

Carrots and Sticks, Chickens and Eggs: Understanding Variations In Party Finance Regulatory Regimes

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Abstract

The past four decades have witnessed a widespread growth in state intervention in political party finance, both in the “carrots” of direct public subsidies for political parties, and in the “sticks” of political finance regulation. What is the relationship between the growth of legislation in both areas? Why do some countries adopt strict limits on party fundraising and party spending, whereas others take a much lighter regulatory approach? This paper examines the spread of regulations and subsidies, looking first at patterns of usage in 66 electoral democracies, and then investigating the sequence of adoption in European democracies. The examination of usage finds little support for theories that have linked political finance regulation to institutional and social factors, but it finds evidence that the adoption sequence for subsidies and regulations has a long-term effect. Despite pressures for regulatory convergence, countries that start with the carrot of public subsidies are much less likely to subsequently impose regulatory sticks. The paper concludes with a discussion of the wider effects of state intervention into party finance: while established parties derive some obvious benefits from this new “public utility” status, like traditional telephone companies and electricity providers they also face new risks in a deregulatory age.

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Carrots and Sticks, Chickens and Eggs: Understanding Variations In Party Finance Regulatory Regimes

Why do some countries highly regulate political finance whereas others persist with much more limited regulatory regimes? In recent years regulation of party finance has been an active area of legislative intervention into the broader rules of electoral competition. In many of today's established democracies the basic competitive rules have been fairly stable since at least the 1950s, and often for much longer than that. For these countries, the last half century has brought only slight changes in the franchise (most notably, the reduction of the voting age in the 1960s or 1970s), and only a few countries have introduced major changes into their electoral systems (Carter and Farrell 2010). Yet below the high-profile level of electoral formulas, lawmakers have been much more active, intervening in the framework of competition in unprecedented ways, including the introduction of rules that directly affect the financing of candidates and political parties.

One prominent innovation has been the payment of direct public subsidies to political parties. Such subsidies were a novelty when they were first introduced in a handful of countries in the 1950s and 1960s; half a century later they had become the norm for liberal democracies (Nassmacher 2009: ch. 8; van Biezen and Kopecký 2007). Countries have shown much less uniformity in another side of political finance regimes: in the development of party finance regulation. Whereas some countries have adopted strict limits on party fundraising and party spending, others still take a much lighter regulatory approach. This divergence is all the more puzzling given that some have depicted the spread of regulation as intimately connected to the spread of public subsidies, as the price that parties pay for gaining subsidies. If it is indeed the price, why does the price vary so widely? And how do we explain the fact that some countries have introduced heavy regulation even without the carrot of party subsidies?

This paper seeks to answer these questions, viewing the development of political finance regulations as the product of a variety of institutional and political pressures which may affect the scope and rigor of the regulations. The paper begins by

constructing a multivariate model to explain cross-national differences in the extensiveness of regulation, looking at the combined impact of factors which have been identified as important in past analyses. It then investigates the impact of regulatory sequences, examining experiences in European Union states to see whether policy outcomes reflect the initial impetus for public intervention in this area. The paper concludes with a discussion of the implications of changes in parties' legal status due to increased state intervention in their finances.

Regulating Party Finance

Political parties' finances have not always been regulated by the state. Indeed, well into the 1960s many countries' laws treated political parties as purely private associations, with their internal operations regulated the same way as other private not-for-profit organizations. Even in the UK and some other Commonwealth countries that tightly regulated *candidates'* campaign spending, *political parties'* financial activities were largely exempt from legal restraints. In the ensuing decades many countries have begun to intervene more actively in the realm of party finance, for instance by introducing public subsidies for political parties or by placing restraints on donations to parties and on party expenditures.

Arguments in favor of expanded state intervention in this area generally point to one or both of two inequalities that intervention is supposed to ameliorate. The first type of argument highlights resource inequality among individual citizens; the second highlights resource inequality among political competitors. In the first instance, the main perceived threat is that donors with deep pockets will undermine the equality of the vote, a principle that is central to the legitimacy of modern representative democracies.¹ Anti-corruption legislation is often used to address the most blatant misuse of resources for political ends; this includes laws against bribing individual public officials. Political finance regulation can take aim at more subtle forms of influence-buying, particularly ones that arise from perceived links between campaign resources and electoral success. Even if politicians are not trying to line their own pockets or get other economic benefits

¹ Note that some nineteenth century proto-democracies found it fair to weight votes in terms of wealth, arguing that those who had more at stake in taxation and other decisions should also be given more say in their outcome.

for themselves or their families, if they are seeking election or re-election, and if they need campaign funds, they may be extra attentive to actual and potential campaign donors. Because of this, and because the means to donate to politics are unequally distributed, unregulated political finance may undermine the political equality promised by other electoral procedures. Thus, one justification for party finance regulation is that rules are needed to reduce the political impact of economic inequality among citizens and firms. Such arguments lead to policies that limit the influence of any particular donor. Ways to achieve that include capping the amounts that individual donors may give, or instituting direct public subsidies to dilute the importance of gifts from private donors.

A second common justification for such regulation is “to create a more level playing field” by addressing systematic inequalities among the political parties which are the potential *recipients* of political donations. Because of their different policy positions, parties are not equally likely to benefit from the largesse of wealthy donors. For instance, parties which favor wealth redistribution are less likely to receive big donations than parties which favor low taxation. For this reason an unregulated political finance regime favors parties which support the status quo in terms of the distribution of resources in society. It also tends to be biased towards established political parties, especially ones which have some plausible chance of contributing to a future governing majority. Thus, a second type of justification for political finance regulation is to overcome some of the inequalities among political competitors, providing them more equal opportunities to present their policies and candidates, so that voters’ knowledge of their alternatives is not solely determined by the depth of party coffers. Such arguments support regulations that lead to more equal outcomes in terms of party resources and party campaign opportunities; they also may be invoked to justify payment of party subsidies, to ensure that serious competitors have adequate resources to communicate their messages.

