Exit, Voice and Mobility

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Labour Mobility has become an essential right to the citizens of Europe. Utilising the Hirschman model of Exit, Voice and Loyalty as a starting point, Pfister develops an argument focusing on the increased saliency of exit in the New Economy. This increased labour mobility affects the liberty of fiscal policy in European states which is empirically investigated through an analysis of taxation trends.

INTRODUCTION

This paper takes a closer look at one of the phenomena the process of globalisation entails: Mobility of people. While one factor of production, capital, has already achieved an unmatched level of mobility, labour is just beginning to move legally and freely in the new economy. Economically speaking, labour mobility entails important benefits and efficiency gains for the aggregated economy and personal opportunities for the worker. However, the implications of labour mobility go beyond the economic sphere, as it has profound influences on politics in the new economy. Particularly interesting in a world of increased mobility of factors of production is the case of labour mobility within Europe. Guaranteed by the Treaty of Rome establishing the European Community in 1957, the freedom of movement of workers and people within the European Union (EU) today is only becoming a reality now, with the removal of most of the barriers to the provision of this freedom. Although even within the EU labour mobility is far from complete, it is nevertheless an interesting case to study the effects of mobility, as the EU is the most integrated regional economy.

The argument that follows is that increased labour mobility pressures states to adopt favourable fiscal or social policies towards mobile citizens, and that increased mobility empowers people within a society and creates new social cleavages.

In order to study the implications of labour mobility for economically integrated Europe, the model of Exit, Voice and Loyalty developed by Albert Hirschman will guide the analysis. The first part of the argument presents this model in its original outline of 1970, conceived mainly for firms and organisations, before expanding it to fit states and political process in an increasingly integrated political economy, where the exit option becomes readily available for labour. The second part will argue that due to increased labour mobility, the option of exit gains importance as an alternative to voice. This has two important consequences: On one hand, the model predicts an empowerment of the mobile labour force as citizens within the nation state. On the other hand, it puts competitive pressure on states in an international context – a competition expressed through fiscal policy. The third part tests the hypothesis of tax competition against empirical data provided by the EU and the Organisation of Economic Cooperation in Europe (OECE). Both the supportive and critical evidence will be analysed and explored. Lastly, the possibilities of mobility affect the social fabric within the European societies, predicting new cleavages in the social structure of Europe between losers and winners of the integration along the lines of skills and mobility.

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Three last caveats have to be addressed before entering the argument: While mobility of people can be analysed both across physical space (geographical mobility) and across different sets of jobs (occupational mobility), this paper concentrates on the former. [1] Additionally, within geographical mobility the argument focuses on mobility across jurisdictions, which is voluntary and not coerced. Furthermore, the argument considers only legal forms of migration within liberal democratic nation states to avoid the debate on illegal immigration.

THE HIRSCHMAN MODEL

In order to analyse ongoing processes in the world and to convey these processes into an academic discussion, the need for models is evident. As this paper concentrates on both economic and political aspects, it is reasonable to propose a model of analysis that takes into account tools of both fields of study in order to combine their respective usefulness in the understanding of economic and political processes. Such a model was proposed by Hirschman in his work *Exit, Voice and Loyalty – Responses to Decline in Firms, Organizations, and States* – in which the author emphasises "the usefulness of certain tools of economic analysis for the understanding of political phenomena, and vice versa". [2] Thus, the purpose of this section is to first present the Hirschman model and second to adapt it to the political spheres, taking into account increased labour mobility.

Presenting the Model[3]

In Hirschman's model, firms and organisations [4] face two competing forces of recovery: 'Exit' and 'Voice'. The two forces are signals emitted by customers or members [5] in response to a deterioration of existing conditions. Eventually these signals acknowledged by the firm in a way to correct its behaviour and thereby prevent it from becoming obsolete.

Exit, the first force at work, is a consumer's response to two possible conditions: an increase in prices or a deterioration of quality. Interested in the latter condition, Hirschman suggests exit as a neat, indirect, and impersonal economic behaviour. It is what the idiom 'to vote with one's feet' refers to: a customer can freely switch from one product to another. A dissatisfied client stops consuming a deteriorating product and by doing so fulfils two functions: On the one hand, she increases - or at least defends - her personal welfare. On the other hand, she signals the firm, through market forces, that there is need for adjustment – it is then up to the firm to adopt a strategy for recovery corresponding to the amount of exit. The fundamental assumption is that if consumers not only react to prices but also to quality in products offered [6] - assuming further that a quality decline is accidental (and not a deliberate attempt by the firm) - then "any exit whatever of consumers in response to quality decline will result in revenue loss". [7] As long as there is a function, which indicates a relationship between change in sales and change in quality, a firm can react to exit. In short, through pure market mechanisms exit enables the influence of a firm's behaviour via a feedback process.

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[1] Nevertheless, the importance of the occupational mobility for changing nature of politics in the new economy is acknowledged.

[2] Albert O. Hirschman, *Exit, Voice, and Loyalty: Responses to Decline in Firms, Organizations, and States* (Cambridge, Harvard University Press, 1970), p. 18, emphasis omitted.

[3] The following presentation is based on *Hirschman, Exit, Voice and Loyalty*, op.cit.

[4] For readability "and organisations" is omitted hereafter.

[5] For readability "or customers" is omitted hereafter.

[6] In this case, the model of the familiar demand function changed in a way that the quantity depends on quality instead of prices. The assumption is that the price does not change when quality changes.

[7] *Hirschman, Exit, Voice, and Loyalty*, op.cit., p. 23, emphasis omitted.

The second force in the model is voice, allowing "the customer [...] to make an attempt at changing the practices, policies, and outputs of the firm from which one buys or of the organization to which one belongs". [8] This objectionable state of affairs is expressed through either collective or individual action and is addressed to whatever regime is presiding over the quality of a product. Voice, in the words of Hirschman is thus messy, personal and direct – "political action par excellence". [9] As with exit, voice affects a firm's feedback mechanism and may influence its decision-making process.

