Panel of Experts – Political Donations

Submitted by Dr Shane Leong, Dr James Hazelton and Dr Edward Tello.

Date: 17 September 2014
Dear Dr Schott, Mr Watson and Mr Tink,

Submission to Panel of Experts - Political Donations

We thank you for the opportunity to contribute to this important inquiry. Further, the Panel must be commended for producing a series of high quality working papers. We are researchers with Macquarie University’s Department of Accounting Corporate Governance. Under the supervision of James Hazelton, Shane Leong and Ed Tello have completed PhD and Masters theses respectively, both of which involved Australian political donations disclosure and we draw upon the findings of this research to comment on the matters under consideration by the Panel.

Broadly, we concur with moving toward a more publicly funded election model. Our analysis of the democratic risk posed by corporate political donations (Leong et al., 2013) suggests that the ideal model is removing corporate donations altogether. This is not an option, however, given the High Court’s decision in Unions NSW v State of NSW. As the only other tool Australia has for mitigating democratic risk is disclosure, it is important that there be proper disclosure and accountability surrounding corporate political donations.

Assuming the absence of full public funding, we support the proposal that corporate donations should be approved by shareholders and suggest that such donations be disclosed in annual reports, in addition to the existing state and/or Federal disclosure regimes. We recognise that this would require the cooperation of jurisdictions beyond NSW, but note that such disclosures are recommended by best practice non-financial reporting guidelines, such as the Global Reporting Initiative framework (currently at version 4).

We present our more detailed comments below, grouped under the questions being considered by the panel.

1. Whether or not it is feasible and in the public interest given all considerations (including legal, constitutional and others), to provide full public funding of State election campaigns.

3. If full public funding of State election campaigns is to be provided:

(a) what measures can be put in place to ensure the integrity of public funding;

(b) what is the appropriate regulation of third party campaigners (such as peak bodies, companies or industrial organisations) to run political campaigns and the impact of full public funding on them;

(c) what is the impact on minor parties and independent candidates; and

(d) what is the level of public funding that would be required?

The feasibility and desirability of public funding depends on its design. Mandatory full public funding, with an effective donation limit of effectively $0, risks putting the government in a position where it can substantially limit the development of new political parties. In some ways, incumbent parties are actually less in need of money than newer ones because they have established ‘brands’ worth far more than any amount of money. It might therefore be to the benefit of these parties to set the funding level at too low a level for newcomers to establish a brand name.

Further, Professor Twomey has indicated in her submissions to this Panel that a mandatory full public funding system is unlikely to be constitutionally valid, and therefore not feasible. This constitutional barrier might be avoided by using a voluntary system in which candidates/parties could freely choose to accept donation limits or bans in exchange for
public funding. Further, the existence of the Clean Elections system – described in the Panel’s second working paper - indicates that it is possible to create a form of public funding where candidates receive most of their funding from the state and abide by token donations (e.g. $150).

Thus, the major question is not whether it is feasible (for the answer is yes), but whether it is desirable, from both a theoretical and practical standpoint.

There is good reason to believe that public funding is desirable from a theoretical standpoint. The major problem with public funding is that it diverts taxpayer funding away from a potentially more valuable use. However, financing elections does not appear a poor use of tax dollars if results in elections not being financed by corporations, unions and other wealthy interests. If public funding does anything at all to reduce the influence of money on elections, then the money is likely being put to just as good a use as available alternative.

The desirability of public funding is more contentious from a practical standpoint. Professor Twomey’s submission already presents a clear and succinct description of the practical problems that would result from public funding: the difficulty in ensuring equitable distribution of money; more candidates running for office would increase the size of ballot paper to potentially confusing levels; state branches cannot be prevented from accepting money for Federal elections or for administration costs that must be spent for both State and Federal elections; and the likely increase in third-party campaigners.

While the practical considerations are the most contentious element of public funding, ultimately, we do not believe these issues to be so grave as to merit abandoning the entire idea. Equitable distribution could be achieved by using a matching funds system, such as that used by New York. Under this system, candidates are entitled to receive a certain amount of matching funds for every dollar collected – e.g for every dollar the candidate collects, he or she is given six. There is a maximum amount of money that a candidate can receive as matching funds, but candidates are permitted to continue collecting donations.

As Malbin et al. (2012) observe, this sets a fair and simple eligibility criterion – anyone who can collect contributions is entitled to matching funds. There is no need to risk unfairly excluding candidates from receiving public funding by setting an arbitrary threshold, such as percentage of the vote received or number of token contributions collected. In addition, this rule allows money to be distributed before an election, when it is needed most. Finally, as candidates would have to work to obtain contributions, this could mitigate the risk of an excessive number of candidates cluttering up the ballot paper.

