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Authors

Caselles, Joaquin Artes
Viñuela, Enrique García

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REFORMING ELECTORAL FINANCE IN THE NINETIES: A CASE STUDY OF SPAIN^{**}

Joaquín Artés Caselles*
Department of Economics
University of California, Irvine

Enrique García Viñuela *
Departamento de Economía Aplicada IV
Universidad Complutense de Madrid

“[I]f a party can manipulate the state in the interests of its clients in civil society, it should also be able to manipulate the state in its own interests.” Katz and Mair (1995)

ABSTRACT: Spain reformed the law regulating campaign expenditure in the first half of the nineties. Political parties represented in Parliament claimed that the aims of the reforms were equity and the control of public expenditure in a time of recession. However, the new regulations helped the parties to attain more ‘self-serving’ objectives (i.e., to solve their financial problems by shifting campaign costs to public budgets and improve their credibility, damaged badly by the fund raising scandals reported by the media). A principal outcome of the new campaign regulation was to establish an effective cap to electoral expenditure. This would have not been feasible in the seventies or eighties. Subsequently, the parties confronted a situation of parametric choice, trapped in a prisoner’s dilemma in which each party had to spend more in order to prevent the others from obtaining electoral advantage. But in the nineties, the two largest parties, ridden with problems of soaring electoral debts and disgruntled voters, used the political finance reforms of as a coordination device to attain a Pareto efficient position.

JEL classification: K30 H40.

Key words: “financing campaign spending”, “public subsidies to political parties”, “campaign finance reform”, “game theory applications”.

^{**} Joaquin Artes, Department of Economics, University of California, Irvine, 92612, CA USA. Email address: jartes@uci.edu . Tel: 949 244 9226.

Enrique Garcia Vinuela, Departamento de Economía Aplicada IV, Universidad Complutense de Madrid, 28040 Madrid, Spain.

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I. INTRODUCTION

Since the Spanish electoral law was passed in 1985, several of its parts concerning campaign financing have been overhauled. In this paper we assess the impact of those changes and suggest a political economy explanation for the campaign spending ceilings adopted. First we begin by an overview of the key features of the reform acts and the main goals that political parties intended to achieve by changing the campaign funding system in a period of recession and increasing public distrust about the financial activities of parties. In the second section we present data which reflect the effects of the reforms in bringing under control the explosive growth of parties' campaign costs in the previous decade, on the public subsidies diverted to campaign funding and on other facets of the electoral regime as well. The third section offers a game theoretic rationale for the reforms that rests on the evolution of the Spanish political system after the restoration of democracy in the mid seventies towards what could be described to some extent as a two party dominated system. Finally, in the conclusions, we briefly appraise the achievements of the reforms on efficiency and equity grounds.

II. OBJECTIVES OF THE LEGAL CHANGES IN CAMPAIGN FUNDING

In 1985 the new Spanish electoral law (LOREG)¹ set up a system of campaign financing based on four principles: (i) partial public financing of parties' electoral spending, (ii) the imposition of a limit to what parties could spend on an election, (iii) a cap on campaign contributions by individuals and organizations, and (iv) reporting requirements by political parties and their donors. These principles were dictated by equity concerns (e.g., levelling the playing field among parties competing in a general election by giving them an equal opportunity to persuade voters). And to deter actual or perceived corruption by lessening politicians' reliance on money from special interest groups.

The use of public funds to pay for political parties activities is a common argument among advocates of the ideal of political equality (García Viñuela and Vázquez Vega, 1996). The mandatory ceiling on party expenditures was set to make the electoral contest more competitive. It was deemed undesirable that parties could outvote rivals because of differences in their command of resources to deliver their message to the public. To prevent this from happening paid television advertising spots about electoral politics were not allowed. And a tight campaign contribution cash limit of 600 euros per election (for individuals as well as corporations) and provisions requiring full disclosure of the contributors' names were also established. Moreover

¹ Spain uses a system of proportional representation of party lists, with a legally mandated threshold of exclusion of 3%. Under such a system a party polling more than 3% of the vote receives a percentage of the seats in the lower house proportionate to its percent of the vote in the election. Parties then fill its seats from their lists of nominees. These rules strengthen central party machineries and encourage more disciplined and ideological parties than when voters cast ballots for individual candidates. Since political parties control the members of the legislature campaigns are based on party performance and platforms rather than on candidate idiosyncrasies.

independent expenditure by individuals or groups on behalf or in opposition to a party's list of candidates was forbidden during the election campaign ².

