

## **National Analysis**

**Prepared by EKINT Hungary**

### **Institutional Framework and Enforcement Mechanisms in the Area of Political Party Finance**

#### **Overall background**

Since 2010, most aspects of Hungary's constitutional and public legal structure has undergone fundamental transformations. This applies, to varying degrees, to all the three areas covered in this analysis as well. (The partial exception is conflict of interests regulations, where the changes have not been so fundamental). This has two consequences for the following analysis. The first and most direct consequence is that the analysis must describe many changes in the legal framework that has taken place in a relatively short period of time. The second, more indirect but also more consequential implication is that, since the new framework has been in effect for a short period only – and in the case of political party finance we are only going to see the new rules in practice for the first time in the coming weeks and months only – we are not yet in a position to fully assess the practical impact of the new frameworks from an implementation and enforcement point of view. Regardless, the analysis will discuss the experiences with the previous regimes, and many of those observations are going to be relevant for the future as well.

#### **Political Party Finance**

##### **Political party financing (PPF) including electoral campaign financing (ECF)**

#### ***Background***

Legal provisions on functioning of political parties, on political party financing and electoral campaign financing include the following laws:

Articles VIII and IX of the Fundamental Law of Hungary

Law XXXIII of 1989, as amended, on operation and financial management of political parties,

Law XLVII of 2003 on foundations assisting the functioning of political parties, carrying out scientific, awareness raising, research and educational activities,

Law C of 1997 on the election procedure – repealed by Law XXXVI of 2013 on the election procedure,

Law XXXVI of 2013, as amended, on the election procedure, having entered into force 3 May 2013

Law LXXXVII of 2013 on making the campaign spending of the election of the Members of the National Assembly transparent

***The operation and financial management of the political parties***

The Fundamental Law of Hungary declares, as part of the freedom of association, the free establishment and operation of political parties. It also says that the detailed rules for the operation and financial management of political parties are regulated by a cardinal act. The Fundamental Law does not contain more rules on the operation and management of the political parties; it does not provide for specific entitlement (e.g. from the state budget), nor exclude that. The Fundamental Law says only that the detailed rules for the operation and financial management of political parties are regulated by a cardinal act. This cardinal act is the Law XXXIII of 1989 (hereinafter: Political Party Law or PPL), as amended.

The Political Party Law determines the acceptable sources of the revenues of the political parties, as well as some limits with regards the financial managements of the political party's assets.

The political parties may get revenues from the following sources:

- a) party membership fees,
- b) quarterly allowance from the state budget allocated to the political parties receiving more than one per cent of the votes in the general elections mainly on the basis of the votes they received;<sup>1</sup>
- c) monthly allowance from the budget of the Office of the National Assembly for the purpose of the operation of the parliamentary group of the political party,<sup>2</sup> which, in addition to a base amount, reflects to the size of the parliamentary groups;
- d) real estates transferred free of charge from state assets;<sup>3</sup>
- e) contribution from enterprises and/or other legal persons,<sup>4</sup>
- f) contribution from natural persons irrespective of their nationality;<sup>5</sup>
- g) legacy of (natural) persons, irrespective of their nationality;
- h) income from business activities of the party. These may include revenues from issuance of publications, sale of party badges and other similar objects, organisation of events, rent and sale of movable and immovable properties, trade with stocks excluding shares.
- i) after-tax-profit of enterprises established by the party. A political party may establish limited-liability company with the exclusive membership of that political party;
- j) other sources, such as bank loans.

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<sup>1</sup> 25% of the total amount determined in the State Budget [in 2013 2,548,900,000 HUF (8,721,046 EUR as of 28 October 2013), 0.016% of the total expenditure] are allocated evenly among the political parties that gained mandate in the National Assembly, while the remaining 75% are allocated according to the number of votes cast on the political parties and their candidates in the first valid round of the elections. Political parties not obtaining at least 1% of the votes cast are not allowed to receive any state budget allowance. In the current parliamentary cycle six political parties receive such allowances, five ones are represented in the National Assembly, one is not.

