

## Shangri-La Governance

A Sketch of an Integral Solution for European Economic Policy based  
on a Synthesis of Europe's Problems

Hardy Hanappi

Email: [hanappi@econ.tuwien.ac.at](mailto:hanappi@econ.tuwien.ac.at)

Homepage: <http://www.econ.tuwien.ac.at/hanappi>

Institute for Mathematical Methods in Economics

Vienna University of Technology

(Revised version<sup>1</sup>: 13-10-2012, Hanappi\_2012s)

### Abstract

This chapter provides a preview of what governance in a better future state, Shangri-La governance, should take care of. The starting point for each policy feature, of course, is a contradiction that contemporary political economy cannot solve – what appears as problem already incorporates the ideas of its solution. Problem areas are grouped as corners of a hexagon. A sketch of an overarching policy program derived from existing contradictions is presented. The main result is that the different policy areas are so tightly linked that only a holistic approach – taking care of all corners of the hexagon simultaneously – can promise success. Piecemeal engineering in isolated corners, i.e. what is currently happening, is bound to fail. A newly formulated overarching European economic policy clearly will include the particular role to be played by Eastern European countries. After almost ten years since the enlargement of the EU to central and Eastern European countries it is remarkable that this integration does *not* occur as one of the six major contradictions to be solved today. Quite the opposite is formulated in the concluding paragraphs: Despite the many shortcomings and – hopefully mostly transitory – disadvantageous developments in several Eastern states an overall assessment of welfare implications of integration can hardly ignore the positive net effects. These many-layered experiences can, and should be considered as a kind of historical laboratory experiment testing if cohesive forces within the EU are strong enough to assure the survival of this political entity – and this test has been passed.

### Introduction

In economic theory a synthesis of divided analytical results seems to be urgent. The last decades of research have been characterized by an acceleration of the narrowing down of the scope of each phenomenon under investigation. The methodological imperative driving this development has been the priority given to rigorous treatment using a unique

---

<sup>1</sup> A first version of this chapter was presented at the Stockholm conference of the EU COST Project IS0902: 'Systemic Risks, Financial Crises and Credit' (<http://www.worldfinancialcrisis.eu/>) in September 2010.

mathematical apparatus developed for the natural sciences. Since broader social phenomena usually escaped the modeling possibilities of this toolbox the standard procedure adopted was to assume these difficulties away: the model was allowed to be inadequate to reality in order to be solvable with the standard formal method. It was a facilitating preparatory work first to divide and to isolate parts of a phenomenon: Smaller problems with less essential endogenous variables did lend themselves to archaic formal modeling much easier. Nevertheless each of these reduced formal exercises was using rather different 'heroic assumptions', stemming from the different specificities found in the real economic world. The only remaining binding element between all models was the formal language they used. Seen from this perspective the (formal) convention to consider only equilibrium points to avoid problems with non-linear dynamics can be interpreted as an attempt to provide social identity of a certain group of economists. Equilibrium modeling became an orthodoxy, which on the other side of the coin was characterized by a falling apart of topics approached as soon as it tried to describe real economic phenomena. Only in its most abstract form, as general equilibrium theory, it achieved a universal understanding. But this was not an understanding of the real economic world; it only was the void understanding of its own abstract implications.

Parallel to a highly specialized microeconomic theory of the representative firm, a utility theory, a pure and a monetary theory of international trade, a theory of social choice, a real business cycle theory, and the like – all based on the same equilibrium dogma – the last decades also saw an explosion of different new methodologies. Since the current crisis has revealed the impotence of the orthodox dogma with respect to economic policy, it is tempting to propose a reversal of the basic strategy. The diversity of methods has to be accepted as an advantage – and it is the object of investigation which is the unifying motor. Reality drives science instead of methodological unity forcing the dynamics of reality into a static prayer without real correlate. From a scientific point of view such a change certainly looks attractive.

Leaving the equilibrium world behind, a first glance at actual life processes immediately shows one basic characteristic: Evolution proceeds in sequences of sudden pushes, thus (at least) two types of models are needed: In one model dynamics have to be slow enough to serve as (almost) constant background for the fast dynamics described by the second dynamics. Moreover innovation of new essential variables and processes, as well as extinction of old elements plays an important role. For these types of models, focusing on a transient build-up of social structure, a changing set of models, as diverse and heterogeneous as at first sight the reality it addresses appears, is adequate.