In Spanish LOREG public financing of campaign expenditure for general elections consisted of a subsidy based on a party's vote-getting record and its seats in the Legislature. And the amount that legally could be spent was established initially at 26.4 eurocents per inhabitant plus a lump sum of 132,223 € for each electoral district (province) in which the party fielded a list of candidates ³.

The cap that the parties had set for themselves turn out to be too high and did not restrain campaign expenditures at all. Although most parties spent much less than they were allowed to, LOREG financing of the 1986 and 1989 general elections left them seriously indebted. At the beginning of the nineties parliamentary parties decided to reform LOREG and by Law 8/1991 settled a new campaign funding method. Two important modifications were introduced. First, the limit on party expenditure was cut down to 15 eurocents per inhabitant and the lump sum per district to 120,202 €. Secondly, mailing expenditures of parties were no longer computed to calculate the ceiling on campaign spending and were financed separately by a new subsidy to political parties of 12 eurocents for each propaganda mail sent (within the limit of the number of eligible voters) in every district where a list of party candidates were running for election ⁴. To qualify for the new subsidy a minimum number of Congress deputies was required ⁵.

Party leaders argued that the new regulations were enacted to cut campaign expenditure. However the subsidy introduced to reimburse parties for mailing costs lead us to think that an undeclared purpose of the reform was to help parties (specially the ruling and debt ridden Socialist Party, PSOE) out of their financial problems. In our view the then governing and beleaguered Socialist Party (as well as the other parties endorsing the law, although they were under less political pressure) used the reform as a billboard for political advertising. That is to say, to publicized that campaign expenditures were going to be cut, a very popular move in a period of recession. But what they would not announced was that the new set of rules, which remained obscure to ordinary voters, involved as a matter of fact a substantial increase in public subsidies.

² Independent spending was regarded less as a right for individual expression than as a potential subterfuge to evade the reform's spending limits. Martin Liton (1994, 93) distinguishes two models of democracy: One is based on voter's sovereignty, the other draws an analogy between the electoral process and a football match. While the first (American) model legitimizes no infringement of free speech during the election campaign, the second (European) does not allowed outside participants (i.e., non party organizations) to take part in it.

³ The expenditure limits and public subsidies were set in real terms and therefore to be adjusted upwards to account for changes in the Consumer Price Index. On the contrary the contribution limit was not tied to the rate of inflation and its real value has decreased over time.

⁴ In addition to direct cash assistance and the publicly financed mailing, parties are granted in-kind services during the campaign, like free broadcasting time in the state run networks and meeting space in town halls. The allocation criteria of the in-kind subsidies are less dependent on electoral strength than the cash transfers, so their impact is more equalizing.

⁵ Either 5 deputies in the lower chamber or, what is far more demanding, 10 senators in the upper house of the bicameral legislature.

Three years later, by Law 13/1994, the expenditure cap was lowered again. This time it was set at 24 eurocents per inhabitant of the voting districts in which a party fielded a list of candidates while the fixed amount per district was removed. This ceiling, like the previous ones, applied only to the formal campaign period, which was shortened from three to two weeks. The mailing subsidy was preserved and is still in force nowadays.

