

Chapter 6

Embedded in Global Politics

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The eastern Mediterranean has been the birthplace of European culture. As its history vividly shows cultural evolution always has been embedded in a powerful political organization, in an empire. The ancient Greek city state first of all had to rely on the force of Athens' fleet. The internal development of cultural advance only did follow the victories of external military might. The population controlled by Greek rulers - and later by the Roman Caesar – was directly subordinated to the commands of the local military representatives of the top of the coercive hierarchy. With a growing territory to be controlled the biggest problem of the ruler soon was how to delegate military power to lower ranked commanders. Too much power would eventually result in a revolt of some lower parts of the hierarchical pyramid, whereas too little power could endanger the enforcement of local exploitation, which these lower ranks had to ensure. Call this problem the 'power distribution problem of hierarchy' (PDPH), it reappears again and again in history. Each of the ancient empires (Greece, Islamic and Roman Empire) passed its zenith and started its decline as a consequence of inability to meet the challenges of the PDPH. It is interesting to study this breakdown of large empires in detail. The slowly starting disintegration of those parts of the territory, which are most distant from the empire's central city, first appears only as a minor difficulty of coherent governance. But then matters are getting serious as soon as local military forces declare themselves to be independent, and cannot be brought in line with the empire's central coercive force any more.

The eastern part of the fallen Roman Empire with its center in Constantinople was quite significant in this respect. The centralized power hierarchy that Rome had constructed and maintained dissolved into bits and pieces of a network of smaller power nodes. When the Ottoman Empire during the 17th and 18th century was able to reassemble this large territory its major achievement was the implementation of a military rule combined with a strict administrative and ideological organization. It is important to acknowledge how these old but deeply rooted structural features of this last large empire of the eastern Mediterranean still are mirrored in some of today's political features of the area. The way in which a local society at the periphery gets rid of its central authoritarian exploiter has not changed too much: It needs the local soldiers led by a military officer with political ambitions. Be it Gamal Abdel Nasser in Egypt fighting colonialism, or Gadhafi in Libya, or be it Marshall Tito in Yugoslavia trying to break loose from Moscow-centered Stalinism – they and many others first and most important were cadres of the local military.

The feature of an emergency of a set of military backed territorial rulers after the breakdown of a large empire also can be found with respect to the end of the Ottoman Empire (compare [Hanioglu, 2008]). But as the power of the old regime typically is a mix of military and ideological power – with the latter till the 20th century being the power of an

accommodating religion – the broken up structures after its end are characterized by both layers of power too. While relative military strength of successor states is rather easy to determine since the means of direct coercive force do not change too much during this period of metamorphosis¹ of the global system, there always is a broader range of possible ideological frameworks available for these newly emerging political entities. The power of information - how the interpretation schemes of political dynamics are used by local populations and how they can be formed and manipulated – is a much more shapeable process, a domain which allows for some creative new elements grafted on pre-existing inherited views. In the eastern Mediterranean after the Ottoman Empire by and large *four strong and different ideological frameworks* can be distinguished: Arab nationalism, Islam (and parallel, though with less impact, the two other monotheistic religions Christianity and Judaism), socialist ideology, and capitalist ideology. As history teaches the blending of some of these basic elements often proves as particularly successful to maintain social coherence. To complicate things even more the two forms of power in the successor states of the Ottoman Empire, military power and ideological power, were subject to interference by the global colonial powers, in particular Britain, France, and Italy. This overlay of global colonial power structures to some extent hides the kind of agreements, compromises, and purely oppressive solutions which global players did choose to incorporate these states in their empires. Only with the end of this stage of colonialism in this area, more or less after World War 2, the older forms of local power reappeared again.

Before discussing the global embedding of the eastern Mediterranean politics after World War 1 it is necessary to highlight another property of the Ottoman system of governance, a feature that was essential for its long-lasting dominance: the millet system². This system was an institutionalized method of administration that helped to exert ideological dominance of Muslims by giving a limited range of legal rights to all non-dominating religious streams. This was necessary since at the zenith of its power the Ottoman Empire had population of approximately 70 million people with a majority of 40 million non-Muslims. The millet system established categories for the Greek Orthodox, the Armenian (including Armenian Catholic, Evangelical and Apostolic), the Syriac Orthodoxy and the Jewish communities, organizing people according to their religious affiliation. It aimed at equality of these religions by ensuring that each community could exercise its own personal status law as administered by the relevant religious authorities. But at the same time it also assigned a special status to Muslims: All disputes between non-Muslims and Muslims were to be administered under Muslim law (1), non-Muslims could not officially hold positions within the imperial government (2), and non-Muslims had to pay a tax (3). The millet system thus combined legal protection of local ideologies (religions) with measures ensuring the dominance and attraction of the Empire's prime ideology. To take *pre-existing individual religious believes* as a starting point for *institutionalizing ideological dominance* has proved

¹ Compare [Hanappi, 2013a] for a discussion of the evolutionary concept of alternating periods of metamorphosis and (crystal) growth.

² Compare [MacQueen, 2013, pp. 10-11].

to be an incredible political success: The empire lasted from 1453, the conquest of Constantinople, till 1918, the end of World War 1. As MacQueen emphasizes, 'Of the imperial rulers in the Middle East, it was the Ottomans who arguably left the most lasting political, economic and social legacy in the region.' [MacQueen, 2013, p. 9].

What needs to be highlighted in the context of the contemporary political situation is this early occurring focus of politics on pre-existing individual social identity. To combine plurality of less powerful groups at low local levels with strict rules for making it impossible for members of these lower ranks to ascend to really powerful positions, this administrative and legal achievement is indeed remarkable. The illusions of plurality might be sufficient for some backward oriented believers to feel protected, but there also is a dynamic element, a temptation: Religious affiliation need not be a fate; the more flexible individuals could convert and become Muslims. This selection of those who are career-oriented, with clear legal and monetary advantages, it is extremely attractive to join the dominating ideological group. It is this general type of selection mechanism on the ideological battlefield which seems to be the most long-lasting behavioral trait inherited from the millet system. Seemingly strong determined ideological leaders at the top often selected as most flexible, opportunistic career-seekers looking down at the backward, though well-administered plurality of the religiously confused majority of the population – is this the frightening caricature mirroring contemporary societies?³

As mentioned above the evolution of the Eastern Mediterranean is characterized by a somewhat special trajectory. When the global colonial competition between the major European nation states, above all between Britain and France, was culminating the area still was under the political umbrella of the Ottoman Empire. There were, of course, already some severe cracks in its governance structure – in 1789 Napoleon had landed in Egypt, in 1830 French rule was established in Algeria, Britain was dominating the Persian Gulf since 1820 and in 1869 had opened the Suez Canal, in 1881 Tunisia became a French protectorate, and in 1882 British rule was established in Egypt – but in principle the Ottoman Caliphate in Constantinople lasted from 1517 till 1923. In other words, the essential turning point in the history of the area indeed was the breakdown of the old established state system of Europe during World War 1. Until this point the populations of the Eastern Mediterranean were military and ideologically dominated, mostly by the Ottoman rulers, but partially already by colonial empires.

The explosion of newly emerging political entities after WW1 did follow the strategies, and relative spheres of influence, of the victorious colonial nations. In the south and east, the African countries and the Middle East, rich oil reserves and the ideological surge of Arab nationalism were the essential elements of the political reshaping. On the northern shores of the Mediterranean a substantially smaller secularized Turkish state emerged. And the

³ Western societies might well be considered in a similar perspective, though the dominant religion in OECD countries now typically is mainstream neo-classical economic theory, a believe system I have dubbed 'microtheology' in [Hanappi, 1994, p. 168].

territories on the Balkan Peninsula entered a state of quickly changing unstable local regimes. These territories had been dominated by the ideological combat between Islam and Christianity, shaken by the armies of Istanbul and Vienna for centuries. When both old empires crashed in WW1 these lands had not developed any independent political and institutional structures. They were doomed to fall prey to short-lived revitalized kingdoms and transient adventures of dubious political groupings – in most cases themselves marionettes of the new big players in the rearranged global political arena. As a matter of fact the Ottoman Empire was the last power that unified the larger Eastern Mediterranean area; just like the Byzantine Roman rulers had done it in the previous centuries. After the final fall of the Ottoman Empire northern and southern remainders experienced very different developments - with a substantially smaller and geopolitically (at first) unimportant Turkey in the middle. Austria also had been reduced dramatically after WW1, the territory between the old centers of Vienna and Istanbul were sliding into an indeterminate political vacuum, while the Arab part in the South was finally subordinated to the needs of the large colonial powers. Britain took Iran, Iraq, Palestine and Egypt (plus some less important areas), France took Syria, Tunisia, Algeria and Morocco, and Italy just had to be content with Libya. The anti-colonial forces that immediately responded to this belated attempt of colonial expansion – the main global subordinations had taken place in the previous centuries already – could be based mainly on two ideological frameworks: Arab nationalism and a politically interpreted Islam. But during the interwar period the center of gravity of political power rapidly shifted away from Europe, leaving Britain, France and Italy as minor players in the approaching confrontation between capitalism and communism, between Washington and Moscow. Moreover the new political and social phenomenon of Fascism in Italy, Germany and Austria quickly attracted the attention of European policy making. The Balkan was out of focus and the societies there took their own winding road in between the emerging global forces that prepared for World War 2. There were communist and socialist groups structured along the schism of the labor movement, i.e. Kautsky contra Lenin and Lenin contra Trotsky; there were fascist groups of different shades, there were conservative monarchists and nationalists, there was the socioeconomic split between (often Islamic) land-owners and the poorer (less religious) mass of population – and its mirror image of (mostly catholic and more to the North) lower nobility insisting on inherited feudal rights subordinating their menial staff. The war then drowned all these transient power constellations, the German Wehrmacht swept over the Balkan and even to North Africa. Though the two decades of the interwar period certainly were a most turbulent episode for the population of south-east Europe their deeper socioeconomic impact on economic structures and lifestyles was probably less pregnant than the 500 years before WW1. The mountainous landscape was important for military strategy, but only of minor economic importance. It rather was the Ukraine, which attracted central European powers as a supplier of agricultural products. And a cultural impact of the Nazi army on the oppressed population during the seven years of war can rather be expected as an insisting on national and religious identity – against the also existing local collaborators. The interwar period thus was not at all an ideologically and politically stable environment in Europe's south-east,

despite the efforts of several later emerging regimes to enrich their national history by legends of a return to national roots during these two decades.

With World War 2 and the new global world order to which it led the fate of global influences on Europe's south-east took another dramatic turn. The globe was divided into two distinct spheres of influence – in military, economic, and cultural terms – one dominated by the USA, the other one belonging to the USSR. And for 45 years the borderline between these two hemispheres cut south-east Europe into two parts! The development path of these two parts during this era was different and for each of the parts it proved to be rather significant.

The northern countries (Yugoslavia, Romania, Bulgaria, and Albania) became part of the ring of satellite states around the USSR and all adopted some kind of 'Stalinist production system'⁴ for their economy. Each of these four examples needs a somewhat different analysis since they were confronted with a rather different involvement of the new leading political cadres. Moreover those closer to the USSR (Romania and Bulgaria) clearly had a bit less room to move than those who were a little bit distant (Yugoslavia and Albania). In Romania and Bulgaria a strong and centralized clique emerged. In Albania a more independent, but soon highly 'ortho-Stalinist' development lead by Enver Hoxha could be observed. First Albania's communist party during the war was closely cooperating with the Yugoslav communists, but already in 1948 the animosities between Tito and Hoxha resulted closer links between Moscow and Tirana, and a more distant relationship between Yugoslavia and the USSR. After Stalin's death Hoxha felt safe to strengthen his connection to Mao Zedong's China, while Tito was experimenting with what he called the 'third way' – a road to socialism, which was in between Kautsky (central European Social Democracy) and Lenin (Bolshevism). Vis-a-vis this new and more open-minded approach the party establishment in Albania followed an extremely Stalinist policy stance⁵. In such an environment it is no surprise that the Albanian democratic and cultural evolution had a hard time.

By far the most interesting case is **Yugoslavia**. First of all the new state unified a large and heterogeneous territory, providing common state institutions and even a common official language (Serbo-Croatian). As can be observed in all members linked to the Soviet bloc a specific redirection of trade flows was quickly installed: Exports of a variety of goods to the USSR should be met in particular by energy imports. But Tito, who had survived Stalin's murderous attacks against old bolshevist comrades during his time in Moscow and after the war was sent by Stalin to govern Yugoslavia in Stalinist style, Tito turned against Stalin in 1946. Using Stalin's own methods (e.g. extensive secret police) to get rid of direct control by the USSR a first profound crack in the Eastern bloc occurred. Yugoslavia was excluded from its trading network from one year to the other and had to start trade relations with western

⁴ See (Hanappi, 1994, pp. 112-161) and (Hanappi, 2004) for a detailed treatment of the concept of Stalinist production systems.