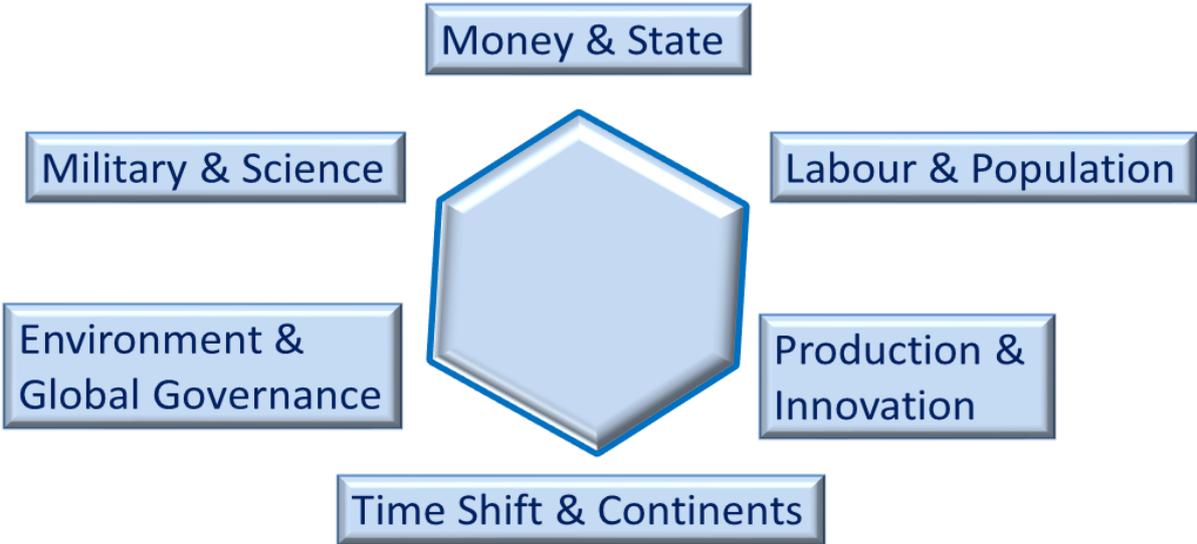
If it is not a methodological canon which provides the unity of the social sciences but the fact that it is *one* real world – outside all modeling languages – that has to be understood, then descriptions of the most pressing contradictions of this world are the best starting point. Contradictions indicate what is least understood - relative to a quickly increasing urgency. Bringing these contradictions under a common overarching interpretation can be a tool for a preliminary research program of the social sciences. It is evident that interpretation has to

be founded on historically observed trajectories, there simply is no alternative. The further the impact of contradictions is projected into the future, the longer the look back into human history has to be; far reaching interpretations of the past are mirroring daring speculations about mankind's future. Again there is no way to avoid speculation. Contemporary contradictions first are short-run pointers to the future, only more history encapsulated in a slow dynamics model informs long-run *reasonable* speculation<sup>2</sup>.

This chapter takes a first few steps along this methodological route. It identifies six major fields of contradictions and then works on the links between them to encompass the overall understanding of the current crisis. This approach at the same time provides the possibility to formulate the economic policy measures which could overcome the six fields of outstanding contradictions. They show what governance in a world that got rid of these problems will be able to do – they are foreshadowing 'Shangri-La Governance'.

**1. Cornerstones of Political Economy – a Hexagon**

The so-called Washington consensus has been a doctrine of global economic policy that consisted of some crude conservative rules of thumb becoming prominent during the Reagan era. The Pentagon tried to enforce these rules on the global economy via IMF and Worldbank, to some extent the deep crisis since 2008 can be traced back to the misconceptions inherent in the Washington consensus of the Pentagon. In contrast to the Pentagon plan the hexagon of main contradictions and their proposed solutions proposed below are designed to overcome this crisis (compare figure 1). Let a hexagon replace the Pentagon consensus:



<sup>2</sup> It was Hegel who distinguished between reason ('Vernunft') and rationality ('Verstand'). Reason always has to be speculative while rationality is a behavioural mode based on deduction of results from assumed facts with the use of a predetermined formal apparatus. Nevertheless speculation not necessarily is a blind guess; it can be well-informed leading to a so-called reasonable speculation.

## Figure 1: A hexagon of main contradictions

A brief description of each corner is necessary.

*Money & State:* A deep crisis usually surfaces first as an avalanche of bankruptcies in the area of interbank payments, it appears as solvency crisis. This is due to the fact that collaterals – an integral part of any credit contract – during times of low crisis expectation are not touched upon. But if crisis expectations increase beyond a certain socio-psychological threshold, then a sudden run for liquidity of almost all agents sets in and leads to a simultaneous breakdown of the weakest financial intermediaries. This process urgently needs theoretical clarification leading back to an understanding of the foundations of the central notions of money, credit, and capital (compare (Hanappi, 2009)). As any symbol system of social value, i.e. money, needs a carrier system (e.g. an e-payment network) as well as a political power system to enforce it, i.e. state power, it is evident that money forms and state forms have to be discussed and designed under the same header<sup>3</sup>.

*Labour & population:* The interbank crisis quickly and via numerous channels initiates a crisis in production units. As interest paid by these units to banks and insurances are part of the profit they extract from employing workers, they necessarily will immediately go for drastic reductions of cost. And for those units, which are unable to do that the wave of bankruptcies will swap into the production sphere of the economy. As the states are trying to reduce their budget deficits (which are additionally burdened by the interest paid for the banks' debts that have been transferred to the state) by lowering social transfers and increasing taxes the problem is aggravated. Bankruptcy of financial intermediaries and production units in all areas leads to severe unemployment. In the second stage of a deep crisis the interruption of the income stream of the majority of the population even in richer countries cannot be compensated by a depletion of stocks of savings any more - consumption levels fall. Problems of employment organization that already existed before the crisis (full-time, high-skilled, high-pay versus unemployment of low-skill; old-age employment versus youth employment; etc.) get worse. Social unrest based on rising poverty makes governance difficult and a turn to radical political solutions knocks at the door of capitalist democracies.