Regulation of political finance generally adopts one of three approaches to remedy these perceived problems of resource inequality: restricting the supply of political donations, limiting the demand for campaign funds, and making sure that voters are able to assess the financial strings attached to their politicians (for instance, Nassmacher 2009, Casas-Zamora 2004, Alexander 1976, ch. 7). In regulation of political party finance, the supply-side approach restricts private funding for parties by limiting who can give and/or

how much they can give. The demand-side approach restricts parties' fundraising needs by limiting their opportunities to spend money during campaigns. This is another way to limit the impact of parties' differing fundraising potentials. Supply-side and demand-side rules both have the effect of limiting the *flow* of funds changing hands, with the aim of reducing the impact of financial inequalities. The third approach, transparency, aims to diminish the *political impact* of citizens' and parties' financial inequalities by exposing links between donors and political parties to public scrutiny. These three regulatory approaches are compatible, but –as will be seen below -- countries vary widely in the extent to which they pursue these regulatory routes.

Supply Side Regulation Supply side regulations aim to moderate the political impact of financial inequalities by restricting the supply of political funds. The most direct approach is to cap the amount of permissible donations (in cash, and sometimes also in kind). These limits may be expressed in terms of “contributions per campaign” or “annual contributions”.² Separate or additional rules may restrict political giving to certain types of donors. Prohibitions against foreign donations are widespread, often defended on the grounds that donating to campaigns should be restricted to those who have the right to vote. The same line of reasoning is sometimes used to prohibit party donations from anyone other than individuals – most notably, preventing corporate and trade union donations. These supply side restrictions all aim to reduce the extent to which parties could be beholden to their donors. The presumption is that parties will not feel much obligation to those who give only modest-sized donations (though “modest” is defined differently in different countries).

Demand Side Regulation Other types of regulations may attempt to moderate parties' demand for funds by directly or indirectly limiting party spending. They can directly cap the amounts that political parties may spend for election purposes. They also can take a more indirect route to the same end by limiting what parties can purchase. Restrictions on campaign spending are among the oldest tools for regulating political finance, going back at least as far as the British Corrupt Practices Act of 1883. This act took both direct and indirect approaches to limiting candidate spending, strictly capping

² Sometimes the limits cumulate donations to all political parties within one cycle, so that parties are not tempted to splinter in order to gain more largesse.

candidates' allowable campaign expenses, but also prohibiting candidates or their supporters from spending funds on what was then the most expensive means of electoral persuasion: "treating" voters (providing free refreshments) (Pinto-Duschinsky 1981). In the modern era, the most widespread and salient purchasing restrictions are those that limit or prohibit the sale of political advertisements on broadcast media.

Transparency Regulation The third regulatory approach aims to limit the influence of money in politics by publicizing links between parties and their donors, giving voters the opportunity to punish parties if they do not like apparent influence-buying. Disclosure laws most often require the recipient (the political party) to publish information about donors who give above a certain amount. Disclosure laws also may apply to donors (as in Ireland, where required self-reporting to a government agency is a check on the accuracy of party reporting). Disclosure laws often require parties to provide regular reports on their expenditures and on all sources of income. Such reports offer a means to check on the accuracy of donor reports: there clearly is something deeply amiss with donor reports if a party consistently spends far beyond its declared revenues.

These three types of regulatory approaches are not mutually exclusive, and some countries have adopted all of them. Others, however, have been much more selective in their use. The remainder of this paper attempts to identify some of the factors that explain these differences. At the outset, however, it is important to note that regulations vary in their efficacy and stringency. For instance, thresholds vary widely among countries which limit the size of legal donations to political parties, ranging from the very low to the very high. (For example, in Western Europe at the beginning of the century Belgium was on the low end, with a giving threshold of €500 per party per year, up to a total of €2000 to all parties, while Spain was on the high end at €55,000 per year – more than 100 times as large a limit!). Similarly, disclosure laws seem more or less useful for increasing accountability, with some requiring parties to immediately post information about large donations made during campaign periods, while others ask for disclosure only long after elections are over, meaning that voters must wait years before holding parties accountable for any unseemly transactions the disclosure might bring to light.

Transparency policies also vary in the extent of penalties they impose, and on whether any party officials are held personally liable for inaccurate reporting.

As a result of these implementation differences, two countries which adopt similar general regulatory approaches may in practice have very different degrees of limitations on the flow of money into politics. Nevertheless, one common pattern in political finance regulation is revision and reform of existing laws. Once a country introduces regulation of supply or demand or transparency, it may continue down this path. As a result, some countries that start with relatively lax regulations in a given area have moved step-by-step to revise and tighten existing rules, often in response to political scandals that highlight loopholes in existing rules. Countries that accept the principle of regulating the supply or demand of political funds are much more likely to tinker with the rules than to abolish them. But this still begs the question of why countries move from situations of non-regulation towards norms that accept specific types of state regulation of political finance.

To answer these questions about variations in regulatory approaches the following analysis starts by examining patterns of regulation in 72 electoral democracies, looking for clues about the links between policy choices and political circumstances. It then takes a cross-temporal look at the impact of regulatory sequence, investigating the relationship between party subsidies and party regulation in the new and established democracies of the European Union.

Party Finance Regulation in Contemporary Democracies

This investigation begins by taking a closer look at how much democracies actually vary in their regulatory vigor and emphases. The analysis examines political finance regulation in 72 electoral democracies using data from International IDEA (based on data collected by International IDEA in 2002). The countries included are the ones classified by Freedom House as “electoral democracies” in 2002 for which data is available for all relevant regulation types. These and similar data have been examined in other studies (for instance, Austin and Tjernström 2003; Casas-Zamora 2004; van Biezen 2010), but previous studies have focused on bivariate relations. The analysis presented here considers the joint impact of factors that have been said to shape political finance

regulatory approaches, using a multivariate analysis in a search for clues to explain differences in the vigor and the emphasis of regulatory approaches.

