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Reference standards for income comparisons: evidence from immigrants' return visits

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Abstract

The present paper shows evidence consistent with Falk and Knell's (2004) prediction that individuals' reference income increases with ability. To overcome the difficulty that the reference income is not observed in most data sets, I use indirect evidence from immigrants return visits to their countries of origin. Falk and Knell's model predicts that more educated immigrants are less likely to have returned to their country of origin for a visit, and that they are more likely to have difficulty feeling at home when they do return for a visit. Both predictions are tested using data from the German Socio-Economic Panel and cannot be rejected.

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1. Introduction

A large number of studies has shown that self-reported satisfaction with one's life or income is correlated with reference group income.[1] The two mechanisms that are typically invoked to explain this correlation are Duesenberry's (1949) "relative income effect" and Hirschman's (1973) "tunnel effect", according to which an increase in reference income may have a *positive* effect on satisfaction, as long as it is a signal that one's own income is also going to rise in the future.

However, a central difficulty in these studies is that the researcher usually does not observe with whom people compare their income.[2] It is typically *assumed* that people compare themselves with others who are similar in terms of age, gender, education, region, or occupation. There is clearly a need to find out more about the determinants of a person's reference group.

In a model by Falk and Knell (2004), individuals trade off a self-enhancement motive (choosing a low comparison income to make oneself feel good) against a self-improvement motive: aiming high in one's comparison in order to be more motivated, and thus more productive, at work. Falk and Knell's main result is that the optimal comparison income increases in a person's productive ability. Falk and Knell show for 255 students at two universities in Zurich that there is indeed a positive correlation between high-school grade (their proxy for ability) and the aspired grade (the reference standard) on the final university exam, even controlling for a number of possible common influences. To the best of my knowledge, this is the only test of their model so far.

2. Empirical Strategy

To overcome the difficulty that reference standard are unobserved in most data set, the idea is to exploit information on a particular aspect of the migration experience, which can be assumed to have an influence on the reference income. I assume that, by refreshing memories of the living standards in the country of origin, return visits lower immigrants' reference income, other things being equal. This negative influence holds as long as the average income in the country of origin is lower than in Germany, which is the case for most immigrants.

The next building block of the test is the relationship between return visits and ability, which can be derived directly from Falk and Knell's main proposition. Falk and Knell (2004, 433) show that the optimal reference standard increases in a person's productive ability, as the self-enhancement effect is assumed to be independent of ability, while the self-improvement effect has greater returns the more productive the person is. Now if, according to Falk and Knell's model, more productive immigrants have more to lose from a lower reference standard, and if each return visit to the country of origin lowers the

[1] See the survey by Clark et al. (2008). McBride (2001) and Luttmer (2005) are two of the best-known studies for the U.S.; for Germany, see the studies by Ferrer-i-Carbonell (2005), Schwarze and Härpfer (2007), and D'Ambrosio and Frick (2007), Schwarze and Winkelmann (2011) and, with a particular focus on neighbourhood effects, by Knies et al. (2008), Dittmann and Goebel (2010) and Knies (2012). Pérez-Asenjo (2011) explores implications of relative income concerns for labour supply.

[2] One exception is the Chinese national household survey of 2002 in which people are asked about their reference group for income comparisons. See Knight et al. (2009), Knight and Gunatilaka (2010) and several companion papers as well as Akay et al. (2012).

reference standard (my additional assumption), then more productive immigrants should return for a visit less often, other things equal.

The ceteris paribus clause deserves discussion. While the intrinsic benefit of a return visit may well be idiosyncratic to a first approximation, the costs of a visit are likely to be correlated with an immigrant's productive ability. The *direct monetary* costs of a visit (ticket prices etc.) will depend on the distance to the country of origin, a variable that I can control for. Once distance is controlled for, these direct costs are arguably independent of the immigrant's ability (and of the immigrant's education, which proxies for ability in the empirical part below). In contrast, other costs, which are less amenable to formal modelling, may well differ by education; for instance, more educated immigrants are more likely to emigrate for political reasons, and they are therefore more likely to be in danger when returning to their country of origin. I attempt to also control for such third factors; see the discussion in Section 3. below.

