<sup>30</sup> See, e.g., *Law for Election of State Duma Deputies* in the Russian Federation.

requirements. And Article 8 does not mention merger of associations (or, presumably, merger of associations and single political organizations).

- Article 7 and Article 8 of the *Draft Law* separately regulate the redistribution of state budget subsidies for political organizations and associations of political organizations in the event of separation into two or more political organizations (corresponding to the different qualification thresholds for funding of three and four percent, respectively).<sup>31</sup>

From a drafting standpoint, these problems in the Working Group's draft law could be cured by:

- Eliminating the "hereinafter" reference in Article 1(1), and redrafting Articles 3, 7 and 8 to better distinguish between "political organizations" and "associations of political organizations"; or
- Making qualification thresholds for state budget subsidies the same for both political organizations and associations thereof, and redrafting to combine elements of Articles 3, 7 and 8; or
- Providing in Article 1(1) that the term "political party" will be used thereafter to refer to both political organizations and associations thereof, treat them the same, and then rewrite the entire Draft Law accordingly.

The third option would recognize that the legal distinction between political organizations and associations thereof is not worth preserving outside the area of candidate nomination and election. Once associations of political organizations have qualified for public funding (and, certainly, once they have qualified for seats in the Saeima), they should move beyond the temporary mechanism of 'association' and be viewed as political parties.

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**Recommendation:** Lawmakers in Latvia should reconsider the status of 'associations of political organizations' under the law, with a view toward recognizing their limited and temporary purpose in nominating and electing candidates. Instead of becoming permanently distinct legal entities, associations of political parties that succeed in winning Saeima seats (or in qualifying for state budget subsidies) could be viewed as simply "political organizations (parties)" as contemplated by the Law on Public Organizations and their Associations.

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## ADDITIONAL DRAFTING ISSUES AND RECOMMENDED CHANGES

The *Draft Law* is fairly comprehensive. But it would benefit from some reorganizing and refining so as to group related elements and make points more clearly. The sections on state budget subsidies, although new and important, would be more appropriately placed further into the law.

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- **Article 2:** Sources of Funding.
  - **Article 2(4):** Services provided to political parties without payment to those providing the service are a permitted source of funding.
  - **Article 2(5):** 'Donation' defined.
  - **Article 15(4):** Defines services provided to political parties without payment for such services as equivalent to material donations for purposes of law.
  - **Article 15(5):** Value of services provided to political parties [presumably without payment] may not exceed legal limits on donations.

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<sup>31</sup> These provisions of the draft law also illustrate practical problems of implementation in the event of merger or separation for purposes of redistribution of state budget subsidies (discussed above).

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- **Article 15(6):** Political parties may refuse donations.

These provisions disperse or mix ideas about controls upon financial and non-financial donations, and should be consolidated in basic provisions and definitions for political party funding within a revised Article 2.

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- **Article 15(2):** Requires political parties to appoint a person or group of persons to determine value of each material donation.
- **Article 15(3):** Requires a 'certified evaluator' to determine the value of donated real estate, vehicles, or computer hardware.

As discussed elsewhere in this report, requirements for certifying the value of donated materials or services are well intended but too complicated, and should be consolidated with responsibilities of the party Finance Officer for all record-keeping and reporting.

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- **Article 14:** Funding Restrictions.

This provision should be renamed 'Prohibited Donations' and should be moved up to become new Article 3, following provisions on permitted sources of funding (Article 2). As discussed elsewhere in this report: the provision banning donations from foreign institutions (14(1)(5)) should specifically include 'foreign governments'; the provisions banning donations through 'third party' intermediaries party-founded foundations (14(2)&(3)) should be strengthened to clearly prohibit contributions that are reimbursed or advanced ('contributions made in the name of another').

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- **Article 16:** Prohibition of Anonymous Donations

This provision (if separate) should follow 'Prohibited Donations' as new Article 4.

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- **Article 11:** Donations

This section should be renamed 'Limitations Upon Donations' and moved up to become new Article 5. Paragraph (4) is a penalty, and should be integrated into an article regarding penalties and sanctions at the end of the law.

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- **Articles 3, 4, 5, 6, 7 & 8:**

These issues are discussed elsewhere in this report.

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- **Article 6(2):** Political parties not permitted to place state budget subsidy funds in credit institutions for purposes of gaining profit (earning interest).

This provision appears to be based on some sense that parties should not make money with public funds (mentioned again in Article 12). It should be permissible for all political party funds to be productive in an interest bearing account while unspent, and it should be impermissible for any party funds to be deposited in or invested through any non-standard account (cannot be gambled away on risky investments). Nor should parties be encouraged to spend public funds more quickly. As long as funds (or interest earned from funds) are only used for appropriate expenses of the political party, and kept in accounts that are fully reported, there is no harm if some interest is earned.

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- **Article 15(1)**: Requires all monetary donations to be directly transferred to the bank account of the political party; requires material donations to be transferred to recipient political party, and specifies circumstances of transfer of material donations must have written confirmation.

It is understandable that most financial transactions in Latvia occur by means of bank account transfers. Also, it is valuable to use bank transfers as a means of authentication of the donor and documentation. But the *Draft Law* and *Current Law* make it difficult for private donors to make donations to political parties – particularly membership fees which, while subject to limits and other controls on donations, are probably not very large in amount. Further discussion is in Part Five of this report.

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- **Article 15(7)**: Provides that confirmation form for material donations shall be subject to approval by Cabinet of Ministers.

Forms related to implementation of election law or political party finance law should be determined by the Central Election Commission. The Cabinet of Ministers should not be involved in such administrative detail.

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- **Article 19**: Subjects ‘management’ [expenditures] of state budget subsidies to laws controlling state expenditures and procurement by state and municipal governments [orders], including requirement for ‘competitive bidding’ if an order exceeds 1000 lats.

This provision adds far too much ‘red tape’ into management and spending of public funds by political parties; requiring competitive bidding would be particularly onerous. Although the law can and should impose certain restrictions or obligations upon parties regarding state funds, parties do not become state government bodies by accepting the subsidies. The law should not over-regulate or complicate parties’ spending of public funds, as long as spending is for administrative expenses of the party and properly reported/disclosed. Parties should be entitled to pick their vendors and, within reason, favor their supporters (including for reasons of confidentiality of political strategy in their planned expenditures). A policy of state subsidies for political parties must have confidence in reporting and disclosure as a means of controlling ‘self-dealing’ or other abuses of public funds.

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- **Articles 21, 22, 23, 25 & 26**: Declaration of Financial Activity (reporting), Transparency, Disclosure, Audits and Accounting.

Discussed in Part Six of this report (Transparency & Accountability).

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- **Article 24**: Consequences of political party’s failure to submit Declaration of Financial Activity.

Discussed in Part Eight of this report (Sanctions & Penalties).

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- **Article 25**: Audit of Financial Operation

Discussed in Part Six of this report (Transparency & Accountability).

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- **Article 26**: Accounting Regulations

Discussed in Part Six of this report (Transparency & Accountability).

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## **CENTRAL ELECTION COMMISSION:**

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## INDEPENDENCE, RESOURCES & EXPERTISE

Since the Law on the Central Election Commission was enacted in 1994, the CEC of Latvia has been responsible for implementing the election process, conducting civic and political party education programs, supervising and training local election officials, and other traditional election administration functions. The CEC has organized Saeima elections, local elections and two referenda in recent years. The CEC is generally well regarded as capable, professional and nonpartisan. As a government agency, however, Latvia's CEC is relatively small and under-financed.

Article 20 of the *Draft Law* provides that the CEC shall control and supervise the transparency and compliance of financial operations of political parties with the requirements of the *Draft Law* and other laws. It should be apparent that giving additional and significant responsibility to the CEC will demand a commitment of financial and personnel resources to permit the CEC to develop expertise in this area and to effectively carry out such duties. Responsibility for political party finance will also inject the CEC more deeply into partisan politics, which will require extra effort to preserve its budget and operating autonomy. A discussion of the role of monitoring and enforcement bodies in regulation of political party finance, with recommendations for Latvia, is in Part Seven of this report.

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**Recommendation:** The *Draft Law* intends for implementation of state budget subsidies for political parties to begin following Saeima elections in October 2002. Public funding would be provided annually beginning in 2003. If public funding is adopted, the revised law should include a provision that directs the Cabinet of Ministers to appoint an independent and non-partisan commission in 2005, a year before the following Saeima elections, to assess implementation of the program for state budget subsidies and to issue a report with recommendations for possible improvements.

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## Part Five: Legal Controls and Other Regulatory Issues

### REGULATION OF POLITICAL PARTY FINANCE

#### Types of Controls

Political finance laws in modern democracies impose a wide range of legal controls upon political party (and candidate) financing. These include: prohibitions upon certain types of contributions, limitations upon the amount of contributions, limitations or prohibitions upon certain kinds of expenditures and limitations upon total amount of (campaign) expenditures. Such controls also include requirements for record-keeping, periodic reporting and public disclosure of political finance information by parties (discussed in Part Six of this report).

Specific elements of these controls vary greatly among modern democracies and are largely a matter of policy choices for each country. There are generally no 'absolute' right or wrong choices or magic formulas for these regulations, except that they must be reasonable and fair: as a matter of their practical impact on parties and candidates (and their supporters) who are regulated, and as a question of credible enforcement. Unreasonable restrictions limit political expression and competition, and push political financing outside a regulated and publicly disclosed system – towards 'off-the-books' spending.

#### Jurisdictional Scope / Accountability

Legal controls on political party financing are not effective if the jurisdiction of the law is defined too narrowly or in isolation from other political activity. Restrictions upon political party receipts and expenditures, and requirements for disclosure, must encompass all political finance activity that is undertaken by or on behalf of the parties (and their candidates). Otherwise, these rules become merely a formality and a sideshow to politics.

Moreover, political parties and individual persons must be held accountable for complying with the restrictions and disclosure requirements of the law. Accountability is even more crucial when political parties receive subsidies from public funds.

No political finance system is seamless and without potential loopholes, but the most obvious opportunities for evasion and avoidance of the law should be addressed from the start. The proper jurisdictional scope of the law, and the placing of accountability in parties and their officers, can be achieved through careful definition and rule-making in the law itself.