The data from International IDEA indicate the presence or absence of regulation in a wide range of areas. The analysis here focuses on eleven of these areas of regulations, looking at a range of policies that cover demand-side, supply-side and transparency areas (as described below and in Appendix 1). Table 1 shows the broad variation in the extent to which each country has regulated party finance across these eleven areas. This table raises some questions about whether the spread of party finance regulation has been quite as universal as is sometimes suggested: 19 of the 72 countries (26%) have *none* of these party finance regulations; an additional 31% have only low levels of regulation. None of the countries have more than nine out of the eleven types of regulation. This table also gives a first glimpse of the link between direct subsidies to political parties and regulation of their finances. The relationship it shows is clearly unidirectional: among the lightly regulated countries, slightly more than half pay public subsidies to parties, but almost all of the highly regulated countries do so. It appears that few countries impose extensive political finance regulations without offering the carrot of party subsidies.

The differences among countries are not just in the extent of regulation, but also in its focus. Thus, some countries tightly regulate the supply of political money but have no limits on spending, while others focus on capping the demand for political money. For example, Australia regulates in all the transparency areas, but has no demand-side regulations and almost no supply-side restrictions. Estonia has restrictions in all of the supply-side areas, but no demand-side restrictions. In contrast, Sweden regulates in none of the areas, while France scores high for regulation in all three areas. How do we explain these differences? To answer this question, we start by considering the impact of institutional and political factors that are often said to shape political finance regulatory regimes.

Table 1
Party Finance Laws:
Regulatory Breadth and Direct Subsidies

Extent of Regulation	Percent Countries (Number)	Direct Subsidies to Political Parties	
		Yes	No
NONE 0 Areas	26% (19)	Austria El Salvador Finland Malawi Panama Slovakia South Africa Sweden Switzerland Uruguay	Barbados Botswana Cyprus Dominica Guyana Jamaica Madagascar Micronesia Sierra Leone
LOW 1-3Areas	31% (22)	Australia Colombia Costa Rica Denmark Guatemala Germany Honduras	Indonesia Iceland Namibia Netherlands Nicaragua Niger Norway
MEDIUM 4-6 Areas	26% (19)	Belgium Bolivia Bosnia/Herz. Canada Czech Rep. Dominican Rep. Hungary Ireland	Italy Japan Lithuania Mali Paraguay Spain United Kingdom
HIGH 7-9 Areas	17% (12)	Argentina Brazil Bulgaria Ecuador Estonia France	Israel Mexico Poland Portugal Romania
ALL 10-11 Areas	0		United States
Total	72	50	22

Source: International IDEA 2010

Explaining Regulatory Approaches

Past studies of political finance regimes have identified social, institutional and political factors that may help explain variations in national regulatory patterns. All three types of

variables will be incorporated into the following multivariate analysis that tries to identify sources of regulatory variation.

Social Social context influences on party finance regulation may include the size of the country, and the distribution of resources within the country. As Ewing and Issacharoff argue, larger jurisdictions may “present greater regulatory challenges” (2006:6), and therefore may respond by adopting greater amounts of regulation. Inequalities in the distribution of wealth may also lead to regulation: such inequalities “may invite some intervention to ensure fair access and to avoid abuse” (Ewing and Issacharoff 2006: 6). In keeping with these arguments, this analysis incorporates population size (logged) and the Gini coefficient. (For descriptions of these and other variables see Appendix 2.)

Institutional Two institutional factors figure prominently in most explanations for regulatory differences in this area: electoral systems, and public subsidies to political parties. It has been argued that financial regulation of parties is more likely in systems based on competition between *parties*, rather than on competition between *candidates*. For instance, Kevin Casas-Zamora lists electoral systems and regime structures as institutional factors that shape political finance practices, including its regulation (2005: 6). Ewing and Issacharoff also mention electoral systems among several institutional factors that explain the shape of political finance regulation. Joel Johnson found evidence that countries with candidate-centered electoral systems are more likely to have *candidate*-focussed disclosure laws, but he did not investigate whether such regulations occur instead of, or in addition to, regulation of *party* finances (Johnson 2008). Michael Pinto-Duschinsky investigated this question, and concluded that countries with majoritarian electoral systems tend to have less overall political finance regulation than those with proportional systems (2001). To test these relations in a multivariate context this study uses a dummy variable for proportional systems. We would expect parties to be more highly regulated in systems which put the greatest emphasis on intra-party

competition (such as list system proportional representation) as compared to candidate-centered electoral systems (single member districts, alternative vote).³

Public subsidies for political party are another institutional factor which is often linked with political finance regulation. In this case, however, the nature of the expected relationship is a bit less clear. The fundamental question is whether the presence or absence of subsidies is something that can help to explain the degree and focus of political finance regulation (are they an independent variable?), or whether these subsidies should be viewed as a component of the regulatory framework (are they the dependent variable?). Because of this uncertainty, the following analysis will run two models, one that includes public subsidies as an independent variable, one which does not.

Finally, the model includes two other institutional variables that Ewing and Issacharoff name as influences on political finance regulation: regime type and the role of the courts (2006). In presidential systems, as in parliamentary regimes with majoritarian electoral systems, political finance regulation may be lighter, and more focused on candidates than on parties. In countries where constitutions give courts strong authority, and where courts play an active role in electoral regulation, we might expect to see more regulation, because self-regulating partisan legislators have to answer to another authority in this area. For instance, constitutional courts may be able to force foot-dragging legislatures to adopt regulations to meet constitutionally-mandated requirements for parties to be accountable for their finances. This institutional factor may be a manifestation of what Fisher and Hopkin describe as a cultural difference in the legal treatment of private associations and in views of the proper limit of state intervention in political competition (2004). Is there more party finance regulation in countries where constitutions give high courts an explicit right to intervene in electoral procedures and political party affairs? Because the information on judicial oversight is available for only a portion of the countries covered in the rest of the dataset, this factor is included in a separate model.

³ “Mixed” electoral systems, ones which combine votes for candidates and parties, are coded along with proportional systems, because we expect that they, too, would generate a similar perceived need for party regulation.

