

## **Part 2**

### *Annexes*



## Introduction to Part 2

The Annexes to the interim assessment fall into three categories.

The first section contains more information about the Review. This explains how the Review is going about its work and what it hopes to achieve. The *Objectives of the Review* discusses what the Review is trying to achieve. The *Process of the Review* includes details of the political parties that have been contacted and ways the public has been involved so far.

The second section provides background information on the current system of party funding in the UK. It puts the work of the Review in a wider context. *Recent Views on Party Funding* sets out the views that committees, other reviews and think tanks have put forward in the last few years. *Political Party Income and Expenditure for the Last Four Years* shows how much money the political parties with representation in the devolved assemblies, European Parliament and Westminster have received and spent in the last four years. *Existing Public Funding* explains why each area of public funding was developed and the different criteria used to allocate it.

The last section provides a more detailed analysis of some of the issues discussed more briefly in the different scenarios. There are no Annexes related to scenario 1.

### Scenario 2

*Regulating Campaign Expenditure* considers some of the concerns that the current system has enabled money to be targeted at marginal seats despite the limits and whether a different approach to the detail of regulating campaign spending is needed.

### Scenario 3

*Financial Effects of a Cap on Donations* uses the data available on donations to help weigh up the effects a cap on donations may have and contribute to the debate on public funding.

*Trade Unions* looks at the existing laws that regulate the political activities of trade unions and makes them different from other organisations.

*Third Party Campaigning* assesses the impact that people who campaign for or against a political party, but are not part of that party have, the existing controls on this type of campaigning and whether changes such as a cap on donations would diminish the central role of political parties in campaigning to win elections.

### Scenario 4

*Ways an Incentive Scheme Could Work* identifies some of the options for operating an incentive scheme to provide examples of how such a scheme could work and whether it would be practical.



# Objectives of the Review

When the Review began there was a general feeling, shared by experts, the public and the parties alike, that, rightly or wrongly, there was a lack of public confidence in how political parties were funded. This concern seemed to coalesce around three public policy issues: the perception of buying influence; the amount of money that is spent at elections; and the need for more democratic engagement. This general feeling forms part of the background against which the objectives of the Review were originally formulated.

## Published objectives

*The following objectives were published on our website in July:*

I started off by making three assumptions. These were:

- The financial health of political parties is fundamental to our parliamentary democracy;
- How parties are funded should be fully transparent; and
- A future system should encourage democratic engagement and be as fair as is possible between parties.

Working from these assumptions I adopted the following objectives for the Review:

- To improve public confidence in party funding;
- To try to ensure that parties compete on the basis of policies and competence, not money;
- To contribute to greater democratic engagement; and
- To be as fair as is possible to all political parties and candidates.

### *Objective 1. To improve public confidence in party funding*

The public needs to be reassured that the system of party funding is transparent, open and well-regulated. Most people are probably unaware in any detail how parties are funded including, for example, that there is already some public funding for parties. Any system of party funding, especially if the public's money is involved, must be fully accountable. The Electoral Commission currently regulates the system on the public's behalf, except on the issues where Parliament regulates the use of the money it provides to parties and MPs that is intended to support their Parliamentary activities. The role of the Electoral Commission is being reviewed by the Committee on Standards in Public Life. I want to ensure that the work we each do is well coordinated and that our conclusions, if possible, are complementary.

### *Objective 2. To try to ensure that parties compete on the basis of policies and competence, not money*

In 1998 the Neill Committee recommended a cap on the amount that political parties can spend at elections and this was introduced; there have for many years been caps on what candidates can spend. It is now suggested, by the Electoral Commission among others, that the expenditure allowed in an election year should be further reduced, and some think there should be a ceiling on expenditure in every year. My objective is to avoid an "arms race" on campaign expenditure, while still allowing parties to campaign effectively and fully inform the public of the issues at stake.

### *Objective 3. To contribute to greater democratic engagement*

Greater engagement with the democratic system is a widely shared objective; that is, increasing the number of members of the public that are involved in politics and with political parties, and using politics as a means for people to be empowered and take control of their lives. As we live in a Parliamentary democracy this should mean engaging with political parties. Although the Review is about funding, rather than democratic engagement, encouraging more engagement in the party political process should be a factor taken into consideration when weighing up different options for the party funding system.

### *Objective 4. To be as fair as is possible to all political parties and candidates*

My review should try to avoid giving advantage to parties on the basis of any of the following:

- Whether a party is new or established;
- The size of the party;
- Whether the party is contesting seats in all of the UK or only part of it;
- Whether the party is in government or not; and
- The wealth and influence of the party's supporters.

### *Tests*

The tests against which I will assess both the various proposals put to me and my final recommendations lead on from the objectives. They are that:

- Political parties have sufficient money to fulfil their function;
- There is sufficient transparency so that sources of funding are clear; and that
- The proposals can be properly policed in a cost-effective way.

These tests are common ground. They reflect other publicly available statements of principle, such as those published by the Electoral Commission, the Hansard Society, and the Council of Europe, as well as the statements made by the political parties.

# Process of the Review

## Terms of reference

The terms of reference are as follows:

“To conduct a review of the funding of political parties.

In particular:

- To examine the case for state funding of political parties including whether it should be enhanced in return for a cap on the size of donations;
- To consider the transparency of political parties’ funding;
- And; to report to the Government by the end of December 2006 with recommendations for any changes in the current arrangements.

Sir Hayden Phillips will work closely with stakeholders including, especially, the political parties and the Electoral Commission. He has been asked to aim to produce recommendations which are as much as possible agreed between the political parties with a view to legislation as soon as Parliamentary time allows.”

## Process of the Review

The way I have chosen to undertake the Review is through three broad, interwoven strands of work. These are:

- Analysis of the issues;
- Public engagement; and
- Engagement with the political parties.

## Analysis of the issues

The analysis strand is looking at the current situation, both in terms of the law and practice, and how any future system could work. It includes statistical modelling of the various options around a possible cap on donations.

I have been very fortunate in that I have been able to build on the work already done, especially the Fifth Report of the Committee on Standards in Public Life, the Neill Committee report, entitled “The Funding of Political Parties in the United Kingdom” (1998).<sup>12</sup> In addition, many people have been very generous with their time – politicians, academics and expert practitioners, not forgetting ordinary members of the public who have been willing to share their views with me and in some cases enter into discussion with me and members of my team to discuss further the issues and ideas raised.

I have been ably assisted by a number of academics who attended a seminar that was hosted for us by Professor Robert Hazell, at the Constitution Unit of the University College London. In addition some of them have generously allowed me to meet them and discuss the relevant issues. Professor Justin Fisher of Brunel University, and Professor Tim Besley of the London School of Economics, have kindly agreed to advise us.

In addition, I have had regular meetings with Sam Younger, Chairman of the Electoral Commission, in his role as regulator of the system, and with Sir Alistair Graham, Chair of the Committee on Standards in Public Life, and I am grateful for the assistance that they and their staff have given to me.

During the Electoral Commission's international conference on the regulation of political party financing in September I was able to discuss the key issues with some of the leading practitioners from around the world, including Jean-Pierre Kingsley, Chief Electoral Officer, Elections Canada; Nicole Gordon, former Executive Director of the New York City Campaign Finance Board; Ellen Weintraub, Commissioner of the US Federal Electoral Commission; and Paul Dacey and Kevin Bodel, respectively Deputy Electoral Commissioner and Director of Funding and Disclosure of the Australian Electoral Commission.

## **Public engagement**

The public engagement strand began when we launched our website, [www.partyfundingreview.gov.uk](http://www.partyfundingreview.gov.uk), providing information and inviting public comment. On 25 July we launched our online forum, hosted by the Hansard Society, allowing members of the public to debate the issues with each other and with us.

We have entered into a dialogue with the public, responding to the emails and letters we have been sent, asking people further questions, listening to what they have to say, and feeding their views into our analytical work and my discussions with the political parties.

To date I have received over 1,100 letters, more than 200 emails, over 200 posts to our online forum, and more than 3,500 visits to our website. Almost 3,000 copies of our information booklet have been distributed.

