

## Chapter 2

### What Others Have Said

#### Introduction

A CONSENSUS ON THE ECONOMIC IMPACT of Quebec sovereignty has emerged in Quebec. It was articulated by a group of prominent Quebec economists speaking before the Bélanger-Campeau Commission on behalf of the Association des Économistes Québécois (1990). If Quebec were to separate, they argue, there would be no significant impact in the long run on the Quebec economy and that the short-run impact would depend very much on how the break was made. The smoother and more harmonious the political and economic relations between Quebec and Canada during the split, the smaller the economic disruptions would be. Uncertainty during the transition period is seen as being the only cost of sovereignty.

This chapter reviews the pre-Bélanger-Campeau-report literature on the economic consequences of Quebec sovereignty to see if the literature supports this emerging consensus. Subject to a few exceptions, this chapter focuses only on the more rigorous technical analyses of sovereignty, which have been relatively rare, and does not cover the journalistic and partisan articles and papers dealing with sovereignty. The exceptions concern papers which have been widely quoted in the

debate over Quebec sovereignty or which deal with important issues not covered in analytical papers.

The chapter is divided into sections, each treating a specific type of analysis. The second section addresses the critical question of the surplus from Confederation. The larger the surplus, the greater the gains are from membership in the Canadian federation. The third section covers general equilibrium analyses which seek to estimate the overall impact of Quebec sovereignty on the output and income of Quebec and other regions. The fourth section deals with fiscal balance studies which concentrate narrowly on the federal deficit or surplus with Quebec and the other regions; it attempts to show who gains and who loses from Confederation. Fiscal balance studies have been a perennial favourite of Canadian analysts. The fifth section focuses on studies of the trade flows between Quebec and the rest of Canada. The sixth section examines some studies which have been prepared by financial institutions and have been used particularly by the Parti Québécois to show the economic viability of a sovereign Quebec. The seventh section looks at the question of the viability of a Quebec dollar. The eighth section considers the issue of financing government deficits and debt. The ninth section reviews the evidence on the likely effect of constitutional uncertainties on the Quebec and Canadian economies. The tenth section provides conclusions on the literature review.

The scarcity of up-to-date hard analysis of the costs and benefits of Confederation and the economic impact of Quebec sovereignty is cause for concern. Important decisions on the future of Quebec and Canada that are currently being made without adequate information on their likely economic consequences.

#### The surplus from Confederation

The most important economic argument in favour of a federation has to be that economic integration of the component parts creates a surplus which can be distributed among the participants. In the final overview study for the C.D. Howe Accent Quebec series, Judith Maxwell and Caroline Pestieau list four ways to generate the surplus:

- The opportunity to achieve greater scale and specialization in economic activity can lead to gains from trade among the

participants in the form of more efficient production and higher incomes.

- Interregional compensation and insurance programs for pooling the risks of cyclical fluctuations (both short- and long-term) can produce a smoother flow of economic activity and create a more favourable environment for development within each region.
- The sharing of such joint services as transportation, communications, and defence can lead to both cost savings and an improvement in the quantity and quality of these services.
- Bargaining power in international negotiations can be increased through the consolidation of strength (Maxwell and Pestieau, 1980, p.14).

After reviewing the Canadian experience in generating a surplus in each of these four ways, namely gains from trade, pooling of risk, sharing of overheads, and international bargaining power, Maxwell and Pestieau express some doubts about the size of surplus which has actually accrued.

In summary, the current perceptions of the surplus from the existing system are not particularly favourable. In areas where surpluses have been created as a result of specialization in interprovincial trade, most provinces are now seeking ways to restructure their economies in the direction of less specialization. In areas where the pooling of risks or sharing of overheads could be expected to generate a surplus, several provinces object strongly to both the methods employed and the results achieved. Finally, in areas where a consolidation of strength could be expected to increase Canadian bargaining power, certain analysts would argue that this power has not been used to create a healthy national economy, let alone a surplus for the individual regions. (Maxwell and Pestieau, 1980, pp.20-21)

In their pioneering study of regional aspects of Confederation Whalley and Trela used general equilibrium analysis of the gains and losses from Confederation and concluded that "Confederation may be the source of a deficit rather than a surplus" (Whalley and Trela, 1986, p.196). But these results derive largely from the distortions in resource allocation caused by the National Energy Program. Consequently, their study may not still be applicable. They also voice some pessimism about the prospects for future surplus as a result of the tendency towards

regional balkanization and the competitiveness of the Canadian economy in international transactions (1980, p.21).

