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# Incentives that lead to lawlessness. How to create pervert state institutions - the case of Poland

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## **Abstract**

**Main thesis:** In Poland key state institutions (here secret service) are inefficient because of the conflict of interest within them. Policymakers failed to identify and prevent old clientelist networks from colluding against public interest and the formal mission of state institutions. After 1989/1990 systemic changes key state institutions became controllers without control. That produced incentives for freeriding.

**Theoretical Perspective:** analysis refers to New Institutional Economics and Game Theory to describe incentives that mobilized actors to act against democratic rule of law after transformation period.

## **1. Systemic Change in Central and Eastern Europe**

The transformation in all Central and Eastern Europe (hereafter CEE) and its implications are not fully described and analyzed by scholars. Yet there is quite wide consensus that the state institutions in CEE are not as efficient as those in the Western Europe<sup>1</sup>. State institutions in CEE failed to fight and/or prevent corruption, organized crime and many others pathologies that appeared after the systemic change. This paper is a case study that shows how conflict of interest within secret service in Poland after the 1989/1990 changes, affected negatively their performance and how this phenomenon reproduces though time. Although this study will focus on situation in

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<sup>1</sup> The difference between „old” and „new” countries of the European Union can be seen in Transparency International Index, World Bank Reports etc.

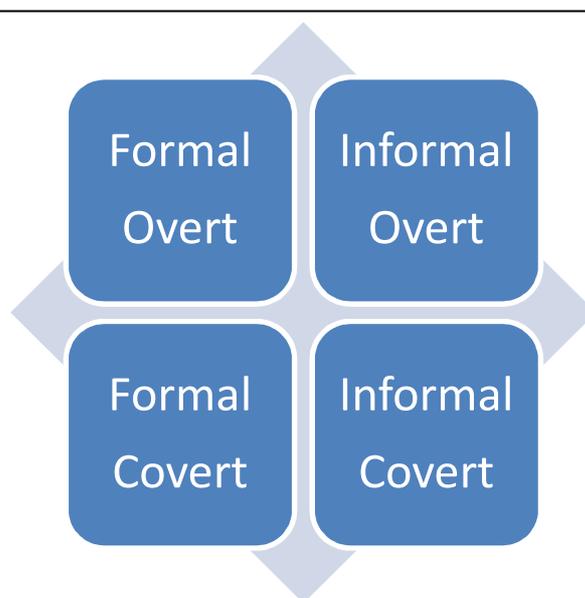
Polish secret service, there are several indicators that to some extent the pattern described here is typical to various institutions not only in Poland but all CEE (see Łos, Zybortowicz 2000: 201-215).

In one of his papers Colin F. Camerer asks a question: “is game theory meant to describe actual choices by people and institutions or not?” (1997). My answer is yes. I hope that game theoretical model used in this paper, together with new institutional economics approach, provides new interesting insight into explaining systemic change in CEE.

## 2. The nature of formal and covert institutions

The transformation in CEE can be interpreted using terminology introduced by Douglass C. North, John Joseph Wallis and Barry R. Weingast in their book “Violence and Social Orders” (2009). The aim of the transformation process is to change communist regime which is a limited access order into a liberal democracy - open access order. That supporting free market competition as an opposition to state regulated economy. That also means building new open access institutions that do not protect the interest of the ruling elite, privileges and rent seeking but support the rule of law. One of these institutions are – both civil and military - secret service.

In every modern society we can find various types of institutions and organizations. New institutional economics analyses focuses on division



**Figure 1** Types of institutions and organizations

between formal and informal ones (North 1993). Very rarely we can find another

interesting division – between covert and overt institutions (Héritier 2001). First typology should not be perceived as a contradictory to the second one. In fact they are complementary to each other. In fact any institution can be perceived by these two variables. Therefore we four types of institution that are shown in Figure 1.

The specific role of the secret service – either in open or limited access order – is that it is a formal and covert institution. That implicates two fundamental facts.

I. The very essence of a limited access orders that the communist police states in CEE (but also in Egipt, Libia and other countries before the revolts in Northern Africa 2011) is that regulatory function of the state is not only performed by overt institutions like law, the party and bureaucracy. In those systems very important, but rarely studied, regulators are military and civil secret service. This is the case of “regulation through infiltration” (Łoś, Zybortowicz 2000: 47-52). In the police state both economy and society are regulated by formal and covert institutions that extort obedience to the rules (Waller 1994).