Voice and exit are connected in two essential ways: First, voice can be interpreted as a residual to exit. In this case, everyone who does not exit on a particular product or service offered is a candidate for voice. Further, the elasticity of demand of quality and the level of voice are inversely linked. In other words, the more inelastic the demand the more forceful is voice. In the extreme case of no elasticity, exit is not possible and the level of voice will be highest. Voice as a residual for exit is thus complementary to exit. [10]

Secondly, voice can be considered an alternative to exit. Customers might wish to postpone exit in order to influence the firm to change behaviour of production, if there is a prospect of effectiveness. The question then is what conditions make a consumer stay with a product if she could, *ceteris paribus*, substitute the deteriorated product for another, superior one. Hirschman identifies loyalty as the main factor for someone's urge 'to do something' and to stay with a product, although its quality is deteriorating compared to others. Two further perceptions influence the level of voice: The first is the consumer's evaluation of the chances of the firm changing its behaviour, and second if it would be worthwhile if the firm does so. Loyalty can be defined in general terms as a psychological attachment to a process or good. Defined as such, loyalty increases the opportunity cost for exit and is likely to increase the degree of voice. [11]

The important issue concerning the interplay of exit and voice is the conception that voice foregoes more opportunity costs in comparison to exit - this is certainly true if loyalty is not very significant. The voice feedback mechanism for a firm thus becomes more important when the number of overall availability of goods and services increases. In this case, considering the whole market, voice becomes less affordable, and if exercised it becomes more influential. Furthermore, with a spread of products, exit is more likely to occur. "Hence, in comparison to the exit option, voice is costly and conditioned on the influence and bargaining power [of] customers[, thus] voice is more likely to be an active mechanism primarily with respect to the more substantial purchases and organizations in which buyers and members are involved". [12]

For Hirschman, only one of the two mechanisms tends to dominate in a firm. So the responsiveness is either biased towards receiving feedback from exit or from voice. Ultimately, "organizations need to rely on both mechanisms, at different times, in order to ensure that they can respond to constituent dissatisfaction*".* [13] A complete presentation of the model also involves acknowledgement that the process of exit and voice and the interplay through a feedback mechanism must allow time for adaptation and change, as the process is not immediate but gradual.

So far, the working model, originally conceived for analysing rather economic processes, has been presented, but without the necessary adjustment to fit political processes.

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[8] *ibid.*, p. 30.

[9] Hirschman, *Exit, Voice, and Loyalty*, op.cit., p. 16.

[10] cf. Annex I.

[11] Johnathon W. Moses, "Exit, vote and sovereignty: migration, states and globalization", *Review of International Political Economy*, Vol. 12, No. 1 (2005), p. 67 and Hirschman, Exit, Voice, and Loyalty, op.cit., p. 77 - also refer to Annex I.

[12] Hirschman, *Exit, Voice, and Loyalty*, op.cit., p. 40.

[13] Moses, op.cit., p. 59.

Hirschman himself acknowledges he "had neglected the possible role of exit in the analysis of political behaviour" [14] in his original work on exit, voice and loyalty. As will become clear in the next section, governmental behaviour is significantly influenced by the mobility of production factors.

Exit and Voice in the Political Process – Caveats

Analysing political processes, voice is interpreted as participation, while exit is results in leaving a given political jurisdiction. However, there are fundamental differences between customers and citizens. Customers are, under regular market economic circumstances, very volatile to changes in products characteristic; thus, their main reaction to deterioration of a product's quality is to substitute the product. For citizens on the other hand, voice is often the only conceivable option to address deterioration in citizenship quality. Exit in the form of emigration was usually unavailable or reserved for a negligible segment of the population: the very rich and the nothing to lose. In the Western industrial democratic state system, voice has become institutionalized through the process of democratic state building, giving voice a slight advantage over the option of out-migration. Furthermore, citizens tend to be more 'loyal' than customers, which increases the perceived value of voice as to bring change from within. [15] Finally, the assumption that citizens act like consumers must be indulged with caution, as there are empirical and normative objections as well as differences in resources. [16] Similar caveats apply to the comparison between firms and states. Whereas the former reacts more strongly to exit driven feedback and is responsible to the stakeholders, the latter is more likely to be responsive to voice and is accountable to its citizens. [17]

Although the problems of comparing states and firms, as well as customers and citizens as equal are inherent, the view of Johnathon Moses is adopted "that the benefits associated with these sorts of assumptions (e.g. parsimony and intuitive grasp) outweigh their apparent costs". [18] Furthermore, the model applied is a one, which combines the political and the economic of social interaction and is therefore advantageous for the analysis. Lastly, on a theoretical level, abstractions have to be made to grasp the complexity of certain phenomena, such as labour mobility, in the politics of the new economy. This said, the analysis now turns to integrating labour as a mobile factor of production in Europe into the model developed above, assuming that there is a right to participate as citizens in the political processes.

Exit and Voice in an Integrated World – Labour Mobility

In order for a common market to fully profit from the advantages it provides, there must be the free movement of all factors of production. The idea of a 'common market' for the European community, therefore, needed the possibility of free movement, not only for goods and services, but also of the factors of production – labour and capital. Although already mentioned in the Treaty of Rome (1957), the basic four liberties have only been achieved and conceptualised with the realisation of the Single European Market in 1993. [19] The result of increased labour mobility within the EU has profound effects on government behaviour as well as on citizen liberties and their power visà-vis the state, through making exit available as a strategy to all citizens of the union. The focus of the model should thus reside on the implications of the possibility to move on the state and the citizens.

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[14] Albert O. Hirschman, "Exit, Voice, and the State", *World Politics*, Vol. 31, No. 1 (1978), p. 91.

[15] Scott Gehlbach, *Political Model of Exit and Voice* (Madison, University of Madison, 2005), p. 5.

[16] For instance, whereas consumers have different resources available (purchasing power), citizen activity for voice tends to rest on the principle of one person - one vote. (Moses, op.cit., p.60).