A last issue that needs to be discussed are the *opportunity costs* of a return visit. In the basic labour supply model, the opportunity cost of an hour of leisure is the foregone consumption; if the hourly wage differs between people, so will the opportunity cost of leisure. However, the present paper studies not the choice of leisure, but the choice of how this leisure is spent: namely, whether people return to their countries of origin for a visit, or whether they stay in Germany or go to some other country. That is, the choice that is modelled here can be thought of as conditional on a given amount of leisure. The concept of leisure that seems to be most relevant here is the amount of paid vacation an employee is entitled to. In Germany, most employees have between five and six weeks of paid vacation a year; this amount varies mainly by age and tenure and not by education, which is the regressor of interest here. In conclusion, then, the opportunity cost of a return visit in terms of foregone earnings is essentially zero for employees; any variation in the opportunity cost that does exist will mainly be captured by a control for age, and the remaining variation after the adjustment for age is assumed to be independent of education. For the self-employed, who are free to choose the number of days of vacation, this argument does not hold, and I therefore exclude them from the estimation.

As a second test of Falk and Knell's model, I test whether better educated immigrants will have greater difficulty feeling at home when they do return to their countries of origin. The argument that leads to the prediction is as follows: Falk and Knell (2004) argue that immigrants with higher ability (or education) are more likely to adopt a higher reference income. I add the auxiliary hypothesis that a higher reference income will estrange immigrants from their countries of origin, and that they will therefore have a harder time feeling at home when returning to their country of origin. To test the prediction, I estimate an ordered probit model for immigrant's feelings on their return visits, again attempting to control for common influences.

3. Data

The two tests are carried out using data from five waves of the German Socio-Economic Panel (SOEP), a longitudinal survey of private households which began in 1984 (Wagner et al., 2007). The SOEP oversamples immigrants and contains a rich array of questions related to immigration, which makes the data well-suited for the present purpose. In particular, in the waves of 1996, 1998, 2000, 2002, and 2004, immigrants were asked

about return visits to their countries of origin.

In this paper, an immigrant is defined narrowly as a respondent who was born outside of Germany and who still has foreign nationality at the time of the survey. It would have been preferable to include also naturalized immigrants, but in the SOEP only immigrants with foreign nationality are asked the question about return visits. As noted above, I drop self-employed immigrants because for them the assumption that the number of days of vacation is given is less convincing. The resulting estimation sample consists of 7822 person-year observations. Depending on the specification, the actual number of observations will be somewhat lower due to the listwise deletion of missing values.

In the five waves of the SOEP used here, immigrants are asked: "since you have come to Germany to live, have you visited your country of origin?" For about 83% of immigrants the answer is yes. Unfortunately, information on the *number* of visits is not available in the SOEP. There is also a question on how immigrants feel when they do visit their country of origin. The question runs: "When some people have lived for a long time in Germany and visit their (former) home country, things may have changed. How is that for you? How do you feel in that situation?" The five answer categories (with percentages in parentheses) are "I feel at home right away on the first day, as if I hadn't ever been away" (24.4%); "I feel at home within a short time" (36.4%); "at first I feel like a stranger, but after a few days I feel at home" (25.6%); "it takes quite a long time until I feel more or less at home" (8.1%); "I feel like a stranger in my own country" (5.4%). Thus, about 60% of immigrants feels at home quickly, while 40% report difficulty feeling at home when visiting their country of origin.

The regressor of interest is education in years, which—following Falk and Knell's original article—is used as a proxy for ability. As Table 1 shows, the variable ranges from 7 to 18 years, with a sample mean of about 10 years. Immigrants who have returned for a visit tend to have fewer years of schooling. The means are 9.99 years for those who have returned versus 10.57 years for those who have never returned. The difference is statistically significant.

Better education (as a proxy for ability) is correlated with a number of other factors that will also affect the probability of a return visit. Immigrants who have median or above-median years of schooling tend to be male, younger, of better self-reported health, and tend to live in smaller households than immigrants with below median years of schooling.[3] More years of schooling are associated with a higher household income, a lower unemployment rate, and a higher probability of owning the house or appartment in which one lives.

Immigrants with more years of schooling tend to come from countries that are geographically further away from Germany, as the measure "distance to country of origin" shows. The distance is measured between the capital of the country of origin and Frankfurt, which is situated in the centre of Germany and is the country's main airport. Moreover, and quite strikingly, better educated immigrants are much more likely to report that they came to live in freedom or to escape a war in their country of origin. By contrast, there is little difference with respect to whether the immigrant still has family abroad; for this variable, the share of positive answers is almost 100%, regardless of educational level.

[3]The results are available from the author upon request.