Thus, to protect and facilitate political finance regulation, the proper scope of legal regulation and standards for accountability must be clearly articulated in laws regarding elections, political parties and political financing. Since these issues are directly related to transparency and disclosure (as well as regulation), they are discussed more fully in Part Six. A related issue, 'third party' or independent spending, is discussed below.

### RESTRICTIONS UPON RECEIPTS AND EXPENDITURES

#### Prohibitions Upon Certain Types of Contributions

Political finance laws generally prohibit political parties and candidates from receiving certain types of contributions. The Working Group's draft Law on Financing of Political Organizations and their Associations prohibits political parties from receiving donations from:

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- Employees of the Central Election Commission;
  - Municipalities;
  - Trade Unions;
  - State and municipal institutions and enterprises, including companies where government ownership of stock exceeds 50%;
  - Foreign institutions, enterprises, organizations and individuals; and
  - Religious organizations.
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**Recommendation:** The law should more clearly state two prohibitions:

- Political organizations may not accept monetary contributions, or donations in any form, from foreign governments.
  - It is prohibited to use any State or municipal funds, personnel, facilities, supplies, materiel, equipment, or any other State or municipal resources in support of political organizations or for election campaign purposes, except as specifically authorized by law.
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The *Draft Law* also includes three prohibitions regarding State subsidized enterprises or those contracting to provide goods or services to the State. While the policy interests behind these restrictions may be justifiable, drafting should be careful not to be over-inclusive; the scope of financial interaction with governments is typically quite broad in modern societies, and these prohibitions may be more encompassing in application than desired.

Finally, the Draft Law prohibits parties from receiving contributions through ‘intermediaries’ and from establishing political party foundations (or other intermediary funding organizations). The first issue is extremely important and should be more clearly addressed; the second is reinforced by accountability requirements for parties to operate and make expenditures exclusively through a designated account (discussed in Part Six).

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**Recommendation:** The law should include a clear statement of the following:

- Contributions passed through an intermediary, or falsely reported in the name of another person or entity, are prohibited. A person or entity making a contribution to a political party, and who is identified on a party’s political finance disclosure report as the contributor, may not receive funds from another person or entity (including any advance payment or reimbursement) to make such contribution. No person or entity may distribute funds (or tangible goods) to another person or entity with the intention or understanding that the recipient will contribute such funds (or goods) to a political party.
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### **Limitations Upon Amount of Contributions**

The current Law on Financing of Political Organizations sets a limitation upon contributions to a particular political party by either natural persons or legal entities at no more than 25,000 lats per calendar year. The *Draft Law* proposed by the Working Group would reduce these limits significantly:

- Natural persons would be limited to donations of no more than 1000 lats per year (approx. 1600 USD) to a party; and
- Legal entities would be limited to donations of no more than 5000 lats per year (approx. 8000 USD) to a party.

Deciding the limitation amount for contributions is truly a policy choice that depends upon political culture and circumstances of each country. And the figures proposed in the *Draft Law* are not unreasonably meager (somewhat less generous than combined contribution limits to candidates in USA for primary and general elections [which have not changed for over 25 years]).

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Nevertheless, setting low contribution limits invites evasion and ‘off-the-books’ spending, particularly when instituted in a drastic reduction from prior law. Low limits also may starve parties that depend upon larger donations. Concern about influence of ‘special interests’ can be addressed through reasonable limits and strong reporting and public disclosure policies. Thus, policy-makers should be careful they do not enact limitations that will be widely disregarded and undermine legal compliance and transparency.

### **Expenditure Limitations**

Limits upon total election campaign expenditures by political parties or candidates (also called spending ‘ceilings’ or ‘caps’) are favored in a few countries (such as Canada, Israel and South Korea) as a way to reduce overall political spending and ‘level the playing field’ among competing parties or candidates. Expenditure limits are not easily monitored and enforced, and invite evasion through ‘off-the-books’ or ‘third-party’ spending (but, see next recommendation).

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**Example:** Under the Canada Elections Act, Candidates and registered parties are subject to an election expenses limit based on the number of electors registered on the voters list for the constituency (most recently based on 62 Canadian cents per number of registered voters [subject to inflation adjustment]). (§§ 414 & 422)

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**Example:** In the United States, the Supreme Court has held limitations upon candidate expenditures under political finance laws to be an unconstitutional burden upon their right of free speech under the U.S. Constitution’s First Amendment – unless such limits are accepted ‘voluntarily’ by candidates as a condition of receiving public funding.<sup>32</sup> Thus, expenditure limits are set in federal election law only for elections for U.S. President (not for U.S. House or Senate). A program of subsidies based upon matching small private contributions is provided in the presidential primaries, with state-by-state and national spending limits. A full grant is provided to major party candidates for the general election, who agree to raise no private funds for the general election campaign and abide by an expenditure limit that equals the grant. Because of cost-of-living adjustments since 1976, the grant of federal funds in the 2000 election for each of the Gore-Lieberman and Bush-Cheney campaigns reached 67.56 million USD.<sup>33</sup> Similar ‘matching’ or grant programs of public funding, coupled with spending limits, have been enacted in a few American states.

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### **Restrictions Upon Media Advertising**

Some countries, such as Great Britain, have outright prohibitions upon political advertising. Others, such as France, place severe limits upon such advertising. These approaches are viewed as a key method for limiting political expenditures and ‘leveling the playing field’ among parties, as well as avoiding overly negative or simplistic ‘sound-bite’ political appeals.

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<sup>32</sup> See Buckley v. Valeo, 424 U.S. 1 (1976). The Buckley case, and its important distinction between legal limits upon political giving (contributions) and limits upon political spending, has cast a long shadow on political finance regulation in the United States and continues to be controversial. For a description of the consequences of Buckley and critique of its application, see, e.g., Buckley Stops Here: Loosening the Judicial Stranglehold on Campaign Finance Reform, E. Joshua Rosenkranz (The Century Foundation Press, New York 1998).

<sup>33</sup> For more information, see [www.fec.gov](http://www.fec.gov). The campaign of George W. Bush declined to participate in the ‘matching’ subsidy program in the 2000 presidential primary period, presumably to avoid spending limits in each contested state and the overall limit (raising over 100 million USD in the primaries), but Bush and the Republican Party accepted the federal grant in the general election and its spending limit.

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These restrictions may work in countries with a smaller number of well-established parties. But in a new democracy based upon multi-party elections, severe restrictions upon media advertising would limit dynamic party development and under-inform voters about their choices. Moreover, such regulation is extremely difficult to monitor and enforce.

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**Example:** France has remarkably strict rules about television advertising: only political parties, not candidates, may purchase air time or sponsor advertisements; each party's total number of advertisements is limited according to a formula based upon the proportion of votes received in a prior election; political advertisements are permitted on public broadcast stations only; detailed restrictions apply to content and production aspects of political advertising; all campaigning expenditures are restricted to the month before of the election.

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**Recommendation:** This report suggested in Part Four that availability of free broadcast time to political parties during the election campaign could be conditioned upon a party's agreement to not purchase (and not permit other persons or groups to buy on its behalf) additional media advertising time beyond prescribed limits (for example, purchases of media advertising could not exceed an amount comparable to the time allocated to a party for free, or perhaps twice that amount). This approach would serve to place a limit upon media advertising, which increasingly constitutes the largest share of campaign expenses. As noted earlier, this restriction would not operate fairly or effectively unless free broadcast time allocated to political parties was substantial.

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#### **'In-Kind' (Non-Monetary) Donations**

A political finance law must anticipate 'in-kind' (non-monetary) donations being provided to political parties (and candidates), particularly during the election campaign. Non-monetary donations can take many forms: goods and supplies, vehicles, fuel, computers and office equipment, real property, use of office space or other facilities, or the personal services of the donor or donor's employees.

While theoretically easier to monitor than money, donations of facilities, goods and services are often difficult to control because donors and recipients do not think of them as contributions, and documentation is not made of their transfer or use. Party leaders in Latvia acknowledge that 'in-kind' donations are widespread and generally unreported.

The draft Law on Financing of Political Organizations and their Associations continues the current law's defining of a transfer of "movable or immovable property owned by a natural or legal person" as a "donation." Article 15 then addresses this issue extensively. This new provision not only requires that the circumstances of such donations be highly documented, but that:

- Donations of material goods must be accompanied by a written confirmation;
- Each party must appoint a permanent officer with specific responsibility for determining the value of material donations, and
- Donations of real estate, vehicles or computer hardware must be determined by a 'certified valuator.'

This provision also states that donations of services, as with material donations, are subject to contribution limits.

Article 21, regarding the contents of the annual Declaration on Financial Operation report, includes the following categories of itemized receipts:

- "8) movable and immovable property received as donations, including the donor of each part of property;" and
  - "11) donations provided to the political organization concerned as services, specifying each donor and the value of each donation in monetary terms;"
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**EXAMPLE.** The Political Parties Act of Estonia distinguishes between monetary donations, non-monetary gifts and “support of activities.” Non-monetary gifts include “a service provided to a political party without charge if the service is provided by an enterprise, company or institution for which the provision of such service is a business activity or [expense], or if a third person pays to the service provider for the service in full or in part.” For “support of activities,” the law provides:

- 1) An activity support is the sale of goods or provision of services at a price lower than the market price by an enterprise, company or institution for which the sale or provision of the service is a business activity or [expense].
- 2) The value of an activity support is the difference between the market price of goods or services during the sale or provision thereof and the price paid by the political party.
- 3) The supporter of activities shall assess the monetary value of the activity support and forward it to the political party. A committee or valuator designated by the leadership of the political party shall present its assessment of the value of an activity support, which shall be indicated in the report.
- 4) The same requirements and restrictions apply to the making and acceptance of an activity support as to monetary donations.

The Political Party Act of Estonia further provides that upon acceptance of a donation, at the request of the donor, the political party shall issue a document certifying the making of the donation and acceptance thereof by the political party. The Act also provides that political parties shall maintain a separate register of donations, for which the Minister of Finance shall establish the format pursuant to the Act.