*Production & innovation:* While the disappearance of firms with insufficient productivity increases in the course of usual business cycles is a customary – in the aggregated long-run even beneficial – phenomenon, the deep crisis changes the context. It does not make sense to wait for surprising technical innovations that can drag the economy out of depression, the political and social context does not allow for the courageous entrepreneurial activity that was the motor of the labor productivity growth cycles during capitalism's heyday. Indeed the concept of innovation suddenly changes its character: It is a large-scale, socio-political innovation, which becomes necessary – and once it has been achieved, advanced societies

---

<sup>3</sup> The transfer of debt of financial intermediaries to government debt, which characterized the second stage of the crisis, is just another manifestation of this unity of the problem area 'money and state'.

will face only small-scale innovations allowing for material reproduction on a continuous high level<sup>4</sup>. Of course, this issue only concerns advanced economies like the EU countries<sup>5</sup>. Strong traditional growth processes have to take place in the poorer parts of the world, the new European regime is only one side of a global disparity, which will have to be consciously overcome.

*Time shift & continents:* This cornerstone addresses both sides of the just mentioned unequal development – the relation between first and third world – and therefore sets Europe’s problem into a global context. The central observation on which this contradiction is founded concerns the ability of global capitalism to amplify existing uneven stages of development in order to extract additional surplus value<sup>6</sup>. If – in the times of the Western trade triangle in early capitalism - wealthy British merchant ships exchanged with rulers of African tribes new technologies to exploit the local population against black slaves, which they carried (and sold) to America’s cotton field owners, then this whole (capitalist) procedure cemented the pre-capitalist political economy in Africa and America. The socio-economic state of development of continents during colonialism, despite or even because of new military technology, drifted further and further apart. After the two world wars a comparable development during the second wave of globalization could be observed. Travelling today from one continent to another continent the traveler experiences a time shift<sup>7</sup>: Outside the small enclaves of militarily secured outposts of advanced capitalism in some big cities of Africa, South America, and Asia there is a society living in a different era. How to cope with this contradiction, which capitalist interference is less and less able to exploit for additional profit-making, is not Europe’s problem only. But Europe can and should be developed into a pilot project, which shows how to overcome the contradicting forces.

*Environment & global governance:* As just hinted at, only global governance can go beyond Europe’s role to be a good pilot project. This not only concerns the previous cornerstone, where global governance will have to tame the exploitative forces of local national elites and transnational corporations. Most important will also be a conscious reframing of global policies concerning environmental conditions. The range of problems is rather wide, from water and energy resources, CO<sub>2</sub> pollution, to information pollution by media empires. In a sense to solve this set of policy questions will remain a core activity of Shangri-La governance.

*Military & Science:* This last cornerstone needs most explanation. As all other cornerstones it is composed of two concepts. As some readers might have noticed the sequence of the two words usually hints at a process: From the more abstract to the more concrete, from the less specified to the more involved, policy-oriented concept. This is also true for this last cornerstone. Coercive power, brutal physical force, which in modern times is organized in

---

<sup>4</sup> Fortunately enough the human mind seems to be sufficiently malleable to experience this (materially modest) type of ‘reproductive innovation’ as growth of personal utility.

<sup>5</sup> See (Hanappi, 2012a) for a summary of Joseph Schumpeter’s contribution to this point.

<sup>6</sup> Compare (Hanappi, 2011a) for a more detailed treatment of this property.

<sup>7</sup> A similar point has been taken up by Bob Jessop, compare (Jessop, 2004).

military and paramilitary troops of fighters, always has been a vital element of political economy. An almost natural counterpart to coercive power is knowledge, which in organized form is called science. From the age of first social forms onwards knowledge has mainly been used to extend the reach of coercive power. In the middle ages a king spread the message of an example of how cruel disobedience had been punished to all subjects to frighten them – and save cost for individual punishment expeditions. Transforming coercive power into internalized informational power did breed first religion and later science to do so. But starting with the revolution of the natural sciences during the 17<sup>th</sup> century sciences started to gain a life of their own. While coercive power always aimed at taking away growth possibilities of others to advance the own might, scientific activity – first usually under an umbrella of a strong coercive monopoly – tended to show that cooperative efforts creating a new inter-individual subject called ‘science’ can dispose of the zero-sum mode of behavior of coercive agents. Science started to free its activists somewhat from the role of supporters of a coercive ruler. Till today any fallback into a military regime has been accompanied by a push for power expanding military science paralleled by fierce oppression of critical free science. One can indeed interpret the struggle for democracy (or communism) as a struggle against coercive dictatorship; a struggle, which needs science to provide organizational algorithms, which shall substitute the coercive ruler. Today’s global political economy is characterized by a return to military solutions, to solutions with the help of direct coercive power. This concerns inter-state conflicts, intra-state conflicts, and the rise of criminal activities on all levels. Pro-military scientific knowledge is used extensively across all borderlines of all conflict parties on all levels<sup>8</sup>. Critical, pro-democratic science is in the defense. In short, this cornerstone marks the danger of a third world war, and the need for a community – a unity - of critical scientists to prevent it. The second concept, science, thus is pointing at political action again.

After this quick tour of explanation a similarly brief overview of how a possible solution to each of the problems might be circumscribed seems to be appropriate (compare table 1).

