

Drams, Laris, and Politics

Political Funding Regulations in Armenia and Georgia

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FOREWORD

Money and Politics: A dangerous Mix

Political party financing has always been and probably will remain for the foreseeable future a hot topic in multiparty democracies. In the United States money is seen by many as the decisive factor in election campaigns as hundreds of millions of dollars are spent every year for that purpose. In the older democracies of Europe such massive amounts are not devoted to elections but there have, nevertheless, been numerous scandals bringing to the open corrupt and illegal practices to fund parties and their election campaigns. In many cases state resources have been used to solicit campaign contributions and often there is still an unhealthy relationship between business and politics. So although unethical actions still occur, with the introduction of state financing and transparency rules in many European countries, they have become much less frequent.

Political parties need money to operate and generally not all expenses can be covered by membership fees. In many parts of the world it is an accepted practice that the state has taken over part of the funding - in some cases without any special conditions, in other cases earmarking the money for certain activities – and parties are obliged to provide information about campaign donations, that can also be subject to legal limits. Nevertheless, loopholes remain since watertight systems are difficult to establish. A recent debate in the Dutch parliament about party funding led to a tightening of the disclosure rule for donations to the central party-offices, but did not (yet) lead to a better regulation of local party funding. The Netherlands still does not fully implement the Council of Europe's anti-corruption Group's (GRECO's) recommendations on regulations for party funding.

But this is just one part of the story. The Dutch practice scores much higher than a number of European countries that have better regulations in place but do not apply them properly as the research of Ketevan Bolkvadze makes clear. Internal party rules, general

accountability and media scrutiny have created an informal electoral context in which money is not the dominant factor in Dutch politics. The level of campaign spending is relatively low and voters rely on the free media to get the information they want. Public debates also help the voters to make up their minds. There will of course always be complaints about media access or the advertising budgets of opponents but the very high turnout in Dutch national elections can be considered as evidence of a high level of political trust. Regulations are important – to help promote level playing fields – but they will only have the desired effect if they are respected in practice and seen as part of a set of informal rules to protect the democratic quality of a given society.

This paper analyses the party funding systems of Armenia and Georgia. These countries have been labelled as hybrid democracies where dominant single parties or party coalitions almost have a monopoly of power. In these countries the lack of a (paid) membership basis – and therefore of an important source of independent funding – forces parties to find revenues from either the state or from private donors. Since state funding is limited – these are relatively poor countries – parties have to rely on physical or corporate donors. Although there are disclosure rules and limitations in both countries, only parties with access to oligarchic or other rich private sources have a chance to challenge parties in power, that often have access to additional, administrative resources. In October 2012, the ruling party of Georgia, the United National Movement (UNM), lost the parliamentary elections with one of the main explanations being that its opponent, the Georgian Dream Coalition, had been able to rely on the financial support of a local billionaire to compensate for ample resources of the ruling party.

Often party funding rules are manipulated to serve those in power. Take the disclosure rules in Armenia that make it hard to trace where the money of the richest parties comes from, or the sudden adaptations to the Georgian law when the ruling party saw itself confronted with a very rich contender.

Through GRECO there is a set of campaign financing rules for Europe, but as this paper shows, the implementation leaves much to be desired for, especially in the hybrid

political systems that we have seen developing in some post-soviet countries. The OSCE/ODIHR fortunately adds strength to the work of GRECO by including assessments of campaign financing in its election observation reports. The EU has set up so called Eastern Partnerships for six countries that are somewhere in between authoritarian, half democratic and more or less democratic. By offering these states association and deep free trade agreements, the EU also hopes to be able to promote better democratic conditions. It has introduced the ‘more for more’ principle – the more an Eastern partner does to enhance democracy and human rights, the more (financial) support it will receive. The EU should certainly also apply this principle to party funding. This study offers a lot of recommendations on how to improve the situation in at least the two countries dealt with in this paper. To avoid being accused of hypocrisy, the EU should also look at itself. Corrupt party financing practices still occur within its own territory. Under the justice-for-growth approach, promoted by the European Commission, the fight against corruption is one of the priorities and thus a tool to tackle illegal party funding.

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1. Introduction

Political funding is doubly crucial for the functioning of democracy. On the one hand, it can strengthen the workings of multiparty democracies. ‘Without money in politics, competitive multi-party democracies could not function, nor could their governments operate. Like a form of free speech, political finance is linked to the health and strength of a democracy’.¹ On the other hand, political funding can also become associated with large discrepancies and corrupt practices that are detrimental to the state of democracy. The advantages and disadvantages of political funding have long been debated among scholars dealing with Western democracies. However, this topic has attracted much less attention in the context of the hybrid regimes in the former Soviet Union. This is regrettable since the ‘dark side’ of political funding here looms even larger, given the fragile democratic institutions, widespread corruption and lack of transparency. Furthermore, due to the specific problems characterising hybrid regimes, the solutions proposed for Western democracies might not readily ‘travel’ to the post-Soviet region.

As demonstrated by the last two decades of democratisation, even authoritarian states have adopted democratic institutions and formal rules. Authoritarian and semi-authoritarian rulers have instead devised and fine-tuned various informal strategies to thwart electoral competitiveness, without actually breaking the formal regulations. This explains why a push for certain regulatory provisions, which might have worked in more democratic contexts, could have detrimental or unforeseen effects in hybrid regimes.² Political funding regulations must therefore be analysed against the backdrop of the existing political milieu. This policy paper, prepared under the auspices of the Netherlands Institute for Multiparty Democracy’s (NIMD) South Caucasus Regional Program, delves into political finance regulations in Armenia and Georgia – two hybrid

¹ USAID (2003) p. 1.

² For instance, in the West, lower spending limits are often regarded as a tool for leveling the playing field by curbing influence of rich contenders. In the context of hybrid regimes, strict expenditure limits turn into a comparative handicap for opposition parties since incumbents can continue abusing state resources.

regimes in the South Caucasus.³ In view of the political environment in these countries, this policy paper focuses on: what are the major shortcomings of the Armenian and Georgian political finance regulations? The aim is to uncover areas where reforms could foster the emergence of functional multi-party democracies.