Table 1: Summary statistics

Variable	Mean	SD	Min	Max	N
Ever visited country of origin	0.91	.	0	1	7702
Difficulty feeling at home on visit	2.34	1.10	1	5	7122
Years of schooling	10.05	2.48	7	18	7348
Male	0.50	.	0	1	7822
Age	44.17	14.21	17	88	7822
Not working, unemployed	0.10	.	0	1	7822
Owns residence he or she lives in	0.20	.	0	1	7822
Household size	3.43	1.52	1	13	7822
Child under 16 in household	0.48	.	0	1	7822
Single	0.10	.	0	1	7786
Married	0.80	.	0	1	7786
Married but separated	0.02	.	0	1	7786
Divorced	0.05	.	0	1	7786
Widowed	0.03	.	0	1	7786
Years since migration	22.44	10.44	0	52	7066
Distance (in km)	1965.68	1364.35	192	16468	7730
Health poor or bad	0.20	.	0	1	7808
Monthly household net income	2314.30	1776.31	183	101522	7460
Family abroad	0.98	.	0	1	820
Left because of war	0.02	.	0	1	7822
Came to live in freedom	0.02	.	0	1	7822
Limited residence permit on arrival	0.07	.	0	1	7822
Year = 1996	0.22	.	0	1	7822
Year = 1998	0.19	.	0	1	7822
Year = 2000	0.24	.	0	1	7822
Year = 2002	0.19	.	0	1	7822
Year = 2004	0.16	.	0	1	7822

Note: SOEP 1996, 1998, 2000, 2002, 2004. Income is in 2005 euros. Distance is measured between Frankfurt and the capital of the country of origin.

Most of these variables are also associated with the probability of a return visit, and should therefore be controlled for in the multivariate analysis below. For instance, immigrants who have been back for a visit tend to come from countries that are closer to Germany, tend to have higher household income, tend to be older and to have resided in Germany for a longer time, and are slightly more likely to have family abroad. Other striking differences concern the self-reported reasons for migrating: people who came to live in freedom or to escape war are much less likely to have returned for a visit, presumably because they are more likely to be in danger when returning. People who received only a "limited residence permit" when they arrived in Germany are also less likely to have returned for a visit, presumably because they expect having difficulty when they re-enter.[4] Of course, these are all bivariate associations only; the multivariate analysis below will show whether these differences still exist once other factors are controlled for.

[4]The SOEP contains this information only for the arrival in Germany; the *current* residence status is not reported.

4. Results

Table 2 shows the results for the probability of a return visit. The table reports estimated marginal effects from a probit model; the effects are evaluated at the sample mean. The prediction that education decreases the probability of a return visit is supported by the data. The estimated marginal effect is -0.007 (s.e. 0.0013) in the bivariate model. When individual characteristics are controlled for, the marginal effect is larger in absolute value (-0.0096), which mainly reflects the fact that, as seen above, more educated immigrants tend to have higher household income, and that people with higher income tend to return for a visit more often.

Table 2: Results for the dependent variable 'probability of a return visit'

	(1)		(2)		(3)	
Years of schooling	-.0096***	(.0012)	-.0025**	(.0011)	-.0028**	(.0011)
Household net income	.051***	(.0033)	.032***	(.0032)	.028***	(.0033)
Male (d)	.0018	(.0057)	-.0049	(.0052)	-.003	(.0052)
Age	.0071***	(.0013)	.0019	(.0012)	.0022*	(.0012)
$Age^2/100$	-.0056***	(.0014)	-.0024*	(.0013)	-.0028**	(.0013)
Health poor or bad (d)	-.0051	(.008)	-.0019	(.0071)	-.000079	(.007)
Single (d)	-.00073	(.011)	-.021*	(.013)	-.02	(.012)
Married but separated (d)	.00058	(.021)	-.029	(.027)	-.027	(.026)
Divorced (d)	-.024	(.016)	-.038**	(.017)	-.038**	(.017)
Widowed (d)	-.074**	(.03)	-.07**	(.031)	-.067**	(.03)
Household size	-.028***	(.0026)	-.021***	(.0024)	-.02***	(.0024)
Child under 16 in household (d)	.031***	(.0084)	.031***	(.0076)	.029***	(.0076)
Years since migration			.0043***	(.00035)	.0043***	(.00034)
Distance (in 1000 km)			-.0083***	(.0015)	-.0083***	(.0015)
Left because of war (d)			-.11***	(.028)	-.11***	(.027)
Came to live in freedom (d)			-.079***	(.024)	-.076***	(.024)
Ltd residence permit on arrival (d)			-.0059	(.009)	-.0056	(.0089)
Not working, unemployed (d)					-.014	(.0095)
Owns residence (d)					.018***	(.0064)
Year dummies	Yes		Yes		Yes	
Pseudo R^2	.11		.23		.23	
Observations	6889		6239		6239	