<sup>2</sup> Upon the provisions of the Articles 5 and 6 of the Law LXVI of 1990, as amended, on the earnings of the members of the National Assembly

<sup>3</sup> This refers to the first allocation of the real estates that happened at the beginning of the 1990's. Since then the political parties are free to sell and buy their own property.

<sup>4</sup> As of 2014 this kind of contribution will be prohibited.

<sup>5</sup> As of 2014 only Hungarian citizens can donate a political party.

The law also impose some limitations regarding the incomes: donations (either in-cash or in-kind) cannot be accepted from the following sources:

- indirect donations from the state budget,<sup>6</sup>
- donations from foreign state,<sup>7</sup>
- anonym donations.

As a special form of financing the activities of the political parties, the Hungarian legislation allows the political parties to establish foundations which, by carrying out scientific, awareness raising, research and educational activities, assist the functioning of political parties. Any political party may establishes foundations for such purposes but only those political party foundations are entitled for quarterly allowances from the state budget the founders of which are also entitled for similar subsidy. The method of allocation of the subsidies is similar to that of the political party quarterly allowances.<sup>8</sup>

### ***Control of financial management of the political parties***

The political parties enjoy special status with regard their obligations of keeping their books. The scope of the Law C of 2000 on accounting covers the political parties, although a government decree<sup>9</sup> in an explicit way declares that only the provisions of the Law XXXIII of 1989, as amended, on operation and financial management of political parties apply to the political parties' above mentioned obligations.

The Annex to the Political Party Law determines the content of the annual reports of the political parties, by following the main types of incomes (cf. the categories mentioned above) and the main groups of expenditures. Therefore, the annual reports of the political parties do not exceed 12-13 lines.

The name of the contributor(s), however, must be disclosed when the amount of contribution(s), from the same person and within the same fiscal year, exceeds the amount of 500,000 HUF (appr. 1,710 EUR) in case of Hungarian citizens and domestic enterprises or legal persons and the 100,000 HUF (appr. 342 EUR) in case of foreign entities.<sup>10</sup>

The external audit of the political parties is vested in the State Audit Office (other state organs, especially governmental organs cannot examine the financial management of the political parties). The purposes of the audit are to check whether

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<sup>6</sup> State institutions, state owned companies or companies with participation of the state, foundations receiving subsidies directly from the state budget or from the budget of the state institution are banned to donate political parties and political parties are also banned to accept such donations. As from 2014 any kind of legal persons (the scope of which is much wider than the before mentioned organisations) are banned to support political parties.

<sup>7</sup> As from 2014 donations from foreign organisations other that foreign states, as well as from foreign citizens are also prohibited,

<sup>8</sup> The subsidy is allocated according to the number of votes cast on the political parties and their candidates in the first valid round of the elections. In 2013 the state budget allocated 1,260,900,000 HUF (4,314,162 EUR as of 28 October 2013) for this purpose.

<sup>9</sup> Government Decree 224/2000 (XII. 19) on specific provisions applicable to the book-keeping and reporting obligations of „other organizations” as defined under the law on accounting

<sup>10</sup> As from 2014 foreign entities, as well as Hungarian entities other than natural persons will not be allowed to give contributions to a political party (cf. above), and only the name of those contributors must be disclosed whose contribution exceed the 500,000 HUF (appr. 1710 EUR).

- the political party's annual financial reports, which are to be published in the Official Gazette, comply with the legal provisions, and contain such data that correspond to those in the books of the political party and if they are real ones;
- the political party has complied with the provisions of the law on accounting and other relevant pieces of legislation with regards the book-keeping and financial management;
- the political party's financial resources are from lawful sources, it did not accept banned contributions, and it did not conduct banned economic activity.

In order to conduct the audit in a unified way, the SAO established its own methodology.<sup>11</sup> In the case of the political parties receiving regular allowance from the state budget the audit is due in every two years when the previous two fiscal years are examined by the auditors.

