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Financing Democracy: A Case Study

Assessing Public Subsidy to Political Parties in Chile

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OVERVIEW OF POLITICAL PARTIES FINANCING SYSTEMS IN THE WORLD

Regulatory schemes applicable to the ongoing financing of political parties[1] tend to combine multiple mechanisms to achieve the most relevant objectives to each country's context while mitigating the risks that such mechanisms represent. There is no single design that ensures a transparent and equitable financing system for developing strong and representative democracies. Instead, each country's reality and challenges determine which rules are more appropriate in every case.[2]

Political parties' financing systems worldwide can be comprised of private donations, direct public subsidies, or a combination of both. The following sections offer a summary of the most common regulatory alternatives, distinguishing between both sources of income.

1. Private Financing with Limits

Most countries in the world (67.8%) prohibit foreign contributions to political parties as a way to prevent foreign interventionism in national politics and protect the self-determination principle.[3]

Likewise, most countries allow private contributions without limiting the amount of money each person can donate.[4] According to the Institute for Democracy and Electoral Assistance (IDEA), 44.2% of the analyzed jurisdictions set a cap to private contributions.

Limitations on private donations intend to reduce the influence that any donor can have on political parties. The quantity established as a limit is essential for its effectiveness. If the limit is too high, it will have no impact. On the contrary, if the limit is too low, actors will look for ways to circumvent regulation and collect money outside the system. Therefore, an adequate limitation of private contributions is crucial for this mechanism's success and, ultimately, for the proper functioning of democracy.[5]

Finally, a reduced share of countries (26.1%) ban all legal entities and corporations.[6] The goal of this prohibition is to prevent the influence of corporate interests in politics.[7]

2. Public Financing

Comparative studies show that it is common to introduce direct public funding for political parties as a regulatory mechanism complementary to private donations' limitations. According to IDEA, 59.7% of the analyzed countries regularly grant public subsidies to parties, being most of them located in Europe, where 38 of 43 countries present this financing mechanism.[8]

a. Policy objectives behind public financing of parties

Three objectives are usually sought through this type of subsidy. First, to guarantee that all political forces in the system have access to the minimum amount of resources needed to produce public goods and develop party activities different from elections.[9] This objective comes hand in hand with the belief that pluralism is necessary to accommodate the various ideologies and proposals that encourage voter participation and result in greater citizen representation.[10]

Second, to achieve greater equality among political parties by reducing private money's influence and mitigating the comparative advantage enjoyed by sectors closer to economic power and corporate groups.[11] The achievement of these objectives also depends on having appropriate limits to private donations in place.

A third objective refers to the incentive role that public subsidy can play. Suppose the subsidy is relevant and conditioned to the compliance of all applicable political financing regulations. In that case, it can result in an effective enforcement mechanism ensuring the whole system's success.[12]

b. Public Financing Models in Comparative Jurisdictions

Different jurisdictions opt for a single distribution criterion or an intricate design that combines the different options mentioned below.[13] We often observe regulatory frameworks that are highly prescriptive and highly complex, where each of their components must be considered in conjunction with the others. Only with this global approach it is possible to evaluate the appropriateness of each of the mechanisms that define it and their effectiveness for the achievement of the policy goals set by decisionmakers.[14]

After reviewing other countries' experiences, we see three main alternatives for the allocation and distribution of ongoing public funding to political parties:

i. Fixed contribution equally distributed

Equal distribute funds among all eligible political parties to ensure a minimum floor of funding to enable new parties' appearance and mitigate the comparative advantages of wealthier political forces.[15-16] The main risks associated with this criterion are the proliferation or fragmentation of parties that use them as vehicles for accessing public funds and the misuse of funds allocated to political forces with little citizen representation.[17-18]

ii. Variable contribution distributed based on past electoral performance

Distribution of funds based on the electoral performance obtained in previous elections. This criterion contributes to diminishing the financing gaps while supporting parties that enjoy greater representativeness. The risk posed by this alternative is that fiscal funds end up allocated to dominant political forces, which generally coincide with those that need them the least, perpetuating gaps and betraying the objectives of equity, plurality, and representativeness of sectors of the citizenry whose voices are excluded from institutionalized politics.[19-20]

