Economic Growth Program Issue Brief

The Manufacturing Credit System

Revitalizing American Manufacturing by Learning from American Success

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One of the greatest needs of U.S. manufacturing is access to sustained, adequate credit. The U.S. Farm Credit System provides a model for a new U.S. manufacturing credit system. The federal government should create up to a dozen regional manufacturing credit banks, modeled on the farm loan banks. Like the five banks of the federal farm credit system, each regional manufacturing bank would be a cooperative owned by banks and other credit institutions in its geographic region. Complementing the regional manufacturing credit cooperative banks would be a single federally-chartered GSE: the National Manufacturing Loan Marketing Association (NMLMA), or "Mannie Mac." Mannie Mac would create a liquid market for loans to manufacturing enterprises by purchasing them from banks that belong to the manufacturing credit system and either holding them or selling them in large, structured packages that would be attractive to large investors like pension funds and foreign sovereign wealth funds. The manufacturing credit system and Mannie Mac together would combine flexibility and decentralization with federal support to catalyze the renovation of America's manufacturing base.

The Importance of Manufacturing to the American Economy

The renewal of American manufacturing must be a central part of a successful strategy to allow the U.S. and global economies to grow their way out of the present recession without generating new and unsustainable bubbles based, like the technology and housing bubbles, on asset inflation. Within the United States, the high multiplier effect of investment in manufacturing means that a single job in manufacturing creates other jobs in the economy. Because of the importance of "learning by doing," it is a delusion to believe that the U.S. can concentrate solely on the incubation of new industries and then allow other countries to develop and commercialize them. Indeed, history shows that breakthrough innovations in manufacturing often grow out of existing manufacturing in the same country, in the way that the nascent U.S. telephone industry was supported by the dominant telegraph company, Western Union, and the way that General Electric's Bell Labs and IBM, along with the Pentagon, contributed to the evolution of the IT industry. Finally, global rebalancing requires not only that the chronic trade surplus countries like China, Japan and Germany consume more, but also that the U.S. reduce its unsustainable trade deficit by replacing a significant number of imports with products manufactured in the U.S.

The goal is not the winner-picking "industrial policy" that is caricatured by market fundamentalists, but a comprehensive manufacturing strategy that seeks to create the conditions for ensuring that a renewed U.S. manufacturing sector replaces the oversized housing and finance sectors as an engine of American and global growth. To be successful, a new American manufacturing strategy must question the conventional wisdom that U.S. support for manufacturing should be limited to the innovation phase of the industrial life cycle, in the form of federal and state support for R&D and start-ups. The U.S. leads the world in innovative public-private partnerships to develop new products and channel venture capital to new businesses. But to succeed, a new American manufacturing strategy must help both new and old industries at every stage of the product life cycle, from innovation through development, deployment, diffusion and maturation. The government has a role in guiding the restructuring of old industries, as well as the expansion of new ones, and helping existing big businesses in mature industrial sectors refine their products and processes is just as important as incubating the potential industry leaders of the future.

Learning from our Own Success in Modernizing American Agriculture

The U.S. need not look to Asia or Europe for a successful industrial strategy. American agricultural policy in the twentieth century provides a model for modernizing an entire sector of the economy, with lessons that can be applied to the modernization of twenty-first century American manufacturing.

In the twentieth century, the U.S. achieved amazing success in converting the farm sector, which still employed a third of the population and was largely reliant on animal power and primitive methods, into a high-tech, dynamic economic sector that generates permanent bumper crops while employing only a small number of highly productive farmers and farm workers. The success of American agricultural modernization relied on many factors, including the diffusion of R&D breakthroughs from the state agricultural and mechanical (A&M) colleges funded by federal land grants, by means of extension agents to an open global trading system. The central factor was arguably federally-sponsored access to credit for small and large farm businesses alike.

The U.S. system for financing American agribusiness is based on two elements. The federal farm credit system (FCS), first created in 1916 and flourishing to this day, consists of a system of five federally-backed regional bank cooperatives that provide credit to commercial banks and thrifts in return for share purchases. The organization of the federal farm bank system in the form of a cooperative—rather than a corporation or corporations with publicly-traded shares—has prevented the kind of perverse behavior displayed by the privatized GSEs responsible for housing credit, Fannie Mae and Freddie Mac. In 2006, the farm credit system was responsible for 40 percent of American farm debt.