II. Economic theory states that limited access orders create rent to sustain order (North et al. 2009). This claim is true but lacks precision. In fact limited access orders sustain order by creating overt (privileges for working class and nomenklatura) and covert (operational fund of the secret service) rents. While most social scientist asks in their research about overt rents, very few investigate what happens to the informal ones during transformation process.

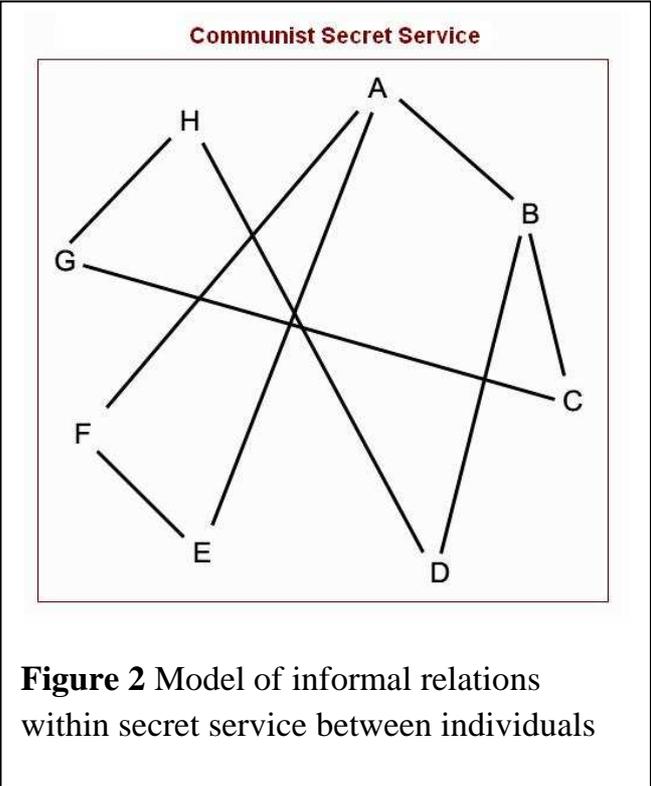
### **3. Institutional incentives before transformation – clientelism and informal coalitions**

Although there aren't many books, written by scholars, about organizational culture of the communist secret services (secret police and intelligence), available data provide information that allow us to describe general norms present in those institutions.

One of the insights is provided by Zbigniew Siemiątkowski – former Minister of Internal Affairs and head of the Intelligence Agency (2009). In his book on the communist secret service he shows the informal rules that regulated relations between

officers within civil intelligence. His findings are also supported by independent works by former spies and other employees of secret service (Andrew, Mitrokhin 2000, Suworow 1985).

The nature of communist secret service required people that were able to work against public interest, against existing formal rules. They were trained in deception, espionage and acquiring sensitive information. In terms of game theory we would say that they were professionals in manipulation of information, signaling and playing games with incomplete and/or asymmetric information. Officers of the secret service needed also to be loyal not to the rules of the institution but to the heads of the communist party. This extraordinary conditions of work



**Figure 2** Model of informal relations within secret service between individuals

produced incentives for specific types of informal relations – patronage and clientelism. Within formal structure existed an informal and partially covert, partially overt institution fueled with reciprocity and mutual commitments. System of relations is modeled in Figure 2.

