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Fred Harrison

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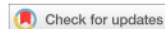


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ARTICLE



Out of the ashes: Ukraine and the new social paradigm

Fred Harrison

Land Research Trust, London, UK

ABSTRACT

Structural reform of society is imperative, if governments are to be equipped to navigate the existential crises that threaten humanity. A new paradigm of governance is proposed, illuminated by Ukraine's need to "build back better" after the war. The twin pillars of property rights and fiscal policies support the current social model. The knowledge required to reform these pillars has featured in the economic literature for more than two centuries. The theory for the alternative paradigm has been empirically tested in culturally diverse parts of the world for more than a century. Policy-makers and the international financial institutions, however, persist with taxes on earned incomes which damage the wealth and welfare of nations. If the post-war aspirations of the people of Ukraine are to be realised, sub-optimal funding policies need to be set aside to accelerate renewal on terms that would inspire other nations.

KEYWORDS

Statecraft; social paradigm; systems thinking; taxation

Introduction

Multiple existential crises, which include climate change, mass migration, and the ideological paralysis which creates the political space for autocrats to exploit, evoke the need for a new statecraft, one that delivers hope in place of despair. The model reviewed here entails a transformation of fiscal policy to one that originated with the French Physiocrats and was articulated by Adam Smith [1]. It was most recently interrogated, and endorsed, by IMF economists [2]. The reform entails the shift of government revenue away from wages and profits and on to economic rents.

This policy is employed by countries such as Denmark [3] and Australia [4,5], although the quantum of revenue directly garnered from rent is insufficient to yield macro-economic and sociological benefits. Australia's best practice guidelines on land valuation [4] and the current application of rent-based fiscal policy [5] should be considered. In the 1990s, a more radical application of the reform was proposed for Russia, to facilitate the transition from command to market economics, but was rejected in favour of the model favoured by neo-classical economics [6].

Governance: a new paradigm

Existing fiscal systems inflict grievous costs on nations. These 'excess burdens' (aka deadweight losses), are enormous. In one assessment, the authors estimated the impact

CONTACT Fred Harrison  fred.geophilos@gmail.com  Land Research Trust, London, UK

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on the USA if government increased the tax rate on the asset value of land from its current 0.55% to 5.55%, with a revenue-neutral reduction of the tax-take on wages and profits. They found that ‘In a representative household model, this increases welfare by 3.4% of steady state consumption, and increases output by almost 15% relative to trend’ [7]. The authors do not quantify the costs of the many second-order pathologies that ripple through society as a result of exacting revenue from wages and profits [8]. The contours of the alternative fiscal model begin to emerge when we address those persistent problems – like housing unaffordability and under-funded public services – which the current model of governance is not able to resolve.

Sceptics who contest the notion of a single ‘silver bullet’ remedy pose three challenges to the practicality of the proposed reform.

- (1) The shift of revenue from the earnings of labour and capital and onto rent-generating assets would not raise sufficient funds to cover budgetary needs.

Mason Gaffney (1923–2020), who spent most of his working life teaching economics at the University of California, authored exhaustive studies that affirmed rent as a stream of income that *was* sufficient to fund the services provided by the modern nation-state [9].

- (2) Transition to the rent-based fiscal paradigm would be disruptive, rendering governments unable to manage the move from the debt-driven fiscal model.

It may be this belief that motivates international financial institutions to insist that debt-distressed countries, which need rescue loans, must continue to apply deadweight taxes; and must fund the repayment of loans through ‘austerity’ measures.¹ The rent-based revenue strategy, however, *is* a viable alternative approach to financial crises, not least because the switch automatically results in an increase in productivity. National income is elevated above historic trends. This is achieved by eliminating the deadweight losses inflicted by conventional taxes [10].

- (3) The fiscal switch would not close the gap between rich and poor, or resolve other endemic problems like the unaffordability of housing.

This pessimism does not withstand scrutiny. According to the study published by the IMF, equity is one of the prime benefits derived from switching revenue onto economic rent [2]. Joseph Stiglitz, a Nobel laureate, addressed the inequality issue at length. He demonstrated that ‘A stiff tax on . . . rents would not only reduce inequality but also reduce incentives to engage in the kind of rent-seeking activities that distort our economy and our democracy’ [11].

Economic rent is not to be confused with the commercial rent paid for hiring a car or leasing an apartment. It is the layer of income net of a nation’s wage and profit streams. Economists classify it as a ‘transfer income’ – the resources redistributed from people who work to produce them to the owners of rent-yielding assets who offer no *quid pro quo* in return. Camouflaging this process was an intentional outcome of the redesign of classical economics into its post-classical form, as actively encouraged by the rent seekers of the late 19th century [12].

The only sensible explanation for opposition to fiscal reform must be rooted in ideology, which rationalises the ‘do-nothing’ strategy. But, the political defence of the *status quo* in relation to existing property rights and income distribution avoids discussion about the ensuing injurious outcomes. We can, however, imagine the prospect of policy-makers in a war torn society being willing to enhance the tools of statecraft. The tragedy of Ukraine affords us the opportunity to consider the degree to which a rent-based revenue policy would provide the optimum route to rebuilding the nation from the ground up.

