Journal of Economic Issues

ISSN: 0021-3624 (Print) 1946-326X (Online) Journal homepage: http://www.tandfonline.com/loi/mjei20

Credit and Capital Formation: Lessons of Mexican Migrant Entrepreneurs in the U.S. Financial Crisis

Eugenia Correa & Alicia Girón

To cite this article: Eugenia Correa & Alicia Girón (2013) Credit and Capital Formation: Lessons of Mexican Migrant Entrepreneurs in the U.S. Financial Crisis, Journal of Economic Issues, 47:2, 555-560

To link to this article: http://dx.doi.org/10.2753/JEI0021-3624470229

Published online: 23 Dec 2014.

JOURNAL OF ECONOMIC ISSUES
Vol. XLVII No. 2 June 2013
DOI 10.2753/JEI0021-3624470229

Credit and Capital Formation: Lessons of Mexican Migrant Entrepreneurs in the U.S. Financial Crisis

Eugenia Correa and Alicia Girón

Abstract: One of the most important elements of financial crises is the credit restriction that follows and the immediate consequences it has on investment and employment. In the post-Keynesian vision, an exit from economic crises frequently requires increased demand, specifically through public expenditure and employment. Furthermore, it requires the exploration of various policies and institutional reforms that could counteract the credit rationing emerging from the first moments of the financial crisis, particularly in regard to the financing of small business. This is one of the principal lessons this paper explores when studying a sample of Mexican immigrant entrepreneurs in three cities in the United States, and their conditions of survival amid the financial crisis.

Keywords: credit rationing, financial crisis, full employment, immigrant entrepreneurs

JEL Classification Codes: B52, F22, G01

Credit restrictions, occurring at the beginning of financial crises, have a nearly immediate effect on the price of financial assets and unleash a downward spiral in prices and risk aversion which reinforce the credit contraction. This process, known as debt-deflation, limits and even paralyzes debt refinancing, with the most destructive consequences for small and medium enterprises (SMEs). This group of firms tends to provide the largest share of employment, and it plays an important role — together with government expenditure — in reestablishing aggregate demand. The buffers adopted during the current financial crisis to confront the downward spiral, such as unemployment insurance, are insufficient to boost employment. Moreover, their very design precludes the kind of economic policies that are needed to counteract the greatest contractionary force — namely, credit rationing for businesses. SMEs, which have important impacts on employment, have particularly limited access to financing. In light of this fact, the lessons to be learned from the U.S. financial crisis, and the

Eugenia Correa is a professor of economics at the Universidad Nacional Autónoma de México. Alicia Girón is a researcher in economics at the Universidad Nacional Autónoma de México. *This paper was translated from Spanish to English by Wesley Marshall. The authors are grateful to CONACYT, México, for their support.*

institutions created to limit credit restriction during the crisis, are of utmost importance (Minsky, 1998).

For example, the repealing of the McFadden Act paved the way for a greater concentration of the American banking sector, and integrated local banks into credit networks dominated by the country's largest banks (Berger 1999; Kregel 2009). At the same time, the banking relationship with local providers of financing has deteriorated. This phenomenon is also evident in the operational transformations of Freddie Mac and Fannie Mae, as these banks became large sources of private business profits (Marshall 2008).

In this paper, we focus on Mexican immigrant entrepreneurs in three U.S. cities — Los Angeles, Chicago, and Houston — during the financial crisis. Specifically, we study their practices of saving and investment in the period 2011–2012 based on surveys and interviews. We, hereby, present a synthesized version of some of our principal findings, which generated a database titled, "Cross-Border Business Experiences. Capital Flows for Development."

Contrary to some views expressed in mainstream literature, we found that Mexican SMEs are very active users of financial services in the US, but much less so in Mexico. Even though small businesses predominate in the group, larger SMEs also operate in nearly all sectors, including in financial services. A good number of entrepreneurs use mortgage refinancing as a source of business capitalization. Entrepreneurs with lower levels of debt have survived the crisis easier than those with large debt, and, in many cases, have even grown their businesses as a result of competitors' bankruptcy.

Immigrants Mexican Entrepreneurs in the U.S. Economy

According to 2010 census data, almost 33 million people of Mexican origin live in the United States, with 13 million in the active labor force. The data reveal that approximately eight percent of the latter numbers are entrepreneurs, even though only a fraction of that number operates businesses that employ workers. Businesses employing workers accounted for about 120 thousand jobs in 2007.

Mexican-owned businesses (with or without employees) represent around four percent of all businesses in operation in the USA, according to 2007 census data. These are principally distributed in California (36 percent) and Texas (34 percent). Despite the crisis, Mexican-owned businesses are estimated to have grown, particularly those not hiring any workers. By economic activity, these firms are distributed in food and lodging services (18 percent), commerce (11 percent), as well as others.