Political Context Finally, the analysis includes two political factors which may shape regulatory approaches: the age of the democratic system, and prior levels of perceived corruption. Newer democracies may have much different political finance regulations than older ones if they acquired these rules as part of a “best practices” package when establishing new electoral and governmental frameworks (van Biezen 2004). In such cases, social and institutional factors are probably much less important for explaining the regulatory outcomes. A dummy variable for post-1974 democracies controls for this factor. In addition, the extent of regulation may be affected by past levels of perceived corruption, with public awareness of corruption likely to lead to greater regulation in the long run. In many countries, political finance scandals seem to be the progenitors of major political finance reforms (for instance, Quebec in the 1960s, Belgium in 1989, France and Ireland in the 1990s; Paltiel 1989, GRECO 2009). Corruption may also be symptomatic of prevalent attitudes towards the role of the state in regulating compliance. As Clift and Fisher argue, “States where loophole-seeking in party finance regulation (and indeed more generally) is more commonplace will adopt a more strict regime; while states where the spirit of the law has been generally upheld will base compliance more upon trust of the parties and other relevant agents” (2004: 680). In her bivariate study van Biezen found a positive but statistically insignificant relation between current⁴ levels of corruption and political finance regulation in 2002 (2010). The current analysis has a slightly different focus, investigating the possible impact of *past* levels of perceived corruption, under the assumption that this is likely to be a lagged relationship. To take account of this model uses World Bank Governance scores from 1996 (the first available year), predating the regulatory indicators by several years.

To what extent do any of the factors above help to explain the extensiveness of party finance regulation? The following analysis looks at 66 countries from the IDEA dataset that Freedom House rated as electoral democracies in 2002, the year that the IDEA data were collected.⁵

⁴ It is not entirely clear from this analysis which year the corruption indicator covers.

⁵ These are the 66 out of 72 electoral democracies in the IDEA database for which other data are available.

Table 2
Institutions, Society & Total Regulation

	Model 1	Model 2	Model 3	Model 4
New Democracy	0.273 (-0.963)	-0.216 (-1.191)	0.364 (0.927)	-0.082 (1.168)
Electoral System	0.565 (-0.944)	1.003 (-1.005)	-0.178 (0.960)	0.418 (1.044)
Inequality	-0.001 (-0.006)	-0.001 (-0.007)	-0.002 (-0.006)	-0.002 (-0.006)
Regime	0.402 (-0.935)	-0.743 (-1.068)	0.627 (0.904)	-0.674 (1.047)
Corruption Control	-0.310 (-0.45)	-0.147 (-0.57)	-0.540 (0.444)	-0.227 (0.560)
Population	1.124* (-0.619)	1.579** (-0.704)	1.056* (0.597)	1.625** (0.689)
Court Oversight		1.333 (-1.066)		1.077 (1.055)
Public Subsidy			2.097** (0.882)	1.746 (1.045)
Constant	-5.221 (-4.76)	-8.101 (-5.275)	-5.772 (4.586)	-9.356* (5.217)
Observations	65	49	65	49
R-squared	0.07	0.16	0.16	0.21
Standard errors in parentheses				
*** p<0.01, ** p<0.05, * p<0.1				

The OLS analysis starts with a basic model in which the amount of political finance regulation is the dependent variable.⁶ The first thing that stands out from this table is how little is explained by these variables. Contrary to the findings of some prior studies, there is no evidence here that countries with proportional representation electoral systems regulate party finance more actively than countries with candidate-centered election rules. Contrary to other predictions this multivariate analysis finds no links between regulatory activism and the type of the regime, the amount of prior corruption, or the

⁶ $Y = \beta_0 + \beta_1 \text{New Democracy} + \beta_2 \text{Electoral System} + \beta_3 \text{Inequality} + \beta_4 \text{Regime} + \beta_5 \text{Corruption Control} + \beta_6 \text{Population} + \varepsilon_i$

Table 3
Institutions, Society & Types of Regulation

	Supply	Demand	Transparency
New Democracy	0.084 (-0.622)	0.006 (-0.213)	-0.208 (-0.227)
Electoral System	0.402 (-0.597)	0.351* (-0.203)	0.015 (-0.216)
Inequality	-0.002 (-0.004)	-0.001 (-0.001)	0.001 (-0.001)
Regime	-0.043 (-0.581)	-0.064 (-0.197)	0.275 (-0.21)
Corruption Control	-0.237 (-0.284)	-0.011 (-0.097)	-0.104 (-0.103)
Population	0.516 (-0.403)	0.368*** (-0.132)	0.278* (-0.141)
Constant	-2.230 (-3.027)	-2.426** (-0.999)	-1.132 (-1.065)

Observations 64 65 65

R-squared 0.06 0.15 0.11

Standard errors in parentheses

*** p<0.01, ** p<0.05, * p<0.1

inequality of wealth distribution. The one positive link that is found is between the size of the country and the amount of regulation: countries with larger populations do tend to regulate more.

Model 2 in Table 2 adds a dummy variable for judicial oversight of political parties and/or elections.⁷ This analysis uses the smaller set of countries for which judicial data were available. In this set population size remains a statistically significant predictor of regulatory breadth, but the judicial oversight variable does not have a statistically

⁷ $Y = \beta_0 + \beta_1 \text{New Democracy} + \beta_2 \text{Electoral System} + \beta_3 \text{Inequality} + \beta_4 \text{Regime} + \beta_5 \text{Corruption Control} + \beta_6 \text{Population} + \beta_7 \text{Court Oversight} + \varepsilon_i$

significant affect. As in Model 1, none of the other variables have an impact on regulatory levels.

Finally, we examine the same models including direct public subsidies to political parties as an independent variable. The bivariate depiction in Table 1 pointed to a strong link between party subsidies and party regulation. This relationship does indeed re-appear in Model 3⁸, but it is not apparent in the smaller sample once court oversight is included (Model 4)⁹. On the other hand, population size remains an important predictor of regulatory volume in all four models, even with the inclusion of public subsidies

These findings do not differ much if we look at different areas of regulation. Table 3 shows identical models of party finance regulation with three different dependent variables: transparency regulations, supply-side regulations, and demand-side regulations. The biggest difference is that in the demand side model the electoral system impact is significant at the .1 level, with the impact in the expected direction: countries with proportional representation systems regulate more than those with more candidate-centered election rules.¹⁰

Party Finance Regulation and Party Subsidies: Chickens and Eggs

These largely negative results do not get us much closer to explaining the cross-national variations in regulatory patterns. Smaller countries regulate less, but beyond this there are no clear institutional or political culprits to explain national differences in approach. The other possible link that emerges from Tables 1 and 2 is that between direct public subsidies for political parties and more extensive regulation of their finances. What this snapshot of national practices cannot reveal is how that relationship came about.