According to its introductory section, the 1994 act was supposed to bring about a reduction in campaign spending of 20% from its previous level (that of the 1993 general election). Political parties maintained that the reason for such a reduction was twofold. First and foremost the experience from past elections showed that the previous cap on campaign expenditures had been set too high. Secondly, the economic crises of the first half of the nineties was forcing governments to cut expenditure in order to control budget deficits and restricting campaign costs was presented as a step in the right direction and an example of parties' contribution to overcome the recession. Nevertheless it seems to us that the parties concealed more self serving motives than the ones they put forward, like finding a way out of their mounting electoral debts and recovering from their decline in reputation and support from voters discontent with parties' illegal fundraising activities.

In the next section we present data that show that the reforms of public electoral funding in the nineties served the parties to attain fully their non-proclaimed goals and only partially the proclaimed ones.

III. THE DATA

Table 1 below displays the evolution of campaign spending in inflation-adjusted euros by Spanish political parties competing in general elections from 1986 onwards.

Table 1.- Evolution of campaign spending and public subsidies in constant euros, 1986-2000.

Election year	Reported total spending by parties	Public subsidy	% of public subsidy over total reported spending
1986	47,857,723	22,812,295	47.67
1989	45,969,773	22,348,843	48.62
1993	45,004,025	35,399,432	78.66
1996	36,140,675	33,873,267	93.73
2000	36,775,304	34,355,667	93.42

Source of data: Calculated by authors from the Court of Accounts' electoral reports ⁶. Expenditures of non reporting parties (parties with no seats in Congress) are not included.

⁶ The Tribunal de Cuentas (Court of Accounts) is a state agency which is in charge of monitoring the funding and spending (both regular and electoral) of political parties and their compliance with the regulatory rules. Its reports about parties' campaign budgets are published after each election.

As table 1 shows electoral expenditures and public subsidies moved in opposite directions from 1986 onwards. The total sums spent in general elections fell at constant prices during the nineties. Reported campaign spending was cut by a very small amount by the first reform act (1991), but it plummeted a 20% (comparing expenditure in the 1993 and 1996 elections) after the enactment of the second (1994) reform. However, if we pay attention to the evolution of state funding we can see that the reform of 1991 raised public subsidies by more than 50% in the general election of 1993, reaching then a record amount and levelling off thereafter.

From inspection of column 4 in table 1 it is remarkable to notice how the combined effects of the two reform acts allowed political parties to charge most of their campaign bills to public budgets. In the last two general elections of the eighties, held in 1986 and 1989, reimburses from the public Treasury to political parties were less than a half of their total spending. After the two reforms were enforced the proportion rose to 93%. In short, the fundamental effect of the new regulations was to almost double the share of campaign expenditures funded by public monies.

It is thus clear that what was advertised by parties as their contribution to get out of the recession by lowering the costs of campaigns was not attained at all because public subsidies rose largely in the aftermath of the reforms. However the new regime permitted parliamentary parties to pay for their campaigns without indulging in the illegal practices of the past.

What were the effects of the new campaign finance rules on the workings of the electoral system? Did the reforms introduce new means to distort the representation of political preferences? This could have been the case if the disproportionality (as defined below) of the electoral system were to be reinforced by the distribution of the public grants. Table 2 exposes the performance of several disproportionality indexes from 1986 to 2000.

Table 2.- Electoral and financial disproportionality indexes, 1986-2000.

Election year	Rae	L&H	Gallagher	Rae (sub.)	L&H (sub.)	Gallagher (sub.)
1986	0.45	3.17	7.41	0.45	3.14	10.22
1989	0.36	3.04	8.51	0.35	2.97	9.76
1993	0.41	3.05	4.30	0.41	3.05	4.30
1996	0.15	1.09	4.38	0.15	1.09	4.38
2000	0.27	1.59	5.69	0.27	1.59	5.69

Source: Computed by authors based on data from the Ministry of the Interior and the Court of Accounts' electoral reports. The electoral data are the percent of votes to parties' lists, therefore null votes are not included. The electoral disproportionality indexes of Rae, Loosemore and Hanby, and Gallagher are taken from Lijphart (1994) and defined as follows:

$$Rae = \frac{1}{n} \sum |v_i - e_i|$$

$$L \& H = \frac{1}{2} \sum |v_i - e_i|$$

$$Gallagher = \sqrt{\frac{1}{2} \sum_1^n (v_i - e_i)^2}$$

Where n is the number of parties represented in parliament, and v_i and e_i the share of votes and seats held by each party in the lower chamber (Congreso de los Diputados). The disproportionality indexes labelled (sub.) are computed using the percent of electoral subsidies received by each party instead of its percent of seats in the lower house.