**Table 1: Contradictions and proposed solutions**

<b>Cornerstone</b>	<b>Problem</b>	<b>Solution</b>
<b>M</b> oney & State	Liquidity & Solvency	From profit-oriented accumulation to innovative reproduction
<b>L</b> abor & Population	Unemployment	From private rigid labor time extraction to flexible public labor time organization
<b>P</b> roduction & Innovation	Bankruptcy	From ideology to design
<b>T</b> ime Shift & Continents	Exploitation	From exploitation of the unequal to the benefits of diversity
<b>E</b> nvironment & Global Governance	Pollution	From general evolution to the human species
<b>M</b> ilitary & <b>S</b> cience	War & Crime	From coercion to democracy

<sup>8</sup> Most frightening, it currently is invading the minds of a whole generation of children playing war games on the internet.

*Reproductive innovation* is a new concept developed more comprehensively in other papers (Hanappi, 2010, 2012b). It indicates that innovation will also play an important role in Shangri-La, in the future mode of production, but that the concept will change its meaning dramatically. Social and technical innovators will have to be motivated directly to increase the utility of the users of their intervention, without necessarily increasing the number of commodities produced.

The term '*flexible public labor time organization*' shall transport the message that how many hours have to be worked in which production or service, and to which extent this occupation is organized by a firm or a public institution, are questions waiting for a radically new design. Again in (Hanappi, 2012b) some preliminary answers are sketched.

The '*benefits of diversity*' in this context are to be understood as an evolutionary device: The trajectory which today's leading OECD-countries have historically experienced – and which makes their rulers so sure that they can consider them as 'most advanced' – is just one of many possible development paths. For other continents this history will not repeat itself. The diversity of their starting points has to be considered as a pool of possible trajectories – each set characterized by strong interdependence of continents. Fortunately – and in contrast to Richard Dawkins, (Dawkins, 1986), view on biological evolution – political economy has not to wait for a 'blind watchmaker'. Humans can take their future fate in their own hands by designing their future actions, by producing and using science. To mentally select a scenario in a set of simulated futures is fundamentally different to being selected or extinct in real time. The pool to select from, the diversity of global starting points, indeed enriches the evaluation procedure – and this presupposes a global government. It is in this sense that the benefits of diversity can contribute most.

The place of '*human evolution*' as part of general evolution is a surprisingly little discussed topic in evolutionary economic theory. The often heard immediate imperative proposed by environmentalists is that human evolution shall be sustainable and compatible to the evolution of all other species – a kind of human biotope. This view is completely incompatible with the positive view on growth of the species, which has been developed by our species. What is even more disturbing is the fact that emergence of a new species as well as the extinction of a species is a non-topic when it comes to the human species. All these questions are left to science fiction authors. The concept of a species itself is by far not univocally defined in the moment, discussions on the usefulness of the concept of sustainability abound. In other words, sound theoretical foundations for the formulation of the goals of global governance are still missing! This is a theoretical task, which cannot be delegated to biologists; it needs social scientists, evolutionary political economists. Only the latter can come up with scientifically underpinned long-run visions that can organize political forces. Since similar arguments can be made for the design of global governance in other areas, this cornerstone is dictating a heavy load of theoretical work.

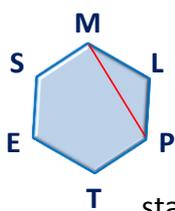
The quick and dirty lines of argument provided above are far from being self-evident. They are just used to serve the following three purposes:

- To express what topics in the current global political economy are particularly urgent.
- To show that all of these topics are closely linked.
- To provide some confidence that these problems – and how these problems – can be solved.

With respect to the second point the next chapter will add more flesh to the argument.

## 2. Using the Hexagon's Links

Moving along the edges of the hexagon is an informative exercise, but only covers a part of the highly interwoven dynamics between cornerstones. The following paragraphs provide entry points to the interplay, the partially contradictory influences between two selected non-neighborly edges of the hexagon. All possible pairs are covered, but the already existing theoretical discourse on each of these pairs clearly can only be briefly referred to.



### **Money & State – Production & Innovation**

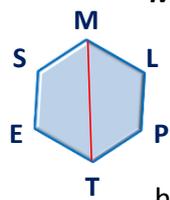
Political control exerted by the state sets the stage for possible actions of production units. Production units outgrowing the domain of a single nation state clearly can combine different political settings in different nation states to optimize profit-maximizing actions: Produce in a nation state with the low wage cost and advantageous labor laws, sell in rich nation states with a rising national currency, pay taxes in nation states with low taxes, and so on. This indicates the need to install internationally powerful political institutions to counterbalance the space of actions of a particular part of the production structure, the transnational corporations (TNCs). For TNCs the part of their activities which could be labeled 'exchange rate exploitation' has become of overwhelming importance. It involves not only the use of continued devaluation of third world currencies and tax paradises, but also the extraction and the focused use of household savings in OECD countries for activities at stock exchanges. Shangri-La governance will need a well-designed structure of political institutions reaching up to the global level to be able to restrict the activities of TNCs, legitimizing only those which are globally welfare enhancing<sup>9</sup>. The concept of 'state' thus assumes a more general meaning: It refers to a node identifying a specific political institution within a hierarchical structure of global governance.