Existing political environment

Before delving deeper into the political funding specificities in Armenia and Georgia, two contextual problems should be highlighted, which significantly undermine the functioning of multi-party systems in both countries. The rationale here is that, in order to detect regulatory loopholes – which often tend to be rather technical – one first needs to grasp the setting in which the parties have to operate.

(1) The vast majority of Armenian and Georgian parties have a very small membership base (if any) and therefore generate *negligible grassroots contributions*. Widespread poverty and socio-economic problems significantly hinder institutionalisation of such contributions. Apart from this, trust in parties is also rather low, causing citizens to abstain from membership in political parties. Instead they participate in politics through limited forms of engagement, such as voting and occasional public protests.⁴ In established democracies, membership or affiliation fees are widely regarded as the most democratic and legitimate form of party financing. “They are donated on a voluntary basis and, notwithstanding material incentives, which may underlie an individual’s motivation, they do not imply a direct pay-for-service relationship”.⁵ In the Armenian and Georgian context, however, the lack of a participatory culture and weak membership base leaves political parties without this critical source of funding. As a result, pressure on parties to raise funds from other alternative sources is double-fold, which also increases the power of moneyed interest groups to influence party behaviour in exchange for financial support.

³ Both Georgia and Armenia are listed as hybrid regimes in the Economist Intelligence Unit’s Democracy Index 2012.

⁴ Nodia, G. & Scholtbach, A.P (2006) p.76; Face-to-face interview with the director of Armenian Civiltas Foundation Salpi Ghazarian.

⁵ Biezen, I. (2003) p. 17

(2) The second challenge concerns the *uneven playing field*, which up until now has characterised the political landscape in both countries. Generally, the party politics in such hybrid or ‘competitive authoritarian’⁶ regimes display different dynamics than in a settings where fair contestation can be taken for granted. In fact, skewed political playing field has become the major feature of hybrid regimes, resulting from an incumbent’s unrestrained access to (and often abuse of) state resources. As Bader (2008: 87) notes,

“A ‘party of power’ is often established in (semi)authoritarian regimes in order to organize support for the regime. Such a party of power enjoys electoral advantage over opposition parties since they are habitually propped up by state resources.”

A winner-takes-it-all approach has been dominating the political scene both in Armenia and Georgia, leaving opposition parties marginalised. These dominant power politics trends coupled with the lack of grassroots contributions pose momentous challenges for opposition parties, and by extension, to the functioning of multi-party democracy.

For the opposition, which on the one hand faces the ruling party’s extensive access to state resources, and, on the other hand, a lack of membership contributions, the only way to redress the skewed playing field seems to be by forming alliances with rich economic actors. Such alliances have repeatedly resulted in the toppling of ruling elites and brought opposition parties to power in a number of post-Soviet states. However, these regime cycles do not necessarily always lead to democratisation and the emergence of multi-party systems, since the parties – whether dependent on state resources or rich financial backers – remain unaccountable to grassroots interests. Besides, sole reliance on rich economic actors also makes the opposition parties extremely vulnerable, since the politically biased authorities can suppress them by cutting the ground from under the feet of their sponsors.⁷

⁶ The term “competitive authoritarianism” was coined by Levitsky and Way (2010) to describe hybrid regimes, where political competition is real but unfair, due to the incumbent’s abuse of state resources.

⁷ Yet another aspect worth mentioning here is the foreign funding, allegedly sometimes channeled in support of opposition parties, even though such funding is legally banned in both countries. This often provides yet another ground for authorities to discredit the opposition with allegations of being led by foreign forces (Russia, the West) and thus serving their interests, instead of the national ones.

Addressing the research question

Definitions. Due to gaps in academic research on political funding in emerging democracies, it is difficult to propose a suitable and simple definition. According to Michael Pinto-Duschinsky (2006), the narrowest definition of political finances is ‘money for electioneering’. Because political parties play a key role in election campaigns, and because it is hard to draw a distinct line between the campaign costs of party organizations and their routine expenses, party funds may reasonably be considered political finance, too. To put it in a nutshell, following his definition, political finance includes *campaign expenses* coupled with the *funds for regular party functions* (such as maintaining permanent offices, carrying out policy research, engaging in political education, voter registration, and other everyday party activities).⁸ On the other hand, there are broader definitions that also include more unconventional forms of political spending. An exhaustive description would require us to include a) political “foundations” and other organizations which, though legally distinct from parties, are allied to them and advance their interests; b) the costs of political lobbying; c) expenses associated with newspapers and media that are created and paid to promote a partisan line; and d) the costs of litigation in politically relevant cases.⁹ Thus, there are a large number of channels through which money can pour into politics. However, this paper follows the narrowest and most straightforward definition of political funding described above as ‘money for electioneering’, or funds for campaigning and regular party functions.

Methods. The study has been conducted using basic qualitative research methods. Initial phase comprised desktop research, review of the existing databases on party finance regulations in Armenia and Georgia, as well as academic publications dealing with the perils of political funding in emerging democracies. Three comparative databases have been used while searching for specific regulatory provisions: prepared by the International Institute for Democracy and Electoral Assistance (IDEA), Stefan Batory Foundation and the Global Integrity Report.

⁸ Michael Pinto-Duschinsky (2006), pp. 189-190.

⁹ Ibid.

IDEA's political finance database shows the different types of regulations in individual countries, and it can also be used to compare the prevalence of various provisions between countries and regions. The second database, by the Batory foundation, aims to examine political finance regulations from the perspective of protecting policy-making against undue influence of private interest groups. Finally, the Global Integrity Report offers a more quantitative analysis of money in politics. Here political finance legislation is measured based on its role in the country's anti-corruption policy.

All three databases provide extensive and detailed information on political finance legislation, but less on how these provisions are enforced in practice and what implications they have for the local multi-party landscape. As with many areas, adopting a law does not automatically bring compliance. So as to cover any serious gaps in the research several face-to-face expert interviews were conducted in the selected countries. The list of expert informants comprised representatives of the democracy watchdog organizations as well as those of the party affiliated research institutes. This strategy gave an opportunity to triangulate the data and get insights into the problem from the major stakeholders such as parties and the non-governmental sector.

