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An OECD Framework for Financing Democracy

"Money is a double edged sword" (OECD 2016). While political finance enables political participation and facilitates democratic competition, it can become a means for undue influence and policy capture, ultimately undermining the government. Therefore, although money is a necessary component of the overall vibrancy of the political sphere, it is one of the greatest threats for a functioning democracy. In a number of countries, the alarm that political finance is growing from mere support into powerful influence is deeply embedded in the society's perception of governance and policy making. Accordingly, survey results from the 2013 and 2015 Edelman Trust Barometer find that 52% of respondents distrust the government (OECD 2016). Since confidence in the government is particularly crucial for the realization of difficult policies and the current context of economic recovery requires numerous unpopular choices, restoring trust is at the forefront of the government's agenda (OECD 2014). To do so, the fine dynamic of political finance must be understood and its regulations optimized.

In an attempt to enhance the regulatory structure, the OECD developed a four-pillar *Framework for Financing Democracy* based on an analysis of selected OECD countries between 2007 and 2015. The framework suggests targeting four main objectives in order to reform political finance structures, namely: promoting a level playing field, ensuring transparency and accountability, fostering a culture of integrity, and ensuring compliance and review (OECD 2016). We will present a closer look at the aim of ensuring a level playing field, since an uneven playing field has been identified as a key inhibitor of democratic competition, and a central component of contemporary authoritarianism (Levitsky and Way 2010).

PROMOTING A LEVEL PLAYING FIELD

To foster a level playing field among parties and candidates, the framework suggests four measures, with two directed at political supporters, and two at political parties and candidates themselves. These four measures and their remaining complications are introduced in Table 1 below.

BALANCING PUBLIC FUNDING

Financial support for political parties and candidates is either of public or of private nature. Historically, in the old democracies of Europe, political funding was traditionally left to private initiative. However, as a result of recent cases of political capture and undue influence, a number of democracies have shown tendencies towards state funding for political activities (Hamilton 2009). Since state-funded democracies are arguably less prone to policy capture, increasing the share of public to private support potentially helps to level the electoral playing field. The OECD's comparative analysis shows that in over 80% of the studied countries, most of the financial support in politics comes from public funds, with Greece and Turkey having the highest public funding share of 90% (OECD 2016).

In order to optimize the regulatory structures surrounding public funding, three important features must be considered, namely the eligibility threshold,

Table 1:
Framework on Financing Democracy – Objectives, Policy Options, and Complications

Overall Objective	Policy Options and Remaining Complications	
Promoting a Level Playing Field	Balancing direct and indirect public contributions	*Remaining complications include* 1) determining the eligibility threshold, and 2) determining the allocation criteria.
	Framing private funding	*Remaining complications include* 1) preventing creative circumvention of regulations, and 2) addressing the increasing complexities due to globalization.
	Applying spending limits	*Remaining complications include* 1) determining the limit, and 2) ensuring that challengers are not at a disadvantage.
	Limiting privileged access to state resources	*Remaining complications include* 1) the undetected illicit use of state resources by incumbents
Ensuring Transparency and Accountability	Requiring disclosure: comprehensive and timely reporting.	
	Enabling scrutiny: timely, reliable and accessible reports.	
Fostering a Culture of Integrity	Applying the integrity framework in the public sector: codes of conduct, disclosure provisions, and whistleblower protection.	
	Promoting standards of professionalism, integrity, and transparency in private donors: appropriate accounting practices, and a code of conduct.	
Ensuring Compliance and Review	Assuring independent and efficient oversight: resources, methodologies, and authorities.	
	Applying dissuasive and enforceable sanctions: confiscation, fines, and criminal charges.	
	Regularly appraising the system: period review, involvement of stakeholders, identifying mitigation strategies.	
	Supporting political parties: helping to comply with regulations, and better understand political finance.	

Source: OECD Report Financing Democracy (2016); authors' analysis.