The strongest argument in favour of federalism advanced by Maxwell and Pestieau is that the regions together in a united Canada have more bargaining power in dealing with their main trading partners than they would have if they were divided into smaller groups (1980, p.23). Subsequent events have borne this out. In negotiating the free trade deal with the United States, which is considered to be so important to Quebec in reducing its dependence on the Canadian market, Canada made two important concessions: guarantee of access to Canadian energy and the modifications to the auto-pact. These concessions could not have been made by a sovereign Quebec.

Regarding the surplus, the Task Force on Canadian Unity argues that "it says something in favour of the present economic union that the Parti Québécois would like to retain many of its elements" (1979, p.76). This is still true today, but perhaps less so. The task force also noted that "there is simply no evidence to support the contention that Quebec has been or is getting more than a fair share of the surplus generated by the Canadian economic union" (1979, p.76).

Recently, Quebec business leaders, such as those represented by the Chamber of Commerce (1990, pp.11-17), have expressed scepticism before the Bélanger-Campeau Commission about the surplus from Confederation. This stems from their dissatisfaction with what they perceive to be a mismanagement of fiscal and monetary policy. Many Quebec businesspeople believe that the federal deficit is out of control and that high interest rates are driving up the Canadian dollar and undermining the competitiveness of Canadian industry.

In my view, existing studies substantially underestimate the surplus from Confederation. If the surplus were not large, how could real income per capita in Canada be the second highest in the world behind the United States as it currently is? Additional evidence that the surplus is probably considerable is provided by the estimates of the output gains resulting from free trade with the United States, which were reported by the Department of Finance to be from 2.5 to 8.9 percent with most estimates around 3 percent (1988, p.32).

### General equilibrium analysis

In a report prepared for the Macdonald Commission, the most comprehensive and thorough study ever of the regional costs and benefits of Confederation, John Whalley and Irene Trela evaluated the regional impacts of the more important government policies within a broader framework than the fiscal accounts (1986). The policies considered included the federal tariff, transport subsidies, energy policies, inter-governmental transfers, provincial impediments to goods and factor flows, the federal tax system, federal transfers to persons, non-tariff trade policies, regional development policies, and agricultural policies.

Whalley and Trela used a 1981 micro-consistent interregional data set for Canada which records production, demand, and interregional and international trade in combination with data on the policy elements. They performed counterfactual analysis using this data set for various changes in policies, using both partial equilibrium and general equilibrium techniques. Their general equilibrium model was calibrated to the data for the 1981 benchmark year, assuming that the interregional economy was in an equilibrium situation that year.

A general equilibrium model is basically a Walrasian system where prices are determined by the equilibrium of supply and demand in the relevant market. In the model used by Whalley and Trela, demand for final goods in each region is treated as the outcome of utility maximization, with each region maximizing a six-level nested constant elasticity of substitution (CES)/linear expenditure system (LES) utility function subject to its regional budget constraint. The regional budget constraint includes capital, labour and resource income received by residents, along with intergovernmental transfers and transfers to persons from the federal government. Supply of goods and services and demand for factors in each region are determined by profit maximization based on production functions with assumed parameters. Demand for intermediate inputs and for factors of production is based on cost minimization. Imports are other sources of supply. Taxes and subsidies are wedges between supply and demand prices. Various other policies are treated as *ad valorem* tariff equivalents. Increasing returns to scale can be incorporated in the model as a variant.

In addition to equilibrium conditions for supply and demand in goods and factor markets in the model, there are other equilibrium

conditions of budget balance at both the federal and regional government levels and of external balance as well as the imposition of zero profit conditions imposed on all industries in all regions and abroad.

Six regions are identified in the model—Atlantic Canada, Quebec, Ontario, Manitoba and Saskatchewan, Alberta, and British Columbia. Two levels of aggregation are used, one with six goods produced by each region, and one with thirteen. These six goods can be assumed to be qualitatively different both interregionally and internationally (the Armington assumption). Public goods are treated separately. There are three types of factors of production: capital services, labour services, and resources. Capital is generally assumed to be mobile. Labour is assumed mobile across sectors and partially mobile across regions, but immobile internationally. Resources are assumed to be immobile. Other assumptions depend on the model variant utilized.

Analysis of the impact of policies is conducted by altering one or more policies and determining the new equilibrium in the model. There will be related changes in resource allocation, relative prices, and the distribution of income both within and across provinces.