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**Example:** In the United States, under the Federal Election Campaign Act, donations of goods and services (‘in-kind’ contributions) are reported as both a receipt and an expenditure by the recipient political committee (including political party committees and candidate committees). The accounting necessity is to keep the financial account balanced. The theory is that the committee has received a contribution in the value of the goods or services (or the difference between their market value and the amount paid by the committee) and has essentially also made a disbursement in the same amount for the goods or services – as if it bought the goods or services itself.

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**Recommendation:** The provisions in the *Draft Law* regarding material (non-monetary) donations are a good improvement over the *Current Law*, but should be consolidated, simplified and strengthened to include these statements:

Donations received by a political party (or candidate) in the form of services, goods, property or use of property, or any other non-monetary or material donations, whether accepted directly or indirectly, are regarded as contributions to such party if not paid for by the political party at full and fair market value.

- Such contributions are equivalent to monetary contributions under the law, are subject to the prohibitions and restrictions of this law, and shall be reported by the party receiving such contributions in political finance disclosure reports as a contribution.
- The amount of an in-kind contribution shall be determined at the fair market value of the services, goods, property or use of property, less any payment by the party or candidate for such goods or services.
- Persons may volunteer their personal time (or use of their personal residence) for election campaign purposes without such time (or use) being viewed as a contribution, as long as such persons are not paid or reimbursed for their time (or use of residence) by any other person or entity.

Reporting forms must either: treat non-monetary donations as an expenditure as well as a contribution, or exclude them from the total of contributions for purposes of reaching a balance of cash-on-hand.

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While the *Draft Law's* effort to place accountability for valuations of non-monetary donations in a particular person is good, that objective should be sought on a more comprehensive basis. Responsibility for determining the value of non-monetary donations should be with the officer of the political party responsible for compliance with all record-keeping and periodic reporting of the party pursuant to the law (see discussion in Part Six regarding political party 'Finance Officer').

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## DEFINING SCOPE OF 'POLITICAL ACTIVITY' AND 'DONATIONS'

A recurring problem in political finance regulation is how to fully and properly define the scope of regulated political activity – especially what constitutes a 'donation.' Regulation and disclosure of political finance activity is not effective if the reporting entities (such as political parties) conduct some or most of their activity 'off-the-books' or through surrogate organizations. Financial disclosure reports become a meaningless formality unless they encompass all relevant spending by (or on behalf of) the reporting entity. These issues of scope (and accountability) for political party finance regulation are discussed in the part of this report.

A related aspect of scope and definitional problems in regulating political finance is the supposedly or nominally independent activity of outside 'third party' persons or groups. Although political finance laws usually address the issue of material ('in-kind') donations, as discussed above, that generally presumes both: 1) an obvious, tangible benefit for a political party (or candidate), and 2) some form of acceptance and 'receipt' of goods or services provided. This issue becomes even more difficult if action or providing of something is less clearly intended to influence an election, or the person or group acting or providing the benefit is doing so independently of the party or candidate benefited.

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**Example:** One expert observer describes the same problem arising in France at the time it adopted reforms in 1990:

"The apparently all-encompassing definition of an election expense remains to be interpreted. Although the 1990 law mentions that party funds used to directly assist a candidate must figure in that candidate's account, party expenditure is not limited, and spending that benefits candidates indirectly need not be accounted for by candidates. Depending on the meaning of indirect benefit, and the manner in which parties support their candidates, the effectiveness of candidate expenditure limits may be illusory.<sup>34</sup>

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### Independent Expenditures

Developed democracies generally do not want to punish or discourage acts of genuine 'free speech' and political expression by persons or groups. Much political dialogue in society involves public issues, public officeholders and candidates. An intention to 'influence an election' should not be imputed to all normal political discourse. And 'independent' speech and action, even if intended to influence elections, is not corrupting if conducted without coordination with parties or candidates nor intended as a means to evade political finance laws for parties or candidates.

Political finance systems take different approaches to regulating and disclosing the financial activity of outside persons or groups.

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<sup>34</sup> "Comparative Studies in Electoral Reform and Party Finance: France," by Don Padget, in compendium edited by F.L. Seidle and published by the Royal Commission on Electoral Reform and Party Financing in Canada in 1992 (p. 92).

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**Example:** In the United States, 'Campaign Guides' of the Federal Election Commission describe 'independent expenditures' and requirements for their reporting and disclosure:

An independent expenditure is an expenditure for a communication [to the general public] which expressly advocates the election or defeat of a clearly identified candidate but which is made independently of any candidate's campaign. Independent expenditures are special because, unlike contributions, they are not subject to any limits. However, an expenditure is "independent" only if it meets certain conditions: It must not be made with the cooperation or consent of, or in consultation with, or at the request or suggestion of, any candidate or any of his or her agents or authorized committees [11 CFR 109.1(a)]. An expenditure which does not meet the above criteria for independence is considered a contribution ...

A candidate is "clearly identified" in a communication when his or her name, photograph or drawing appears, or when his or her identity is apparent by unambiguous reference. [11 CFR 109.1(b)(3)].

A federally registered political committee reports independent expenditures on Schedule E of FEC Form 3X. A political committee must itemize each independent expenditure which exceeds \$200 or which, when added to previous independent expenditures made on behalf of (or in opposition to) the same candidate, aggregates over \$200 during a calendar year. Schedule E instructions explain what itemized information must be disclosed. (Independent expenditures of \$200 or less must be subtotaled and reported as unitemized expenditures on Schedule E.) [11 CFR 104.3(b)(3)(vii) and 104.4(a)]

Any other person (individual or group) must file a report with the FEC on Form 5 at the end of the first reporting period in which independent expenditures aggregate more than \$250 and must continue to file reports in any succeeding reporting period during the same year in which additional independent expenditures of any amount are made. [11 CFR 109.2(a)]. Form 5 instructions explain what information must be disclosed.

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**Example:** Canada recently tried to regulate 'third party' spending for election advertising. The law is directed to persons or groups (but not candidates or parties) that fund advertising messages that are transmitted to the public during an election campaign with a message 'that a reasonable person would understand as promoting or opposing the election of a candidate or political party, or as taking a position on an issue with which a candidate or party is associated.' A 'third party' must:

- Register with Elections Canada if it spends \$500 or more on election advertising;
- Identify itself on advertising;
- Not spend more than \$152,550 in total, or \$3051 in any one constituency, on election advertising;
- Appoint a financial agent to accept all contributions for election purposes and authorize all election advertising expense;
- Appoint an auditor if it spends more than \$5000;
- Not use anonymous or foreign funds for election advertising;
- Report information about donors of contributions prior to the election;
- Report financial details about election advertising expenses within four months after polling day.

However, both the limitations and reporting regime for Canada's 'third party' regulations have been successfully challenged in Canadian courts as an unconstitutional infringement of free speech; these cases are on appeal.

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**Recommendation:** It is possible to prescribe a regulation and format for reporting 'independent expenditures' made by persons or groups. But, as the examples show, it is complicated to administer and difficult to enforce such regulations. At this stage of Latvia's political development, it would be better to focus on preventing undue financial influence upon political parties and encouraging transparency of political party finance through reporting and disclosure. Transparency policies rely upon enforcement of reporting rules through monitoring and by government and non-government

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bodies. Although capable of evasion, this approach can deter the most egregious cases of 'off-the-books' spending by parties and candidates that act through surrogate persons or groups through collusion and coordination. It would be over-kill to attempt regulation or reporting of all truly independent political activity.

However, political finance regulation could impose reporting requirements upon media outlets, particularly television stations. Such regulation could require media outlets to:

- File a report identifying the person or group spending over a minimal amount for a paid communication to the public that mentions a political party, candidate or officeholder, or that makes reference to an election; and
  - Obtain a statement from the person or group that paid for such communication identifying the sources of all funds used to pay for the communication.
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### **'Grey Money' and 'Black PR'**

Similarly, the issue of more indirect and subtle forms of support for political parties and their candidates through biased journalism pose problems for drafting effective political finance regulation. Political pressure and influence upon reporters has been common in many Western countries. Bribing of journalists and biased news coverage (often based on government-friendly 'oligarch' owners of newspapers and radio and television stations) was reportedly widespread in recent elections in the Russian Federation.

The actual result of 'grey money' and 'black PR' are difficult to prohibit. Defining the nature and scope of such regulation and making distinctions in practice raise very difficult questions of semantics and intent. Trying to control or limit news media in reporting news or commentary about political parties or candidates is obviously a serious threat to freedom of the press; such controls are dangerous when implemented by partisan interests.

The better approach is to promote monitoring by civil society, and to encourage stronger internal controls by the journalist profession, perhaps through a professional code of conduct enforced by a professional association.

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**Part Six: Transparency and Accountability****TRANSPARENCY**

Transparency in political party finances is widely regarded as an essential element of democratic reforms. In the United States, legal restrictions upon political activity have been constrained by broad judicial interpretation of free speech rights; reporting and disclosure of political finance activity are viewed as the 'backstop' for preventing corruption of the political process. In established democracies of Western Europe, stricter controls upon political speech and action have long held priority over requirements for transparency; recent political finance scandals there have given new impetus to the need for reporting and disclosure. These developments illustrate the two primary benefits of transparency in political finance.

First, reporting and disclosure of receipts and expenditures by political parties (and their candidates) provides valuable information to news media, civil society and voters about the character of parties. Reporting of the source and amounts of contributions is particularly useful information in evaluating who supports parties and what policy implications such support reveals. Public disclosure of this information presumably acts as a check upon parties' excessive reliance upon particular special interests.

Second, reporting and disclosure is necessary to monitor, enforce and encourage compliance with legal controls upon political finance (such as prohibitions or limitations upon contributions). The entire regime of political finance regulation is meaningless if political finance activity cannot be scrutinized and rules cannot be enforced.

This report earlier suggested that state budget subsidies for political parties could be a valuable mechanism for building political parties as institutions and for diminishing parties' reliance upon private financing. A key premise of this report is also that public funding of parties might also be a politically necessary component of a larger reform package that would tighten controls on, and require greater transparency of, political party finances.

