



**This project is funded by the European Union**

PHARE project No. 2003/004-979-01-03

**Raising the Institutional and Professional Capacity  
of the Corruption Prevention and Combating Bureau  
(Part B and C)**

(Identification No. KNAB 2005/12)

**Aspects of state capture and political financing**

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# **Aspects of state capture and political financing:**

**Report prepared for a presentation to the  
Corruption Prevention and Combating Bureau (KNAB),  
Riga, Latvia**

By

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12 June 2006

Rambøll Management, Denmark, Project funded by EU-PHARE on  
Raising the Institutional and Professional Capacity of the Corruption Prevention and  
Combating Bureau (KNAB)

## 1. INTRODUCTION.

The aim of the presentation will be to present and to summarise some of the main findings of the study of political financing conducted by Dr Marcin Walecki and by the author. The presentation will add to that given by Dr Walecki in May 2006.

Dr Walecki and the author both have studied and acted as advisers on the financing of political parties and election campaigns in a large number of countries. They have been asked to present the experience of foreign countries concerning a number of matters:

1. Public funding of political parties and election campaigns.

2. Problems of setting and enforcing enforcing limits on campaign spending by parties. These include:

(a) What are reasonable limits on campaign spending by political party organisations and by candidates?

(b) How can the value of services in kind be assessed?

(c) How can the market value of purchases of broadcasting time be assessed?

(d) How can "campaign" spending (which is restricted) be distinguished from "non-campaign," routine spending (which is not restricted)?

(e) In countries where there is a limit on campaign spending by political parties, how can spending by candidates of those parties be restricted, especially when the candidates have not yet been selected by their party organisations and registered?

(f) How can the use for partisan, campaign purposes of the administrative resources of the state be controlled? (These administrative resources include the time of persons on public payrolls, computers and telephones in government offices, government cars, and other facilities.)

(g) How can campaign spending by "third parties" (that is, non-party organisations such as interest groups) be controlled?

(h) How can "hidden advertising" be controlled?

However, it is not only the general lessons of foreign experience that they were asked to consider, but also the specific Latvian situation. In the field of political finance there is no simple set of rules that constitute internationally-accepted best practice. Regulations and subsidies must fit the particular needs of each country. For this reason, the project includes an initial review of the topic of state capture in Latvia. This review will attempt to address these main questions:

1. How serious is the problem of state capture in Latvia? What are the main areas of life in Latvia that are affected by state capture?

2. Assuming that state capture is a problem for Latvia, is political finance a cause of the problem? Are reforms of rules concerning the financing parties and election campaigns a promising way to limit or banish state capture?

3. Is the introduction of state funding of parties and/or election campaigns likely to help in reducing state capture? Even if public funding is unlikely to provide a cure for state capture, are there other good arguments for its introduction in Latvia?

The report will make a number of suggestions about the enforcement of political finance rules by KNAB, about possible legal reforms, as well as suggestions for future research and analysis. It must be stressed, however, that these suggestions do not imply any criticism of KNAB's existing operations in the field of political finance. Like other international observers,

Dr Walecki and the author have been impressed by what they have observed about the enforcement of political finance laws in Latvia, which is of higher quality than in a number of countries of Western Europe. However, enforcement of political finance laws is inherently difficult and therefore possible improvements are discussed. (Dr Walecki has written a separate report which deals specifically with enforcement of political finance laws in Latvia by the Division of Control of Financing of Political Parties of KNAB. Therefore, this report will deal only briefly with this topic.)

The standards of research into political financing by of Latvian academics, members of civil society bodies and of some journalists in the field of political are exceptionally high by most international standards. Nevertheless, there appear to be some gaps in research into Latvian political finance and some suggestions will be offered about areas which can usefully be studied.

The presentation of 12 June 2006 will occur slightly under four months before the coming Saeima elections of October 2006. The 270 day pre-election period covered by the limit on campaign spending by political parties is already well under way. There it is by now too late to make recommendations about educational and other measures that would have been especially useful had they been held before the start of the 270 day period.

At the moment it is not possible to assess how successfully the new laws about political finance passed in 2002, 2004 and 2005 are working during the present election campaign. Some problems about the operation of the new laws that have already been identified are discussed in this report and will be raised during the presentation on 12 June 2006. But a further review will be useful shortly after the election and after the date for submission of financial accounts by the political parties (7 November 2006).

*RECOMMENDATION: There should be a review in December 2006 or January 2007 of the successes and problems of the recent political finance legislation. This review should take the form of a one-day or two-day conference of KNAB, representatives of political parties, experts from civil society organisations in Latvia, journalists and one or two foreign experts.*

## **2. "STATE CAPTURE" IN LATVIA.**

### **(A) Overall conclusion.**

On the basis of surveys, experts opinions expressed in statistical forms, interviews, and written sources, it is clear that high-level corruption ("state capture") remains a significant problem in Latvia.

Areas of public life which reportedly are specially affected by state capture include privatisation, banking, construction, gambling and European Union contracts. Corruption has been reported in parts of the judiciary.

Certain leading party politicians are known for their riches. One characteristic of Latvian politics is the existence of political entrepreneurs. Like patronage politicians in the United States in the late nineteenth century, some of them appear to use their political influence and control over political parties to enrich themselves and their political allies. Having made money from politics, they and their business colleagues and families then contribute considerable sums to their parties to defend and to consolidate their power.

However, the situation in Latvia differs considerably from that in Russia. It was the experience of Russia, where a few extremely rich so-called oligarchs seemed to wield great political influence, that first led The World Bank to use the terminology of "state capture". In Latvia, there are millionaires and multi-millionaires. But wealth is not quite so concentrated as it seems to be in Russia. Links clearly exist between wealth and political power in Latvia but not so blatantly as in Russia or Ukraine. Corruption in Latvia does not seem to consist mainly of a few top-level deals; it appears to take a variety of forms and to occur at different levels of politics.

Politics is based largely on political patronage. Lucrative jobs on public boards are often given to party supporters. Some party leaders reportedly act as political bosses in the tradition of "machine politics" of the United States in the late nineteenth and early twentieth centuries. In the absence of clear ideological divisions between political parties, politics consists of battles between personalities and is fuelled by offers of jobs, preferential contracts and favours to lieutenants.

#### **(B) Numerical assessments.**

There are five main sources of information about the extent of high-level corruption in Latvia:

- Economist Intelligence Unit: (Country Risk Service and Country Forecasts), (expert assessments)
- Freedom House, (Nations in Transit) (expert assessments)
- European Bank for Reconstruction and Development (EBRD) and World Bank (Business Environment and Enterprise Performance Surveys, known as BEEPS) (surveys)
- World Economic Forum (Corruption Subindex of the Global Competitiveness Report) (surveys)
- Transparency International, Latvia (Delna) and KNAB (Surveys in 1999 by Delna and in 2005 by KNAB and Delna on Latvian attitudes to corruption)

The annual international corruption rankings produced by Transparency International in its widely-publicised Corruption Perception Index (CPI) need to be treated with a great deal of caution in the opinion of the author. They do not provide information additional to that in the five sources listed above.

#### 1. TRENDS.

According to two of the sources (Economist Intelligence Unit and the BEEPS surveys of the EBRD and The World Bank), problems of corruption and state capture have lessened in Latvia between the late 1990s and 2005, though they remain significant.

Three of the sources suggest that levels of corruption have remained fairly constant (Freedom House, World Economic Forum and Delna/KNAB).

The statistics are set out in Appendix 1.

#### 2. AMOUNT OF CORRUPTION

There are considerable differences between the assessments of the different sources. For example, the Economist Intelligence Unit in the 1990s gave Latvia its lowest rating for corruption while Freedom House give a middling score for Latvia. Since then, the Economist Intelligence Unit has given Latvia improving scores while that scores given by Freedom House have remained stable.

The considerable differences between the different assessments mean that the game of giving statistical scores for the amount of corruption or perceived corruption in a country are inexact. Minor differences between scores given to different countries should not be given too much weight. However, as long as their imprecision is remembered, the results of the different numerical assessments do lead to the conclusion that high-level corruption exists on a serious scale in Latvia. This conclusion is backed by a variety of non-statistical sources.

#### **(C) Evidence from interviews and from published sources.**

[TO BE ADDED]

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### **3. "STATE CAPTURE" AND THE FINANCING OF POLITICAL PARTIES AND ELECTION CAMPAIGNS.**

Are contributions to political parties and to campaign costs a major channel through which a small number of very rich persons in Latvia exert excessive influence over legislation and over major decisions relating to their economic interests?