This allocation criterion helps reproduce past results rather than provide opportunities for emerging and challenging political forces.[21]

iii. Matching funds

In a matching funds system, fiscal resources are allocated based on the private donations that parties manage to collect. This mechanism incorporates an incentive to private fundraising efforts, strengthening the relationship between political parties and their constituencies.[22] It has also been deemed an effective mechanism for reducing the disparity between public and private funding in countries where the former became the main source of party income.[23-24]

The introduction of a matching funds mechanism without any constraints risks party capture by donors. It may also benefit political forces that have a more affluent base, once again replicating the allocation of public resources to those parties that need it the least.[25] Therefore, policymakers should adopt this allocation mechanism together with restrictions that prevent such risks.

CASE STUDY: ASSESSING THE EFFECTIVENESS OF PUBLIC FINANCING OF POLITICAL PARTIES IN CHILE

1. Context of the Analysis

The interaction between economic power and political activity remained practically unregulated since the return to democracy in 1988 until 2003. During this period, the Chilean political system regulation, both in terms of the functioning of parties and electoral campaigns, was characterized by freedom of association, a predominantly private and uncontrolled funding, a passive regulatory role of government, and the absence of accountability mechanisms.[26]

Over the past two decades, Chile has made significant progress in regulating the relationship between money and politics.[27] The introduction of multiple mechanisms -especially those enacted by Congress from 2015 onwards- changed the foundations of the Chilean political system and resulted in a robust and complex regulatory scheme with two main objectives: to avoid the undue influence of money in politics and to level the playing field for all political forces.

In 2016, Congress enacted one of the most important changes, introducing, for the first time, a form of ongoing direct public funding in favor of political parties. This subsidy represents a substantial fiscal effort made to promote plurality in politics, develop solid political projects, and ensure equal opportunities for the full spectrum of political forces.

2. Financing Model Adopted

Like most jurisdictions, Chile's regulatory scheme combines different mechanisms to shape a transparent, equitable, and corruption-free political system that strengthens democracy. Its main components are:

a. Private Financing with Limits

- Prohibits foreign donations.
- Establish a limit to the contributions that each donor can make in a year.
- Prohibits all contributions from legal entities and corporations.
- Prohibits anonymous and identity-reserved donations over a certain amount.

b. Direct Public Financing

- Fixed contribution (20% of available funds distributed proportionally to political parties' geographical representation, without considering previous electoral performance).
- Variable contribution (80% of funds only for parties with parliamentary representation, distributed based on the share of votes obtained in the last elections to the House of Representatives).

3. Definition of the public policy problem at hand

Since the implementation of the reform in 2016, the Treasury has invested CLP 22,663,286,009 (approximately US 29 million) in financing political parties. Despite the sizeable fiscal expenditure that subsidizing politics represents to a country like Chile, little was known about its capacity to guarantee a leveled playing field and provide real opportunities to relevant but financially disadvantaged political forces compared to those that dominate the political arena.

This analysis aims to assess the effectiveness of the subsidy to political parties in achieving those objectives.

4. Diagnosis Summary

The impact evaluation was carried out using political parties' financing data. This section summarizes the impact of the subsidy on political parties' income, the inequalities in access to funding, and present a descriptive analysis of the distribution of public funds.

a. Increase in Political Parties' Income

The introduction of the public subsidy in 2016 contributed to increasing the availability of resources for political parties. The aggregated annual income for 2019 represents an increase of 218.5% compared to 2015, an observable trend for all the years following 2016. Additionally, the reform increased the income levels for political forces located at the lower end of the income distribution before 2016.

b. Decrease in Inequalities in Access to Funding

- **Coefficient of Variation Analysis**

Coefficients of variation (CV) for different years allow us to observe the dispersion in income distribution among political parties.[28] The CV shows the degree of variability concerning the average income among all parties. The higher the CV, the greater the dispersion or inequality in annual income. Given the difference in the amounts of total income and average annual contributions observed in the periods compared, the CV allows for a significant comparison when defining the evolution of inequalities in access to financing experienced by different parties.