Outline. The study is divided into three chapters. The next two chapters investigate the regulatory obstacles in Armenia and Georgia, respectively, from the viewpoint of the country's political landscape. Each country chapter is followed by a set of policy recommendations addressing the identified regulatory loopholes. The concluding chapter outlines three general courses of action that could open up the system of dominant power politics, which has prevailed in Armenia and Georgia for almost two decades.

2. In Quest for the Loopholes: Armenia

POLITICAL LANDSCAPE: Experts on the Armenian political landscape repeatedly highlight the dominance of an oligarchic clique, who enjoys significant economic and political power. The leading Armenian businessmen, a group numbering around 40, not only control industries ranging from banking to mining, but also have translated their

economic edge into privileged political statuses.¹⁰ According to Marilisa Lorusso (2012), from Istituto Affari Internazionali, ‘common wisdom is that the parliament has been turned into an arena where interests of oligarchs are negotiated.’ This creates expectations for political competition between different interest groups and thereby, pluralism - even if feckless¹¹ - at the party-politics level. Political scientists (Hale 2011; Radnitz 2010) have been positing that the emergence of several, even if small, competing pyramid-structures under independent patron-oligarchs could bring pluralism by undermining the overwhelming dominance of a single-party of power.

Nevertheless, looking closer at the everyday dynamics of Armenian party-politics also exposes the misleading character of the above-mentioned expectations. It is true that there is competition between different oligarchs and their interests; however, staying in good terms with the ruling party remains imperative.¹² The majority of oligarchs are either directly affiliated with the ruling Republican Party of Armenia, or those who have formed their own (opposition) parties try not to confront the ruling party too hard, lest they risk their business interests. The latter group mostly serves the purpose of creating a semblance of competitiveness during elections, thereby legitimising the incumbents hold on power. Those opposition parties that genuinely try to challenge the incumbent party’s dominance have a difficult time acquiring financial resources. And the political finance regulations do little to flatten these huge fiscal disparities among the parties.

LEGAL FRAMEWORK: Armenia’s legal framework for the financing of political parties and election campaigns generally reflects GRECO’s widely accepted and acknowledged common rules¹³ against corruption in political funding. Rules are in place to ensure a certain degree of regulation of party expenses. Furthermore, a system of supervision exists and there are even cases in which parties and candidates have been sanctioned for non-compliance. Nevertheless, this has not alleviated serious legal

¹⁰ Aghajanian, L. (2012)

¹¹ The concept of ‘feckless pluralism’ has been coined by Thomas Carothers (2002) to describe the political competition between deeply entrenched parties that essentially operate as patronage networks.

¹² The vivid illustration of this is the party ‘Prosperous Armenia’, founded and led by one of the richest oligarchs – Gagik Tsarukyan. In the run-up to the 2013 Presidential elections he withdrew from the race, shortly after having a behind-the-door meeting with the acting President Sargsyan.

¹³ GRECO (2003)

shortcomings, particularly with regards to transparency and impartiality, which also have allowed undue practical application and politicised enforcement of the law.

Table 1. Global Integrity indicators (2011) for the Armenian political finance regulations, scores range from 1 to 100, with the latter signifying highest positive degree attainable.

Indicator	Score
20 Are there regulations governing the financing of political parties?	50 
21 Are there regulations governing the financing of individual political candidates?	100 
22 Are the regulations governing the political financing of parties effective?	8 
23 Are the regulations governing the political financing of individual candidates effective?	10 
24 Can citizens access records related to the financing of political parties?	63 
25 Can citizens access records related to the financing of individual candidates' campaigns?	31 

According to the Global Integrity indicators, in 2011 Armenia scored just 8 out of 100 in practical effectiveness of its party financing regulations; and 10 out of 100 in its ability to effectively regulate contributions made to individual political candidates. These numbers represent a significant contrast to the evaluation of the country's legal framework, which received better scores: 50 for party financing regulation and 100 for individual candidate regulation. These discrepancies not only reveal the problems in the regulatory framework (50 out of 100), but also expose the outright ineffectiveness of existing regulations (8 out of 100).

Income Regulations: Armenian political finance legislation allows parties to receive funding from the following sources: membership fees, donations from physical and legal persons (in case of campaign finances only from physical persons) as well as state funding. There are no significant shortcomings concerning regulation of membership fees, however, as already mentioned earlier, due to economic and social problems in the country, funds raised through this source are a negligible portion of the parties' income.

The picture becomes more complicated with regards to private donations from physical and legal persons, which represent the primary source of income for the vast majority of parties. One of the serious shortcomings is that with regards to campaign finances there

are no limits on donations from one source, such as employees of the same company. As a result, even though corporate donations are prohibited during campaigning period, businesses use this provision to indirectly funnel large sums to parties during elections by ‘asking’ their employees to donate to a particular party.¹⁴ Because of close informal links between the ruling party and the major businesses, this largely has been benefiting the incumbent (or its satellite oligarch-affiliated parties). Two interviewees named this regulatory loophole as a part of a well-established practice through which the ruling party has been raising money for its pre-election funds, in return allowing donor businessmen to engage in tax evasion or giving them preferential treatment in state-run tenders.

Another regulatory weakness is related to the transparency of data regarding donors. Political parties, while filing declaration forms about their pre-election funds, have to provide detailed information about their donors. However, the publicly available declaration forms (posted on the page of the Oversight Audit Service (OAS) or the website of the Armenian Central Election Commission (CEC)) only contain information on the amounts of the donation, and nothing on donors’ personal data (such as name or ID). Neither the amended Electoral Code, nor any CEC decision allows the public to have access to such data, which undermines trust towards the political parties and raises questions about transparency of the campaign finances. Disclosing certain data on donors is necessary, among other reasons, for revealing instances of mass donations from employees of the same company.¹⁵ Interestingly, the initial version of the electoral code (1999), envisaged unrestricted access to such information. The limitation was introduced by an amendment of 2011, and was justified by government representatives with reference to the privacy interests of donors. Allegedly, in the post-2008 Presidential election period several businessmen, having donated money to opposition parties, were subject to unjustifiable interference and even harassment by the tax inspection and other law enforcement agencies. One of these cases even made it to the European Court of Human Rights.¹⁶ According to the ruling party, the decision to limit public access to donor data was driven precisely by the rationale to prevent such instances of harassment

¹⁴ Batory Foundation (2012) ‘Armenia Country Report’, p.13.