This is not merely a question of interest to scholars. It is of practical importance. If major political contributions by "oligarchs" and other millionaires are the main channel (or one of the main channels) through which they influence the political process, then it is important to control this channel. But if political contributions are a relatively insignificant source of influence and power for the very wealthy, then control of political funding is less significant as a means to combat high-level corruption ("state capture").

At present, the author is able to provide only preliminary impressions. Considerably more analysis of political donations is needed to establish more precisely the extent to which political donations are a principal channel of influence for oligarchs in Latvia.

Based on incomplete analyses of donations, it would appear that most of the richest persons in Latvia do not donate to parties and that many of the largest donors are elected political officials, candidates, party office-holders and those holding positions in public enterprises to which they have been appointed by politicians. (See Cigane 2005)

It would appear that donations to political parties are not the only way in which large sums of money can be used to influence political decisions in Latvia. It is possible to exert indirect influence through ownership and shareholdings in major newspapers or through direct payments to individual politicians. (See, for example, the listing of varied channels of "money politics" listed in Valts Kalnins' study published in 2005 of lobbying in Latvia.)

Consequently, limitations on expenditures by political parties on routine activities and on election campaigns, limitations on the size of donations and public funding of parties all may fail to eliminate the use of money-power in Latvian politics.

It may be argued that controls over large political contributions to parties and election campaigns are, at least, one significant component of a strategy to limit corruption stemming from "state capture" by a small group of very rich persons. This will be discussed further in the next section.

### **4. PUBLIC FUNDING OF POLITICAL PARTIES AND ELECTION CAMPAIGNS.**

In a considerable number of countries, public funding has been introduced in order to release parties from the need to search for private or for business donations. Advocates of state aid to parties have argued that a system of public funding is likely to be fairer and purer. It also has the undoubted attraction to politicians and to party bureaucrats of providing a relatively assured source of income. (See Pinto-Duschinsky 1998a)

Public funding nevertheless has been subject to severe criticism both on political and on practical grounds.

#### **(A) Preliminary considerations about the principle of public funding.**

Some aspects of political finance reform are relatively technical. But the issue of public funding is largely political. It raises issues of political ideology. Therefore, it may reasonably be argued that public bodies such as electoral commissions and anti-corruption commissions should be careful about putting forward opinions about the matter for fear of becoming entangled in party controversy and in disputes about political values. Decisions that are essentially political ought to be taken - arguably - by elected politicians and not by bureaucrats.

It is not appropriate for the author to express a view on the appropriate roles of KNAB within the Latvian political system. It should be noted that the author has argued in his own country (the United Kingdom) that the Electoral Commission in that country should focus on technical problems of legislation and enforcement relating to political finance and should be careful

about venturing into the field of debate about policies on matters such as public funding of parties. (Pinto-Duschinsky 2006.)

Despite this warning about involvement in ideological matters of party politics, KNAB does have a duty stated in the strategic plan to consider the issue of public funding. In order to assist KNAB, this report will attempt to set out arguments and facts that may be used both by supporters and opponents of public funding.

As a general rule, public funding has been supported by persons and parties of the Left and opposed by those on the Right.

Another general rule is that public funding has been popular among professional politicians (for the obvious reason that they and their parties receive such funding). By contrast, ordinary members of the public tend to oppose public funding. (See Pinto-Duschinsky 1998b.) Especially in countries where there is insufficient public funding for essential personal needs, members of the public do not easily understand why the political parties in the legislature justify payments from taxpayers for their political activities.

If possible, proposals to introduce public funding should therefore have the support, on the one hand, of a range of political parties and, on the other hand, of the public.

#### **(B) Types of public funding of parties and elections.**

Systems of public funding vary greatly. Discussion about public funding need to consider both matters of principle and also the practicalities and effects of different types of public funding.

They include:

- Direct financial payments.
- Subsidies-in-kind (free or reduced-cost services such as free broadcasting time on radio and television).
- Indirect subsidies in the form of tax relief on political donations.

Apart from legal provisions for public funding of parties, such funding frequently exists in practice in several forms. Thus countries which do not have formal systems of public funding of political parties actually supply taxpayers' money to them through a number of channels. These alternative channels include:

1. the use the administrative resources of central and/or local governments for partisan purposes. (For a detailed study of the use of these administrative resources in Poland, see Walecki 2005. More generally, see Open Society Justice Initiative 2004)
2. Also, in many countries, payments are made to legislators and to party groups within the national legislature to employ assistants and for travel or office facilities. Similar facilities often are available to elected members of local government authorities. Though intended to assist elected politicians in carrying out their duties as representatives, these facilities are often used for partisan purposes and as resources designed to help the re-election of these incumbents.
3. It is a practice in many countries for political parties to insist that their elected office-holders donate a fixed proportion of their salaries to the party. This practice is sometimes called a "party tax". Since salaries of elected office-holders come from the treasury of the state, this is a form of indirect public funding.

Apart from elected office-holders, the demand to contribute a portion of a public salary is frequently made to those appointed by grace of party leaders to a public board or company.

In this context, the significance of donations from candidates and office-holders in the 2005 municipal elections in Latvia should be noted. (See Cigane 2005.)

**(C) How many countries have public funding?**

According to a study by the author published in 2002 about 104 different countries classified by Freedom House as "free" or "partly free", most of them had public funding in some form or another. There were facilities for free broadcasts for parties and candidates in 79% and there were direct financial payments to parties and/or candidates in 59%. (See Pinto-Duschinsky 2002.)

The statistic about direct financial payment to parties and/or candidates is by now almost certainly too low since the trend towards public funding has continued. In countries with direct public funding, the proportion of income of parties and candidates derived from taxpayers' money varies greatly.

These statistics take account only of formal systems of public funding. they do not include de facto public funding in the form of the use of governmental administrative resources for partisan purposes and the other informal channels of public funding mentioned in the previous section.

It is clear from the statistics, first, that state aid in the form of free broadcasting for parties is the norm. Second, there are direct public subsidies to parties in most democratic or partly democratic countries. In the countries of the former Soviet Union, all except three of them (Latvia, Moldova and Ukraine) had direct public funding in 2002. (See Ikstens et. al. 2002)

The following table gives a summary of the findings of the author's study of political finance laws in 2002 in 104 countries. (There are statistics for countries of the former Soviet Union in Ikstens et. al. 2002a and Ikstens et. al. 2002b):

**REGULATIONS**

*Campaign spending limits:*  
104 countries - 41%

*Ban on paid election advertising on television:*  
104 countries - 22%

*Ban on corporate donations:*  
104 countries - 8%

**SUBSIDIES**

*Free political broadcasts:*  
104 countries - 79%

*Direct financial subsidies from public funds:*  
104 countries - 59%

*Subsidies-in-kind (apart from free broadcasting):*  
104 countries - 49%

*Tax relief on political donations:*  
104 countries - 18%

Public funding is common in countries of the European Union, both in countries of Western and Eastern Europe.

If Latvia wishes to follow the practice that is most usual in the European Union, then it definitely should introduce a system of public funding.

But it is very important to pay attention to the difficult experiences of some countries in Western Europe reported in section (E) below. The fact that public funding is widespread

does not necessarily mean that it works well. Another interpretation of its widespread use is its attraction to incumbent politicians and parties.

**(D) Is public funding always "fair"?**

A common argument in favour of public funding is that it is neutral between parties and candidates and that it is a fair system. By contrast, a system of private funding gives unfair influence to parties and to candidates able to gain the support of a few very rich donors.

However, "fairness" is not an exact term. Disagreements are possible about what constitutes a fair allocation of public funding. In practice, political parties in power, or coalitions of parties, tend to draw up rules that benefit them and are disadvantageous to their opponents.

This point will be discussed further in section (J) below on the allocation of free time for political broadcasts.

As far as the principle of "fairness" is concerned, this topic has been discussed in a number of the author's previous writings on political finance. The following is cited from Pinto-Duschinsky 1998c:

In practice, 'fairness' may have a variety of different, contradictory meanings.

Fairness as Equality of Outcome

Arguably, one way to ensure that each party and each candidate is treated fairly is to provide precisely the same opportunities and financial resources to each, irrespective of their size and popularity. The argument for giving all parties and all candidates an equal share of free television time, or financial grants, is that they all require an equal opportunity to put their case to the voters.