In its reports, the SAO repeatedly underlines that the applicable laws do not give clear guidance for the political parties, for example, in the case of compiling their reports, and, therefore, when facing the uncertainties the political parties act in different ways, according to their own, different, internal accounting policy. The SAO also states that the templates of the reports, as they are in the Annex of the PPL, are not in harmony with the provisions of the law on accounting.<sup>12</sup> As a result of this, it is difficult to compare the reports of the political parties. The SAO, finally, repeatedly suggest the Government submit a legislative proposal to amend (or renew) the PPL in order for it to ensure the transparency of the political party financing, and the accountability of the political parties, as well as to eliminate the discrepancies between the law on accounting and the Political Party Law.

The audits deplore numerous irregularities in the financial management of the political parties. However, these irregularities may be even serious; they remain, principally, without legal consequences. Sanctions can be imposed or initiated in the cases of criminal offences or when the political party accepts contributions, donations from unauthorised sources (e.g. from foreign state, from state owned companies, etc.). The sanction in this case is that the political party is obliged to pay, upon the notification of the SAO, the amount of the unauthorised contribution into the state budget, and that the amount of the allowance of the political party from the state budget is to be reduced by the amount of unauthorised contribution (double penalty). If the political party fails to do so, the amount of unauthorised contribution is collected by the tax authority.

Theoretically there is another sanction in the PPL: according to the law,<sup>13</sup> the SOA, if it has established that the political party acted in an unlawful way, call it to restore the lawful management. *“In case of more serious violation, or if the political party does not comply with the notification, the President of the SAO shall initiate the proceeding of the court.”* Even the wording of this provision raises doubts of its seriousness: this provision does not specify the petition what the SAO could request, nor the authority of the court with regard the potential decision (i.e. obliging the political party to act in accordance with the petition/notification, annulment of unlawful internal rules, imposing fine, etc.) Therefore, this is not a real sanction.

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<sup>11</sup> <http://www.asz.hu/modszertan/modszertan-a-partok-gazdalkodasa-torvenyessegenek-ellenorzesehez/modszertan.pdf>

<sup>12</sup> Cf., for example, reports no. 1205 of 2011, 13023 of 2013, etc.

<sup>13</sup> Art. 10(4) of the PPL.

## *Campaign financing*

The campaign financing has been the most critical point of the political party financing. Due to the issues detailed below, however, the whole system has lost its seriousness in the eyes of the public: although the political parties reported that their spending remained within the legal limit, no one believed them.

From the entry into force of the Law C of 1997 on the electoral procedure, this law specified the limit of campaign expenditures. For each election the National Assembly allocated 100 million HUF<sup>14</sup> as subvention for the electoral campaign of the political entities and the independent candidates. The National Election Commission was authorised to determine the precise amount of the per candidate subvention after the conclusion of the candidate nomination period. This per candidate amount could be considered only symbolic.<sup>15</sup> This subvention from the central budget was transferred to the political parties or to the independent candidates by the designated state organ.<sup>16</sup>

In addition to the above mentioned subvention, a political party could spend one million HUF<sup>17</sup> per candidate for the electoral campaign (but, in case of political parties, at most per 386 candidates). The source of this amount is the general budget of the political party (including in many cases bank loans).

As a result, the total amount of campaign expenditure per candidate could not have exceeded the following amounts: in 1998 appr. 4405 XEU, in 2002 appr. 4251 EUR, in 2006 appr. 3896 EUR and in 2010 appr. 3934 EUR.<sup>18</sup>

Based on these provisions a political party nominating the maximum number of candidates could spend some 400 million HUF<sup>19</sup> for the electoral campaign, including all forms of campaign activities (organising public gatherings, posters, leaflets, paid advertisements, purchase of voters' personal data for direct campaigning, other costs such as remuneration of the campaign staff, etc.). It was up to the political parties how to share this total amount among their candidates, the law did not request the political parties to spend equal amount of money for each and every candidate.