We concur with Professor Twomey that party branches having a role in both State and Federal elections complicates matters. The best thing that can be done is to try keeping Federal money in a separate account, forbid that money from being used for state elections, and accept that the system is imperfect when it comes to administration costs.

The most troubling of the practical issues is that full or near-full public funding may result in increased campaigning on electoral issues by groups that might have otherwise donated this money to political parties. This is a potential loophole that cannot – indeed, should not – be closed. It is difficult to argue that democracy would suffer by, say, unions spending additional sums commenting upon, and campaigning on, workplace reform. It is similarly difficult to envisage how democracy would suffer by environmental groups spending more on commenting on environmental policy or business lobby groups campaigning further on proposed taxes and other regulation.

It is quite possible that many such campaigns might be simplistic and biased. Nevertheless, this does not justify banning such, as it would be akin to banning public comment on government policies. Whilst some might contend that there is just as much danger to
democracy of allowing these campaigns to run as there is in allowing the government to operate without criticism, the crucial difference is that the former is much more compatible with democratic ideals.

Ultimately, these practical considerations merely mean that we should not expect public funding to cause a revolutionary change and we must accept that some donors will be able to influence parties more indirectly by funding their own issue advocacy campaigns. We believe such a scenario is, however, greatly preferable to the current situation.

4. If full public funding of State election campaigns is not to be provided, what models are recommended, taking into account issues including:

(a) What is the appropriate level of caps on political donations;
(b) what measures can be put in place to ensure that any caps are effective;
(c) what is the appropriate regulation of third party campaigners (such as peak bodies, companies or industrial organisations) to run political campaigns and the impact of any proposed models on them;
(d) what is the impact on minor parties and independent candidates; and
(e) what is the level of public funding that would be required?

Two of the authors of this submission have previously argued that there is no best 'one-size-fits-all' political finance policy and that instead, the optimal policy option depends on contextual factors (Leong et al., 2013). The questions of optimal donation cap and level of public funding are linked, as less public funding necessitates a higher donation cap.

When recommending donation limits and public funding level, we suggest that the Panel’s primary objective should be to select a limit that will be observed and will allow parties to acquire enough money. Preventing corruption should be the secondary objective, because setting the limit at an unreasonably low level will likely only result in parties ignoring it, as appears to be the case in India (Gowda and Sridharan, 2012).

Therefore, we argue that donations limits should be to set to the lowest possible level at which the following two conditions hold true:

A. The limits can be expected to be generally observed; and
B. The limits are not expected to lead to inadequate political funding.

5. In considering all reform options, the Panel should consider:

(a) what controls should apply to the making of donations, such as
    i. whether or not particular entities or groups of donors should be excluded;
    ii. whether prior approval of a majority of members of a corporate entity or other organisation is required;
    iii. Any limitations or restrictions on such political donations; and
(b) the appropriate frequency and timing of disclosure obligations under election funding laws.

Contributions from corporations and unions are especially problematic, because organisational leadership takes money belonging to its members and uses it to achieve political objectives with which said members might not necessarily support. We are aware that there is little the NSW Government can do to address this, but believe that Panel might be able to make appropriate recommendations to the Federal Government.
Following on from Ramsay et al. (2001), we argue that it should be mandatory for corporations and unions to provide details about political activity within annual reports. Shareholders and unions members deserve to know the purposes to which their money is being directed. Political activity is considered significant enough be a recommended disclosure of the Global Reporting Initiative, the framework generally considered to be the world’s leading reference for corporate and governmental non-financial reporting.

Furthermore, shareholders and unionists should have at least some say in how their money is directed. Again, similar to Ramsay et al. (2001), we believe corporations and unions should be permitted to engage in political activity only when such activity in in accordance with a policy ratified by its membership at an annual general meeting. Each policy would have to be renewed every four years.

### 6. Whether the penalties for contravening provisions in the Election Funding and Disclosures Act 1981 are commensurate with the nature of the offence. This should include advice on penalties that could apply to donors, intermediaries or recipients of unlawful donations.

We will focus this section of the submission on the question of strict liability.

Your third working paper, *The Merits of Full Public Funding*, observes that the NSW Electoral Commissioner recommends attaching strict liability to political finance offences, so that prosecutors cease being required to prove that defendants knew their activity to be unlawful. As a safeguard, the NSW Electoral Commission (2012) has recommended permitting a defence of honest and reasonable mistake.