This is the principle followed in granting free postal facilities to British parliamentary candidates. Candidates nominated by major and minor parties, as well as independent candidates, have equal entitlements.

By contrast, it can be argued that equal treatment for major parties and for fringe groups is both impractical and unjust. It is arguably unjust and unfair to give a fringe party the same public benefits and the same financial aid as a major party. For a fringe party, that may have only a handful of members, the chance to obtain even a few minutes of free time on television represents a huge benefit. By contrast, the same few minutes will be inadequate for the major parties. Where there are dozens, or hundreds, of competing parties, a policy of allocating precisely the same amount of time to each inevitably results in near chaos, as voters are confronted with a multitude of different messages.

Moreover, such an 'equal time' policy may conceal a strong bias against the main opposition parties. The governing party will normally have separate opportunities to project itself. If the main opposition party receives the same small slice of free television time as dozens of insignificant parties, it will receive a wholly inadequate opportunity to present its message, which will help the government. The unsatisfactory results of the policy of equal television time for large and small parties have been seen in founding elections in several of the previously Communist countries of Eastern Europe and the former Soviet Union.

Positive Discrimination

It may be argued that 'fairness' demands positive discrimination in favour of new or small parties. According to this interpretation, the major political forces in any society already have ample chances to express themselves. Extra opportunities need, therefore, to be provided to the political outsiders to organize themselves and to put forward their views to the voters.

An example of an application of this compensatory ideal of 'fairness' is the scheme introduced in 1975 in the British House of Commons, whereby financial subsidies are given to the opposition parties represented in the lower chamber. The governing party

does not receive a subsidy. The rationale for the arrangement is that the governing party receives the benefit of the advice of the civil service. It is only the opposition parties that need funds to employ staff to prepare their arguments.

#### Fairness Based on Political Support

This involves the principle that small parties and fringe candidates should receive less support than the main ones. This idea may apply to the allocation of time for free electoral broadcasts on television and radio. It may apply also to financial subsidies. For example, it may be argued that only the principal candidates in a presidential election should be expected to debate with each other on national television, or that the large parties should be given more time slots for party political broadcasts than small ones.

This principle has common sense and justice behind it, but it also has problems. The common sense argument for fairness as an allocation *pro rata* to the support enjoyed by each contestant is that it avoids the situation where dozens, or even hundreds, of trivial candidates and parties set themselves up, merely to gain the free publicity that results if all legally recognized contestants are given the same exposure. It is simply not practical for voters to digest so many different messages. In the slang of political scientists and diplomats, there are (especially in newly formed democracies) 'sofa parties', parties so small that all their members can be seated on a single sofa.

The argument of justice is that it is unreasonable for a party or candidate representing a sprinkling of supporters to have the same opportunity to broadcast to the voters as a major party.

The above considerations provide a strong basis for the argument that 'fairness' should mean the proportionality of state aid to each contestant's support. However, the application of this principle produces problems.

The first problem is whether the extent of each party's support should be measured according to its past performance or according to its current performance. The easiest and apparently most objective measure of support is the percentage of the vote gained by each party at the most recent election. This is the main basis for state funding of party organizations in Germany. The weakness of this allocation system is that it may support existing parties at the expense of newly formed ones, or ones that have increased their popularity (as measured by opinion polls or other means) since the last election. In some countries (Namibia, for example), funds are allocated according to the number of votes obtained in a national election, but only to parties represented in Parliament. Parties failing to win a seat in the legislature are thus at a disadvantage.

The second problem is whether the extent of support should be measured by votes, or by some other indicator. It could be argued, for example, that public financial subsidies should match the membership, or the private financial support, for each party rather than its votes.

#### Fairness between Political Parties and Pressure Groups

Systems of regulation and of subsidy affect not only the balance between contesting parties, but also the balance between political parties as a group and other forms of political expression. If a system of regulation restricts political parties, it may have the effect of favouring other, unregulated channels of political communication.

#### Conclusion

The level playing field is an important principle, but it has so many different meanings that different political parties and candidates will frequently disagree as to what is 'fair'. Naturally, they will each tend to favour a definition of 'fairness' that accords with their self-interest.

**(E) Does public funding reduce the potential for corruption?**

There is ample evidence from many countries that politicians are so anxious to obtain money for their parties and campaigns that they offer illegitimate favours to donors. In some countries, candidates for public office find it almost impossible to win elections unless they offer material inducements to electors. Election campaigns are so costly that candidates are virtually obliged to court wealth donors and to give promises of corrupt pay-offs to them in return for their financial support.

It is the hope of reformers that a provision of money from state funds will release candidates from these pressures and will thus reduce corruption.

Yet, the massive corruption associated with political funding in Germany and in Italy has occurred in countries where parties have received lavish state aid. As shown in the author's article on "Financing politics: a global view", there is ample evidence from around the world that public funding is not an effective cure for corruption. (See Pinto-Duschinsky 2002.)

**(F) Does public funding reduce the incentive for political parties to raise money from members?**

Critics of public funding often argue that a reliance on public funds risks making parties lose their voluntary and participatory character. If party organisations become state-funded bureaucracies, they are - it is argued - likely to lose the independence which is essential if they are to play their proper democratic roles.

There are several answers to this objection to public funding.

First, systems of public funding may be devised in a manner that limits the reliance of political parties on taxpayers' money. It is possible, for example, to limit the proportion of a party's income that it may receive from public funds. This provision has been introduced in Germany. (There is disagreement between specialists about whether this provision has worked or whether it has - as argued elsewhere by the author of this paper - been evaded.)

Second, systems of public funding may be devised specifically to provide incentives for small donations by ordinary members and supporters of a party. These incentives may take the form (i) of relief from liability to income tax and other taxes for small donations to a party, (ii) of tax credits and (iii) of matching grants. (Here too there is disagreement among commentators. It has been argued by the British Labour Party that such systems benefit parties whose followings are drawn mainly from the middle classes. Members of the working classes are less likely to benefit from income tax relief because many of them have incomes too low to be liable to such tax.)

Third, with reference to countries such as Latvia, it cannot reasonably be argued that public funding will deter parties from obtaining money from a large number of donors giving small sums. At the moment, ordinary members rarely donate. Party funds come mainly from a relatively small number of medium-sized contributions.

*RECOMMENDATION: Arguably the best systems of financial subsidies by the state to political parties are those designed to provide incentives to the parties to raise additional money in small amounts from members and supporters. The Canadian system of tax credits is one system that should be seriously considered.*

**(G) Should state aid be provided to all parties and candidates or only to those who have obtained a certain threshold of votes in a previous election?**

There is a dilemma. If state aid is provided to all or virtually all parties and candidates, there will be an incentive to create minor new parties for the specific purposes of obtaining the state subsidy. In France, the introduction of public funding was followed by the creation of hundreds of small parties.

On the other hand, if the conditions for obtaining public funding are too severe, the effect will be to give an advantage to a relatively small number of established parties.

Moreover, there is the problem of how to deal with the issue of newly-formed political parties. Whether such parties qualify for public funding cannot be judged on their performance in a previous election because they did not yet exist at the time of the previous election.

Alternatives are

(i) to make the eligibility for public funding dependent upon their success in gaining votes in a forthcoming election. (This may entail lending them money which the new party will be obliged to return if it does not reach the required threshold of support from voters. Or it may mean that money will be provided only after the forthcoming election. There are problems with each of these measures.)

(ii) Eligibility for public funding may be based upon a number of signatures of supporters collected by the new party. (This may make eligibility for public funding too easy and will provide a temptation to the parties to forge signatures.)

#### **(H) Public funding for election campaigns and public funding for the regular activities of political parties.**

Some countries provide public funds for the regular, routine organisation of political parties. Some countries provide public funding for specified routine activities (such as political education or for policy research).

In other countries, public subsidies are given only for election campaigns (this is sometimes in the form of the reimbursement of a proportion of campaign expenses).

Systems of public funding vary also according to the political institutions of each country. In countries where the president is directly elected (such as the United States), public funding may be allocated specifically for presidential campaigns (including internal party contests for presidential nominations). In countries with majoritarian voting systems, where candidates fight separate contests in different legislative constituencies, there sometimes is public funding for individual candidates (as in Canada).