¹⁵ Ibid

¹⁶ RFE/RL (2009)

and secure the contributors' privacy. Nonetheless, according to one of our interviewees, government agencies in any case have access to such information. On the other hand, in the current situation the public is deprived of the possibility to trace the link between businessmen being pressured and their donations to opposition parties. The lack of transparency in donors' data is one of the major shortcomings in the regulations on private donations.¹⁷

Public funding represents the third potential income source for Armenian political parties. Yet, due to its small size and the existing distribution model, public funding does not fulfil its primary aim: prevent heavy dependence on private donors and create a level playing field. According to the current regulations, direct public funding is granted to those parties whose electoral lists (in the last parliamentary elections) have received at least 3% of the total number of votes.¹⁸ The money is allocated in correspondence to the gained votes. This distribution system, although being proportional and thus, supposedly fair, in practice only benefits the incumbent party. In hybrid regimes, where the political playing field is uneven, such a distribution system favours the ruling party, since the incumbents are likely to win landslide victories. In this setting, the proportional distribution of state funding only reinforces the existing discrepancies.¹⁹ Unlike the well-established international practice according to which the eligible parties, apart from proportional funding, also receive basic 'floor' funding, Armenian legislation does not envisage such type of support.

Another problem concerns the small amount of direct public funding. The annual sum to be distributed among the eligible parties was equal to EUR 139,000²⁰ during the period 2008-2012. According to GRECO's 2011 report, all the parties represented in Parliament – which are the main recipients of direct public funding – reported that the funding made

¹⁷ This is not to say that the data even on the minor donations should be publicized. It would certainly be fair for donations up to certain amount to stay private. But when it comes to hefty private/business contributions, donor's data should be more transparent.

¹⁸ These are votes, cast through the proportional voting system in the last parliamentary elections.

¹⁹ To bring the most vivid example, in 2007, the incumbent Republican party received approx. EUR 107 378, while the next party with the highest votes got EUR 20,396 – five times less than the incumbent.

²⁰ The total amount of funds to be spent on parties from the state budget cannot be less than “the product of 0,03 times the minimum salary established by law (EUR 2) and the total number of citizens included in the voting lists during the latest parliamentary elections” (GRECO 2010, p.6).

up only a negligible part of their income and that they were heavily dependent on private donations.

Expenditure regulations: according to the Armenian Electoral Code, during the campaign period individual political party expenditures should not exceed 100,000-fold of the minimum salary defined by the law (this makes up EUR 200,000, there are no limits for the annual political party spending). This rather low threshold theoretically aims to prevent unequal financial conditions for the participating parties. Nevertheless, in practice, it does the very opposite. The current expenditure limits do not reflect the actual pattern of spending and make it virtually impossible for parties to carry out an effective campaign by using (and reporting) only funds that fall within the law. Too low expenditure limits have an adverse effect, encouraging underreporting and pro-active use of the previously identified loopholes. This also contributes to a widespread mistrust towards the published documents on party and campaign financing.²¹ Unsurprisingly, on the Global Integrity Report scale for Armenia, the existing expenditure limits, in terms of effectiveness, scored 0 out of total 100 points (Figure 2). Apart from this, in Armenia, as

22c: In practice, the limits on total party expenditures are effective in regulating a political party's ability to fund campaigns or politically-related activities.

Score: 100 75 50 25 0 ?

in other hybrid regimes, state resources and institutions are widely abused for partisan ends, making it virtually impossible to account for the real campaign expenditures of the ruling party. According to Transparency International Armenia, the illicit part of ruling party expenditures (those spent outside the pre-election funds plus vote-bribing) corresponds to almost 98% of the formally documented expenditures.²²

Figure 2: Global Integrity report (2011) on Armenia, scores range from 1 to 100, with the latter signifying highest positive degree attainable.

²¹ GRECO (2010) p. 16

²² Batory Foundation (2012) 'Armenia Country Report', p. 5

Oversight mechanisms: The Oversight-Audit Service (OAS), established under the auspices of the Central Election Commission, is responsible for supervising both campaign and party finances. Earlier these tasks were divided between the OAS and the Ministry of Justice. However, in the words of GRECO experts, such division of mandate greatly impeded the monitoring of political party financing due to inter-agency coordination difficulties.²³ On a positive note, starting from January 1, 2012, OAS became a permanent body equipped with both supervisory functions. Even though this significantly strengthened the agency’s institutional and investigative capacity, it did not affect its institutional independence. The interviewees uniformly claimed that the responsible audit agency (OAS), as well as the Central Election Commission, are under the undue influence of the ruling party and tend to be selective in their application of the law. As a result, even grave infringements are dealt with in a partisan manner.

Another important loophole concerns the reporting penalties. Surprisingly, there are no fines for providing false information or hiding certain details in the campaign declaration or annual financial reports. The only penalty is imposed for failure to provide these reports in a timely manner.²⁴ Although this might seem as a minor regulatory detail, it runs the risk of incentivising underreporting or the provision of incorrect data. As GRECO’s latest report also highlighted, “The existing arsenal of sanctions only covers some of the violations of political financing rules and lacks proportionality”.²⁵

BRIEF SUMMARY AND RECOMMENDATIONS: The aforementioned analysis is by no means exhaustive since some of the provisions that appear to be adequate on paper are cunningly misused or distorted in reality. Such instances are difficult to detect due to the lack of effective oversight mechanisms, not only from the government, but surprisingly also from the non-governmental sector. Several of the interviewees mentioned that the subject of political finances has almost never been a particular focus of the Armenian media or civil society organisations. Among the operating NGOs only

²³ Ibid, p. 18;

²⁴ Face-to-face interview with Varuzhan Hochtanyan, Director of the Transparency International Armenia; Batory Foundation (2012) ‘Armenia Country Report’

²⁵ GRECO (2010) p. 20

one, the local chapter of the Transparency International has been monitoring campaign and party funding and related irregularities; but again, without much resonance in the media or the NGO sector. As a result, the area of political funding in Armenia remains free from any major scandals, but this does not necessarily attest to the absence of shady practices.