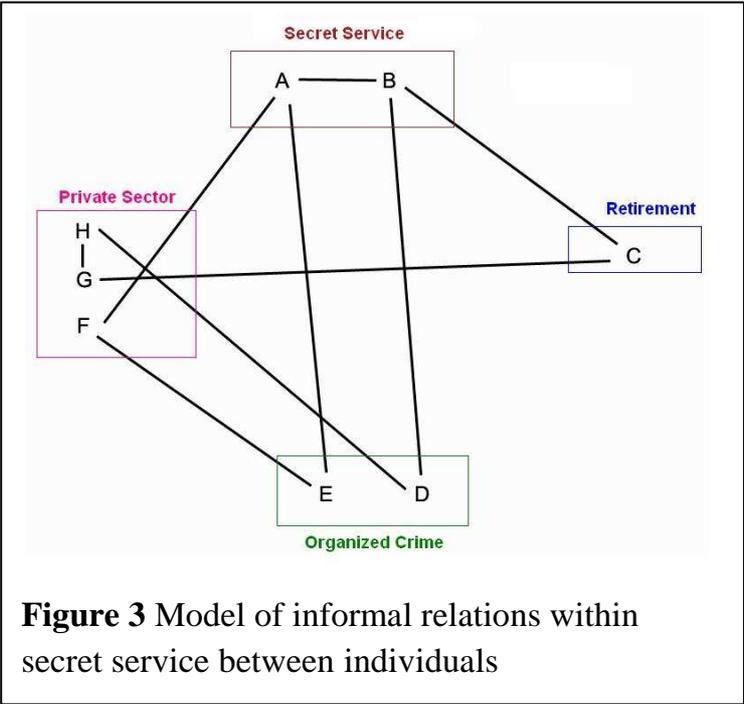
**4. Individual incentives during transformation. The durability of clientelistic ties and emerging conflict of interest**

Systemic transformation of 1989/1990 brought changes not only in politics, economy and society but also state institutions and secret service among them. Civil services were transformed into new institution and the process of verification took place. Officers of the civil secret that broke the law of People's Republic of Poland in their

former service were not allowed to work in new built institutions. As no verification of the officers of the military secret service took place majority of them stayed in the office in new institutions after 1989/1990 reforms.

Transformation produced more opportunities and incentives for the officers to work in new markets – corporate espionage, guard companies, other private companies and corporations and last but not least organized crime. This established a new situation where people from the same clientelist network no longer needed to work in the same institution but diversify their institutional network. Some of the former officers retired but it doesn't mean they lost their social network capital.

This new situation



developed new incentives – to collude (Wedel 2009). The system changed but old loyalties remained. There are several examples that show that towards new institutions were weaker than loyalties towards old clientelist networks (see Report... 2007). Situation of double loyalties is the definitional aspect of conflict of interest. This is where state institutions fail to work to secure public goods and other informal regulators come into play (Dixit 2004). Informal networks of former communist secret service officers became a barrier to foreign investors, entrepreneurs and perverted free market. As the formal rules were less important than the informal ones outsiders were in a position of asymmetric information which put them in a losing position when they entered the game. This game was described by Avinash Dixit and Barry J. Nalebuff (2008, Chapter 2).

## 5. Institutional incentives during transformation. Why clientelism paralyses democratic institutions?

In this context a question arises – why former secret service officers were willing to collude with their present and former colleagues rather than perform their duties according to the formal mission? The answer comes from both new institutional economics and game theory.

### I. New Institutional Economics Approach

The answer to the question can be found in an introduction to a book “Democracy and the Rule of Law” by José María Maravall and Adam Przeworski (2003). In Poland after the democratic changes of 1989/1990 new secret service became controllers without control. The parliamentary commission for the secret service wasn't established until 1995. That means that the actions of secret service were lacking control for over five years when Polish capitalism was consolidating. The risk of being prosecuted for collusion, selling insider information and/or exclusive knowledge from the secret service of democratic state were extremely low (see Zybertowicz 2011). This led to many pathologies including illegal arms trading in which secret service officers were involved, failure to prevent corruption that occurred in tenders and many more (see Report... 2007).

### II. Game Theory Approach

The answer from the perspective of game theory lies within formal reconstruction of actors incentives. Since Mancur Olson's “The Logic of Collective Action” we know that incentives can be monetary, moral, emotional (1965: 65). The model presented below, which is a variation of prisoner's dilemma, tries to join both easily quantifiable incentives (monetary ones) and those hard to quantify (that refer to moral, social profits that can be obtained by being a part of clientelist network – like favours etc.).

