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The return motivations of legal permanent migrants: Evidence from exchange rate shocks and immigrants in Australia

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ABSTRACT

Why do legal permanent migrants return to their home countries? How do home country conditions influence such a decision? This paper uses exogenous exchange rate shocks arising from the 1997 Asian Financial Crisis to distinguish between the motivations of Australian immigrants to return to their home country. A 10 percent favorable shock (a depreciation in a migrant's home country currency) leads to an almost 10 percent reduced likelihood of return in a two year period. The effect is stronger for those with pre-existing intentions to return, weaker for those undecided, and zero for those who initially desired to stay. These results favor a life-cycle explanation for migrant behavior and reject the theory that migrants are target earners who seek to invest upon return home.

1. Introduction

Many individuals who live and work outside their country of birth eventually return to their home country. Although official government statistics are often lacking, indirect estimates of migrants' movements from different countries over time suggest considerable flows: Jasso and Rosenzweig (1982) for example suggest that more than 20 percent of immigrants chose to re-migrate from the United States in the 1970s. Dustmann and Weiss (2007) approximate that 40% of all male immigrants and 55% of female immigrants left the United Kingdom five years after arriving there in the 1990s. Most recently, Gibson and McKenzie (2011) find that over a quarter of the "best and brightest" students who ever migrated from three Pacific countries ultimately ended up returning (33% in Tonga, 27% in Papua New Guinea, and 26% in New Zealand).

The fact that migrants choose to return in seemingly substantial numbers poses a puzzle. People move to where they earn the most, at least according to traditional economic theory (Sjaastad 1962; Harris and Todaro 1970). Hence, most return should occur when earnings in places of origin surpass those at the destination. Yet earnings in migrant-sending countries rarely overtake those of receiving countries' earnings. There should be little or no return. Reality appears to defy this simple prediction.

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More nuanced theories go beyond income maximization and appeal to the inclination of migrants to invest or consume in their home countries. Such theories allow for marginal changes in home country conditions to matter for migrant behavior, even in the absence of wage level reversals. Two competing models are at the forefront: one that regards migrants as *target earners* and the other as *life-cycle agents*. As a target earner, a migrant is credit constrained, so she works abroad until she accumulates a sufficient level of savings to finance an enterprise upon returning home (as in Piore, 1979 and Mesnard, 2004); the primary motive is investment. As a life-cycle agent, a migrant weighs the marginal benefits of obtaining higher income in the host country versus the marginal costs of remaining overseas, given that consumption of goods and services in the home country is preferred (see for instance Stark et al., 1997 or Dustmann, 2003); the goal is to consume. The two models generate different predictions on how migrants respond to home country factors. Most notably, a target earner is thought to cut her stay abroad shorter when her purchasing power for the home country increases while a life-cycle migrant prolongs her stay abroad.[1]

Empirical investigations into why migrants return to their home country have been scant and limited to particular contexts. Governments seldom record the stock and flow of migrants, let alone track their location over time. Another issue is the difficulty of isolating exogenous variation in factors that affect return, limiting the ability for causal inference. Most studies focus on correlations. Constant and Massey (2002), for example, relate covariates of social and economic attachments in the home country with migrant return and find that these are strongly associated for a sample of German guest workers. Kirdar (2013) demonstrates that immigrants to Germany shorten their stays overseas when purchasing power increases for their home country. A chief concern with these studies, however, lies with omitted variable bias, as source country factors are possibly endogenous to variables that are unobserved. That migrants with more social attachments at home are more likely to return need not imply a causal relationship. The group may simply possess other unmeasured characteristics related to social attachments that make return appealing.

Yang (2006) perhaps comes closest to identifying the causal impact of changing home country conditions on return. To confront endogeneity, the author utilizes an unexpected event, the 1997 Asian Financial Crisis, which caused substantial and varied exchange rate shocks between the Philippine peso and foreign currencies. Filipino migrants work in a diverse set of countries abroad, so the crisis created a situation in which, as if, each migrant were randomly allocated different exchange rate shocks during this period. By comparing the behavior of Filipino migrants who attained greater and smaller shocks, the paper establishes the causal impact of changing exchange rates on the decision of migrants to return home. Filipino migrants appear to be driven by life-cycle considerations. They prolong their stay abroad when they experience favorable changes to their purchasing power at home.

This paper focuses on Australian permanent immigrants and their motivations for return. I employ a strategy similar to Yang (2006) in using exchange rate shocks brought about by the Asian Financial Crisis, except I look at a mirror image: data from a destination country on immigrants from multiple origin countries. Doing so provides several new insights that complement previous research: First, because the source of variation is in places of origin rather than destination, I am able to control for conditions in the destination country while distinguishing between the effects of exchange rate shocks from those of other home country shocks that may also influence return, such as changes in home country gross domestic product (GDP) and changes in the price level. Second, I capture households whose members have all migrated and otherwise would have been absent in data collected from the home country, a limitation of Yang (2006). Third, I am able to test which theory of return migration likely holds for legal permanent migrants. Whereas Yang (2006) focuses primarily on Filipino migrants on temporary work contracts abroad, it is unclear whether his results must hold for other types of migrants as well, such as those granted permission for indefinite stay at the destination. For this set of individuals, a reasonable prior in fact is that there could be no motivation for return at all.

Australia is a natural setting for studying migration because of its large immigrant community; 24.7% of its population is foreign-born. Most immigrants are legal permanent residents (as opposed to undocumented), whose immediate relatives are already present in the host country.

My main contribution is the finding that a 10% depreciation of home country currency – which on average is what countries in the sample experienced over the two-year study period – leads to a 0.38 percentage point reduction in the probability that a migrant returns to her home country. The two-year permanent return rate in the period was 4.2%, so the effect is equivalent to almost 10% of the return rate. The result is robust and consistent with the story that migrants return because of life-cycle considerations. The effect is strongest for migrants who have pre-determined that they want to return, weak for those initially undecided, and zero for those who originally stated their desire to stay. This is evidence that migrants seek to optimally *time* their return, rather than *decide* whether or not to return, based on favorable conditions. Moreover, I provide evidence that the effect of the exchange rate shocks does not merely proxy for the influence of other macroeconomic conditions such as GDP per capita growth or price changes in the home country.

[1] As the relevant literature explains, for a life cycle migrant, a positive change in purchasing power at home exhibits a substitution effect that induces the migrant to accumulate more resources abroad since there is a wage premium to staying abroad, while the change also produces an opposite income effect, that encourages the migrant to cut her stay abroad short because of the higher spending power permitted at home. While the total effect is ambiguous, the overall result, if the substitution effect turns out to dominate the income effect, is that migrants prolong their stay in the foreign country because of the favorable change in the home country. The prediction allows the identification of a life-cycle consumer because a target earner never responds to an exchange rate shock in the same way.