According to table 2 the financial reforms of the nineties did not alter a prevailing trend towards diminishing the disproportionality of the political system (as measured by those indexes). That trend is salient whether we compute the indexes using either the share of seats or of votes. However if we look in table 3 at how the shares of votes, seats and electoral subsidies gathered by the two main parties evolved over time a different picture emerges.

Table 3.- Percent of votes, seats and electoral subsidies accumulated by the two largest Spanish parties (PSOE and PP).

Election year	Valid votes	Seats in lower chamber	Electoral subsidies
1986	70.0	82.6	85.8
1989	65.4	80.6	83.1
1993	73.5	85.7	78.1
1996	76.4	84.9	75.3
2000	78.7	88.8	73.4

Source: Calculated using data from the Ministry of the Interior and the Court of Accounts. The indexes are computed adding the percent of votes, seats and electoral subsidies received by the two dominant parties (the socialist party, PSOE, and the conservative People's Party, PP) in each general election.

Table 3 reflects an unexpected outcome. In the first two post-LOREG general elections, those of 1986 and 1989, the proportion of public subsidies accruing to both PSOE and PP was more concentrated than that of seats or votes. But after the reform of 1991 their percent of subsidies became smaller than the percent of seats although still bigger than that of votes. And after the 1994 reform act, that regulated the general elections of 1996 and 2000, electoral subsidies began to be redistributive (in the sense that the proportion of public grants added by the two biggest parties was smaller than their share of votes).

Two questions can be posed. First, why did the two parties which controlled the legislature promote and pass legislation that weakened their position relative to other parties? Second, what

was the distribution of the financial gains brought about by the legal reforms among the political parties?

To answer the second question we calculated the financial advantage ratio for each party and election since 1986 (shown in table 4). This index, based on the Taagapera and Shugart (1989) electoral advantage ratio, is computed as the share of subsidies of each party over its share of votes. Parties with a financial ratio greater than one benefited from the new regulations of campaign financing while parties with a ratio smaller than one did not.

Table 4.- Financial advantage ratios of Spanish parties over time.

Party	1986	1989	1993	1996	2000
PSOE	1.35	1.32	1.06	0.98	1.05
PP	1.04	1.18	1.06	0.97	0.84
PSC	1.18	1.20	0.94	0.98	0.84
IU	0.33	0.45	1.62	1.62	2.29
CiU	1.01	1.10	1.04	1.17	1.17
PNV	1.44	1.30	1.41	1.57	1.50
ERC	-	-	0.25	0.25	0.26
UPN-PP	-	1.80	1.03	1.06	0.78
CC	-	-	0.72	0.84	1.19
UV	0.65	0.65	0.36	0.42	-
PA	-	0.42	-	-	0.13
IC	-	0.60	0.37	0.37	0.35
PAR	0.52	0.51	0.29	0.78	-

Source: Computed by authors using data from the Ministry of the Interior and the Court of Accounts' electoral reports. Non reporting parties (parties with no seats in Congress) are not included. The – sign indicates parties that were not eligible for public funding in an election year.

Table 4 shows that the reforms depressed the financial advantage ratio of the two largest parties, PSOE and PP, while for the medium sized parties the opposite was true. Basque and Catalan nationalist parties (PNV and CiU, respectively) and a multi party coalition from the Canary Islands (CC) improved their financial position after the legal changes. However the most favoured party was the Union of the Left (IU), a coalition of radical groups led by the Communist Party. IU got in the nineties the highest financial advantage ratio while prior to the reforms it was the less favoured party. This is particularly telling if we consider the big gap between the financial advantage index of IU and that of other parties in the 2000 election⁷. Furthermore, having a widely dispersed electorate, IU was a poor performer under the Spanish electoral system⁸. The reason for such a result lies on the campaign funding system established in 1991. The new

⁷ However we have to take into account that the financial advantage ratio of IU is overestimated, since IU pays for the mailing costs and receives the mailing subsidy of its affiliated party IC, Iniciative for Catalonia.