The results of a simulation in which each of the regions is assumed to withdraw from the Confederation are shown in table 1. In conducting the simulations, it is assumed that on withdrawal federal taxes are not collected from the region, that federal expenditures including intergovernmental transfers and transfers to persons in the region are not made, and that labour is immobile between the withdrawing region and the remainder of the country. The results show that if Quebec were to withdraw, it would be worse off by \$6.4 billion and the five remaining regions would be better off by \$3.2 billion. Atlantic Canada would also be a big loser if it were to withdraw. Alberta would gain the most from leaving Confederation would be Alberta because of the energy rents Alberta would regain. But Ontario, British Columbia, and Manitoba and Saskatchewan would also gain. The most important policies producing the pattern of gains and losses are energy policy, equalization, and the tariff. Of these, energy policy is by far the most important.

There are many problems with estimates from general equilibrium models. The parameters are generally not estimated empirically; instead, they are calibrated based on earlier studies. For regional trade elasticities, this is a real problem because there are no time series data

and no earlier studies. Also the assumptions that equilibrium is achieved and markets function perfectly are rather strict. In addition, general equilibrium models provide comparative static results and do not capture dynamic impacts. All these criticisms can be applied to the Whalley and Trela study. The obvious reply, however, is that it is necessary to take this approach and make these types of assumptions to get any estimates at all and that alternative approaches are not available. Whalley and Trela's study is clearly pioneering: no one has ever before been able to make such estimates.

The most obvious problem with Whalley and Trela's estimates of the impact of various regions withdrawing from Confederation, a problem which they acknowledge, is that their data apply to policies in effect

TABLE 1

**GENERAL EQUILIBRIUM IMPACTS OF WITHDRAWAL FROM CONFEDERATION BY INDIVIDUAL REGIONS, USING 1981 DATA**

(Hicksian EV's in \$ Millions)

Impacts on	Withdrawal by					
	Atlantic	Quebec	Ontario	Manitoba /Sask.	Alberta	B.C.
Atlantic Canada	-5,150	358	-512	-189	-1,417	-329
Quebec	607	-6,394	-1,937	-663	-5,674	-1,197
Ontario	792	1,801	713	-1,204	-7,901	-1,943
Manitoba/Saskatchewan	168	331	-630	1,310	-2,209	-429
Alberta	124	308	-1,154	-751	20,534	-667
British Columbia	208	419	-1,163	-385	-2,875	2,389
Total for six original regions	-3,251	-3,177	-4,683	-1,882	459	-2,176
Total for five remaining regions	1,899	3,217	-5,396	-3,192	-20,076	-4,565

Note: Each of these model experiments is specified by removing intergovernmental transfers and federal transfers from to persons in the region, federal taxes paid, and expenditures by the federal government on goods produced by the region. Any gain or loss to the federal government produced by the model has been reallocated to the remaining regions on a proportional basis.

Source: Whalley and Trela (1986, p.198).

in 1981. Three very important policy changes after 1981 which are not accounted for in their analysis are the termination of the National Energy Program, the inauguration of the Canada-U.S. Free Trade Agreement, and tax reform, including the Goods and Services Tax. The National Energy Program in particular had a very substantial regional impact, favouring other regions at the expense of Alberta and, to a lesser extent, British Columbia and Saskatchewan. According to Whalley and Trela, energy policy by far dominates the regional effects produced by other policies. The Economic Council of Canada is updating Whalley and Trela's analysis as part of the research program leading up to its 1991 annual review. Their research should help us better understand how recent changes in policies and economic developments have helped change the distribution of benefits and costs of Confederation.

### Fiscal balance studies

One very partial measure of the costs and benefits of Confederation is given by the federal government fiscal balance by province. Based on certain assumptions about the incidence of federal government revenues and expenditures, this provides an estimate of how much money the federal government injects into or withdraws from a region. It does not show anything about the likely second and subsequent round impacts of respending the money. It also does not adequately quantify the impact of regulatory or commercial policies.

John Whalley and Irene Trela have underlined additional problems with the balance sheet approach (1986, pp.182-183). The first is how to deal with interregional labour mobility. If labour is perfectly mobile, it is not possible to associate a particular group of people with a region. For instance, should a region's gain from a policy be associated with the gain of the people there before the policy was introduced or with those there afterwards. The second is the problem of interregional asset ownership. As there are no data on interregional asset ownership, it is impossible to allocate gains and losses associated with the ownership of assets to the appropriate regions in which the assets are owned. The third is the implicit zero sum game assumption that what one region gains another must lose. But there can be either a surplus or deadweight loss resulting from Confederation. The fourth is that fiscal balance sheet

exercises do not spell out the alternatives which are being compared to the existing arrangements.