The political will to adopt stronger regulation and genuine transparency in political party finance will be difficult to rally in Latvia. The atmosphere in which government, politics and business are conducted in Latvia is widely viewed as not favorable to introducing transparent political financing. The Human Development Report 2000/2001 of the United Nations Development Program (UNDP) recently observed:

In Latvia, public policy is marred by a strong inclination towards seclusion. Closed public policy-making is marked by several features: a small number of decision-makers, considerable influence by business groupings in the decision of political issues (a factor that may be linked to corruption), a lack of transparency in decision-making procedures, and a disregard for public interests.

... [T]he closed policy mechanism operates as a relationship between party financiers and political leaders that is concealed from both the public and the media and is difficult to monitor. Its nucleus is a tripartite commitment between business groupings (party financiers), political leaders and the so-called "grey cardinals." Such relationships ensure the advancement of the interests of party financiers in political decisions, and often serve to satisfy the hidden interests of the politicians involved in such decisions.

... Closed decision-making generates an environment where corruption can thrive. A World Bank study published in 2000 on the spread of corruption in the Central and Eastern European countries recognizes that corruption concerning issues of national

importance in Latvia often manifests itself as the influence of economic groupings in government decisions, pressure on parliamentary deputies, the sale of deputies' votes regarding parliamentary legislation, and the lack of transparency in the financing of political parties.

Clearly, then, reforms intended to bring greater transparency to political party financing are part of the 'big picture' of anti-corruption measures needed today in Latvia.<sup>35</sup> Enacting such measures presents a major challenge to Latvian policy-makers, and works against their perceived short-term political interests. Nevertheless, this report proceeds on the assumption (and hope) that political finance reform is possible in Latvia and that its time has come.

Thus, the following recommendations for legal changes to require transparency in political party financing are comprehensive – even as such reforms might be difficult to enact and implement.

## ACCOUNTABILITY

Four accountability issues must be addressed in laws regarding elections, political parties and political financing in order to protect and facilitate political finance regulation and disclosure:

- 1) Funding accounts of political parties;
- 2) Role of candidates in political party financing;
- 3) Coordination with persons or groups outside the political party; and
- 4) Party officers responsible for political finance compliance.

These four issues are directly related to transparency and disclosure, because they are essential to defining the scope of political finance activity covered by reporting and disclosure regulations. If these issues are not addressed, then the funding of political activity that influences elections and is in support of parties and their candidates can occur outside the regulated and disclosed political finance system.

### Funding Accounts of Political Parties

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<sup>35</sup> **Example:** Latvia is not alone in facing endemic problems in bringing transparency to a political finance system. An expert observer in France described the situation prior to legislative reforms in 1990:

Before the reforms, candidates received some money from the parties and a small reimbursement from the State. ... With [legal] sources furnishing only a small portion of the funds required, many illegal practices and unaccountable cash donations became commonplace. Large business groups such as the Conseil du patronat français and trade unions were major supporters of the parties. Donations often took the form of false advertising contracts or overpriced subscriptions to publications of candidates or parties. Such cash transfers were facilitated by the existence of party newspapers and businesses. Some firms were hired by local governments as consultants at exorbitant fees, fausses factures, the excess of which went to finance the party's expenses as a kickback. In addition, parties in power were able to direct communications and marketing budgets of different departments to agencies that have the parties as clients during election campaigns. Municipalities and local bureaucracies offered services for their party's candidates such as the printing and distribution of brochures and hiring partisans as permanent employees to help build up local political organizations. ... Some of this scandalous activity was revealed in a series of police investigations dating back to 1986.

"Comparative Studies in Electoral Reform and Party Finance: France," by Don Padget, in compendium edited by F.L. Seidle and published by the Royal Commission on Electoral Reform and Party Financing in Canada in 1992 (pp. 79-80).

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A political finance law should make clear that legal controls and reporting requirements extend to all funds and accounts used by a political party (or its candidates). Parties should not be permitted to have ‘official’ accounts, which follow the rules and report their activity, and ‘unofficial’ accounts which operate outside the law.

Most political finance systems permit political parties to maintain more than one account, but require all reporting of party funding to be consolidated. In the United States, political committees are required to identify all bank depositories and all ‘affiliated’ committees (funds under their control or direction).

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**Example:** The Political Parties Act of Estonia requires parties to disclose information about all bank accounts opened on behalf of the political party (in Estonia or foreign states), including the name of the bank and bank account number (or other identification mark) for every account.

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### **Role of Candidates in Political Party Financing**

Political finance laws sometimes ignore the potential for candidates to raise and spend funds outside the party to further their campaigns. Candidate-based political systems usually address this issue directly and, as in the United States and Canada, provide for specific regulation and reporting requirements for candidate committees.

In party-based systems, such as Latvia’s proportional representation voting for the Saeima, the best approach is to require all activity in support of the party and its candidates to be directed through, and disclosed, in party accounts. This may be facilitated by requiring parties to maintain a separate account for election-related expenses during the election campaign period, and to separately report receipts and expenditures during that period.<sup>36</sup> Under this approach, candidates are viewed as agents of their political party; any donations to or spending by candidates must be through the party election account, and reported in the party financial disclosure report for the election.

### **Coordination with Persons or Groups Outside the Political Party**

A political finance law should not be easily evaded by operating through other nominally separate persons or groups. Truly independent political activity (discussed above), is generally protected as ‘free speech,’ and can be distinguished from activity that is done in coordination or cooperation with a political party or candidate. Coordinated activity is equivalent to an ‘in-kind’ contribution to the party; the act of seeking help from or coordinating with outside persons or groups is equivalent to acceptance and receipt of their spending. As contributions, coordinated activities are subject to contribution prohibitions and limitations and to reporting requirements for the political party receiving the benefit.

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**Example:** Campaigns of candidates in France are also subject to the ‘doctrine of agency,’ whereby accounts must also include expenditures made by ‘outside’ persons or groups that are deemed to directly or indirectly support the candidate:

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<sup>36</sup> Separate accounts for election campaign and non-election periods, with separate (but integrated) reporting requirements, also facilitate clearer accounting and better monitoring of state budget subsidies, which are generally provided for either election campaign expenses or (as recommended in this report) for institutional expenses outside the election period.

Candidates are to account for all expenditures made to favour them directly, with their agreement, even tacitly, by legal entities, political groups or individuals. "Directly" implies campaign activities specifically in favour of a candidate. Thus, expenditures by a political group [including parties] in a campaign to benefit all its candidates in general are excluded as they cannot be divided among individual candidates. Included is an estimation of the value of direct or indirect advantages, loans, services and gifts in kind from which the candidate has benefited. This essentially bars interest groups and others from using funds that are not subject to the campaign limit for assisting candidates. Moreover, no form of paid electoral publicity to benefit candidates is allowed without [the candidates'] agreement or that of their official agent. Both parties and interest groups might still try to mount a general campaign to favour a party and not a specific candidate; this would not appear to be contrary to the letter of the law.<sup>37</sup>

**Recommendation:** The political party financing law should clearly state that all funding activity for the party must be conducted out of official accounts. To facilitate separate regulation and reporting requirements during the pre-election campaign period, the law should require political parties to raise funds and make expenditures out of one account during the non-election period and another account during the election campaign time. The law should also clarify that political activities conducted in coordination with a party or its candidates are contributions, and that candidates may not raise and spend funds independently of their party. Model provisions for the Law on Financing of Political Organizations (or implementing regulations) would include:

*Official Accounts and Expenditures:*

- Each political party registered with the Ministry of Justice must establish an Operating Fund through an account in [type of bank or other depository].
- Local or other subordinate branches of the political party may establish separate accounts for operating expenses with the same [type of bank or other depository], but must report all receipts to and disbursements from such accounts to the national party office as part of the Operating Fund. The national party must report financial activity of local or other subordinate branches of the political party on financial disclosure reports for the Operating Fund.
- All expenditures made by a political party (by any official, representative or agent of a party) for administrative, development, or fund-raising activity, or any other institutional expenses that are not for election campaign purposes ("operating expenses") must be from the party's Operating Fund (including accounts of local or subordinate branches of the party). A political party may not use other funds or resources for operating expenses of the party apart from or outside of its Operating Fund.
- All funds received (or non-monetary donations accepted) by the Operating Fund are subject to the prohibitions and limitations of this law.
- A party (by any official, representative or agent of a party) shall not cause, request, authorize, consent to or coordinate with other persons or entities to spend other funds or use other resources for operating expenses of the party, unless such spending of funds or use of resources by other persons or entities is regarded as a contribution to the party. Such

<sup>37</sup> "Comparative Studies in Electoral Reform and Party Finance: France," by Don Padget, in compendium edited by F.L. Seidle and published by the Royal Commission on Electoral Reform and Party Financing in Canada in 1992 (pp. 83, 86-87).

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contributions are subject to the prohibitions and restrictions of this law and shall be reported by the party as contributions in political finance disclosure reports regarding the Operating Fund.

- Each political party that is qualified to receive state budget subsidies under this law, and that accepts such subsidies, shall open a separate State Funds Account through an account in [type of bank or other depository]. Parties shall use such Accounts to receive state budget subsidies and to make expenditures of such funds. Expenditures from this Account may of a similar nature to those made from the Operating Fund, but parties shall not transfer funds directly from this Account to any other party account.
- Each political party qualified to compete in [elections] under the [election law], and intending to seek certification of candidate nomination(s) for [elections], must establish a Campaign Fund through an account in [type of bank or other depository]. The Fund must be established at least sixty days prior to the date prescribed by [election law] for filing candidate nomination documents with the Central Election Commission. The Campaign Fund may be established by transfer of funds from the party's Operating Fund and/or may receive contributions or accept non-monetary donations pursuant to this law. Any funds remaining in the Campaign Fund following the [elections] must be transferred to the party's Operating Fund within thirty days following the [elections] or otherwise disposed of pursuant to regulations of the Central Election Commission.
- All expenditures made by a political party (by any official, representative or agent of a party) for election campaign purposes, or to raise funds for such purposes, must be from the party's official Campaign Fund. A political party may not use other funds or resources for activity conducted for election campaign purposes apart from or outside of its Campaign Fund. During the election campaign period, a political party may use offices, facilities, supplies, materiel, equipment, vehicles, personnel or other party resources previously owned, rented, purchased or contracted for by the party, prior to establishing the Campaign Fund, for election campaign purposes. Any and all other expenditures during the election campaign period for election campaign purposes, including but not limited to any expenditures for advertising or other communications to the public, must be made from the Campaign Fund.
- A party (by any official, representative or agent of a party) shall not cause, request, authorize, consent to or coordinate with other persons or entities to spend other funds or use other resources for election campaign purposes in support of the party or its candidates, unless such spending of funds or use of resources by other persons or entities is regarded as a contribution to that party. Such contributions are subject to prohibitions and limitations upon receipts, and restrictions upon expenditures, of this law and shall be reported as a contribution to the party in its Campaign Fund Report.
- All candidates who are nominated by a political party are viewed as agents of that party. All contributions for use for election campaign purposes accepted by or on behalf of candidates, including donations of monetary or non-monetary resources, must be directed through and reported by the official Campaign Fund of the candidate's party. A party may designate separate Candidate Accounts within its official Campaign Fund to receive funds accepted by or used for the benefit of particular candidates. Candidate Accounts are book-keeping sub-accounts and considered by law as part of the party's Campaign Fund. Candidate Accounts are subject to prohibitions and limitations upon receipts, and restrictions upon expenditures, of this law. Any and all Candidate Accounts must be reported by a party in the Campaign Fund Report.