⁵ Albanian politics had been characterized by extreme brutality already during WW2, when German Nazi troops were said to have held back Albanian Nazis to prevent the worst war crimes.

European countries (compare fig. 1). This immediate disadvantage turned out to be an important positive factor in the mid-run: The more open borders to the west allowed for faster economic growth and the remittances of workers immigrated to neighboring countries proved to be a substantial contribution to local purchasing power. After Stalin’s death in 1953 the USSR and its allies slowly took up trade relations again.

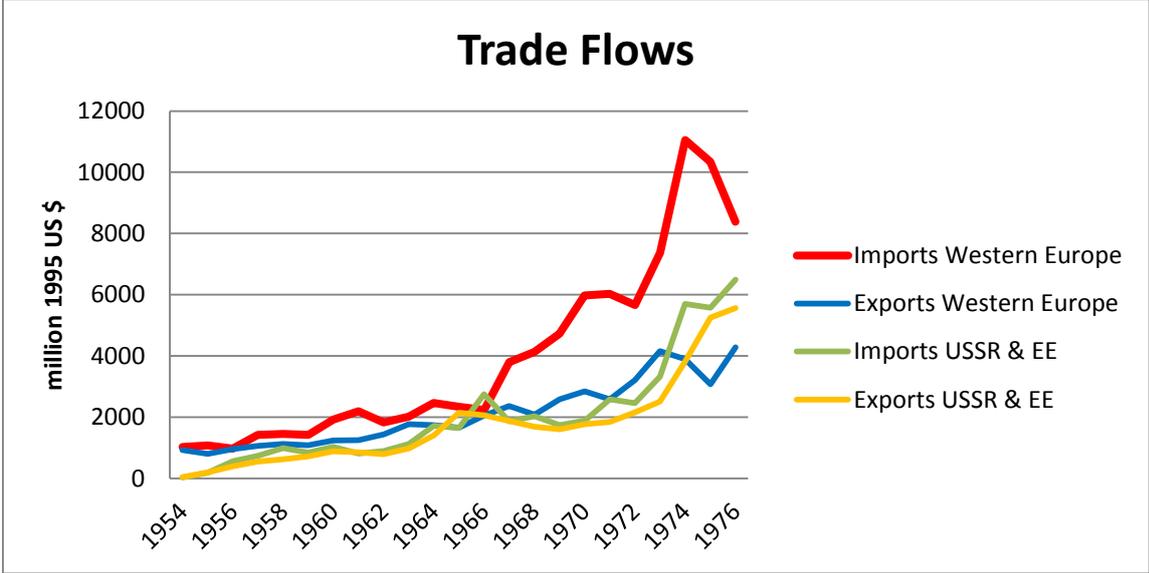


Figure 1: Trade Flows

In this first after-war period, which lasted till the mid-seventies, Yugoslavia’s remarkable upswing to a large extent was stimulated by its accelerating imports from Western Europe, starting in 1966. Later, when higher oil prices exploded the trade balance with the West, it again turned to its Eastern hegemonic power. But the trade with the USSR was so closely balanced on the political level that no large disequilibrium occurred.

After the war Yugoslavia successively developed a rather unique new microeconomic feature too: the labor-managed firm. It was one of the few innovations in economic policy, which tried to break the spell of the doctrines of Stalin: Centrally steered industrialization and ‘socialism in one country’, i.e. in an enlarged USSR. The first two decades after the end of WW2 Yugoslavia indeed experienced an impressive rise of economic activity. Despite – perhaps even ‘because’ - the trade embargo of Stalin it could further develop its role as the second largest state in the area of the large empires of the previous century, Ottoman Empire and Austria-Hungary (compare fig. 2). And in the bi-polar that had emerged after WW2 the border between the two hemisphere cut right through these old territories making Turkey the largest state belonging to the USA dominated world and Yugoslavia the largest of those states closer to the USSR. But unlike Turkey Tito’s Yugoslavia tried to propagate a ‘Third Way’ of non-aligned states and heavily invested in its own military forces.

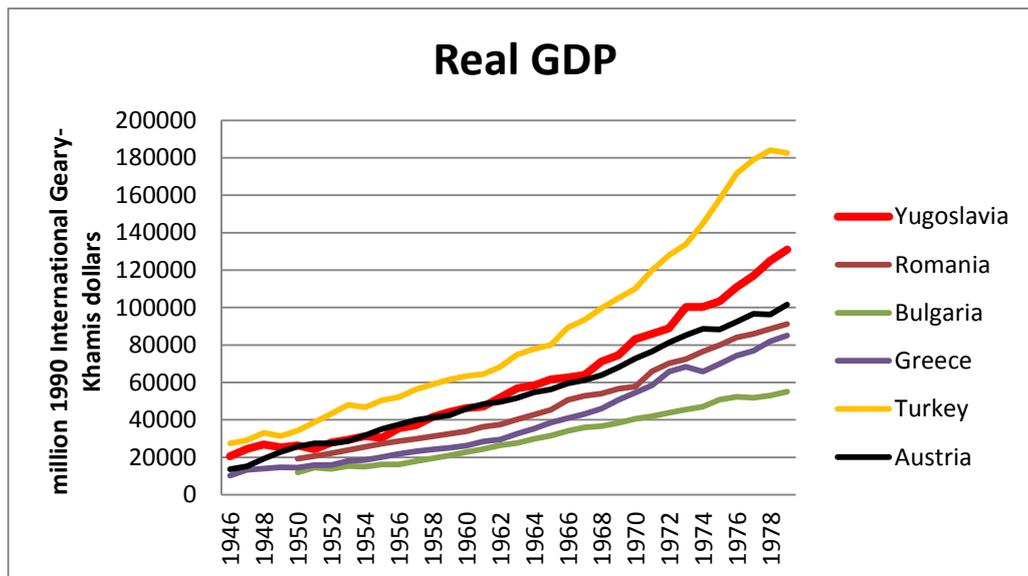


Figure 2: Real GDP Levels 1946 - 1978

It is indeed rather significant that the Eastern hemisphere repeatedly had troubles with its satellite states in this period – Yugoslavia in 1947, Hungary in 1956, Czechoslovakia in 1968, not to speak of the competitor China – while most outposts of the Western hemisphere in this area (Turkey, Persia, Israel) were more firmly in the hand of a centralized military command, which basically was the US dominated NATO. The brief attempt of local communists in Greece immediately after WW2 to get into power was doomed to fail from the beginning as Stalin had already agreed with Western leaders (Churchill) that this state should be 'to 90%' a Western ally. While the support of Yugoslavia kept left forces strong enough to engage in a civil war till 1949, when Tito stopped that support, the final decision of Greece's global role was clear when it joined NATO in 1952. Nevertheless its population remained deeply divided into the two political camps, and when a victory of the united left at the elections in 1967 seemed possible a right-wing military coup ended democracy. Greece was again saved for Western powers, but the rule of a military junta was not the type of government that the USA would propagate as their preferred political style. So after some severe political and even military defeats, e.g. with respect to Cyprus, the military junta was replaced by a more civilized conservative government in 1974. It has to be noted in that respect that the widespread and long-lasting diaspora of the Greek population all over the world has produced a high potential of Greek power groups in the USA, in particular in the political parties there. Greece thus even in its national policy to a considerable extent is subject to influences from expatriates having gained importance (e.g. as politicians or ship-owners) in other parts of the world. The visible political instability of Greece was certainly a main reason why its leaders joined the European Union rather quickly in 1981. To participate in the economic prosperity, which a tighter woven and more specialized economic network undoubtedly brought to EU members was the best safeguard against any socialist ambitions.

Return again to a consideration of Yugoslavia during this long period of reconstruction after WW2⁶. After the first phase of emphasis some deficiencies of the network of labor managed firms running under political elites, which more or less still were militarily controlled, became visible. As several – nowadays mostly forgotten – socialist economists soon remarked⁷, the mix of certain market mechanisms with some socialist features (e.g. state guarantee of full employment) is a rather difficult policy design problem. And this does not just concern the way in which socialist features can be translated into accurate policy measures, it also concerns the selection of well-defined market mechanisms. As many mainstream economists only start to discover today, ‘the market’ as an independent *deus ex machina* does not exist, it is not an invisible pre-existing subject somehow implicit in all human societies. What can exist is a certain market *mechanism*, which is embodied in a socioeconomic environment and is regulated and policed by certain institutions. And there always has been a great variety of possible market mechanisms. With the quantum jump in information technologies the amount of possible market mechanisms (compare the world of auction design) has recently exploded. It is no exaggeration to state that human societies only have just started to explore what market mechanisms (note the plural!) can do. There is a big task ahead of our humble current knowledge.

The political trajectory of Yugoslavia, **Bulgaria** and **Romania** during the first two decades after World War 2 is in general characterized by the way in which these countries were able to deal with the imperial aspirations of the USSR. The example of Tito insisting on his own national type of communist organization of production seduced a prominent leader of communists⁸ in Bulgaria, Georgi Dimitrov, to take into consideration a closer cooperation between Bulgaria and Yugoslavia. While Tito liked the idea Stalin immediately found the formation of a stronger center of gravity of a Balkan type of communism - a Federation of Southern Slavs was discussed since 1944 - rather dangerous for the monolithic power structure of the USSR. When Tito and Dimitrov were invited to Moscow in 1948 to discuss the matter Tito did not participate, only Dimitrov did – and died briefly after the meeting in a hospital near Moscow. Till today rumors about an involvement of Stalin’s secret police exist.

Years later (1965) the Romanian communist leader Gheorghiu-Dej, who also was an early companion and admirer of Stalin, died in a Moscow hospital – again in unclear circumstances. Gheorghiu-Dej had been installed by Stalin as Romania’s premier in 1948, he had been sceptic when Nikita Khrushchev gave his secret anti-Stalinist speech in 1956, and in the same year he had supported the quick military intervention of the USSR when Imre Nagy in Hungary tried to change its countries type of communism; but like in the other cases he also had set out to give priority to Romanian nationalist goals: He always insisted on territorial integrity of his country and had not allowed Warsaw Pact maneuvers on its soil, he

⁶ A most remarkable account of Yugoslavia’s modern history is [Calic, 2010] (in German).

⁷ In this context e.g. Branko Horvat (Horvat, 1986) and Ota Šik (Šik, 1976) have to be mentioned. And as a major forerunner in this debate Oskar Lange laid some important foundations (Lange, 1935).

⁸ It is characteristic for Stalinist regimes of that time that they were tailored to the profile of one single leading personality. After Stalin’s death this form of strict adherence to the command just one person was denounced as ‘cult of personality’.

established special bi-lateral relations with countries like China and Germany challenging the hegemony of the USSR, and he increased output of consumer goods and introduced elements of self-managed firms and economic decentralization. When from 1966 onwards Nicolae Ceaușescu took over leadership in Romania, he continued the later type of a more open policy in some specific areas⁹ and in his first years was rather popular. So in Romania like in Bulgaria and Yugoslavia a certain continuity of policy in the first decades after WW2 can be observed too.

Of course, it has to be mentioned that this continuity was also strongly based on an extensive network of secret police in all of these countries. Stalin's methods of population control by an omnipresent secret police had been successfully copied, and occasionally could be used to turn against their master to achieve local nationalist goals. Despite the many differences between these countries in the Northern part of the Balkan Peninsula, the common experience of a hegemonic military power lead by Moscow occupying their land, with local proconsuls playing an ambiguous game to exploit nationalist feelings while keeping control with impermeable network of secret police and party connections certainly has produced a general attitude vis-à-vis politics in the populations of this area. This attitude probably can be characterized as skepticism, even cynicism, with respect to 'Grand Politics'. After centuries of experience with the two feudal empires, then an intermezzo of fierce fascist aggression, and finally an arrival at a promised socialist land, which rather looked like a nationwide prison – physically as well as intellectually – such an attitude is certainly not surprising. Even more so as a brief look at the economic situation in neighboring countries revealed that those countries, sponsored by the rival in the bi-polar world via Marshall-plan money (e.g. Austria and Greece) were pushing ahead in real GDP per capita (compare fig. 3).

⁹ He extended the international foreign policy ties to include even Israel and Pinochet's Chile, while at the same time daring to speak against the Soviet intervention in Czechoslovakia in 1968.