#### **(I) Consequences of public funding and of other regulations such as campaign expense limits for the internal structure of power within political parties.**

Laws about public funding may have crucial effects on internal party structures. If each party's allocation of public money goes to the central organisation of the party, then local party organisations will become more dependent financially on the national organisation. This will have consequences for internal democracy in the parties.

In order to avoid the centralising tendencies of most public funding schemes, Sweden adopted a system which gave public funds to local organs of political parties.

#### **(J) Free broadcasting for political parties.**

It has been mentioned in Sections (F) and (I) that critics of public funding express the fear that it tends to make political parties into centralised, unaccountable bureaucracies. One way to allay these fears is to give public subsidies not in the form of money but in the form of subsidies-in-kind. The most significant subsidy-in-kind is free broadcasting.

Free broadcasting for parties does, however, raise at least two important issues: first, who should pay for the broadcasting time? Second, how should time be allocated between different candidates and between different political parties?

##### **1. WHO SHOULD PAY FOR FREE POLITICAL BROADCASTS?**

If political parties are not charged for broadcasts, then either the state must pay the broadcasting companies for the advertising time given to the parties, or the broadcasting companies themselves must be obliged by law to provide free time for the parties. Naturally, broadcasting companies prefer the former solution. But in countries such as the United Kingdom, the different broadcasting companies (public

and commercial) are obliged by their charters and licences to carry out certain public services. According to a long-standing practice, this includes providing time for parties to make a specified number of free broadcasts both in the period between elections and during election campaigns.

## 2. HOW SHOULD BROADCASTING TIME BE ALLOCATED TO DIFFERENT POLITICAL PARTIES?

The simple answer is that time should be allocated in an unbiassed, fair manner. What makes matter more complex is that the concept of "fairness" is unclear. The principles of "fairness" in relationship to the allocation of free broadcasting time have been outlined in Section D. The following are among the methods used in different countries for such allocation (see Pinto-Duschinsky 1998d):

### A. Equality between Parties

All political parties contesting an election are allotted the same amount of time. The actual hour of presentation for each party may be determined by lot.

### B. Allocation Based Wholly or Largely on Results of Previous Election

### C. Allocation Based on a Mixture of Principles

In Israel, the allocation of broadcasting time has been based on a compromise between the *status quo* and the new situation. During the 1990s, each party, including those which were not represented in the previous parliament, was given ten minutes and each party already represented in the outgoing parliament receives three additional minutes for each member in the parliament. (Cited in Pinto-Duschinsky 1998d.)

### D. Allocations Agreed by a Committee of Broadcasters

In the United Kingdom, a committee is formed from representatives of the broadcasting authorities and the political parties. The committee tries to agree on a fair allocation. In the past, this has consisted of a number of elements. First, the two main parties have received equal shares. The share of the third party - the Liberal Democrats - has been based partly on the result of the previous election, and partly on its subsequent performance in partial elections, local government elections, and in the polls. Moreover, the formula usually gave the third party a share which is, on the one hand, was smaller than that of the main parties, and on the other hand, larger than its *pro rata* share, as measured either by its previous or current political showing.

The formula that has normally emerged has, therefore, reflected a compromise between a number of conflicting ideas of 'fairness'. Moreover, it has reflected the fact that the broadcasting authorities have the final authority to decide on what they consider to be a reasonable allocation, if there is no agreement between the political parties. Finally, if the broadcasting authorities make a decision in the wake of disagreement between the parties, it is open to any of the parties to take the matter before a court of law. It will then be up to a judge to decide what is 'fair'.

## **(K) Amount of money provided to political parties from public funds.**

There are significant differences between the amounts of money providing in public funding in different countries and in the proportion of total party income provided by such funds.

## **(L) Conclusion.**

Public funding is a significant but complex issue that raises questions of principle but also a large number of practical questions. Public funding does not provide a magic cure to the problem of corruption. But it may nevertheless be justified on less ambitious grounds.

*RECOMMENDATIONS: 1. Any move to a system of public funding needs both public debate about political principles and a detailed technical consideration of the many types and formulae for public funding.*

*2. Against the background of patterns of expenditure on election campaigns in Latvia, special consideration needs to be given to facilities for free election advertising by parties before elections.*

## **5. PROBLEMS OF SETTING AND ENFORCING LIMITS ON CAMPAIGN SPENDING BY PARTIES.**

### **(A) General considerations.**

Before considering the detailed issues arising from the limits on campaign spending by political parties in Latvia, it is important to make a number of general points about the regulation of political finance.

It is easy to pass laws about political finance. In one country or another, new laws are enacted almost every week or every month. Within some individual countries, changes in the laws relating to the funding of parties and election campaigns occur frequently. After the initial reforms, there come reforms of reforms and then still further changes.

The rapidity with which laws are altered demonstrates that reforms often fail to meet their objectives or that they are subject to loopholes and unintended consequences. Sometimes, problems arise because the detailed wording of the law is exploited by parties and donors to evade the objectives of the law.

Though it is easy to pass laws about political finance, international experience tends to show that it is very hard to enact durable, technically sound laws.

Problems typically arise because laws are passed by legislatures in a rush and without an appreciation of vital technicalities. It is not only in "new" democracies that these problems arise. The recent experiences of countries such as the United Kingdom and France show that they too have been affected by these difficulties. (On the shortcomings of United Kingdom legislation on the financing of political parties enacted in 2000, see Pinto-Duschinsky 2006a and 2006b.)

Although there are crucial differences between political institutions, political cultures and issues in different countries, certain standard technical problems arise whenever legal limits are introduced on campaign spending by political parties or candidates. There are standard difficulties raised by limits on the size of donations.

For example, if the law limits campaign spending by parties, issues will arise about:

1. what is meant by an election "campaign"? How are campaign activities to be distinguished from non-campaign, routine activities? Is it enough to designate all spending by a political party during a designated time before an election as "campaign" spending?
2. What is meant by a political "party"? What about spending by offshore islands of political parties: party foundations linked with but legally-independent from political parties (such as the German party foundations or *stiftungen*)? What about non-governmental organisations that support the policies of a particular party or group of parties? (These are frequently referred to as "third parties".)
3. What is meant by "expenditure"? Does the term include only payments of money? What about donations of the services of individuals? What about the free use of equipment and facilities (such as vehicles, office equipment, telephones)?
4. If limitations on campaign spending are imposed not only on political parties but on non-governmental organisations, how is it possible to determine whether a series of non-governmental organisations are not in reality parts of a single organisation? (For example, if an anti-abortion organisation is permitted only a limited expenditure

on a campaign, it may split into one anti-abortion organisation for Riga, another for Jelgava, another for Jurmala and so forth.)

Problems such as these are inherent in all attempts to regulate political finance. For this reason, it is unwise to rush into new laws or to ignore the essential need to pay attention to the task of enforcing the laws. For this reason, the author is generally cautious about advocating changes in the law and puts stress on the need to enforce existing laws.

Those considering legislation in the field of political financing need also to consider its constitutional implications. Political finance rules frequently fall afoul of the constitution of a country. For example, judges may see a contradiction between a law that limits campaign spending by "third parties" and constitutional guarantees of freedom of expression.

Beside considering the constitution of the country in which a political finance law is passed, it is necessary for countries which belong to the Council of Europe to consider the European Convention on Human Rights. In 1998, a decision by the European Court on Human Rights invalidated a long-standing provision of United Kingdom election law which prohibited spending by "third parties" on election campaigns for election by candidates for the House of Commons. (See Pinto-Duschinsky 2001.)

It is a general experience that policy-makers respond to difficulties about the implementation of political finance laws by enacting new laws. In reality, the problems may stem from the non-enforcement or the inadequate enforcement of existing laws. Policy-makers should not be "trigger happy" when it comes to changing the law. Especially in Latvia, where political finance laws have been enacted in 2002, 2004 and 2005, the stress needs to be on enforcement rather than on yet further legal reform.

**(B) What are reasonable limits on campaign spending by political party organisations and by candidates?**

The existing formula for limits on campaign spending in Latvia accords in broad terms with international practice when account is taken of average per capita income in Latvia.

**(C) How can the value of services in kind be assessed?**

Whenever there is a legal limit on campaign expenditure, the largest and richest parties will usually wish to find ways of avoiding the limits. One way to do this is to give estimates of the value of services in kind which are as low as possible.

