



**Government Response to the
Constitutional Affairs Committee
First Report of Session 2006–07**

Party Funding

May 2007

Presented to Parliament by
the Leader of the House of Commons and Lord Privy Seal
by Command of Her Majesty
May 2007

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INTRODUCTION

1. The Government is very grateful for the work of the Constitutional Affairs Select Committee in its inquiry into the funding of political parties.
2. The present system of party funding in the United Kingdom has been the subject of considerable debate over the last twelve months. The issue of political party funding is central to the health of our democracy. There is a keen public interest in securing lasting reform in a way which curbs wasteful spending, does not gratuitously advantage any one party at the expense of others, and does not interfere in the internal structures of any political party. Key to successful reform is a system which will increase public confidence in the democratic process and help stimulate grass roots renewal of political parties.
3. The Committee's report was published in December 2006, in advance of the publication of two other inquiries examining the current regulation of political party funding. The first of these, published in January 2007, was the Committee on Standards in Public Life's review of the Electoral Commission. It made important recommendations in relation to the regulatory role of the Commission. Second, in March 2007, Sir Hayden Phillips published his review into the funding of political parties "*Strengthening Democracy: Fair and Sustainable Funding of Political Parties*". This had been commissioned by the Prime Minister in 2006.
4. Sir Hayden Phillips' report identifies principles which could form the basis of a lasting settlement for the party funding system. Inter-party talks, chaired by Sir Hayden Phillips, will now take place on the basis of these principles.
5. Each of these reports will be valuable as the details of a reformed system of party funding continue to be developed over the coming months, both in the inter-party talks and beyond. The evidence collected by the Committee and its conclusions are an important contribution to this debate.
6. The Government is particularly grateful for the understanding shown by the Committee in agreeing to the delay of this response beyond the usual two month deadline. This was necessary to take account of the recommendations from Sir Hayden Phillips and the Committee on Standards in Public Life.
7. This is the Government's response to the specific issues raised by the Committee. It broadly follows the structure of the December report. In responding to the Committee, the Government has been mindful not to pre-empt the outcome of the inter-party talks. This response is therefore necessarily open on the issues which are the subject of these talks.

THE FUNDING OF POLITICAL PARTIES IN THE UK – CURRENT SYSTEM AND PRINCIPLES OF FUTURE REFORM (Recommendations 1-6)

1. Party funding and the maintenance of a system of parties that compete fairly within the British polity is an issue of central political importance. It is imperative that the Government take a considered and measured view of any proposals for reform, and that reforms command a wide consensus among political parties. Failure to undertake reform, or the promulgating of reforms which are seen to be of a partisan nature will serve only to alienate the public and damage rather than revive political parties in the eyes of the electorate. (Paragraph 13)

2. Decline in party membership has altered the income profile of the main political parties. However, more significantly, it has altered campaigning strategies, led to a reduction in the number of local activists and subsequently reduced the direct contact that parties have with members of the public. (Paragraph 23)

3. Political parties receive income from a variety of different sources. Despite the introduction of a duty to produce accounts under PPERA, a lack of common accounting practices makes it difficult to compile a comprehensive account of the income profiles of the political parties. The Government should ensure that the Electoral Commission produce more digestible, thorough and transparent figures of both the private and public sources of party income. (Paragraph 39)

4. The current system of party financing in the UK is unstable and, unless key issues are addressed, it is likely that these problems will increase further. Not addressing the financial predicament of the parties at this stage could lead to increased dependency on large donations, ever increasing amounts of money being spent between elections and the subsequent further erosion of public confidence due to the increasing appearance of money buying power and influence. (Paragraph 48)

5. We believe that there are problems, both actual and perceived, with the current arrangements for party funding in the UK. While parties struggle with escalating costs and a reduction in the traditional financial support base, public confidence is damaged by the fear that donors may be able to buy political influence. While the PPERA 2000 introduced closer regulation and some improved transparency, it has not finally resolved problems with the system; if anything increased transparency, by revealing the extent of and dependency on donations from a few rich individuals, corporations and trade unions, has increased the negative impact on public confidence. (Paragraph 49)

6. We agree with the Lord Chancellor that party funding is only one issue that has an impact on public confidence, and resolving this issue alone will not fully restore this confidence. However, if handled well, the process could contribute to the restoration of public confidence. If handled poorly, regardless of the merits of any proposals for reform, public confidence and engagement will be further undermined. (Paragraph 50)

8. The Government agrees with the central challenges identified by the Committee in regard to the current system of party financing. As the Committee acknowledges in paragraph 54, the reforms introduced by the Political Parties, Elections and Referendums Act 2000 brought about significant and welcome change to the regulation of party funding, but – for the reasons which the Committee sets out in paragraphs 48 and 49 – further reforms are needed to tackle problems which have come to light since 2000. The review by Sir Hayden Phillips of the current system has specific regard to those issues which the Committee itself has highlighted.