Many studies of immigrant communities have focused on the so-called nostalgia economy as the sector that accounts for the greatest part of immigrant entrepreneurship activities. However, this is somewhat misleading because there has also been a significant development in the sectors of construction (17.5 percent), healthcare, educational, and cultural services (14 percent), waste and decontamination management services (14 percent), transportation (9 percent), and professional services (seven percent). With very few exceptions, (mostly in a particular city, service, or product such as the production of tortillas or gelatins), the businesses of Mexican immigrants carry little weight in economic sectors.

However, it is worth noting that these immigrant-run businesses comprise some 5.4 percent of all U.S. construction firms. Of those, 6.9 percent are in the waste and decontamination management services and 6.7 percent are in transportation. Furthermore, the accelerated immigration of wealthy and highly educated young Mexicans is changing the composition of Mexican-immigrant businesses and their impact on the American economy. But there is a diverse array of obstacles to development among Hispanics, and Mexicans in particular, as compared to other ethnic minorities. Among the ones we identified are the lower levels of education, lack of English-language proficiency, as well as shortage of business training and experience among Hispanics in the USA (García Zamora, 2009).

Migrant businesses still do not have a macroeconomic impact of national scope. Rather, these businesses have an important impact on millions of people because of their insertion into labor and products markets. This is the case of businesses with no salaried workers, or with mainly Mexican workforce.

In general, migrant families have lower incomes, lesser wealth-accumulation capacity, and their personal capital is sharply affected by economic crises (Dymski, 2009; Papademetriou et al. 2010). This tendency has been exacerbated by the latest financial crisis as income levels declined and wealth disparities increased (Galbraith, 2012). Thus, the median household income of Mexicans dropped by more than $4,500 between 2000 and 2010 (in 2010 dollars) — a fall of around ten percent. Even so, the number of Mexican homeowners in the USA rose by over fifty percent in 2010 (PEW, 2012).

While, in general terms, Mexican immigrants remain low-paid workers, who use financial services to send remittances, their use of other financial services has grown in recent years, particularly in relation to mortgages, insurance, and consumer credit. But the mortgages crisis, snow-balling the financial crisis, highlighted both the vulnerability of Hispanic homeowner mortgages and the great diffusion of these financial operations, even among low-income Hispanic (Mexican) households. Initially, this situation gave credence to the idea that the mortgage defaults of low-income migrants started the financial crisis. But the idea has since been discredited by academic literature (Barba and Pivetti 2009; Dymski 2009; Taylor et al. 2011).

Mexican Immigrant Entrepreneurs and Financial Services

For many years, academic literature has considered Mexican immigrants to be overwhelmingly salaried workers without proper documentation, whose usage of financial services is limited to sending remittances. In addition to their legal status as immigrants and workers, many academics have considered low financial education as a factor in explaining the limited financial penetration in this social group. Thus, there is an abundance of studies on remittance flows, and even on the impact of these on local production financing, but very few on the impact of capital flows on entrepreneurship among immigrants.

Unlike other migrant groups, Mexican entrepreneurs demonstrate high levels of participation in financial services, and not only to send remittances. For example, 96 percent of Mexican entrepreneurs use some type of financial service in the USA, and sixty percent of them have at least one mortgage. By comparison, only thirty percent of them have contracted financial services in Mexico and only 3.4 percent have a mortgage in Mexico (Girón, Correa and Rodríguez 2012).

One of the recurring and central themes in the economic debate is precisely the origin of entrepreneurs' financing. Mexican migrant entrepreneurs offer a valuable experience both in terms of their performance in the United States and the extension of their money in Mexico, especially in their communities of origin. We have studied the latter point within the scope of immigrant organizations and the financing of productive projects, but in the remainder of this paper we will explore the former aspect (García Zamora 2009).

According to the data we had previously collected (Girón, Correa and Rodríguez 2012), only 14 percent of Mexican immigrant entrepreneurs obtain financing for their business through loans, while 62 percent pointed to personal and family savings as the origin of their capital, and only 23 percent used both sources. A significant number of these businesses were opened with savings, obtained in Mexico, both through the closing of businesses and the sale of assets, or through the expansion of Mexican-based business capital into the USA. However, another part of the resources, with which businesses have been started, comes from wealth accumulated in Mexico by family members. Moreover, fifty percent of Mexican entrepreneurs have real estate holdings in Mexico, even though these are often unusable due to the social and political conditions, through which their communities of origin are going.

The entrepreneurs are conscious of the importance of financing and the enormous difficulties in obtaining it. Yet, their migratory status has not been an obstacle to the development of their business, because only a small fraction of them (13.6 percent) operate under irregular migratory conditions. The majority are either permanent residents or citizens of the USA.

Home equity and mortgage financing was also very important for Mexican immigrant entrepreneurs. More than sixty percent have at least one mortgage, and more than thirty percent have used it as a source of capital for their firms. Moreover, more than twenty percent of the Mexican immigrant entrepreneurs have lost at least one property to foreclosure between 2008 and 2011.