The coefficients of variation for each year show that the annual income dispersion decreased by 74 percentual points from 2017, reaching its lowest in 2019 (110%). This indicates that the public subsidy has been successful in reducing the gaps in access to funding. However, the observed medians and the existence of CVs above 100% suggest an inequitable distribution of income.

- **Tercile Analysis**

The distribution of annual income by terciles showed that the wealthiest group of parties concentrated 75% or more of the aggregated income in all the years observed. Parties belonging to the first tercile did not concentrate more than 4.32%. However, from 2017 onward, the gap between the first and third terciles decreased. In 2019, the third tercile's average income was 15.15 times higher than the first income, which represents an improvement relative to the years before the reform (in 2015, the ratio was 257.56). Although the differences remain high, this analysis suggests the subsidy has effectively reduced inequalities between political parties.

- **Standardized Gaps Analysis**

A standardized analysis of the economic gaps (considering the level of income per affiliated member) points in the same direction. We saw how in 2013, the wealthiest party received 423.60 times the income per member received by the party with the least resources. By 2019, that ratio dropped to 23.34, suggesting parties at the lower end of the income distribution have increased their financial resources and moved closer to wealthier parties.

c. Inequitable Distribution of Public Funds

The third part of the evaluation answers how effective public funds allocation has been in achieving a leveled playing field for all political forces. The data takes us to conclude that the public subsidy has mostly benefited traditional and wealthy political forces belonging to the third tercile. The concentration of 70% or more of the available fiscal resources in this group of parties reveals that the reform has contributed to maintaining a disparate playing field instead of promoting greater equity between different political forces.

Notwithstanding the above, we observed that the public subsidy has been effective in providing a level of income above the minimum standard of equity[29] (UF 1,500 per year) to most political parties. As of 2019, 19.23% of the parties have not managed to exceed this income. This represents an improvement over what we observe before the reform. In 2015, 38.46% of parties, respectively, were below this income level.

5. Conclusions and Challenges

The analyzed data show that public funding has effectively reduced parties' dependence on private donations and provided financial standing for most political forces. However, there is still a significant inequality in access to funding.

In this inequality context, we see that most of the available public resources are allocated to traditional and wealthy political forces.

All of the above makes it advisable to review the criteria for eligibility and allocation of public funds to achieve greater equity and promote the effectiveness of public resources invested in parties' permanent financing. The criterion of allocating 80% of fiscal resources based on parliamentary representation and past electoral success does not appear the most effective model for achieving the public policy goal pursued with the introduction of the subsidy, suggesting the introduction of modifications to the current regulation.

6. Recommendations for the Chilean Case

Based on the diagnosis presented above, the recommendation is to restructure public financing allocation and distribution criteria as a pathway to reduce further the gap in access to funding between political parties.

Three main changes should be adopted for a successful redesign:

I. Increase the weight of the fixed contribution component and reforms to the allocation criterion

Proposed change	➢ Increase the percentage of total funds allocated to cover the fixed component (e.g., 30%) distributed based on parties' geographical presence. ➢ Redefine the methodology to determine the geographical presence: • Elimination of the advantage currently granted to parties with a nationwide presence, considering only 16 regions.[30] • During the first four years of implementation, parties that are not present in all regions will have funds distributed as if they were registered in three additional regions.[31] The same rule will apply during the first four years of legal existence of a new party. • After four years, funds will be distributed considering the number of regions in which parties are registered.

Advantages	The proposed change would allow emerging parties to expand their presence geographically, make their political projects known, gain access to the electorate, obtaining affiliates, and register in more regions.[32]
Risks	Inefficient allocation of fiscal funds to "paper parties" and parties with low representation that are not committed to developing ongoing activities consistent with their public role.
Mitigation mechanisms	The risks are mitigated by the existence of obligations to return unused public funds by the end of each accounting period.[33] This rule's limited timeframe will allow for the correction of fiscal expenditure represented by those parties that have not managed to consolidate in four years.