9. The Government is committed to taking a considered and measured view of any proposals for reform, and agrees with the Committee that the maintenance of a sustainable system within which parties can compete fairly is of central political importance.

10. The Committee is right to identify falling membership as having altered the income profile of the main political parties (paragraph 23). The Government believes that any reforms to the current system must include measures to redress a trend that has seen membership of political parties halve since 1980. Sir Hayden Phillips' report recommended a matched funding scheme to encourage political parties to recruit paying supporters.¹ The Government believes that such incentive based state funding could be an important component of any future reforms.

POTENTIAL SOLUTIONS: REGULATION AND SPENDING CONTROL

Regulation and Transparency (Recommendations 7-11)

7. While we endorse a transparent system, transparency does not solve problems, but draws attention to them. It also invites “sniping” between opponents. It must be based on readily identifiable risks so that audit functions have a clear overall purpose. (Paragraph 53)

8. We welcome the changes and transparency that have come about as a result of the PPERA. We agree with the basic principles of the current system. We note that the system of regulation has largely developed as a response to specific problems which have emerged, and emphasise the need for constant review and flexibility in what is a very fluid and dynamic environment. (Paragraph 54)

¹ The Review of the Funding of Political Parties, *Fair and Sustainable Funding of Political Parties*, March 2007, p.18.

11. The Government welcomes the Committee's conclusions about the benefits and increased transparency brought about by the Political Parties, Elections and Referendums Act 2000. The 2000 Act – which gained all party support – put in place a detailed regulatory framework, in response to the recommendations of the Fifth Report of the Committee on Standards in Public Life, then chaired by Patrick Neill QC. The Act sought to increase transparency and tackle excessive spending. It established an independent Electoral Commission, laid down national limits on campaign expenditure and required all donations above £5,000 nationally or £1,000 locally to be made public.

12. Although the 2000 Act increased overall transparency of the funding of political parties, the Government agrees with the Committee that the current system of regulation was developed in response to specific problems. The Committee is correct to say that the party funding environment is fluid and fast moving (paragraph 54). As a consequence the Government believes that the regulatory system, and regulator, must be responsive and flexible enough to deal with emerging issues. This was particularly highlighted last year when concerns about loans to political parties surfaced. Loans had simply not been a problem when Neill reported in 1998. In this case, the Government used a Bill then going through Parliament – the Electoral Administration Act 2006 – to extend the requirements of transparency and permissibility to loans. The Government recognises that, notwithstanding the achievements of the 2000 Act, further reform is necessary to ensure regulation meets and anticipates the rapidly changing funding environment.

9. However, we recognise that current reporting methods fail to provide adequate transparency in the way accounts are presented by the Electoral Commission. We urge the Electoral Commission and the Government to work together to improve and strengthen these processes. (Paragraph 55)

10. There needs to be a fine balancing act between regulation and providing the parties with adequate resources to ensure compliance. It would be counter-productive to increase further the financial burden on the political parties by requiring them to re-direct resources in order to assure compliance. (Paragraph 60)

11. We acknowledge the difficulties with regulation, especially its application at the local level. However, these obstacles should not prevent the pursuit and development of a robust, transparent, workable and enforceable regulatory framework. (Paragraph 61)

13. The Government is committed to supporting the Electoral Commission in enhancing its role in delivering maximum transparency in relation to the funding of political parties. The Government maintains a regular and constructive dialogue with the Electoral Commission on all areas of its responsibilities, including the publication of donation reports (paragraph 39 and 55).

