Dear Dr Schott, Mr Watkins and Mr Tink,

Supplementary submission to Panel of Experts - Political Donations

During the Academic Roundtable, Mr Watkins expressed interest in identifying the most plausible way a full or near full public funding system could operate, and whether it was possible to remedy the problems public funding raises. As I have both read and written about public funding systems during my academic studies, I thought I might be able to offer some advice on these matters.

This submission is divided into the following sections:

- **Overview**: Several conceptual problems could be avoided by adopting a multiple matching funds system (similar to New York). Therefore, this submission will begin by providing an overview of this system, along with a table describing how my proposed system would address the concerns surrounding near full public funding.

- **Eligibility for Public Funding**: A public funding system must simultaneously make fundraising achievable for new entrants, but difficult for ‘joke’ and hopeless candidates. This section discusses how this might occur.

- **The Democratic Enhancement Fund**: This section discusses how to permit NSW to sell political access in a manner that precludes the possibility of *quid pro quo*. Doing so will both ease the burden on taxpayers and address the ‘hydraulics’ problem of political finance.

- **Protecting New Entrants and Vulnerable Parties**: This section argues that as a safeguard, new entrants and vulnerable parties should be able to opt out of the new rules until they have reached a certain level of electoral success.

- **Bundling**: This section argues notes that bundling – i.e. when a single person solicits a large numbers of donations – is a risk, but that it is not worth worrying about.

- **Conclusion**: Summaries the benefits of the proposed model.

**Overview**

In a multiple matching funds system, parties and candidates have a low donations cap, but the state matches all donations with a specified amount of money, up to a maximum limit. Once this maximum is reached, donations can continue to be solicited, but they are no longer matched by the state and the donations cap is still in effect.

For example, there may be an annual donation cap of $200, with the state paying $4 per every dollar received. Independents running for the Legislative Council and political parties might receive a maximum of $3 million dollars in public funding per year, while independents contesting a Legislative Assembly seat may have a maximum of $100,000.

This system does raise a number of issues. The table on the next page highlights the major practical concerns about public funding and how the proposed system deals with them.
<table>
<thead>
<tr>
<th>Public Funding Concern</th>
<th>Summary of Solution</th>
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<tbody>
<tr>
<td>How will new entrants raise funds?</td>
<td>By soliciting small donations (e.g. $200) from the public, which are multiplied by the state. This method not only provides a qualification test more viable than ‘votes received in the previous election’ or ‘performance on a voting poll,’ but permits new entrants to access money before an election when they need it most. As an additional safeguard, new entrants (e.g. parties holding less than three seats) can be permitted to opt out of the proposed system and use NSW’s current donation rules. They must still abide by disclosure requirements, expenditure caps and possibly spending caps.</td>
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<td>What prevents the system from funding ‘joke’ and hopeless candidates?</td>
<td>Parties and candidates only become eligible to receive public funding by successfully soliciting a certain amount of funding in the form of small donations. While this is not impossible for ‘joke’ candidates to accomplish, the amount NSW can expect to lose to such candidates is limited by the fact that public money is given in proportion to their ability to secure small private donations from the public. Thus, a joke party will be unable to secure the maximum entitlement without first convincing thousands of people to provide small contributions.</td>
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<td>Public funding may cost too much.</td>
<td>A democratic enhancement fund (described later) may be set up to offset the cost. This will raise money by selling political access, but do so in a manner that virtually precludes the possibility of quid pro quo.</td>
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<td>Too much public funding can lead to parties becoming self-sufficient and ignoring their members.</td>
<td>Direct donations will be limited to a token amount, eliminating large donors. At the same time, small donations will be multiplied, becoming a very important source of revenue. Parties therefore have much more incentive to cultivate and maintain a large base of small donors, rather than a small group of large donors.</td>
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<td>What prevents donations simply being redirected to fund issue advocacy campaigns?</td>
<td>That is indeed a possibility, but as political communication is a vital component of democracy, NSW cannot - and arguably should not - seek to prevent it. However, a democratic enhancement fund should at least stop non-partisan donors acting in this manner by allowing them to easily make large contributions and secure political access, in a way insulated from allegations of corruption.</td>
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<td>The NSW government cannot prevent party branches from receiving money raised from Commonwealth elections and using it for party administration. This creates a hole in any effort to restrict political donations.</td>
<td>The proposed system does not resolve this particular issue. However, I believe that the other benefits are substantial and it is virtually impossible to create a system with no drawbacks.</td>
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Eligibility for Public Funding

Parties and candidates would qualify for matching funds by collecting a specified amount of small donations. Concerning political parties and independents standing for the Legislative Council, a good starting point would be 500 times the maximum contribution, which is $10,000 using the example figures. This provides a threshold that is both high for joke parties, but trivial for genuine ones. All political parties must have a minimum of 500 members and one would expect the vast majority of these people to contribute the maximum - especially as it is only a token amount and will multiply! Any shortfall should be easily covered by contributions from friends, family and contacts of said 500 members.