Note: SOEP 1996, 1998, 2000, 2002, 2004. The table reports marginal effects (at the sample mean) obtained from a probit model. Asymptotic standard errors are shown in parentheses. Asterisks denote level of statistical significance: *** 1% ** 5% * 10%. (d) denotes dummy variables. Income is monthly household net income in 1000 euros, base year 2005. Distance is measured between Frankfurt and the capital of the country of origin. — The omitted reference category for marital status is 'married.'

In columns 2 and 3, further controls are added, which drive down the estimated marginal effect of years of schooling. This is most apparent in the comparison between columns 1 and 2: controlling for distance to the country of origin and for the reasons for migration reduces the estimated marginal effect from -0.0096 to -0.0025. As noted above, this reflects the fact that more educated immigrants are more likely to have left their country of origin for political reasons ("left because of war", "came to live in freedom"), and that people who came for these reasons tend to return less often, presumably because a return visit is more dangerous for them. By contrast, the two controls that are added in column 4 (namely, unemployment status and house ownership as a proxy for wealth)

affect the estimated marginal effect of education much less.

The estimated marginal effect on years of schooling is -0.0028 in column 3. This marginal effect is statistically significant, but relatively small in size: a difference of ten years of education (which corresponds to more than four standard deviations!) affects the probability of a return visit by only about three percentage points (recall from above that about 91% of immigrants have returned to their country of origin for a visit).

To put this marginal effect into perspective, a one standard deviation (i.e., about 2.5 years) difference in years of schooling has a marginal effect of approximately -0.007, that is, of less than one percentage point. By comparison, the standard deviation of monthly household net income is 1776 euros per month. Hence, a one standard deviation increase in income increases the probability of a return visit by $1.776 \times 0.028 \approx 0.05$, that is, by five percentage points (recall that the income variable is expressed in 1000 euros, hence the multiplication by 1.776 and not by 1776). Note that the effects of both education and income are small compared to factors such as distance or having left the country of origin because of a war or because of a lack of political freedom.

Table 3 shows estimated marginal effects from an ordered probit model. The dependent variable measures how long it took the immigrant to feel at home when visiting her country of origin. The variable has five categories. Only the marginal effects for the first category ("I feel at home right away on the first day, as if I hadn't ever been away.") are reported. These marginal effects are again evaluated at the sample means of the covariates.

The main result is that the prediction that better educated immigrants have greater difficulty feeling at home is confirmed. The estimated marginal effects are again statistically significant, but relatively small: a one standard deviation increase in the years of schooling is associated with a probability of feeling at home straight away that is lower by $2.5 \times (-0.0058) \approx -0.015$, that is, by 1.5 percentage points. By comparison, having left to "come to live in freedom" reduces the probability by about 14 percentage points.[5]

As for the other covariates, the more years spent in the host country, the lower the probability of feeling at home right away during a visit. Quite plausibly, people who left because of war or who report that they "came to live in freedom" are considerably less likely to feel at home during a visit, even controlling for years since migration. Immigrants who own the residence they live in (in the host country) are also less likely to feel at home straight away when they return for a visit. This is plausible since owning a house or apartment is in itself a sign of integration, especially in a country like Germany where home ownership is less frequent than in countries such as the United States, the United Kingdom, or France.

[5]The assumption that return visits to the country of origin *lower* the reference income is credible only if the average income is lower in the country of origin than in Germany. I therefore re-estimated the models dropping the 2756 immigrants (37% of the sample) from the EU-15 countries, Switzerland, Norway, the U.S., Canada, Australia, Japan, and Korea. The coefficients on education are again negative and, as expected, tend to be slightly larger in absolute value. The results are available from the author upon request.