When a service provided to a party's election campaign is provided at below the normal market cost, the difference between the market cost and the cost declared by the party in its election spending accounts is a hidden donation.

In Latvia, corporations (legal persons) are banned from providing donations to parties. Therefore, corporations must not provide services to parties for below the market rate for those services. To do so entails contravening the law banning corporate donations. Moreover, a political party which receives services in kind is obliged to record the value of these services at their true market value. If they fail to do this, the difference between the declared cost and the market cost needs to be added to its accounts. If such additions mean that a party exceeds the legal spending limit, then the enforcement authority (KNAB) needs to penalise the party according to the provisions of the law.

There is likely to be disagreement between the enforcement authority and the political parties about market rates of different services. Ultimately, it will be for the law courts to rule on such differences if the parties cannot reach agreement with the administrative authority.

It is impractical and undesirable for the law to specify the market value of every possible service in kind. Nevertheless, it should be possible for the enforcement authority (in Latvia, this is KNAB) to insist on procedures that will ensure that the value of services in kind are accounted for at average market rates.

The following approach to monitoring and enforcing the law on declaring services in kind at average market value is recommended:

1. In some cases, it may be relatively simple to obtain information about the market value of a service in kind. For example, if a political party is given the use of ten cars for one month, it is possible to obtain quotations from ten known car-hire companies for the same service. The party may obtain three quotations from different companies and declare the average of the three quotations as the "average market price" for the service.

The enforcing authority should also obtain estimates to ensure that the figures submitted by parties are broadly in line with the quotations received by the enforcing authority.

2. In harder cases, the KNAB may seek the advice of one or more major auditing firms about the assessment of average market value of particular services. Alternatively, KNAB may obtain the advice of commercial companies which regularly purchase similar services for their clients. For example, the market value of television advertising time may be assessed by companies that regularly purchase such time for commercial clients.

3. On the basis of information about average market values obtained in this way, the enforcing authority should meet with representatives of the political parties to let them have information about market rates it has obtained from auditing companies and from commercial purchasers of services. It should try to agree with the parties' representatives a schedule of rates for services in kind which the parties should use when they are preparing their accounts.

If the political parties object (as they are likely to do) that rates reported by auditors and by commercial purchasers of services are too high, then the enforcement body should be prepared to report these objections back to the auditors and purchasers of commercial services.

If any of the objections made by the parties appear reasonable, the schedule of values of services in kind should be adjusted.

4. The enforcing authority should then give an "advisory opinion" stating (a) the methods of calculation of the value of services in kind which it is prepared to accept, and (b) for some items, the enforcing authority should provide an advisory list of values. (For example, that the hire of a car normally should be valued at Lat X a month.)

5. If political parties are unwilling to accept the advisory judgements of the enforcing authority, they are free to ignore such opinions. However, if the parties declare the values of services in kind at rates considerably below those advised by the enforcing authority, the enforcing authority is free to initiate legal action against the party. The question of average market value will in that case need to be adjudicated in the law courts.

6. Experience of "advisory opinions" in the United States and Canada has shown that they usually are respected by the political parties and candidates and that legal prosecutions are only a last resort.

7. Since Latvia already is in the midst of the election campaign period, the KNAB will need to consider whether it is practical to adopt the method recommended above for the current campaign. If it is too late to do so, the method should be used in future campaigns.

8. In fairness to the political parties which are subject to the laws, many of them only recently enacted, the enforcing authority should prepare an educational programme (a) for senior party officials and (b) for local party officials. This educational programme should ensure that the officials are aware of the current laws and that

they are given guidance about how to fill the necessary reporting forms. Such educational programmes also should train officials of the national party organisations to pass on information to local party branches. (c) There should be written guides to the new laws. (d) Members of civil society bodies and journalists also should participate in the training.

(The issue of educational programmes along the lines suggested above does not appear to fall within the terms of reference of the current project. However, the issue was raised in correspondence with KNAB in February 2006, soon after the start of the 270 day pre-election period covered by the ceiling on permitted campaign expenses. The author does not have information about the precise educational activities undertaken by KNAB in connection with the campaign expense limits. Many of the recommended procedures may already have been implemented. The procedures are set out as "best practice" and there is no implication that this has not been followed.)

*RECOMMENDATIONS: 1. KNAB should consider adopting the methods given above for assessing the average market value for the CURRENT election campaign.*

*2. If it is too late to use these methods for the CURRENT election campaign, KNAB should consider their introduction for FUTURE election campaigns.*

*3. The practice of issuing advisory opinions should be considered as an operating method of KNAB. If necessary, further advice should be sought from the relevant enforcement authorities in Canada, United States and, at local level, New York City.*

*4. The KNAB should ensure that its capacity for educational activities is sufficient to carry out these recommendations. Concerning educational activities about the enforcement of political finance laws, they probably will need to involve both the division for controlling political financing and the educational division of KNAB.*

*5. It is beyond the scope of this study to give an opinion about the judgement of Dr Valts Kalnins about the weakness of the educational activities of KNAB. (Kalnins 2006.) However, it is important to ensure that a capacity exists within KNAB to carry out the educational activities outlined above.*

*6. The study of methods of enforcement of political finance laws drafted by the author and Dr Walecki (Pinto-Duschinsky and Walecki 2005) should be translated into Latvian either in part or as a whole.*

#### **(D) How can the market value of purchases of broadcasting time be assessed?**

Since a high proportion of campaign expenditure in Latvia is devoted to the purchase of advertising time on television, it is essential to ensure that the costs of such purchases are reported at average market values. The general points about the assessment of market values for all commercial services which are set out in the previous section apply also to the purchase of broadcasting time. But there special considerations:

1. It would be unjust for the owners or managers of a broadcasting channel to offer advertising time at different rates to different political parties. It would also be unjust for them to deny advertising time to particular parties on the basis that all available time has already been sold.

Admittedly, it is possible for managers of broadcasting channels to argue that large parties which offer to buy a large amount of broadcasting time are entitled to special discounts that are normally given to bulk purchasers and to commercial clients who make their purchases at an early date.

However, if broadcasting channels are permitted to give significantly different rates to different political parties, this opens the door to discrimination and even to potential corruption. For instance, a broadcasting authority may be tempted to give preferential rates to a major party which seems likely to form the next government with the hope or the promise that it will be given special legal privileges by the next

government. A fascinating study of political financing in parts of Latin America submitted for a doctoral dissertation at the University of Oxford by a Costa Rican scholar who is currently the Vice-President of Costa Rica details this undesirable pattern of huge discounts for election broadcasting in Uruguay. (See Casas 2005.)

In some countries where paid election advertising is permitted, there are two legal restrictions on broadcasting companies: first, the same rates must be offered to all candidates (or parties). Discounts cannot be offered on a discriminatory basis. Second, advertising time cannot be monopolised by a single party or group of parties. If the demand by parties for paid advertising time exceeds the time available, there must be a fair way to distribute the time between the rival parties. In Canada, there is a neutral broadcasting arbitrator who has the power to decide on the distribution of paid advertising time to the different parties if the parties are unable to agree between themselves on such a distribution.

2. Concerning the market value of broadcasting time, this should be assessed in the same manner as that recommended in the previous section.

3. It is vital to note that broadcasting authorities are forbidden by the law banning corporate donations from providing broadcasting time at below the average market value. This is a relevant point in view of the massive discounts reportedly offered during the municipal elections of 2005.

*RECOMMENDATIONS: 1. KNAB should issue a statement intended for the broadcasting authorities, the political parties and the public about the legal requirement to avoid offers of broadcasting time at below-market rates.*

*2. KNAB should warn that the offer of broadcasting time at below-market rates may lead to subsequent prosecution of broadcasting authorities for giving disguised political donations.*

*3. KNAB should warn parties that if they receive broadcasting time at below-market rates, they must declare the costs of broadcasting time at average market rates and must ensure that such declarations at the full average market rates does not push them over the legal limit for campaign spending.*

*4. KNAB should request that both the broadcasting authorities and the political parties should keep KNAB informed during the campaign itself of their purchases of broadcasting time and of the rates paid.*

*5. KNAB should specify that one good test that broadcasting time is being sold to parties at average market rates is that the same rates are given to all parties.*

**(E) How can "campaign" spending (which is restricted by law) be distinguished from "non-campaign," routine spending (which is not restricted)?**

In most democracies, political parties have permanent organisations, offices and staffs. Often there are both national and local offices of parties. In addition to this, sometimes there are offices of party groups in the legislature and, for parties in member countries of the European Union, there are offices of party groups in the European Parliament. Frequently, there are party foundations which are legally independent from parties but actually closely associated with parties.

