Out of the Ashes of General Motors

The Phoenix of Renewable Energy

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It may be prophetic that among the brands GM chose to kill was the Pontiac Firebird, a classic hot car of the 1960s sporting the fabled Phoenix on its hood. In mythology, the Phoenix was a colorful bird that incinerated itself in its nest, then rose from the ashes as its own offspring. GM too, says Michael Moore, could be reborn as something else. In a June 1 eulogy of sorts, he wrote:

> "So here we are at the deathbed of General Motors. The company's body not yet cold, and I find myself filled with—dare I say it—joy. It is not the joy of revenge against a corporation that ruined my hometown … Nor do I, obviously, claim any joy in knowing that 21,000 more GM workers will be told that they, too, are without a job. But you and I and the rest of America now own a car company!"

What would we want with a car company? Moore suggests that the bankrupt mega-builder of obsolete gas guzzlers can be transformed into a mega-builder of things we need more—mass transit vehicles, including bullet trains, light rail mass transit lines, energy efficient clean buses, hybrid or all-electric cars, and alternative energy devices such as batteries, windmills, and solar panels. The factories that built the cars that helped destroy the environment can become the tools for cleaning it up. This would, of course, take some investment; but Moore suggests that to pay for it all, the government could impose a two-dollar tax on every gallon of gasoline.

It sounds good right up to the gas tax, a regressive tax that would hit hardest in the wallets of the poor and would raise alarm bells for politicians, the oil lobby, and voters. Isn't there some way to fund the plan without driving up the tax burden or the national debt? In fact, there is.

To Put Our New Car Company to Good Use, We Just Need to Own a Bank

The federal government could create its own credit with its own government-owned lending facility, on the model of the Reconstruction Finance Corporation used by President Roosevelt to fund the New Deal. But instead of merely recycling borrowed money as Roosevelt did, the new facility could actually create credit on its books. Its capital base could be leveraged into many times that sum in loans, in the same way that private banks routinely create money (or "credit") today. Assuming a reserve requirement of 10%, if the $300 billion or so that remains of the TARP money were deposited in the new bank, this money could be leveraged into $3 trillion in loans. If the money were counted as capital, at an 8% capital requirement it could become $3.75 trillion in loans, or 12.5 times the original sum.

Indeed, it is the sovereign right of governments to create the national money supply, but few governments exercise that right today. The only money the U.S. government now issues are coins, which compose only about one ten-thousandth of the U.S. M3 money supply. The rest is created by private banking institutions when they make loans. This includes the privately-owned Federal Reserve, which creates Federal Reserve Notes (dollar bills) and lends them to the government and to commercial banks. Federal Reserve Notes compose only 3% of the money supply. All of the rest consists merely of credit created on the books of private banks.

Many authorities have attested that banks simply create the money they lend as accounting entries on their books. The Federal Reserve Bank of Dallas states on its website:

> "Banks actually create money when they lend it. Here's how it works: Most of a bank's loans are made to its own customers and are deposited in their checking accounts. Because the loan becomes a new deposit, just like a paycheck does, the bank … holds a small percentage of that new amount in reserve and again lends the remainder to someone else, repeating the money-creation process many times."

This was confirmed recently by President Obama himself. In a speech at Georgetown University on April 14, he said:

> "[A]lthough there are a lot of Americans who understandably think that government money would be better spent going directly to families and businesses instead of banks—'where's our bailout?' they ask—the truth is that a dollar of capital in a bank can actually result in eight or ten dollars of loans to families and businesses, a multiplier effect that can ultimately lead to a faster pace of economic growth."

The money generated by banks through the multiplier effect comes at a heavy cost in interest. One advantage of a government-owned bank is that it could fund public projects interest-free or nearly interest-free, cutting production costs dramatically. Interest comprises as much as 77% of the cost of goods and services, such as public housing, that require large amounts of capital. The cost of interest is lower for labor-based services such as garbage collection, for which it makes up only about 12% of the cost. Averaging them all together, the overall cost of interest has been estimated to be about half the cost of everything we buy. If money for infrastructure development were issued interest-free, projects currently considered unsustainable because of the burden of interest could become not only self-sustaining but actually profitable for the government.

In *The Modern Universal Paradigm* (2007), Rodney Shakespeare gives the example of the Humber Bridge, which was built in the UK at a cost of £98 million. Every year since the bridge opened in 1981, it has turned an operating profit; that is, its running costs (basically repair, maintenance, and staff salaries) have been exceeded by the fees it receives from travelers crossing the river Humber. But by the time the bridge opened in 1981, interest on its construction loans had driven its cost up to £151 million; and by 1992, only 10 years later, the debt had shot up to a breath-taking £439 million. The UK government was forced to intervene with sizeable grants and writeoffs to save the local residents from bearing the brunt of these costs. If the bridge had been financed with interest-free, government-issued credit, these costs could have been avoided and the bridge could have funded itself.