[17] Furthermore, while firms maximize profit, it is debatable whether states maximize any one thing.

[18] *ibid.*

[19] Treaty of the EU, signed in Maastricht in 1992 and *entré en vigueur* on November 1 st , 1993.

Traditionally, the exit option (to emigrate) has been more expensive for citizens than the option to voice (to influence policymaking). Thus, as Moses points out, it makes more sense to think of exit as a residual to voice in the context of states and citizens. [20] In a world where mobility of people is limited, a citizen reacts with voice to the quality of citizenship, a move expressed as job availability, welfare provisions, tax levels, ideology or other. The decision to voice depends on two factors: on the benefits and the cost of citizenship. [21] A government, facing traditional situations, faces discontent in the form of voice and the threat of exit is small. [22] As the cost for exit is comparatively high, exit becomes a residual to voice in the sense that exit is the last resort, the last option for which a citizen might opt. [23] Furthermore, if voice is the standard procedure for addressing dissatisfaction in citizenship quality, the polity of the state can address the problem as an internal one. The success of adaptation to voice depends on the existing political and societal institutions channelling voice (feedback). [24]

With no barriers to mobility, the situation changes fundamentally, as it transforms exit into an alternative to voice. The elasticity demand for citizenship quality increases, meaning citizens become more volatile to variations in the quality of citizenship provided by the state. Thus, discontented citizens are more likely to exit instead of voice. In addition, the cost of exit inflicted upon the state rises relatively to the amount of voice compelling the state to respond not only to voice, but also to exit. [25]

Derived from this analysis, two major two major hypotheses concerning political sovereignty due to increased human mobility can be advanced. Firstly, there is a twofold increase of influence by mobile people on internal politics: bottom-up and top-down: On the one hand, a disgruntled citizen has the threat of exit, which becomes credible and if carried out, inflicts cost on the state, such as revenue loss, brain drain, loss of workforce. On the other hand, due to “the increased empowerment of citizens, states themselves need to become more responsive to citizen demands – failure to do so [leads] to resource and legitimacy losses”. [26] Secondly, and partially as a result of the first prediction, states will enter into competition for mobile factors, in order to retain and attract advantageous mobile resources. [27]

So far, the original model of exit and voice as proposed by Hirschman has been presented to identify its major aspects as relevant to this argument. In addition, the model was adjusted to fit states and citizens and a world with free mobility of labour as citizens. In the end, two possible outcomes were predicted by the adopted model. The rest of the paper will, based on these outcomes, discuss findings in the context of the EU, which is arguably the most integrated and ‘globalised’ region in the world today.

TWO CONSEQUENCES

The increased mobility of factors of production has profound impacts on the politics of states, and the effects of ‘movable property’ on the political process were identified early by economists. James Harrington for instance, wrote in 1747 about the ‘flightiness’ of money, which “raised questions about favourable or unfavourable political consequences”. [28] Montesquieu, James Steuart and Adam Smith perceived “the possible exit of capital [...] as a

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[20] Moses, op.cit., p. 60.

[21] The cost of citizenship can be expressed in economic terms (e.g. taxes), social terms (e.g. opportunities, military draft) and the opportunity cost associated with choosing citizenship elsewhere (Moses, op.cit., pp. 62ff).

[22] This can be a loss in tax revenue, loss in defence capability, or brain drain amongst other things.

[23] The question of political resignation or withdrawal is not addressed.

[24] Moses, op.cit., p. 63.

[25] For a graphical representation, refer to Annex I.

[26] Moses, op.cit., p. 66.

[27] *ibid.*, p. 65ff. Intuitively, states could also be in a negative competition for mobile labour, as it is conceivable that policies are designed in a way to pressure out migration of ‘undesired elements’ of society.

[28] Hirschman, “Exit, Voice, and the State”, op.cit., p. 97.

salutary restraint on arbitrary government". [29] Whereas capital (and capitalist for that matter) enjoyed always a greater freedom to move, the mobility of labour is another issue. After the great migration flows of the late 19 th and early 20 th centuries, the completion of democratic nation states tied its citizens to the country. Migration and thus mobility of labour became restricted. With European economic integration and the idea of a common market, it was economically important to let all factors of production flow freely as to maximize the efficiency gains and to distort economic shocks. [30] Labour, and thus citizens of Europe, are now empowered with the threat of exit when it comes to internal political influence and bargaining.

Fiscal Competition

In the western world, income taxation is an essential tool for states to fulfil their responsibilities and to provide public goods to their citizens. Furthermore, citizens can actively take part in the political process to induce redistribution of collected tax money. There is competition among different individuals or groups (owners of a particular resource or factor of production) through fiscal policy within a given jurisdiction. As David Wildasin puts it, groups have "an incentive to participate in the political process to exploit the other and to defend [themselves] against exploitation". [31] This is the voice aspect of Hirschman's model.

However, if factors become mobile, exit as a strategy becomes available to avoid or influence this competition over redistribution within a society. Exit is thus an alternative to voice over taxation policy connected to redistribution policy. This has two consequences: on one hand, there is a tendency for decreased taxing of mobile factors and increasingly taxing immobile factors. On the other hand, the "owners of the [mobile] resource no longer have an incentive to participate in the local political process". [32] In short, the increased mobility of factors has profound implications on redistributive fiscal policy.

Any change of a tax levied on individuals in a given jurisdiction (payroll taxes, income taxes, consumption taxes, saving taxes, etc.) influences the quality of citizenship. It affects the redistribution capabilities of the authority collecting the tax, while at the same time changing the citizens' purchase power. Such a modification can induce citizens either to exit or to voice their complaints. In an extreme case, where taxation is the only factor of citizenship quality and everything else constant, a mobile labourer has no incentive to participate in the political process. [33] Any benefits of any fiscal transfer she might receive by participating will decrease by the fact that other mobile labourers will be attracted by the increased benefits and flow into the jurisdiction until the benefits have vanished. Furthermore, any increased taxation levied onto her, inflicted by others, can be avoided if she leaves. [34] This raises the question of fiscal competition among government, which arises if different jurisdictions compete for productive, mobile resources. This can take on two forms: it can be expressed through taxation or through the provision of different 'welfare - citizen packages'. Or, in the words of

[29] *ibid.*, p. 99.