A most important element of this global governance concerns the policing of a sign system representing social value, i.e. a global currency system enabling **money transactions** and **finance of innovation**. The demand for money transactions dispersed in space, though greatly improved by the use of electronic carrier systems of social value signs, still is in

<sup>9</sup> There is an exploding body of economic literature trying to explore these new challenges, be it under the header of new economic geography, e.g. (Navaretti & Venables, 2004), be it in an attempt to reconcile it with mainstream approaches to international trade, e.g. (Markusen, 2004).

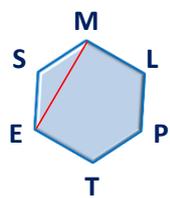
desperate need for global regulation<sup>10</sup>. Policing the distribution of money transactions over time is an even more demanding task. Coins carried by household members are concerned as well as whole national pension systems expressing a contract between generations. The former example seems to be solved easier since the average social value of the coin carried in the pocket will not change dramatically during the time it stays there<sup>11</sup>. The latter example, due to its longer time horizon will have to consider the changing social values involved in technical and social innovations. Regulation by political authorities therefore becomes intermingled with the core activity of entrepreneurial production units doing innovation<sup>12</sup>. Interplay between the risk-taking explorations of certain production units on the one hand and the needs and scope related and available for these activities set by political institutions on the other hand becomes mandatory. The annually reached bargaining results between these two sides, the 'stability party' and the 'innovation party', will then have to be translated into interest-at-risk augmented money flows policed by political institutions, by states (in the more general sense). Since these flows occur at points in time far away from each other, they appear as contracts about flows, and in this form need strong and enduring political authority to be trusted in. Note that strong states need very strong and highly sophisticated democratic control.

#### **Money & State – Time Shift & Continents**



Global governance taken care of by one global state includes the idea of one global currency expressing one global system of social values of commodities and services. Even this simple straight-forward statement immediately shows how demanding – though in the long-run indispensable – this task is. Exploitation via deteriorating exchange rates of the third world has to be stopped. Production in the first world has to be redirected towards more commodities designed for underprivileged people in the third world, despite lacking effective demand. Education systems for all parts of the world urgently need an upgrade.

#### **Money & State – Environment & Global Governance**



Which environmental goals should receive which attention? By drawing on all available expertise, i.e. science, plus the vote of taxpayers a global government should then decide how much social effort, i.e. money, should be spent on every task. The income of a global state will have to be collected by

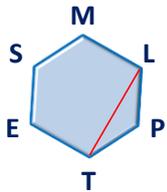
<sup>10</sup> To some extent these questions have been discussed in traditional monetary theory and international finance, e.g. (Walsh, 2000), (Shubik, 1999), (Mishkin & Eakins, 2009), and (Mishkin, 2010).

<sup>11</sup> Indeed inflation can be interpreted as a compression of (economic) time, which is doing exactly that: Reducing the social value represented by coins in the short-run. For the short-run political regulation thus boils down to prevent inflation and deflation. While the former hurts the owner by reducing the purchasing power of his coins, the latter would induce to delay any purchase, and therefore would paralyze economic circuits. Standard policy prescriptions for national banks evidently reflect this short-run stability goal.

<sup>12</sup> Not all production units are involved in innovation, but those which are will play an even more important role than today. Their future aim will be to increase overall utility of the human species, call it welfare (compare e.g. the discussions surrounding (Bentham, 1789)), (Sen, 20120), and (Roemer, 1996)), by means of technical and social innovation. A rich set of literature on innovation has started to blossom in the last decade.

taxes, and exactly these taxpayers (by the use of a probably rather sophisticated democratic algorithm) will co-determine the weighting scheme of importance. As Jessop already argued more than 10 years ago there is a contradiction between national state power and global environmental concerns, a contradiction that breeds the need for a global political authority. (compare [Jessop, 2000]).

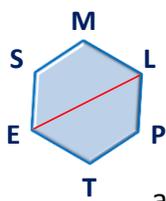
### ***Labor & Population – Time Shift & Continents***



Flexible labor time organization cannot stop at the borders of continents. Historically seen waves of large-scale migration typically were a consequence of political catastrophes or large natural disasters, but diverging employment and wage differences are a permanent source of migration decisions too.

Though a more fluid mixing of the global population has its advantages (it activates creative diversity, see above), it nevertheless should not be based on a divergence of living conditions in different continents. Unfortunately migration flows without political intervention will work exactly in this disastrous direction: Most educated and able parts of the poor continents' population will emigrate and make the gap between continents continuously larger. This implies that incentives for migration in the opposite direction have to be developed and implemented rather quickly.

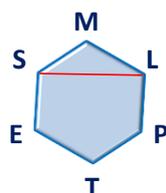
### ***Labor & Population – Environment & Global Governance***



Traditional labor union policy cared mainly about real wages and job security; environmental questions were out of focus. More recently part of the workers in leading OECD countries are getting a bit more concerned by rapidly deteriorating environmental quality, while the working population in all other parts of the world still remains mostly ignorant. It can be expected that

environmental dynamics will teach the human species a lesson soon – the hard way, of course. As critical science is in the defense it gets less and less voice, also in this respect – only sporadic and singular warnings reach the public. The immediate policy conclusion therefore is that critical science and environmentalist concerns have to form a coalition to prevent the worst. And this coalition has to mobilize the global working population, a process which in turn can be an additional route towards reasonable global governance.