14. The Government recognises the Committee's concern that effective regulation requires a fine balancing act (paragraph 60), providing strong controls and transparency but not imposing an excessive burden on political parties at grass

roots level. Campaigning at local level is, as the Committee points out, vital to raising awareness of political issues and encouraging participation and engagement. The Government would therefore wish to see an appropriate balance struck in any future reforms and believes that this can be achieved whilst still providing for greater transparency (paragraph 61).

The Electoral Commission (Recommendation 12)

12. We recommend change to the Electoral Commission to help it become an effective watchdog with appropriate powers of enforcement. We recommend that the provisions in PPERA should be changed to allow a minority of Commissioners to be people with practical past experience of politics from across the political spectrum. (Paragraph 64)

15. The Government firmly believes that the Electoral Commission has a key role to play in securing and maintaining a more effective regime of party regulation. The Government would therefore welcome a change to the provisions in the 2000 Act to allow a minority of Commissioners to be people with experience of politics from across the political spectrum (paragraph 64). The Committee on Standards in Public Life's January review of the Electoral Commission made recommendations in similar terms.² The Government is pleased to note that the Electoral Commission's response to the Committee on Standards in Public Life's report indicates that it supports this change.³ The detail of how this would work in practice will need to be explored further. The Government also agrees with the Committee's recommendation that the restriction on the number of years (currently ten) before someone who has been politically active can be employed by the Commission should be reduced.

16. The Government is currently considering the wider recommendations of the Committee on Standards in Public Life's report which relate to the regulatory role of the Electoral Commission. These provide a platform to re-focus the Electoral Commission's capacity and resources on its regulatory role (both in relation to party funding and electoral conduct), complementing the recommendations of this Committee's report.⁴ The Secretary of State for Justice will issue a full response to the Committee on Standards in Public Life's recommendations in due course.

Spending Control (Recommendations 13-21)

13. Campaigning is a core activity for political parties which provides information and encourages participation and engagement. It is the means by which political choices are presented to the voters. However, we are concerned about the negative public perception of impersonal and expensive campaigns and their potential impact on participation and engagement should campaign costs continue to escalate. (Paragraph 71)

² Committee on Standards in Public Life; *Eleventh Report: Review of the Electoral Commission*; January 2006; p.60; Recommendation 29.

³ <http://www.electoralcommission.gov.uk/templates/search/document.cfm/18596>

⁴ Committee on Standards in Public Life; *Eleventh Report: Review of the Electoral Commission*; January 2006; pp.9-10; Recommendations 1-9.

14. We recommend that there should be a tighter cap on overall party spending. This limit should be set by the Electoral Commission, and should be determined as the result of an open debate about the real cost of politics. (Paragraph 72)

17. The Committee is right to identify the positive impact which campaigning can have on raising awareness of political issues and encouraging participation and engagement (paragraph 71). The Government further agrees with the Committee that impersonal and expensive campaigns can damage voter engagement and draw the wealthier political parties into an “arms race” to spend more. Sir Hayden Phillips identified the same problem in his report, citing evidence that spending by the two main parties in the twelve months before the 2005 General Election rose to £90 million,⁵ representing an increase of 40 per cent on the same period before the 2001 General Election.

18. The Government therefore agrees with the Committee that there should be a tighter cap on overall party spending at the national level (paragraph 72) as a part of a wider package of measures to ensure that expenditure is capped at an appropriate level nationally and controlled comprehensively at the local level and for a longer period of time.

15. Although election spending at constituency level is subject to defined limits, extensive spending can take place, including in marginal constituencies outside these limits. Any change, even if designed to encourage a more general shift from national to local campaigning would still be subject to loopholes, and it is not clear whether it would be administratively feasible to close these. (Paragraph 78)

16. We see merit in the focus of campaigning being shifted from the national to the local level. Whilst recognising that parties must take control of spending, we recommend that there be a modest increase in local spending limits, to be set by the Electoral Commission. (Paragraph 79)

17. With an increase in the frequency of elections within the United Kingdom, the current definitions of campaign periods for spending regulation periods are outdated, and allow a range of activities outside of those periods, which, although within legal definitions, do not reflect the spirit of the law. (Paragraph 87)

18. The effects of any reform to address constant campaigning would be far reaching and should only be considered in the context of an agreed overall package of proposals, including limitations on all sources of income and expenditure. (Paragraph 88)

19. Part of this package would be a revision of the present arrangements to enable the expenditure of all parties, both at local and national level to be capped over a five year accounting period. During this period parties would be allowed to