All the caveats notwithstanding, fiscal balance sheet exercises became very popular after the Parti Québécois came to power in 1976 and after the release of the new provincial accounts which made such calculations possible. At that time a public controversy broke out between the federal and Quebec governments over whether the federal government fiscal balance with Quebec was a deficit or a surplus. The answer depended quite critically on the assumptions made to distribute federal revenues and expenditures across provinces. The Quebec government jumped the gun and published provincial economic data for Quebec which basically used the same incidence assumptions made by Statistics Canada in preparing the data (the Quebec government and Statistics Canada cooperated in preparing the provincial economic accounts, see Quebec, Ministry of Industry and Commerce 1977). The federal Minister of Finance countered with a more reasonable statement which made a persuasive case for the use of alternative assumptions (1977). Using the new fiscal balance data, the Economic Council of Canada calculated the likely short-term changes in both the level and distribution of taxes if provinces were to become fiscally autonomous (Glynn, 1978).

In 1979, on the basis of its own examination of the fiscal balance data, the Task Force on Canadian Unity concluded thus:

Statistical evidence from recently developed provincial accounts fails to establish that Quebec has been a major net recipient of federal funds (that is federal expenditures minus tax contributions from Quebec) until quite recently, when temporary subsidies for oil imports were established. Moreover, the evidence confirms in part the current contention that central government expenditures have been concentrated in income support measures, while the province has been receiving a disproportionately small portion of funds to generate employment. (1979, p. 75)

More recently, Robert L. Mansell and Ronald C. Schlenker have prepared an analysis of the regional distribution of federal fiscal balances following an updated version of the Department of Finance's methodology (1977). The adjustments to the provincial economic accounts data for this purpose are three. First, certain indirect taxes are

reallocated to reflect the province in which the good is consumed rather than produced, reflecting the generally accepted regional incidence of such taxes. Second, public debt interest payments to non-Canadians were removed from the public debt charges which are distributed across provinces. Third, transfers associated with regulated pricing of energy were included (under the National Energy Program, when the gap between the international and domestic price widened, these transfers became very large). An additional adjustment was made to allow for the increasing federal deficits from the mid-1970s and the pattern of increasingly negative fiscal contributions. The adjustment was made by increasing revenues for each province by the same percentage so that the aggregate revenue of all provinces would equal total expenditures in each year and the federal budget position would be in balance. All nominal magnitudes are expressed in 1990 dollars. No adjustments are made for the fact that departments are headquartered in Ottawa.

Table 2 from Mansell and Schlenker shows the provincial allocation of net federal fiscal balances after making all the above-noted adjustments, and table 3 provides the same data in per capita form. From 1961 to 1988, Quebec received by far the largest federal fiscal contribution (\$72.4 billion), but on a per capita basis the federal fiscal contribution to Quebec (\$401) was much smaller than that to the Atlantic provinces or Manitoba. Alberta made by far the largest contribution to the federal government from 1961 to 1988 (\$207.6 billion). The large federal fiscal contribution to Quebec at the beginning of the 1980s reflected in large part the subsidies for the consumption of petroleum out of the petroleum compensation account. During the 1980s, Quebec's gain in fiscal transactions with the federal government turned into a small loss by 1988.

André Raynauld has also calculated the federal fiscal balance from 1961 to 1988 (1990, pp.20-31). His results differ from those of Mansell and Schlenker in that he did not make all of the adjustments they made, except for distributing the deficit based on tax revenues. He also did not denominate all fiscal balances in constant 1990 dollars.

In addition, Raynauld made another adjustment to public debt charges which Mansell and Schlenker did not make. The previous adjustment for the deficit implies that the debt is eliminated, he argues, so the distribution of public debt charges loses its significance. Raynauld

proposes two alternative adjustments for public debt charges. Because spending could be higher, without public debt charges, the first adjustment spreads public debt charges among provinces based on the distribution of other expenditures. The second adjustment distributes public debt charges based on tax revenues on the assumption that taxes could be reduced. Raynauld argues that such an adjustment is all the more necessary because the payments of interest on the public debt result from voluntary investment choices by citizens. Quebec residents receive only 18 percent of the interest on the public debt, while Ontario residents receive 61 percent because of the decisions they make to purchase federal government obligations. In my view, Raynauld's case for this adjustment is convincing.

These adjustments to the distribution of public debt charges are very significant. The net federal balance in Quebec calculated by Raynauld is a surplus of \$987 million in Quebec before the adjustments. But after a \$2,029 million adjustment to expenditures, there would be a deficit of \$1,042 million, and after a \$1,776 million adjustment to taxes, there would be a \$789 million deficit. Depending on the method of adjustment chosen, Quebec realized a gain of between \$800 million and more than \$1 billion in 1988 as a result of its fiscal transactions with the federal government.