- All expenditures for election campaign purposes made by or on behalf of candidates must be from the Campaign Fund (including any Candidate Account within the Fund) of the political party that has nominated the candidate. Candidates may not use any other funds or use any other resources for election campaign purposes, nor cause, request, authorize, consent to or coordinate with other persons or entities to spend other funds or use other resources for such purposes (unless regarded and reported as a contribution to the party's Campaign Fund). Candidates may use their own personal funds for personal expenses related to the election campaign, without limitation, but must report any such expenditures exceeding [amount] on the party's Campaign Fund Report as a contribution to and expenditure by the party. Personal funds of candidates used for such expenditures may not be obtained from any gift or donation from any other person or group.

Elements described in the model law above may seem complicated and cumbersome. But requirements of this type are necessary to sufficiently define the scope of a political party finance law and to prevent evasion of the law through uncontrolled, unreported 'off-the-books' spending.

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### **Party Officers Responsible for Political Finance Legal Compliance**

To compel political parties to follow the law, political finance laws in modern democracies generally require parties to assign an officer in the party with responsibility for complying with legal requirements for record-keeping and periodic reporting.

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**Example:** In Canada, the Chief Agent of each registered party is responsible for administering its financial transactions and meeting the law's reporting requirements. No person or entity, other than the Chief Agent or a person authorized by the Chief Agent, can incur or pay for the party's expenses.

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**Example:** In the United States, the regulations of the Federal Election Commission (FEC) provide (at 11 CFR 102.7):

#### REGISTRATION, ORGANIZATION, AND RECORDKEEPING BY POLITICAL COMMITTEES

- (a) Every political committee shall have a treasurer and may designate, on the committee's Statement of Organization, an assistant treasurer who shall assume the duties and responsibilities of the treasurer in the event of a temporary or permanent vacancy in the office or in the event the treasurer is unavailable.
- (b) Except as provided in subsection (a), no contribution or expenditure shall be accepted or made by or on behalf of a political committee at a time when there is a vacancy in the office of the treasurer.
- (c) No expenditure shall be made for or on behalf of a political committee without the authorization of its treasurer or of an agent authorized orally or in writing by the treasurer.
- (d) Any candidate who receives a contribution, as defined at 11 CFR 100.7, obtains any loan or makes any disbursement in connection with his or her campaign, shall be considered as having received the contribution, obtained the loan or made the disbursement as an agent of such authorized committee(s).

Further, the treasurer of a political committee is responsible for (at 11 CFR 102.9):

- Keeping required records on all receipts (noting amount, date, name and address of source of contributions) and disbursements (noting amount, date, purpose, name and address of payee);
- Signing and filing complete, accurate reports and statements to the FEC on time;
- Retaining a copy of each statement, disclosure report and notice filed with the FEC, along with original backup records relevant to the report or notice (such as bank statements, paid invoices, etc.);

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- Preserving the above records for three years after the related report or statement is filed and making them available to the FEC upon request; and
  - Exercising 'best efforts' to obtain, maintain and report all required information.

The treasurer is responsible for complying with record-keeping requirements, even if he or she appoints someone else to keep the committee records. In the absence of the treasurer, only the assistant treasurer (identified on the Statement of Organization) may sign reports and assume the treasurer's duties.

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**Example:** Political finance laws enacted in 1988 and 1990 in France provide for an 'agent' (either an individual or electoral finance association) to account for receipts and expenditures of parties and candidates: "The use of an official agent is optional but is required of candidates and parties if they are to be eligible to receive donations from legal entities or subsidies from the government and for their donors to qualify for tax deductions."<sup>38</sup>

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**Example:** The German Law on Political Parties requires professional standards of accounting to be followed in record-keeping for political party accounts:

#### Article 28: Compulsory Bookkeeping

Political parties must keep accounts of income and expenditure which are liable to account as well as of their assets. The accounts shall be drawn up in accordance with the principles of proper bookkeeping and with regard to the purposes of this Law. The accounting documents must be stored for six years; account books, balance sheets and statements of account for ten years. The period of storage shall commence at the end of the accounting year.

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**Recommendation:** The political finance law should require political parties to appoint a party officer responsible for complying with requirements of the law for complete and accurate record-keeping and periodic reporting. Model provisions for the Law on Financing of Political Organizations (or implementing regulations) would include:

#### *Responsibility:*

- The Chairman of each registered political party (or other senior party official with primary responsibility for management of the party) shall appoint a Finance Officer, which shall be subject to approval by Central Election Commission.
- A Finance Officer shall be appointed by each registered political party within thirty days of enactment of this law, or by a new political party within thirty days of registration; if an Officer resigns, is discharged, dies, or otherwise cannot fulfill his/her duties, a new Officer shall be appointed within ten days, subject to approval by Central Election Commission.
- The Finance Officer of each party shall be qualified as a [Certified Public Accountant or comparable professional degree].
- The Finance Officer of each party shall be responsible for keeping complete and accurate records of political finance activity, and for reporting information about such activity in a timely and accurate manner, pursuant to the requirements of this law [and implementing regulations].

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<sup>38</sup> "Comparative Studies in Electoral Reform and Party Finance: France," by Don Padget, in compendium edited by F.L. Seidle and published by the Royal Commission on Electoral Reform and Party Financing in Canada in 1992 (p. 86).

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- The Finance Officer shall observe professional accounting standards in record-keeping, document preservation and internal auditing, and in preparing and submitting financial statements and reports required under this law.
  - The Finance Officer shall be responsible for reviewing all contributions to the party to ensure such contributions are permissible under this law, and shall maintain all necessary documentation related to contributions. The Finance Officer shall make determinations as to the value of non-monetary donations to the party, shall request information from donors to verify such value, and shall maintain all documentation related to such contributions.
  - All payments, disbursements or expenditures of any kind by the political party exceeding [amount] must be approved by the party's Finance Officer.
  - The Finance Officer shall request from the Chairman of the political party (and from party officials at local and subordinate levels of party organization) all financial records, data, documentation or other information necessary to keep complete and accurate records of political finance activity and to submit reports about such activity in a timely and accurate manner. The Officer shall report to the Chairman if such information is not provided or is inadequate for purposes of complying with this law.
  - The Chairman of the political party (and party officials at local and subordinate levels of party organization) shall provide or direct others to provide to the Finance Officer all records, data, documentation or other information requested by the Officer.
  - The Finance Officer of each party and the Chairman of each party (or other senior party official with primary responsibility for management of the party) shall be responsible for compliance with this law, and shall be personally liable for actions (or failures to act) that are grossly negligent or deliberately illegal.

These model law elements may, again, seem complicated and cumbersome, and onerous for political party officers. But these type of requirements are needed to ensure accountability is properly and fully placed with party personnel to comply with record-keeping and reporting requirements.

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## REPORTING

Modern democracies have adopted a variety of reporting requirements, schedules and forms to implement transparency in political finance activity. Most political finance systems employ some form of routine, periodic timetable for reports, usually based on calendar years or divisions thereof.

Most systems also require special reports to be filed during and/or immediately after election campaigns. The informational value to the voting public of pre-election reports is significant, particularly as to funding sources for parties, but such reporting requirements are difficult to implement. The closer to an election such reports are required, the more valuable the information – but the more burdensome for parties (in the midst of election campaigns).

### Case Studies

These examples illustrate different approaches to reporting requirements.

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**Example:** The Political Parties Act of Estonia requires parties to submit to the National Election Committee, within one month after national or local elections are held, a report – additional to its regular quarterly reports – of expenses incurred and sources of funds used for the conduct of the campaign by a party or the candidates on that party's list.

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**Example:** Following a general election, every registered political party in Canada is required to submit an audited return of its election expenses to the Chief Electoral Officer within six months of election day. Candidates, through their official agents, must submit audited returns of their election expenses to their local election officials within four months of election day. Such reports must disclose: the amount and source of all contributions, the names and addresses of all donors whose contributions exceed \$200 (about \$130 US), and all election expenses incurred.

Registered parties are also required to submit an annual fiscal period return within six months after the end of the fiscal period. Such reports must disclose: the amount and source of all contributions, the names and addresses of all donors whose contributions exceed \$200, and all expenditures of the party during the fiscal period.

Canada's Chief Electoral Officer is entitled to correct a party's Election Expense Return for technical deficiencies that do not materially affect its substance, or to request a party to correct the return within a specified period of time. (§ 432(1)&(2))

The Chief Electoral Officer publishes the financial returns of political parties and a summary of each candidate's returns. Elections Canada provides on its website: access to reports of candidates' contributions and expenditures from the last general election to reports of parties' receipts and expenses for fiscal periods; it also has a searchable database on its website for contributions and expenditures reported by candidates.

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**Example:** The German Law on Political Parties requires parties to publicly account for their assets and for the sources and use of their funds in an annual Statement of Account.<sup>39</sup> As described earlier, reporting is necessary not just for disclosure policy values but because of complicated state budget funding allocation methods that are dependent on information reported by parties as to their private fundraising. To encourage clarity and transparency, the structure and components of the annual Statement of Account are set out in the Law:

#### **Article 23: Obligation to Render A Public Statement of Account**

(1) The executive committee of the party shall render public account of the origin and appropriation of funds received by the party within a calendar year (accounting year) as well as of its assets in a statement of account.