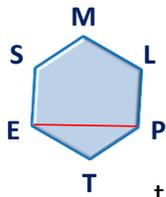
### ***Labor & Population – Military & Science***



As history shows, high unemployment can be reduced by a government with the decision to start a military conflict. Military draft can send previously unemployed persons to the battlefield, a fallback on coercive

solutions can have economically beneficial consequences in the short-run (e.g. the surge of the US Dollar in the course of Middle East wars), and can even win a democratic election (e.g. Thatcher after the Falkland war). Military science can anticipate these effects and can consult politicians; a turn towards external aggression in case of internal troubles is an all-times classic of policy consulting. But even without external outlet military solutions might

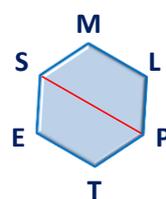
help to solve domestic problems with the labor force. One has to keep in mind that the most primitive form to extract surplus value from a worker is not a labor market with many unemployed. It is the simple threat of coercive power, e.g. of being tortured, which can induce people to work for the benefit of others. The return of this more primitive form of exploitation – at the limit to what used to be considered a crime – is what typically takes place in the course of a deep crisis<sup>13</sup>.



### ***Environment & Global Governance – Production & Innovation***

These two cornerstones go together particularly well. Reproductive innovations in the field of environmental improvements, which then are turned into global solutions by global governance – this is the stuff visions can be made of. But there is more: To find the place of the human species in the overall evolution of the planet (compare the solution column in table 1) implies a certain type of interactions expressed as material exchange supporting our species – and this is what today is called production structure. To turn production processes on their feet, namely on the quantitative material exchanges which they are, does not mean that the consideration of social values attached to these quantities loose importance. Social values, including the visible price structure into which they are transformed, are turned upside down too. Instead of a vaguely defined global agent that recently has been dubbed ‘financial markets’, and which is thought to determine all actions, the possibilities of diverse and well-defined market mechanisms are subordinated to conscious explorations along the lines of reproductive innovation. As markets are finally understood as what they always were, namely possible frameworks of rules, their diversity becomes a toolbox for investigating utility increases beyond the basic biological needs. The subject using this toolbox for well-specified areas (excluding basic biological needs) is the global government, which governs with its help the adaption process of production structures. A more detailed treatment of such a ‘grand design’ for Shangri-La goes beyond the scope of this chapter.

### ***Military & Science – Production & Innovation***



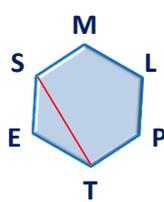
To organize the personnel of a capitalist firm in the same way as a general organizes his army is a rather traditional, though still predominant prescription. As such it has stimulated lots of studies in organization theory concerning the obvious contradiction between exchanges of products of capitalist firms – relying on market mechanisms – and exchanges within capitalist firms – organized as hierarchical command structures<sup>14</sup>. The long-run emancipatory move away from military dictatorships with hierarchical structure towards democratic feedback control of societies as far as capitalism is concerned was stopped at the doors of the privately owned factory. And till today much of the ‘scientific’ literature on firm organization reads much like a proposal for *troops* and *divisions* to brought into a *formation*

<sup>13</sup> Labor productivity increases during Fascism as well as the flourishing of the different kinds of global Mafia organizations are outstanding examples of the success of coercion as a means of exploitation.

<sup>14</sup> A classic text on this topic is (Williamson, 1983).

which can *conquer* 'the market'. Concepts like '*charismatic leadership*' and '*corporate identity*' are obviously shared by theorists of military and management. In Shangri-La this last bastion of hierarchical dictatorship, the capitalist production unit, has to give way to a more civilized, a more democratically oriented type of production unit. The idea is not new, and many dead alleys of 'labor-managed firm organization' have already been visited<sup>15</sup>. But hurdles appear to be finally mastered; there is no reason to believe that reconciliation of democratic feedback loops at the micro-level (production units) cannot be reconciled with Shangri La governance at the macro level. Solutions certainly have to be sophisticated, but already existing contemporary technical abilities to support them should never be underestimated.

### ***Military & Science – Time Shift & Continents***



The mechanisms of colonialism did teach an important – though rarely understood – lesson to theorists of political economy: A fallback on purely coercive politics on a global scale allows for a more sophisticated democratic handling of class struggle in the domestic economy of the imperial power. Export of coercive methods then allows local rulers in a colony to cement their exploitation mechanism, thus pushing back revolutionary forces and increasing the time lag between continents. The neo-colonial traits of US-policy after World War 2 (e.g. in Saudi Arabia) as well as the policies of some European countries (e.g. France and Italy) in North Africa show that this type of strategy has not ceased to exist with the fall of the old imperial regimes in World War 1. Of course military technology and scientific support for international political strategy have experienced incredible advances since. But the methods remained the same: Support for dictatorial leaders in North Africa to keep immigration to Europe at the doors was used and worked well until the Arabian Spring in 2011; crude oil exports from Saudi Arabia (OPEC's swing producer) to the US petroleum firms were never closed down as the Saudi regime always was supplied with weaponry needed to suppress internal or external revolt. Fortunately enough, modern means of strategic analysis (e.g. game theory) cannot only help the neo-colonial power to design such policies; it also can be an instrument for progressive forces to understand how a transition towards Shangri La governance can be initiated.