II. Reduction of the variable contribution weight and elimination of eligibility requirement

Proposed change	➢ Decrease the percentage of total funds allocated to cover the variable contribution (e.g., 50%) determined based on past electoral performance. ➢ Extend electoral performance measures to all types of elections and not only to the House of Representatives. ➢ Eliminate the eligibility requirement of having parliamentary representation.
Advantages	This adjustment balances the importance of the variable component, which part of the literature deems inadequate for determining the ongoing funding since it is independent of the party's public goods production.

	Thus, this change can boost the impact of public financing while maintaining a significant component linked to past electoral performance as a way to prevent fiscal money from supporting parties with low representation. The inclusion of other elections to determine electoral performance improves the indicator of a political party's representation and citizen support power.
Risks	Access to the variable contribution without any requirements other than legal registration risks the creation of parties with the sole objective of receiving fiscal funds. It can also encourage instrumental fragmentation and proliferation of parties.
Mitigation mechanisms	The existing regulation on the formation and dissolution of political parties seems to be enough to prevent an excessive increase in the number of parties.[34-35]

III. Introduction of Matching Funds

Proposed change	➢ Allocation of a percentage (e.g., 20%) of available funds to introducing a compensation system that rewards smaller private donations that parties manage to collect annually.[36]
Advantages	Incentivizes parties to come closer to their bases and citizen involvement in political activity through institutionalized parties, ultimately strengthening the quality of democracy.[37-38] Corrects the imbalance observed between private and public funding sources. Captures the variations that parties experience in citizen support outside the election period, preventing them from benefiting from the results obtained years ago.

	Dissociates the daily partisan activity from elections, which contributes to strengthening the public role they play through their ongoing actions and the generation of public goods.[39] Promotes multiple small donors instead of large financers, preventing capture.
Risks	Parties with more affluent bases will benefit the most.
Mitigation mechanisms	Matching funds should be restricted only to small donations, for which the identity of the contributor is known. Establish a ceiling on the subsidies that each party receives due to this component. This limit will prevent parties associated with wealthier sectors from capturing an excessive proportion of the public funds distributed under this criterion.[40] Include an express prohibition on indirect donations to avoid fraudulent triangulation of contributions. Sanctions for the violation of this prohibition must be sufficiently dissuasive.

Endnotes

[1] Ongoing financing refers to those contributions made to political parties outside of electoral periods.

[2] Casas, K., Zobatto, D. (2015). El Costo de la Democracia. Ensayos sobre el Financiamiento Político en América Latina. Serie Ensayos Jurídicos, (273). Instituto de Investigaciones Jurídicas. México, p. 19.

[3] IDEA data indicate that 122 of 180 countries studied establish this type of prohibition, representing 67.8% of the jurisdictions analyzed. 30.6% do not establish this prohibition, while the remaining 1.7% do not present information on this matter. In the Latin American context, only Belize, Nicaragua, Suriname, and Guyana do not prohibit foreign contributions (Source: IDEA, Political Finance Tool https://www.idea.int/data-tools/question-view/527 (last visited: April 13, 2020).

[4] IDEA data indicate that 79 out of 179 countries studied establish this limit, representing 44.2% of the jurisdictions analyzed. The 50.3% do not establish any limitation, while the remaining 5.6% do not present any information in this regard (Source: IDEA, Political Finance Tool https://www.idea.int/data-tools/question-view/542 (last visited: April 13, 2020).

[5] Organisation for Economic Co-operation and Development (OECD). (2014). Financing Democracy: Funding of Political Parties and Election Campaigns and the Risk of Policy Capture, OECD Public Governance Reviews, OECD Publishing. Paris, p. 11. IDEA, Political Financing Tool https://www.idea.int/political-finance-tool-new (Last visited: April 13, 2020).

[6] IDEA data indicate that 47 of 180 countries studied establish this prohibition, representing 26.1% of the jurisdictions analyzed. 70.6% do not establish this prohibition, while the remaining 3.3% do not present data on this matter. In the LATAM context, only Mexico, Costa Rica, Brazil, Peru, Paraguay, Argentina, and Chile prohibit contributions from legal entities (Source: IDEA, Political Finance Tool. (last visited: April 13, 2020).