These party bureaucracies carry out work during the period between elections and in the period immediately before elections. In practice, there is no clear distinction between some of the routine and campaign activities of parties. Whereas spending on election broadcasts clearly is a campaign expense, other expenditures are harder to categorise. For example, how should the costs of employing party officials in the period before a campaign be categorised? Those officials would in any case have been employed and paid by the party even if there had been no election in the coming months. However, in the period before an

election the party officials will tend to spend more and more of their time on pre-election activities.

Items which it often proves hard to categorise either as "routine" or "campaign" include:

- Policy research
- Political education
- Opinion polling
- Preparation of photographs, posters, publications
- Production costs of broadcasts
- Rental of permanent party offices
- Other office costs (telephone, heating, postage, and so forth)
- Salaries of permanently employed staff

In practice, there is no objective and precise method of determining the boundary line between routine and campaign costs for items such as those listed above. Therefore a method of determination is needed that is similar to that for the market value of services in kind (discussed in Section C above).

*RECOMMENDATIONS: 1. The method for determining which items must be included in political parties' campaign costs should be similar to those set out for determining the average market value of services in kind.*

*2. The procedures of Elections Canada are recommended as an example of best practice in regard to this issue. Some of the relevant advisory opinions issued by the Canadian Chief Electoral Officer should be translated into Latvian if this has not already been done.*

*3. It is important for the staff of national organisations of parties to ensure that local party organisations, candidates and assistants to candidates are well informed about the expected standards of record-keeping and about the definitions to be used to distinguish between regular items of spending and campaign items.*

*4. The enforcement body should conduct field audits on a selective basis to ensure compliance. (This has been considered more fully in the training given by Dr Walecki. It is understood that such audits are in fact carried out by KNAB.)*

**(F) The problem of defining the period when the election campaign starts.**

Latvian law is clear about the time when the campaign period starts for political parties. This is currently 270 days before the election. However, a problem arises concerning the start of the campaign period for a party's candidates who have not yet been formally registered as candidates.

This registration occurs only shortly before the election. Therefore, those who are "possible" candidates are able to conduct propaganda in their own names or in the name of a civil society organisation (NGO) which is intended to benefit a particular party. This propaganda escapes the control on campaign spending by parties. Theoretically, a solution to the problem would be to oblige all parties to select and to register their candidates before the start of the campaign period - that is, at least 270 days before the election. But this would be wholly unreasonable. Alternatively, the pre-campaign period during which the spending limit on parties applies could be shortened from the current period of 270 days. However, in the view of the author, it is too early to consider changing the length of this pre-campaign period.

Not all problems have solutions. The matter of propaganda by independent persons who have not been registered as candidates of a political party arguably falls into this category. Similar problems will be discussed in the section on spending by so-called "Third Parties".

**(G) How can the use for partisan, campaign purposes of the administrative resources of the state be controlled and prevented?**

Although this issue does not fall within the terms of reference of this project, it is essential to the proper functioning of limits on campaign spending by political parties.

In some countries, the use of public resources for party purposes has been notorious. For years, the Gaullist Party in France reportedly took advantage of the fact that it controlled the mayorality of Paris to employ many people on the city municipal payroll even though they were expected to spend much of their time carrying out work for the party.

The use of public resources for partisan purposes may be regarded as a form of corruption. Moreover, it gives unfair advantages to political parties which control mayoral offices and other public positions. In addition, the use of administrative resources of national and local government authorities makes a nonsense of limits on campaign spending by political parties.

There has been some limited study of the use of administrative resources for electoral purposes in Latvia. (TO BE ADDED). In the opinion of the author, further study is needed to determine the extent of the problem in Latvia. Such study should include an examination of the activities of staffs employed by legislators and the rules governing such activities.

Once there has been an assessment of the probable extent of the use of "administrative resource" for partisan puposes in election campaigns, two further steps are needed. First, unless it already has been carried out, there needs to be a review of the existing regulations governing the standards of conduct of publicly-funded employees of government departments, municipalities, public boards, and of legislators. These regulations should forbid such employees from using their office time or office facilities for party political activities or objectives. The author has carried out reviews for the British Embassy in Warsaw and for the United Nations Development Programme in Vilnius of the relevant regulations in the United Kingdom.

If this review reveals codes of conduct that allow public officials to use public facilities and time to engage in party political activity, the codes need to be tightened.

Second, provided that there are codes of conduct for public officials that effectively prevent them from using public office for party benefit, these codes need to be actively enforced.

If the experience of foreign countries is any guide to problems in Latvia, the control of the use of "administrative resource" for partisan, campaign objectives is likely to be a major matter.

*RECOMMENDATIONS: 1. There should be a three-fold programme to control the use of administrative resource for partisan, campaign purposes. This should consist of (A) research, (B) assessment of existing codes of conduct and reofirms of such codes where they are found to be defective and (C) enforcement of codes of conduct.*

*2. KNAB should ensure that public officials are fully aware of existing codes of conduct about the use of the services of public employees, public vehicles and office facilities of government and municipal departments for campaign purposes.*

*3. The only exception to the rule that government ministers must not use official vehicles for travel to party meetings and must not use public officials to prepare for and to attend such meetings is where a minister needs security protection.*

**(H) How can campaign spending by "third parties" (that is, non-party organisations such as interest groups) be controlled?**

Whenever there are controls specifically on the financing of political parties, it will become logical to establish off-shore islands of political parties - namely, entities which are legally independent but which are in practice closely linked with a political party and on which reliance may be placed to forward the interests of that party.

Accordingly, if controls on the financing of political parties are to be effective, further controls need to be imposed on "third parties" - these supposedly independent bodies which take partisan stances and which participate in election camapigning.

The problem which then arises is that the circle of activities that must be controlled gets wider and wider until freedom of expression is unduly limited and until it becomes virtually impossible to enforce all the legal controls.

Not only is there a problem of defining what constitutes a "third party" (that is, an interest group, party foundation, or partisan think-tank), there also is the problem of defining what constitutes an expression of partisanship that is so blatant that it needs to be regulated as a form of "campaign" expenditure.

These matters have been the subject of a considerable number of cases before various constitutional courts. Some of these decisions are complex and decisions vary between different legal jurisdictions.

In general, the position is as follows:

1. Neither in the United States nor in member countries of the Council of Europe is it permissible to ban campaign spending by "third parties" in order to prevent evasion on campaign spending limits for parties and/or candidates.
2. The Supreme Court of the United States allows especially wide latitude to "third parties" to intervene in election campaigns. By contrast, the Canadian courts have permitted campaign spending by "third parties" to a limited degree only in order to preserve, to a considerable extent, the fairness between rival political parties and candidates which campaign spending limits are designed to achieve.
3. In general, controls on political spending by "third parties" are imposed when two things happen: first when a "third party" makes expenditures on what are construed as "campaign" activities and, second, when spending on such activities exceeds a total stated in the relevant law.

For example, in the United Kingdom, "third parties" are obliged under the terms of the Political Parties, Elections and Referendums Act 2000 (PPERA) to register with the Electoral Commission when they intend to spend at least GBP 10,000 in England or GBP 5,000 in Scotland, Wales or Northern Ireland on campaigning for or against a party or group of candidates.

(See <http://www.electoralcommission.gov.uk/regulatory-issues/thirdparty.cfm>)

Once registered such "third parties" are subject to a spending limit and they may only receive funds from categories of donors permitted by the legislation.

The United Kingdom laws on "third parties", introduced in 2000 alongside limits on campaign spending by national party organisations, have proved something of a mess. Crucially, there is ambiguity about what constitutes "campaigning" under the terms of the legislation. The matter has not yet been tested in the law courts and the United Kingdom Electoral Commission has been notably inactive in contacting groups that have engaged in partisan political activities with a view to asking them to register as "third parties" and to subject themselves to the declarations and restrictions entailed by such registration.

Moreover, the requirement for organisations to register as "third parties" when they intend to spend above the threshold amount on campaigning is difficult to enforce since such intentions are not obvious in advance.

There are additional problems, which it is not necessary to detail in this report.