[30] Richard Baldwin and Charles Wyplosz, The Economics of European Integration (Berkshire: McGraw-Hill, 2004), pp. 345ff.

[31] David E. Wildasin, "Factor mobility and fiscal policy in the EU: policy issues and analytical approaches", Economic Policy (2000), p. 348.

[32] *ibid.*

[33] It is argued that taxation is an important and decisive factor for citizenship quality. Not only on the purchase power level, but also indirectly. The tax revenue collected by the state is the basis for public goods provided (health care, infrastructure, welfare state, security, etc.). Thus, it is imaginable in this model that certain citizens would advocate for an increase of taxes.

[34] Wallace E. Oates, "Fiscal competition and EU: contrasting perspectives", Regional Science and urban Economics, Vol. 31 (2001), p. 140 and Wildasin, op.cit., p. 348.

Hirschman: "it is likely that many states [...] have hit on various devices and strategies through which they have parried excessive tendencies toward exit". [35]

As the state faces increasing threats of exit from mobile citizens, manifested through a loss in revenue and resources, it is forced to respond to new pressures from within (out-migration) and from outside (in-migration). To gain a competitive edge over other jurisdictions, the taxes must be comparatively lower to keep mobile labour inside the jurisdiction and to attract mobile labour, which is leaving another jurisdiction. This would eventually result in a 'race to the bottom' of taxes levied on mobile labour and thus lead to a suboptimal equilibrium between tax revenue and government spending. Furthermore, states, in order to fulfil their responsibilities, will seek to increase the taxes on immobile factors (e.g. land) and enlarge the tax base.

Analysing the progression of the taxes levied on land, which is by definition the most immobile factor of production, an upward trend since the beginning of the recording in 1979 can be identified. In the nineties, the trend exuberates and the tax burden on land has increased significantly. Thus, there is evidence for the hypothesis that immobile factors are increasingly taxed. [36]

However, data on personal income tax shows a different, mixed picture. The OECD identifies a slight overall decrease in wage tax burden in all OECD countries since 1996. [37] Looking at different family structures, data shows a tax decrease advantage for the 'traditional' one earner family with two children in comparison with the 'modern' single person without children. While both groups experienced a decrease in their income tax burden, the traditional family (less mobile) profited more from the decrease in taxes. [38]

The picture becomes blurrier with a look at the EU alone. The implicit personal income tax rate on labour has been rising in the 'old' fifteen member states until 1998 and has only since begun to decrease. [39] While there was a rise of 30 to almost 40 per cent from 1970 to 1997 in the implicit tax rate on income, the fall since has been one of only 1.4 percentage points. [40] Compared internationally, this is rather small and the average European tax burden still lies above the mean. [41] Furthermore, there is no convergence of member states tax burden within the EU. While some member countries levy taxes of around 40 per cent on income earned and others tax income at a low rate of 25 per cent, there seems to be no substantial downward trend by the high taxing countries. [42] Overall, the implicit tax rate on labour income presents rather a stabilizing trend from the sharp increase before 1996 instead of a downward trend. [43] As these statistics are based on the implicit tax rate, they take into account that direct taxes on labour income have been reduced, but that states have compensated this tax loss by increasing indirect taxes and enlarging the tax base. [44]

It must be acknowledged that empirical data does not support the first hypothesis conclusively. While there is some downward pressure on taxes since the mid nineties, this trend has not been substantial. There are several reasons explaining why the data does not

[35] Hirschman, "Exit, Voice, and the State", op.cit., p. 105.
[36] Eurostat, (cf. Annex II.1).
[37] OECD (2005), Taxing Wages (Paris, OECD Office de Publication, 2005), available at SourceOECD.org, p. 26.
[38] cf. Annex II.2 and II.3. OECD, op.cit., pp. 102105.
[39] There is not enough data available for the EU25 yet. Implicit tax rates measure the average effective tax burden on the different types of income or activity in the economy.
[40] Eurostat (cf. Annex II.4 and II.5) and European Commission, Structures of the taxation system in the EU (Luxembourg, European Commission, 2004), available at europa.eu.int/comm, p. 90.
[41] European Commission, op.cit., pp. 11ff.
[42] Except for Sweden.
[43] OECD, op.cit. and Hans-Wernder Sinn, "The New Systems Competition", *National Bureau of Economic Research (NBER)*, Working Paper 8747 (2002), p. 9.
[44] European Commission, op.cit., pp. 11ff.

fully support this argument. First, the data available does not show the different tax levels by degree of mobility. Although all citizens within the EU are legally fully mobile, there might be different levels of mobility due to social, political or psychological factors. The data available, however, is not regrouped by socioeconomic background of the labourer, which, it must be acknowledged, would be more appropriate for this study. [45] Second, the member states of the EU might not yet be subjected to the increased, theoretical labour mobility across large segments of the population, which in turn puts pressure on countries to engage in fiscal competition. There have been several studies on the lack of 'labour flexibility' in the Union, spurred by the initiation of the Lisbon Strategy in 2000, which calls for an increased 'adaptable workforce'. [46] Thus the mobility of labour might not be a given. A third reason, a counter argument to the second, lies in the nature of taxation in an increasingly internationalized world: It is assumed that there is a highly mobile labour force at the top of the social segmentation, which is highly skilled labour with technological, transferable and flexible skills. In this case, with an increasing portion of foreign factors of production within a jurisdiction, the question of taxation is not so much on lowering the taxation of all incomes, but only on that of national factors income. While judging the mobility and speed of adjustment of foreign factors (both labour and capital), the ideal rate is through taxing both foreign and national factors of production. This keeps the observed overall income tax rate stable. [47] A fourth, and last reason given in this context, includes political reasoning. For the majority of the European countries, the implicit tax rate on labour reflects directly the importance of contributions in financing the social security and welfare state. If more than 60 percent of the overall tax rate is a contribution towards the social system, and if most people accept the redistributive nature of the system, the pressure of individual people to lower taxes might be reduced and the state can keep tax rates stable, instead of engaging in fiscal competition across jurisdiction. [48]