Table 3: Results for the dependent variable 'feeling at home during the return visit'

	(1)		(2)		(3)	
Years of schooling	-.0028	(.0018)	-.0062***	(.0019)	-.0058***	(.0019)
Household net income	.023***	(.0034)	.03***	(.0044)	.031***	(.0046)
Male (d)	-.019**	(.0083)	-.011	(.0088)	-.01	(.0088)
Age	.00091	(.0021)	.004*	(.0023)	.0042*	(.0023)
$Age^2/100$	.0013	(.0022)	.00067	(.0023)	.00056	(.0024)
Health poor or bad (d)	-.024**	(.01)	-.025**	(.011)	-.025**	(.011)
Single (d)	-.11***	(.013)	-.11***	(.014)	-.11***	(.013)
Married but separated (d)	-.069***	(.025)	-.082***	(.025)	-.083***	(.025)
Divorced (d)	-.11***	(.013)	-.098***	(.014)	-.098***	(.014)
Widowed (d)	.024	(.029)	.0012	(.028)	.00088	(.028)
Household size	-.003	(.0039)	-.0032	(.0042)	-.0027	(.0042)
Child under 16 in household (d)	-.015	(.012)	-.02	(.013)	-.019	(.013)
Years since migration			-.0055***	(.00062)	-.0054***	(.00062)
Distance (in 1000 km)			.0075**	(.0035)	.0075**	(.0035)
Left because of war (d)			-.064**	(.03)	-.066**	(.03)
Came to live in freedom (d)			-.14***	(.02)	-.14***	(.02)
Ltd residence permit on arrival (d)			.0063	(.022)	.0062	(.022)
Not working, unemployed (d)			-.025*	(.014)		
Owns residence (d)			-.029***	(.011)		
Year dummies	Yes		Yes		Yes	
Pseudo R^2	.016		.024		.025	
Observations	6395		5807		5807	

Note: SOEP 1996, 1998, 2000, 2002, 2004. The table reports marginal effects (at the sample mean) for the category 'felt at home straight away'. The marginal effects are based on an ordered probit model. Asymptotic standard errors are shown in parentheses. Asterisks denote level of statistical significance: *** 1% ** 5% * 10%. (d) denotes dummy variables. Income is monthly household net income in 1000 euros, base year 2005. Distance is measured between Frankfurt and the capital of the country of origin. — The omitted reference category for marital status is 'married.'

5. Conclusion

Using data from the German Socio-Economic Panel, this paper has shown that more educated immigrants are less likely to have returned to their country of origin for a visit, and are more likely to experienced difficulty feeling at home when they did return. These patterns are consistent with Falk and Knell (2004)'s prediction that individuals' reference income increases with ability. Needless to say, the results merely constitute a test of the model, which it tentatively passes. No attempt is made to identify the model's parameter or to rule out alternative hypotheses for the observed behaviour.

The focus on what immigrants actually *do* in the process of assimilation is close in spirit to recent papers by Hamermesh and Trejo (2013) and Zaiceva and Zimmermann (2011; 2013) on immigrants' time-use and contrasts with the earlier contributions in economics that mainly study the *outcomes* of assimilation, such as earnings.

In future work, bringing together the literature on the assimilation of immigrants and the literature on goal-setting can offer additional insights. Due to the difficulty of observing goals, the latter literature has been mostly theoretical, with empirical evidence coming mainly from experiments. While experimental work certainly has many advantages for theory-testing, there is of course always a drive to take the theory to real-world settings. The study of immigration appears to be a fruitful application here, since the setting of

(higher) goals is certainly a main motivation behind the migration decision; also, once in the host country, immigrants adapt their goals and their behaviour in response to the new environment that they discover. In particular, much more than for natives, there is a clear *choice* to be made about the reference group (natives, other immigrants, people back in the home country). As pointed out by Stark (1991), this choice will depend on the expected length of stay in the host country, and will in turn influence the probability of return migration.

The study of assimilation and the goal-setting of immigrants has a temporal dimension that is not explicitly taken into account in the model by Falk and Knell (2004). The recent contributions by Suvorov and van de Ven (2008), Koch and Nafziger (2011), and Hsiaw (2013) are promising here in that they add a dynamic perspective. They study how goal-setting can be an alternative to binding, external commitments for overcoming problems stemming from present-biased preferences. Immigrants likely use both techniques to prevent them more returning "too early" in the face of initial difficulties.

Immigrants' reference standards are likely to change as the economic and political context of their host country evolves. A number of recent studies for Germany have exploited the 1999 reform in the citizenship law that made naturalization easier and in particular introduced birthright citizenship for immigrant children born after January 1st, 2000. Sajons (2011a;b) and Avitabile et al. (2013a;b) have shown that the reform has affected the integration and return migration behaviour of migrants. Studying the effect of the reform on the choice of a reference group would be a natural extension of this line of research.

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