Ukraine: strategic renewal

Because of the displacement of millions of people from its territory since the war launched by Vladimir Putin, Ukraine needs a comprehensive plan of action for its post-war recovery. This offers the scope for developing a strategy that turns the historic tragedy into a triumph of the human spirit. What might such a plan look like? Three issues are addressed to interrogate the impact of the rent-based fiscal model. The first concerns the declared aspirations of the displaced Ukrainian people. The second relates to the existential needs of people in other parts of the world. The third issue relates to the opportunity to maximise the development and adoption of the productivity-enhancing innovations of the digital age.

- (1) Ukrainians oppose the attempted annexation of their country on three grounds: the right to defend their land, the desire to protect their national identity, and the commitment to personal freedom.

Western nations, and the international financial institutions, will assist in post-war recovery of Ukraine. We know, from the historical record, that such interventions are framed in terms of financial and fiscal policies that bequeath a legacy of distress. This is what happened when the Soviet Union, and the Yeltsin administration that followed, failed to adopt the rent-based strategy for funding the renewal of the economy and society of Russia [6]. And, today, based on reports in the mainstream media, we know that the attempt by the People’s Republic of China to adopt market economics is bedevilled by disruptions in the property market [13]. Instabilities in the real estate sector, caused in large part by land speculation, are incentivised by the failure of government to collect the full rental value of land and natural resources which remain, to this day, as public property.

By avoiding the tax-induced burdens on labour and capital, the Ukrainian government would avoid the distortions that result in sub-optimum social and economic outcomes; would avoid the debt-based model that leads to financial crises; and would consequently chart the fastest path to self-funding growth. This, in turn, would create the space within which people were free to use land to best effect; consolidate their identities as hard-working, entrepreneurial people; and ensure their freedom from the constraints currently imposed by creditor institutions on debt-burdened nations.

- (2) Mass starvation is one indicator of a global system in crisis. According to the World Food Programme [14], an estimated 828 million people are hungry

(January 2023). Since 2019, the number facing acute food insecurity more than doubled to 345 million. Famine is a risk in 49 countries. This humanitarian tragedy is the result of a dysfunctional social model at multiple levels of failure.

Yatsiv et al. [15] emphasise the need to restore the pre-war volume of Ukrainian food exports. Pre-war levels of productivity, however, will not be sufficient to meet the extraordinary challenges of both the post-war conditions within Ukraine, and the existential threats that now challenge the world. Productivity needs to be raised above historical trends, to accelerate the flow of food to meet the needs of those regions that are suffering diminished production as a result of climate change and soil depletion.

If the production of food is a singularly important mission to rescue the plight of hundreds of millions of people, optimum incentives are needed. These are delivered by the rent-based revenue system of governance. In the mid-18th century, when the UK was still a largely agricultural country, Adam Smith reviewed the economic impact of an annual ground rent to fund the budgetary needs of the state. He concluded that ‘Ground rents, and the ordinary rent of land, are, therefore, perhaps, the species of revenue which can best bear to have a peculiar tax imposed upon them’ [1:Bk.V, Ch. 2, p.370]. The rent-based model removes the fiscal obstacles to the investment of labour and capital on the land, and maximises the output of food. Ukraine, as one of the world’s bread baskets, would achieve the humanitarian goal of helping to rescue the hungry people in Africa by conforming to economic best practice. This, in turn, may encourage other food producing nations to undertake the reform.

- (3) The digital age promises a step-change in the quality of people’s lives. Even under conditions of war, digitalisation would increase the efficiency of companies by reducing production costs [16]. Russia’s wanton destruction of Ukraine’s energy system has speeded up the need to deploy innovation in the provision of alternative energy sources [17].

Unintended negative consequences of digital innovations are imposed immediately on the most vulnerable people in society. This happens through the productivity gains that yield cuts to the costs of production. The savings are, with alacrity, absorbed as increases in land values [18]. The benefits do not percolate down to people working in fields and factories, but are captured by the owners of rent-yielding assets in all their forms – urban land, fossil fuels, the radio spectrum, financial instruments that constitute claims on real estate, and so on. The only way to neutralise this unintended impact is for the net income, or rents, to be recycled back into the economy to fund the public goods that everyone can access. Under this model, the people of Ukraine would be able to enhance capital formation and entrepreneurial activity, to meet the desperate needs of their decimated nation.

Discussion

If Ukraine recovered within the terms of the rent-based fiscal system, other nations would be inspired. The benefit of such a global shift would be enormous, in terms of addressing existential threats like the eco-crisis. Floods are already swamping whole

communities across North America and Asia; and fires are devastating forests and the habitations in their way. In Ukraine's case, the war is adding to the wanton damage of the natural environment [14]. What escapes attention, however, is the extensive damage routinely inflicted by contemporary forms of governance. Gaffney [18] explains how systematic disruption to both urban and natural habitats is an embedded feature of taxation. He illustrates the process with the subsidies that induce the urban sprawl that degrades rural habitats. This process is reversed when rent is treated as public revenue. And by reforming the pricing system it would meet, for example, the needs identified by Kicaj et al. [19]: limiting the consumption of fossil fuels and encouraging the switch to clean energy.