Indications that the model will hold eventually come from studies on fiscal competition in existing federal states (where mobility is long established and the tax system is decentralized), such as Switzerland. Gebhard Kirchgässner concludes that there is observable tax competition between the different jurisdictions with a focus on high earning people. [49]

New Social Cleavages and Empowerment of People

There is a second, counteracting mechanism for states to compete with each other for mobile labour. A government can deliberately shape citizenship quality policies to attract the mobile factor it wants. This means that the different European welfare systems could enter into competition to attract 'wanted' and deter 'unwanted' people. This is nothing new in itself, as exhibited by the vast literature on offering attractive investment packages to foreign direct investment in the international finance regimes. What is new, is that states will start to "compete with one another in offering more attractive citizenship bundles" [50] for the mobile people. The competition is twofold: either a state designs a policy attracting labour and people it finds useful by promising tax reduction, providing more education, or reforming the welfare system. Alternatively, the authorities can decrease the redistribution scale as to gain

[45] The Author could not identify any such studies or data on regional levels.

[46] Alexandros Tassinopoulos and Heinz Werner, "To Move or Not to move – Migration of Labour in the EU", IAB Labour Market Research Topics, No. 35 (1999) and Richard Baldwin and Charles Wyplosz, *The Economics of European Integration* (Berkshire: McGraw-Hill, 2004), pp. 345ff. The 2006 European Year of Worker Mobility can be seen as an acknowledgment that the EU workforce is not as mobile after all.

[47] Theory advanced by Wildasin, op.cit.

[48] European Commission, op.cit., p. 91.

[49] Gebhard Kirchgässner and Lars P. Feld, "Income tax competition at the State and Local Level in Switzerland", *Regional Science and Urban Economics*, Vol. 31 (2001), p. 204.

[50] Moses, op.cit, p. 70.

economic competitive edge over other states. [51] Within the EU and its guaranteed freedom of movement and residence, this option is becoming increasingly obsolete, as sub-central governments are likely to be constrained by not only the exit option of people, but also by the decreasing tax revenue discussed above. Unfortunately, there is no study or data analysing the possibility of states engaging in competition over welfare systems, so the discussion remains hypothetical. [52]

The second hypothesis derived from the model predicted an empowerment of the citizens within a jurisdiction when the exit option becomes more readily available. This increased influence is dual: bottom-up and top-down. As the effectiveness of voice increases, due to the credibility of exit as a threat, conceived as a loss of resources, mobility provides citizens with more influence on policymaking. Furthermore, citizens with the exit option enjoy more freedom in choosing a way of action to respond to a loss in quality of citizenship. On the other side of the spectrum, the citizen's participatory power is boosted by the fact that states have to become more responsive to the citizen as a mobile factor. [53]

Assuming mobility is unequally distributed across the social structure of labour, the increased power has significant implications for the citizens of a state. Immobile workers will be put at a participation disadvantage in the policy making process. As states becomes more responsive to the increasingly mobile labour force in order to construct and reform the citizenship package, the less mobile labour force has decreased possibilities of influencing the policy process by voice. Furthermore, coupled with the analysis of the preceding part on fiscal competition, the redistributive policy and the taxation policy in the future will be increasingly to the disadvantage of the immobile factors of production. Hence, assuming that only very highly skilled labour is mobile, all other (e.g. immobile labour), will face a deterioration of the citizenship quality and an increase in the tax burden. There is thus a widening gap between the mobile and immobile labour. While the mobile labour can freely choose which citizenship package she desires and how it should be designed, the immobile labourer, with comparatively decreased citizenship power and comparatively increased contribution burden, is clearly a loser in the process of European economic integration. This phenomenon has important complications for the social fabric within not only the Union's member states but also for the Union as a whole. One of the many current debates in the union can be understood in this light: The discussion opposing advocates calling for harmonization of the welfare and tax systems within the EU in order to assure social cohesiveness, to those advocating free market regulations, also in tax and welfare systems, as to increase the economic efficiency due to competition. [54]

CONCLUSION

In a market economy with capitalistic structures, the mobility of factors is important for growth and the creation of wealth. Although capital as a factor of production has been relatively mobile for a long time, the legal mobility of the workforce has only recently become an issue for markets and politics, especially in the EU, where the Treaty of Rome guarantees this mobility. A change in factor mobility has not only important consequences for the economy, but also for the political and social fabric of a given society.

This paper has demonstrated how the Hirschman model of 'Exit, Voice and Loyalty' can be altered to describe political process linked to factor mobility. The modified model

[51] Sinn, op.cit., pp. 13ff.

[52] Baldwin *et al.,* op.cit., pp. 427ff.

[53] This could be an explanation for growing citizen dissatisfaction with political action in democratic states. Pharr and Putnam (2000), *Disaffected Democracies*, cited by Johnathon W. Moses, "Exit, vote and sovereignty: migration, states and globalization", *Review of International Political Economy*, Vol. 12, No. 1 (2005), pp. 69ff.

[54] George R. Zodrow, "Tax Competition and Tax Coordination in the EU", *International Tax and Public Finance,* No. 10 (2003)

predicted three outcomes, the first of which is a dual empowerment of people's ability to influence the political process. Due to the possibility of exit (bottom-up empowerment), the mobile people received a credible threat to inflict a loss for the jurisdiction, to which the authorities eventually respond (top-down empowerment). Secondly, the model predicted a competition between authorities to retain and attract mobile people. Governments do this by engaging in fiscal competition, either through taxes or through 'citizenship packages'.