As seen above, we are hardly dealing only with regulatory imperfections, but rather confronting systematic problems, such as biased state institutions. For instance, the Armenian Electoral Code prohibits state and municipal employees from exerting any influence on voters by using authority granted to them. Yet, in practice, the problem of vote-buying, directly involving state employees, has almost become an intrinsic part of the Armenian pre-election phase in recent years.²⁶ The same applies to the media coverage of the candidates: even though the publicly funded media outlets are required by law to ensure impartial coverage of the election subjects, the reality proves different.²⁷ These examples bear witness to the fact that even the soundest legal provisions are problematic in the context of dominant power politics. It is no news that in the absence of independent state institutions, the rule of law easily becomes the law of the ruler.²⁸ Without tackling these structural problems, reforms to the political party finance legislation does not guarantee a robust multi-party system. Nevertheless, by pinpointing acute regulatory loopholes the following recommendations seek to increase transparency and narrow the financial gap between the parties. Improved regulations might not be sufficient, yet they are a necessary condition for a competitive multi-party system.

1) Clear **limits on donations from one source** should be introduced to the campaign income regulations. Absence of such restrictions enables businesses to funnel large sums of money to parties via their employees, even though the law prohibits corporate donations during the campaign period.

²⁶ OSCE/ODIHR (2013), p. 8

²⁷ Ibid, p. 9.

²⁸ Berglund, C. (2013a)

2) **Data on donors** should become publicly available. More specifically, the electronic declaration forms on the party's campaign funds at a minimum should comprise the donor's name and identification number. Among other reasons, it is crucial for revealing instances of mass donations from employees of the same organisations/companies. The government's earlier-mentioned argument for hiding such data is invalid, since state agencies anyway have access to and make politicised use of this information.

3) The Armenian government should introduce a substantial **basic funding** scheme for eligible political parties (i.e. parties that overcome 3% threshold in the parliamentary elections). It is also an established practice to provide two-fold of the basic funding to those parties that pass double sum of the threshold, thus 6% in the Armenian case. Basic funding scheme might not automatically create a level playing field, but will most certainly boost the competing capacity of smaller political parties.

4) The annual **direct public funding** should also increase. Generally, there are no established standards on the amounts of direct public funding, since each country adapts these rules to its socio-economic capacity and the political environment. But taking into account the current condition of the Armenian multiparty system, plus the virtual absence of membership contributions, there is an acute need for substantial state support. Government should introduce gradual increase mechanisms of direct public funding.

5) **Expenditure limits** from the pre-election funds should also be increased. The existing limits do not reflect the real pattern of the campaign expenses and neither do they prevent unequal financial conditions of the parties. In some cases, lower expenditure ceilings are believed to advantage smaller parties by curbing the intrinsic superiority of the wealthy opponents. However, in the Armenian context, where the hidden part of the ruling party's expenditures is almost as big as its formally documented spending, lower limits are actually counter-effective and disadvantage the opposition parties *vis-à-vis* the incumbent.

6) Finally, fines should also be introduced for **providing false information** in the campaign declaration and annual financial reports.

3. In Quest for the Loopholes: Georgia

POLITICAL LANDSCAPE: Georgia's October 2012 parliamentary election was a critical milestone not merely because the government for the first time was changed through the ballot box, but because it significantly raised chances for developing a competitive multiparty democracy. In the *ex-ante* environment, the ruling United National Movement largely resembled the 'party of power' and dominated all three branches of government, thereby not leaving much room for fair inter-party competition or a level political playing field. It is still too early to determine whether the recent change of power will be a true democratic breakthrough or yet another pendulum swing from one hegemonic ruling party to another. However, the UNM's determination to remain a political contender, coupled with the intra-coalition dynamics of the Georgian Dream (GD) could be seen as a transition to 'feckless pluralism', with chances of evolving into a multiparty system.²⁹

The ruling coalition currently consists of 6 parties, with rather diverse ideological backgrounds and political goals. So far there are no clear signs of any formal split within the bloc, although existing intra-coalition differences expose themselves almost on a daily basis. Soon after the elections, Prime Minister Ivanishvili stated that he was in favour of within-bloc competition and considered the formation of divergent factions as "a healthy way to promote political pluralism".³⁰ Nevertheless, Ivanishvili has not been particularly tolerant towards political contenders from Saakashvili's UNM party.

UNM's determination to remain a serious political force also plays a crucial role in developing inter-party competition. "If the UNM survives, it has a chance of becoming the most well resourced and institutionalized opposition force Georgia ever had".³¹ However, the increasing number of defections from the UNM, as well as pressure on

²⁹ Berglund, C. (2013b)

³⁰ International Crisis Group (2012) p.10

³¹ Welt, C. (2012)

local self-governance institutions under their control, illustrates the risk that the Georgian Dream could end up as another ‘party of power’. In the following sections the existing party finance regulations will be analysed from the perspective of such risks.