More than 75 percent of the entrepreneurs recognized that the crisis affected their business to a degree. Some of them sold assets or partially closed their business, while others reduced their activity and sales, and third were either on the verge of closure or already closed. Only 25 percent stated that the crisis did not affect them or that it opened new business opportunities for them. The sectors of business most affected by the crisis have been construction, professional services, and restaurants. Among the business strategies adopted by the entrepreneurs to survive the low service demand, on one side, and the rising cost of energy and financial service, on the other, were: worker layoffs, sale of personal assets, and mortgaging new assets. The smallest of businesses (re-) incorporated family members to survive the crisis.

Our data are completely consistent with those provided by the University of North Carolina-Chapel Hill (2011). They estimated that over 1.3 million Hispanic families had lost their homes due to foreclosure between 2009 and 2012 (Bowdler, Quercia and Smith 2010).

Conclusions

The rationing of credit to small and medium businesses has been developing for years in the U.S. economy. With the financial crisis, however, the institutions working to limit the damage caused by credit rationing could not act in time to prevent significant increases in unemployment.

The situation with Mexican entrepreneurs in the USA reflects the whole spectrum of problems that businesses, facing limited access to financing, experience even though they are users of financial services. As a result of the crisis, many have lost their homes and businesses. At the same time, other business owners have survived and even thrived, especially those that did not use mortgage credit to fund their firms.

One of the lessons our study offers is precisely the need to innovate and restructure financial institutions to permit viable (re-)financing of liabilities in the enterprise sector, which is generally viable and could create high levels of employment. Because one of the greatest consequences of a financial crisis is the paralysis of financing to labor-intensive employers, reestablishing them should be a priority, especially when the policies of liquidity provisioning to the largest banks have proven insufficient in restoring financing for economic activity.

References

Barba, Aldo and Massimo Pivetti. “Rising Household Debt: Its Causes and Macroeconomic Implications: A Long-Period Analysis.” *Cambridge Journal of Economics* 33 (2009): 113-137. Doi: 10.1093/cje/ben030. Accessed December 2, 2012.

Berger, Allen, Rebecca Demsetz and Philip Strahan. ”The Consolidation of the Financial Services Industry: Causes, Consequences, and Implications for the Future.” *Journal of Banking and Finance* 23, 2-4 (1999): 135-194.

Bowdler, Janis, Roberto Quercia and David Andrew Smith, *The Foreclosure Generation: The Long-Term Impact of the Housing Crisis on Latino Children and Families*. Center for Community Capital: University of North Carolina, 2010. Available at www.nclr.org/images/uploads/publications/file_Foreclosures_final2010.pdf. Accessed April 29, 2013.

Dymski, Gary. “Afterword: Mortgage Markets and the Urban Problematic in the Global Transition.” *International Journal of Urban and Regional Research* 33, 2 (2009): 427-442.

Galbraith, James K. *Inequality and Instability: A Study of the World Economy Just Before the Great Crisis*. New York: Oxford University Press, 2012.

García-Zamora, Rodolfo. *Desarrollo económico y migración internacional: los desafíos de las políticas públicas*. Mexico: Universidad Autónoma de Zacatecas, 2009.

Girón, Alicia, Eugenia Correa and Patricia Rodríguez. Experiencia empresarial transfronteriza. Repatriación de capitales para el desarrollo. Database. Mexico: Universidad Nacional Autónoma de México, 2012.

Kregel, Jan. “Background Considerations to a Regulation of the U.S. Financial System: Third Time a Charm? Or Strike Three?” Working paper no. 557. New York: Levy Institute, 2009.

Marshall, Wesley. “Quiebra de Fannie Mae y Freddie Mac desde la experiencia latinoamericana.” *Ola Financiera* 1 (2008). Available at www.olafinanciera.unam.mx. Accessed November 10, 2012.

Minsky, Hyman. *Stabilizing and Unstable Economy*. New York: MacMillan, 1998.

Papademetriou, Demetrios G., Madeleine Sumption and Aaron Terrazas with Carola Burkert, Stephen Loyal and Ruth Ferrero-Turrión. “Migration and Immigrants Two Years After the Financial Collapse: Where Do We Stand?”. Washington, D.C.: Migration Policy Institute, (2010). Available at www.ucm.es/centros/cont/descargas/documento21629.pdf. Accessed October 30, 2012.

PEW Hispanic Center. “Hispanics and the Economic Downturn: Housing Woes and Remittance Cuts.” PEW, 2009. Available at www.pewhispanic.org. Accessed November 4, 2012.

——. “The Nation’s 10 Largest Hispanic Origin Groups.” PEW, 2012. Available at www.pewhispanic.org. Accessed November 4, 2012.

Taylor, Paul, Rakesh Kochbar, Richard Fry, Gabriel Velasco and Seth Motel. “Wealth Gaps Rise to Record Highs between Whites, Blacks and Hispanics.” PEW Hispanic Center, 2011. Available at www.pewhispanic.org. Accessed November 4, 2012.

Osili, Una Okonkwo and Anna Paulson. “Immigrants’ Access to Financial Services & Asset Accumulation.” Yale Department of Economics website, 2007. Available at www.econ.yale.edu/seminars/labor/lap07/osili-paulson-071105.pdf. Accessed October 30, 2012.