

Kompromat: A Theory of Blackmail as a System of Governance

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Kompromat in Ukraine



Leonid Kuchma - Former president of Ukraine, 1994-2005



Leonid Derkach, head of Ukrainian state security service.



Yuriy Kravchenko, Ukrainian Interior Minister

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Kuchma to Kravchenko: “This is the mechanism at work here. They have a case on virtually every collective-farm head.... Say, Guys, if you don’t give, [expletive], the number [of votes], say it like that, that are needed, then tomorrow all of you will be where you should be.”

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Why are steps 1 and 2 necessary? Why does the state need evidence of crime to extract resources? Why does the state not extract resources from whomever it wants?

Sketch of a theory of *Kompromat*

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3. Blackmail/corruption benefits central state, not low-level bureaucrats (contra Becker-Stigler 1974).

Mechanisms of citizen power

1. Inappropriate state punishments provoke political unrest.
 - ▶ Example: Executions of leaders of Easter Rising in Ireland lead to Irish war of independence
 - ▶ “Thousands of people in Dublin, who ten days ago were bitterly opposed to the whole of the Sinn Fein movement and to the rebellion, are now becoming infuriated against the Government on account of these executions.... If there be a case of cold-blooded murder, by all means try the man openly, before a court-martial if you like, but let the public know what the evidence is and prove that he is a murderer, and then do what you like with him. But it is not murderers who are being executed.” - Irish politician John Dillon

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2. State needs citizens to provide information to apprehend criminals or to seize criminal assets.
3. Community punishments (e.g. shaming) complement violent state punishments.

Implications of the theory: Examples from Russia

- ▶ Police do not deter crime
 - ▶ “Organized crime would be easier to deal with if it didn’t have protection (*krysha*) in governmental structures, if there was no corruption. We do in fact have all the information we need for a massive attack on criminal groupings: technical information, addresses, contacts, but they are protected from above. So all we can do is to collect *kompromat* and wait for a good moment.” - Russian general in regional anticrime unit

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- ▶ Police corruption benefits central state, not individual police officers
 - ▶ “The evidence suggests that the FSB was facilitating the smuggling activity through an RBOC [Russia Based Organized Crime] group in return for a cut of the profits. *This was not for the enrichment of the officers concerned*, but to raise operational funds for active political measures in Europe that had no Russian ‘fingerprints’ on them.” - Russian mafia research Mark Galeotti

Model: Citizens

- ▶ Continuum of citizens with mass 1. Citizens have legal income:

$$y - mx$$

where y is citizens' human capital (identical for all citizens in base model), m measures negative externalities due to crime, and x is the fraction of citizens who commit crimes.

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- ▶ Citizens who choose to commit crimes get additional income k , so criminals' total income is

$$y - mx + k.$$

Assume that $k < m$, that is, crime is socially harmful.

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- ▶ The state can inflict an additional punishment π after revealing evidence that target has committed a crime, by mobilizing citizens' retributive motivations against target. The state may demand a bribe b in exchange for not revealing evidence of crime. b must satisfy

$$b \leq \pi$$

$$b \leq (1 - t_c)(y - mx) + k = w \text{ (wealth constraint)}$$

Model: State

- ▶ The state spends money on police to detect crimes. The cost of detecting a crime with probability p is $c(p, \lambda)$. Assume

$$c(p, \lambda) \uparrow \text{ in } p$$

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- ▶ State's total revenue from taxes/bribes must be greater than $c(p, \lambda)$ (budget balance condition).
- ▶ Citizens choose to commit crimes if benefit from crime k is greater than expected cost:
 - ▶ $k \geq p[(t_c - t_n)(y - mx) + \pi]$ if state inflicts punishment π on criminals.
 - ▶ $k \geq p[(t_c - t_n)(y - mx) + b]$ if state allows criminals to pay bribe b to escape additional punishment.