This ends the circle around possible connections of nodes of the hexagon. The many topics and ideas that only could be touched upon should show how fertile the proposed structure is. Additionally it should have become clear that it is not possible to single out a problem to do an isolated, partial analysis for this problem only. The nodes of the hexagon are much too tightly interwoven to allow for such a treatment, it needs the view on the whole network to understand the evolution of a single node. In other words, the next big task for social science is synthesis – an extremely difficult and highly sophisticated synthesis.

---

<sup>15</sup> Compare e.g. the early discussion between Benjamin Ward and Branko Horvat, (Ward, 1957, 1959) and (Horvat, 1959, 1986).

The good news is that there already exists an enormous amount of highly specialized research. In each field somewhat different research methods are used to draw conclusions from growing datasets and more or less explicit (hypothetical) theoretical models. What is urgently needed are efforts to synthesize the major results of the different disciplines. Such a synthesis will evidently imply that a certain selective screening and filtering of what is essential in each discipline has to take place. This filtering should not proceed exclusively along the lines of methodology used. There is a broad set of valid methodological approaches which is not to be ranked with respect to scientific value<sup>16</sup>.

From the perspective of scientific practice what is needed is well-organized teamwork of many transdisciplinary researchers. Today no single researcher can be expected to oversee advanced research in more than two (neighboring and narrowly defined) disciplines, the amount and permanent growth of contributions is simply too large. Communication within an advanced research team with only few possible links becomes the crucial issue. But unfortunately communication between researchers, due to institutional and mental intervention of capitalist ideology (in particular in the social sciences), has run into a stalemate: Competitive behavior (keeping results secret, unsound ideological attacks, monopolizing research funds, and the like) dominates all cooperative possibilities. Indeed across the social sciences there would be some sure candidates for building bridges:

- Game Theory in the perspective of John von Neumann
- Input Output Analysis in the sense of Leontief
- Computer Simulation of the Interaction of Heterogeneous Agents (ABS)
- Network Analysis including Fractal Analysis
- Discrete Choice Econometrics

Science policy in Shangri-La will immediately change the unfortunate situation of today's 'science in a capitalist mode': All research will be financed by tax revenues, and the value of scientific contributions will be judged with respect to its overall contribution to current and future social welfare<sup>17</sup>.

---

<sup>16</sup> Today Hegel's famous remark attributing the highest stage of scientific development to the most abstract science, i.e. mathematics, is not plausible any more. The fundamental insight, which emerged since Hegel's time, was that any formalism owes its structure to the object of investigation from which it had been abstracted. With the evolution of external objects (not belonging to the world of language) new formalisms are needed for new objects of investigation. Contemporary mathematics is the language of theoretical physics, of rules for relations between inorganic (entropy increasing) matter. When John von Neumann tried to envisage a new object of investigation, (entropy decreasing) human society, he suggested a far-reaching adaption of the existing analytical apparatus, called game theory. But this was only one specific attempt to meet the new challenge. With new objects emerging, empirically oriented research methods periodically gain new importance – Hegel's original image of a ladder of scientificity should be replaced by a pulsation of an ever changing set of partially new scientific languages.

<sup>17</sup> This change immediately gets rid of the current neglect of basic research, which occurs due to the time horizon of short-term profit maximizing firms. Furthermore the (more difficult and more sophisticated) evaluation with respect to the whole society's welfare implies an important role for democratic mechanisms that are needed for social aggregation.

## Conclusion

As a conclusion first some implications for Central and Eastern European states can be highlighted. It is a fact that the Eastern enlargement of the EU took place several years before the deep crisis hit the world economy. But even at that point in time the integration process that had started with the end of the Soviet Union was already more than ten years old. During this whole long period transformation did take place in a continuous and peaceful way. Though many commentators are repeatedly complaining that the process has been too slow and too heterogeneous across countries, the plain fact is that it has been a permanent feature – and looking back this should indeed produce astonishment and admiration. Even the property that each of the new countries followed its own development path – making them hard to compare and torpedoing most attempts of conclusions on aggregates – should be seen as a precious experience: Diversity is possible and improves stability in particular as environments are getting rough. It only can be speculated what would have happened if indeed the first prescriptive vision of the early 90-ties (e.g. made by Jeffrey Sachs) had come true, namely a US-like capitalist system in each country within 100 days. Most political economists today would consider this a nightmare; all being alike would imply that all would fall simultaneously as soon as a severe shock strikes. Europe now has a first prove that diversity has advantages: productivity levels and changes of these levels can coexist in particular if they concern different commodities and services; different speeds of development can be very beneficial if speed concerns a broader cultural evolution and not just the metaphysical microeconomic-theory-concept of income-derived utility. Many other diversity driven improvements could be mentioned. The Eastern European experience thus should provide additional necessary optimism to engage in the pilot project Europe.

Perhaps a few statements that emerged during this long line of argument, some in between the lines, shall be kept in mind:

To describe Shangri-La Governance is to produce a focal point to serve as orientation for current improvements. It should discourage useless piecemeal engineering aiming at saving the currently existing flawed system.