(2) The statement of account must be scrutinized by a certified auditor or auditing company in accordance with Articles 29 to 31. In the case of parties which do not meet the requirements of Article 18 (4), sentence 1, the statement of account may be scrutinized by a sworn public accountant. It must be submitted to the President of the German Bundestag by 30 September of the year following the accounting year and circulated by him or her as a Bundestag printed paper. The President of the German Bundestag may extend the limit up to a maximum of three months in extenuating circumstances. The party statement of account shall be submitted for discussion to the next national party convention following its publication.

(3) The President of the German Bundestag shall examine whether the statement of account has been prepared in accordance with the regulations of Section V. The result of the scrutiny shall be recorded in the report specified in Paragraph 5.

(4) The President of the German Bundestag shall not fix the volume of state funds to be allocated to a party under Articles 18 and 19 until a statement of account complying with the provisions of Section V has been submitted. The decisive basis for payments as defined in Article 18 shall be the statement of account for the preceding year, for payments as defined in Article 20 the statement of account submitted the preceding year. A party that fails to submit the report by 31 December of the following

year shall forfeit its entitlement to state funds; the amounts fixed and disbursed to the other parties shall remain unaffected.

(5) The President of the German Bundestag shall report to the German Bundestag each year on the trend in the financial situation of the parties and the party statements of account. The report shall be circulated as a Bundestag printed paper.

Parties' Statements of Account must be scrutinized by an independent auditor (see discussion below). Then the Statements, along with auditor's certificate, are submitted to the office of the President of the German Bundestag. The Statements are examined to ensure they comply with the Law. If not, or if a party has failed to submit a Statement, no public funding may be allocated to that party. Results of examination of political party Statements of Account are circulated as a Bundestag document. Recent changes to the German Law on Political Parties provides that parties' Statements of Account and documents and reports of the President of the Bundestag related thereto shall be published on the Internet.

The German Law on Political Parties provides for extensive political finance information to be included in the Statement of Account:

#### **Article 24: Statement of Account**

(1) The statement of account shall comprise a bill of receipts and expenditure and an account of assets. It shall be drawn up in accordance with the principles of proper bookkeeping and with due regard to the purposes of this Law. The statement of account of the whole party shall incorporate separate accounts for the party's national branch and the Land branches as well as statements of account of the subordinate regional branches of each Land branch. Land branches and their subordinate regional branches shall attach to their statements of account a complete list of all donations received, together with the names and addresses of the donors. The Land branches shall keep the statements of account of their subordinate regional branches together with their own accounting documents.

(2) The bill of income shall include:

1. Membership fees and similar regular contributions
2. Donations from natural persons
3. Donations from legal entities
4. Income from assets
5. Income from organized events, distribution of printed material and publications and other activities associated with income
6. State funds
7. Other income
8. Grants from party branches
9. Gross receipts from items 1 to 8.

(3) The bill of expenditures shall include:

1. Personnel expenditure
2. Business expenditure
3. Expenditure for general political work
4. Expenditure for election campaigns
5. Interest
6. Other expenditure
7. Grants to party branches
8. Gross expenditure from items 1 to 7.

(4) The statement of assets shall comprise:

1. Property assets
  - I. Capital assets:
    1. Property in the form of houses and real estate
    2. Office equipment
    3. Financial investments
  - II. Working capital:
    1. Claims on party branches
    2. Claims on state funds
    3. Monetary assets

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4. Other assets
  - III. All property
  2. Debits:
    - I. Reserve funds:
      1. Pension obligations
      2. other reserve funds
    - II. Liabilities
      1. Liabilities towards party branches
      2. Liabilities towards banking institutions
      3. Other liabilities III.
  - Gross debit
  3. Net assets (positive or negative)
    - (5) The statement of account must show the total amount of bestowals made by natural persons up to 6,000 German marks per person as well as the total amount of bestowals made by natural persons which exceed the amount of 6,000 German marks separately.
    - (6) The statement of account shall be preceded by a summary covering the following items:
      1. Income of the whole party in accordance with Paragraph 2, nos. 1 to 7, and their total
      2. Expenditure of the whole party in accordance with Paragraph 3, nos. 1 to 6, and their total
      3. Surplus or deficit
      4. Items of possession of the whole party in accordance with Paragraph 4, nos. 1 I and II 2 to 4 and their total
      5. Debit items of the whole party in accordance with Paragraph 4 nos. 2 I and II 2 and 3 and their total
      6. Net assets of the whole party (positive or negative)
      7. Gross receipts, gross expenditures, surpluses or deficits as well as net assets of the three organizational levels - national branch, Land branches and their subordinate regional branches.
- In addition to the absolute figures for nos. 1 and 2, the percentage rate of the income sum pursuant to no. 1 and of the expenditure sum pursuant to no. 2 respectively must be indicated.
- (7) The number of members at the end of the year must be indicated.
  - (8) The party may attach brief explanations to the statement of account, especially to specific items.
  - (9) Public grants appropriated for political youth organizations shall not count towards the absolute and relative upper limits. They must be indicated in a party's statement of account for information purposes but shall not be included in its bill of income and expenditure.
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**Example:** In the United States, during an election year, committees registered with the Federal Election Commission (including political party and candidate committees) are required to file<sup>40</sup>:

- Quarterly reports for the first three quarters of the year;
  - Pre-election report, due twelve days before the general election and covering the period (since the prior quarterly report) up to twenty days before the election;
  - Post-election report, due thirty days after the general election and covering the period (since the pre-election report) up to twenty days after the election; and
  - Year-end report.
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### Baseline Statement of Assets

Transparency and disclosure in political party financing is usually associated with ongoing, periodic reporting obligations regarding party receipts and expenditures. And that is the most essential component. But full transparency in political party financing must start from a 'ground zero.' Ideally, a complete statement of assets and liabilities by each political party is made prior to, or integrated into, the periodic reporting of money coming in and going out. Each party should submit a statement of assets – all cash, securities,

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<sup>40</sup> Political committees are also required by FEC rules to file reports before and after 'primary' elections, special reports for 'independent expenditures' and special reports for large contributions received during the final twenty days before an election.

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property or anything else of value the party owns or controls – as well as liabilities – money owed on debts, loans, mortgages, etc. A sample of an asset statement is available on the website for Elections Canada: [Newly Registered Party's Statement of Assets and Liabilities](#).

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**Recommendation:** As recommended above, political parties should be required to maintain separate accounts for an Operating Fund and a Campaign Fund, and to conduct and report all party financial activity through these accounts. When the program of state budget subsidies begins in 2003, qualified political parties would be required to maintain a State Funds Account, which would be reported simultaneously with the Operating Fund.

To properly institute transparency in Latvian politics (and assuming Saeima elections are held on schedule next October), each registered political party should be required to submit on 31 July 2002 a complete statement of party assets and liabilities as of 30 June. That report should include disclosure of receipts and expenditures during the period 1 January through 30 June 2002. Any new political party registered after 30 June that qualifies to contest the election should be required to submit a statement of assets and liabilities and a financial report of receipts and expenditures for the previous three months within ten days of registration.

As of July 1, all political parties would then need to consolidate all existing accounts and funds into an Operating Fund. Political parties that qualify to compete in the Saeima elections should be required to also then form a Campaign Fund for new receipts and expenditures during the election campaign period.

Despite the informational value of financial disclosure reports filed during the midst of an election campaign, it is advisable (at least through the 2002 Saeima elections) to require a full report of the Campaign Fund within 20 days after the election. To require preparation of a financial disclosure report during the heat of the campaign is to create a burden and distraction on parties that invites inaccuracy and dishonesty (from which it is difficult to later extricate). While the lack of financial disclosure during the campaign loses some impact and deterrent effect, it is more important to begin a period of transparency in political party financing that is reasonable and credible.

Parties that do not qualify to compete in the elections would not form a Campaign Fund nor file a financial disclosure report until they submit another 'semi-annual' financial report covering receipts and expenditures during the period 1 July to 31 December, due on 31 January 2003. Parties that competed in the election would terminate their Campaign Fund within 30 days after the election. They would also be required to submit another 'semi-annual' financial report for the Operating Fund covering the period 1 July to 31 December, due on 31 January 2003.

Thereafter, the law should provide for a similar schedule of semi-annual reports in Saeima election years and annual reports in other years.

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## INDEPENDENT AUDITORS

Political finance reporting and disclosure systems usually require some form of professional audit of reports. These regulations should specify the timeline and standards for review, and the consequences for audits revealing incomplete record-keeping or inaccurate reporting.

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**Example:** In Canada, the Auditor's examination of the party's Election Expense Return must enable him or her to give an opinion as to whether the return presents fairly, and in accordance with generally accepted accounting principles, the information contained in the financial records on which the report is based. (§ 426(1)) The Auditor's opinion must indicate, if necessary: if the party's return

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does not present fairly the information contained in the financial records on which the return is based; if the auditor has not received from the registered agents or officers of the party all the required information and explanations; or if based on the examination of the party's records, proper accounting records do not appear to have been kept. (§ 429(1) & 430(2)). The Auditor must have access at any reasonable time to all of the registered party's documents, and may require the registered agents and party officers to provide any information or explanation that, in his or her opinion, is necessary in order to properly prepare the required financial reports. (§ 430(3)).

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**Example:** The German Law on Political Parties provides the following:

Article 29: Audit of the Statement of Account

- (1) The audit specified Article 23 (2), sentence 1 and Paragraph 3 shall apply to the party's national branch, its Land branches and to at least four subordinate regional branches chosen by the auditor.
- (2) The auditor may require the executive committee and the persons authorized by them to furnish any information and evidence he may need to perform his auditing duty with due care. He must therefore also be allowed to examine the documents used to compile the statement of account, the books and written documents as well as the cash balance and existing assets.
- (3) The executive committee of the regional branch to be audited shall provide the auditor written assurance that all the receipts which are liable to account, expenditure and assets are included in the statement of account. Reference may be made to the assurance provided by the executive committees of subordinate regional branches. It is sufficient for the executive committee member responsible for financial affairs to provide this assurance.