In March of this year, Congressman Chris Van Hollen introduced a bill to establish a Green Bank aimed at catalyzing clean energy and energy efficient projects. The proposed bank would be an independent, tax-exempt, wholly owned corporation of the United States, with the exclusive mission of providing a comprehensive range of financial support to qualified clean-energy and energy-efficiency projects in the U.S. If this Green Bank were operated on the fractional reserve system, its initial capital base could be leveraged many times as loans. The loans could then be paid off with the income generated by the projects, preventing inflation and allowing additional loans to be made. Unlike the bank bailouts that have eaten up so much of the government's revenues, green projects create real goods and services and real profits; and the projects could be particularly profitable if they were created without the burden of interest.

Historical Precedents

Funding public projects with government-issued credit is not a new idea. It has a long and successful history, including these notable examples:

- In the early eighteenth century, the colony of Pennsylvania issued money that was both lent and spent by the local government into the economy, producing an unprecedented period of prosperity. This was done without producing price inflation and without taxing the people.

- When Abraham Lincoln needed money to fund the American Civil War, rather than paying 25 to 36 percent interest charges, he avoided going into debt by printing Greenback dollars that were "legal tender" in themselves. The ploy not only allowed the North to win the Civil War but helped fund a period of unusual national expansion and development.

- The island state of Guernsey, located in the Channel Islands, used government-issued money to fund roads, bridges, and other needed infrastructure throughout most of the 19th and 20th centuries, without price inflation and without incurring government debt.

- The Bank of North Dakota, founded in 1919, is a wholly state-owned bank that creates credit on its books just as private banks do. This credit is used to serve local needs, and the interest on loans is returned to the government. Not coincidentally, North Dakota has a $1.2 billion budget surplus at a time when 47 of 50 states are insolvent, an impressive achievement for a state of isolated farmers battling challenging weather.

- During the First World War, when private banks were demanding 6 percent interest, Australia's publicly-owned Commonwealth Bank financed the Australian government's war effort at an interest rate of a fraction of 1 percent, saving Australians some $12 million in bank charges. After the First World War, the bank's governor used the bank's credit power to relieve the depression conditions in other countries by financing production and home-building, and lending funds to local governments for the construction of roads, tramways, harbors, gasworks, and electric power plants. The bank's profits were paid back to the national government.

- A successful infrastructure program funded with interest-free "national credit" was also instituted in New Zealand after it elected its first Labor government in the 1930s. Credit issued by its nationalized central bank allowed New Zealand to thrive at a time when the rest of the world was struggling with poverty and lack of productivity. According to a book titled *State Housing in New Zealand*, published by the Ministry of Works in 1949:

"To finance its comprehensive proposals, the Government adopted the somewhat unusual course of using Reserve Bank credit, thus recognizing that the most important factor in housing costs is the price of money—interest is the heaviest portion in the composition of rent. … This action showed … it was possible for the State to use the country's credit in creating new assets for the country."

The Inflation Objection

The objection invariably raised to proposals for government self-funding is that the result would be dangerously inflationary. Addressing that issue in the Winter 2004 edition of the *New Zealand Guardian Political Review*, Stan Fitchett explored whether the New Zealand government's 1930s approach would create price inflation today. He confirmed with bank officials that 97 percent of the New Zealand money supply is now created by commercial banks when they make loans. The year he was writing, the money supply increased by 18,527 million New Zealand dollars, or 16.8 percent; and 97 percent of this increase came from commercial bank lending. Fitchett confirmed with banking experts that if the Reserve Bank had created 100 million New Zealand dollars to build new houses in New Zealand, the sum would have had no noticeable impact on inflation, since it was only one-half of one percent of what was already being added to the money supply annually by private commercial banks. Similar ratios apply in the United States and other countries.

If it is dangerously inflationary for public banks to create money, then it is dangerously inflationary for private banks to do it; but we don't hear economists and politicians clamoring for the private credit machine to be shut down. To the contrary, a flood of money is being poured into that choking and sputtering machine in a desperate attempt to get its pistons firing again. A more efficient solution to the credit crunch would be for the government to abandon its old Tin Lizzie-model credit machine and create a shiny new public Firebird model; and the first thing the new credit engine might be tested on are green energy projects of the sort proposed by Mr. Moore. Out of the ashes of a failed GM could arise not only a new, clean way of traveling but a new way of funding government and the services we expect from it.

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