⁵ The Review of the Funding of Political Parties, *Fair and Sustainable Funding of Political Parties*, March 2007, p.13.

spend their money as they see fit, provided spending is within predetermined spending caps. Any elections falling within the accounting period would continue to be subject to their own spending caps within the laid down accounting period, but would also be counted within the overall five year cap. (Paragraph 89)

20. It is essential that, both in perception and in reality, money cannot buy undue influence, (or indeed, buy the election result) from within or outside the party. Third party spending should therefore be subject to a transparent and robust regulatory regime and should be regulated within the same accounting period as that determined for political parties so that current loopholes can be eradicated. (Paragraph 92)

21. Any extension of the existing arrangements for limiting spending (however defined) would not be sufficient to address all the current concerns about the funding of the political parties. It should be considered as part of a broader set of proposals. (Paragraph 96)

19. The Government agrees with the Committee that, although election spending is subject to defined local limits, extensive spending can take place outside those limits (paragraph 78). Sir Hayden Phillips came to the same conclusion, stating that the 2000 Act “sought to control the level of spending, but it has proved inadequate to the challenge”.⁶

20. The Government agrees with the Committee and Sir Hayden Phillips that the controls put in by the 2000 Act no longer work as well as they should. There is an excessively elaborate procedure for determining what constitutes an election period and when the regulated period should begin.

21. The current regulated periods do not reflect the reality of almost continuous campaigning. It allows parties a free rein to spend large amounts of money before the regulatory clock has begun to tick. The practical effect of this is that some candidates have been able vastly to outspend their opponents – distorting the process at a local level. The Government therefore believes that changes to the existing controls need to be explored in order to reflect the near constant state of electioneering.

22. The Government agrees with the Committee’s conclusion that there should be a modest increase in the local spending limits in order to encourage greater levels of local campaigning centred on individual constituencies (paragraph 79). Sir Hayden Phillips has recommended a corresponding decrease in the national expenditure limit for General Elections,⁷ which the Government also supports.

23. Any workable system of continuous regulation of expenditure would need to clarify accurately the division between local and national spending, which has become blurred in recent years by rapid advances in the internet and telecommunications (paragraphs 88 and 89).

⁶ The Review of the Funding of Political Parties, *Fair and Sustainable Funding of Political Parties*, March 2007, p.13.

⁷ *Ibid.*, p.7.

24. The Government is committed to securing a workable solution in order to close current gaps in expenditure controls. Any such solution needs to be explored in detail with the other political parties, and the Committee's proposals in this area will provide a valuable contribution to these discussions.

25. The Government agrees with the Committee that third party spending should be subject to a transparent and robust regulatory regime (paragraph 92). In particular, there is an issue in relation to fund-raising organisations such as unincorporated associations which raise significant funds for political parties, which are currently not subject to the same level of transparency that exists for individual donors. The Government believes that this discrepancy needs to be addressed.

26. The Government notes the Committee's recommendation that reform of expenditure controls should be considered as part of a broader set of proposals on party funding. The inter-party talks, chaired by Sir Hayden Phillips, will be discussing what a broader package of proposals should look like and the balance of the different possible elements – including expenditure controls – in that package.

POTENTIAL SOLUTIONS: SOURCES OF FUNDING

Donations (Recommendations 22 & 23)

22. **Any meaningful limit on donations from individuals, corporations and trade unions would lead to a shortfall in funds, which would not be addressed by a reduction in the current level of the cap in spending alone. However, a donation limit would greatly increase the incentive for parties to widen their support base to a larger number of small donations, a development we would welcome. In principle therefore, we agree that transparency of donations is not enough, and the parties should take steps to agree voluntarily to binding limitations on donations. However, such a limit should only be considered within the broader context of a discussion about alternative sources of funding, including state funding, for political parties. (Paragraph 109)**

23. **This issue is difficult to resolve, not least because of the present disagreement about the status of trade union funding to the Labour party. Any move to change the nature of party funding must not stray into prescriptive devices to require political parties to organise internally in ways that violate their democratic relationships with other institutions. (Paragraph 110)**

27. The Government agrees with the Committee that a limit on donations should be explored in detail, alongside spending limits, to bring further stability, fairness and public confidence to the funding of political parties. At present, all three main parties in the UK are agreed in principle to some form of donation limit.