LEGAL FRAMEWORK: Prior to the elections, the Saakashvili government responded to the challenge mounted by billionaire Bidzina Ivanishvili by tightening mechanisms of party financing. By the end 2011, a number of amendments had been introduced to the party/campaign finance regulations, making them considerably stricter. As a matter of fact, these amendments also incorporated important recommendations from GRECO. However, it has been argued that these changes were primarily driven by the incumbent’s efforts to curb the Georgian Dream’s ability to compete on an equal footing.³²

Although the amendments introduced in late 2011 significantly tightened earlier

Indicator	Score
20 Are there regulations governing the financing of political parties?	100 
21 Are there regulations governing the financing of individual political candidates?	100 
22 Are the regulations governing the political financing of parties effective?	54 
23 Are the regulations governing the political financing of individual candidates effective?	50 
24 Can citizens access records related to the financing of political parties?	88 
25 Can citizens access records related to the financing of individual candidates' campaigns?	75 

regulations, not even the earlier regulations would have qualified as lax. According to the Global Integrity scale (Table 2), the Georgian legal framework for political finances (before the December 2011 amendment) received the highest attainable 100 points; Yet, with regards to the practical effectiveness of these regulations, results were only half as good, with scores 54 and 50 for parties and individual candidates, respectively.

Table 2. Global Integrity indicators (2011) for the Georgian political finance regulations, scores range from 1 to 100, with the latter signifying highest positive degree attainable.

³² Batory Foundation (2012) ‘Georgia Country Report’

Income regulations: The income of political parties is regulated by the organic law on “Political Unions of Citizens”. It allows the parties to receive income from the following sources: (1) Membership fees; (2) State funding; (3) Donations, and (4) income received from producing and distributing party symbols, holding lectures, and other activities, that do not change the non-profit status of the party.

Before the 2011 amendments the *membership fees* did not fall under detailed regulations. The introduced changes set annual upper limit of GEL 1200 (EUR 550) on individual membership fees. This was a step forward, since absence of such ceilings entailed risks of bypassing the regulations for private donations. However, the practical problem linked to the membership fees remained intact: the sums received from this source represent only a small portion of the parties’ annual income – usually ranging from 5 to 10 percent.³³ The problem, most certainly, will persist for some time, since resolving it requires increasing public trust towards political parties, which currently is quite low.³⁴ In the upcoming few years, this leaves the political parties at the mercy of state funding and private donations, and also explains why regulations affecting these two aspects are particularly pressing.

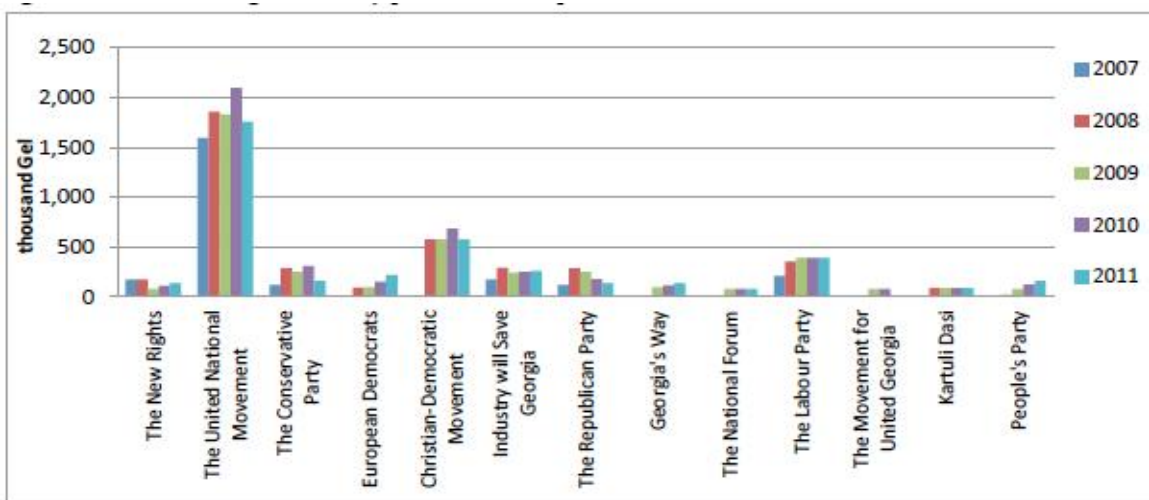
As for *state support*, there are three types of funding from the budget: 1) direct transfer to parties; 2) via the Centre of Electoral Systems Development, Reforms and Trainings; and 3) targeted finance of TV advertisements during the campaign period. Direct transfer consists of GEL 150 000 in basic ‘floor’ funding, which is granted annually to those political parties that pass the 4% threshold in the latest parliamentary and 3% in the latest municipal elections. Furthermore, parties that succeed in overcoming 8% and 6% barrier (in legislative and municipal elections respectively) are granted double size of the basic funding, i.e. GEL 300 000 (EUR 135 000).

Apart from this basic funding, eligible parties also receive additional funding calculated in proportion to their mandates and received votes.

³³ Transparency International Georgia (2011) p. 4

³⁴ According to the CRRC’s 2012 Caucasus Barometer, public trust in political parties only reaches 16%.

Table 3. State financing received by the political parties through the period 2007-2011, source: Transparency International Georgia



Certainly, the existence of such proportional funding is a positive aspect, however if we look at its distribution pattern for the last 5 years (*table 3.*), it becomes clear that the formula strongly favours the ‘party of power’. Just as in Armenia, proportionality might seem to be a fair argument for this distribution logic, however it also reinforces the dominance of a single party and jeopardizes political competition. Consequently, additional financial resources should be allocated to support the basic ‘floor’ funding scheme. As a result, the budget of smaller parties could increase and so would their competing capacity, *vis-à-vis* the ‘party of power’ propped up by administrative resources.

Donations. The amendments of December 2011 introduced a ban on corporate donations. The limit was also set for private donations (from natural persons) at GEL 60 000 (EUR 25000) and for donations from one source – at GEL 500 000 (EUR 232 000) annually. This can be seen as an effective mechanism to curb the influence of big businesses in electoral outcomes. Nonetheless, according to the Transparency International (TI) Georgia experts “even though legal persons are not allowed to make donations [...] it does not mean that their shareholders or executives are forbidden as well”. Donors’ data analysis conducted by the TI during the 2012 pre-election period, revealed that 74 of the

UNM and 30 of the Georgian Dream contributors had direct connections with businesses and some even represented a single legal entity. “Donations on behalf of such individuals, underlines the fact that business is not free from politics” (TI report on 2011 campaign finances). This, in itself, is not a negative phenomenon – certain links between business interests and political parties exist in the vast majority of western democracies as well. However, in the Georgian case, where corporate donations are banned, yet, donations from individuals with close ties to businesses makes up a rather big portion of the political parties’ income, shows the systemic need for the existence of such a source. Allowing corporate donations, but introducing tighter control and transparency provisions would be a wiser decision in this case. As already noted above, in the absence of membership fees donations represent the major source of income for opposition parties (since state funding mostly favours the ruling parties).