⁸ The Spanish electoral system uses the d'Hondt rule which gives big parties more seats than most proportional representation formulas. With such a rule small and medium-sized parties can only win seats in large constituencies

method computed mailing costs separately and paid for them with a special subsidy which was distributed to parties depending on their total electorate, never mind if dispersed or not, as long as they got at least a 5% share of the national vote or 5 seats in the lower chamber. Since IU fitted this category it benefited much more from the mailing subsidy than from the ordinary electoral cash grants, which did not reward the votes polled by a party list in a district when they fell short of achieving representation in that district (that is, when votes were not enough to gain at least a seat for the party in the lower house ⁹).

This differential effect of the reforms is also conspicuous in table 5, which displays the public subsidy per vote in constant prices received by each party. The two biggest parties maintained more or less their pre-reform position. Strong regional parties (PNV, CiU and CC) improved their fortunes, but not as much as IU. The public money per vote pocketed by IU was more than twice as much the amount most parties got in the 2000 election. ¹⁰ It is also noteworthy the differences in money per vote between the major regional parties (PNV, CiU and CC) and the much smaller counterparts (ERC, UV, PAR) ¹¹.

Table 5.- Public subsidy per vote in constant 1992 euros, 1986-2000.

Party	1986	1989	1993	1996	2000
PSOE	1.53	1.45	1.61	1.34	1.52
PP	1.18	1.30	1.61	1.33	1.21
PSC	1.33	1.31	1.43	1.13	1.21
IU	0.38	0.50	2.45	1.85	3.31
CiU	1.15	1.20	1.58	1.59	1.69
PNV	1.64	1.43	2.12	2.15	2.16
ERC	-	-	0.37	0.34	0.37
UPN-PP	-	1.98	1.56	1.45	1.13
CC	-	-	1.09	1.14	1.71
UV	-	0.72	0.55	0.57	-
PA	-	0.45	-	-	0.18
IC	0.73	0.66	0.55	0.51	0.50
PAR	0.59	0.56	0.45	1.07	-

Source: Calculations by authors using data from the Ministry of the Interior and the Court of Accounts' electoral reports. Non reporting parties (parties with no seats in Congress) are not included. The – sign indicates parties that were not eligible for public funding in an election year.

or where their voters are strongly concentrated, as are in Spain those of the regional parties in Catalonia, the Basque Country and the Canary Islands.

⁹ District size, the number of seats filled in a district, is critical parameter to attain representation in the lower house. It varies widely in different parts of the country, ranging from 1 (in the small cities of the North African coast) to 34 in the populous province of Madrid. For its effect on minor parties see footnote 8.

¹⁰ The subsidy per vote of IU is overestimated, since the numerator includes the subsidy for the mailing expenses undertaken by IC, but the votes of IC are not counted in the denominator.

¹¹ PSC, the third party listed in the table, is the Catalan branch of PSOE. UPN, the Union of the People of Navarre, is a right of centre party which runs for election usually in coalition with PP.

Why did the two largest parties, PSOE and PP, support legislation that according to some of our indicators (like the share of public subsidies, the ratio of financial advantage or the amount of public money per vote) were detrimental to them? Table 6 presents the evolution of the percent of campaign spending in general elections funded by public subsidies. Data in the table reveal that the reforms let PSOE and PP to shift all but fully the costs of their electoral campaigns to public budgets¹². Thus general elections were no longer a heavy burden on their finances and both parties could cope with the most pressing political problem haunting them at the time of the reforms: popular disgust with their irregular funding practices. Nevertheless minor parties represented in Parliament also gained from the raising flow of public grants¹³.