In addition, the Electoral Commission and Social Market Foundation ran a seminar in May with politicians and journalists discussing the various issues involved; the Joseph Rowntree Reform Trust asked questions on party funding in an opinion poll; the New Politics Network has conducted a survey among local party activists, run a website, and has held fringe events at the party conferences; and the Electoral Commission has undertaken quantitative research, that is, opinion polling, and qualitative research, through deliberative forums, into public attitudes. I understand that the Commission will continue to undertake this research, looking among other things at the public's views on the scenarios contained in this assessment. I am very grateful for all these organisations, and others, for sharing their research and their results with me.

I hope that the publication of this interim assessment will stimulate a further round of public discussion of the issues.

## **Engagement with the political parties**

At the start of the review I invited all parties represented in the UK Parliament, the European Parliament, the Scottish Parliament, the National Assembly for Wales, and the parties based in Northern Ireland to meet me. I am pleased to say that I have met or have arranged to meet all those that requested a meeting, a number of them on more than one occasion. This has included travelling to Northern Ireland, Scotland and Wales to meet parties represented there. It has been invaluable for me to see the issues through the eyes of the people directly involved in the running of parties, and I thank the parties for their contribution and openness.

## Recent Views on Party Funding

The funding of political parties is under heavier scrutiny than at any other time in recent history. We currently have a funding system with a large degree of transparency, and yet trust in how parties are funded has not increased, even though more information than ever before is in the public domain. The issue that gave birth to this Review was the controversy about loans to political parties, the reporting of which has been resolved due to the provisions put into the *Electoral Administration Act 2006*.

The Review offers a chance to look at how political parties are funded in the round, looking at both income and expenditure, and also how much of that income comes from the state either directly, in terms of grants, or indirectly, for example in terms of freepost at elections.

### *Fifth Report of the Committee on Standards in Public Life (“the Neill Committee”) – 1998*<sup>13</sup>

The Neill Committee’s recommendations concentrated on creating a more open and transparent system, so that the public would know where the money was coming from in terms of the reporting of donations, and where it was being spent, in terms of the reporting of national party campaign expenditure. The Committee also recommended creating an Electoral Commission, which would have as one of its core functions monitoring and regulating the party funding system.

The Government accepted the vast majority of the Neill Committee recommendations, and these became law with the passing of the Political Parties, Elections and Referendums Act 2000. The key principles underlying the Neill Committee recommendations, openness and transparency, are now an accepted public expectation.

The Neill Committee also recommended a slight increase in public funding through the creation of a Policy Development Grant that would allow parties represented in the House of Commons to formulate their policies more effectively. It also recommended that tax relief for donations be introduced, which was a recommendation not accepted by the Government. However, overall the Neill Committee felt that the time had not come “if it ever will” for substantially increased levels of state funding.

It should be noted, though, that the background against which the Committee made its report was significantly different from the current situation. Since 1998, when the Committee reported, there has been a large drop in turnout at general elections, down 12 percentage points between 1997 and 2001; the membership of the main parties has decreased substantially, especially affecting the number of activists at a local level; parties have found themselves in significant debt; there is a police investigation into allegations of abuse of the honours system; and there has been a massive growth in the use of new technology, especially mobile phones and the internet, with the different opportunities for campaigning and organising that these allow. These changes perhaps help to explain why the issue of party funding has not gone away in the intervening years.

### *Institute for Public Policy Research (ippr) report “Keeping it Clean” – 2002*<sup>14</sup>

The ippr report of 2002 identified two key problems: declining membership; and the so-called campaign “arms race”. It was argued that both these factors compel parties to seek large donations even though the donations are then made public, and are often subject to a great deal of negative publicity.

The ippr report recommended a donation cap of £5,000, arguing that this was a level where the public could see that donations could not buy influence or be perceived as buying influence. The

report argued that the fall in income due to a cap could be alleviated by lessening the amount parties could spend at an election, and possibly by controlling the amount that parties could spend annually. The authors recommended incentives at the local level for parties to recruit and retain members and small donors, such as a system of “Tax Relief Plus” to incentivise the donor and reward the party. For example, a maximum donation of £50 might attract £50 from the state while a £100 donation might gain an £80 top-up.

### *New Politics Network “Strong Parties, Clean Politics” – March 2003<sup>15</sup>*

The New Politics Network published a report featuring articles from MPs from the three main political parties, arguing for further reform of the party funding system. In his introduction, Peter Facey, the Director of the New Politics Network, argued that further reform of the party funding system could end the perception of sleaze. He said that:

“we wish also to illustrate the immense opportunities such reform could bring if approached with these additional objectives borne in mind. We have a rare opportunity to look at the general health of our parties, to stabilise political party membership, remove the concern that parties are beholden to a few rich backers, and to create a framework under which parties seek new and effective opportunities to engage with the electorate.”

In addition, the New Politics Network published a report in 2004 entitled “Life Support for Local Parties”, looking at the parlous state of many local constituency parties in terms of the number of members they have, and arguing that this could be strengthened through reform of the party funding system.

### *Electoral Commission “The Funding of Political Parties” – December 2004<sup>16</sup>*

Over the course of 18 months the Electoral Commission conducted a comprehensive review, including hearing from the experts in the field and conducting in-depth assessments of public opinion. The report recognised the funding challenge facing parties, and that there was no public appetite for large-scale state funding. It argued that political parties should concentrate their efforts at the local level, and recommended tax relief for small donations, and an equivalent scheme for non-taxpayers. In the view of the Electoral Commission, this would have the desirable consequences of delivering broader streams of income, and of encouraging more effective engagement with the electorate.

The Electoral Commission did not recommend a cap on donations, but it did say that if a cap were to be introduced it should be set at a low level, and the figure the report mentioned was £10,000.

The report also recommended lowering the amount parties could spend at national elections and raising the amounts that candidates could spend. This would be aimed at stimulating more local campaigning by parties. In addition, the report recommended extending the Policy Development Grant scheme, recommended by the Neill Committee, from solely parties represented in Westminster to include parties represented in devolved administrations and the European Parliament.

### *POWER Inquiry – March 2006<sup>17</sup>*

The POWER Inquiry conducted a wide-ranging investigation into the causes of the recent decline in involvement in politics in the UK, and came out with a series of recommendations. Those directly related to party funding are that:

- Donations from individuals to parties should be capped at £10,000, and organisational donations should be capped at £100 per member and subject to full democratic scrutiny within the donor organisation.

- State funding to support local activity by political parties and independent candidates to be introduced based on allocation of individual voter vouchers. This would mean that at a general election a voter would be able to tick a box allocating a £3 donation per year from public funds to a party of his or her choice to be used by that party for local activity. It would be open to the voter to make the donation to a party other than the one for which they have just voted.

## Views since the Review began

Over the course of the last few months there have been various contributions from thinktanks and from MPs to the public debate, and some of them are discussed below.

In March, Andrew Tyrie MP published a paper “Clean Politics”,<sup>18</sup> arguing for a cap on donations at £50,000; lowering the cap on national party campaign expenditure for a general election from approximately £20 million to £15 million; tax relief for donations; and a general public subsidy to eligible parties based on the number of votes gained.

Alan Whitehead MP produced a pamphlet, “Anti-Politics and Political Parties”,<sup>19</sup> in April, making the case for increasing public funding on the basis that it provides “the guarantee that the civil life of the state functions well, and it restores the proper role of politics to the civil life of citizens.” Public funding would combat the rise of what he terms “anti-politics”, the widespread disinterest and in some cases hostility to politics.

The Leader of the House of Commons, the Rt Hon Jack Straw MP, gave a lecture<sup>20</sup> to the Fabian Society in June in which he argued that reducing election expenditure should be the priority, rather than a cap on donations. He saw a real risk in any moves that would push the funding of political parties down the same route as in the US, that is, of massive campaign spending and large amounts of unregulated expenditure, which he saw as highly undesirable.