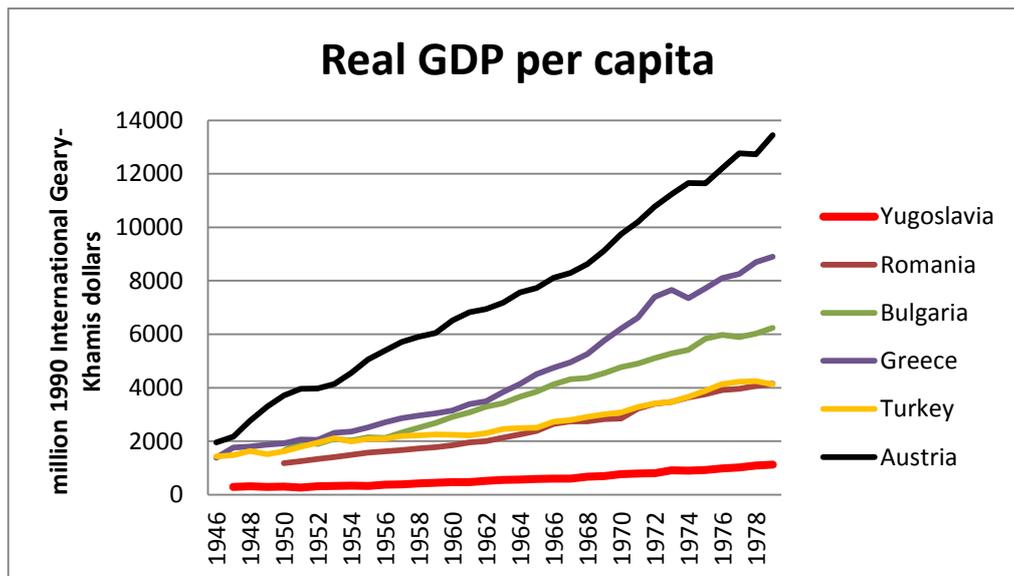


Figure 3: Real GDP per capita 1946 - 1978

These were the preconditions for the breakdown of the Soviet bloc that took another decade, the latent discontent of the populations combined with an irreversible process of degeneration of the mindsets of most representatives of the political elite. The deeper reasons for this singling out of such a political class certainly can be found in an implicit social selection process that gratifies a combination of apparent opportunism with secretly applied police methods. But notice that these were just preconditions and not the triggers of the downside of power of the Soviet empire. The triggers are to be found in a remarkable change in the politics of the Western hemisphere that occurred as a response to the crisis of the 70-ties.¹⁰

The conservative roll-back in the western hemisphere started with Margret Thatcher's electoral victory in Britain in 1987, reached its first zenith with Ronald Reagan's presidency in the USA in 1980 and was completed by Helmut Kohl's triumph in Germany in 1982. Contrary to most of the comments in Western media the crisis in Yugoslavia during the decade from the late seventies onwards was not an internal affair of conflicts between aggressive ethnic groups forced into an artificial political unity. Neither was it the logical outcome of another failed communist experiment trying to improve on the 'natural' best social order, i.e. capitalism. Any overly simplifying polemic based on vested interests prohibits the learning of the valuable lessons that the history of Yugoslavia provides. The internal dynamics, which indeed prepared a development that finally led to war, to the attack of NATO forces, have to be traced back to an economic policy, which allowed for some Western style improvements of consumption: Workers could leave the country to work in Austria and Germany and their remittances to their families in Yugoslavia did improve purchasing power. This in turn enabled another new element, the growth of consumer credit. As long as the USA backed

¹⁰ The breakdown of the stable exchange rate regime (Bretton Woods system) in 1971 had induced a sudden increase in crude oil prices and this worldwide energy price hike (via the *expectation* of a global recession) had indeed synchronized (and as a consequence deepened) business cycles in Western countries.

the idea of a united Yugoslav nation that acted as a disturbance of the USSR (a competing Stalinist system) even the US-dominated IMF did not see a problem in the deteriorating trade balance, which reflected the overshooting of import demand. But then the crisis in the Western hemisphere struck: The extremely expensive 'Star Defense Initiative' of Reagan caused a substantial jump of interest rates in the USA, which in turn attracted capital from Europe causing European interest rates to rise sharply, leading to a massive shutdown of smaller firms and high unemployment rates. This hurt the Yugoslav work force in Western states, but it also made the interest on domestic credits in Yugoslavia unbearable. In this difficult situation Milosevic, the prime minister, made two crucial decisions:

1. The Stalinist doctrine of economic policy had no place for wage-price systems or monetary policy in general, it was only focusing on 'industrialization in one country' – the rest was simply set by the central planning office¹¹. As a consequence there was no theoretical background explaining how to deal with the elements of a mixed economic system with exploding credits and international labor migration. Milosevic thus just imitated what in Western economies today is called 'austerity policy': Class struggle led by the ruling political class to increase exploitation, in particular by reducing employment, lowering wages and reversing all benefits brought about by enhanced credit systems and social transfers. The disastrous self-amplifying forces of economic collapse quickly spread over all regions of Yugoslavia.

2. Like Stalin, Milosevic and his political elite thought that strong centralization of power can pacify the emerging unrest and turmoil in Yugoslavia's regions. But Yugoslavian nationalism rapidly turned into Serbian nationalism – reminding on Stalin's Georgian nationalism – and provoked all kinds opposing nationalist streams in the other regions of the country. The short intermezzo of nationalist state-building during the interwar period was awakened again, sometimes including the even older cultural traits of religious communities. But administrative, police-supported centralization measures of course were completely inadequate to fight the internal economic crisis. They speeded up the process of disintegration. Taking away most of the autonomy granted to regions (e.g. Kosovo and Vojvodina) earlier, these regions felt justified to cultivate their local nationalism.

Despite this preparatory internal policy mistakes the triggering element for the breakdown has to be found in the international sphere. There were two distinctive steps in international policy which pushed the Yugoslav economy over the cliff. First there was the initiative advanced by Germany and Austria, which proposed to the most north-western region of Yugoslavia (today Slovenia) to split from the rest. The argument was based on the fact that this region's was three times as productive as some least developed regions of Yugoslavia (e.g. Kosovo). Subsidizing one part of the country with surpluses generated by another part – a process that some would consider being the very reason for the emergence of larger

¹¹ This deficiency of Stalinism is shared by all varieties of so-called 'Marxist-Leninist'-style that share a neo-Ricardian interpretation (better: a reduction) of Marx' views.; compare [Hanappi, 2014].

political entities – can be key with which an outside power can kill this political entity¹². It is interesting to note that this outside intervention was motivated by purely economic expansionism. The second step, the political and military intervention of the USA (commanding NATO forces) can be interpreted as a reaction to this economic expansionism. Under the disguise of humanitarian intervention Albania was transformed into an entry point for the US Navy while air strikes exploited the civil war between ethnic paramilitary groups on the ground. The final victory of this policy consisted in the destruction of the Yugoslav nation state. The political and military vacuum after the war was filled by a diversity of small and weak political entities.

For Romania and Bulgaria the breakdown of the Soviet Union implied a fundamental shake-up of their national political economy too. For both countries greater independence from Russia suddenly became possible. In this respect the clearest picture of what has been going on since the end of World War 2 can be seen if one returns to a famous thought usually attributed to Clausewitz: 'War is a continuation of politics by other means' [Clausewitz, 1872, chapter 1.24]. Since 1949 the military forces of the Western Hemisphere – organized as NATO – have been advancing towards Europe's east in steps, which easily can be interpreted as following the political power structure. In 1949 the military of the 12 founding NATO members (Belgium, Canada, Denmark, France, Iceland, Italy, Luxembourg, the Netherlands, Norway, Portugal, the United Kingdom and the United States) was installed to balance the fragile bipolar structure. With the rapidly evolving Cold War between the two blocks NATO moved closer to the USSR and its allies: Greece and Turkey joined in 1952, and West Germany followed in 1955. With this move the hegemony in the Mediterranean Sea could be secured, in particular since Persia, ruled by a close ally (the Shah) blocked the USSR in the North East. Then, after the Eastern Block was imploding in the late eighties, NATO expanded to the east; first the Czech Republic, Hungary and Poland joined in 1999, five years later in 2004 Bulgaria, Estonia, Latvia, Lithuania, Romania, Slovakia and Slovenia followed. Finally Albania and Croatia joined NATO in 2009 (compare fig. 4). Military dominance of the USA represented by NATO, which it controls, has been successively implemented in Europe's south-east. But while coercive force is an important necessary condition for the installment of the basic institutions enabling capitalist processes, it is by far not sufficient to unleash the corresponding economic forces. The newly won territory till today has not lived up to the grand expectations, which many mainstream economists believing in a return to capitalism 'as the natural state of society' were propagating.

The countries in Europe's south-east, which had belonged to the Soviet Block thus all remained economically weak – even after they came under the influence of western capitalism. With respect to employment and income security the population the situation clearly worsened, whereas with respect to consumption possibilities at best a mixed picture emerged. But besides this continuing malaise of structural economic problems the most critical development in these countries did arise due to a lack of democratic evolution: On

¹² Already during the Yugoslav war this argument has been brought forward in [Hanappi, 1993].

the one hand there was the devastating experience of Stalinist regimes dressing as the grand aspiration of 'Real Socialism'. On the other hand the image of a capitalist world where an 'age of high mass consumption' [Rostow, 1978] is already ruling – an image entering eastern households via their TV-sets – proved to be unachievable for their own private lives. This double frustration across the generations left a population with deeply ingrained cynicism with respect to politics.

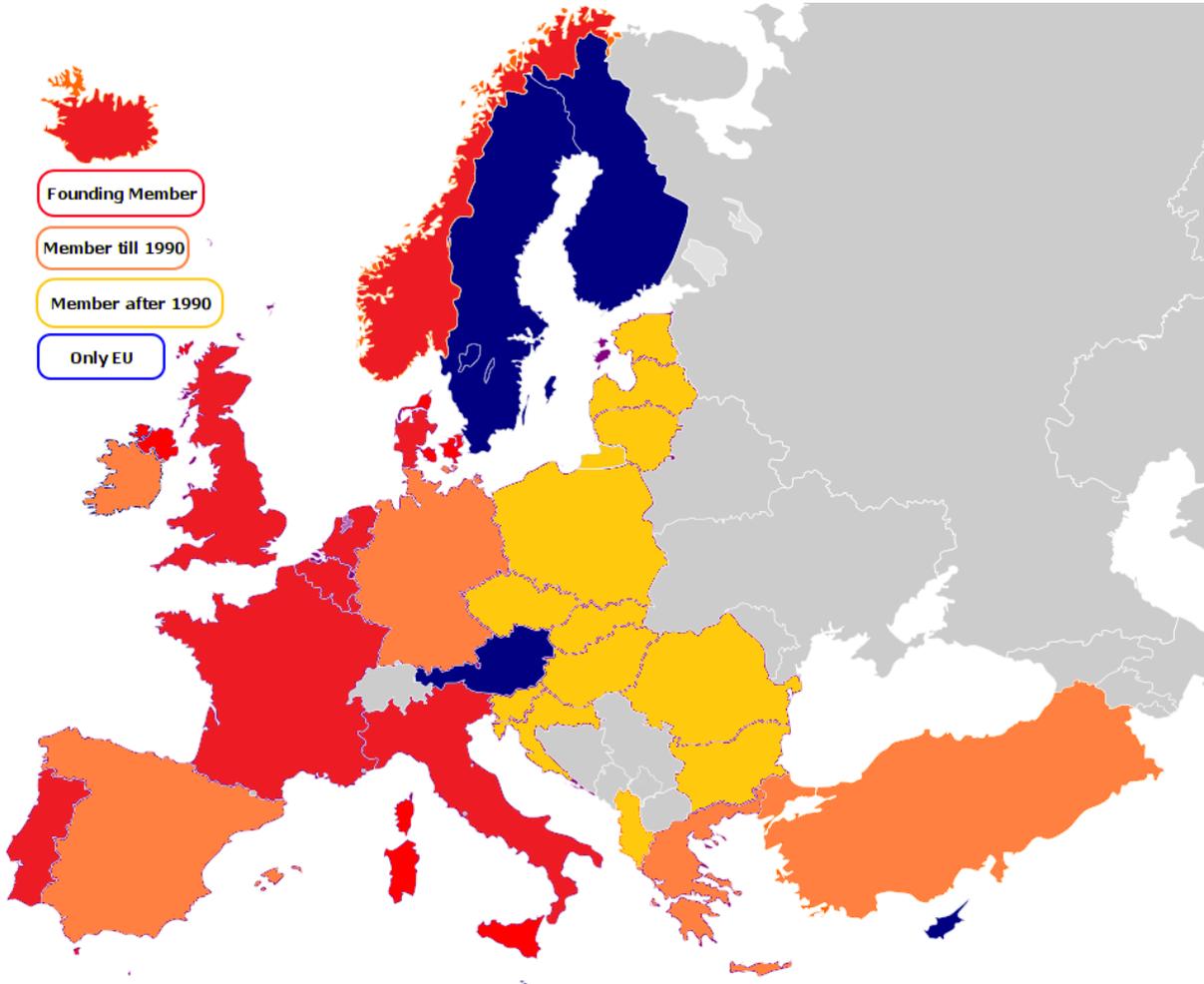


Figure 4: Eastward expansion of NATO

The development of the three countries in the south of south-east Europe (Greece, Cyprus, Turkey), which never had been members of the Soviet Block took place along more diverse routes. They will be dealt with separately.