[7] IDEA, Political Financing Tool https://www.idea.int/data-tools/question-view/529 (last visited: April 13, 2020).

[8] Data provided by IDEA indicates that 84 of 174 countries studied establish regular public contributions to political parties, representing 59.7% of the jurisdictions analyzed. 29.3% do not provide any tax funds to parties. 8% do so only regarding election campaigns, while the remaining 2.9% do not provide any information in this regard. In the LATAM context, only Belize, El Salvador, Nicaragua, Venezuela, Bolivia, Guyana, and Suriname do not contemplate this form of financing (Source: IDEA, Political Financing Tool https://www.idea.int/data-tools/question-view/548 (last visited April 13, 2020).

[9] Literature defines public goods generated by public parties as the development of political programs and public policy studies that contribute to the legislative discussion, the generation of knowledge and information on issues of interest to citizens, political training and preparation of candidates, incentives for the participation of women and young people in politics and mechanisms for citizen participation. (Aninat S. I., and González T, R. (2014). Financiamiento permanente no electoral de los partidos políticos. Propuestas de Política Pública Centro de Estudios Públicos (2). Chile, p. 11.

Valdés Prieto, S. (2008). Financiamiento Público de Partidos Políticos: Propuesta para Chile. En: Reforma de los Partidos Políticos en Chile. PNUD, CEP, Libertad y Desarrollo, Proyectamérica y Cieplan. Chile, p. 303-304, 319)

[10] Falguera, E., Jones, S., and Ohman, M. (2014). Funding of Political Parties and Election Campaigns: A Handbook on Political Finance. International Institute for Democracy and Electoral Assistance (IDEA), p. 23.

[11] Ibid.

[12] Ibid.

[13] Falguera, E., et. al. (2014), p. 24.

[14] Organization of American States (OAS). (2012). Observando los Sistemas de Financiamiento Político-Electoral: Un Manual para las Misiones de Observación Electoral de la OEA.

[15] OECD (2014), p. 8

[16] For this study, we have established an annual income of UF 1,500 as the minimum standard of equity in access to financing. This level of income would allow parties to pay for their basic operational expenses, favoring their institutionalization. *Unidad de Fomento* (UF) is an account unit used in Chile, which is indexed for inflation. Its value as of May 23rd 2020 is $28,716 Chilean pesos, equivalent to USD 35.52.

[17] Falguera, E., et. al. (2014), p. 23, and 250.

[18] OECD (2014), p. 8

[19] Falguera, E., et. al. (2014), p. 23.

[20] The OAS makes a statement in this regard when referring to the mechanism for the distribution of public funds, stating that "In systems where distribution is based exclusively on the votes obtained in previous elections, the parties with less electoral wealth and the new ones have fewer and no public resources, respectively. On the other hand, in systems where public funding is distributed solely based on candidate registration could stimulate growth in the number of parties and fragment the system. Therefore, the mechanism for distributing direct or indirect public resources should consider the electoral strength and participation of small and new parties as distribution criteria." (Author's translation to English). OAS (2012), p. 15.

[21] OECD (2014), p. 8

[22] Falguera, E., et. al. (2014), p. 24.

[23] Casal Bértoa, F., Rodríguez Teruel, J. (2018). Political Party Funding Regulation in Europe, East and West: A Comparative Analysis, p. 3-5.

[24] "Although financing from individuals or groups can potentially unbalance the conditions of competition, it does not mean that public resources should entirety replace private resources. Parties financed entirely by the State would lack political incentives to engage with the individuals, groups, or sectors they claim to represent". (Author's translation to English). OAS (2012), p. 14.

[25] Falguera, E., et. al. (2014), p. 24.

[26] Nogueira Alcalá, H. (2015). Alcalá, H. (2015). Democracia, Representación Política y Financiamiento de Partidos y Campañas Electorales en Chile. Teoría y Realidad Constitucional (35), p. 543-575. Chile, p. 573.