According to the Law,<sup>20</sup> the election campaign means the statement of the election program, the promotion of candidates or of political party list, of political parties, the organisation of election meetings, the placement of posters, the exploitation of volunteers.

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<sup>14</sup> In 1998 appr. 429,400 XEU, in 2002 appr. 410,800 EUR, in 2006 appr. 375,300 EUR and in 2010 appr. 375,100 EUR.

<sup>15</sup> In 1998 appr. 111 XEU, in 2002 appr. 143 EUR, in 2006 appr. 143 EUR and in 2010 appr. 183 EUR per candidate.

<sup>16</sup> Although the Law on electoral procedure designates the Ministry of Finance, this Ministry was in charge of this task in 1998, the Ministry of Interior in 2006 and the Ministry of Local Government in 2010.

<sup>17</sup> In 1998 appr. 4294 XEU, in 2002 appr. 4108 EUR, in 2006 appr. 3753 EUR and in 2010 appr. 3751 EUR.

<sup>18</sup> In HUF the total amount increased slightly election by election due to the less and less candidates, but in EUR, due to the deteriorating exchange rate, it decreasing.

<sup>19</sup> In 1998 appr. 1,720,000 XEU, in 2002 appr. 1,640,000 EUR, in 2006 and in 2010 appr. 1,500,000 EUR

<sup>20</sup> Art. 149 o) of the Law C of 1997 on the electoral procedure

The campaign period was determined by the law as the period starting from the announcement of the date of the elections by the President of the Republic until 0:00 hours of the day prior to voting.<sup>21</sup> Since the only obligation of the President of the Republic was to call for the election at least 72 days before the polling day, the length of the electoral campaign varied (in the case of the 2002 parliamentary elections this period lasted for almost four months, i.e. 115 days). The importance of this is that, theoretically, the campaign expenditures should be emerged during this period. In its Interpretative Statement No. 4 of 2002 the National Election Commission declared that the „promotion of political party” or „promotion of candidate” as well as „promotion of political party list” can be considered as campaign activity as from the registration of the political party or candidate or list for the given election. Since the registrations of the political party or candidate or list happen around the 20<sup>th</sup>-25<sup>th</sup> day prior to the Election Day, activities conducted in favour of a political party or candidate or list prior to the official registration could not be fell under the campaign activities. The SAO considered that this Interpretative Statement encumbered its task: *„In the practise expenditures for the ‘promotions’ and for other campaign activities arise even before the date of the registration of the candidate. The legal provisions in force do not oblige the political parties or candidates to keep such a record on the expenditures arisen between the call for elections and the date of registration from which one could determine when, for example, the purchased campaign poster were used [for the purpose of campaign]. In the absence of such record it is impossible to establish whether an expenditure is part of the campaign expenditures or not.”*<sup>22</sup>

In addition to the paid services, political parties running for the election may have benefited some free-of-charge service as follows: the national, regional and local public broadcast companies were obliged to air, at least twice during the campaign period, free of charge the advertisements of, respectively, the political parties nominating national lists, the political parties nominating regional lists in the coverage area of the regional public broadcast company, and candidates running in the constituencies of the coverage area of the local public broadcast companies.

### ***Control of use of campaign finance resources***

Timewise, the first obligation of the political entities running for the elections is to give an account on use of state subvention, within 30 days after Election Day (i.e. the second round) to the Ministry that granted that said subvention.<sup>23</sup> The respective ministries issued a template of report that the political parties and independent candidates had to use. The State Audit Office also checked these reports against the criteria detailed below.

According to the Law on the electoral procedure, the State Audit Office is obliged to check the use of state subvention and other financial resources applied for the elections. The audit must be conducted within a year after the second round of the elections. Political parties and independent candidates obtaining mandate in the National Assembly are subject to *ex officio*

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<sup>21</sup> Art. 40 of the Law C of 1997 on the electoral procedure

<sup>22</sup> SAO Report No. 0307 of March 2003, p. 5. <http://www.asz.hu/jelentes/0307/jelentes-a-2002-evi-orszagyulesi-valasztasra-forditott-penzeszkozok-elszamolasanak-ellenorzeserol-a-jelolo-szervezeteknel-es-a-fuggetlen-jelolteknel/0307j000.pdf>

<sup>23</sup> See footnote 16

audit, in case of other political parties and independent candidates the audit may be conducted upon request from other contestants.