Turkey in a sense is the easiest case to understand from a military point of view. Controlling the entire southern part of the Black Sea, where the northern shores were controlled by the Soviet Block, it is evident that including it NATO as fast as possible was mandatory for the western military alliance. Moreover Turkey understood as the remainder of the Ottoman Empire had a strong cultural tradition in rule systems obeying to hierarchical order, a property that lends itself to an outstanding role of military command hierarchies. Parallel to this cultural continuity a most remarkable rupture occurred with the ascent of Mustafa

Kemal 'Atatürk' to power in 1923. Immediately after World War 1 the monarchy in Istanbul remained in power and accepted the terms of the peace treaty formulated by the victorious colonial powers. Atatürk split from Istanbul and concentrated his supporters of the Turkish National Movement in Ankara. From there he formed the territory of the new Turkish state – with means of forcible displacement and other coercive measures, which cause hot debates till today. Most important was his break with the political influence of religion, his strong move towards a secular republican organization of the new Turkey. In 1924 the new constitution of the Republic of Turkey officially abolished the caliphate and the use of the shari'ah as the basis for the legal system. At the core of the new constitution of the secular state were the famous six principles: Republicanism, Secularism, Populism, Nationalism, Statism, Reformism. And the military was seen, and understood itself, as the defender of these six principles. After the eleven years of constant warfare of the Ottoman Empire, from 1911 to 1922, the new Turkish Republic tried to avoid (outside) military conflict and opted for neutrality in World War 2. But inside Turkey severe inequalities were only too visible: between Ankara and Istanbul, between the large cities and the open land, between the different ethnicities (Turks, Armenians, Kurds, etc.), and as a consequence between rich and poor. Nevertheless, despite the internal socioeconomic problems, the primacy of military influence did lend itself very well to the geopolitical role which Turkey was assigned to fulfill as a Western NATO member from the fifties onwards.

To understand the current situation of Turkey and Greece in the geopolitical context, in particular the sharp contrast that has evolved, it is necessary to take into account the expansion of NATO towards the east (compare fig. 4). Since 2007 Greece is not a frontier territory anymore, but Turkey still is¹³. Moreover, with the introduction of the Euro at the turn of the century in core EU states - including Greece - there emerged a peculiar opportunity for international finance, a condition which Greece shared with Italy, Spain, and Portugal (but not with Turkey): The credit-worthiness of these EU states could be targeted as if they were just large firms. With self-amplifying loss of value, steered by bank-led rating agencies, the local government fraction of the national ruling class could be forced to arrange a bail-out based on a sharp increase of exploitation the local working population¹⁴. Since this type of dynamics could be of crucial importance for many states in Europe's south-east it has to be portrait with more details and some empirical data.

Assume that social dynamics are best understood by the consideration of (global and local) class dynamics. Furthermore consider that the ruling class consists of three different fractions: Owners of production units, bankers (financial intermediaries), and political rulers (governmental bodies and their administration). Profits emerge by exploitation at the level of production units, in other words revenues received by firm owners are larger than their

¹³ Of course, the historical conflict on the Aegean coast of Asia Minor during the first decades of the 20th century still plays a role too. But this now, after almost 100 years and a common membership in the EU already in a test phase in Cyprus, should vanish in the background of the minds of new generations.

¹⁴ The instruments of this policy range from tax increases via reduction of social transfers to a general decrease in wages and firing of public employees.

wage cost. These profits are then shared between the three fractions of the ruling class, bankers receive interest (called capital cost of firms: $r^F \cdot D^F$) and state agents receive salaries paid with government income (mainly wage tax T^W , profit tax T^F and value added tax T^V reduced by the cost of infrastructural work, σ , plus interest on public debt, $r^S \cdot D^S$, which is a transfer to the banking fraction of the ruling class). Equation [1] summarizes this distribution of gross profit.

$$\pi = \pi^F + \pi^B + \pi^S \quad \text{with} \quad [1]$$

$$\pi^B = r^F \cdot D^F + r^S \cdot D^S$$

$$\pi^S = T^W + T^F + T^V - (\sigma + r^S \cdot D^S)$$

This distribution thus is determined by the different interest rates r , mirroring the class internal struggles between the fractions, and the historically inherited net debt levels D . Superscripts refer to the firm fraction (F), the bankers' fraction (B), and the state organizing fraction (S). Since total profit π determines what remains as π^F for the owners of production units it is the increase of the force of exploitation f , which is not just in the common focus of all three fractions but also motivates the firm fraction during periods of frozen inter-fraction relations. The force of exploitation is defined as

$$f = \frac{R^F}{W^F} \quad \text{with} \quad [2]$$

$$W^F = L \cdot w^F$$

It is the ratio between the aggregate of total revenues R^F and wage sums W^F of all production units. The wage sum, of course, is the product of the number of wage receivers L and the average wage w^F they are paid. Rearranging [2] shows how π can be increased:

$$\pi = R^F - W^F = R^F - L \cdot w^F = f \cdot W^F - L \cdot w^F \quad [2']$$

The direct route would be to reduce average wage w^F and employment L decreasing the second term, i.e. production cost. But as the first term shows this bears the risk that total revenues – determined by the demand side – will decrease too unless the force of exploitation f is increased sufficiently. The after-war period was characterized by **two important mechanisms** enabling such an increase in the force of exploitation: (1) By using specific geographic or cultural differences to other countries domestic exploitation can be supplemented by extending production and demand to these other areas thus establishing what I call *exchange rate exploitation*¹⁵. (2) The second mechanism aims at the expected stability of the prevailing class rules and enables long-run (social) contracts, which lead to additional *present* demand out of *expected* future profits and wages – financial intermediation based on trust in stability and the abstract nature of money, both handled by the banking and the state fraction of the ruling class.

¹⁵ See [Hanappi, 2011] for a more detailed treatment of his concept.

Exchange rate exploitation typically concerned the interactions in production¹⁶ between leading OECD countries and poorer Asian, African, and Latin American countries. In a more subtle form it also is part of generating profits in tourism, an export of services of some poorer countries. When Greece joined the EU and introduced the Euro this type of mechanism to increase the force of exploitation became impossible.

But these same developments, which had stopped mechanism (1), were enhancing the possibilities for the second mechanism. Expectations on the political stability of Greece became almost equivalent to the expectations of the political stability of the EU, a process further strengthened when the Greek currency became EU currency. In the years from the early 90-ties up to 2007 this increase of the force of exploitation based on financial intermediation worked well. Note that this mechanism also allowed for some modest improvements in the poorer strata of the Greek society, explaining why this time period was in general not experienced as an increase in the force of exploitation.

Some basic features of this argument are summarized in figure 5.

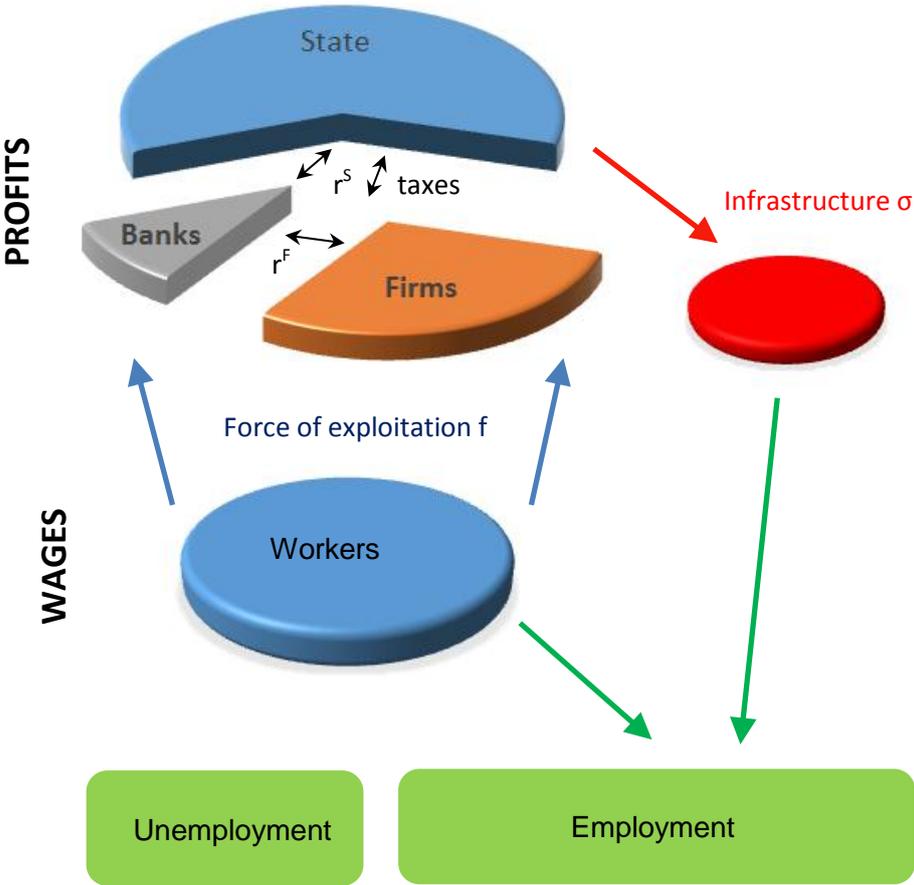


Figure 5: Simple Class Dynamics

¹⁶ See the literature on global value chains, e.g. [Serfati,].

The exploitation of workers is possible due to the private ownership of the means of production, which allows producing unemployment, which in turn forces workers to accept a wage sum that is low enough for the emergence of a profit sum, i.e. a difference between total revenues and wage cost remaining in the hands of firm owners. The force of this exploitation process (slope of the blue arrows) is measured as the ratio between total profits and wage sum, called f . Growth of f measures an increase of exploitation and is due either to an increase in revenues, or a reduction in the wage sum, or a change of both. Reasons for this development can be increased sales, higher prices, technical progress, lower wages and reduced employment (accompanied by increased labor intensity). Once total profit is extracted the three different fractions of the ruling class are engaging in their infra-class struggle. Major instruments for this conflict are interest rates and taxes (net of subsidies). Part of the state activities produces necessary infrastructure (red arrow) and constitutes a considerable share of total employment (green arrows).

The sizes of pie charts in figure 5 are approximately those existing currently in *Greece*¹⁷. The long-run development of total profits (in firms and banks), total wages and infrastructure (compensation of public employees) over time is shown in figure 6.

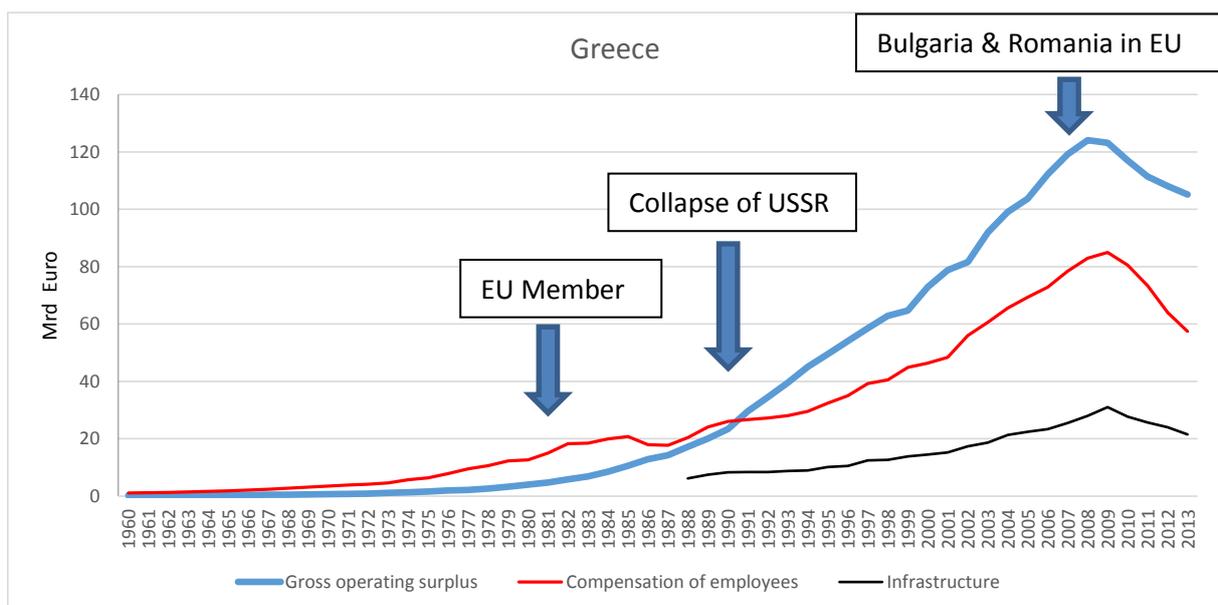


Figure 6: Long-run developments in Greece

The surge of profits, which started with EU membership, had been further fuelled by the disappearance of the Soviet Bloc. The turning point in 2007-2008 came when several pivotal - and interdependent - events occurred in global politics: (1) A further step in EU Eastern

¹⁷ The data collected by national statistical offices, Eurostat and OECD, which has been used to produce the figures in this chapter, had to be somewhat adapted to be used as indices for the theoretical concepts proposed. E.g. what is usually reported as 'gross operating surplus' is only profits of firms including banks and has to be corrected to include the part of profit used by the state fraction of the ruling class. But a share of this state part of profits is used to provide substantial infrastructure for a society's reproduction and not just for control by the ruling class. Since much more empirical work is needed for a proper analysis, the index for this share simply is assumed to follow the wage sum of state employees.

enlargement reduced Greece’s geo-political importance; (2) After a long period of radically aggressive US foreign policy during the Bush era a possible change due to a new democratic president Obama irritated the (global) ruling class; (3) The enormous amount of capital that had been posed in financial markets due to narrowing possibilities for high expected profit rates in the real economies around the world finally reached a sensitivity border of a critical mass of top investors – a landslide of changed strategies in global financial markets occurred. The third event – later to be recognized as the deepest global crisis since the Great Depression – has to be discussed in more detail to understand its implication for Greece.