[27] In 2003, Law No. 19,884 introduced transparency and accountability obligations for political parties, established limits on electoral spending, and created a direct public funding mechanism for electoral campaigns, together with other measures aimed to meet the most urgent public policy goals of that time.

In 2015, Law No. 20,840 replaced the binominal electoral system with a proportional one to allow the representation and inclusion of all relevant political sectors, removing entry barriers for sectors with lesser electoral success and a significant presence in society have representation in Congress.

In 2016, Law No. 20,900 for the strengthening and transparency of democracy was enacted. This law reduced by 50% the limit on electoral spending allowed for each candidate, increased direct public funding for campaigns, established stricter rules for campaign activities, and introduced a form of ongoing direct public funding in favor of political parties, all to achieve greater equity in politics. It also prohibited contributions from legal entities and companies to campaigns and parties, lowered the maximum amounts that individuals can donate, and eliminated anonymous and identity-reserved donations to reduce conflicts of interest and dependence on private money.

Finally, Law No. 20,915, also from 2016, strengthened the public and democratic character of political parties by introducing changes to the law enacted during the military dictatorship. Among the main modifications are the modernization of the procedure for the constitution of new political parties, the establishment of rules for their internal democracy and transparency requirements, all focused on preventing corruption and traffic of influences.

[28] The coefficient of variation is defined as the ratio of the standard deviation (σ) to the mean (μ), $CV= \sigma/\mu$.

[29] See endnote No.16.

[30] The current rule rewards parties registered in all regions by considering them as registered in an additional region (so, if a party is registered in all 16 regions, the calculation will consider them as registered in 17). However, this rule means that the fixed component mostly benefits the more traditional and affluent political forces that belong to the third tercile. As a result, parties assigned the majority of the fixed contribution are the same ones that receive the majority of the funds corresponding to the variable contribution, reaffirming the comparative advantages they already have in accessing funding.

[31] Without exceeding the maximum of 16 regions.

[32] This recommendation is in line with public funding mechanisms that favor competition between existing parties with new ones, avoiding entry barriers into the political arena (Valdés, (2003), p. 307).

[33] Article 40, DFL No. 4 Constitutional Organic Law on Political Parties.

[34] The minimum number of members required for a political party's constitution is equivalent to 0.25% of the electorate that voted in the House of Representatives' last election. This requirement applies to each of the regions in which the party wants to register. In any case, the minimum number of members must exceed 500 voters per region. (Article 6, DFL No. 4 Constitutional Organic Law on Political Parties)

[35] In Chile, a party becomes extinct by law when it does not reach 5% of the valid votes cast in the last election to the House of Representatives in each of at least eight regions or at least three geographically contiguous regions. A political party that does not reach this threshold in one or more regions might remain registered as such if it obtained at least four elected members in at least two different regions. It shall also be dissolved when its members' number falls below 50% of the number required by law for its constitution, in each of at least eight regions or at least three geographically contiguous regions. The minimum number of members updates after each election to Congress. (Article 56, DFL No. 4 Constitutional Organic Law on Political Parties).

[36] Aninat and González, (2014).

[37] Ibid, p. 31.

[38] The OAS has held that "...low impact private financing (small and numerous donations from citizens) is fundamental to consolidate representative parties, and financing an electoral campaign is an extension of the right to choose. In unequal societies, the problem is that the extended right is exercised by few people and becomes a formal justification for transferring structural asymmetries to electoral competition". (Author's translation to English). OAS (2012), p. 14.

[39] This last point is particularly relevant considering the 2019 Democracy Audit Report prepared by the United Nations Development Program (UNDP). The 2014 report already warned of the deterioration in citizens' perception of political parties and representative democracy risks. Despite all the reforms to the political system introduced in recent years (see Chapter II), the

confidence drop in political institutions has not been reversed. Evidence shows that lack of trust has widened in the last decade. In 2008, 42% of the population identified with a political party, while only 23% did in 2018. Furthermore, in 2018, only 3.2% declares they belong to a political party. (United Nations Development Programme (UNDP). (2019) Diez Años de Auditoría a la Democracia: Antes del Estallido. Chile, p.57).

[40] Aninat and González, (2014), p. 18.