The other element of the American farm financing system is the Federal Agricultural Mortgage Association or "Farmer Mac." Like Fannie Mae and Freddie Mac in the housing sector, Farmer Mac creates a deep and liquid secondary market for mortgages and other loans made by the members of the U.S. farm credit system to individual farmers and agribusiness corporations. Unlike the two dysfunctional housing GSEs, Farmer Mac has persisted in its original mission with admirable prudence and sobriety. The world's financial arteries are not clogged with toxic assets made up of repackaged U.S. farm credit system loans.

Needed: A New Manufacturing Credit System

At the center of a new American manufacturing strategy should be a new American manufacturing credit system, inspired by the successful U.S. farm credit system.

The federal government should create up to twelve regional manufacturing credit banks, modeled on the farm loan banks. Existing Federal Reserve districts could be used as designated federal manufacturing districts. Each regional manufacturing bank would be a cooperative owned by banks and other credit institutions in its geographic region. The regional manufacturing credit banks would catalyze low-interest loans by member banks to promising manufacturing enterprises in each region.

Complementing the regional manufacturing credit cooperative banks would be a single federally-chartered GSE: the National Manufacturing Loan Marketing Association (NMLMA), or "Mannie Mac" for short. Mannie Mac, like Farmer Mac, would create a liquid market for small loans to manufacturing enterprises by purchasing them from banks that belong to the manufacturing credit system and either holding them or selling them in large, structured packages that would attract large investors like pension funds and foreign sovereign wealth funds. While the mortgage-backed securities disaster has revealed the pathologies of poorly-designed or deceptive securitization, there is still a legitimate role for institutions that create secondary markets for loans, like Farmer Mac in the agricultural sector and the proposed Mannie Mac in the U.S. manufacturing sector.

Funding the Manufacturing Credit System

The seed money to fund the new regional manufacturing credit banks could be provided either directly or indirectly by the federal government.

The federal government could capitalize the banks in the manufacturing credit system directly by congressional appropriations. Alternately, the federal government could provide for the use of bonds to provide the initial capital of the banks. The Treasury could issue special bonds and use the proceeds to create the initial capital reserves of the manufacturing credit system banks. Or the individual banks, structured as government-sponsored enterprises (GSEs), could be allowed to issue their own bonds and use the proceeds to build reserves.

If these approaches were politically unpalatable, the banks in the manufacturing credit system might be funded indirectly, by means of state and local municipal bonds that receive favorable federal tax treatment. Elsewhere we have proposed the creation of Made in America Bonds (MABs), which would be taxable, tax-credit bonds in which the federal government subsidizes part or all of the interest paid to the bondholders.[1] The model would be other tax-credit bond programs, including the Build America Bonds (BABs) and Recovery Zone Facility Bonds (RZFBs) created by the American Recovery and Reinvestment Act of 2009.

Here is how MABs could be used to capitalize a new manufacturing credit system: States, local governments, and other entities qualified to issue MABs under state and federal law would be allowed to use some of the proceeds of sales of MABs to buy shares of the cooperative regional manufacturing credit banks. The model would be the ownership of farm credit system banks by commercial banks and other financial institutions, only in this case state and local governments and government entities would share ownership of the manufacturing credit system bank in their region of the country. In this way, the state and local governments could fund the cooperative banks with indirect federal support, as an alternative to direct federal funding.

The Time Has Come for a Manufacturing Credit System

Increasing the access to low-cost credit of American manufacturing enterprises, especially small and medium enterprises, would not by itself be sufficient to rejuvenate American manufacturing. A new American manufacturing strategy would need to include many other, complementary policies, including diplomatic pressure against currency manipulation, procurement policies that use the purchasing power of the U.S. government to provide a guaranteed, large-scale market for U.S. manufacturers, tax reforms that encourage the onshoring of high-value added manufacturing, commodities policies that promote low and stable costs for energy and resource inputs into manufacturing, and workforce development policies including education and immigration reforms.

In the context of intelligent pro-manufacturing policies like these, a manufacturing credit system modeled on the successful American farm credit system can help produce a rebalancing of the U.S. and global economies, while generating jobs and helping America exit the present crisis by means of high, sustained growth in productivity and output. To further this objective, Congress should create a manufacturing credit system on the model of the farm credit system, consisting of a number of regional, cooperative manufacturing credit banks, along with a government-sponsored enterprise charged with creating a secondary market for low-interest loans to American manufacturers, the National Manufacturing Loan Marketing Association ("Mannie Mac").

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[1] Michael Lind and Daniel Mandel, "Made in America Bonds: How to Finance a Renaissance of American Manufacturing," Economic Growth Program Issue Brief, March 2010 (Washington, D.C.: The New America Foundation).

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