Model: Summary

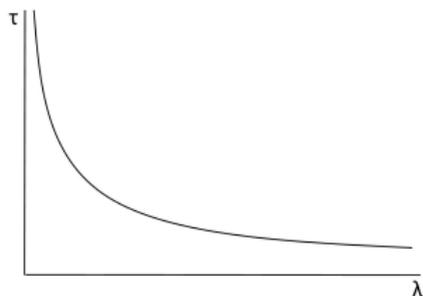
State maximizes revenue by choosing

1. Tax rates t_n, t_c
2. Whether to allow criminals to pay bribe to escape punishment
3. Bribe rate b
4. Crime rate x

Subject to constraints

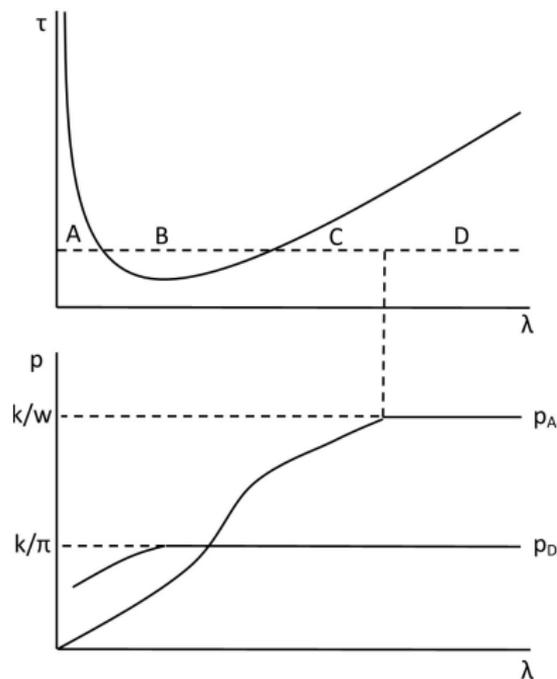
1. Fiscal capacity constraints: $t_n \leq \tau, t_c \leq \tau$
2. $b \leq \pi$
3. Citizen wealth constraint: $b \leq (1 - t_c)(y - mx) + k$
4. Citizen incentive compatibility constraints:
 - ▶ If state inflicts punishment π on criminals, then
 - ▶ $x = 1$ if $k > p[(t_c - t_n)(y - mx) + \pi]$
 - ▶ $x = 0$ if $k < p[(t_c - t_n)(y - mx) + \pi]$
 - ▶ If state allows criminals to pay bribe b , then
 - ▶ $x = 1$ if $k > p[(t_c - t_n)(y - mx) + b]$
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Results when citizens are not retributive ($\pi = 0$)



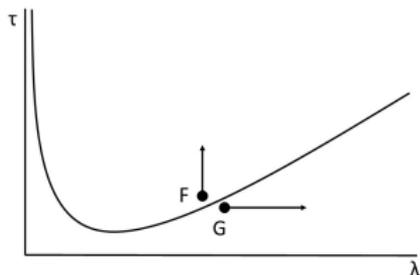
- ▶ Above curve, state deters crime completely ($x = 0$). Below curve, state allows crime ($x = 1$) and spends nothing on police.
- ▶ Criminal justice and public finance are **separable**: If police are used, they are used to deter crime in a socially optimal way. (Application of Diamond-Mirrlees 1971 idea that optimal taxes are characterized by production efficiency.)
- ▶ Higher fiscal capacity τ makes state more likely to deter crime because state can capture a larger percentage of tax base, and so has stronger incentive to maximize size of tax base. (Similar to Olson 1993.)
- ▶ Higher police capacity λ makes state more likely to deter crime because deterring crime is less costly.

Results when citizens are retributive ($\pi > 0$) and wealth constraint binds ($\pi > w$)



- ▶ Segment A: State does not deter crime ($x = 1$).
- ▶ Segment B: State deters crime ($x = 0$).
- ▶ Segments C and D: State does not deter crime ($x = 1$).
- ▶ p_A = optimal level of policing if state chooses to allow crime.
- ▶ p_D = optimal level of policing if state chooses to deter crime.
- ▶ **Failure of separability:** Police may be used to raise revenue, not to deter crime in a socially optimal way.

Dynamics of state capacity when citizens are retributive ($\pi > 0$) and wealth constraint binds ($\pi > w$)



- ▶ Increasing police capacity by moving from F to G moves state from *non-kompromat* regime to *kompromat* regime.
- ▶ High crime in *kompromat* regime reduces productivity, tax revenue, and return from investing in fiscal capacity.
- ▶ Thus investments in police capacity and fiscal capacity can be **substitutes**. State G is more likely to invest in police capacity and less likely to invest in fiscal capacity than state F.
- ▶ Compare to Besley and Persson (2009), in which different components of state capacity are complements.
- ▶ With multiple periods, can generate examples with pictured dynamics, with states F and G diverging over time.

Historical causes of *Kompromat*: The legacy of the Soviet Union

- ▶ Model implies that *kompromat* is more likely to appear when fiscal capacity is low and police capacity is very low or very high.
- ▶ Essentially no tax bureaucracy in Soviet Union because taxation mostly meaningless in command economy. No equivalent of IRS.
 - ▶ “From the 1930s to the present time there has been no real taxation system in the USSR, so the task now is not a tax reform but the establishment of a whole taxation system from scratch.” - Sergei Aleksashenko, former deputy governor of Central Bank of Russia
- ▶ Very large Soviet police bureaucracy (the KGB). KGB not reformed after fall of Soviet Union, systems and personnel of KGB continue to form core of present Russian security agency (the FSB).
- ▶ Soviet legacy of unusually low fiscal capacity and unusually high police capacity may help to explain *kompromat*.

Additional results: *Kompromat* and inequality

- ▶ Suppose there are two classes of citizens (rich and poor) with different levels of human capital $y_r > y_p$.
- ▶ With plausible parameter values, state allows rich but not poor to commit crimes.
- ▶ Intuitively, blackmailing rich is more profitable than blackmailing poor.
- ▶ Allowing rich to commit crimes increases inequality between rich and poor.

Additional results: Retributive motivations and welfare

- ▶ Previous authors (Sethi and Somanathan 1996, Boyd et. al. 2003, Bowles and Gintis 2011) have argued that retributive preferences increase material welfare by increasing cooperation, and hence that retributive motivations are favored by evolution.
- ▶ Key assumption in this argument is that information about crimes diffuses automatically through the population.
- ▶ I assume that a strategic actor, the state, gathers and chooses whether to broadcast information about crime.
- ▶ Increasing strength of retributive motivations (increasing π) can reduce material welfare by increasing wasteful spending on police used for blackmail, or by increasing crime rate.
- ▶ Evolved retributive motivations may have become maladaptive with modern broadcasting technology.