Article 30: Audit Report and Auditor's Certificate

- (1) The result of the audit must be set out in writing in an audit report which must be delivered to the executive committee of the party and to the executive committee of the audited regional branch.
- (2) If no objections are to be lodged after the final result of the audit, the auditor must confirm by means of a certificate that, after a dutiful audit and on the basis of the party's account books and documents as well as the information and evidence furnished by the executive committees, the statement of account as audited (Article 29 (1)) complies with the provisions of this Law. If objections are to be lodged, the auditor must refuse to provide this confirmation in its auditor's certificate or modify it accordingly. The names of the regional branches audited must be stated in the auditor's certificate.
- (3) The auditor's certificate must be attached to the statement of account to be submitted and published verbatim in accordance with Article 23 (2), sentence 2.

Article 31: Auditor

- (1) A person appointed as auditor must not be a member of the executive committee, a member of a general party committee, an appointed accountant or employee of the party to be audited or of one of its regional branches or have been such during the last three years prior to his appointment.
- (2) The auditors, their assistants and the legal representatives of an auditing company participating in the audit are obliged to discharge their duties in a conscientious and impartial manner and to exercise discretion. Article 168 of the Corporation Act shall apply as appropriate.

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Simple provisions for auditing in less developed democracies (and as envisioned by the *Draft Law*) often prove inadequate in practice. Particularly when conducted by auditors paid by each party (or other reporting entity), such audits tend to be, at best, narrowly performed based upon financial records and documents presented by the client, with little or no effort to question such materials or seek more information. At worst, the audits are a fraud, giving the client what it wants and facilitating unreported 'off-the-books' spending by the political party or candidates.

**Professional Accounting Services: Personnel & Computer Software**

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The political party finance system must encourage and assist parties to comply with requirements for complete, accurate and honest record-keeping and reporting of parties' financial activity. Political parties should not be expected to make the commitment of personnel and resources needed to fully carry out their responsibilities, at a corresponding loss to other organizational and administrative needs (absent threat of extensive monitoring and prosecution that even an improved enforcement regime will be unable to make credible). That is, parties will probably view minimal compliance with legal requirements as sufficient, and devote no more resources than necessary to achieve that level of compliance.

Thus, financial transparency of parties should not only be required by the state, but also facilitated and specifically funded by the State. This will not only encourage compliance by parties, but remove their ability to make excuses for failure to meet reporting requirements fully and on schedule.

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**Example:** The Independent Election Commission of South Africa developed a regulatory framework for the political parties' financial statements, and in 1999 provided each party with accounting software and an accounting system (including accounting 'templates') to facilitate the disclosure process.

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**Recommendation:** The new law should include the following requirements and provide for the State to give the following funds and resources to parties in addition to the proposed annual grant to support transparency:

- Each political party qualified to receive state budget subsidies shall hire a qualified accountant ('certified public accountant [CPA]' or equivalent status) to maintain records and supporting documents, to complete and submit all financial reports required under law, and to respond to any official inquiry about the party's financial activity. The accountant can be – but not necessarily – the same person as the party Finance Officer, described above (who has legal responsibility for reporting but may only supervise and not personally perform the work). The accountant is expected to work approximately half-time professionally on accountant responsibilities for the political party (and may engage in other professional or business activity), except for the month immediately preceding when a party financial report is due under the law, at which time the Party Accounting Officer is expected to work full-time on such party accounting duties.
- The State shall provide to each political party qualified to receive state budget subsidies a monthly grant (probably from the Central Election Commission) that is equivalent to one-half the market value of the average monthly salary for a 'certified public accountant (CPA)' or equivalent status; such grant shall double for the month immediately preceding when a financial report is due under the law. Such funding for accounting personnel shall be the same for all qualified parties. Parties may choose to supplement the salary, or other compensation or benefits, of the accountant if they wish, and may hire other personnel to assist in record-keeping and other accounting duties. But parties may not utilize this grant of state monies for any other purpose than to pay compensation for professional services of an accountant; parties may not divide these funds so as to pay more than one person for accounting services from these funds at any given time.
- Prior to the time the new political party finance law goes into effect, the State shall provide to each political party qualified to receive state budget subsidies appropriate computer software to facilitate record-keeping and financial reporting under the law (the software should be updated periodically). This software should be developed by the Central Election Commission in cooperation with the State Audit Office and other appropriate government bodies with technology expertise.<sup>41</sup> At the same time, the State shall provide a one-time grant of funds for computer modernization to each political party qualified to receive state budget subsidies, equivalent to the market price of a typical office 'PC' computer.

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<sup>41</sup> This is an obvious area for international assistance.

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- The Central Election Commission shall develop training manuals for party Finance Officers and party accountants that fully explain record-keeping and reporting requirements under the law and demonstrate how to use the state-provided computer software to meet these requirements. The CEC shall periodically send updated information or other instructional material to parties, as well as reminder notices one month prior to each financial reporting deadline.
  - Within two months after the new political party finance law goes into effect, the Central Election Commission, in cooperation with the State Audit Office and other appropriate government bodies with technology expertise, shall conduct a one-day training seminar to explain record-keeping and reporting requirements under the law and to demonstrate how to use the state-provided computer software to meet these requirements.
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### **Public Access to Political Party Financial Information**

Most political finance disclosure systems do not place as much emphasis upon providing public access to disclosure reports as in the United States. For example, according to one observer: "The French [disclosure] system is not intended to inform the public about who finances the electoral process, but to ensure that contribution and expenditure limits are respected."<sup>42</sup> The problem with this approach – even for purposes of enforcement – is that it fails to engage competing parties, civil society and journalists in the scrutiny that facilitates enforcement, and relies almost exclusively on administrative review to detect irregularities or violations.

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**Recommendation:** The revised Law on Financing of Political Organizations, or is implementing regulations, should provide for the following:

- 1) Political finance disclosure statements and reports submitted to the Central Election Commission pursuant to this law shall be:
    - Copied, filed and organized by the Central Election Committee within five days of receipt; and
    - Made available for examination (and photocopying at reasonable cost): by the general public, including but not limited to representatives of news media, academics, non-governmental organizations or any other interested persons or groups; and in a suitable facility established and supervised by the Central Election Commission.
  - 2) Within thirty days of receipt, the Central Election Commission (assisted by the State Audit Office) shall prepare summaries of statements and reports submitted pursuant to this law by political parties, and shall have all summaries published in [official gazette or appropriate newspaper] as soon as practicable.
  - 3) At the time of issuing implementing regulations for this law, the Central Election Commission shall submit a special budget request to the Saeima proposing additional funding to provide adequate facilities and resources for public disclosure of political finance statements and reports.
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### **Publication**

Some countries require that political finance reports (of candidates or parties) be published in an official 'gazette' or other publication. The current Law on Financing of

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<sup>42</sup> "Comparative Studies in Electoral Reform and Party Finance: France," by Don Padget, in compendium edited by F.L. Seidle and published by the Royal Commission on Electoral Reform and Party Financing in Canada in 1992 (p. 78).

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Political Organizations in Latvia does not. Publication of the full reports by such means is a lengthy and expensive task that generally does not advance the interests of transparency and disclosure much. That is particularly true if the reporting schedule is not rigorous and such reports are published long after the election; it is even worse if the public has low confidence in the accuracy of such reports.

The exception, of course, is Internet posting of campaign finance reports, which is revolutionizing transparency where it is practiced. Technology to support such posting is, of course, expensive. And it is not very meaningful unless reporting schedules are rigorous and the information is timely considered, such as during the election campaign. As mentioned above, after reporting and disclosure practices have become more familiar and parties and monitoring bodies more capable, Latvia's political finance system could require immediate pre-election reports. Then, perhaps with international assistance, Latvia's CEC should skip over old publishing technologies and move directly to Internet posting of such information.

For now, it may be enough to focus on: improving compliance with record-keeping and reporting obligations by political parties; enhancing the capacity of monitoring and supervisory bodies; and encouraging scrutiny of party financial reports by journalists and civil society.

#### **Role of Civil Society and the News Media**

In addition to scrutinizing the financial reports of political parties, civil society groups and journalists can play an important role in monitoring the outward display of spending by parties, particularly during the election campaign. Dr. Michael Pinto-Duschinsky has observed: "Since the object of collecting political money is to use it to win public office, rich candidates and rich parties will usually display their wealth in ways which will become obvious if their activities are monitored."<sup>43</sup>

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**Recommendation:** In cooperation with Latvian civil society groups and news media (and with assistance from international organizations), the CEC should conduct a training seminar about transparency in advance of the next Saeima elections. The topics should include an explanation of Latvia's revised political party finance laws, opportunities under the law for scrutinizing political party finance reports, and methods for monitoring of political party financial activity.

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<sup>43</sup> *IFES Commentaries*, "A Perspective for Russia's Electoral System: (b) Monitoring and reporting patterns of campaign spending. See: [www.ifes.ru:8101/eng/index.html](http://www.ifes.ru:8101/eng/index.html).

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## Part Eight: Sanctions & Penalties

### PUNISHMENT AND DETERRENCE

#### Balancing Severity and Appropriateness

Political finance regulation is unsuccessful without effective monitoring and enforcement. Effective enforcement requires that the law impose meaningful sanctions and penalties for violations, and provide mechanisms for imposing such punishments fairly.

Sanctions and penalties must be sufficiently severe to serve as deterrence to violators. But punishments should be fair, reasonable and suitable – appropriate to the seriousness of the violation and within the political capacity of enforcement bodies to apply. Often penalties prescribed in political finance laws for even minor violations are too severe (e.g., suspension of party activity or dissolution of a party, or criminal sanctions). A political finance system is not ‘tougher’ on violators if the law provides for penalties so harsh that no election authority or court would ever impose them. Nor should the system scare off political participation of new and inexperienced parties with the threat of extreme or arbitrary punishment.