Table 6.- Percent of campaign spending funded by public subsidies, 1986-2000.

Party	1986	1989	1993	1996	2000
PSOE	60.2	73.5	90.9	100	100
PP	41.8	54.3	97.4	100	100
PSC	65.0	69.7	89.9	100	71.8
IU	8.4	30.5	69.8	98.6	71.8
CiU	41.6	45.6	90.2	89.8	82.7
PNV	47.7	32.7	50.0	86.3	90.9
ERC	-	-	7.0	9.3	23.1
UPN-PP	-	90.9	73.4	99.6	100
CC	-	-	21.6	51.1	84.4
UV	28.0	19.5	22.1	26.3	-
PA	-	20.0	-	-	92.6
IC	-	90.0	18.8	83.1	17.4
PAR	10.2	15.2	17.3	98.5	-

Source: Calculations by authors using data from the Ministry of the Interior and the Court of Accounts' electoral reports. All percentages are rounded to the nearest tenth. Non reporting parties (parties with no seats in Congress) are not included. The – sign indicates parties that were not eligible for public funding in an election year.

To sum up the data displayed in this section, the reforms of the nineties imposed a cap on campaign spending and increase to a great extent the flow of electoral subsidies to parliamentary parties that made them less dependent on private sources of money. PSOE and PP could thus pay for their expenditure with public money and electoral campaigns ceased to be the heavy burden on both parties finances that had been since democracy was restored. Other medium sized parties improved their financial advantage ratios while the share of public subsidies enjoyed by PSOE and PP declined. Medium sized parties and some of the small ones also profited from an increased proportion of their electoral spending funded by public funds. As attested by our data

¹² Campaign subsidies reimburse parties' actual expenditures up to the statutory ceilings. Parties spending beyond the legal limits are fined. Upfront cash payments are available to parties which achieved eligibility for public funding in the previous general election.

¹³ For IC, the only exception, the percent of campaign spending paid by public subsidies is understated in table 6. See footnotes 7 and 10.

IU was, surprisingly, the party which benefited most from the reforms. But equity was in no way achieved, since parties with less than 5 deputies or that polled less than 5% of the national vote were not eligible for the new subsidy enacted to pay for mailing expenses. And parties which held no seats at all advantaged neither from the old subsidy nor from the new one¹⁴. Therefore the reform increased existing de facto inequalities between parties inside and outside Parliament¹⁵.

IV. A POLITICAL ECONOMY EXPLANATION OF CEILINGS TO CAMPAIGN EXPENDITURE

Why did the Spanish parties agree to set an effective ceiling to campaign spending in the nineties and not before? We suggest a game theoretic approach to answer this question.

After democracy was restored in the mid seventies the situation of the Spanish political parties (which had been banned for forty years) could be portrayed as a state of nature in which no party was sure of its own strength or that of others'. In this setting we can assume that the priority for each party was to locate itself in the political spectrum in such a way that its vote share was maximized.

Party voting functions could be written as:

$$V_1 = f(G_1, G_2, \dots, G_n) \quad (1)$$

Where V_1 are the votes for party 1, a function of its own electoral spending G_1 and other parties' spending G_1, \dots, G_n . We can assume that in such a setting each party considers its electoral results depending positively on its own spending and negatively on that of other parties. We can also assume that parties will not follow other parties' unilateral increases in their campaign expenditures. Thus parties faced a multiplayer prisoner's dilemma in which each party has to decide how much to invest without knowing the spending of their opponents. So we expect the signs of the relevant partial derivatives to be:

$$\frac{\partial V_1}{\partial G_1} > 0$$

$$\frac{\partial V_1}{\partial G_i} < 0, \forall i \neq 1$$

¹⁴ This does not imply that the reforms impaired public interests. In the short term limiting competition in the political market is not necessarily harmful. As Cass (1998, 48) points out fewer parties will reduce the costs of acquiring information about the candidates with the greatest probability of winning the election.