28. The Government supports the Committee's view that any move to change the nature of party funding must respect the way in which the individual political parties have evolved and are internally organised (paragraph 110). Sir Hayden Phillips has agreed with this, stating that *'the detailed design of a limit on donations does present difficulties: each party has a distinctive structure, tradition and approach to*

*fundraising... In common with the CASC, I would not favour an approach to funding reform which prescribes how parties should or should not organise themselves beyond any necessary changes in donations policy’.*⁸

29. The Government welcomes the Committee’s and Sir Hayden Phillips’ recognition that a particular issue arises in respect of contributions made to the Labour party out of the political funds of affiliated trade unions. The Government supports Sir Hayden Phillips’ analysis that the *‘peremptory imposition of a simple cap on donations from all organisations and individuals alike would place the Labour Party at a peculiar disadvantage’.*⁹

30. As the Committee recognises, this is not a simple issue to resolve. In the Government’s view, the precise design of a donations limit would need to strike a balance between securing public confidence and not placing one party at a particular disadvantage over another. Again, this will be a central subject of the inter-party discussions, chaired by Sir Hayden Phillips.

Loans (Recommendation 24)

24. We welcome the new provisions for the reporting of loans under the Electoral Administration Act 2006. However, recent allegations with regard to loans (be they substantiated or not) have had a negative impact on public confidence in the political system. In order to restore this confidence fully, we recommend that all loans to political parties be made illegal, with the exception of those from UK based financial institutions, at commercial rates. (Paragraph 114)

31. As soon as it became aware of concerns about loans to political parties, the Government acted swiftly to ensure that all loans are subject to the same degree of transparency that applies to donations. The Government welcomes the Committee’s backing for the provisions included in the Electoral Administration Act 2006 on the reporting of loans. The Government believes that these new transparency arrangements are working well, but recognises that further consideration may need to be given to loans to political parties in the event that a cap on donations is introduced. As mentioned earlier in this response, the widespread public concern about loans has highlighted the need for any system of party funding to be able to respond rapidly to new and emerging issues.

State Funding (Recommendations 25-29)

25. Any extension of state funding should offer the taxpayer visibly cleaner and healthier politics; it should be accompanied by robust regulation and be focused towards the local level. It should also seek to maximise flexibility in determining funding for new parties, and towards stimulating local activity. These aims should be kept in mind when considering different methods of how any potential system of the state funding of political parties is devised and operated. (Paragraph 126)

⁸ The Review of the Funding of Political Parties, *Fair and Sustainable Funding of Political Parties*, March 2007, p.10.

⁹ *Ibid.*, p. 10.

26. While we consider it is neither helpful nor desirable to try to distinguish between “good” and “bad” expenditure, we recognise the need for further debate around the values and principles that should govern state funding. (Paragraph 128)

32. The Government strongly agrees with the Committee that any extension of state funding must offer the taxpayer visibly cleaner and healthier politics and not simply be applied to shore up parties’ existing arrangements (paragraphs 126 and 130). The Committee is right to identify state funding as a means which could encourage greater local activity and stimulate smaller political parties, provided they meet necessary eligibility criteria.

33. The Government believes that the current system of state assistance for political parties has been of benefit to opposition parties, not least in holding the government to account. Short and Cranborne Money has given millions of pounds of state aid to the main opposition parties, and has increased more than threefold since 1997.

34. However, the Committee is right that further debate is needed in order to define fully the values and principles governing state funding (paragraph 128). In particular, the Government believes that any extension of state funding would only command support if it were part of a comprehensive reform package which addressed public concern about current funding and spending arrangements.

27. We agree that state funding should not be used as a tool to dictate to parties how they should behave or organise. Neither should such funding be simply applied to shore up such parties’ existing arrangements. However, while we are sympathetic to the argument that any state funding should be directed towards the local regeneration of parties, this would be difficult to monitor. (Paragraph 130)

28. Instead, we are of the view that the means by which state funding is determined and distributed should incentivise party activities. Matched funding for membership fees should be introduced as a means of encouraging recruitment, as well as the introduction of a fixed annual amount of funding on the basis of votes cast at the previous election to give greater incentives to parties to increase activity, and thereby engagement and turnout, in seats other than marginals. (Paragraph 131)

29. We see positive benefits from allowing small donations to political parties to benefit from tax relief, but we suggest that this should be limited to £250 per donor per annum. We also recommend that a ‘matched funding scheme’ for non-taxpayers should be set up alongside it. (Paragraph 139)

35. The Government supports the Committee’s view of the principles and aims that should underpin any extension of state funding (paragraph 131). Sir Hayden Phillips’ recommendations on state funding chime with those of the Committee, particularly with regard to matched funding as a means of encouraging recruitment and the introduction of a fixed annual amount of funding on the basis of votes cast at the previous election.