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the allocation criterion, and the proportion of direct to indirect public funds. To determine the eligibility threshold, 76% of OECD countries use previous party performance as an indicator (OECD 2016). The exact threshold varies among countries, with Germany having a threshold of 0.5%, Turkey having a threshold of 7% (OECD 2016), and the worldwide average being approximately 3.5% (International Institute for Democracy and Electoral Assistance 2014). Nonetheless, the general consensus is that the minimum level establishing eligibility for public funding should be below the electoral threshold, such that new and smaller parties are able to enter the political arena.

Once eligibility has been determined, the allocation of public funding occurs to a large extent based on ‘equal access’ where an equal amount is distributed to all parties, and ‘proportional access’ where an amount is distributed based on past election performance. In isolation, both methods present drawbacks, since mere equal distribution could cause a proliferation of political parties, and mere proportional distribution may result in a replication of past results (OECD 2016). As a result, public funding is commonly determined by a combination of an equal sum distributed to all eligible parties, and a variable sum distributed based on previous electoral performance.

Once eligibility and allocation have been established, public funding can occur both directly and indirectly depending on the form in which public resources are made available. Direct public funding is provided by all OECD countries with the exception of Switzerland, usually in the form of money via bank transfers (The Electoral Knowledge Network 2012). Indirect public funding refers to resources with a monetary value (The Electoral Knowledge Network 2012) which can take a variety of forms, including tax reliefs implemented by 40% of OECD countries (OECD 2016) and free access to public goods and services. For example, political parties in Portugal and the United States are exempt from the income tax, while in Belgium they are provided free advertisement space for campaign posters.

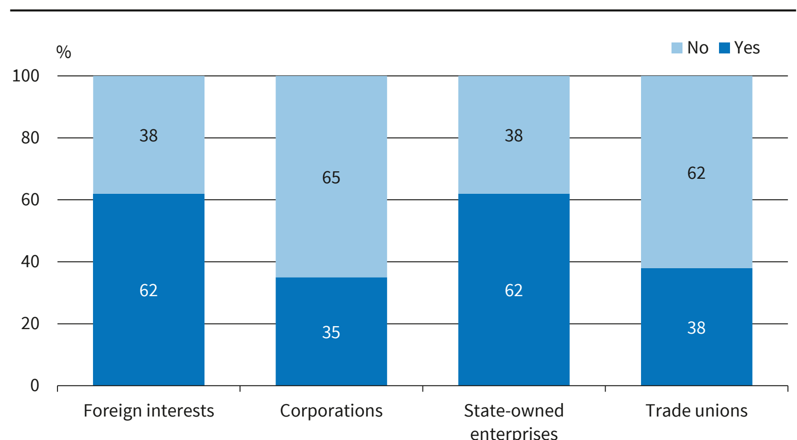
In addition to allocating funds such that they promote a level playing field, earmarking is used to confirm that targeted financial resources are used in accordance with their aim. Earmarking occurs in approximately 43% of OECD countries and entails general usages such as party and campaign activities as well as more specific and meaningful expenditures (OECD 2016). Since a study conducted by UN Women in 2013 indicated that over 80% of females identify access to funding as one of their biggest challenges to enter the political sphere, earmarking practices have been used to focus on gender barriers by distributing public funding such that it enforces electoral quotas and promotes the nomination of female candidates (Ballington and Kahane 2014). This can be carried out either via incentive structures: providing additional funding if parties meet such criteria, or via penalty structures: reducing public funding if parties fail to fulfil the conditions (Ohman 2012). In France for example, the maximum allowed difference between the number of male and female candidates in a party is 2%, in Portugal at least 33% of candidates must be female, and in Ireland at least 30% (OECD 2016). In the case of non-compliance, France, Portugal and Ireland implement a penalty in the form of losing a share of public funding, namely a variable portion in France, 25-50% in Portugal, and 50% in Ireland (OECD 2016). Alternatively, Croatia and Georgia implement incentive structures providing additional public funding if a given quota is met. However, research by [Magnus] Ohman (2012) has shown that incentive and penalty structures have a different impact on parties depending on their financial independence and size. Larger and better-funded parties can afford to give up on allocated public resources or forfeit additional funds, and are thus more difficult to regulate. Serbia, for example, promotes female participation by rejecting candidate lists that do not meet the target quota requirements (OECD 2016). However, even this rule becomes misapplied if parties place women in unwinnable positions simply to meet the target quotas.