The New Local Government Network published a paper,<sup>21</sup> also in June, making the case for political parties to be funded by a “civic aid” scheme, whereby parties would be able to claim £25 for every registered supporter or donor giving £50 or more in any one financial year. The aim would be to stimulate local democratic engagement by encouraging the parties to strengthen local activism so that they could get more people to give donations. Only parties that had signed up to a “Charter of Democratic Practice”, renouncing violence and discrimination, would be eligible for this funding.

In September, Demos published “Serving a Cause, Serving a Community”,<sup>22</sup> a paper by the Secretary of State for Transport and Secretary of State for Scotland, the Rt Hon Douglas Alexander MP and Dr Stella Creasy arguing the case for a renewal of parties, and for strengthening and reforming local party activism. The authors argue that parties must re-evaluate how they relate to the communities that they serve, and that they should open themselves up to engage with social activists. They mention the role that the funding of political parties could serve in enabling this.

The Young Foundation has recently published a paper<sup>23</sup> by Fiona Mactaggart MP, Geoff Mulgan and Rushanara Ali arguing that some activities of parties, such as the formulation of policy, the development of leaders, and the maintenance of links with the community could be classified as being in the public benefit. They argue that these activities should be legally separate from their other activities such as campaigning, and that only these public benefit activities should receive public funding, through matched funding of donations.

As has been shown, the last few years have produced a wealth of argument and discussion as to how political parties are funded. While there has not been any agreement, it is noticeable that the same themes continue to emerge, such as the importance of transparency, a reduction in expenditure limits for parties, and some form of public funding, which may indicate a growing consensus.

# Political Party Income and Expenditure for the Last Four Years

Income and expenditure for the last four years (to the nearest £'000) for political parties that have representatives at Westminster, the European Parliament, the Scottish Parliament, the National Assembly for Wales, and the parties in Northern Ireland. Figures obtained from the Statement of Accounts as submitted to The Electoral Commission and sorted by 2005 expenditure.

	2002		2003		2004		2005	
	Income	Expenditure	Income	Expenditure	Income	Expenditure	Income	Expenditure
The Labour Party	21,184	22,085	26,940	24,281	29,312	32,109	35,304	49,804
The Conservative and Unionist Party	9,928 <sup>1</sup>	10,486 <sup>1</sup>	13,619	16,034	20,041	26,238	24,227	39,206
Liberal Democrats	3,695	3,387	4,096	4,005	5,060	4,614	8,582	8,783
Scottish National Party	973	1,040	908	1,394	1,306	999	1,085	1,187
Ulster Unionist Party	563	509	726	965	619	719	592	826
Sinn Féin	521	421	750	594	620	824	707	705
Social Democratic & Labour Party	539	640	717	750	814	580	640	581
Plaid Cymru – The Party of Wales	579	537	534	581	536	472	561	491
Scottish Socialist Party	153	183	293	342	418	393	406	415
The Green Party	193 <sup>2</sup>	211 <sup>2</sup>	233	281	461	502	413	413
Respect – The Unity Coalition	<sup>3</sup>	<sup>3</sup>	<sup>3</sup>	<sup>3</sup>	498	590	435	399
Alliance Party of NI	143	155	296	300	131	126	227	270
Democratic Unionist Party	285	254	192	269	354	331	344	204
Scottish Green Party	30	21	78	81	86	84	111	102
Progressive Unionist Party of NI	32	32	65	54	72	69	35	41
Forward Wales	<sup>3</sup>	<sup>3</sup>	<sup>3</sup>	<sup>3</sup>	30	30	26	26
Independent Kidderminster Hospital and Health Concern	7 <sup>4</sup>	4 <sup>4</sup>	5	6	10	7	10	12
Scottish Senior Citizens Unity Party	<sup>3</sup>	<sup>3</sup>	6 <sup>5</sup>	5 <sup>5</sup>	12	11	10	10
UK Unionist Party	2	4	3	3	1	1	1	<sup>6</sup>
UK Independence Party	258	232	505	635	1,317	1,703	<sup>7</sup>	<sup>7</sup>

## Notes

1 Nine months to 31 December 2002

4 18 months to 31 December 2002

2 Figures from 01 September 2001 to 31 December 2002

5 From 06 February 2003 to 31 December 2003

3 Party not registered at The Electoral Commission

6 Negligible amount

7 Overdue with The Electoral Commission at time of print



## Existing Public Funding

Political parties in the United Kingdom receive public funding at present, and have done so for many years. The same is true of parties in many liberal democracies. This section describes the key elements of the existing public funding arrangements for political parties.

### Short Money

This is provided to opposition parties in the House of Commons to help them discharge their Parliamentary duties. Recipients must be represented in the House of Commons by two or more sitting MPs (that is, MPs who have taken the Oath of Allegiance to HM The Queen), or one sitting MP and more than 150,000 votes at the previous general election.

It was introduced in 1975 on the suggestion of Edward Short, the then Labour Leader of the House of Commons, and has three components:

- Funding to assist an opposition party in carrying out its Parliamentary business;
- Funding for the opposition parties' travel and associated expenses; and
- Funding for the running costs of the Leader of the Opposition's office.

It is not available to the government of the day, which can draw on the resources of the state, including the Civil Service, to meet its obligation to Parliament.

In the financial year 2005–2006, the Conservative Party received over £4 million in Short Money. The Liberal Democrats received around £1.5 million; they do not receive any money in relation to the running of the office of their leader. Other eligible parties with representation at Westminster received lesser amounts, dependent on votes cast and seats won.

Sinn Féin is not eligible for Short Money as its MPs do not take the Oath. But it does receive funding analogous to Short Money to help its MPs undertake their representative business.

Short Money is administered by the House of Commons authorities.

Equivalent funding schemes exist for parties represented in the Scottish Parliament, the National Assembly for Wales and the Northern Ireland Assembly.

### Cranborne Money

A similar scheme for opposition groups exists in the House of Lords. Cranborne Money, named after the then Leader of the House of Lords, was introduced in 1996. It is to help opposition parties and crossbenchers to conduct Parliamentary business.

In 2005–2006 the Conservative Group received around £435,000 in Cranborne Money, the Liberal Democrats Group £210,000, and the Convenor of the Crossbencher Peers £38,000.

Cranborne Money is administered by the House of Lords authorities.

### Policy Development Grants

Policy Development Grants are specifically provided to enable parties to prepare policies for inclusion in their manifestos. They have been provided since 2002.

A £2 million fund is distributed annually among political parties with two or more sitting MPs. It is divided according to a complex formula which seeks to benefit all eligible parties. It is divided equally among parties contesting the same geographical area. In Great Britain the Conservatives, Labour and Liberal Democrats receive the same amount of money, approximately £458,000. In Northern Ireland the eligible parties there, the DUP and the SDLP, receive the same amount of money, approximately £155,000. The Scottish National Party receive approximately £162,000 and Plaid Cymru approximately £151,000.

The Policy Development Grant is administered by the Electoral Commission.

## **Indirect public funding**

When parties and candidates put themselves forward for election they become eligible for support in kind. The principal methods are set out below.

### *Party political broadcasts*

Political parties do not have to pay for the air time they obtain for party political broadcasts. As a general rule, party political broadcasts are available to all parties that put candidates forward in at least one-sixth of the contested seats across the UK or one of its constituent countries.

The terrestrial commercial broadcasters are under a statutory obligation to carry party political broadcasts, while the BBC has a formal obligation to carry them under its Charter Agreement.

It has been estimated that if the parties had to buy equivalent advertising time at commercial rates, their value would be in the region of £68 million for an election year, and £16 million in a non-election year.<sup>24</sup>

### *Freepost at elections and use of meeting rooms*

Candidates are entitled to free postage for one election mailing to each elector in the constituency. This applies to elections to devolved bodies and the European Parliament as well as general elections. It is not available for local government elections in Great Britain although it is provided for local elections in Northern Ireland. For general elections the total cost of freepost is over £20 million.

Candidates are also entitled to the free use of public meeting rooms, e.g. schools, town halls, for all elections in Great Britain. There is no such provision in Northern Ireland.