		State security service officer (A, B) (former communist secret service officer)	
		Playing by the Rules	Collude (Free ride)
Private sector employee / Organized crime member (D, E, F, G, H) (former communist secret service officer)	Playing with the rules	$s$ $p$	$s+r$ $p-l_o$
	Collude (Free ride)	$s$ $p+yr$	$s+r+r_c$ $p+yr+r_c$
$0 < s < p$	$s$ – salary		$r_c$ – clientelistic rent
$y > 1$	$p$ – profit		$l_o$ – lost opportunities
	$r$ – informal rent		

**Figure 4** Payoffs in former communist secret service officers prisoner's dilemma

In this model we have two types of actors. First one is a former communist secret service officer that passed verification and works as a security service officer (represented by actors A and B in Figure 3) in democratic Poland. Second one is a former communist secret service officer that after the systemic transformation plays a role in a private sector or became a member of an organized crime (represented by actors D and H in Figure 3). Both of them can play with the official rules (in case of organized crime that means not to collude with state officials) or collude with each other (free ride) (in case of organized crime that means free riding either on the whole society or other criminal groups).

While playing according to the rules both actors can acquire only their natural payoff – salary for the officer and profit for the entrepreneurs (both legal and illegal

ones!). When officer plays with the rules and entrepreneur free rides (colludes or bribes other officer), our officer gains only his normal salary and free rider gains his profit and additional rent from the information acquired (parameter  $y$  is there to show that entrepreneurs rent is always higher than the one acquired by free riding officer).

When officer free rides and entrepreneurs play fair the officer acquires his salary and additional rent (from for example bribes) but entrepreneur misses out some opportunities to gain additional profit that he would gain if he had colluded. When both actors collude with each other they not only gain additional rent (that has a monetary equivalent) but also clientelistic rent (that is hard to quantify benefits that are connected with being a part of clientelistic network – like being able to ask influential person a favor or being invited to meetings of “old boys network” (Schaede 1995)).

When we assume that the risk of being punished for collusion is extremely low the dominant strategy for both actors is to collude. This way the systems of incentives supports conflict of interest and makes players act against common interest.

## **6. Conclusions**

One of the key role of social sciences should be to identify which state institutions are the uncontrolled controllers. These institutions are endangered with a situation of conflict of interest because they are very vulnerable to incentives from outside the institution. This rent generating process lead to poor performance of state institution and create opportunities to develop informal institutions that replace inefficient regulators (Dixit 2004) that is more uncontrolled controllers. New Institutional Economics and Game Theory framework can become efficient theoretical perspectives that will allow scholars to describe this phenomenon and provide practical recommendations that help to build efficient state institutions.

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Zybertowicz, Andrzej. 2011. Exclusive Knowledge in the Perspective of Informal Relations. Transparency of Mechanisms of Functioning for Voters, Entrepreneurs, Politicians and Administration,

In The Rentier State: Nation, State and the Integration of the Arab World. London: Croom Helm, 85-98. Beblawi, Hazem, and Luciani, Giacomo. Chaudhry, Kiren. 1997. The Price of Wealth: Economics and Institutions in the Middle East. Ithaca: Cornell University Press. Chong, Alberto, O, Ana De La, Karlan, Dean, and Wanthekron, Leonard. 2004. "Does Taxation Lead to Representation?" British Journal of Political Science 34: 229-49. Ross, Michael. 2012. The Oil Curse: How Petroleum Wealth Shapes the Development of Nations. Princeton: Princeton University Press. Sandbu, Martin. Incentives are crucial to analyzing how markets work. For example, when the price of an apple rises, people decide to eat more pears and fewer apples because the cost of buying an apple is higher. At the same time, apple orchards decide to hire more workers and harvest more apples because the benefit of selling an apple is also higher. That is one reason people drive smaller cars in Europe, where gasoline taxes are high, than in the United States, where gasoline taxes are low. A gasoline tax also encourages people to take public transportation rather than drive and to live closer to where they work. When policymakers fail to consider how their policies affect incentives, they often end up with results they did not intend. For example, consider public policy regarding auto safety. How to Provide Incentives. Reward and recognition activities that are transparent work to build trust with employees. State the timeline and allow a certain amount of time for employees to accomplish the actions that you'd like to see when you communicate the incentives criteria. Reward every employee who achieves the expectations. Tell the employees exactly why their contribution made them eligible to receive the incentive. You also want to avoid doing the same thing every time because those incentives eventually become entitlements. Once they are entitlements, they lose their power to recognize employees or to communicate and reinforce the behaviors the employer wishes to encourage. The Bottom Line.