¹⁵ The restrictive legislated limits on private contributions set by the reforms, the fact that they were not indexed, and the lack of tradition in Spain of voluntarily giving money to political parties curtailed also the ability of new parties to compete in the electoral arena.

$$\frac{\partial G_i}{\partial G_1} = 0, \forall i \neq 1 \quad (\text{parametric choice})$$

Voting functions like (1) lead to the following preference ordering for each party electoral spending: 1st) Restrict not electoral spending if others restrict theirs, 2nd) Restrict spending only if other parties follow suit, 3rd) Restrict spending even if others do not, and 4th) No party restricts campaign spending. This preference structure describes a prisoner's dilemma game. Its payoff matrix is displayed in table 7.

Table 7.- Prisoner's dilemma payoff matrix (ordinal utilities).

Other parties (columns)	Restrict campaign spending	Do not restrict campaign spending
One party (rows)		
Restricts campaign spending	(2 nd , 2 nd)	(4 th , 1 st)
Does not restrict campaign spending	(1 st , 4 th)	(3 rd , 3 rd)

The Nash equilibrium of this game is in the downright cell and is the only position that is not Pareto efficient. The structure of the game grants welfare improvements if we move from the Nash equilibrium towards the upper left cell. But we cannot expect this cell to be a stable equilibrium. Non cooperative behaviour is a dominant strategy, since each party finds convenient to free ride, increasing its own spending whatever other parties do. This was in our view the circumstance that the Spanish parties confronted from the first general election, held in 1977, to the late eighties. The parties were struggling to locate themselves in a turbulent political framework; more concerned with self-definition (that is, programmatic differentiation from potential political rivals) and inner tensions about ideological and organizational problems than to reach agreements on campaign costs limits, whose effects, by the way, were not well known at the time. During this transition period staggering increases in campaign expenditures beside causing substantial deadweight losses left the biggest parties with soaring debts.

But in the nineties an imperfect two party dominated system consolidated, with PSOE and PP typically polling more than 75% of the votes in general elections and holding 85% of the seats in the lower chamber ¹⁶. Although debt problems were particularly severe for PSOE, both parties had to face well publicized scandals of irregular financing ¹⁷ as well as the anti-politics mood that

¹⁶ About ten or twelve parties are normally represented in the Spanish legislature, but only PSOE and PP are able to rule, on their own or in coalition with a minority party. Therefore the system can be classified as a two and a half party dominated using Blondel's measure of the effective number of political parties.

¹⁷ The Filesa affair (for PSOE) and the Naseiro affair (for PP) were the most outstanding scandals in the early nineties. Filesa was the name of a corporation run by two elected representatives of the Socialist Party that charge businesses and banks for fictitious consultancy work in order to fund campaign spending. The Naseiro affair was about kickbacks paid by public works contractors to People's Party officials in the city council of Valencia. In Spain

was in full force in the early nineties. And being afraid of their electoral impact both players were willing to reach an agreement to control campaign costs.

In this new scenario the preferences of the two dominant parties towards limiting campaign spending could be arranged as follows: 1st) Restrict spending if the other party does restrict its own, 2nd) Restrict not if the other party does not follow suit, and 3rd) Restrict campaign expenditures unilaterally. This preference structure defines an assurance game. The payoff matrix for this game is shown in table 8.

Table 8.- Assurance game payoff matrix (ordinal utilities).

Party A (columns)	Restricts campaign spending	Does not restrict campaign spending
Party B (rows)		
Restricts campaign spending	(1 st , 1 st)	(3 rd , 2 nd)
Does not restrict campaign spending	(2 nd , 3 rd)	(2 nd , 2 nd)

A voting function that generates such a preference ordering for the two biggest parties is the following:

$$V_A = f(G_A(G_B), \sigma_A(G_A)) \quad (2)$$

Were V_A stands for the votes of party A, G_A is its campaign spending, G_B is the campaign spending of party B and σ is the risk associated to illegal campaign funding.