At this point in time however, the empirical evidence does not show a clear trend for the latter hypothesis. The picture for the EU, as the most integrated economic entity in the world, which not only allows but also encourages labour mobility, is mixed. There is a slight downward trend for taxes on income identified in recent years, although not a substantial one. Furthermore, the overall tax burden has not decreased, as taxes on immobile factors (land) increased, and the tax base has enlarged. It is therefore suggested the study be repeated in about five to ten years with the purpose of substantiating the argument to its fullest. At the same time, there should be more attention paid to the identification of statistical differences between the mobile and immobile population.

The other prediction by the model has implications that go beyond the empirical. While mobile people become more politically empowered, immobile people will become increasingly marginalized. On one hand, only the mobile people will profit from the empowerment, gaining bottom-up and top-down bargaining power visà-vis the authorities. On the other hand, the predicted fiscal competition (both in taxes and citizenship packages) implies a focus in favour of the mobile factors, while the immobile are predicted to not only be marginalized in the policy making process, but also bear a heavier burden due to higher taxes. There are thus clear winners and losers from increased mobility.

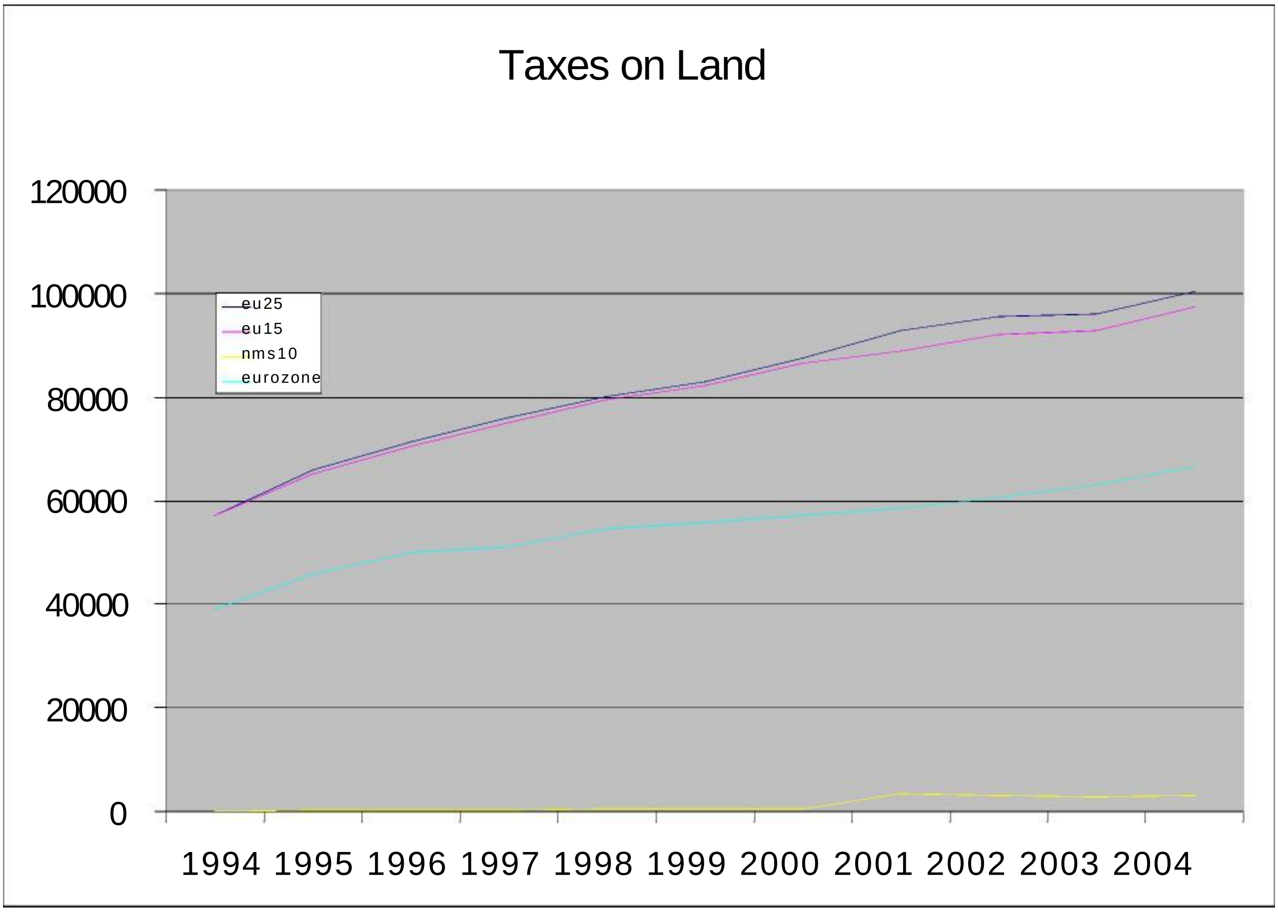
Annex I – Graphical Representation of Quality-Demand in Citizenship

Source: Moses (2005), p. 64.