All of the established democracies in this study (and some of the newer democracies) began with a situation where political party finances were no more regulated than those of other private associations, and where parties did not benefit from state subsidies. The introduction of restrictions on party financing is in some ways an unexpected development, particularly because in most cases such restrictions have been

⁸ $Y = \beta_0 + \beta_1 \text{New Democracy} + \beta_2 \text{Electoral System} + \beta_3 \text{Inequality} + \beta_4 \text{Regime} + \beta_5 \text{Corruption Control} + \beta_6 \text{Population} + \beta_7 \text{Public Subsidy} + \varepsilon_i$

⁹ $Y = \beta_0 + \beta_1 \text{New Democracy} + \beta_2 \text{Electoral System} + \beta_3 \text{Inequality} + \beta_4 \text{Regime} + \beta_5 \text{Corruption Control} + \beta_6 \text{Population} + \beta_7 \text{Public Subsidy} + \beta_8 \text{Court Oversight} + \varepsilon_i$

¹⁰ Models including public finance show no differences from those without this variable.

imposed by the very parties which have prospered under the unregulated *status quo*. Is it possible that the circumstances which prompt parties to initiate such changes may help to explain differences in the resulting party finance regulatory regimes? In particular, is it possible that in the long-term the scope of party finance regulation depends on whether subsidies or regulations were the prime impetus for initial reforms?

Subsidies are the main impetus for reform when governing political parties propose public funding for parties to address their financial difficulties. Subsidy-driven reforms fit the portrait of cartel party cooperation (Katz and Mair 1995) or a revenue-maximizing perspective (Scarrow 2004: 656): large parliamentary parties may cooperate in introducing the reforms because they are motivated by mutually-compatible financial aims more than by zero sum electoral aims. These parties share a mutual interest in introducing public subsidies while keeping other regulation to a minimum. When parties' financial needs are the main engine that put political finance on the legislative agenda, we would expect subsidies to be accompanied by little or no regulation. Few new restrictions would be introduced, and those rules that are adopted may be fig leaves only, lacking clear enforcement provisions.

The situation may be much different when reforms are driven by a push for better regulations. Such may be the case when parties are responding to political finance scandals, situations that threaten to taint either particular parties or the entire political class. In the wake of such scandals, parties may be eager to promote financial restrictions in order to distance themselves from the offenders. From an "electoral economy" standpoint, one or more parties may hope for short term electoral profits from championing reforms, even if such reforms might ultimately impose long term costs on them (Scarrow 2004: 657). The party most tainted by the scandal may be the most eager reformer. In situations where regulations are the main solution to whatever problems put reform on the agenda, we would expect to see the resulting regulation affect more areas, and probably to see rules with more enforcement teeth. Under these conditions public subsidies may be introduced or increased as a way of sweetening the deal for parties, paying them off for accepting restrictions that may reduce their revenues. However, given the circumstances these carrots may be much smaller than in cases where reform is driven by parties' financial needs. That is particularly true if some parties chose to

compete on the issue of political reform, perhaps even disavowing new or larger subsidies in hopes of scoring points with a disaffected electorate. Subsidies to political parties are harder to defend in a political climate which has parties and politicians under attack for being more interested in their own finances than in the general welfare.

Does it make a difference which was the chicken and which was the egg in political finance reform? Up to now this question has been difficult to answer because of a lack of cross-national data about the sequence of regulatory reform. The following assessment is a first attempt to examine the sequence of political finance implementation and its possible impact. This investigation looks at the development of regulation in 26 EU states¹¹ plus Norway. These countries are chosen for several reasons, but most importantly because a great deal of information on the details and sequence of regulation is newly available thanks to reports from the Council of Europe's "Group of States Against Corruption" (GRECO). One of the tasks of GRECO is to report on member states' compliance with the 2003 Council of Europe Committee of Ministers "Recommendation on Common Rules Against Corruption in the Funding of Political Parties and Electoral Campaigns".¹² Since 2007 GRECO has been issuing detailed reports on transparency in political finance in each of the member states. The following section relies heavily on these reports, supplemented by other studies of political finance regulation in each country. Aside from the not inconsequential matter of data availability, focusing on the EU member states offers several other advantages. These parliamentary and semi-presidential countries include both old and new democracies, and they employ a range of electoral systems. These diverse cases present a wide range of experiences with the spread of political finance regulation.

The following analysis connects the impetus of reform with the sequence of regulation. Cases where subsidies precede other reforms are assumed to be subsidy-led reform. Conversely, cases where regulations precede subsidies are assumed to be regulation led. The question is whether these sequences have lasting effect: have cases with different origins developed in different ways, or have they converged on similar regulatory approaches?

¹¹ All current EU member states except Cyprus, for which GRECO reports are not yet available.