# Regulating Campaign Expenditure

## Specific concerns with the current system

The Review is aware of concern that some parties are using material that counts towards the national expenditure limit in a targeted way in marginal constituencies to enable them to spend more there than the candidate limit alone would allow. Examples include letters addressed to individual voters from a party leader and leaflets put through letter boxes in marginal constituencies which only mention the name of the party. Some feel this goes against the spirit of the current rules which intended national campaigning to cover only those activities with truly national coverage of voters.

A further specific problem is caused by candidate campaign expenditure limits coming into effect only five to six weeks before an election. This means large amounts of money can be spent in constituencies close to the date of election which are not regulated or reported. The Electoral Commission register of donors shows that some donors gave donations to multiple constituency parties, many of which were well over the limit of what candidates can spend on campaigning in the regulated period for a general election.

The Electoral Commission proposed increasing the limit for the regulated period for candidates to four months but this was rejected by Parliament during the passage of the *Electoral Administration Act 2006* because of practical concerns over finding election agents for the four-month period and uncertainty as to when the four-month period would start.

The Electoral Commission has held a series of consultative meetings with political parties around the UK to seek their views on these specific issues and will be reporting in due course. However, a new approach to regulating expenditure could help overcome these difficulties.

## Changes to the way campaign expenditure is regulated

The Review is also aware of issues around the present regime for regulating election campaign expenditure that go beyond discussion of whether the current limits are the right ones. The system for regulating candidate spending at general elections devised in 1883 still underpins the current regulation of election spending. Many of the principles remain the same, but changes in society, the electoral system and party campaigning all point to problems with the approach. A different century faced different problems. It may be that the time has now come to change the whole approach to regulating campaign expenditure rather than modifying a nineteenth-century model.

Current expenditure limits are based on a specific definition of campaigning in relation to election periods. However, political parties are always seeking to persuade people on a range of issues that their ideas and approach are better than other political parties. This is the primary purpose of political parties and is positive for democracy. People are being encouraged to get involved to establish a progressive momentum towards an election. The specific activities a party decides to carry out at a certain point in time will be influenced by the electoral cycles, but persuading voters is a continuing, positive activity.

Regulation faces an additional challenge when the defined periods for election campaign spending overlap, as happened with the European Parliament election of 2004 and general election of 2005.

This problem could be avoided if, rather than trying to define the period in which election campaigning takes place, there were continuous limits on party campaign expenditure. Parties

could be given an expenditure limit for the whole year. These could apply to parties separately at a national and local level to take into account the different ways political parties are organised. The limits might be further adjusted to take account of the number and type of elections occurring in a year.

Continuous regulation of expenditure could be applied to local parties to ensure that the money spent locally is recorded and included in expenditure limits. This would be a significant addition to the workload for local parties, although regulation could be made proportionate; only basic information might be required from local parties with low levels of expenditure. The regulation of charities could provide a possible model as it is flexible and recognises some charities are large, professional organisations while others are small and run by volunteers. Charities are required to present expenditure in particular formats and financial thresholds determine how much information charities have to provide.

Some would argue that it is important that candidates can spend to campaign in elections without the money being controlled directly by the party. A specific limit could remain for candidates to use in the period five to six weeks before the election, but with all their expenditure outside of this period being local party expenditure. This would, however, introduce a third category of expenditure for political parties to manage, adding further complexity.

### *Advantages*

A more continuous process of regulation would better reflect the current climate of continuous campaigning. It would also avoid specific concerns that large amounts are spent in marginal constituencies promoting candidates before the candidate limit comes into force five to six weeks before the election. This spending is currently not reported anywhere as it does not come under the definition of national party spending, and it is incurred before the candidate spending limit takes effect. Even if the regulated election period is lengthened, there is likely to be a tendency for those parties with sufficient money to spend large amounts just before any election period starts. There are a number of permutations for how continuous regulation of expenditure could help solve these problems, but broadly speaking by doing away with election periods it would prevent parties or candidates from frontloading expenditure to avoid them.

### *Disadvantages*

Parties rely on volunteers at local level and many are already struggling to find people to take posts such as election agent or local treasurer as a result of falling membership and the increased responsibilities regulation has placed on these office holders. At the moment election agents are legally liable for ensuring their candidates do not exceed the election campaign expenditure limit. While some are prepared to take the responsibility for a five to six week period, there are already difficulties finding people willing to do this. It would be more difficult to find someone willing to take legal liability for reporting all local party expenditure and making sure the expenditure limit is adhered to year in, year out.

Not all elections are fought on the basis of parliamentary constituencies, which tend to form the basis for the organisation of local party units. This would make year-round regulation of local expenditure difficult where elections were being fought across different boundaries. It would also cause difficulties where campaigning is taking place for parties using a list system of proportional representation.

Parties have a certain amount of expenditure that is not directly connected with a particular election campaign. It is difficult to draw the line between core expenditure and campaigning. Examples are member relations, accountancy, building, office expenses and staff. For example, staff may be campaigning and a mailing may be used to encourage members to campaign.

Buildings may be located in prominent places to increase the local presence of a party and office expenses may include stationery and postage used for campaign mailings. Expenditure may also not be evenly distributed, for example new computer software to help all campaigning activities may artificially increase spending in one year but provide benefits over a number of years.



## Financial Effects of a Cap on Donations

To understand the possible effects of any cap on donations, the amount that parties currently receive and the amount that they spend need to be analysed. The following information has been taken from the three main parties' annual Statement of Accounts, which are sent to the Electoral Commission and made publicly available. All figures are in millions of pounds.

### Conservative Party

	Donations, including membership fees	Total Income (including donations)	Expenditure
2002 <sup>1</sup>	Approx 11.0	Approx 15.8	Approx 16.7
2003	8.5	13.6	16.0
2004	14.7	20.0	26.2
2005	14.4	24.2	39.2
<b>Annual Average</b>	<b>12.5</b>	<b>19.3</b>	<b>27.1</b>

Total net liabilities as of 31 December 2005 = £18.0m

<sup>1</sup> Due to the reporting year for the Conservative Party being the financial year rather than the calendar year in 2002 those figures have been disregarded in calculating the average.

### Labour Party

	Donations, including membership and affiliation fees	Total Income (including donations)	Expenditure
2002	14.1	21.2	22.1
2003	19.3	26.9	24.3
2004	20.0	29.3	32.1
2005	25.6	35.3	49.8
<b>Annual Average</b>	<b>19.8</b>	<b>28.2</b>	<b>32.1</b>

Total net liabilities as of 31 December 2005 = £27.2m

### Liberal Democrats

	Donations, including membership fees	Total Income (including donations)	Expenditure
2002	1.7	3.7	3.4
2003	2.1	4.1	4.0
2004	2.8	5.1	4.6
2005	6.2	8.6	8.8
<b>Annual Average</b>	<b>3.2</b>	<b>5.4</b>	<b>5.2</b>

Total net assets as of 31 December 2005 = £298,000

This shows that, for the three main parties, the proportion of donations as part of the total income ranges from approximately 50% to approximately 80% depending on the party and the particular year. The amount of donations increases in the year prior to a general election.

Donations of over £5,000 to a central party, or over £1,000 to an accounting unit, have to be declared to the Electoral Commission. We used this publicly available data to calculate what the effects of any cap would be in terms of the reduction of party income. We have cleaned the data as much as possible, seeking accurately to record the amount each donor gave in any one particular year. If a donor gives quarterly it currently appears on the Electoral Commission register as four separate donations. We assumed that any cap would apply to the total amount a donor gives on an annual basis, and so adjusted the data accordingly.

It should be noted that as donations of under £5,000 to a central party, or £1,000 to an accounting unit, do not have to be recorded or reported to the Electoral Commission, the figures we have used only deal with reported donations, and therefore do not tell the whole story of the number of donations received. However, we believe any margin of error to be minimal, and any impact on the results to be negligible.

In addition, due to the very nature of the fact that we are dealing with donations to political parties, it is difficult to predict with certainty future trends, so the analysis can only be based on past behaviour, and on an assumption that future trends of donations would be similar. In general, the trend is that donations follow the perceived success of a party.