First it has to be noted that the role of Greek banks (within the country) has not changed dramatically – neither before nor during the crisis. As figure 7 shows, their share in profits remained rather constant¹⁸. They have been, and remained, rather unimportant parts of the global network of financial intermediaries. The disaster of finance reached Greece from the outside.

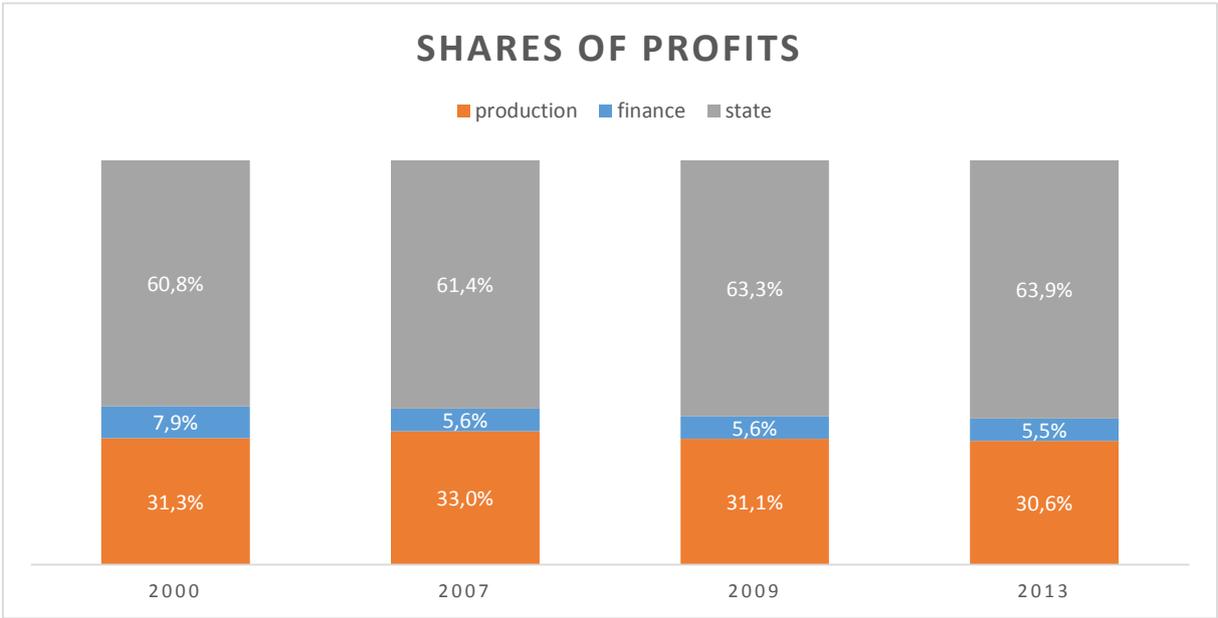


Figure 7: Development of profit shares in Greece

To see how small the Greek economy compared to the EU and the global finance is compare figure 8. What has happened in the global economy, usually described as the burst of an enormous financial bubble, therefore appeared to this country like a natural disaster, like an economic earthquake, which came out of the blue.

But a financial crisis is not a natural disaster, is not just ‘bad economic weather’. It follows its own internal logic, which can be described, can be understood, and even can be avoided as soon as a different social system is implemented. Such crisis are not ‘natural’, they are just fast processes driven by powerful economic agents with rather myopic expectations and

¹⁸ Note that the large share of profits of the state also indicates the importance to pay for coercive class rule, a feature inherited from the times of the rule of the military junta. It also includes payments for the priests of the Greek Orthodox Church (all paid by the state) who secure ideological dominance of the ruling class.

little knowledge on (and interest in) external effects. The Greek tragedy in this perspective is just another external effect. A quick look at figure 8 shows how small the country, its GDP and its contribution to finance and insurance, really is.

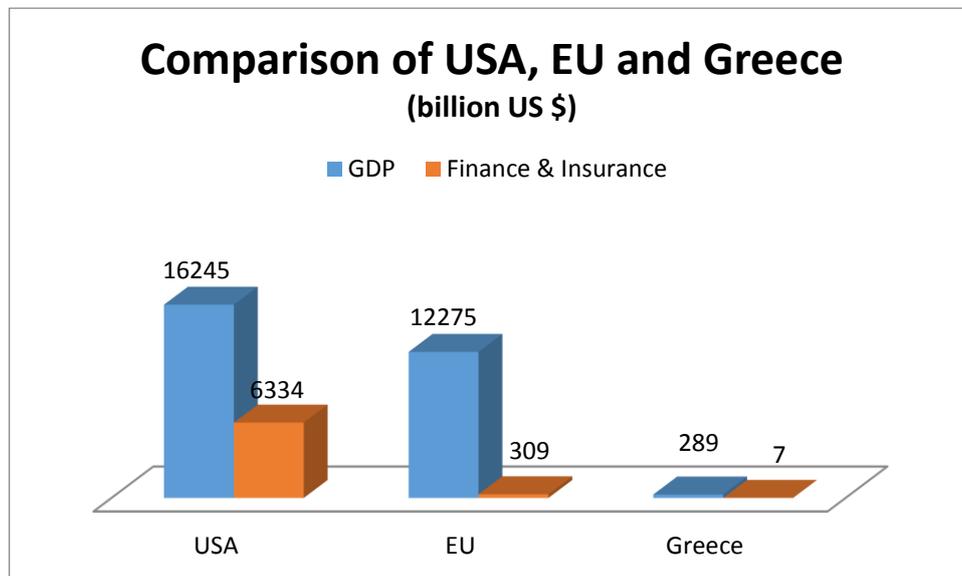


Figure 8: Greece in comparison in 2012

From the point of view of capitalist dynamics the repeated pulsation of boom and crisis is just the common profile which it necessarily follows. It is just the size of heavier, but less often occurring downturns which is so alarming¹⁹. What typically happens during such a Nadir of a usual business activity is that capitalist entities change from civilized competition to massive and aggressive take-over behavior. Since the winner gains the market share of the extinct loser there often occurs a desperate economic fight, with many participants going through phases of existential crisis. Nevertheless the business world has developed a civilized brutality: Once a new constellation is stabilizing, the winning firm will take over and re-vitalize the most profitable remainders of the killed opponent – and will ‘externalize’ the rest. The final victims of the process on this battlefield are always the now unemployed workers of the closed down, ‘externalized’ production units. Considering the just reported explosion of the profits of large banks paralleled by extremely high persistent unemployment the current global crisis seems to follow the same pattern²⁰. What is new this time is the fact that entire nation states, like Greece, which financially are small compared to the financial empires that rule the globe, can fall prey to the activities of the latter if several conditions are in place. One of the most important pre-conditions for the financial assault on Greece was the fact that its currency was the Euro. Being a Euro area country implied a kind of additional special collateral: In case of emergency the state fractions of all Euro area countries could enforce their taxpaying workforce as well as local SMEs to repay credits. In

¹⁹ Keep in mind that after the Great Depression of the Thirties not only the famous transformation of the US economy towards Fordism became necessary, but there also emerged Hitler’s Fascism in Europe.

²⁰ While the fight for dominance at Wall Street that started with the assault on Lehmann Brothers in September 2008 now seems to have calmed down with the help of the Obama administration, the many other battle zones that were stimulated by it are still self-amplifying.

the end it would be the political stability of the Eurozone, which would be at stake – and the global financial engineers were correctly assuming that first the case of Greece and then in the sequel the case of European banks would be not important enough to risk this overarching task. What happened was that from 2009 onwards bank risk of the finance fraction of the ruling class was transferred to the state fraction, a transfer to the promise to use cuts in government expenditure for social infrastructure accompanied by increases in wage taxes. The global squeeze on expected profit rates in the real economy, which in turn had been the result of the successful return to conservative economic policies starting in the Thatcher-Reagan-Kohl era which had produced tremendous amounts of profit sums waiting to be re-invested, first could be channeled into the labyrinths of new financial ‘innovations’ traded in immaterial market places. This dubious practice – though artfully hidden behind a veil of pseudo-scientific voodoo mathematics – enabled a delay of a great crisis from the mid-eighties onwards. When finally in 2008 a coincidence of several trigger events caused the fall of this house of cards and the big robbery of the global finance fraction started, the turn towards political entities as possible prey was inevitable. Conservative ideology had prepared the common sense to consider states like firms, less efficient firms of course. This had been the background for the infamous debate on ‘rather private than public’ for decades already. With this technology assisted brainwash the general public indeed was speechless and confused when the global financial crisis struck and the immediately following transformation into austerity programs executed by the state fractions followed.

But Greece is not just another big firm. It cannot be shut down, all Greek people fired and advised to look for work somewhere else, just some islands be kept and re-animated to serve as tourist attractions of the larger firm EU. Greece is a political entity and the essence of such an entity is to provide and to safeguard the rule set necessary to guarantee the reproduction its members, of society. This is different, in many respects opposed to the essence of a capitalist firm, which is the accumulation of profit, the growth of capital. Despite this simple and evident facts the Greek state fraction, partly forced by representatives of the state fraction of other countries (the Troika), dealt with the assault on the firm ‘Greece’ like any other firm owner.

Since intra-class conflicts of the ruling class in Greece became petrified with horror when global finance claimed a quick repayment of its credits, all efforts focused on an increase of total profits exploited from the local workforce. ‘National profit’ is the difference between ‘total sales’ and ‘total cost’. If in an environment of a stagnating global economy ‘total sales’ could only be increased by increasing government expenditure - which is unrealistic because the increase of government debt needed to finance it would have to turn to the same creditors that had initiated the financial pressure in the first place – it is straight forward to concentrate on reducing ‘total cost’. All policy instruments directed at this goal are nowadays summarized under the header of ‘austerity policy’. An additional fashionable adjective for this kind of policy is ‘efficient’. It transports the idea that a policy has to lead to the highest profit for a given set of inputs, or to the lowest amount of inputs – e.g. a

minimum of employees - for a given amount of output. Figure 9 shows how successful austerity policy has been implemented in Greece during the crisis.