Raynauld's estimates of the net fiscal balance with Quebec from 1961 to 1988 are given in table 4. During the 1960s, after making the first kind of adjustment to public debt charges of spreading across provinces based on expenditures, Quebec experienced a cumulative net fiscal loss of \$4.6 billion in its relations with the federal government. But, after 1972, Quebec began to gain. From 1972 to 1980, Quebec experienced a cumulative net fiscal benefit of \$12.3 billion, which increased to \$22.7 billion from 1981 to 1985. From 1986 to 1988 Quebec continued to register a moderate gain in the \$1 to \$1.7 billion range. Since 1972, Quebec's fiscal benefit has averaged \$2.3 billion per year. Quebec has clearly gained from its fiscal relations with the federal government based on Raynauld's estimates. Similar results are shown in table 4 if the second type of adjustment to public debt charges (distributing based on revenues) is made.

Isabella D. Horry and Michael Walker of the Fraser Institute have also done a study of the provincial distribution of federal revenues and

expenditures (1991). Their study differs from those of Mansell and Schlenker and of Raynauld in that they use data from the Financial Management System rather than the Provincial Economic Accounts. The Financial Management System is a standard system of public accounting developed by Statistics Canada. Their study does not make any of the adjustments made by Mansell and Schlenker and by Raynauld, except for an adjustment to eliminate the deficit. Indirect taxes are distributed based on factor incomes rather than on consumption, thereby allocating the taxes disproportionately to Ontario and Quebec, where manufacturing is concentrated. Horry and Walker show that Quebec derives a net benefit in 1988 of \$1,996 million from its fiscal relations with the federal government. In per capita terms at \$304, Quebec's net fiscal benefit is only a fraction of those received in Saskatchewan at \$1,854, Manitoba at \$1,521, New Brunswick at \$2,526 and Prince Edward Island at \$4,315. Ontario, British Columbia, and especially Alberta are net losers in their fiscal transactions with the federal government. Ontario's net loss is \$831 per capita; British Columbia's is \$645; and Alberta's is \$1,688. In my view, by allocating indirect taxes based on factor incomes instead of the more generally accepted consumer expenditures and by failing to adjust for the distribution of public debt charges, Horry and Walker open their estimates of net fiscal benefits to some criticism.

A more reliable estimate of Quebec's gain in its fiscal relations with the federal government than Mansell and Schlenker's, Raynauld's, or Horry and Walker's would require that all the adjustments suggested by Mansell and Schlenker be made to the data as well as the additional adjustment to public debt charges proposed by Raynauld. In addition, with respect to the Mansell and Schlenker and Raynauld estimates, part of the net federal balance outside of the country should be allocated to Quebec to reflect the benefits Quebec derives from foreign aid, defence and other expenditures abroad. The federal net balance outside the country was estimated by Mansell and Schlenker to be \$8.8 billion (1990 dollars) in 1988. Quebec's share, based on its 25.6 percent population share in 1988, would be more than \$2.2 billion or \$339 per capita, a far from trivial sum. In the absence of all the required adjustments, all estimates significantly underestimate Quebec's gain from its fiscal rela-

tions with the federal government. If estimated correctly, Quebec's gain would be substantial.

Static fiscal balance calculations may be misleading if it would be possible to achieve economies after separation. For instance, the Quebec Chamber of Commerce argued in its brief to the Bélanger-Campeau Commission that spending is inflated by overlapping jurisdictions and by duplication between the federal and provincial governments (1990, p.13). The only concrete evidence cited is a study done twelve years ago by Germain Julien and Marcel Proulx at École Nationale d'Administration Publique. According to this study, 277 of 465 programs examined, or 60 percent, involved some degree of overlap (1978, p.33). Overlap occurred in all sectors except the post office, defence, and veterans affairs. The elimination of overlap is expected by Julien and Proulx to provide more than a billion dollars in savings for a sovereign Quebec. Their estimate overstates the potential savings since the degree of overlap has been reduced by federal government expenditure restraint in recent years.

### Trade flows

There are no current comprehensive studies of trade flows between Canada and Quebec. Indeed, the data on interprovincial trade flows are not available in constant dollar terms, and their coverage outside the manufacturing sector is poor.