## Shortfalls

We calculated the average yearly amount that parties would receive if a cap were set at various levels between £100,000 and £5,000. The range of the shortfalls that the parties would face is as follows:

	Cap £100,000 – £5,000
Conservative Party	£3.1 – 7.2m
Labour Party	£6.9 – 12.6m
Liberal Democrats	£0.6 – 1.3m

We then made certain assumptions about the change in behaviour that may be expected as the result of a cap. These were that:

- Parties would seek to encourage more donations;
- Donors would seek to avoid the cap by channelling donations through family members and other sources; and
- Parties would actually spend less, possibly in conjunction with a reduction of the amount the national party can spend at a general election.

Different scenarios could be modelled by altering the percentage effect of the above changes, which may be driven by a publicly funded incentive scheme for members or small donations, a cap on election expenditure, and other factors. Obviously behavioural changes are notoriously difficult to predict, so again this adds an element of approximation into the modelling.

## Adjusted shortfall

Assuming variations of 10% in each of the three variables, that is, a 10% increase in parties seeking donations and in large donations being split and channelled through other sources, and a 10% decrease in the amount of donations required due to decreased spending, the following

adjusted figures show the range of the shortfalls that the parties would face, again with a cap set between £100,000 and £5,000.

	Cap £100,000 – £5,000
Conservative Party	£0.8 – 5.1m
Labour Party	£4.3 – 10.4m
Liberal Democrats	£0.1 – 0.9m

With an increase of 20% in the amount of donations due to parties seeking more donors, while the other variables remain at 10%, the following range of shortfalls result (a plus sign signifies a surplus rather than a shortfall):

	Cap £100,000 – £5,000
Conservative Party	£0.2 – 4.9m
Labour Party	£3.5 – 10.1m
Liberal Democrats	£+0.1 – 0.8m

With an increase of 30% in the amount of donations due to parties seeking more donors, while the other variables remain at 10%, the following range of shortfalls result:

	Cap £100,000 – £5,000
Conservative Party	£+0.5 – 4.7m
Labour Party	£2.7 – 9.9m
Liberal Democrats	£+0.6 – 0.7m

### Reported donations average

	Cap of £100,000	Cap of £50,000	Cap of £10,000	Cap of £5,000
Conservatives	£6.5m	£5.7m	£3.5m	£2.4m
Labour	£8.1m	£6.2m	£3.4m	£2.5m
Liberal Democrats	£1.6m	£1.4m	£1.0m	£0.8m

### Shortfall

	Cap of £100,000	Cap of £50,000	Cap of £10,000	Cap of £5,000
Conservatives	£3.1m	£3.9m	£6.1m	£7.2m
Labour	£6.9m	£8.8m	£11.6m	£12.6m
Liberal Democrats	£0.6m	£0.8m	£1.2m	£1.3m

**Adjusted shortfall with 10% change in variable factors**

	Cap of £100,000	Cap of £50,000	Cap of £10,000	Cap of £5,000
Conservatives	£0.8m	£1.7m	£4.0m	£5.1m
Labour	£4.3m	£6.4m	£9.4m	£10.4m
Liberal Democrats	£0.1m	£0.3m	£0.7m	£0.9m

## Trade Unions

Different issues arise in relation to the funding of political parties for trade unions compared to other organisations because their political activities are regulated differently. *The Trade Union and Labour Relations (Consolidation) Act 1992* includes restrictions on the political activities trade unions can carry out, such as donating to a political party. An independent person, the Certification Officer, has the main responsibility for enforcing the law.

The regulation of trade union political activities and their financial relationship with political parties is often misunderstood. The first section of this Annex explains the current regulations relating to the political activities of trade unions. The second section looks at the implications for the different scenarios.

### Current regulations relating to the political activities of trade unions

#### *Political funds*

A trade union can only carry out political activities if its members have agreed that the union can pursue political objectives. All activity in support of the political objectives must be paid for from a special fund set up for this purpose, known as the political fund. A trade union must ballot its members initially on whether to pursue political objectives and set up a political fund. It holds a ballot every 10 years thereafter. If the members do not agree to the union having political objectives and setting up a political fund, the trade union will not be able to carry out any of the activities specified in law as being a political object.

The political fund is financed by contributions from trade union members. This is a separate contribution paid on top of the membership subscription fees and this can only be used for the political fund. It is sometimes referred to as the ‘political levy’. The general membership contributions cannot be used for political activities.

Under law, trade union members in Great Britain have the right to opt out of paying contributions to the political fund. In the past, changes have been made to the law to require trade union members to opt in to paying contributions to the political fund. The issue of whether the assumption should be that trade union members pay, or do not pay, has been controversial. The latest figures for Great Britain show that approximately 10% of trade union members opted out of paying a contribution to the political fund in 2006. For the affiliated trade unions, the figure is very slightly higher.<sup>25</sup> In Northern Ireland, trade union members opt in to paying these contributions.

The political funds of trade unions are overseen by the Certification Officer and he can investigate complaints by union members into the handling of contributions to the political funds and requests to opt out.

There are 201 trade unions.<sup>26</sup> Of these, 29 have political funds. The latest figures show the combined balance of all political funds on 31 December 2004 was £13.4 million.

#### *Political funds in affiliated trade unions*

Of the 29 trade unions with political funds, 17 trade unions are affiliated to the Labour Party. UNISON has two political funds, an affiliated political fund known as Labour Link and a general political fund which is not affiliated to any political party.

Trade unions affiliate to many organisations, not just political parties. For example, many affiliate to the Trades Union Congress and international labour organisations.

Affiliation is a description of a category of membership open to an organisation rather than an individual. It does not necessarily mean that each member of a trade union would wish to join that organisation, but that the trade union as a whole wishes to.

The organisation being affiliated to will decide how much it wishes to charge other organisations to affiliate to it in the same way that it would decide how much it wishes to charge individuals who wish to join it. This will often be based on the size of the organisation that wishes to affiliate and in the case of trade unions the number of members is often used as a measure of size. However, the trade union may have discretion over how it wishes to define the number of members it has. For example, it may have the freedom to exclude certain categories of membership, particularly those who do not pay subscriptions to the union, such as honorary, retired or unemployed members. The Review is aware of anecdotal evidence that affiliations to other organisations may use a particular definition of “member” for financial reasons if the trade union cannot afford to pay an affiliation fee based on its total membership or to increase its voting power within the organisation it is affiliating to.

Affiliation to the Labour Party follows a similar pattern to affiliation to other organisations. The process is illustrated in the figure following. At present, the Labour Party asks affiliated trade unions to pay £3 per member affiliated. Trade unions can also affiliate at a regional level to the regional Labour Party and at a branch level to a Constituency Labour Party. Affiliation to the Constituency Labour Party costs £6 per 100 members.

The view that trade union affiliation is organisational membership is not agreed by everyone. Some people say that trade union affiliation should be seen as a collection of individual membership subscriptions. They point to the link between individual contributions to the political fund and the amount paid in affiliation fees; to individual trade union members voting on whether the trade union should affiliate; and to individual union members voting in elections for Leader and Deputy Leader of the Labour Party.