While we agree with reducing the prosecutorial burden of proof, we are concerned that introducing strict liability may be going too far. The Panel should therefore consider whether it is possible to increase compliance without introducing strict liability, or at least minimising its usage.

One might, for example, have the test be whether a reasonable person in those circumstances would have (or should have) suspected that the conduct was illegal. Alternately, it could be a defence that a reasonable person in those circumstances would be unlikely to suspect their behaviour contravened the law.

Imposing strict liability creates the risk that people will be prosecuted for innocently and unknowingly violating electoral law. The honest and reasonable mistake defence specially does not apply to matters of law. Imposing strict liability is very much akin to saying: It doesn’t matter how little known the requirements of the law were; it doesn’t matter how reasonable an oversight was – anyone who violates this law must be punished. Strict liability is serious business and should be treated as such.

The following examples present real-life incidents where people were subject to potential legal trouble due to ignorance or misunderstanding of political finance law. Each of these incidents occurred outside of NSW, so it is possible that some or all of these situations would have been legal here. Nevertheless, they show that political finance law can catch people it was never intended to, thus illustrating the potential danger of strict liability:

1 Ramsay et al. (2001) only dealt with corporations, not unions.
2 The current version (G4) indicator SO6 requires reporting the total monetary value of financial and in-kind political contributions made directly and indirectly by the organization by country and recipient/beneficiary.
1. Four people hired a professional painter to create a large sign supporting George Bush. They violated the law by neglecting to include a disclaimer stating who had paid for the sign and whether Bush had authorised it. Further, if anyone contributed more than $250, they would also have violated campaign finance reporting obligations. Had the group spent over a $1000, which was unlikely but not impossible given how noticeable they wanted the sign to be, the group would have been further guilty of failing to register as a political committee (Smith, 2003).

2. After being diagnosed with cancer, a couple set up a trust fund that would give $1 million to each of their children, payable once the child had turned thirty, earned a bachelor’s degree and married. One of the children used his share to fund his political campaign. However, as the fund was established during the electoral cycle, the money was deemed a donation from the candidate’s parents and he was fined $210,000 (Smith and Toner, 2003).

3. A congressional candidate borrowed money to fund her campaign. However, as her husband co-signed the loan, the Federal Election Commission deemed half of the money as belonging to him. As the husband’s share exceeded the contribution limit, he received a fine (Lynch, 2001).

We concede that there may possibly be some situations where strict liability is necessary. However, we believe that it should only be used as a last resort. Ultimately, if strict liability is adopted, then we concur with the points raised in your fifth working paper, which suggested that: a) it should only apply to party agents or people in positions of responsibility; and b) the penalties imposed by strict liability offenses should not be particularly large. These two conditions would mitigate the risk of strict liability provisions severely penalising the wrong people.

7. Any amendments to legislation to ensure that limits on political donations and disclosure requirements cannot be avoided through the use of artificial structures or other means.

We agree that efforts should be made to avoid circumvention of legislative requirements via artificial structures. Whilst this is a complex area (and one difficult to fully address) we offer the following initial thoughts:

- Banning donations from structures whereby identifying the ultimate owner is problematic, such as trusts;
- Requiring that donating organisations are genuinely ‘operating’. Following from the current tests for the classification of business size, evidence of operations might be operationalised as exceeding thresholds for two of the following three indicators:
  - Employees;
  - Sales; and
  - Assets.
- Requiring that any non-publicly listed entity disclose its share register
- Requiring disclosure of basic identifying information for any entity, including place of business, directors and industry (by GICS code)

8. Any other matters relevant to political donations.

First, we believe that corporate donors should be required to report the nature of their business. This would help determine a corporation’s interests and facilitate easier tracking of industry contribution behaviour.
Second, a form of public funding that could be made available to all candidates at relatively low cost is web hosting. The NSW Electoral Office (or another agency) could maintain a candidate website index, with candidates grouped by electorate. Users would select their electorate and be provided with a link to the personal website of every candidate participating in that election (who has a website). The provision of a content management system would ensure that any candidate could design their own site.

The primary reason to create this website is to make a more level playing field. All players – big and small – would have a forum that is considered easily accessible; where they can communicate everything they choose to say; and where those who want to listen can do so. Even if many people chose not to use this resource and continued to rely on mediated information for their decision-making, we believe the symbolic value of such a site would nevertheless be significant.

Once again, we thank you for the opportunity to comment on this most important matter and we wish you luck in your endeavour.

Yours Sincerely,

Dr Shane Leong, Dr James Hazelton and Dr Edward Tello.
Reference List