I believe this formula is also appropriate for independent Legislative Council candidates. If these people are to be given sufficient funding to conduct a competitive statewide campaign, then they will need to be eligible to receive almost as much money as an entire political party. Since the benefit will be comparable to that received by a party, it isn’t unreasonable to subject them to the same qualification test. Independent candidates contesting Assembly seats can have a lower qualification threshold (such as maximum contribution times 60), as it is unreasonable to expect them to have the same level of support as a party.

While some new entrants will find these eligibility criteria easier to meet than ‘number of votes received in the last election’ or ‘polling result,’ others may find it harder to raise money under the proposed system. For this reason, as discussed later, new entrants should be allowed to opt out of the new rules, subject to certain qualifications.

The Democratic Enhancement Fund: Offsetting the Cost to Taxpayers and fixing the ‘hydraulics problem’

The two biggest risks concerning near full public funding are: a) NSW will not accept the cost and b) donors will attempt to avoid the caps. I propose an original pre-emptive response to these risks by implementing a compromise solution based upon the selling of political access, but which should still be an improvement on the current situation.

This solution involves creating what I term a ‘democratic enhancement fund’ (DEF) to raise money to support a public funding system. The DEF would function like a kickstarter campaign and donors could be encouraged to contribute certain amounts and receive specified rewards. For example, donating $15,000 could entitle the donor to a year’s access to exclusive networking meetings with other DEF donors and members of both the Government and Opposition. Higher rewards, possibly limited in number, could include invitations to even more exclusive events with Cabinet ministers.

Many undoubtedly dislike the idea of permitting wealthy interests to purchase political access. However, while it would be possible to reign in the sale of access, it is impossible to ban it completely, as that would require banning politicians from meeting with all donors. A better option is therefore to alter the circumstances in which access is sold, such that these sales involve less risk of corruption and greater benefit to democracy.
The strength of a DEF is that private interests can contribute large sums of money without raising quid pro quo concerns. From a politician’s perspective, the only impact DEF contributions ever have is reducing the cost of public funding to taxpayers. Candidates and parties will receive exactly the same amount of money regardless of whether specific DEF donors decide to give or withhold their financial blessings. This absence of quid pro quo risk justifies DEF donations being exempt from NSW’s normal caps.

In addition, a DEF provides a solution to the ‘hydraulics problem’ of political finance – i.e. restricting money from one source only causes it to turn up somewhere else. Non-partisan donors have no incentive to find creative ways around the rules when a DEF allows them to easily make large contributions and secure political access. Further, the fact that no party or candidate specifically benefits from DEF donations is advantageous to donors, as they are insulated from corruption allegations.

Partisan donors may very well avoid using the DEF, preferring to engage in activity such as launching issue advocacy campaigns. However, this poses no danger to NSW. Political campaigning cannot and should not be prevented, as they are vital elements of a functioning democracy. Additionally, NSW has an expenditure cap in place to prevent these groups from dominating elections. A rise in political advertising by partisan donors is a small price to pay for reducing the potentially corrupting influence of non-partisan contributors.

A DEF also helps address the ‘hydraulics problem’ from the party’s point of view. DEF donations will genuinely support democracy by helping to remove corruption and providing a more level playing field to new entrants. This, combined with the impossibility of quid pro quo, means that parties can be more open and obvious concerning fundraising. Any allegation of greed can be countered with the reminder that each dollar raised is one less taxpayers are forced to contribute.

Parties may therefore increase the price of political access each year as needed. It would not only become justifiable to explicitly sell rewards such as a sit-down meeting with the Premier or a Cabinet Minister, but a premium could be charged on the ground that the money supports all parties, not just one. Increasing the amount of money placed in the DEF would then serve to justify an increase in public funding entitlements.

Protecting New Entrants and Vulnerable Parties

The proposed system may inadvertently cut funding to smaller parties or independents. This problem could be rectified by allowing independents and parties to opt out of both the new public funding system and low donation cap, but with two very important qualifications.

First, this option is only available to new entrants and the most politically vulnerable. Forcing new entrants to operate under the same donation rules as major parties is both unnecessary and detrimental to democracy. Major parties have had time to grow their membership and develop their brand names. It is unfair to expect new entrants to operate under restrictions their established counterparts never had to, especially since doing so serves no anti-corruption rationale. New entrants do not – any may never have - the power to grant favours to their benefactors, hence the risk of corruption is insignificant.
If a new entrant wins a few seats, then I would argue that it should be considered politically vulnerable and retain the right to opt out. The need to prevent corruption hasn’t yet become imperative enough to trump the need to avoid hindering the party’s development, as vulnerable parties don’t hold real power. Vulnerable parties only hold potential power, as their influence on any political decision can be reduced to nothing by major parties winning a majority of seats or the combined influence of other minor parties and independents holding the balance of power. It is possible that a ‘vulnerable’ party may succeed in being able to raise an absurdly large amount of money by opting out, but the expenditure cap will prevent said party from downing out its rivals.

Allowing new entrants and vulnerable parties to opt out merely acknowledges that the biggest democratic risk surrounding these people is not that they will be corrupted, but that they will be denied the money needed to properly develop their support base and prove to the electorate that they are credible choices.