Prior to the Bélanger-Campeau Commission, the most recent thorough study of trade flows between Canada and Quebec was carried out by the Canadian Unity Information Office in 1978; their study dealt with trade flows in 1967 and changes in trade flows between 1967 and 1974. The study, which presents disaggregated data on trade flows by industry, highlighted the extent to which the industrial structure of Quebec was concentrated in industries related to forest products (wood, furniture, and pulp and paper) and in those non-durable, labour-intensive consumer goods (leather, textiles, knitting mills and clothing). Of the \$1.2 billion trade surplus with the rest of Canada which Quebec enjoyed in 1974, \$1 billion was concentrated in "soft" industries (textiles, knitting, leather, clothing, furniture) which are highly protected by tariffs and are increasingly subject to foreign competition. These "soft"

**TABLE 2**  
**TOTAL FEDERAL FISCAL BALANCES BY REGION WITH BALANCED FEDERAL BUDGET**  
**(Millions of Dollars)**

	NFLD	PEI	NS	NB	QUE	ONT	MAN	SASK	ALTA	BC	TERR	Sum	Outside
1961	-380	-124	-1,054	-559	1,345	2,317	-284	-535	221	346	-267	1,026	-1,026
1961-1969	4,681	-1,804	-11,783	-6045	6,726	24,412	-3,009	-3,048	3,944	9,093	-2,592	11,211	-11,211
1970-1979	-13,055	-4,028	-24,992	-15,052	-31,538	32,948	-6,966	-1,809	69,076	19,492	-3,723	20,353	-20,353
1980-1988	-18,477	-4,618	-28,657	-19,569	-47,629	46,972	-13,414	-2,790	134,562	17,577	-11,172	52,814	-52,814
TOTAL	-36,184	-10,450	-65,433	-40,665	-72,441	104,332	-23,389	-7,647	207,582	46,162	-17,487	84,378	-84,378
1986	-2,283	-491	-2,940	-1,917	-1,018	12,610	-1,082	-1,090	5,363	1,950	-1,719	7,384	-7,384
1987	-1,993	-469	-2,410	-1,754	8	13,473	-1,671	-2,227	4,006	2,405	-1,022	8,346	-8,346
1988	-1,969	-513	-2,444	-1,823	356	13,110	-1,824	-1,776	4,187	2,669	-1,168	8,805	-8,805

Source: Mansell and Schlenker (1990).

**TABLE 3**  
**PER CAPITA FEDERAL BALANCES BY REGION WITH BALANCED FEDERAL BUDGET**  
**(\$1990)**

	NFLD	PEI	NS	NB	QUE	ONT	MAN	SASK	ALTA	BC	TERR	Average
1961	-830	-1,180	-1,430	-935	256	372	-308	-579	166	212	-7,030	56
1961-1969	-1,061	-1,841	-1,729	-1,091	136	395	-349	-359	297	541	-6,819	63
1970-1979	-2,382	-3,451	-3,047	-2,256	-507	413	-687	-198	3,686	820	-6,071	90
1980-1988	-3,603	-4,102	-3,698	-3,089	-820	562	-1,416	-292	6,563	687	-16,855	233
AVERAGE	-2,350	-3,143	-2,833	-2,150	-401	455	-813	-280	3,521	688	-9,778	127
1986	-4,019	-3,865	-3,367	-2,700	-156	1,384	-1,010	-1,079	2,258	675	-22,621	291
1987	-3,508	-3,694	-2,745	-2,464	1	1,454	-1,549	-2,192	1,685	822	-13,270	326
1988	-3,466	-3,979	-2,768	-2,553	54	1,391	-1,683	-1,753	1,748	894	-15,167	340

Source: Mansell and Schlenker (1990).

**TABLE 4**

**NET FISCAL BALANCE OF FEDERAL GOVERNMENT**  
**IN QUEBEC, 1961-88**  
**(- Federal Surplus/+ Federal Deficit)**

	Method 1		Method 2	
	\$ Millions	\$ Per Capita	\$ Millions	\$ Per Capita
1961-71	-4,575		-4,020	
1972-80	12,268		10,640	
1981-85	22,705		18,282	
1986	1,716	262	1,326	203
1987	1,392	211	1,075	163
1988	1,042	157	789	119

Method 1: Net fiscal balance after correction for the federal deficit, public debt charges being allocated to other expenditure programs and distributed among the provinces based on total expenditures.

Method 2: Net fiscal balance after correction for the federal deficit, public debt charges serving to reduce taxes and being distributed among the provinces based on total taxes paid.