FRAMING PRIVATE FUNDING

Private funding is recognized as a fundamental right of citizens, an expression of their freedom of speech, and a means of showing support for a political party or candidate. However, if inadequately regulated, it can be misused to promote private interests and potentially divert policies away from public priorities. Especially in

Figure 1

Types of Banned Private Contributions in OECD Countries



Source: OECD (2016); authors’ calculations. © ifo Institute

light of the extortionate costs of running, the special interests of financially able individuals are given too much weight. Furthermore, a concern that arises is not only the point at which "money stops being speech and starts becoming power", but whose money, and thus whose speech should influence the domestic political debate (Weinberg 2012). Therefore, countries have introduced bans and limits on specific sources of private funding including foreign individuals, corporations, state owned enterprises and trade unions.

Placing a limit on the amount of a single contribution is challenging, since a limit which is too high has only little impact, and a limit which is too low invites creative circumvention of the regulation (OECD 2016). While the administration of placing a ban is arguably simpler, the impact is comparable to that of a low limit. Thus, it invites artistic evasions and hidden forms of finance, leaving it hard for enforcement to be effective. Membership fees are one way to conceal donations, for example. They are particularly common in Korea where in 2015 they amounted to 26% of total party income, on average (OECD 2016). Since political parties in Korea must only account for the sum of membership fees, regulatory bodies are unable to detect whether certain members paid unconventionally large fees to hide private donations. Figure 1 shows the share of OECD countries that ban specific types of private contributions.

Donations from foreign individuals may steer regional politics towards foreign interests, reducing the responsiveness of the parties towards their constituents and potentially endangering the country's sovereignty. While the majority of OECD countries (62% as seen in Figure 1) ban foreign private funds, the exact definition of 'foreign' varies between countries. In Mexico, a Mexican citizen may not make donations while living abroad; the United Kingdom permits British citizens living overseas to contribute, as long as they are registered to vote; and in Germany a donation is categorized as 'foreign' if it originates from outside the European Union (OECD 2016).

Funding from corporations can lead to undue influence, especially if it makes up a significant share of overall political funding. In Brazil, private funding from corporations corresponds to 75% of overall campaign expenditure, with the 20 largest donors (of 20,000 total corporate donors) contributing more than 30%. Since a very concentrated group of firms donate a substantial amount, Claessens, Feijen, and Laeven (2008) investigate whether signs of political influence can be observed. They find that the dominant contributing firms substantially increased their bank financing, indicating that access to loans and other forms of bank finance present an important channel through which political connections operate. The authors estimate that the economic cost of this rent seeking totals approximately 0.2% of Brazil's GDP per annum.

Donations from corporations have become more and more complex in the face of globalization. Firms are increasingly connected internationally through mergers, contracts, and partnerships, such that foreign firms may influence domestic politics through their domestic subsidiary companies (Weinberg 2012). This was seen during the US presidential elections in 2012, were non-US companies circumvented the foreign funding restrictions by using their US subsidiary firms and US employees to donate. The exact numbers are difficult to trace, however a UK defense contractor, the-Swiss bank UBS, and the Belgian beer company InBev donated approximately USD 804,960 each (OECD 2016). While donations via subsidiary daughter firms are legally prohibited, these indirect channels of influence are virtually impossible to monitor, and whether a domestic firm is acting independently or under influence from its foreign mother firm is difficult to verify.

APPLYING SPENDING LIMITS

The explosive growth in campaign expenditure has led to spending races between parties, threatening political equality (Balise 2016). In theory, spending limits reduce the overall cost of elections, prevent a spending race, and promote a level playing field (OECD 2016). However, opponents argue that campaign expenditure falls under the fundamental freedom of free speech, and limitations in spending equate to a limitation of political expression (OECD 2016). Furthermore, the Supreme Court in the United States ruled against spending limits based on the argument that challengers require more resources than incumbents, and spending limits establish only a formal equality while actually putting challengers at a relative disadvantage, and thus ultimately limiting political competition (OECD 2016). Samuels (2001) argues that whether spending limits create relative disadvantages depends on the general advantage of an incumbent in terms of reputation and voter base. He suggests that if the general advantage is strong as in the US, spending limits may be detrimental to the chances of the challenger. However, if the general advantage is low as in Brazil, spending limits may not have a differential effect on incumbent and challenger.