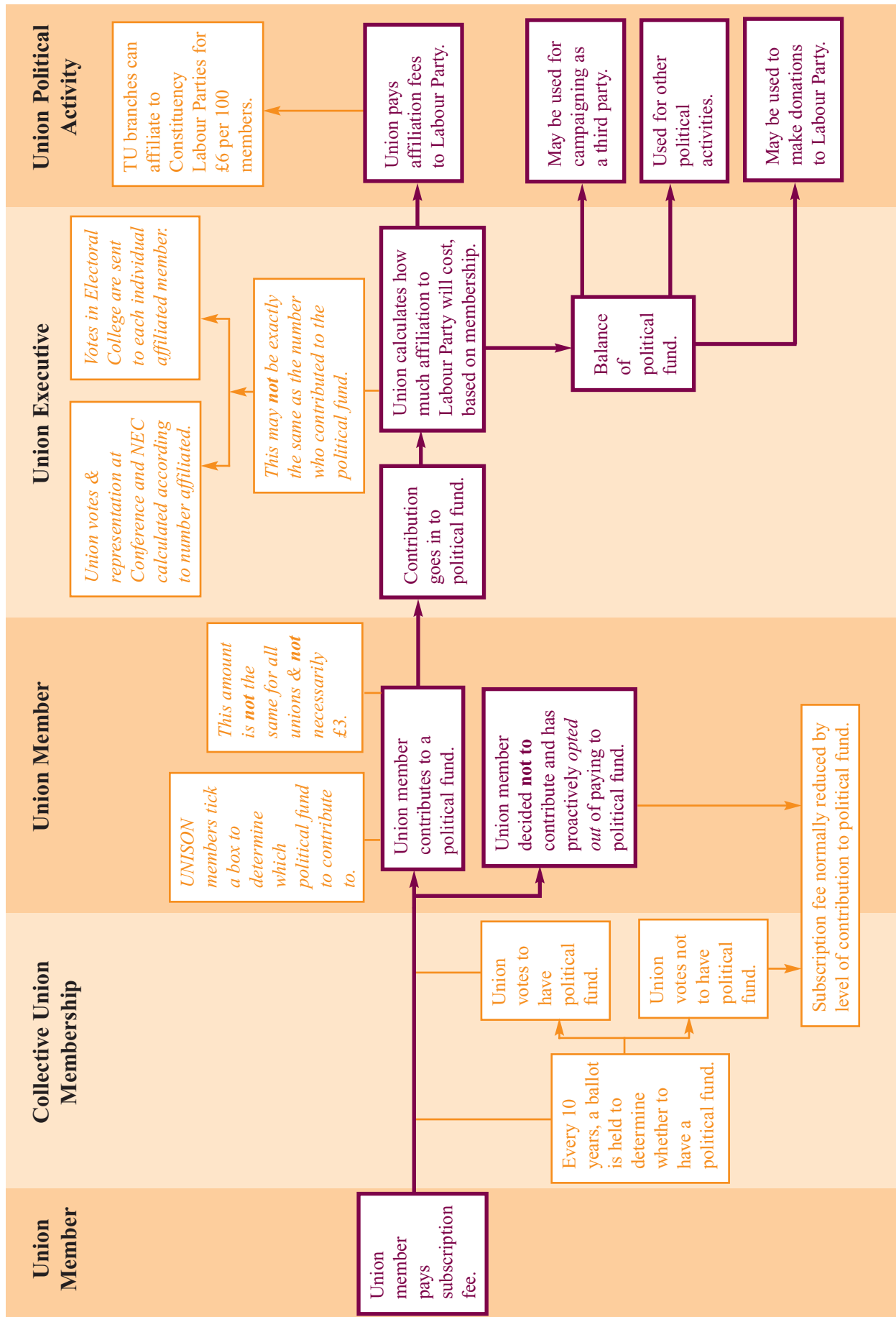
As with individual membership subscription fees paid to political parties, affiliation fees are treated as donations to a political party and are reported to the Electoral Commission in the same way. Payments over £1,000 at a local level and £5,000 at a national level have to be reported and can be viewed on the Electoral Commission’s online register of donations.

Trade unions are not the only organisations to affiliate to the Labour Party. There are also 14 socialist societies which pay an affiliation fee based on the number of members they have and are entitled to representation and votes within the party structures, in a similar way to trade unions.

As affiliation fees are payment for organisational membership, they entitle trade unions to certain rights within the Labour Party in a similar way to individual members. Affiliated organisations are entitled to send representatives to regional conferences; vote at the Party Conference; vote in the Electoral College to elect the Party Leader and Deputy Leader; and have places on the National Policy Forum and National Executive Committee.

Affiliated trade unions may also give money to the Labour Party in addition to paying affiliation fees. They use their political funds for a range of political activities, which may include campaigning at an election as a registered third party (see Annex I).

Political Funds in the Affiliated Trade Unions



### *Non-affiliated trade unions*

Non-affiliated trade unions can still use their political funds to support particular political parties. For example, the RMT has made donations to the Scottish Socialist Party. They also use their political funds for a range of other political activities, which may include campaigning at an election as a registered third party.

### **Trade unions and the scenarios for changing the way political parties are funded**

The Committee on Standards in Public Life considered how existing trade unions regulation was working and concluded, “We have received no evidence to suggest that the legislation is not working satisfactorily, and no case has been made out for any reform. We do not propose any change in the law in this respect.”<sup>27</sup> Since 2000, the Certification Officer has received three complaints regarding political funds. Two of these were withdrawn and one was not upheld.

### *Increasing transparency*

Scenario 2 outlines the advantages and disadvantages of increasing transparency and identifies areas where transparency could be increased in relation to trade unions.

### *Implications of a cap on donations*

If a cap on donations were introduced, as discussed in scenario 3, and the existing definition of a “donation” was used, then the Labour Party would have to change the basis for calculating affiliation fees where the affiliation fee worked out at more than the cap. Trade unions would not be able to pay an affiliation fee that was more than the cap in donations regardless of the number of members the trade union had.

A number of different arguments have been made on this issue. Some believe that a cap on donations should apply to trade unions for the same reasons that a cap on donations should apply to individuals and companies; that is, the perception that large amounts of money given to political parties buy influence. Others believe that trade union affiliation fees should not be restricted by a cap on donations for some of the following reasons:

- Affiliated trade unions are an integral part of the Labour Party, a different relationship to the one private sector corporate donors have with political parties
- It may require the Labour Party to change how it calculates the fees it charges trade unions to affiliate
- Requiring a change in how trade unions affiliate to the Labour Party may alter the constitution of the Labour Party. It is argued that no other political party would be affected in the same way and it is inappropriate for the state to interfere in the internal organisation of a political party. It could be seen as impinging on freedom of association.

The alternative view of affiliations, that they are a collection of individual donations, would mean that a cap on donations would prevent some trade union members from being able to affiliate. Once the collective payment had reached the level of the cap, no more members would be able to pay the affiliation fee. With this understanding, it would be open to argument whether the affiliation fee per member should be considered as the donation rather than the collective payment. The low level of the affiliation fee per member would not be affected by a cap on donations.

### *Would a cap on donations in itself cause the constitution of the Labour Party to be changed?*

Trade unionists have set out a number of reasons why they feel a cap on donations would challenge the existing structures of the Labour Party, with Professor Keith Ewing, writing in a Trade Union and Labour Party Liaison Organisation paper, stating that, “The constitution of the Labour Party would be fatally undermined”.<sup>28</sup> They stress that trade unions are members of the Labour Party and have rights according to their size. Professor Ewing says in relation to the effect of a cap on donations, “it would be absurd if a large union like UNISON could affiliate only on the same basis as a very small union”. This in turn would affect the basis of representation at the Labour Party Conference, the National Policy Forum, the internal party structures, the selection of candidates and the election of Leader and Deputy Leader. They conclude that this would impinge on the principle of freedom of association as political parties must be allowed to determine their own structures.

However, there is an alternative view that recognises that affiliated trade union involvement with the Labour Party goes beyond a financial relationship but that the wider relationship can continue even if regulatory measures such as a cap on donations mean the financial relationship changes. A cap on donations does not affect political funds. It also does not stop the Labour Party charging affiliation fees to trade unions, although it may alter the basis on which they set their affiliation fees. The trade union may end up paying less in affiliation fees, but could either redirect the political fund towards other political activities or reduce the amount they charge union members in contributions to the political fund. The Labour Party could still determine the trade union’s influence according to the number of members contributing to the political fund. Trade union representation could still be determined on the same basis as at present. The only difference would be the amount the trade unions pay in affiliation fees.