Source: Raynauld (1990).

industries accounted for 18 percent of Quebec's manufacturing shipments and nearly 30 percent of the province's employment in manufacturing in 1974. The average level of tariff protection in Quebec based on the structure of Quebec production was estimated to be 10 percent in 1974, or 1.5 to 2 percentage points higher than in any of the other Canadian regions. It would be useful to have more current information on industrial structure, trade flows, and effective tariff rates.

In another study done for the Canadian Unity Information Office in 1979 on the special problems of the textile and clothing industry, the structure of the industry and interregional trade flows were examined. In 1976, two hundred thousand people were employed in the textile industry in Quebec, with total wages and salaries of approximately \$2 billion. Textile and clothing industry employment accounted for 23 percent of employment in Quebec manufacturing. In 1976, almost 60 percent of employment and 62 percent of establishments in the industry were in Quebec compared to 31 and 27 percent respectively in Ontario.

The study concluded that Canadian consumers bear the cost of protection of this industry, and Quebec benefits from it.

An early attempt to model the economic impact of Quebec separation on trade flows was by Tim Hazledine (1978). He used an *ad hoc* five-region Canadian economic model which combined production, trade flows, employment, and incomes. The model was calibrated using 1974 data. Hazledine estimated that if the Canadian external tariff were applied to Quebec following separation, the cost to Quebec would be about 5 percent of Quebec GDP. Given the change in trade flows and the progress which has been made in modelling, Hazledine's analysis is primarily of historical interest and has little relevance to the current policy debate. Another study by L. Auer and K. Mills (1978), which was prepared for the same conference, also examined the impact of imposing Canadian tariffs on an independent Quebec using 1974 data. This study, which produced estimates of lost output and employment that were about half those of Hazledine, is also outdated. Finally, Leon Courville in his independent 1979 used the same data in his independent 1979 study to estimate losses of output which were very similar to those of Hazledine. A problem with all these studies—in addition to the obvious one of being out-of-date—is that they estimate only the short-run impact of the disruption of trade flows resulting from separation and the imposition of external tariffs. The long-run impact would be mitigated by the redeployment of capital and labour, which is not included in any of these models as it would be in a general equilibrium model.

The Task Force on Canadian Unity wrote the following in 1979:

We have examined the evidence provided by a number of recent studies dealing with interregional trade, the interprovincial shipment of manufactured goods, the number of jobs dependent on the Canadian market, federal expenditures in Quebec, and other related topics. The major conclusion to be drawn from the trade data is that Quebec's economy is highly dependent upon the Canadian common market. Canada's tariff structure and trade policy have a major impact on the level of production, employment and income of that province's manufacturing sector. Compared with its international exports whose production takes relatively large inputs of natural resources and technology, Quebec's trade with Canada is based upon the manufacture of labour intensive products. It relies on Canadian markets for

the sale of about \$7 billion of these goods, most of which could not withstand foreign competition. Severing the ties to Canada's customs union would profoundly disrupt Quebec's economy. Quebec's and Ontario's favourable trade balances with the rest of Canada unquestionably indicate that both provinces derive definite advantages from the Canadian customs union. (1979, p.75)

André Raynauld has prepared for the Association des Economistes Québécois and for the Conseil du Patronat du Québec an analysis of more recent trade flows that also underlines the high degree of interdependence of Canada and Quebec and particularly the dependence of Quebec on Canada (Raynauld, 1990, pp.13-19 and ASDEQ, 1990, pp.10-13). Unfortunately, this analysis contains no data on the structure of Quebec trade in manufactured goods. But the aggregate data presented confirms the conclusions of the earlier studies about the greater dependence of Quebec on exports to Canada than vice versa.

The regional distribution of trade in manufactured goods in 1984 as measured by manufacturers' shipments is shown in table 5 taken from Raynauld. It is striking the greater extent to which Quebec is dependent on interprovincial exports than the other regions. Such exports counts for 26.5 percent of shipments in Quebec, compared to 13 percent in British Columbia and 17 to 18 percent in the other provinces. On the other hand, Quebec is less dependent than other provinces on international markets for its exports of manufactured goods. International exports account for 35.6 percent of shipments for British Columbia, 31.3 percent for Ontario, and only 21.2 percent for Quebec.