¹² Council of Europe Rec(2003)4

Table 4
The Sequence of Political Finance Regimes: Subsidies and Regulations

		Supply Side		Demand Side	Transparency	
	Public Subsidies to Party Central Offices	Donation Cap	Ban on Corporate Donations	Cap on Central Party Campaign Expenditure	Requirement for Parties to Publish Accounts	Required Disclosure of Big Donors
Subsidy-led						
	Germany	1959	no	no	1967	1967
	Sweden	1965	no	no	No	no
	Finland	1967	no	no	1969	no
	Norway	1970	no	no	1998	1998?
	Austria	1975	no	no	No	no
	Denmark	1987	no	no	1990	1996
	Slovenia	1990	1994	no	1994	1994
	Romania	1990	1996	2000?	No	1992
	Luxembourg	1999	no	no	2007	2007
	Slovakia	199?	no	no	No	no
Regulation-led						
	Portugal	1988	1993	2000	1979	1974
	Estonia	1996	1989	1994	no	1989
	Lithuania	1999	1999	no	1991	No
	United Kingdom	2002	no	no	2000	2000
	Latvia	No	1995	2004	2004	1995
Concurrent						
	France	1988	1988	1995	1988	1988
	Belgium	1989	1989	1989/no	1989	1989
	Bulgaria	1990	1990	2009	1990	1990
	Ireland	1997	1997	no	1997	1997
Unregulated						
	Malta	No	no	no	No	no
Mixed						
	Italy	1974	1993	1993	1993	1974
	Spain	1978	1985	no	1985	1978
	Greece	1984	2002?	2002?	no?*	1984
	Hungary	1990	no	no	yes	1989
	Czech Republic	1990	no	yes?*	no	1991
	Poland	1993	2001	2001	2001	1997
	Netherlands	1999	no	No	no	No
						1999?

Sources: Greco 2007-2010; Pujas and Rhodes 1999; Roper 2002; De Sousa 2004.

*Discrepancy between IDEA data and GRECO reports.

Table 4 shows the sequence of political finance regulation and direct public subsidy introduction in the 27 European countries.¹³ It lists the initial implementation date of six types of policies in each of the countries: public subsidies to party central offices (for either campaigns or other expenses); caps on the size of donations; bans on corporate donations; caps on central parties' campaign spending; legal requirements for parties to publish their accounts in some form; legal requirements for parties to disclose the names of big donors (at least to state enforcement authorities, but not necessarily to the public). These policies were chosen because they are prominent types of rules, and thus for most cases information about each was readily available.¹⁴

The countries in Table 4 are classified into four logically distinct sequence patterns. Most of the cases easily fit into these four cases, but there is a fifth “mixed” group for the residual cases. Yet in fact even these mixed cases show a common set of development patterns.

Subsidy-led policies: Carrots without Sticks The largest group consists of countries where public subsidies were introduced prior to other regulations. Some of the earliest countries to adopt subsidies are in this group, including Germany, Sweden, Finland, Norway and Austria. This primarily northern European set includes all the Scandinavian countries. Almost all countries with subsidy-led regulation subsequently introduced some transparency requirements; none of them introduced demand side or supply side rules. Where party subsidies were introduced prior to regulations on parties' finances, low regulation has persisted.

Regulation-led policies: Sticks Before Carrots Regulation-led policymaking was rare in these European countries, with the Baltic Republics as the big exception. In all of them, political finance regulations pre-dated the introduction of direct state subsidies to political parties. Indeed, as of 2009 Latvia still had not adopted such subsidies.¹⁵ The sequence of regulation in the Baltics reflected fears about the excessive

¹³ The IDEA database documents the existence of laws, but provides no information about when these laws were adopted.

¹⁴ As much as possible the dates reflect when the laws were adopted, not when they went into effect. Readers with country expertise: please feel free to set me straight if you spot errors in these dates!

¹⁵ The 2009 GRECO report says that in 2009 the Latvian legislature was considering introducing direct public subsidies to political parties, but there is no information on whether these were adopted at that point.

influence of big donors in countries with increasingly expensive election campaigns: policy-makers began with regulation of donors and of spending, but when political finance scandals arose anyway they turned to public subsidies in a stated effort to wean parties from less proper funding sources. In the U.K., the other case in this group, political parties now receive very modest “policy development” subsidies to help them with their campaign manifestos, but the central parties receive no other direct public subsidies. The U.K. policy development subsidies were implemented in 2002, two years after a scandal-driven reform of central party finance. In the course of these reform debates policy-makers from all parties rejected any suggestions of including party subsidies in the initial reform.

Simultaneous Introduction: Carrots AND Sticks: In a third group of countries party subsidies were implemented alongside a broad range of party finance regulations. In three of the four cases – France, Belgium, and Ireland – these big changes were the response to big political finance scandals. All three countries implemented a very strict package of restrictions on giving and expenditure, in each case representing a radical break with the previously unregulated status of political party finances. In these cases public subsidies were introduced to compensate parties for their foregone revenues. Campaign spending caps were also supposed to help the parties cope with the new donation limits, by reducing the arms race aspect of political fundraising. Given the argument about the likely spread of regulation to new democracies as part of “best practices” appeals, it is surprising that Bulgaria was the only one of the new central European democracies that introduced subsidies and a full range of political finance regulation in its initial electoral legislation.

No Policies Malta is a case unto itself, with its political party finance remaining completely unregulated.¹⁶ This may be due in part to the fact that while Maltese politics are highly partisan, its elections are formally candidate-centered affairs, conducted under STV rules. As in the UK prior to the year 2000, Maltese law regulates candidates’ expenditures, but does not legally recognize or regulate party efforts.

Mixed policies: A classification based on pure types almost inevitably produces some mixed cases, yet even the residual cases show some remarkably similarities.

¹⁶ At least as of 2008, the year of the most recent GRECO report.

Countries which initially introduced limited regulation alongside subsidies invariably did so by adopting some type of transparency policy. Tellingly, no country began by imposing supply-side or demand-side limits ahead of transparency requirements: transparency rules sometimes led to limits on spending and giving, but not the other way around. Unlike the countries that adopted subsidies first, then transparency –and stopped there -- more than half of the “mixed policy” countries subsequently expanded the scope of their regulation to include demand side or supply side regulations. Most of the countries in this group are newer democracies which introduced subsidies and some regulations in the first wave of legislation to establish electoral procedures (e.g., Spain, Greece, Hungary, the Czech Republic). In these newer democracies subsidies were intended to foster the emergence of competitive party politics in countries which had suppressed all opposition parties; worries about the parties being captured by big donors came a little later, if at all. Hungary, the Czech Republic and the Netherlands have not (yet?) seen a second such wave of regulation.¹⁷