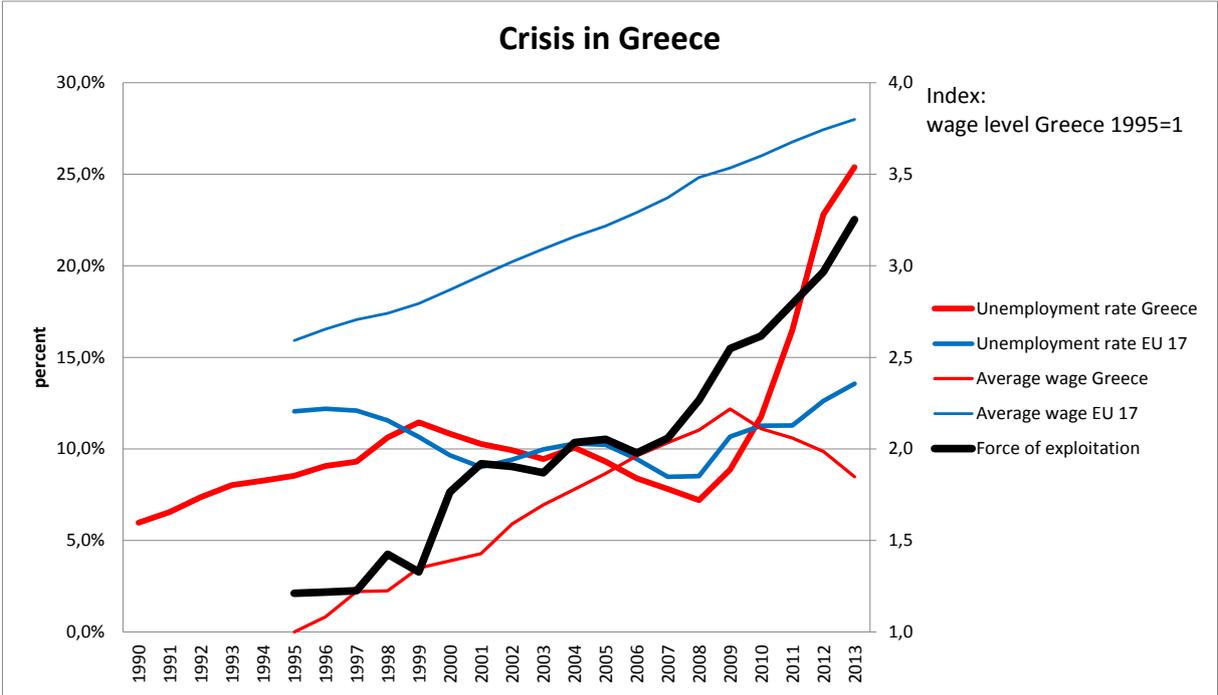


Figure 9: Austerity policy in Greece

A steep drop in average wages (right hand scale, 1995=1) and a reduction of the number of employees (an explosion of unemployment rates) did lead to rapid fall in the wage sum from 2008 onwards. At the same time the force of exploitation f (right hand scale, remember equation [2]) more than doubled. These developments are different from the general pattern observed in the Euro area (blue lines). Since 2008 the difference in unemployment rates and wage levels between Greece and the average EU area is dramatically increasing.

There is no sign that austerity policy will change its self-amplifying impact on further unemployment, ever lower wages, lower government revenues and growing inability of workers as well as the fractions of the local ruling class²¹ to pay back their debts to global finance. Figure 10 depicts these financial developments in Greece. Though total government debt seems to stabilize at a very high level and the actual interest rate applied to it has been falling (in particular since 2012) the dangerously shrinking economic activity that has been caused by austerity policy will be less and less in a position to generate enough surplus to avoid a moratorium of debt. Those households that were not able to transfer their bank accounts to foreign countries constitute a problem for creditors too, though on a smaller scale.

²¹ Parts of the ruling class of Greece have already left the country, or at least have transferred their bank accounts out of the control of the Greek tax authority. The same applies to the flight of human capital, since 2009 emigration of well-educated workers is soaring. The latter development already has a long lasting negative impact on the countries future prospect.

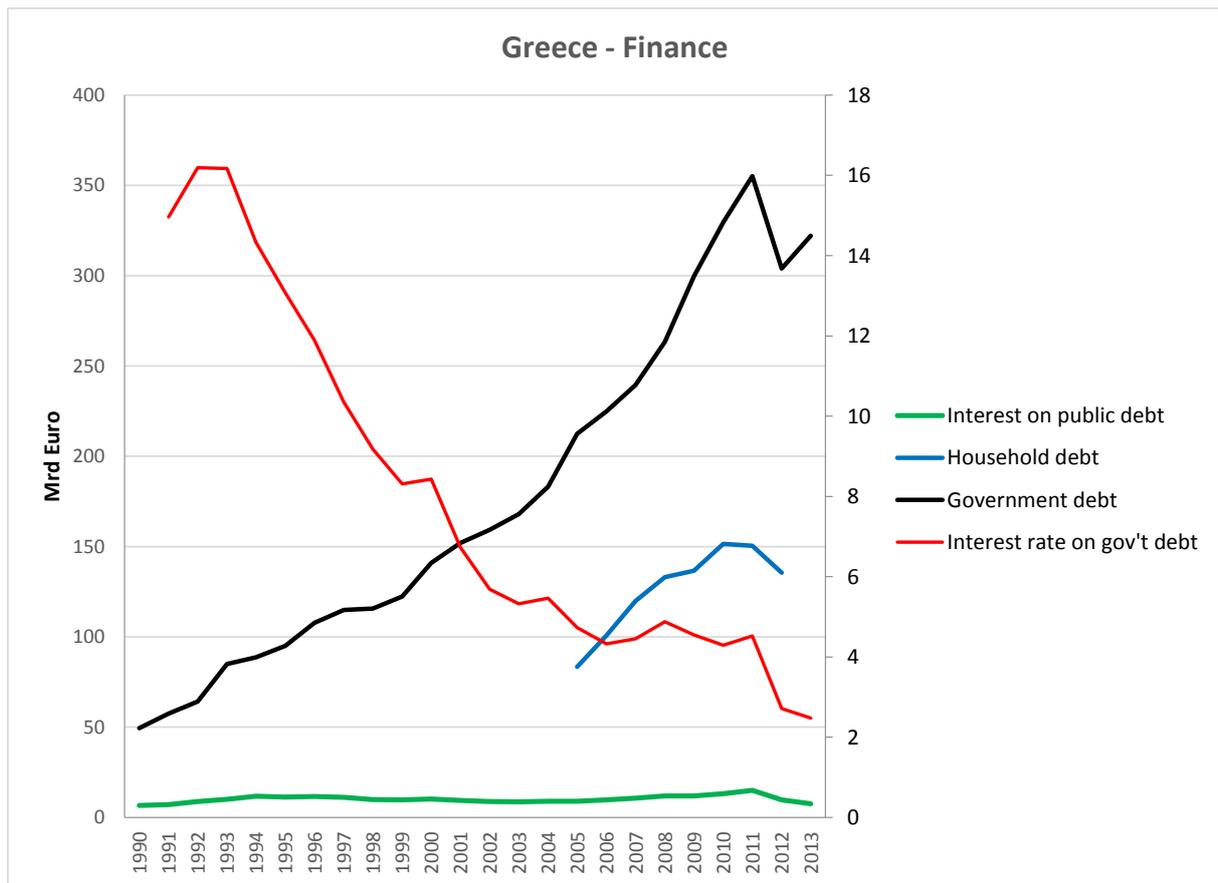


Figure 10: Financial developments in Greece

As the diagram also indicates, the explosion of government debt has in the first place also been caused by the high interest rates Greece had to pay to global finance in the nineties; that is before the Euro was introduced. This throws a light on an important issue: Analysis of class dynamics has carefully to distinguish between the global players, e.g. the global fraction of finance, and local national ruling classes. The chalybeate bath of the crisis of global financial players - which reduced their number and purified their strategies - is experienced at the level of national class dynamics as an assault on their culturally inherited local class relationships and exploitation practices. Unification of the global finance fraction of ruling classes is much more advanced than those of production firms, where the large transnational corporations are still struggling along their interwoven relationships via global value chains. Not to speak of the state fractions, which lag so far behind that they do not even aspire to achieve continental unification in the near future. Admittedly, as long as the rules of a democratic system are in upheld, the politically oriented state fraction of the ruling class has the most difficult job. To pacify not only the usual class struggles, but as well intra-class conflicts and conflicts between local SMEs and global players - to be even elected by all of these groups - is not an easy task. There thus is the permanent danger that parts of this fraction of the ruling class opt for less democracy, sometimes even for an intervention of militarily supported dictatorship 'to set the record straight'. Greece has experienced such an episode in the seventies, in other European countries, e.g. Hungary, similar developments

can be observed²². As the considerations in the first part of this chapter show the elites in south-east Europe are historically and culturally somewhat in danger to be too easily convinced that a quick jump to an intervention by military forces is an acceptable solution for the problems of governance²³.

On a more theoretical level the case of Greece proves to be revealing too: When the global financial crisis struck the mainstream macroeconomic model had not only completely failed to predict the crisis, it also provided no answer for economic policy what to do next. For many critical social scientists this proved that the mainstream neo-classical framework had been misleading policy-makers and thus should be replaced by the older approach of Keynes, which had been designed as a practical answer to the Great Depression of the thirties. Such an interpretation fails in two crucial respects.

First, neither politicians, nor business leaders, nor important financial decision-makers ever based their actions on a full-fledged neoclassical economic model, simply because none of them really knows it. At best they have assimilated a few features dressed as slogans, which they sell as management literature after retirement. It only is this mass of derived pseudo-economic jargon that pollutes and confuses the media and acts as a weapon in ideological class struggle. In the academia the neoclassical mainstream approach has not failed at all, but was extremely successful as an instrument to seduce many of the most promising brains of two generations of economists to spend their lives with useless formal exercises. This theory never was designed to describe economic reality adequately so that economic policy can be given advice. This theory is an instrument of class struggle using the *via negativa*: it excludes reality and therefore under the label of a synthetic science leaves the scholar speechless - but permanently occupied with language development. This characterizes what the inhabitants of the ivory tower of high-brow economic theory praise as their 'state of the art'.

Second, the return to Keynes' macroeconomics is only justified in so far Keynes indeed was a man of practice who wanted to save capitalism from its self-destructing features. Interpreted in the framework used in this chapter²⁴ his central advice is to let activity oscillate between the firm-owner fraction and the state fraction of the ruling class to iron out the inherent business cycles of capitalism. In this context the finance fraction of the ruling class (banks) acts as a mediator between the state fraction (ministry of finance) and the firm owners. Following Keynes some contemporary critics of the mainstream neoclassical theory (Post-Keynesians) would therefore suggest that in the case of Greece it just would need additional investment demand of the government to get the capitalist process going again. Finance could provide money to enable the monetary authority to increase government expenditure, or even better to increase the money supply to induce firm-owners with the help of lower interest rates to invest themselves. Of course, the state

²² Evidently Stalinist regimes and contemporary authoritarian regimes in former states of the Soviet Bloc can be interpreted as systems with an overwhelming dominance of the state fraction of the ruling class.

²³ Recent developments in Egypt prove this common cultural heritage in the Eastern Mediterranean.

²⁴ See the appendices 1 and 3 of [Hanappi, 2013b] for the details of this framework.

fraction would have to return this support to the finance fraction as soon as the next 'natural' capitalist boom returns and tax revenues exceed government expenditure. It should be clear by now why all this sounds so wrong if applied to the case of Greece. And it points exactly to the deficiencies of Keynes' analysis. (i) The failure to distinguish between global finance fraction and local national fractions of Greece's ruling class blurs the difficulties getting new government credit and leaves the sheer existence of the Troika unexplainable. (ii) The trust in a 'natural' capitalist business cycle has no empirical correlate of 'innovative firms' driving it in a small open economy that has been integrated in a large EU for political and military reasons. More generally spoken the ignorance with respect to the political side of political economy is particularly harmful in the case of Greece. (iii) There is a narrowing down of Keynes' agenda in the time dimension, namely to focus only the short-run, and in the dimension of content, namely to concentrate only on the stimulation of the demand side. The implied ignorance is reflected in a neglect of all stock variables, e.g. government debt, and their influence on short-run dynamics via the expectations of economic agents, e.g. traders in global finance. (iv) Despite Keynes's insisting on the importance of the monetary side of macroeconomics his treatment of the subject is sporadic²⁵ and inadequate for contemporary dynamics. This not only concerns national, partly centralized wage-price systems and the whole range of modern financial instruments but in particular is missing the pivotal ingredient of an adequate model for exchange rate dynamics.

For all these reasons a return to Keynes macroeconomics is not a possible answer to the problems of Greece, the name of Keynes only should remind us that economic theory is always made for economic policy.

The most important lesson to be draw from the case of Greece is that the problem of the Greek political economy is *not* an endogenous problem of Greece. It is impossible to isolate Greek economic dynamics from the influence of European political economy and the strategies of global players, e.g. the finance fraction of ruling classes. Therefore any advice for Greek economic policy has to be just part of economic recommendations for Europe. An attempt to provide such a preliminary policy program can be found in [Hanappi, 2013b].

In several military respects **Turkey** shares its history with Greece being a front country of the West from the years of the Cold War onwards. But unlike Greece, Turkey remains to be a cornerstone of NATO till today. How important this country still is for the Western military alliance can be seen in the size of military expenditure of Turkey, compare figure 11. Being the largest military power along the eastern border of the West, followed by Israel in the south and Poland in the north, it certainly plays a special role. There is no doubt that this

²⁵ First John Hicks, and later many other Keynesians have tried to construct a consistent framework based on Keynes prose fragments. Nevertheless it only reached a somewhat closed formal representation when it was rejected by the school of 'New Classical Macroeconomics' in the textbook of Thomas Sargent [Sargent, 1979]. Not all Keynesians were ready to give up the beautiful vagueness of Keynes' rhetoric skills and therefore dubbed the more formal type of Keynesianism 'Bastard Keynesianism'. Neither of the two variants did stand the test of time when the global financial crisis struck in 2008.

military strength also is one of the foundations of Turkey’s increasingly independent role in European politics²⁶.