The overall effect on the limits on permitted campaign spending by national parties in the United Kingdom introduced in 2000 seems to have been to weaken political parties and to encourage the growth of off-shore islands of parties which have escaped the same degree of regulation and scrutiny.

4. it is inherently difficult - if not impossible - to control campaign spending by "third parties" because, even if each "third party" is subjected to a strict limit on permitted

campaign spending, there is no way of controlling a proliferation of "third parties" each advocating the same policies and each supporting the same political party. The conclusions that emerge are that the imposition of legal limits on campaign spending by political parties are likely to lead to the development of spending by sympathetic non-party organisations. Campaign spending by these sympathetic non-party organisations ("third parties") is hard to define in legal terms and is hard to enforce.

Despite these problems, proponents of spending limits will argue that unregulated and ever-increasing spending by parties on election campaigns is the greater evil and that the problems of controlling campaign spending by "third parties", though intractable, are nevertheless a tolerable side-effect.

For Latvia, these arguments are now somewhat theoretical since spending limits for political parties are currently in force.

*RECOMMENDATIONS: 1. Campaign activities and spending by non-party organisations in Latvia should be kept under observation during the current elections.*

*2. Legislation and practice in Canada concerning the control of campaign spending by "third parties" should be studied as an example that might be followed in Latvia, despite the fact that the Canadian system is not without problems. (See Appendix 2.)*

#### **(I) How can "hidden advertising" be controlled?**

The term "hidden advertising" is used frequently in Latvia but the author has not heard it used in other countries. Therefore its meaning needs to be clarified. It appears to mean one of the following:

- an article written in a newspaper which supports the views of a party or of a leading political figure,
- an article written in a newspaper which appears so reflect so closely the views of a politician or of a political party,
- an article written in a newspaper which appears in the name of a journalist but which, it is suspected, has been written in return for a secret payment from or on behalf of a politician or a political party.

These different possible uses of the term "hidden advertising" have very different implications.

In the first and second uses of the term, there is nothing contrary to democratic norms of freedom of expression. Rich citizens have the right to invest their money in newspapers and have the right (within wide limits) to promote whatever political views they desire in these newspapers. Moreover, it is accepted that there is access within a democratic country to information and to newspapers imported from foreign countries.

It is only when parties or donors make payments to secure a particular piece of newspaper coverage that the question of political advertising arises.

If it is suspected that parties and donors are making such payments to journalists, evidence for this needs to be collected. It is not enough to show that an article takes a partisan approach.

As far as the author is aware, studies of "hidden advertising" have concentrated on analysing the content of articles in particular newspapers but have not taken the further step of trying to demonstrate that there have been secret payments to journalists.

Thus, the first step toward the control of "hidden advertising" (in the sense of secret payments to journalists) must be to establish the existence of such secret payments.

A separate issue concerns the ownership of newspapers. It may reasonably be argued that the public is entitled to know the identity of the major shareholders of newspapers. Legislation forcing such disclosure is worthy of discussion.

## **6. WORK PRIORITIES FOR KNAB'S DIVISION OF CONTROL OF FINANCING OF POLITICAL PARTIES.**

This topic is dealt with in a separate report by Dr Walecki. The author of this report endorses the views of Dr Walecki and will make only two points, one of them is general and the other is particular.

1. The general point is that it is tempting for every institution charged with enforcing political finance laws to focus on the immediate, time-consuming tasks of routine administration. Typically, a high proportion of the working time of the members of the enforcement body will be spent in chasing very small political parties which have failed to submit the legally-required financial accounts by the required date.

Though such routine tasks are necessary, the enforcement body should be organised in a manner that leaves sufficient time to attend to strategically important tasks.

If it appears that certain political parties may be obtaining excessive discounts on normal advertising rates for their campaign advertisements, it is a strategically-important matter that the enforcement body should act on this matter in the manner outlined in Section 5(D).

There may be a number of managerial techniques that will assist the Division of Control of Funding of Political Parties to avoid becoming consumed by routine administration. For example, in periods when the demands of routine administration become especially great (before and after an election), there will be a case for employing additional members of staff on a temporary basis. These may be reassigned from duties elsewhere within KNAB or may be especially recruited for a limited period of time.

Another possible way to ensure that there is time for pro-active enforcement is to create a sub-division within the Division of Control of Funding of Political Parties that will specifically be responsible for field audits and for strategic enforcement matters.

*RECOMMENDATION: Consideration should be given to creating a sub-division of the Division of control of Financing of Political Parties to be responsible for field audits and for strategic enforcement matters.*

2. The particular point is to reinforce and add to Dr Walecki's recommendation about the current ban on political donations by former members of the KGB. Were this law to be challenged in the European Court of Human Rights, it is possible that it would be declared invalid. Lists of members of the KGB are incomplete and sometimes inaccurate. A considerable time has now passed since Latvia gained its independence and the anti-KGB law may now be outdated.

Apart from these issues about justice and human rights, it takes an undue amount of administrative effort to administer the law and the contributions discovered to have come from alleged former members of the KGB are usually small and relatively insignificant. In the past year, there have been 105 contributions amounting to a total of 16,000 Lats. It takes the equivalent of one full time member of the staff of the Division of Control of Financing of Political Parties to administer this particular provision of the law.

*RECOMMENDATION: While the current law remains in existence, the Division of Control of Financing of Political Parties should follow up reports of donations from alleged former members of the KGB (1) if the donations are at least 500 Lats, (2) in the case of donations under 500 Lats, the Division should make investigations only of a small sample of such donations (perhaps 10% of reported cases).*

## 7. CONCLUDING COMMENTS

### (A) Research priorities

[To be added]

### (B) Thoughts on some underlying issues about politics in Latvia.

[To be added]

## APPENDIX 1

### Measures of "State Capture" and Corruption in Latvia.

#### 1. Economist Intelligence Unit

Country Risk Service and Country Forecasts

Countries are rated from 0 to 4, with 0 being the best and 4 the worst rating for corruption.

Ratings for Latvia:

1998 - 4

1999 - 4

2000 - 4

2001 - 4

2002 - 3

2003 - 3

2004 - 3

2005 - 2

Sources: Email communications from Aidan Manktelow, Philip Whyte and Johann Graf Lambsdorff.

Notes: The scoring for each country is based on the assessment of a specialist at the headquarters of the Economist Intelligence Unit and a local correspondent. Supervisors at the headquarters are responsible for trying to ensure consistency of standards between countries.

*Comment:* The ratings for Latvia have shown improvements from a low base.

#### 2. Freedom House

Nations in Transit

Countries are rated for corruption on a seven point scale with 1 being the best and 7 the worst. Ratings for Latvia:

1999-2000 3.5

2001 3.5

2002 3.75

2003 3.5

2004 3.5

2005 3.5

Source: Goehring and Schnetzer (2005).

Note: Scores are assessed by a panel of experts.

*Comments:* The Freedom House ratings differ considerably from those of the Economist Intelligence Unit insofar as Freedom House's initial ratings were considerably better than those of the Economist Intelligence Unit. In addition, the ratings given by Freedom House have remained stable whereas those of the Economist Intelligence Unit have shown considerable improvements.

#### 3. European Bank for Reconstruction and Development (EBRD) and World Bank Business Environment and Enterprise Performance Surveys (BEEPS)

Three surveys conducted jointly by the EBRD and the World Bank have examined state capture as a part of the business environment in Latvia and a number of other countries in Central Eastern Europe and the former Soviet Union. These surveys are known as BEEPS 1 (1999), BEEPS 2 (2002) and BEEPS 3 (2005).

The core findings were the reported existence of serious high-level corruption (state capture) in 1999 and lessening amounts of state capture in 2002 and in 2005.

BEEPS 1: 1999  
BEEPS 2: 2002  
BEEPS 3: 2005

[STATISTICS TO BE ADDED]

Sources: The World Bank 1999, The World Bank 2002, The World Bank 2006a and The World Bank 2006b

#### 4. World Economic Forum

Corruption Subindex of the Global Competitiveness Report

	<u>Score</u>	<u>Ranking of Latvia</u>
2001	4.73	39 (out of 75 countries including in the survey)
2002	4.59	53 (out of 80 countries including in the survey)
2003	4.85	49 (out of 102 countries including in the survey)
2004	5.11	48 (out of 104 countries including in the survey)
2005	5	53 (out of 117 countries including in the survey)

Sources: Email communications: Irene Mia and Thierry Pfeiffer, Global Competitiveness Network, World Economic Forum

Notes: (1) the higher the scores the less bribery has been reported by the sample of businesspeople interviewed. In 2002, scores ranged between 6.5 (for Finland) and 2.13 (for Bangladesh). (2) The number of Latvian business executives interviewed was: 2001 - 29, 2002 - 65, 2003 - 184, 2004 - 194, 2005 - 170.