The capacity of corporate funding to encourage the emergence of a competitive multiparty system primarily hinges upon the absence of state pressure on big businesses. During the last few years, businessmen have openly been complaining about undue state pressure and it is therefore critical that all stakeholders remain alert to such instances. Interestingly, even though before the emergence of GD, corporate donations were not banned, opposition parties very rarely received such funding due to the afore-mentioned hurdles. Consequently, allowing corporate donations would be only be conducive to genuine party competition, if there is not state pressure on companies donating to and backing opposition forces.

Expenditure regulations: One of the positive novelties introduced to the Election Code by the December 2011 amendments, was related to the compensation of the campaign expenses. According to Article 56 of the Code, election subjects overcoming 5% threshold would be reimbursed GEL 1 million to cover election campaign expenses. This in theory made it easier for new parties to compete. The above-mentioned amendments also set limits to the annual campaigning expenditures, which should not exceed 0.2% of the country’s overall GDP for the previous year. In 2012 this ceiling made up

approximately GEL 48.5 million (EUR 22.8 million) - still a tremendously high amount for such a small country.

Moreover, the December 2011 reforms resulted in more comprehensive financial declaration forms, unifying 70 different types of expenses, yet some small gaps still remain in this regard. According to Transparency International Georgia, the declaration forms do not oblige the parties to provide a detailed description of every payment. Prior to the amendment, declaration forms had a graph, where election subjects had to indicate to whom the party paid the sum, for what service, timeframe, area of service provided and units and amount of goods/services received.³⁵ Re-inclusion of such requirements would significantly increase transparency of the campaign spending.

According to the latest amendments, expenses that qualify as vote buying became subject to administrative and criminal charges. The initial version of the law, passed in December 2011, even envisaged criminal liability for voters, businesses and civil society organizations. However, in May 2012, after active campaigning by democracy watchdog groups such provisions were dropped. Having regulations restricting vote-buying is in itself a positive phenomenon, since up until now bribing of voters has been one of the key obstacles for free elections in Georgia. But for the practical effectiveness of these regulations, the penalties should be commensurate and applied proportionally.

Interestingly, the law does not foresee liability for funding activities with vote-buying effect from the state or municipal budgets.³⁶ This is one of the critical loopholes in the expenditure regulations and should be addressed. It is no news that the state and local government activities, financed from the budget, were often toeing a partisan line, at the expense of taxpayers' money. This subtle vote-buying form usually benefits the incumbent party and further reinforces the uneven political playing field. Against the backdrop of recent developments, when municipalities were staffed by supporters of the new government, above-mentioned trend might persist for a long time, unless the law imposes strict penalties for state-funded activities with vote-buying effect.

³⁵ Transparency International Georgia 2012

³⁶ Batory Foundation (2012) 'Country Report Georgia'

Oversight Mechanisms: The State Audit Office (former Chamber of Control) is vested with the power to oversee the spending of state funds. Following the far-reaching amendments of December 2011, the State Audit Office (SAO) was given wide discretionary powers to establish standards for party funding audits, verify lawfulness of annual and election campaign declaration forms, request information on the origins of donations from administrative agencies and commercial banks, and apply to prosecutors office if signs of crime were discovered. Parties are obliged to submit their annual financial declaration forms together with the auditor firms report to the SAO no later than February 1 of each year. With regards to campaigning, all election subjects have to submit their income/expenditure reports every three weeks from their date of registration. However, the law does not require SAO to publish these reports, which in the words of the OSCE representatives is “detracting from transparency”.³⁷ Apart from this, even though the Audit Service is in charge of verifying legality and completeness of the submitted reports, it has no obligations to publish its conclusions.

These reforms resulted in very strict party funding regulations. To be sure, transparency and accountability of political finances are important to maintain the integrity of the electoral process. However, as the October 2012 Parliamentary elections and its run-up phase demonstrated, these new strict regulations did not quite ensure full transparency, since they were applied selectively and disproportionately against the opposition parties. This is demonstrated by the conclusions of an OSCE/ODIHR Election Observation Mission report, which examined 40 randomly selected cases allegedly involving infringements of the law. According to the report, the SAO summoned over 200 individuals as witnesses and questioned 100 individuals and legal entities that donated to the Georgian Dream coalition (then opposition), out of which 68 were fined by the courts. By contrast, only 10 UNM (then ruling party) donors were investigated and 8 fined, even though the number of donations to the UNM was 6.5 times higher than that to the GD.³⁸

Another loophole, also exposed by the 2012 Parliamentary elections, is related to the basis of determining illegality of the donations. In all 79 cases, which deemed individual

³⁷ OSCE (2012) p. 15

³⁸ OSCE (2012) p. 16.

donations illegal, decisions were founded on the basis that the donor did not have sufficient income. These conclusions were drawn by examining the donor's tax records from the previous two years. However, according to the law, such a criterion does not constitute a sufficient ground for determining unlawfulness of a private donation.³⁹

Such instances reflect the downside of the SAO's wide discretionary powers. Maybe the new GD-government will be incentivised to address the existing regulatory gaps since the State Audit Office has remained controlled by a former UNM lawmaker. However, the risk that this institution will remain a tool for political retribution still looms large.