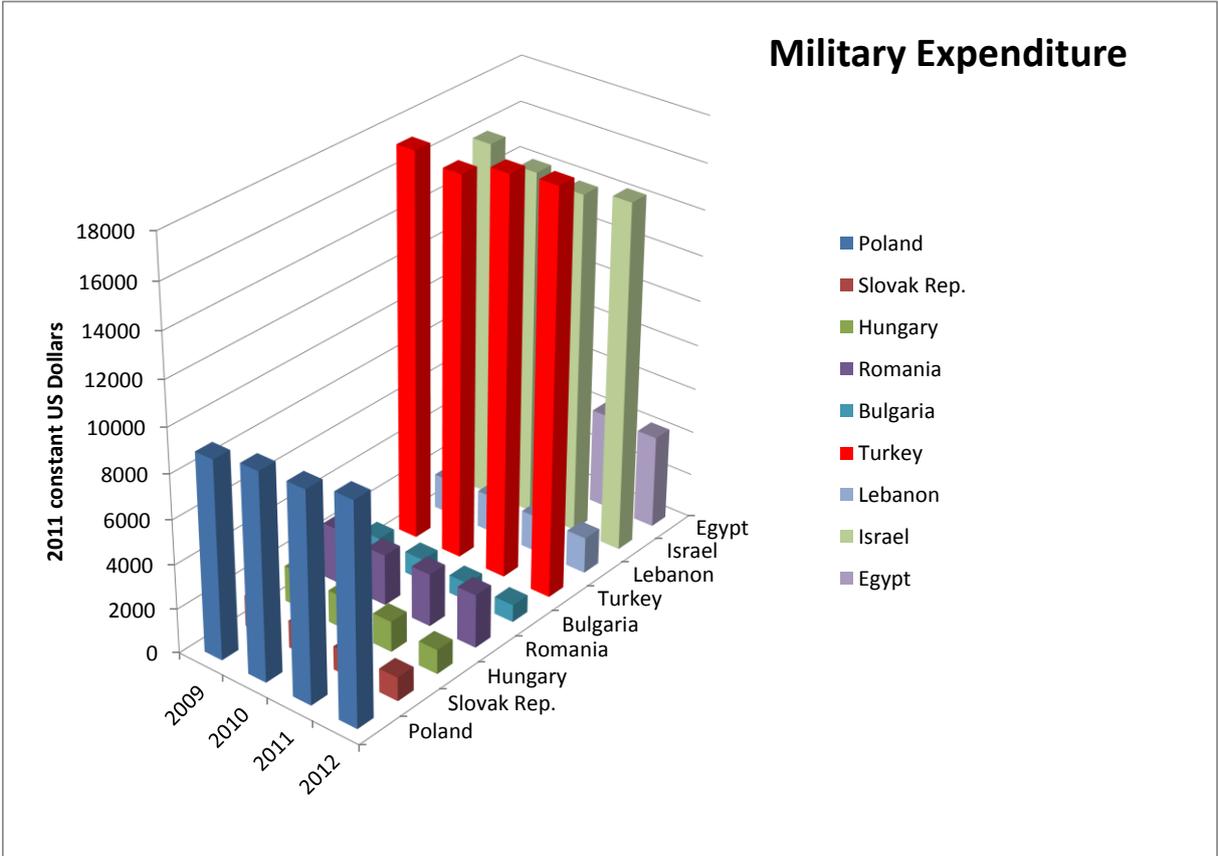


Figure 11: Military expenditure along Europe’s east and south-east border

Another important difference to Greece concerns the ideological superstructure. While in Greece the Greek Orthodox Church is extremely closely interwoven in all parts of the ruling class and also exerts strong influence on the working class, Turkey’s ruling class is much more split between secularism and Islam. The state fraction of the ruling class with its central pillar in the military traditionally tended towards more secular views, which also were attractive for capitalist firm owners. On the other hand politically oriented Islam, reaching out from the Middle East was able to organize its own ideological power center within the state fraction of the ruling class. When in 2002 Recep Erdogan’s new political party AKP wins the elections and explicitly combines religious goals with state functions Turkey’s ruling class is definitely split into two camps. An important pre-condition for the electoral successes of Erdogan’s Islamic movement consisted of the rapidly increasing gap in Turkey’s income and wealth structure, which mirrored the widening opposition between the large cities and the open land (in particular Turkey’s south-east). Poor citizens living in the little developed regions in Turkey’s periphery were voting against the secular ideology that

²⁶ Comparing military expenditure in Greece (2009: 11,5 billion US S) to the military giant Turkey (2009: 17,3 billion US S) shows how ridiculous the argument for high military spending of Greece due to ancient rivalry between the two states is. In 2009 (at the height of the crisis!) Greece spent 3,3% of GDP on its military, by far the largest share of all EU states (Germany: 1,4%; France: 2,6%; UK: 2,7%; Italy: 1,8%; even Turkey only 2,6%).

had favored the urban elites at their expense²⁷. With the AKP religious consolidation promised to go hand in hand with economic improvements.

These developments in Turkey are not just a possible sign for Turkey being a last south-eastern outpost of Europe; they certainly are of even more general significance for the return of religious movements to state politics. This return to religious state leadership is a global phenomenon and has at least two major sources: On the one hand global interdependencies - the real economic and political links as well as how they are communicated - have become extremely complicated to understand, while on the other hand the dominant interpretative template of the ruling class, i.e. the neoclassical theory that is conquering all social sciences, aims at irrelevance and confusion²⁸. In particular the least educated strata of the population, which are most distant from the ability to comprehend by their own experience what is going on, are prone to fall prey to overly simple, but somehow consolidating religious manipulation. As the events of the Arab Spring recently vividly showed nationalism and religious fanaticism are brothers in arms when it comes to fight the awakening of enlightenment. But to use religion and ethnicity (or race) to gain state power is a play with fire. Once these demons of the past are revived, their foundations are so volatile that soon further splits and conflicts between newly emerging groups will enter the stage. This is what starts to happen in Turkey within the AKP right now. In its most dramatic form this already has happened in Iraq after the USA had tried to implement what a strictly market-oriented paradigm would prescribe. After a formidable failure of this economic policy to reach any one of its self-declared goals the country broke up into a civil war between rivaling religious sub-groups²⁹. A comparable process currently takes place in Syria, though there is a more substantive issue of geo-politics at stake there: For Russia the Syrian ports of Latakia and Tartus³⁰ are of strategic importance, and thus for Western forces any peace arrangement in Syria is at the same time an arrangement with Russia's access to the Mediterranean Sea. Note that Latakia lies just 50 km south of the Turkish border, according to the definition of Europe proposed in this chapter this means 50 km south of Europe. In that sense the civil war in Syria is a war along Europe's southern border. Consider also that Erdogan could expel an ethnically competing group, the Kurds, to a region in the north of the dissolving state of Iraq. This piece of the south-east borderline is also far from being consolidated, Turkish airstrikes repeatedly attack villages in this region where they assume Kurdish PKK fighters, which in turn infiltrate Turkey. And finally Turkey has Iran as a neighbor, a state, which is ruled by Shiite mullahs. In many respects Iran, a state previously ruled by one of the most Western-oriented emperors, Shah Reza Pahlavi, did fall deepest into the impasse of a dogmatic religious regime. The contrast to Europe - to be presented by Turkey - to an even pre-Stalinist type of social system could not be sharper.

²⁷ The Gini-coefficient of Turkey still is almost double as high (0,41) as the one in EU states.

²⁸ In this respect it reminds on the dogmatism of the Catholic Church at the end of the middle Ages: Highly educated and specialized scholars working with most sophisticated methods in ivory towers on extremely irrelevant questions.

²⁹ See [Cafruny A. and Lehmann T., 2012], [Bayat, 2013] and [Ali, 2013] for a detailed discussion of this process.

³⁰ Tartus is the only port of the Russian Navy in the Mediterranean Sea.

And this fact makes the religious foundations of Erdogan's AKP look dangerous for a future EU membership of Turkey³¹. Ethnicity is as fragile a pillar of Turkish policy as is religion. One of the darkest events of modern Turkish history, the treatment of Armenians, still lingers in the background of many of today's political bargains.

It is a classic policy move to distract observers of internal policy problems by turning to surprising foreign policy issues. Following this route Erdogan has used the Arab Spring events to present Turkey as an international role model for an economically successful, 'secular Islam state' – a contradiction in terms. But trying to team up with some Arab states, e.g. Qatar, proved to be more difficult than expected. After the upheavals groups and leaders still were in unstable positions and the new geo-political setting was – and still is – in flux. It is not evident in which respects Turkish Islamism indeed can be a model, its historical emergence seems to be much too specific to be of any help for the disasters of civil society that in the moment plague the Arab world. Moreover, at the home front unrest could not be stopped by ever more police, secret service and other coercive instruments. As internal difficulties did rise the tensions not only between the army and the ruling party but also within the AKP itself became severe. In the latter respect an additional policy aspect of countries along the NATO frontier became visible: In many of these countries a considerable part of the ruling elite has emigrated and stays now in Northern America, but still maintains tight links to national policy in their European home country. Indeed this fact always has been used by the USA to use these links to influence local European policy³².

The relationship between Turkey and the European Union mirrors the track of Turkey's domestic turns. Before the takeover by Erdogan's AKP the accession of to the European Union was a declared priority of Turkish governments. Resistance against these plans rather came from some conservative parties in the EU, belonging rather to the state fractions of the ruling class trying to please voters that could be irritated by a hypothesized danger of losing their economic status by foreign intruders. Usually these voters were already endangered, though by other forces: small shop owners by transnational corporations and workers with precarious employment by cost reductions and austerity programs. Part of the strategy of the AKP clearly was to play on the self-esteem of a Turkish nation; if the EU makes it difficult for Turkey to join, then Turkey will work on becoming the leader of the prospering nations around the Eastern Mediterranean. In the meantime the EU had its own problem of coming to grips with its Eastern Enlargement in 2004. With 10 more Eastern European countries to be economically and institutionally to be integrated the focus turned away from Turkey. Then, in 2007, the European Union advanced to the western shores of the Black Sea by taking on board Romania and Bulgaria. This move left several west-Balkan countries as an internal home-work of integration (in the meantime Croatia has joined and Serbia is on its way), while the case of Greece followed its own tragic trajectory. The situation changed

³¹ Note also that 84% of the Turkish population are Sunnis.

³² The influence of the Democratic Party of the USA on PASOK in Greece was a notorious case before Greece moved back from the front. Policy in Poland, Turkey and Israel cannot be understood without taking a look at these, usually even personal links.

when the global crisis pushed Europe’s core countries into the deep recession of 2009. As figure 12 shows, the downturn of GDP in Turkey was similar to the one in the large EU countries, but in the mid-run Turkey clearly is growing on a higher trajectory.

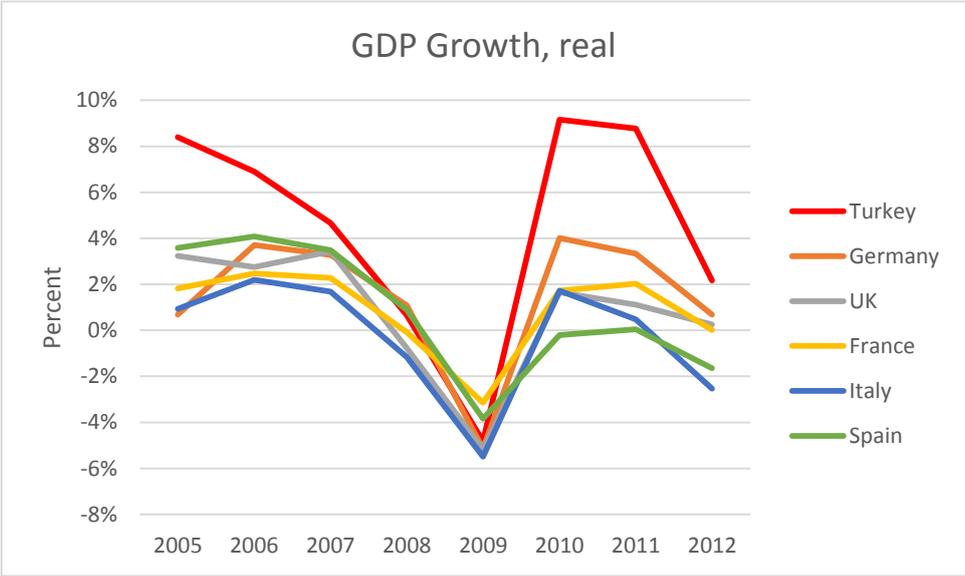


Figure 12: Real GDP Growth in Turkey and 5 large EU Countries

The potential for growth, i.e. capital accumulation, in Turkey can easily be explained by the already mentioned high income inequality combined with a large and cheap labor supply moving to the big cities. Figure 13 compares absolute sizes of GDP and labor supply.