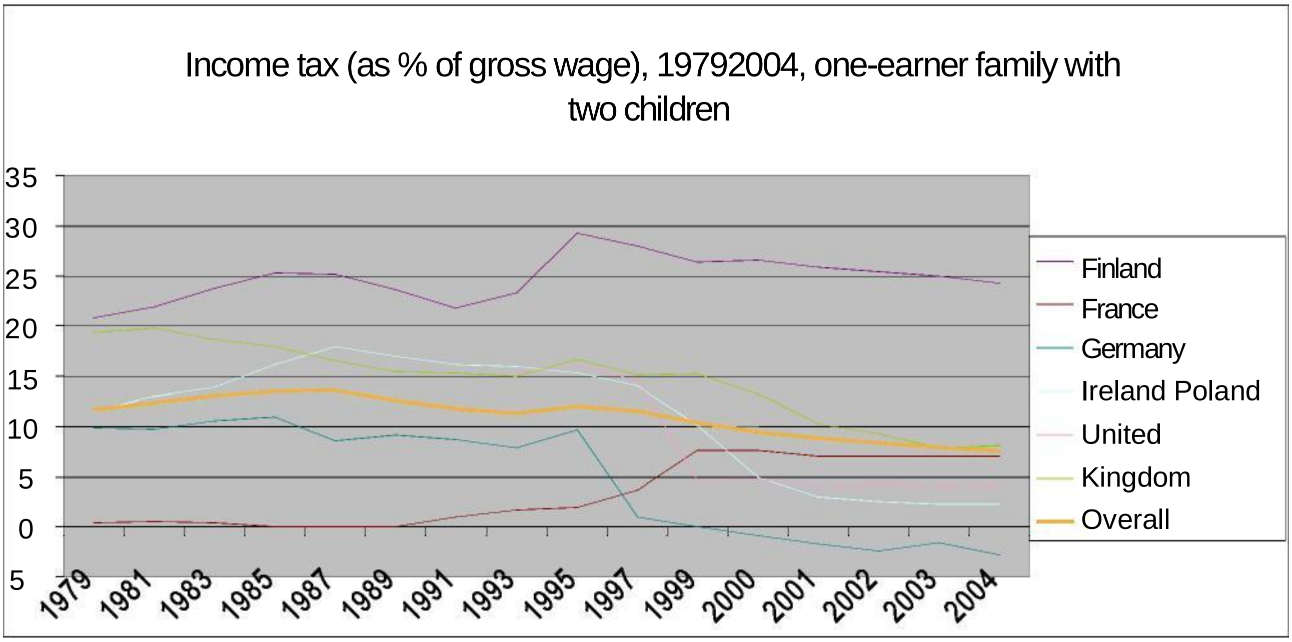
NB: there are two ways of interpreting the graph (as D’ is more elastic than D)

- (1): The difference between D and D’ is temporal: D’ represents more mobility over time to D
- (2): the difference between D and D’ is social: D’ represents more mobile factors than D

Annex II – Statistical Support

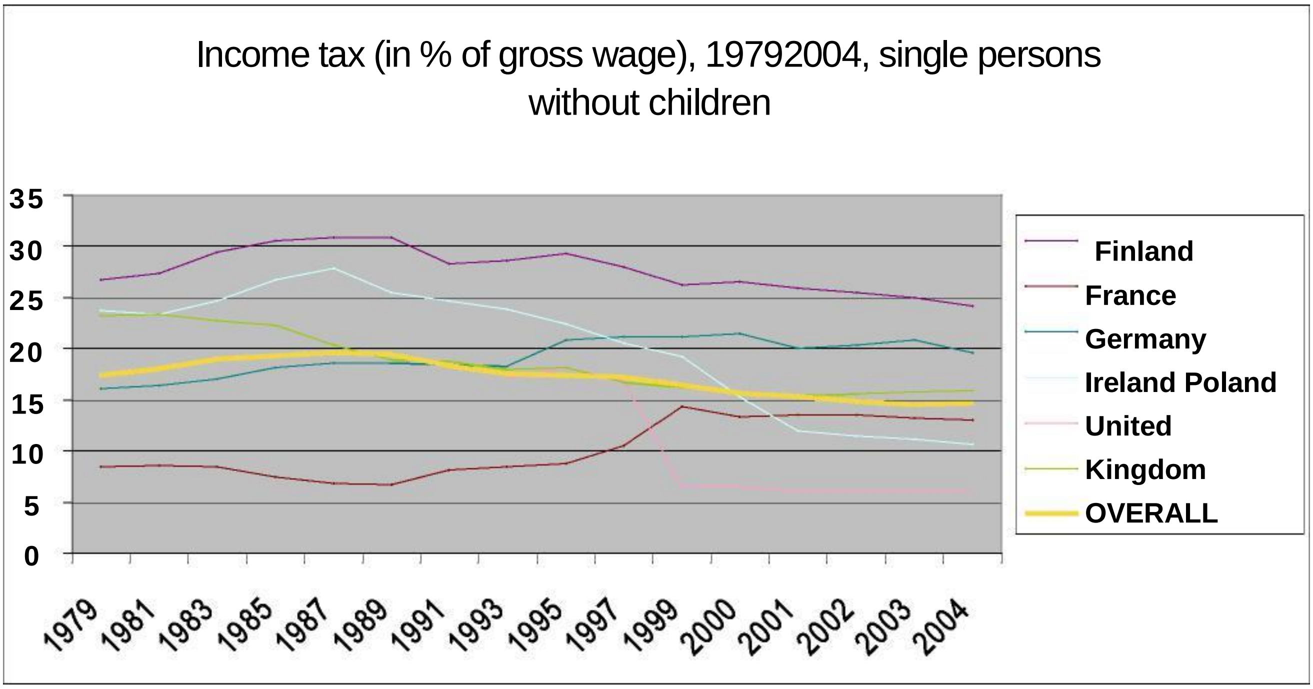


The source of the data is mentioned. Graphical representation by the author.