The right to opt out might be denied to parties currently holding three or more seats, as any party with that many seats presumably has a decent membership base and established brand name. Such parties can handle themselves and the need to prevent corruption overrides the need to avoid hindering their development.

I am in favour of automatically allowing independents to opt-out, as some of them may depend on being self-financed and cannot readily acquire a support base. However, if it were deemed necessary, Independents might be denied the right to opt out if they won seats during both of the last two electoral cycles, whilst running as independents. Thus, a candidate who was previously a long serving member of Party X before deciding to turn independent retains the right to opt out.

Similar to above, the idea is that an independent who has held a seat for two elections must have an established reputation and support base and need not be treated like a new entrant.

The second qualification concerning the right to opt out is that it does not come with an exemption from all accountability requirements. Parties and candidates would still be subject to disclosure requirements and expenditure caps. Additionally, people who opt out of the new public funding system should be entitled to the same level of public funding as they would have received as per the current NSW electoral rules. Opting out is hardly a safeguard for the vulnerable if it means renouncing all entitlement to public funding! Further, cutting off their public funding will weaken the argument that DEF money benefits all parties.

Candidates could further be subject to donation limits, but as the point of this system is to provide the most vulnerable with the freedom to source money in a way that best suits their strengths, the limit could be higher than the current $5000 indexed to inflation. I would further recommend that independent candidates who chose to opt out be permitted to contribute to their campaign an amount equal to the maximum entitlement they could have potentially received via public funding. This rule will prevent self-financed candidates from dominating elections without hindering their entry into politics by forcing them to find scores of people willing to provide start-up money they never needed or wanted. Preventing a millionaire from self-funding his election serves no anti-corruption rationale, as he cannot corrupt himself. Literally the only thing accomplished by preventing a millionaire from self-funding is to put in place a barrier to running as an independent – which is exactly the opposite effect public funding should have.
**Bundling**

Heightening the importance of small donations may encourage people to become ‘bundlers’ – i.e. solicit large numbers of donations from friends, family and other contacts. While this could allow small donors to have an unprecedented level of political access via the bundler, the public is likely to be just as concerned about bundlers as it was about large donors. Bundling becomes especially concerning if it results in managers pressuring their subordinates into donating.

Ackerman and Ayres (2006) have proposed creating a secret refund booth to allow people pressured into giving money to secretly claim back their contribution. However, I do not recommend using this method as, given the small amounts involved, the administrative burden appears to outweigh the benefits.

Ultimately, I believe that the risk of bundling is insufficient to reject a multiple matching funds model because NSW has already provided people with reason to act as bundlers by adopting donation caps. Granted, lowering donation caps to $200 would provide people with even more incentive to become bundlers, but such a low contribution cap would greatly limit the potential harm bundlers can inflict.

**Conclusion**

Public funding is not a silver bullet that will magically end all of NSW’s corruption concerns. There will always be loopholes which cannot – and arguably should not – be plugged. For better or worse, lobbyists will still be meeting with politicians, wealthy partisan donors can fund their own advertising campaigns to influence elections and there may be a rise in bundling.

Nevertheless, public funding does have the potential to weaken the financial link between those who make the rules, and those who are subject to them. There are different ways one could design a public funding system, but the one proposed in this document contains the following beneficial features:

1. Candidates and parties can qualify for public funding prior to an election, meaning they will have a good idea as to their campaign budget. Further, new entrants will benefit by being able to access pre-electoral start-up funds.
2. As a safeguard, new entrants and vulnerable parties/candidates may opt out of the proposed system and use the electoral funding rules as they currently stand. This is an option only granted to the smallest and most vulnerable of parties and candidates and is lost should the party/candidate experience a certain degree of electoral success.
3. Public money is given in proportion to the ability of parties/candidates to secure small private donations from the public. Therefore, even if a joke party manages to become eligible for matching funds, it will be unable to secure the maximum entitlement without first convincing thousands of people to provide small contributions.
4. Established parties are incentivised to cultivate a large number of small donors, as they are ineligible for any public funding without them. This will mitigate the risk of parties becoming self-sufficient and feeling free to ignore their members.
5. People will be incentivised to donate to political parties knowing small amounts will be multiplied.
6. Candidates and parties become eligible to receive public funds by successfully soliciting a certain amount of funding in the form of small donations. This provides a qualification test which is usually more viable for new entrants than ‘votes received in the previous election’ or ‘performance on a voting poll.’

7. One drawback of donation caps is they prevent wealthy benefactors from helping new entrants when they need it the most. However, matching funds allow several small donors to provide as much assistance as a large donor, thereby remedying this problem.

8. A democratic enhancement fund model will allow NSW to raise money by selling political access, but in a manner that precludes the possibility of *quid pro quo*. This will both ease the burden on taxpayers and address the ‘hydraulics’ problem of political finance.

I thank the Panel for the obvious effort you are placing into this inquiry.

Yours Sincerely,

Dr Shane Leong

Reference List