Contemporary contradictions and speculative visions can be the poles and the sources of inspiration for social research and policy<sup>18</sup>.

An enormous amount of knowledge in economics has turned out to be of no social value – the quest starts anew. Those scholars whose intellectual capital stock has been completely devaluated will not give up their institutionalized academic strongholds, but will fight to the bitter end to keep any challengers at doors. For the new quest new organizational forms will be needed.

But as informed visions of a secularized Shangri-La seem to be possible<sup>19</sup> – the bottom of Pandora's Box is reached.

---

<sup>18</sup> Some more general methodological thoughts are summarized in (Hanappi, 2011b).

---

<sup>19</sup> It has to be stressed again that for this goal all parts of the social sciences have to become one effort. As Oliver Kessler put it: ‘...an understanding of the roots, dynamics, and consequences of the crisis cannot be confined to just economic, sociological or political considerations. The “traditional” categories of international political economy or even economic sociology are inadequate. ... existing disciplinary boundaries might be more part of the problem than part of the solution.’ (Kessler, 2009)

## Bibliography

- Bentham J., 1789, *Introduction to the Principles of Morals and Legislation*, published by J. H. Burns/H.L.A. Hart (The Collected Works of Jeremy Bentham), 2<sup>nd</sup> edition, Oxford 1996.
- Dawkins R., 1986, *The Blind Watchmaker*. New York: W. W. Norton & Company.
- Hanappi H., 2009, *Money, Credit, Capital and the State. On the evolution of money and institutions*, invited paper at the Verein für Socialpolitik (Ausschuss für Evolutorische Ökonomik) July 2009 in Jena. The updated version will be published in a forthcoming book edited by Uwe Cantner with Springer in 2012. On the web: [http://ftp.econ.tuwien.ac.at/hanappi/Papers/Hanappi\\_2011B\\_22\\_04\\_11.pdf](http://ftp.econ.tuwien.ac.at/hanappi/Papers/Hanappi_2011B_22_04_11.pdf)
- Hanappi H., 2010, *From Growth to Innovative Reproduction. A Roadmap for a European Model of Evolution*, paper presented at the EAEPE Conference 2010, October 28-30 in Bordeaux. Published as [MPRA Paper No. 29062](#).
- Hanappi H., 2011a, *Deepening Contradictions. From Exchange Rate Exploitation to Fascism*. Manuscript on the web: <http://www.econ.tuwien.ac.at/hanappi/publications.html> .
- Hanappi H., 2012a, *Schumpeter*, in: Handbook of the Theory of the Firm (eds. Dietrich and Krafft), Edward Elgar publ. London.
- Hanappi H., 2011b, *Signs of Reality - Reality of Signs. Explorations of a pending revolution in political economy*. Published as [MPRA Paper No. 31570](#).
- Hanappi H., 2012b, *Can Europe Survive? Ten Commandments for Europe's Next Ten Years*, forthcoming in Papers for Evolutionary Political Economics (PEPE), No 9 (2012). On the web: [http://ftp.econ.tuwien.ac.at/hanappi/Papers/Hanappi\\_2012b\\_newest.pdf](http://ftp.econ.tuwien.ac.at/hanappi/Papers/Hanappi_2012b_newest.pdf)
- Horvat B., 1959, *Workers' Management in Yugoslavia: A Comment*, Journal of Political Economy, vol. 67/2, pp. 194-198.
- Horvat B., 1986, *The Theory of the Worker-Managed Firm Revisited*, Journal of Comparative Economics, vol. 10/1, pp.9-25.
- Jessop B., 2000, *The Crisis of the National Spatio-Temporal Fix and the Tendential Ecological Dominance of Globalizing Capitalism*, International Journal of Urban and Regional Research, Volume 24(2).
- Jessop B., 2004, *Globalization: It's about Time Too!* , Hong Kong Journal of Sociology, number 5 (2004).
- Kessler O., 2009, *Interrogating the Current Financial Crisis*, International Political Sociology (2009) 3, 449–468.
- Markusen J., 2004, *Multinational Firms and the Theory of International Trade*, MIT Press.
- Mishkin F., 2010, *Economics of Money, Banking, and Financial Markets (9<sup>th</sup> edition)*, Prentice Hall.
- Mishkin F. & Eakins S., 2009, *Financial Markets and Institutions (6th edition)*, Prentice Hall.
- Navaretti G. & Venables A., 2004, *Multinational Firms in the World Economy*, Princeton University Press.
- Roemer J., 1996, *Theories of Distributive Justice*, Harvard University Press, Cambridge (USA).
- Sen A., 2010, *The Idea of Justice*, Penguin Books, London.

Shubik M., 1999, *The Theory of Money and Financial Institutions*, MIT Press.

Walsh C., 2000, *Monetary Theory and Policy*, MIT Press.

Ward B., 1957, *Workers' Management in Yugoslavia*, Journal of Political Economy, vol. 65/5, pp. 373-386.

Ward B., 1959, *Workers' Management in Yugoslavia: Reply*, Journal of Political Economy, vol. 67/2, pp. 199-200.

Williamson O., 1983, *Markets and Hierarchies: A Study in the Internal Organizations: Analysis and Antitrust Implications*, Macmillan.