Equation (2) posits that each party's votes are dependent on their own electoral spending, which is itself a function of the other party's spending. We can expect that as spending raises, marginal vote return falls and that beyond a certain critical amount of spending m , vote returns are null¹⁸.

We can also expect that beyond a certain level of expenditure, due to high debts, the electoral results of a party would worsen. This is so because it comes into action the σ variable, which represents the risk that voters do not support the party they associate with financial scandals. As this kind of risk increases with campaign expenses, we can suppose that below a certain level, n , σ is zero while above that point, as voters becomes more concerned, it causes vote losses, probably at an increasing rate¹⁹.

contributions by public corporations or public work contractors are banned, either for campaign activities or to pay for the regular expenses of party organizations (i.e., the maintenance of offices and staffs).

¹⁸ It may also be suggested that spending beyond the critical amount m does not increase the level of political debate. That is to say, it has no social value, contributing neither to the public awareness of the election nor to a better understanding of the issues.

¹⁹ Voters will rarely be well informed about the financial activities of parties, since they have no incentive to spend much time gathering or assessing information about politics. But we may presume their perceptions to be influenced

According to the above assumptions, the partial derivatives are signed as follows:

$$\frac{\partial G_A}{\partial G_B} > 0 \quad (\text{strategic interdependence})$$

$$\frac{\partial V_A}{\partial G_A} = 0, \forall G_A > m$$

$$\frac{\partial V_A}{\partial G_A} > 0, \forall G_A < m$$

$$\frac{\partial \sigma_A}{\partial G_A} > 0, \forall G_A > n$$

$$\frac{\partial \sigma_A}{\partial G_A} = 0, \forall G_A < n$$

$$\frac{\partial V_A}{\partial \sigma_A} < 0$$

Total differentiation of function (2) yields:

$$dV_A = \frac{\partial V_A}{\partial G_A} \frac{dG_A}{dG_B} dG_B + \frac{\partial V_A}{\partial \sigma_A} \frac{d\sigma_A}{dG_A} \frac{dG_A}{dG_B} dG_B \quad (3)$$

In an scenario of high campaign spending in which each party's expenditure is devoted to a large extent to counterbalance its rival spending ($G_A > m$) and debt problems and campaign funding affairs put at risk party credibility ($G_A > n$), each party is interested in restricting its electoral expenses if the other follows suit ($dV_A = 0$ if $dG_B = 0$). But would not limit spending without rival's reciprocity, since in (3) $dV_A < 0$ if $dG_B > 0$.

This kind of interdependence explains the two Nash equilibria of the assurance game: one non-cooperative in the downright cell and the other cooperative in the upper left cell. The latter is the only equilibrium which is Pareto efficient. Like in the prisoner's dilemma game, both parties improve if they move towards cooperation. But now the cooperative outcome is a stable equilibrium because neither party can benefit by a strategy of non compliance.

by the frequency of media revelations of campaign funding scandals, which will be also taken into consideration by party officials anxious to prevent electoral decline.

V. CONCLUSIONS

In this paper we have discussed the Spanish reforms of electoral finance in the early nineties and proposed a rationale for the imposition of ceilings on campaign spending. The incentive to reach an agreement on restricting expenditure during the campaign was fostered by the shift of voters' preferences towards an imperfect two party dominated system and by the urge of the two major parties to address the financial problems and funding scandals that were undermining their credibility. Capping electoral spending allowed the two biggest parties to get under control their catch up game in campaign spending, lowering the costs of elections and improving welfare if, as it seems likely, the social marginal value of their electoral spending was negative. But the reforms failed to open up the political system as has been promised. Minor parties were excluded from the increased provision of subsidies that allowed parties in Parliament to pay for their electoral bills with funds from the public Treasury. The reformist zeal of the political parties in the nineties can be seen as a case of self-serving legislation. Nevertheless the reforms were effective, compared to the status quo ante, in reversing the trend of growth of electoral expenditure and in making the parties less dependent on interested private sources of money.

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