BRIEF SUMMARY AND RECOMMENDATIONS: The December 2011 and several subsequent legislative amendments⁴⁰ resulted in a comprehensive regulatory framework, largely in compliance with international recommendations, including those of the Group of States against Corruption (GRECO). Apart from the proportionally distributed direct public funding, there is also basic 'floor' funding available for eligible parties. However, due to the ruling party's extensive use of administrative resources and the partial nature of the overseeing authorities, this has not sufficed to level the political playing field. For instance, the introduction of strict penalties to curb illegal donations was arguably counterproductive since these fines – when doled out selectively – turned into a tool for the ruling party. As in the case of Armenia, the success of reforms hinges upon the impartiality of enforcement authorities. With this disclaimer in mind, we will outline a set of recommendations targeting the most impinging loopholes identified in the Georgian political financing regime. The extent to which the new Georgian government's acts upon these recommendations will give us further clues as to its commitment to reform.

1) In order to reduce financial disparities among Georgian political parties, one of the major suggestions would be to **increase the amount of direct public funding**. This should include both proportional as well as basic 'floor' funding, but in particular the latter. Since proportional funding tends to reinforce existing discrepancies, basic funding

³⁹ Ibid.

⁴⁰ In May and June 2012.

holds a stronger promise to improve political competitiveness, by equipping small political parties with greater financial resources.

2) Competitiveness could also be enhanced by **allowing corporate donations**. Undoubtedly, this type of funding entails the risk of increasing the influence of moneyed individuals on policy making, but in the virtual absence of membership fees and lack of substantial state funding, this risks weighs less in contrast to the benefits of increased competitiveness it could bring. In addition, such risks could be neutralised by introducing reasonable ceilings and tight transparency mechanisms concerning corporate donations.

3) In relation to the campaign spending declarations electoral subjects should be obliged to **provide a detailed description of every payment** (to whom the party paid the sum, for what service, timeframe, area of service provided and units and amount of goods/services received). Such information was required by the previous legislation and re-inclusion of it would further increase transparency of campaign expenditures.

4) It is also recommended that the funding **activities from the state and municipal budgets with vote-buying effects** be defined as infringement of the law, and give rise to administrative liability. If applied in due manner, this could help curb the well-established practice of abusing administrative resources for partisan ends.

5) For further enhancing transparency of the campaign finances, it would be suggested that the **State Audit Office be obliged to publish campaign finance reports** submitted to it (every three weeks) by the election subjects during the campaign period. The same should apply to the **SAO's conclusions** on the above-mentioned reports. This transparency would compel the State Audit Office to be consistent in its judgments with regards to all electoral subjects, no matter their political stance.

6) Also, to prevent arbitrary and inconsistent practices in relation to imposing penalties, it would be recommended to clearly **define criteria for determining illegality of the donations**, as well as, scope of the SAO's authority to conduct inquiry into potential infringements of the law.

3. Conclusions

This policy paper has provided an analysis of the Armenian and Georgian political finance legislation with an eye to improving the prospects for multiparty democracy in these countries. This endeavour was guided by the following research question: what are the major shortcomings in the Armenian and Georgian political finance regulations? In order to identify these shortcomings, one first needs to be aware of the peculiar political environment prevailing in hybrid regimes. Bearing this in mind, each country chapter started with a brief analysis of the existing political landscape, with a specific focus on the state of political competitiveness. The subsequent sections, in each chapter, unearthed regulatory loopholes in the legal framework in view of their informal undue usages. In the end of each country chapter, recommendations were proposed in order to foster transparency and strengthen the ability of local political parties to compete. Beyond these country-specific recommendations, there are three general patterns that emerge from this examination of political financing complications in hybrid regimes.

First and foremost, *independent oversight mechanisms* are critical in promoting a healthy multiparty system. Regardless of whether the provisions strict or lax, it is the enforcement authorities' arbitrary, inconsistent and selective practices that thwart fair competition and transform the regulations into a mere partisan instrument. By the same token, if the sticks and carrots were applied impartially, the effect of the financial disparities on the political playing field could be significantly decreased (but not fully disregarded). Consequently, all the advocacy efforts in both countries should be directed towards boosting the neutrality of the oversight authorities. Certainly, this is not a panacea in hybrid regimes, where institutions are used for partisan purposes, but it would at least wrangle one potential tool of repression from the hands of the incumbent.

Secondly, a *substantial* and *carefully elaborated public funding* scheme could in crucial ways contribute to the emergence of competitive political systems in Armenia and Georgia. Despite controversies over its fiscal cost for the taxpayers, there are several arguments in favour of state funding. If disbursed regularly, it would provide parties with adequate resources for performing essential democratic activities and thereby, increase

their stability and institutionalisation level. Robust public funding to some extent helps to even out disparities resulting from the incumbents' (ab)use of state resources. Apart from this, by providing a reliable income source, this scheme could lower the stakes of being out of the office, and thus, weaken the winner-takes-it-all approach in favour of a more moderate competition style.⁴¹ Certainly, it should be kept in mind that increasing state funding *per se* will not make parties more democratic or inclusive; but building the right incentive-structures could lead them to this direction. For instance, allocating certain portion of public funding could become conditional upon including women and minorities in the party, building up regional structures, conducting research and establishing member database. This way public funding could contribute not only to the inter-party competition, but, most importantly, to multi-party democracy, with more inclusive political system and stable political parties.

Finally, *corporate donations* could play a positive role in opening up these countries from dominant-power politics. As demonstrated both by the Armenian and Georgian cases, a ban on corporate donations (in the Armenian case ban applies to the campaign only) does not necessarily curb the close links between big businesses and political parties. It reinforces the use of loopholes and hides the murky side of these links. Allowing corporate funding but imposing strict disclosure requirements could potentially make the political race more transparent and easier for the interested citizens to trace these 'alliances'. The absence of substantial public funding and membership fees, coupled with 'party-of-power' trends in these countries creates systemic need for such funding. One has to be realistic and acknowledge that corporate funding provides rich moguls with significant influence, but in hybrid regimes it also allows opposition forces to seek out autonomous financial resources, thereby fostering competitiveness, even though it very well may be far from societal needs and interests. Feckless pluralism involving political rivalry between business elites could, according to several scholars of democratisation, eventually evolve into multiparty democracy.⁴²

⁴¹ IFES (2009) p. 18

⁴² Radnitz, S. (2010); Hale, H. (2011); Rustow, D. (1970)

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