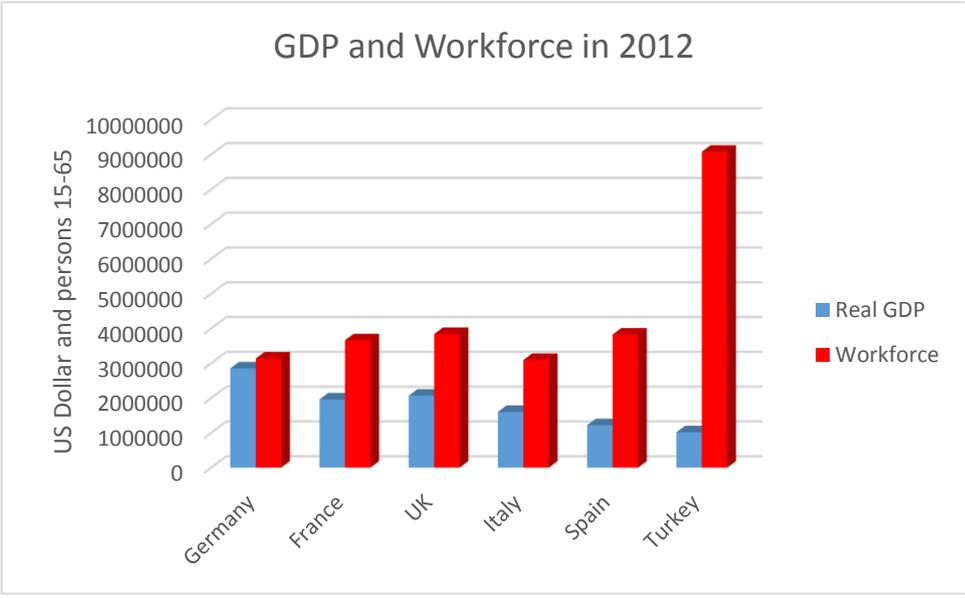


Figure 13: GDP and Workforce (age 15-65) in 2012

It is this potential contribution to the European capital accumulation process, which induces the firm-owner fraction of the European ruling class (since the crisis mainly consisting of big business) to push for the inclusion of Turkey again. Global finance, at least its European branch, until the more recent developments in 2013 has been quite euphoric about such a

perspective too. But world politics, following Barack Obama's advance across the Pacific to focus on China-US relations, has made finance more skeptical with respect to the highly explosive developments in the Near East – eventually contaminating countries like Turkey. Nevertheless, as recent history shows the mood of global finance, i.e. the profit expectation process of its leading decision-makers, is an extremely volatile variable. If Putin's Russia can be forced to accept the inclusion of the Ukraine in the EU (a process that started the hard way in autumn 2013), pacifying the Black Sea region with its huge energy resources, and at the same time conflicts in front of China and within China prove to be much more difficult than expected, then investors' choice might turn quickly towards Turkey again. In the latter case it is highly questionable if the group around Erdogan can be the local partner for the global ruling class again. The best guess probably rather would be a newly emerging mix of important Turkish business elites and a rejuvenated army fraction. With that constellation Turkey as a part of the European Union probably could be a modest contributor to a reconciliation of the capitalist process in Europe – coming at the price of increased law-and-order policy, markedly increased force of exploitation (remember variable f discussed in the context of Greece), and a strong further shift to extreme inequality in income and wealth.

Though the question of energy supply provided by the Near East has not been discussed explicitly yet, it is evident that this issue is at the heart of the interest of the global ruling class in this part of the world. And with respect to European energy demand it is clear that everything that happens in the Near East directly affects Europe's other big energy supplier, Russia. The three most southern parts of Europe' South-East – Cyprus, Turkey, and Greece – not only are important as countries through which the pipelines delivering European energy have to flow, these countries – together with Israel – also own a large oil reserve that recently has been discovered in the Eastern Mediterranean. This issue should wake up policy-makers in the European Union. Perhaps a well conducted decision-making process on the future usage of this wealth can be a challenge for EU-politicians that improves their problem-solving capacities. Unfortunately this fraction of the European ruling class has a rather disappointing track record in the region, e.g. with respect to Cyprus, so the odds are not too good.

The island of **Cyprus** can best be regarded as a laboratory for testing dangerous economic policies. Being remainders of British dominance in the Mediterranean Sea, Cyprus and Malta early on developed some special economic, and in particular financial features, that served the British (and other countries') ruling class to store money under the control of a different, usually easily manipulated, national legislature. This type of diversification of nation states, the split-up of the state fraction of the ruling class, has been a significant institutional evolution in the after-war period. In this respect Europe's most famous examples of course are Switzerland and Luxemburg. But contrary to these examples Cyprus is an island, exposed far south in the open sea and a traditional port for all sea trade passing by.

The first experiment came soon after Cyprus became independent in 1960. With a military junta taking power in Greece in April 1967, this most coercive part of the Greek ruling class

was propagating nationalist ideology. In Cyprus internal conflicts already had been permanently evolving since the British had left a vacuum of state power. Greece as well as Turkey had fuelled the rivalries by re-injecting and supporting religious motives from 1958 onwards³³. In 1974 the Greek military junta tried to solve the issue for once and for all, testing if the Turkish military – and the international community – would accept this move. Turkey did not, and the northern part of the island was invaded by Turkish troops. Since this failed military experiment the Cyprus is divided. It also showed that legal agreements are just an epiphenomenon: From a legal point of view the Greek junta had broken a Treaty signed in 1960 and so intervention of Turkey was legally justified, but on the other hand the newly founded Turkish state on the island (the ‘Turkish Republic of Northern Cyprus’) never was legally accepted by any other nation, only by Turkey. International agreements are driven by current power relations and not vice versa. The failed conquest of Cyprus (by both states) left the population of the island as victim.

Another failed policy initiative on Cyprus can be found in the attempts of the United Nations to reach a unification of the island by diplomatic means. While the intervention of the peacekeeping force of the UN (UNFICYP) from 1974 onwards certainly has contributed to a more civilized style of conflict, the latest diplomatic initiative of UN secretary general Kofi Annan in 2002 did not succeed. Despite political pressure from the UN, the EU, and the USA the Greek government as well as nationalists (of both sides) on the island rejected the project. The lesson to be learned from this failure is that once the seed of deep ideological conflict (eventually supported by religious aberrance) has been successfully implanted, any short-run intervention of international diplomacy has very limited influence. It either takes a new generation of citizens socialized in a different environment, or an actual direct interference in the power structure of a state (or both elements) to overcome this micro-political potential for conflict. This Cypriot experience can be generalized to all Balkan countries too.

The third example of a failed economic policy experiment on Cyprus dates from the recent crisis years: the Cypriot debt crisis. Cyprus joined the EU in 2004 and introduced the Euro in 2008. After the collapse of the USSR in 1990 the island had increasingly attracted newly rich tourists and businessmen from the former Eastern Bloc, with its currency now being the currency of the core EU countries Cyprus acquired a new role: Surplus generated in Russia – partly by more or less criminal activity - was transferred to the island and then re-exported as hard-currency, ‘clean’ Euro amount. The sheer amount of this type of financial transfers dwarfed the GDP produced in Cyprus³⁴ – and the profit shares remaining in the country enabled its citizens to receive a disproportionately high amount of credit. Then the crisis struck, the GDP decreased in 2009 by 1.6%, local tourism and the shipping industry went

³³ The return to religious roots later proved to be an extraordinary strong instrument for the manipulation of ethnic groups in Yugoslavia.

³⁴ While GDP was 24 billion US \$, the banks had deposits of 120 billion US \$ (half of them from Russia). Moreover these banks held 22 billion Euro of Greek private debt; a channel on which the Greek crisis could be transmitted to Cyprus.

down, unemployment increased and loans could not be served. The value of commercial property fell by one third, and the Cypriot banking sector was approaching a collapse.

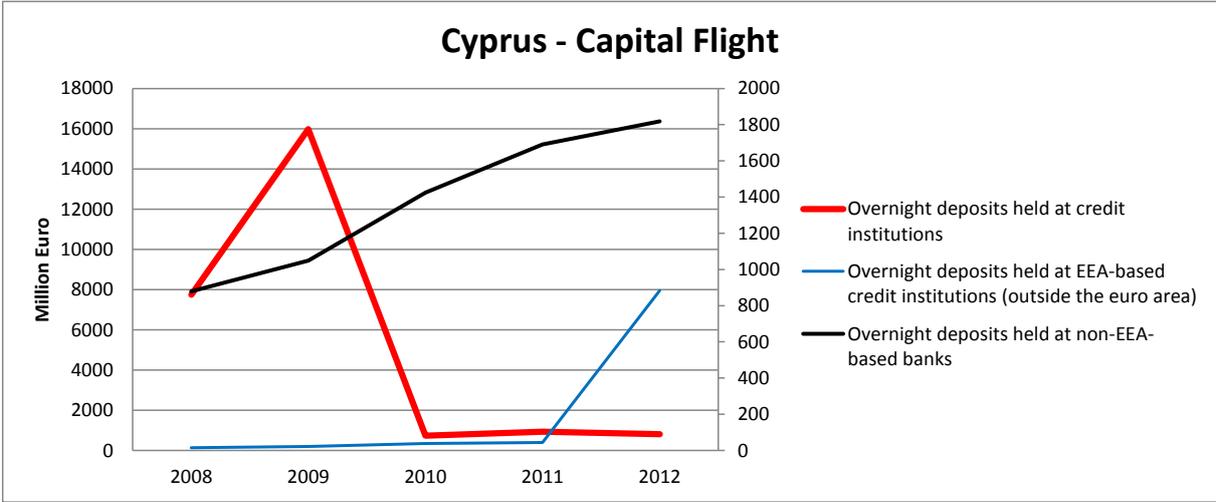


Figure 14: Cyprus Finance in Crisis

This was the situation when the worldwide transfer of debts to the finance fraction of the ruling class towards debts to the local national state fractions, i.e. the ‘government debt crisis’, had started. When the Cypriot Central Bank applied for help the state fractions of the core EU members seemed to have decided to make an exemplary attempt to directly take hold of the large deposits in Cypriot banks by forcing them to stop to return savings. This was an outstanding exploration of the use of such a measure, since it was clear from the beginning that it would destroy any trust of customers in financial institutions. Such an experiment could only be dared in a small, relatively isolated country; and it evidently aimed to get hold of money from non-European, e.g. Russian, origin. The experiment failed dramatically and caused permanent damage. Big money had been already transferred away from Cypriot accounts to other countries when the strike was performed³⁵ and the effect on the Cypriot economy was a lasting loss of reputation mirrored in capital flight (compare figure 14)³⁶.

Cyprus as a small laboratory for dangerous policy experiments has experienced a marked economic decline and there is little hope for a new upswing. The role of a safe haven for money stemming from unclear origins has lost much of its glamour, though remainders of the Russian connections still can be found. One option for Cyprus hopefully would be to play the role of a facilitator in questions of European energy policy, as already mentioned above. But this certainly would need a unified island, a condition that crucially depends on the more important players in world politics: the USA, the EU, Turkey, etc.

³⁵ At the time 10% of the shares of the Cypriot Central Bank were owned by the Russian oligarch Dmitry Rybolovlev. It was at best naïve to believe that closing bank counters can beat the fast and sensible movements of capital. In the hindsight it is much more probable that the exercise should simply be used as a signal to show, how coercive measures of the state fraction can hurt everyday life.

³⁶ While deposits of Cypriots in banks outside the Euro-area went up (right hand scale in fig. 14), those using Cypriot institutions went down dramatically (right-and scale). Source: IMF

In many respects this also is a general result of this compressed tour de force through Europe's South-East. It is a hotbed of world politics for many reasons, energy supply and important strategic position (from a military point of view) are just two dimensions. The people living in this area of Europe have experienced more troubles and harder times since the end of World War 2 than most other Europeans. Integrating them into European welfare increase means also to learn from their experience, to understand how and where the flourishing of the living conditions of one group of Europeans is built on the misery of another group. The analytical tool sketched in this chapter, i.e. geographically structured class analysis, can be used to throw some light on these dynamics. Despite its often speculative character (and thus its necessarily short predictive horizon) it can and should inform the citizens about which type of European democracy they should fight for. It should not be too surprising if the wisdom slumbering in the south-east corners of Europe for many hundreds of years can contribute major pieces to the blueprint of a future more democratic Europe.

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