36. The Government is not persuaded that tax relief on donations, even where it is accompanied by a matched scheme for non-taxpayers, represents a necessary component of a reformed system of party financing, but is open to further debate.

37. The Government is clear that the state funding element of any reform package, and the way in which it should operate, is a matter that needs detailed discussion in the inter-party talks, chaired by Sir Hayden Phillips.

CONCLUSIONS (Recommendations 30-33)

30. We recommend that any proposals for the reform of the system of party funding should be based on the following key principles:

- Any system of funding should be transparent, and be subject to the full scrutiny of the regulating body, in order to ensure sufficient public support and bolster public confidence in the integrity of the political system.
- It should be workable.
- It should, as far as is practical, be fair between existing parties and new entrants.
- Every effort should be made to attract a consensus among the major political parties.
- It should be based on the principle that the main purpose of political parties is to be a vehicle for public activism and engagement, and should subsequently be focused on making political parties fit for this purpose. (Paragraph 146)

38. The Government agrees with the Committee's key principles for the reform of party funding (paragraph 146) and believes that, to a large extent, these principles are already important features of the existing system, as set out in the 2000 Act. The existing regulatory framework is a good example of a system that is workable, offers transparency, is fair between existing parties and new entrants and was agreed by all of the main political parties. However, there is consensus that further reform is required to meet the fast changing funding environment. The Government believes that this change should build on the successes of the existing system.

31. As radical a change may be a step too far for the United Kingdom to take at this stage, but if the public are to see a benefit from greater state funding it will be because they are convinced that it is the way to ensure that parties are free from any appearance they are influenced by powerful paymasters. Increased regulation of donations and of spending, combined with wider availability of state funding, are justified if they open up a clear route away from interest based funding along which further steps can be taken if the benefits become more apparent. Without this sense of direction voters may well conclude that the parties are voting to give themselves more money without removing dependence on their other paymasters. (Paragraph 151)

32. We recommend that within a stronger and more robust regulatory framework there be a package of changes to the system of party funding to include: an overall cap on spending, both at local and national level; greater transparency about the sources of all elements of party funding; a voluntarily agreed binding framework for the limiting of all large donations leading to an increase in state funding for political parties. We agree that the aim of reform should be to strengthen the political parties, and that no party should be financially disadvantaged by any changes that are introduced. (Paragraph 154)

33. We acknowledge that all of the elements of the package we propose cannot be achieved immediately. We therefore recommend a two staged approach: a lower national cap on spending alongside a voluntarily agreed binding framework for a limit on donations should be pursued immediately. A combined matched funding and tax relief scheme should also be introduced with immediate effect in order to encourage small donations. The first stage would give parties time to adjust before more radical changes, including further extensions of state funding for political parties, are introduced. This package would not only provide a stable route for parties, but also a transparent and sustainable funding regime which could also be acceptable to the public. (Paragraph 155)

39. The Government agrees with the conclusions of the Committee in relation to the aims of further reform, in particular that any reform must look to strengthen the parties, and that no party should be financially disadvantaged by any changes. The final package of reform will depend on the outcome of the inter-party talks, chaired by Sir Hayden Phillips, but the Government envisages that such a package is likely to cover issues of donations and expenditure. The Government believes that there may also be cross party support for a measured and accountable extension of state funding, as a part of this wider package, and for an enhanced regulatory role for the Electoral Commission, which the Government also supports.

40. The Government is grateful to the Committee for its contribution to the current debate. It is committed to working out the practical arrangements required to take the regulatory framework for party funding to new levels of rigour, transparency, fairness and effectiveness. However, this is not something that can be achieved unilaterally. All political parties must play their part in developing, and maintaining, a system of party funding in which the public can have confidence.



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