The purpose of the audit is threefold:<sup>24</sup> it is to establish whether the political parties and independent candidates

- a) have complied with the provision of limiting the campaign expenditures (see above) and
- b) have disclosed, in the official gazette (Magyar Közlöny) within 60 days after the second round of the elections, the details of their campaign budget, i.e. the amount, sources and manner of usage of state subvention and other financial resources applied for the election;
- c) recorded the revenues and expenditures, as well as they kept their book in lawful manner.

Since no changes had happened to the applicable legislation, the State Audit Office repeatedly gave voice of its concerns regarding the serious shortcomings of the legal framework.<sup>25</sup> These are, *inter alia*, as follows:

- the provisions of the Law on electoral procedure and those of the Law on operation and financial management of political parties do not ensure the transparency of the sources and use of the campaign expenditures. “*These shortcomings upheld the non-transparent nature of campaign financing and give space for corruption.*”
- because of shortcomings in the applicable legislation, many provisions of the legal provisions are uncertain for even those political parties that had participated in the elections since the beginning;
- the authority of the SAO is not sufficient to deplore and to investigate allegations regarding the suspected/assumed exceeding or campaign expenditures: the SAO cannot launch investigations based on news, studies, rumours, etc. The SAO can audit only the documents submitted by the political entities;
- publishers of advertisements, or of posters are not obliged to notify either the National Election Commission, or the SAO, or the political parties running for the election of the quantity and total value of these campaign tools. These data remain hidden unless they appear in the books of the given political entity. If these expenditures paid by a third party, it does not constitute the part of the campaign expenditures even if it is obvious that these campaign tools are in favour of a political entity;
- it is not specified in the laws which period of time and what kinds of activities should be taken into account regarding the establishment of revenues and expenditures of a campaign;
- the meaning of the terms (i.e. material expenditure) used by the laws should be determined by the laws, as well as detailed rules should be given regarding the form and content of the reports to be published in the official gazette;
- who and under what conditions may contribute to the campaign expenditures under the title “other contributions”. As of today, expenditures paid by third party(ies) in favour of

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<sup>24</sup> See SAO’s reports on audit of campaign expenditures (9916/1999, 0307/2003, 0718/2007 and 1105/2011)

<sup>25</sup> See footnote 24

a candidate, sometimes, however out of their knowledge, do not constitute the part of the campaign expenditures, and these third parties are not obliged to disclose their spending.

- What would be a realistic limit for campaign expenditure?<sup>26</sup>

Because of these shortcomings, the possibilities of the SAO are very limited: *“The SAO ... must [take] notice of [the situation where] it may conduct only document-based audit and it may take into account only those expenditures as campaign expenditure what the political entity declared as such, and which were recorded in the books by the deadline of reporting.”*<sup>27</sup>

As reported by the SAO, the political parties adopted internal rules regulating specific provisions on the book-keeping and reporting of the campaign expenditures, the responsibilities of authorising the payments, separation of campaign expenditures from other expenditures during the campaign, etc. These internal rules determine, however, such important terms, such as campaign period, campaign expenditures as well.

It is not surprising that, under such circumstances, all political entities remain within the allowed legal limit of campaign expenditure, and the SAO has been able to find only minor irregularities.

The Law on electoral procedure impose sanction in case of exceeding the limit of expenditures: in such cases the political entity is obliged to pay twice the value of the excess to the central budget within 15 days after the excess is established by the SAO.<sup>28</sup> In case of delay debts are to be recovered as taxes.

To facilitate the fulfilment of the obligations arising from the Law on electoral procedure, the SAO issued guidance in 1998 on the proposed form of reporting.<sup>29</sup> Except in 1998, the political parties follow this guide.