An argument can still be made that it would not be appropriate for the state to determine how political parties set their membership fees, including affiliation, but this can be seen as separate from the argument about whether a cap would change the structure and organisation of a party. Theoretically, a cap on donations would constrain all parties in terms of the level they set their membership fees although it is unlikely a cap would be set lower than any of the individual membership fees political parties currently charge. Alternatively, it could be argued that membership fees should be treated differently from donations, although steps would need to be taken to make sure membership fees were not used as a way of avoiding a cap. For example, trade union affiliation fees are not classified as donations in some existing legislation, but the *Political Parties, Elections and Referendums Act 2000* does include affiliation fees and membership fees within its definition of a donation.

### *Other effects of a cap on donations*

The concern over the impact of a cap on donations on the way political parties are organised is not limited just to trade unions affiliated to the Labour Party. A cap on all donations could affect socialist societies’ affiliation to the Labour Party. It could also affect the way the Co-operative Party is organised because over 90% of its subscription income comes from co-operative societies: trading organisations that include co-operative supermarkets. The Co-operative Party also makes donations to the Labour Party rather than incurring expenditure in election campaigning itself, as, under a 1927 electoral agreement, candidates stand on joint Labour and Co-operative Party tickets. There are currently 29 Labour/Co-operative MPs.



## Third Party Campaigning

In the context of an election campaign, third parties are people or organisations which are not themselves candidates or parties. Third parties campaign in favour of or against a candidate or political party. They have not been authorised to campaign on behalf of a candidate or party. Some people or organisations may campaign more widely on political and election issues but are only considered to be third parties under the present definition if they support or oppose a particular candidate or party.

### Present controls on third party funding

The present controls on third parties focus on campaigning during election periods. National regulation of third party expenditure during election periods was introduced in 2000. However, restrictions on what third parties could spend in favour of candidates have been around much longer. This is now set at £500.

The present system introduced by the *Political Parties, Elections and Referendums Act 2000* requires third parties campaigning nationally during an election period and who spend over £10,000 (or £5,000 in one region) to:

- Register with the Electoral Commission;
- Be subject to the same rules for receiving donations, declaring donations and providing accounts as political parties; and
- Not spend over the prescribed amount.

Election	Regulated period	Controlled Expenditure Limit			
	(ends with the date of the poll)	England	Scotland	Wales	Northern Ireland
Westminster	365 days	£793,500	£108,000	£60,000	£27,000
Scottish Parliament	4 months	N/A	£75,800	N/A	N/A
National Assembly for Wales	4 months	N/A	N/A	£30,000	N/A
Northern Ireland Assembly	4 months	N/A	N/A	N/A	£15,300
European Parliament	4 months	£159,750	£18,000	£11,259	£6,750

Source: Electoral Commission

### How much third party campaigning is there at present?

At the 2005 general election there were 26 registered third parties who spent £1.7 million between them (including one who registered but did not spend anything).<sup>29</sup> The two highest spenders were the Conservative Rural Action Group who spent £550,370 and UNISON, the public sector union, who spent £534,916. The remainder spent less than £58,000 each. Only 10 third parties registered at the 2001 general election.

## **Possible impact of change on third parties**

### *Lowering the amount that parties can spend on campaigning*

If election campaign expenditure limits were lowered further, this may increase the influence of third parties. However, if the limits on third party spending were altered proportionately and mirrored any changes in approach for regulating party and candidate expenditure, then the effect of third party spending is unlikely to change.

### *A cap on donations*

If a cap on donations were to be introduced, it may be that some donors continue to give to political parties up to the level of the cap. However, they may then spend more of their money that previously would have been donated to a political party on campaigning as a third party. This could be to campaign on a particular issue or for or against a particular party. This need not be because they are trying to find a way around the cap but simply because they wish their money to be used for political purposes.

It would be quite possible for someone who at present donates money to be used, for example, in billboard advertising, to fund billboard advertising as a third party. On the face of it, there could be little difference between a billboard funded by a party and one funded by a third party.

## **Evidence and experience from other jurisdictions**

The US is often cited as an example of why the UK needs to ensure excessive amounts are not spent on campaigning by third parties and third parties do not become dominant in elections. However, the situation in the US has resulted from some specific circumstances that are not found in the UK.

The US Supreme Court ruled that there should be no restrictions on what people can spend on campaigning as long as it is not in conjunction with the candidate. In their view, the expenditure of money was protected under the freedom of speech provisions of the constitution.<sup>30</sup> Unlike the UK, the US has no limits on spending by third parties in elections and there is much more money in politics in the US than in the UK. In particular, third parties in the US can buy television advertising, an expensive form of campaigning but one that guarantees wide coverage.

While the US Supreme Court ruled that limits on third party spending would impinge freedom of speech, the Supreme Court in Canada upheld limits of third party campaign expenditure saying that, “the spending limit system would lose all its effectiveness if the independent spending were not also limited”.<sup>31</sup>

In New Zealand, campaigning by third parties is prohibited unless it is authorised by a party or candidate. As a result it comes within the expenditure limits for the party or candidate. However, advertising promoting particular issues rather than political parties is not regulated. And so campaigning for or against a particular policy associated with a particular party is not controlled.

## **Conclusion**

Some have voiced the concern that changes to the current way political parties are funded could result in a dramatic increase in the spending and influence of third parties. This may mean that the effectiveness of lowering the campaign expenditure limit or introducing a cap on donations is reduced.

However, some make the case that as the UK has a long tradition of controlling third party spending and does not permit third parties to buy broadcast advertising time it is unlikely that

third party spending would become problematic. The culture of politics in the UK is very different from that found in the US and comparisons should be made with caution. When repeat proposals for change, careful thought should still be given to the effects on third party spending. Where appropriate, the existing rules may need to be tightened to reflect other changes made. It is unlikely that third party spending is a sufficient reason in itself for ruling out lower campaign expenditure limits or caps on donations.



# Ways an Incentive Scheme Could Work

## *Current situation*

At present donations to political parties do not qualify for income or corporation tax relief, although they are exempt from inheritance tax and capital gains tax. However, in practice, these current exemptions are rarely used.

The Neill Committee recommended that a system of tax relief should be introduced, limited to the basic rate of tax, on donations of up to £500 a year to eligible, registered political parties. This is the only substantive recommendation of the Neill Committee that was not accepted by the Government. The Government said this was because the administration and cost of tax relief to Her Majesty's Revenue and Customs (HMRC) and political parties would potentially be too burdensome relative to any prospective take-up.

The Neill Committee considered examples of tax relief systems in the US and Canada. In the US, taxpayers decide whether to contribute \$3 of their income tax to presidential campaigns, but have no say over which political party should benefit. This type of system would not meet the aims of the incentive scheme outlined in scenario 4, in as far as it would not incentivise either the political party to engage individuals, nor individuals to be engaged with parties. Canada has introduced a new system of party funding since the Neill Committee report but retained its system of tax credits. Refunds are given on income tax to individuals who donate to political parties – there is no direct benefit to the party. The system operates on a sliding scale according to the amount donated, with a 75% refund on donations of Can\$400.

The common criteria for judging mechanisms for incentive schemes are that they should be cost-effective for both parties and the Government to administer, straightforward for the public, donors and parties to understand, yet also prevent abuse or fraud. In addition, the system should support the wider aims of an incentive scheme outlined in scenario 4.

## **Possible incentive scheme mechanisms**

### *Tax relief to party*

“The essential difference between direct [public] funding and funding by tax concessions is that, in the latter case, the funding results from the decisions taken by taxpayers to support the political parties and involves a contribution by the taxpayers out of taxed income.”<sup>32</sup>

There are just over 29 million income taxpayers in the UK, while the population of the UK is just over 60 million, although not all these people will be “permissible donors”. Only a minority of taxpayers complete annual tax returns. This would make any scheme that relied on opting in through the tax return difficult to administer.

Two systems provide a model for how tax relief could work administratively: the Gift Aid scheme for charitable donations and the Mortgage Interest Relief At Source payment system (MIRAS) that operated until April 2000. These are models of how a system for funding political parties could work, leaving aside any arguments about whether political parties should become eligible for charitable status.

Charities can claim back from HMRC the income tax at basic rate that a donor has paid. The charity has to show an audit trail back to a specific donor and a Gift Aid declaration. There is no minimum amount that Gift Aid can be claimed on, although charities may choose not to if the costs in administration will be greater than the amount they will gain. There is no maximum amount as long as the individual has paid income tax greater than the amount being reclaimed.