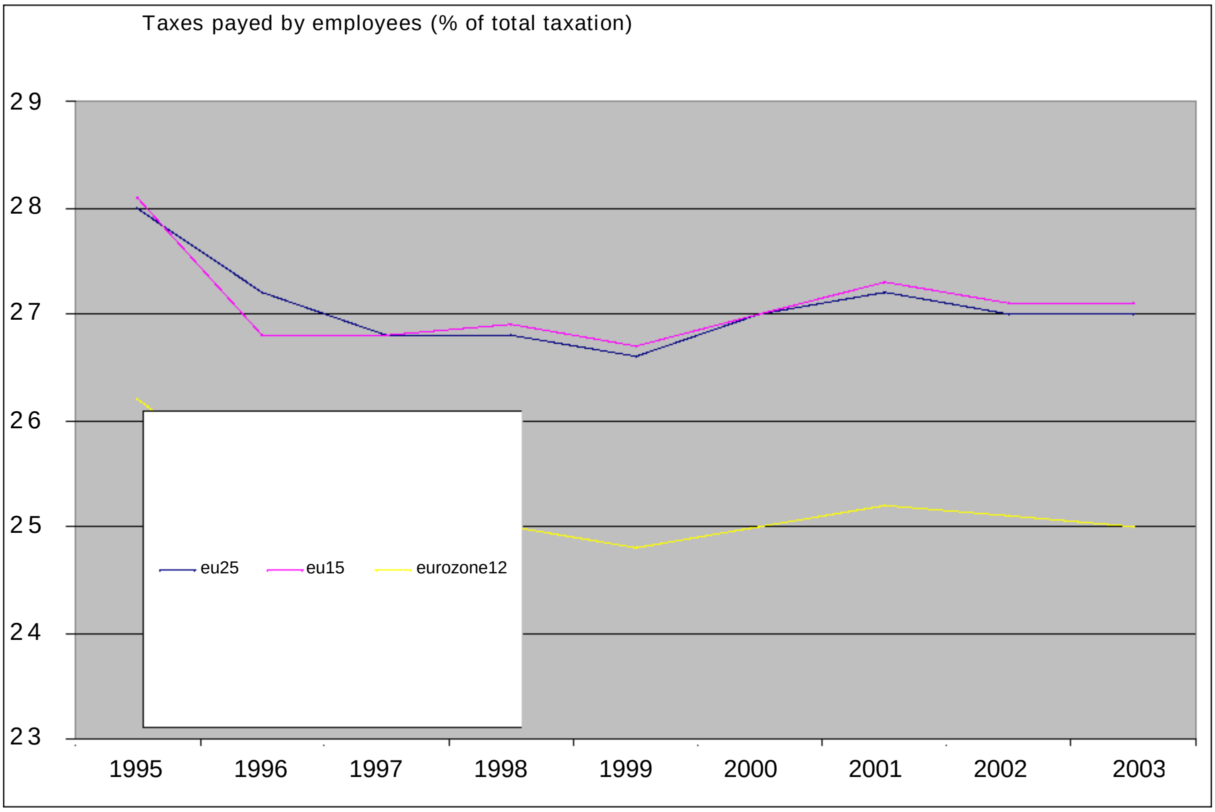
ANNEX II.1, source: EUROSTAT (2006)

ANNEX II.2, source: OECD (2005), pp. 102ff (six countries have been chosen for representation purposes)

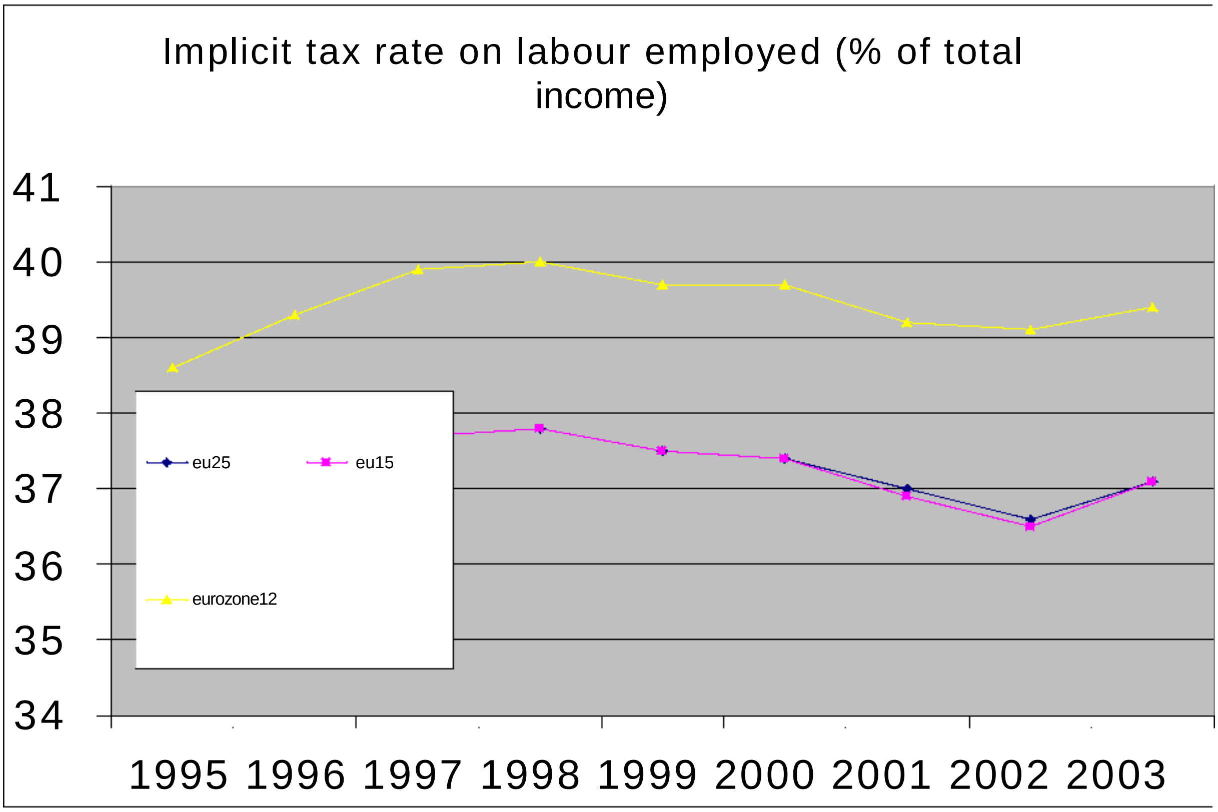


ANNEX II.3, source: OECD (2005), pp. 102ff (six countries have been chosen for representation purposes)

ANNEX II.4, source: EUROSTAT (2006)



ANNEX II.5, source: EUROSTAT (2006)



ANNEX II.6, source: EUROSTAT (2006)

ABBREVIATIONS

EU	European Union
OECD	Organisation for Economic Cooperation and Development
EC	European Commission

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Internet Resources and Statistical Data

OECD	www.oecd.org
OECD	www.SourceOECD.org
EU	www.eu.int
EUROSTAT	epp.eurostat.cec.eu.int