#### Classifications of Penalties and Sanctions

Political finance regulation often fails to identify particular types of offenses or differentiate between the gravity of such offenses for purposes of imposing punishment. Political finance laws should provide for a range of ‘graduated’ penalties and sanctions that fit the seriousness of the violation:

- Modest monetary fines for minor breaches (e.g., late filing of reports);
- Larger fines for more serious or repeat violations (e.g., failure to file reports; acceptance of contributions in amounts exceeding legal limitation; improper expenditure of state budget subsidy funds); these sanctions include forfeiting funds not reported or from illegal donations, or denial of public subsidies;
- Adverse electoral consequences for significant violations that undermine the integrity of the elections or affect the vote outcome (e.g., submitting false information on financial reports; raising and spending funds outside official reported account); these sanctions include: disqualification of candidacy (or party candidate lists), administrative termination of parties, or invalidation of election results.
- Criminal sanctions for egregious and clearly deliberate violations.

#### International Models of Sanction/Penalty Regimes

International practice varies widely regarding penalties and sanctions.

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**Example:** The German Law on Political Parties provides that, if a party obtains donations illegally or fails to disclose them in their annual Statement of Account, the party loses their entitlement to public funding in an amount double the illegally obtained or undisclosed donation (Article 23a(1)). Illegal donations must be transferred to an account of the President of the Bundestag, who passes on such monies to charitable, academic, scientific or religious organizations (Article 23a(3)). Political parties are further obligated to provide, in their internal organizational regulations, for measures to monitor and enforce these provisions for Land (state) or subordinate party branches.

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**Example:** France has more elaborate and peculiar political finance regulation and public funding than might be appropriate for Latvia (discussed above), but its system for imposing sanctions for violations

illustrates the variety of penalties that can be imposed depending upon the offense. One expert observer has described the penalty regime in France as follows:

These more serious efforts at [political finance] regulation have also included substantive penalties. The Commission [nationale des comptes de campagne et des financements politiques] can retract the authorization of official agents, order candidates who exceed expenditure ceilings to remit the amount of the illegal expenditure to the State and deny their right to reimbursement [for campaign expenses]. Approval of the account [financial report] is necessary for reimbursement to candidates and for public funding of parties.

Penalties for infractions by candidates or donors can include loss of candidate reimbursement, fines ranging from 360 FR [nearly 50 USD] to 15,000 FR [over 2000 USD] or imprisonment from one month to one year. These include infractions regarding contributions, limits, disclosure, campaign accounts and political advertising. Legal entities may be further penalized by being excluded from procurement contracts for up to five years; their directors are subject to the same penalties as individuals.

Candidates who commit infractions may face more severe punishment. Elections may be cancelled and candidates may be declared ineligible to contest an election for a year or, if declared elected, he or she may be forced to resign from office. In the case of overspending by presidential candidates, penal and financial penalties may be imposed but candidates may not be declared ineligible. Accounts [financial reports] which are not submitted, or are late or defective may render legislative candidates ineligible. Legislative candidates who spend over the limit are not automatically declared ineligible because the judge is required to consider the amount and the impact of the overspending. Specifically, France's electoral law requires consideration of whether the infraction committed was likely to have had a determining influence on the voters' freedom of choice and the validity of the election result. Thus, small infractions and a significant margin for the winner will not lead to canceling an election result. Before the reforms, such infractions were often committed by candidates on all sides and appeared to lead to a mutual disregard for the law.<sup>44</sup>

This description of approaches to penalties in France illustrates that prescribing punishments for political finance violations that are not adjusted to the seriousness of the violation, or are simply too severe for the circumstances, is not only unfair, but likely to discourage enforcement. If the only sanction for violations is a political 'death penalty' – such as overturning elections, disbanding parties or denying candidate registrations, then authorities will be reluctant to impose any sanction in many cases, and the law becomes ineffective.

**Example:** All offenses and penalties under the Canada Elections Act are found in Part 19 of the Act. There are three categories of offenses related to political parties, their agents and officers:

- Offenses which result from an act or omission of a person or party which did not exercise due diligence;
- Offenses which result from an intentional act or omission of a person or party; and
- Offenses which result from a willful act or omission of a person or party.

The Act provides for two processes for prosecution of offenses, depending on the seriousness of the offense:

1. Offenses prosecuted on summary conviction; and
2. Offenses prosecuted on indictment.

<sup>44</sup> "Comparative Studies in Electoral Reform and Party Finance: France," by Don Padget, in compendium edited by F.L. Seidle and published by the Royal Commission on Electoral Reform and Party Financing in Canada in 1992 (pp. 87-88).

Penalties for convictions vary depending on the procedure provided for prosecution:

1. On summary conviction –
  - Fines vary from a maximum of 1000-2000 for persons and 10,000-25,000 for parties and other entities
  - Imprisonment varies from a maximum period of three months to one year
  - Or both a maximum fine and maximum imprisonment
2. On indictment –
  - Fines vary from a maximum of 5000 to 25,000
  - Imprisonment varies up to a maximum of five years

A person may also be liable to perform community service, to compensate any other person who has suffered damages, to perform a legal obligation, or to take any other reasonable measure to ensure compliance with the Act. (§ 501)

The Act also provides for additional penalties for persons convicted of illegal or corrupt practices (§ 502):

- A person convicted of an illegal practice will, in addition to any other penalty, not be entitled for the next five years to be elected or to sit in the House of Commons or hold any federal office, or both;
- A person convicted of a corrupt practice will, in addition to any other penalty, not be entitled for the next seven years to be elected or to sit in the House of Commons or hold federal office, or both.

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**Example:** The U.S. Federal Election Commission adopted an Administrative Fine Program last year to simply processing and resolution of cases involving ministerial violations of requirements for filing reports. On its web-site, the FEC describes this program:

Beginning with the July 15, 2000 quarterly reports, the Commission will implement a new program for assessing civil money penalties for violations involving:

- Failure to file reports on time;
- Failure to file reports at all; and
- Failure to file 48-hour notices.<sup>45</sup>

The Administrative Fine program is based on amendments to the Federal Election Campaign Act (the Act) that permit the FEC to impose civil money penalties, based on schedules of penalties, for violations of reporting requirements that occur between January 1, 2000, and December 31, 2001.

If the Administrative Fine program had been in place for the April 2000 quarterly reports, approximately 90 committees would have faced civil money penalties ranging from \$275 to \$12,000.

The interaction of several factors will determine the size of the penalty:

1. Election sensitivity of the report;
2. Committee as late filer, including the number of days late, or nonfiler;
3. The amount of financial activity in the report; and
4. Prior civil money penalties for reporting violations.

One factor used to determine the amount of the civil money penalty is the *election sensitivity* of the report. Under the new rules, the following reports are considered election sensitive: the October quarterly, the October monthly and the pre-election reports for primary, general and special elections. All other reports are considered nonsensitive. The Commission will also consider whether the committee is a *late filer* or a *nonfiler*. In the case of nonsensitive reports, a committee will be considered a late filer if it files its report within 30 days after the due date, and a nonfiler if it files its report later than that. In the case of election-sensitive reports, a

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<sup>45</sup> Under the U.S. Federal Election Campaign Act, political committees that are registered and reporting to the FEC must file special reports within 48 hours of receiving contributions of \$1000 during the pre-election campaign period.

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committee will be considered a late filer if it files a report after its due date, but more than four days before the applicable election; a committee that files later than that will be considered a nonfiler. The third factor is the *amount of financial activity*—that is, the total amount of receipts and disbursements in the report. The final factor is the existence of *prior civil money penalties* for reporting violations under the Administrative Fines program.

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### **Working Group Draft Law**

The draft *Law on Financing of Political Organizations* developed by the Working Group provides for sanctions for political parties in Article 24, “Consequences for Failure to Submit Declaration on Financial Operation.” The content of these provisions actually contemplate actions against parties that file incomplete or inaccurate declarations (as determined by the ‘Sworn Auditor’), as well as for failure to submit.

Under the *Draft Law*, if a political party is deemed to have not met its reporting obligation, the Chairman of the Central Election Commission shall first, within five days, warn the leader of the party. If the warning does not produce an adequate response within two weeks, the Chairman shall then, within one week, initiate legal procedures to terminate the operation of the political party. The same process is provided for failure of a political party to submit the Annual Accounting Survey to the CEC at the time required by law. Thus, the *Draft Law* imposes only one type of sanction – administrative termination of the party – for all types of violations of political finance rules.

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**Recommendation:** After the substantive revisions have been finalized for amending the Law on Financing of Political Organizations, a working group should be created by the Ministry of Justice to focus upon penalties and sanctions. The working group should identify all violations and offenses that arise from the law as amended, categorize them as to seriousness, identify appropriate types of penalties and sanctions (consistent with other Latvian civil and criminal practice) and prescribe procedures for imposing punishments. Following amendment of this Law, the working group should examine other election laws to recommend similar revisions to sections regarding election-related offenses.

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**Part Nine: Conclusion**

In an article entitled "Democracy Out of Balance: Civil Society Can't Replace Political Parties," Ivan Doherty recently wrote<sup>46</sup>:

The global democratic revolution of the past decade has demonstrated that people regard democracy as a necessity and a right in and of itself, and not merely an aspiration to be balanced against or even overshadowed by other national or economic interests. Truly open and democratic systems of government are not a threat to individual or communal welfare, but rather provide the means by which a nation can attain its full potential, both economically and politically. Democracy requires working democratic structures: legislatures that represent the citizenry and oversee the executive; elections in which voters actually choose their leaders; judiciaries steeped in law and independent of outside influences; a system of checks and balances within society; and institutions and leaders that are accountable to the public.

The active support and collaboration of strong, inclusive political parties in partnership with a vibrant civil society must gain acceptance as the correctly balanced equation to achieve a more transparent and participatory system of government.

Democratic development and institutional transparency are at a crucial crossroads in Latvia. Regulation and disclosure of political party financing is an essential component. Success will require the Government to exert leadership in this area, encouraged by the Latvian people and international supporters. And it will need cooperation within the *Saeima* and among political parties to overcome their short-term political fears and perceived interests.

Political finance reform is difficult to achieve in every country, and factors impeding change are strong in Latvia today. But current attention to political finance issues in Latvia presents a special opportunity for this former 'captive nation' to finally break from the past, take bold steps and give the values of democracy and transparency a real chance.

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<sup>46</sup> Policy Review, April & May 2001, pp. 31-2.