Although spending limits remain a controversial topic, the majority of OECD countries (65%) have introduced such limits (OECD 2016). The exact level at which spending limits should be placed remains context-specific among countries. Korea designs the limit in accordance with the socio-economic dynamics of each election, taking the voter population, number of constituencies, and inflation rate into consideration. While Korea limits total expenditure, Brazil, Chile, and Mexico, for example, place spending limits on particular expenditures, such as TV advertisements.

LIMITING ABUSE OF STATE RESOURCES

To ensure a level playing field between incumbent and challenger, incumbents must be restricted in their privileged access to state resources. Abusing government

resources to promote re-election occurs, for example, when state-offices are used for party meetings, official vehicles become means of transportation during campaigning, and advertisement materials are printed in government facilities. Given the prevalence of such incidents in the past, the abuse of state resources is one of the most effectively addressed risks involved in political financing, with 82% of OECD countries banning the illicit usage of state resources (OECD 2016). While most countries oversee the general adherence to the ban, Japan specifically focuses on advertisement expenditure. During election periods, all advertisements are monitored in terms of number and length, including print, radio, and television ads (OECD 2016). The allocation is equalized for all running parties to ensure that no abuse of state resources occurs, and it thus establishes a level playing field amongst them.

Researchers have voiced the concern that limiting the abuse of state resources may create a double advantage for incumbents if it coincides with spending limits. First, incumbents can circumvent the ban on using state resources if they remain undetected as they are close to the source, while challengers have no access to the resources (Pinto-Duschinsky 2013). Second, incumbents can hide campaign expenditure in their legislative duties to circumvent spending limits, while challengers are unable to spend more since they have no access to additional resources (Pinto-Duschinsky 2013).

TOO MUCH LAW, TOO LITTLE ENFORCEMENT

While many countries have reformed their political finance structures, the lack of compliance and enforcement remains a prevalent issue. In isolation, political finance regulations remain relatively ineffective (OECD 2016), their potential being undermined by a lack of political will and capacity (Balise 2016). In response, the OECD framework presents three additional objectives to be addressed simultaneously to the level playing field, namely: transparency and accountability, a culture of integrity, and compliance and review mechanisms.

Transparency and accountability require disclosures in the form of comprehensive and timely reporting. However, since these reports have been described as "works of fiction" in France, "just the tip of the iceberg" in Japan, and "inventions of breathtaking scale" in the United Kingdom (Pinto-Duschinsky 2013), they must coincide with independent and reliable systems of scrutiny. Lord Bew (2013) said that in order to fundamentally affect the system, "changes must be incorporated into the culture of the organization, driven by leadership and positive example". To foster a culture of integrity, the OECD framework suggests addressing public and private donors separately by introducing codes of conduct, disclosure provisions, and whistleblower protection in the public sector, and by establishing self-regulation and appropriate accounting practices in the private sector. While these suggestions aim to create incentive mechanisms to promote compliance, the enforcement must be further promoted. The OECD framework suggests an independent and effective oversight body, dissuasive and enforceable sanctions, a constant appraisal of the system, and the provision of support to help political parties comply with the regulations and better understand political finance.

In conclusion, there is no one-size-fits-all model, and differences between countries must be incorporated into the design of a regulatory framework. However, regardless of structure, the institutions responsible for enforcing political finance regulations must have a clear mandate, legal power, and the capacity to conduct effective oversight and enforce sanctions. In an attempt to further develop the political finance structures, countries would potentially benefit from highlighting and sharing effective practices to identify variations of policies and practices that effectively safeguard the integrity of the political process (OECD 2016). Overall, establishing a framework to address the paradox within public funding is a key lever for restoring society's trust in government, and for forming a foundation for inclusive growth (OECD 2016). As stated by Lord Bew (2013), "society can expect better outcomes when decisions are made fairly and on merit, and not influenced by alternate interests".

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