This examination of the sequence of regulation in European countries has found clear evidence that the initial impetus for political finance regulation can have long-term effects on the subsequent pace and intensity of regulation. Countries have converged to the extent of agreeing that parties which receive public subsidies ought to be financially accountable to the public. Yet in countries where carrots are initially adopted without sticks, the sticks seem much less likely to be adopted later. Demand and supply side regulations have only developed in countries where regulation was a more prominent part of the initial reforms. All the countries in the group are adherents to the Council of Europe norms on party funding, which advocate supply and transparency limits and which endorse direct public subsidies for political parties. But despite this, their regulations have not (yet) converged. This path dependency view of political finance regulation suggests that the initial justifications for legislative intervention in this area have long term effect. This may be due to the fact that once parties gain acceptance for the idea that they should receive direct public subsidies, they have little reason to agree to further intervention into their finances. In a more positive light, it may be that once

¹⁷ In the Hungarian case, this was at least partially due to the constitutional requirement that legislation in this area must be adopted by a two thirds majority.

subsidies become the major source of party income, other sorts of funding scandals are less likely to arise.

Carrots, Sticks, and Political Competition: Benefits and Risks

What does the spread of direct public subsidies and party finance regulation mean for political parties? In most countries the introduction of public subsidies has radically changed party budgets, making them reliant on the state for a large portion of their funds (cf. Nassmacher 2009). The impact of specific types of regulations is more difficult to track: as noted above, countries which regulate in similar areas generally do so in very different ways, differing in the strictness of regulations and in the detail of their enforcement mechanisms. Lax new regulations may do little to change actual practices. Strict regulations may do little more than relocate the channels through which funds are flowing. Indeed, the history of political finance regulation tends to be a tale of creativity, as each wave of regulation leads donors and recipients to find and exploit newly-evident loopholes. Finally, some practices which are banned by new legislation may not have been occurring anyway: for example, rules which ban corporate donations have little impact in countries where firms were not making (legal) donations to politics. Thus, it is difficult to generalize about how various rules have affected actual party fundraising and spending.

A more generally evident effect of the spread of party finance regulation is the way it has helped to change political parties' legal status. The introduction of either party finance regulations or subsidies has often been accompanied by new legal definitions of political parties, generally (but not always) codified in a separate Party Law. This legal language defines what a party is, and may even establish rules for getting onto a public registry of political parties, thus clarifying which organizations are covered by the new subsidies and finance rules. With or without the introduction of a parties law, the new regulations and subsidies alter political parties' pre-existing status as private associations, transforming them into what some have described as public utilities, both privileged and constrained by the state (Epstein 1986; van Biezen 2004). As van Biezen notes, this picture of parties as public utilities closely resembles the Katz and Mair cartel party model, with parties becoming partly absorbed by the state, no longer just an emanation of

society. This “public utility” metaphor has a great deal of resonance, but it is perhaps an imperfect one. And even to the extent that it does apply, as Epstein himself noted, its implications for dominant political parties are not purely positive.

One of the imperfect parallels in the public utility comparison is that utilities benefited from state protection because they were seen to be natural monopolies. According to the theory of natural monopolies, there are some economic sectors in which competition between firms does not improve consumer welfare. At one point this was widely deemed to be true in infra-structure intensive sectors with costly delivery systems (wires, pipes, rails, etc). Services could be delivered more efficiently when all consumers were served by a single service provider. Thus the justification for promoting some firms to public utility status was to benefit consumers by eliminating all other competitors, not just some of them. Justifications for political parties’ protected status in democracies are much different because they generally focus on *enhancing* political competition, not eliminating it. It is true that the effect of new regulations may be to protect established political parties from new competitors, with subsidy rules and restrictions on outsider financing making it more difficult for newcomers to mount credible challenges. In most cases established parties enjoy state subsidies that favor incumbents (because they are paid out in proportion to prior electoral success). Yet while established political parties may be treated in a privileged way *as a group*, in contrast to traditional public utilities they do not enjoy legal protections to their market *share*. Some rules may make it more difficult for new parties to enter the electoral fray, but the established parties continue to compete with each other. Moreover, even in countries where established parties are the recipients of generous public subsidies, parties can and do suffer electoral defeats that are severe enough to put them out of business entirely (for instance, in Italy).

In addition, even to the extent that the public utility analogy does apply, it is important to remember that this semi-public status imposes costs on firms as well as benefits. The analogous costs on political parties may be onerous enough to outweigh the advantages of this status (see Epstein 1986, ch 6). The cartel party diagnosis portrays the chief drawback of such arrangements as their cost to society: parties become less effective representatives when they enjoy institutional protections from potential challenges to their “established party” status. In this free market view of democracy,

public welfare suffers when participants in the self-regulated political market use rules to stifle competition. Less notice has been given to the costs to the parties themselves that may result from their loss of autonomy.

Public utilities have much less control over their core functions than do traditional businesses, because they need to answer to public regulators to justify the prices they charge and the salaries and the dividends that they pay. Similarly, parties in this position lose some control over their internal affairs, often held to higher standards than are applied to either private associations or to traditional state agencies. For instance, as shown above, one of the most common side effects of the new status is that parties' financial affairs are open to public scrutiny. Even if initial transparency rules are lax, over time such statutes tend to get tightened, requiring parties to provide more and more timely details, and implementing sanctions against parties which fail to meet these standards. In many countries another result of parties' new legal status is greater regulation over their internal statutes, for instance requiring them to designate leaders who are legally responsible for the organization's activity, and in many cases requiring the organizations to be internally democratic. While internal democracy may be in keeping with the ideology of many or most political parties within democracies, it might constrain more personalistic parties. At the least, control by the base is a style of operation that the state does not impose on traditional private associations, on public agencies, or on privately-held firms.

These public intrusions into parties' internal operations can potentially become a liability for the parties themselves given that their market share is not protected. But perhaps the more serious threat from the public utility status is that it is not necessarily permanent. This is something that traditional public utilities know all too well. Epstein described American political parties as public utilities at almost the exact time that the American Bell telephone public utility was being broken up because of anti-trust litigation. (This break-up happened in 1984; Epstein's book was published in 1986.) Subsequent years have seen the introduction of competition into other once-monopolistic utility markets in the United States and elsewhere. Competition has been introduced with the stated end of lowering costs and providing better services by increasing competition, with change spurred in the part by policy makers revising their ideas about the existence

of natural monopolies. Phone companies, electricity providers, water companies and postal services have all faced rising competition due to deregulation.

