Financing a Green Shift

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Windmills being installed in the North Sea by a specialized boat-crane.

Is a Green Shift really affordable?

A reality facing most countries today is that the pandemic has incurred severe economic dislocations. This includes Canada that has not escaped serious economic damage, both seeing a fall in GDP as well as rising unemployment and struggling small businesses. Considering that we also have a climate crisis, many progressives have advocated the idea that the economic recovery should as a main focus invest in renewable energy and other CO2 emission reducing projects, partly on the premise that many such investments have good job creating potentials and therefore good economic recovery potential.

However, on the other side of the political spectrum we find the neoliberal establishment, including Canada's conservatives and fossil fuel lobbyists. Here the howl is that now, due to the cost of the Covid-19 crisis, we absolutely cannot afford a Green Shift. But is that really true?

To answer this question, one has to dig into how the current political economic system's financial and monetary components interact. In this regard, an interesting fact is that in the midst of the corona crisis—when all governments supposedly were severely cash-strapped—large offshore wind power projects are continuously being launched, many with governments in leading roles.

Wind Power Competitive

A reason for this surprising development is that generating electricity from offshore wind power has become competitive with fossil fuel-based electricity generation. This implies that incomes from selling electricity over the assumed project life of a wind farm will be able to amortize both original investment as well as pay for the period's operating costs.

When that's the case, government's part of such projects can be financed 'off-budget'. In practice that means that a given government needs not invest in the project from its ordinary tax-based income streams but can establish a limited liability company, with shares either fully or in a controlling amount in the hands of the government.

The established company can now issue debt. The government's only—but important—direct economic participation is that it underwrites the debt, in other words assumes project risks. Besides that, the project will not affect ordinary government revenue and expenditures.

Since government debt of advanced economies such as Canada are considered risk-free, such a construction will ensure that interest rates will be the lowest possible and financing costs kept to a minimum. This financing model worked well for the construction of the Great Belt Link, an 18 kilometre combined bridge and tunnel link over the Great Belt, at a capital cost approximately equivalent to C$8 billion in current prices.[1]

In particular, the model ensured that toll rates and collection was kept under public control and consequently have been falling in real terms (compare to Ontario toll highway 407, originally built for public money but privatized for 99 years by the Harris government for a give-away price. Since Harris didn't put any limitations on price setting, tolls have risen steeply, way above consumer inflation, in the process creating stupendous profit for owners).

The Great Belt Link, here the East Bridge with its 1600m span over the main shipping channel out of the Baltic Sea.

Another possibility

When projects promise to generate future income streams that over time can amortize investments, countries with their own currency and central bank will have another possibility for financing large and socially important infrastructure projects. Instead of borrowing the money by issuing bonds to private financial markets at interest costs, the government can 'sell' the bonds to its own central bank, which will pay for the bonds by expanding its balance sheet, i.e. by creating new money.

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[1] https://sundogbaelt.dk/en/construction-costs-and-debt/

Neoliberal economic doctrines, which still lives in an economic universe that operates as if the gold standard still was in force, rejects this possibility, primarily for two reasons. First, even though it creates debt that is not likely to ever be paid back (and therefore effectively is simply creating new money out of thin air) it still violates the balanced budget principle at the centre of neoliberal economics. Second, it's claimed that it will lead to run-away inflation.

It's true that when governments previously issued money in excess of revenue under the framework of the gold standard, when fractional reserves of hard money were required to undergird the monetary system, there were limitations on the amount of money that governments could issue. This was because the gold standard was based on the premise that people had the right to convert bank notes to gold coins on demand.

Today modern state money is only backed by the state's ability to collect taxes and its legal framework—including rules for banks and contracts. However, there must also be included a promise to uphold trust in the monetary system. The consequence of this is that a government can in fact, at will, have its central bank create new money and send it into circulation by spending the money, but it will be constrained by the 'trust' factor that requires that price stability is not challenged by the followed monetary policies.

When trust is broken: German banknotes in 1923, so worthless that children used them to play with.

The Limits are in the Real Economy

If we disregard the political bias perpetuated by conservatives, who maintain that "states are like households", the real limiting factor to the money creating power of governments is to be found in the real economy. This was expressed by then Bank of Canada governor, Graham Towers, when he at the start of the Second World War was asked if he could finance the war. He answered: "The limiting factor is men and materials". After the war, it was found that Canada had indeed successfully financed the war partly by a massive money expansion without inflation became a serious problem.

This is a key to understanding some of the challenges that we face in connection with a Green Shift. Due to the Covid slump, there are plenty of "men and materials" idle in the economy. Thus, for projects that can generate returns, money is not the problem. As the economy expands again there might arise problems with supporting infrastructures, and men and women with appropriate skills. If any of these factors are in short supply and cannot quickly be raised to correspond to demands of a Green Shift, cost-push price inflation can indeed become a problem.

Considering that, it is therefore important that governments in their recovery packages also create incentives that can ensure that for instance certain pools of experts and skilled labour will grow in step with the requirements.

A particular problem for Canada is that its public institutions, which ought to provide the coordinating essential for a rapid Green Shift, are infiltrated by mindsets and lobbyist influences serving corporate and financial sector interests. This means that the preferred economic strategy for the Green Shift hitherto has been to let private market operators take the lead.

However, this can create unnecessary burdens. First, private financing is often, quite simply, not needed if governments understand how to unleash their money creating and debt raising powers. Second, the model where private financing take control of projects makes them unnecessarily expensive both during construction as well as during later use. During use, the problem is that large infrastructure and energy projects often have monopolistic characteristics that favour mark-up pricing and consequently will lead to excess profit extractions. Private partners will also tend to see participation from the lens of localized profit motives, which can lead to poor coordination with other elements of a Green Shift.

If projects are of a nature where governments cannot implement them without money from financial markets or private investors, a model where governments retain full project and pricing control is therefore essential. We should strive to avoid that large renewable energy and infrastructure projects end up as monopolistically competitive enterprises that are able to gouge consumers, which in effect will end up not only slowing down a Green Shift but also keep the trend of growing economic inequities in place.