People of all income levels and wherever they may be located would benefit, as with the strategy for elevating development in the Global South. This is illustrated by the threat from mass migration, which is driven by the absence of the right to remain in countries bedevilled by unemployment, the militarisation of politics – the list is a long one. These are the outcomes of the adversarialism that is built into the fabric of governance that 'raids' earned incomes, to privilege those who rely on the transfer of rents. Enhancing people's freedom to remain in their home communities diminishes migration as an existential threat to Europe and North America.

At present, governments persistently fail to solve problems that can be attributed to the underfunding of (say) health and welfare services. This is fostering deep dissatisfaction, tending to persuade people to support autocrats who promise palliatives that do not address root causes. By contrast, the rent-based fiscal paradigm would initiate a healing process. Statecraft would be transformed into one that united nations and opened the discourse to new forms of cultural renewal. This, in turn, would enhance the capacity of law-makers to negotiate ways through the existential crises. An example is the endemic problem of corruption.

In the case of pre-war Ukraine, corruption was a legacy of its historical association with Russia, and then, following the fall of the Soviet Union, the privatisation of state-owned assets. But even in western democracies, corruption is a feature of governance that employs the coercive form of funding [20]. That coercion evaporates when property rights are adjusted to enable the flow of net income into the public purse. Rents are audited, and public agencies and policy-makers are held accountable for their stewardship of the public's revenue.

Conclusions

Under conditions of enormous personal distress, Ukraine's intellectual communities remain engaged in identifying strategies for rebuilding their society. Some of this creative thinking appears in this monograph, revealing the shortcomings in authorised discourses.

The materialism promoted by neo-classical economics, for example, is insufficient to meet people's full needs. Kovalyshyn et al. [21] observe that 'the quality of life/standard of living of the population is a complex, multifaceted concept that broadly reflects the degree of satisfaction of citizens with the environment and their personal lives – and this goes beyond mere consumption'. This level of complexity is why, to deliver both 'equity and efficiency' [2], a whole-of-life systems approach is needed for reform. The holistic

approach reveals how the dividends from work and enhanced productivity would organically benefit everyone through the funding of public goods. Ukraine, if it adopted this fiscal model, would synchronise civil society with governance to deliver optimum outcomes that meet personal needs and social and ecological imperatives.

Ukraine has been rendered materially desolate by Russia's military ambitions. Regions occupied by Russian troops have retreated to subsistence levels of production. The post-conflict needs of these territories, however, can reach beyond the restoration of pre-war levels of production in, for example, agriculture [22]. This potential warrants examination through the holistic perspective. Much of the resources needed to rebuild the demolished towns and villages can come from the economic model that delivers *increased* net gains. This is the optimum route to Ukraine becoming self-sufficient and corruption-free. The rent-funding model provides those additional resources, because it yields results that are 'better than neutral' [10]. By removing the incentives that induce land speculation, land hoarding and the under-use of land, for example, economic productivity and the welfare of whole communities are elevated to hitherto unattained heights. The recirculation of the additional net income to meet people's shared needs, by investing in the rehabilitation of infrastructure (highways, energy, cultural amenities), would entice back to their communities the refugees who fled the war.

Other countries, and most immediately the western democracies, have a direct vested interest in advocating the optimum funding model. Unless people in Africa and South America are able to feed themselves, they will increase the rate of migration into Europe and the USA. That, in turn, will arouse passions that intensify the drift to autocracy. The fiscal model that begins to diminish such threats is theoretically and empirically credible.

Ukraine is up to the challenge. Its role in feeding the world is acknowledged, but it does not generate the net income needed to fund the post-war recovery. The farm sector is not as competitive as the 'big players' in other countries [23]. The extensive terrain, and the legacy of collectivisation, encourages sub-optimum forms of production. But out of the ashes of Putin's war, Ukraine could become one of the supreme contributors to the qualitative leap forward in the unlocking of human potential. This would be achieved by recognising that spatial scale is not the key to agricultural productivity or to the optimum net gains needed to fund evolution of the future. More relevant is the intensity of loving care devoted to production; the recognition of responsibility for personal actions that disallows the 'free riding' (aka rent seeking) on other people's backs; and the symbiotic relationship of the farming community to social and ecological habitats within the pricing framework ordained by their government. The people of Ukraine are demonstrating that they possess what has been called the power of the land [24]. As such, they can originate the model that most swiftly overcomes the trauma of war. They need enriched metrics on the nature of economic competitiveness and personal happiness. The outcome would be a social paradigm capable of nurturing back to health the people who wish to rebuild their families and communities, and to bring back to life the land for which so many are offering the ultimate sacrifice.

Note

1. Pakistan is one recent case, in which IMF loans are tied to conditions that included the imposition of austerity measures on the population. John Reed and Farhan Bokhari, 2023, 'Pakistan secures \$9bn of pledges to aid recovery', *Financial Times*, January 11.

Disclosure statement

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