### ***Changes in the campaign finance as from 2014***

The Law LXXXVII of 2013 on making the campaign spending of the election of the Members of the National Assembly transparent will enter into force establishing new framework for the campaign financing. The major features of the law are as follows:

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<sup>26</sup> NGOs estimated in both 2006 and 2010 that the major parties exceeded the legal limits by about an order of magnitude, and even smaller parties spent two to three times as much as the legally permitted sum.

<sup>27</sup> SAO Report of 0718 of 2007, p. 6. <http://www.asz.hu/jelentes/0718/jelentes-a-2006-evi-orszaggyulesi-valasztasra-forditott-penzeskozok-elszamolasanak-ellenorzeserol-a-jelolo-szervezeteknel-es-fuggetlen-jelolteknel/0718j000.pdf>

<sup>28</sup> This happened only once in the history of elections in Hungary after 1990, although it is an open secret that the political parties spend much more than allowed by the law for electoral campaign. In 1998 the former minister of finance(!) running for the elections as independent candidate attached too many invoices to his report exceeding the 1 million HUF limit.

<sup>29</sup> Annex 2 of Election Booklets No. 44 <http://www.valasztas.hu/hu/ovi/content/vf/vf44.htm>

- a) the maximum expenditure per candidate will increase up to 5 million HUF (appr. 17,107 EUR), therefore the maximum amount of campaign expenditure by a political party nominating the maximum number of candidates is 995 million HUF<sup>30</sup> (appr. 3,404,386 EUR), which is some 2.5 times more than today's limit of some 400 million HUF)
- b) each single member constituency (SMC) candidate will receive 1 million HUF (appr. 3421 EUR) as subvention for his/her campaign expenditure only. This amount cannot be transferred to other candidates or to the general campaign budget to the party.
- c) the political parties that have been able to nominate national list will receive subvention the amount of which depends on the number of candidates they nominated in the SMCs. This subvention can be spent for any kind of expenses. The base of the subvention is 995 million HUF (appr. 3,404,386 EUR). The amounts are as follows:

No. of SMC candidates	Subvention % (base: 995 M HUF)	Maximum subvention	
		HUF	EUR
1-27	15	149,250,000	510,657.95
28-54	30	298,500,000	1,021,315.91
55-80	45	447,750,000	1,531,973.86
81-106	60	597,000,000	2,042,631.81

- d) the basic amounts (i.e. the 1 million HUF and the 5 million HUF) are indexed year by year by the official inflation rate;
- e) expenditures can be paid, exclusively, via bank transfer or by so-called Treasury card (issued by the Treasury);
- f) these payments must be made during the campaign period for campaign activities (as per the Law on electoral procedure);
- g) all SMC candidates must submit a final report, within 15 days after the election results became final, to the Treasury which check if i) the payment was made for "material expenses" as defined in the law on public finance, ii) invoices are in accordance with the law on accounting, iii) the payment was made during the campaign period via the accepted ways only. In case of any irregularities, the candidate concerned is obliged to pay fine the amount of which is established by the Treasury but which cannot exceed the double of the subvention received. The SAO has similar authority exercising its authority within one year after the elections.
- h) No changes in the obligation of the candidates and political parties to disclose, within 60 days after the elections, the details of their campaign budget, i.e. the amount, sources and manner of usage of state subvention and other financial resources applied for the election;
- i) No changes in the authority of the SAO with regard the audit of the political parties' reports.

<sup>30</sup> Since from 2014 the number of members of the National Assembly is 199 only, out of which 106 elected in single member constituency and 93 on national list.

Advantages of the changes can be summarised as follows:

- the per candidate 5 million HUF limit is more realistic than the previous amount of 1 million HUF;
- the law clarified some terms, for example the term of “material expenses”, the period of time within which some payments can be made;

However, the new provisions do not exclude the so-called third party payments (in favour of a candidate or political party) or payments out of the campaign period for such services that were used during the campaign period.