In this new market, established companies that once enjoyed a protected status sometimes find themselves handicapped in a newly competitive environment. As today's telephone companies have found out, some of the stiffest competition can come from challengers who have helped to redefine consumer wants and the ways in which these are met. Thus, in the United States "old" AT&T was out-competed by one of its former subsidiaries (Southwestern Bell - SBC), which eventually bought out the mother company. The new company prospered by meeting new demands for internet and cell phones rather than by sticking to its old model of providing land-lines.

Political parties are not immune to similar challenges to their protected status, and they may find themselves similarly handicapped in the face of new competitors that mobilize around single issues or platforms based on discontent with the status quo. Such organizations may seek to capture established parties (as in the current Tea Party movement in the U.S.), or they may begin as populist movements with initially limited aims – and subsequently begin to fight for these aims by running candidates of their own (for instance, the Pirate Party in the 2009 European elections). Opposition movements can also challenge traditional parties by using the increasingly available tools of direct democracy. In this environment of U-tube videos "going viral" and social-network based communication, more highly regulated competitors may find it difficult to adapt to more nimble competitors which face fewer legal restrictions.

Due to their public utility status, parties often face greater restraints on, and greater scrutiny of, their political activities than do other associations which claim to represent the public interest. In the political finance realm, parties often have much greater restrictions on fundraising, and much higher requirements for transparency, than do purely private individuals or associations. So called "third parties" in politics – groups that advocate interests and back candidates without themselves contesting elections – may be only loosely regulated even in countries which impose strict controls on party finance. Crucially, even when political party finance is tightly regulated, other private associations generally are permitted to raise unlimited sums from undisclosed sources, including corporations. In addition, in many countries firms enjoy tax

advantages for contributions to trade-promoting groups, but not for contributions to political parties, because lobbying efforts qualify as a business expense. For these reasons, wealthy potential donors may well prefer to advance their interests primarily by supporting lobbying groups and other associations, rather than by contributing to political parties. In short, it is not implausible to view third party organizations as potentially privileged fundraisers in comparison with the strictly regulated political parties. So far this is scenario has played out most visibly in the United States, but it is equally likely elsewhere, even if its effects may be at least partially diminished by the spread of public subsidies.

Because of the possible impact of third party intervention in politics, a few countries have attempted to restrict third party spending during campaigns, trying to prevent these organizations from outspending legally restricted political parties. However, these laws have proven to be difficult to craft in ways that do not restrict legitimate political activity. Often they fall afoul of guarantees of free speech embedded in national constitutions (as reformers in the US and Canada have discovered). Indeed, as a result of the U.S. Supreme Court's *Citizens United* ruling in January 2010, the United States today is facing the prospect of unlimited corporate and interest group spending in campaigns. Even when campaign-time restrictions on third parties do pass legal challenges, private interest groups are generally free to spend their resources outside of election periods to try to influence public debates. These examples make clear that legislation which may once have placed political parties in an apparently privileged place may in fact hamper them from competing with less regulated groups. While political parties may have become a bit like public utilities as a result of increased state oversight and benefits, they may have as much in common with the struggling modern phone companies as with the older Bell Telephone monopoly that Epstein had in mind.

In short, the trend towards greater regulation of political party finance is well documented and it seems unstoppable. These rules may have indeed helped to transform parties' status. Yet as they have become highly regulated wards of the state, they have been placed in cages that both protect and imprison them. Cut off from oligarchical funding, and subject to financial transparency that is intended to hamper corruption, parties may well lose their relevance for monied interests. At the same time, populist

single interest groups may be quicker than established parties to mobilize around new issues, putting parties at a disadvantage in recruiting supporters – let alone dues-paying members! State subsidies may partially compensate the parties for the resulting financial squeeze, but they do not offset the political squeeze caused by their diminished relevance to major interests. Nor are there any guarantees that such subsidies to parties will continue to be paid at current levels: such subsidies will not necessarily survive unscathed in an age of fiscal austerity, when policy makers are cutting subsidies to education and arts groups, and are even under pressure to cut their own salaries. If this happens, political parties which have accepted sharp supply-side restrictions on private giving may face deep financial crises. To note this is not to argue against party finance regulation, and it is certainly not an argument for political finance corruption. It is, however, to note that today's political parties, like today's telephone companies, may find that once-protected markets do not offer long-term guarantees.

Appendix 1

Types of Party Finance Regulation

Supply Side

- ceiling on how much a donor can give
- ban on foreign contributions to parties
- ban on corporate contributions to parties
- ban on donations from government contractors to parties
- ban on trade union contributions to parties
- ban on in-kind donations to parties

Demand Side

- ceiling on party election expenditure
- ceiling on how much a party can raise

Transparency

- Donors must disclose party donations
- Parties must disclose donors
- ban on anonymous contributions to parties

Appendix 2
Variables: Definitions and Sources

Variable	Measurement	Source
Regulations	Total number of regulatory areas (out of 11)	IDEA 2010
Electoral System	Proportional = 1	Carter and Farrell 2010 and from author
Population	Logged, for 2002	World Bank Development Indicators 2010
Inequality	Gini Coefficient, 2002 or first prior year if 2002 not available, except India and Indonesia 2005 and Sierra Leone 2003	World Bank Develop Indicators 2010
Regime	0 = Presidential .5 = mixed 1 = parliamentary	Cheibub 2006
Corruption Control	-2.5 to 2.5; 1996 except Lesotho, 1998. Positive numbers = better governance.	Quality of Government Institute (World Bank Indicators)
Subsidies	Public subsidies to political parties = 1	IDEA 2010
New Democracy	Democratization post 1974 = 1	Cheibub 2006
Court Oversight	Constitutional court oversight of elections and/or political parties = 1	Autheman 2004

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