There are detailed rules explaining exactly what is eligible and for how much. Gift Aid claims are subject to risk-based or randomly selected audit and HMRC recovers wrongly submitted claims.

The legislation that established Gift Aid uses a different meaning of a donation to that defined in the *Political Parties, Elections and Referendums Act 2000*, requiring donations to be made through freewill and not through paying for a benefit. For example, the admission fee to attend an event over and above the actual cost of putting on the event would be a donation if arranged by a political party under the *Political Parties, Elections and Referendums Act 2000*, but would not be eligible for Gift Aid if put on by a charity.

For the MIRAS scheme, the borrower paid interest to the lender minus the tax. HMRC refunded the tax to the lender directly. If the borrower was not a taxpayer, they would also pay interest minus the tax, but the lender would be refunded from the then Department for Environment and the refund was treated as public expenditure rather than income tax recovery. A tax relief scheme for political donations need not prevent non-taxpayers from participating.

If it was so desired, a limit could be placed on the amount of tax that could be reclaimed for a donor with this mechanism.

The advantages of such systems are that they put parties on a comparable footing to charities, and this may encourage people to see donations to political parties as contributing to organisations that serve the public good. The rationale for the amount the state would give is clear, and the idea that it is an individual's tax that is being refunded to the party, rather than public funding coming from general state funds, may alleviate the concerns some have that parties which they do not support are being funded through their tax contributions.

The disadvantages are the costs both to the parties and HMRC in processing claims. Only 29 million people in the UK pay income tax. It would therefore be necessary for a similar arrangement to be made for non-taxpayers. The Gift Aid rules show how complex a system could end up being.

### *Match funding*

The main differences between a tax relief scheme and a match funding scheme are the way it is administered and the amount of the incentive. As mentioned above, a tax relief scheme could have an equivalent scheme for non-taxpayers running alongside it.

In this context, match funding should not necessarily be interpreted as meaning matching donations like for like: for instance, the proportion of match funding could change depending on the amount of the donation. Such flexibility would enable a match funding scheme to be more or less generous than a tax relief scheme. It could be as simple as matching each donor who gives over £50 in a year with £25 of state funding, as suggested by the New Local Government Network. Alternatively, it could be more sophisticated such as the ippr suggestion that a £50 donation might attract £50 from the state while a £100 donation might gain an £80 top-up.

In terms of administration, the scheme could work in a similar way to tax relief. It is unlikely that an individual donor submitting details of their donation to the Government to claim match funding is going to be a cost-effective way of administering the system for either Government or political parties. Therefore it would require the political party to make the claim.

A potential disadvantage of this scheme is that it could be seen to be more open to fraud, unless a system of checks were to be built in to the system. This would need to be done without compromising the attractive simplicity of the scheme, and avoiding making the scheme unnecessarily burdensome for political parties and the state to administer.

Both tax relief and match funding schemes aim to encourage more people to give small donations to political parties and parties to engage more with potential donors of small amounts. It would be possible to design the system so that smaller donations receive proportionally more public funding than larger donations. With a tax relief scheme, this could only be done through putting a limit on the amount that could be claimed. An example of this would be the Neill Committee recommendation of limiting tax relief to donations of up to £500 a year. Donations over this amount would still receive tax relief, but only on the first £500. With a match funding scheme, a more sophisticated means of weighting donations could be used.

### Illustrations of how tax relief and match funding could work

	Donation	With public funding	Proportion of public funding to donation
<b>Tax relief with £500 cap</b>	£50	£64.10	28%
	£100	£128.21	28%
	£500	£641.03	28%
	£1,000	£1,141.03	14%
<b>Match funding weighted to favour small donations</b> (scale shown in the right hand column)	£50	£100	100%
	£100	£150	50%
	£500	£750	50%
	£1,000	£1,250	25%

### *Voucher scheme*

The POWER Inquiry, drawing on a Council of Europe suggestion<sup>33</sup> recommended that voters be given a voucher for a certain amount of public funding in a polling station at a general election. They could indicate which party should receive their voucher and need not necessarily allocate their voucher to the party they voted for, for example in the case of a person who voted tactically. The POWER Inquiry recommended that the voucher should be worth £3 and it should go to the local unit of the party and not the central party.

By distributing a voucher at a polling station it could involve more people and does not rely on people being proactive to claim the incentive. It would be easier to administer, as those attending would already have identified themselves and confirmed that they are on the electoral register. It may help increase turnout as there is value in attending a polling station even in a safe seat and encourage parties to campaign in a safe seat, even if it is for people to allocate their vouchers to that party rather than vote for them.

There are disadvantages, however, as it confuses two different relationships: that of voting and that of allocating public funds. The voter may expect or wish the recipient of the voucher to remain secret, as their vote was secret. Yet, if no identification of who gave the voucher is provided to the party, it prevents them from engaging with supporters.

General elections are infrequent ways of engaging the public. Voters would not often have the opportunity to express their opinion on who should receive their allocation of public funds and parties would only have an incentive to engage with voters when they already have an incentive to do so, that is during general election campaigns. There is a real danger that the public may become more cynical and feel that political parties are only contacting them to get money from them. It is doubtful whether this mechanism can meet the principle aim of an incentive scheme, that of increasing democratic engagement, because it does little to make voters feel closer to parties or make parties seem less remote. It may be more helpful to view this mechanism as a way a general subsidy from public funds could be distributed, as discussed in scenario 4.

There are also practical problems that would need to be overcome. It may be confusing for the voter if the parties the candidates on the ballot paper belong to does not match the parties they can allocate their voucher to – which may well be the case if independents are standing or if emerging parties are unable to field candidates in all seats. In some areas, there may be so few members of a local party that the resources cannot be put to effective use or are open to abuse. By receiving public funds, there may be an expectation of more accountability, which local parties with few members may struggle to meet or find resource-intensive. Some parties may receive such a small amount that the administration and accountability required is disproportionate.

### *Grant per party member*

Rather than distributing an incentive for each donation given, parties could be rewarded with public funding for each member they have. Donating money does not require people to get involved with a political party and many members of political parties will be more engaged than donors. It could be argued that this more accurately incentivises the type of behaviour that indicates high democratic engagement. While party members who pay subscriptions would be caught by tax relief and match funding incentive schemes, this scheme captures membership from people who do not pay subscriptions because they have a low income or no income. The money supporters of political parties have is no longer so important.

Many parties, and not just the largest political parties, have centralised membership systems which would allow straightforward administration of the scheme. However, the public funds are likely to be used centrally by the party which may increase the centralisation of political parties.

The drawbacks are that a consistent definition of a member would need to be imposed on political parties, who at the moment determine their own structures. Even then, it relies on parties keeping accurate membership records and it would be relatively easy for parties to over-inflate membership figures, even if unintentional where people do not explicitly tell the party they wish their membership to cease. If the figures were audited externally to control this, it would remove the current confidentiality over who belongs to a party.

### *Tax relief to individual*

Under this mechanism, the party would receive no additional financial benefit. The donor would receive the financial incentive to give directly through receiving a refund on the income tax they had paid on any money donated.

This would be very difficult to administer in the UK where most taxpayers do not complete tax returns and it would be difficult to justify any equivalent for non-taxpayers, as effectively the state would be paying them to give to political parties. It would also require people to disclose to the state the amount of donation they had given. This may act as a disincentive to some donors as at present donations below £200 do not have to be recorded and they may be concerned about providing information on their donations.

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## Annex B – Process of the Review

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## Annex C – Recent Views on Party Funding

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### **Annex E – Existing Public Funding**

24. Andrew Tyrie, quoted in Electoral Commission Background Paper, *The Funding of Political Parties*, May 2003.

### **Annex H – Trade Unions**

25. This is based on the total of those paying contributions and those who opted out and excludes categories of union membership who do not pay contributions such as honorary, retired or unemployed. From Certification Officer's Annual Report, 2005–2006.
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