*Comments:* the score for 2005 is slightly higher than for 2001 but the difference does not appear to be significant. The index is based on answers to a narrow range of questions and its significance is limited by this fact. The questions on the basis of which the subindex is calculated are as follows: 1. How commonly are bribes paid in connection with import and export permits?

2. How commonly are bribes paid when getting connected with public utilities?

3. How commonly are bribes paid in connection with annual tax payments?

[www.weforum.org/pdf/Gcr/Composition\\_of\\_Growth\\_Competitiveness\\_Index](http://www.weforum.org/pdf/Gcr/Composition_of_Growth_Competitiveness_Index)

#### 5. Transparency International

Corruption Perception Index

Rank order of Latvia

1998	71 equal	(out of 85 countries included in the Index)
1999	58 equal	(out of 99 countries included in the Index)
2000	57 equal	(out of 90 countries included in the Index)
2001	59 equal	(out of 91 countries included in the Index)
2002	52 equal	(out of 102 countries included in the Index)
2003	57 equal	(out of 133 countries included in the Index)
2004	57 equal	(out of 145 countries included in the Index)
2005	51 equal	(out of 158 countries included in the Index)

Source: <http://www.icgg.org>

Note: "equal" means that at least one other country has the same ranking.

*Comments:* (a) the index does not convey original evidence but consists of a reworking of evidence from other sources. (b) Transparency International reveals the identity of the sources used but refuses to divulge the statistics for each source. (c) Sources differ from year to year. (d) There are different sources for different countries. (e) It has been the policy of Transparency International to give a weighting to the the corruption subindex of the world Economic Forum three times greater than

the ranking of other sources. (f) The countries included in the ranking differ from year to year. (g) some sources rank countries according to an overall definition of corruption but other sources (such as the world Economic Forum) rank only narrow aspects of corruption. (g) For these and other technical reasons, an improvement in the rank order of a country does not necessarily imply a reduction in perceived corruption in that country; likewise, a decline in a country's rank need not imply a worsening of perceived corruption.

A total of thirteen different sources were used to rank perceptions of corruption in Latvia. Only one of these (Economist Intelligence Unit, Country Risk Service and Country Forecasts) was used every year. The "Corruption Perception Index" rankings for Latvia are notable for the frequent changes in the sources used. Sources for the rankings of Latvia in the Corruption Perception Index were as follows:

1998:

1. Economist Intelligence Unit (Country Risk Service and Country Forecasts),
2. Gallup International (50th Anniversary Survey),
3. United Nations Development Programme. World Development Report (Private Sector Survey)

1999:

1. Economist Intelligence Unit (Country Risk Service and Country Forecasts),
2. Freedom House. Nations in Transit
3. Political Risk Services (International Country Risk Guide),
4. Gallup International,
5. The International Crime Victim Survey,
6. The Wall Street Journal, Central European Economic Review,
7. The World Bank and University of Basel

2000:

1. Economist Intelligence Unit (Country Risk Service and Country Forecasts),
2. Freedom House. Nations in Transit
3. Political Risk Services East Syracuse

2001:

1. Economist Intelligence Unit (Country Risk Service and Country Forecasts),
2. Freedom House. Nations in Transit
3. World Economic Forum: Business Competitiveness Report, 2001

2002:

1. Economist Intelligence Unit (Country Risk Service and Country Forecasts),
2. Freedom House. Nations in Transit
3. World Economic Forum: Business Competitiveness Report, 2001
4. World Economic Forum: Business Competitiveness Report, 2002

2003:

1. Economist Intelligence Unit (Country Risk Service and Country Forecasts),
2. Freedom House. Nations in Transit
3. World Economic Forum: Business Competitiveness Report, 2001
4. World Economic Forum: Business Competitiveness Report, 2002
5. World Economic Forum: Business Competitiveness Report, 2003
6. World Market Research Centre
7. BEEPS [Business Environment and Enterprise Performance Strategy] 2002

2004:

1. Economist Intelligence Unit (Country Risk Service and Country Forecasts),
2. Freedom House. Nations in Transit
3. World Economic Forum: Business Competitiveness Report, 2002
4. World Economic Forum: Business Competitiveness Report, 2003
5. World Economic Forum: Business Competitiveness Report, 2004
6. World Market Research Centre
7. Merchant International Group

2005:

1. Economist Intelligence Unit (Country Risk Service and Country Forecasts),
  2. Freedom House. Nations in Transit
  3. World Economic Forum: Business Competitiveness Report, 2003
  4. World Economic Forum: Business Competitiveness Report, 2004
  5. World Economic Forum: Business Competitiveness Report, 2005
  6. World Market Research Centre
- Sources: for 1998 and 1999, email from Johann Graf Lambsdorff; for 2000-2005, Internet Center for Corruption Research, <http://www.icgg.org>.

## APPENDIX 2

### **Rules effective in Canada since 2004 about campaign spending by "third parties"**

The Elections Canada Act [Year] included provisions about the restriction on campaign spending by non-party organisations ("third parties"). These restrictions were then appealed to the Canadian Constitutional Court on the ground that they infringed freedom of expression. In the case of *Harper v. Canada (Attorney General)*, the Alberta Court of Appeal invalidated the restrictions on "third party" spending in the Elections Canada Act. However, the Constitutional Court then overturned the decision of the Alberta Court and reinstated the provisions in the Act.

On 18 May 2004, the Chief Electoral Officer of Canada, Jean-Pierre Kingsley, announced that "the third-party provisions in the *Canada Elections Act* are once again in force across Canada." According to the Chief Electoral Officer's statement.

A third party is a person or group other than a candidate, registered political party or an electoral district association of a registered political party. The following obligations apply to third parties:

- Any third party, immediately upon incurring \$500 [about 200 Lat] in election advertising expenses after the issuance of the writ, must register with Elections Canada [s. 353].
- All third parties must identify themselves on their election advertising and state that the ad was authorized by the third party [s. 352].
- Third parties must appoint a financial agent to accept all contributions for election advertising purposes and authorize all election advertising expenses on behalf of the third party [ss. 354, 357].
- Third parties that spend \$5,000 or more on election advertising must appoint an auditor [ss. 355, 360].
- Third parties must not use anonymous or foreign funds for their election advertising [ss. 357, 358].
- Third parties will have to report the details of their election advertising expenses within four months after election day [s. 359].
- Third parties must not incur election advertising expenses of a total amount of \$168,900 [This limit is indexed annually based on the inflation adjustment factor] during an election period in relation to a general election, and not more than \$3,378 [This limit is indexed annually based on the inflation adjustment factor] of that amount may be incurred to promote or oppose one or more candidates in a given electoral district [s. 350].
- Third parties must not circumvent or attempt to circumvent the spending limits [s. 351].
- Third parties will have to report who contributed money to the third party for election advertising purposes in the period beginning six months before the issue of the writ and ending on election day [s. 359].
- Third parties, political parties and candidates must not transmit election advertising to the public on election day [s. 323].

(<http://www.elections.ca/content.asp?section=med&document=may1804&dir=pre&lang=e&tonly=false>)

It should be noted that these rules attempt to exercise control on campaign spending by "third parties" exclusively regarding expenditure on "advertising". Other campaign-related spending is not controlled.

As mentioned in Section 5(H), a method for avoiding limits on campaign spending by "third parties" is to multiply the number of separate "third party" organisations which each spend money on pursuing the same political objectives. The Canadian rules attempt to cope with this possible method of evasion by a general prohibition that bans any scheme by a "third party" deliberately to set up separate, supposedly independent bodies which, in practice, cooperate with each other in dividing between them an advertising budget that exceeds the legal limit. ("Third parties must not circumvent or attempt to circumvent the spending limits [s. 351].") In order to enforce this regulation, the Canadian authorities would need to establish the existence of such a conspiracy. The authorities would need to convince the courts that a number of separate campaigning bodies were actually a single body. With care and planning, "third parties" probably could arrange their affairs to make it difficult to prove that the separation into branches had taken place with the intent of evading the Elections Canada Act.

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