Raynauld highlights the relative positions of the regions with respect to interregional trade with the following observations:

*In percentage of shipments of region of origin*

1. Atlantic provinces to Quebec	8.8 percent
Quebec to the Atlantic provinces	4.4 percent
2. Ontario to Quebec	8.0 percent
Quebec to Ontario	17.0 percent
3. Prairie provinces to Quebec	3.8 percent
Quebec to the Prairie provinces	3.3 percent

4. British Columbia to Quebec	1.7 percent
Quebec to British Columbia	1.8 percent
5. Other provinces to Quebec	6.8 percent
Quebec to the other provinces	26.5 percent

As Raynauld notes, Quebec is more than four times as dependent on the other provinces as other provinces are on Quebec and almost twice as dependent on Ontario as Ontario is on it. Nevertheless, Quebec and Ontario remain each other's most important markets. On the other hand, the Atlantic provinces are more dependent on Quebec. Bilateral trade with more distant provinces is less important.

**TABLE 5**  
**DESTINATION OF MANUFACTURING SHIPMENTS BY PROVINCE OR REGION OF ORIGIN, 1984**  
**(Percent of Shipments)**

Provinces of Origin	Provinces of Destination						Other Provinces	Outside Canada	Total
	Atlantic	Quebec	Ontario	Prairies	B.C.				
Atlantic	54.2	8.8	6.8	1.5	0.7	17.7	28.1	100.0	
Quebec	4.4	52.3	17.0	3.3	1.8	26.5	21.2	100.0	
Ontario	2.1	8.0	51.6	5.1	2.0	17.1	31.3	100.0	
Prairies	0.8	3.8	7.3	69.4	6.0	17.7	12.9	100.0	
British Columbia	0.3	1.7	3.3	8.3	51.1	13.8	35.4	100.0	

Note: Total = Province of destination + Other provinces + Outside Canada

Source: Statistics Canada, *Destination of Shipments of Manufacturers 1984*, Catalogue 31-530 as cited in ASDEQ (1990, p.13).

Raynauld also presents data on the surplus or deficits on interprovincial trade which are shown in table 6. Ontario and Quebec are the two regions which have experienced large trade surpluses in manufacturing. In 1984 Ontario had a surplus of \$8 billion; and Quebec, \$3 billion. All other regions have registered deficits.

Raynauld also examined data on trade balances in energy, agriculture and minerals. Quebec had a deficit of \$2.3 billion on energy trade in 1987, \$523 million on agriculture in 1984, and \$2.7 billion in non-

**TABLE 6**  
**SURPLUS OR DEFICIT IN INTERPROVINCIAL TRADE**  
**IN MANUFACTURED GOODS**  
**(Millions of Dollars)**

Provinces	Exports	Trade Imports	Surplus
<b>Atlantic</b>			
1967	259	1,129	-870
1974	727	2,210	-1,483
1979	1,519	3,664	-2,145
1984	1,805	5,206	-3,401
<b>Quebec</b>			
1967	3,289	3,005	284
1974	6,666	5,573	1,093
1979	10,524	9,807	717
1984	15,075	11,744	3,331
<b>Ontario</b>			
1967	5,548	2,591	2,957
1974	9,552	5,330	4,222
1979	17,620	8,781	8,839
1984	20,908	12,694	8,214
<b>Prairies</b>			
1967	684	2,252	-1,568
1974	1,600	4,007	-2,407
1979	3,090	8,160	-5,070
1984	4,071	9,687	-5,616
<b>B.C.</b>			
1967	470	1,273	-803
1974	1,002	2,427	-1,425
1979	1,986	4,326	-2,340
1984	2,486	5,015	-2,529
<b>Canada</b>			
1967	10,250	10,250	0
1974	19,547	19,547	0
1979	34,739	34,739	0
1984	44,347	44,347	0

Note: British Columbia includes the Yukon and Northwest Territories.

Source: Statistics Canada, Catalogue 31-504, 31-522, 31-530 as cited in Raynauld (1990, p.56).

transformed minerals. These figures suggest that Quebec is an advanced economy which exports manufactured products and imports raw materials. Raynauld argues that any measures to restrain this trade will have direct repercussions on Quebec's production, employment and income.

Raynauld makes a case that the integration of Quebec into the Canadian economy has enabled Quebec to grow more rapidly than Ontario and Canada in recent years. The gap in GDP per capita between Quebec and Ontario has narrowed from 25 percent in 1961 to 18 percent on average from 1986 to 1988. This progress could be threatened, he argues, if the integration between the Quebec and Canadian economies were disrupted as a result of Quebec's separation and the break-up of the Canadian common market.

### **Studies by major financial institutions**

The Parti Québécois has often cited three studies done by major financial institutions as evidence of the economic viability of a sovereign Quebec (1990, pp.26-28). Another more recent study by a U.S. investment bank has also been the subject of some controversy.

#### *Toronto Dominion Bank*

The first study was done by the Toronto Dominion Bank (1990). In its policy paper arguing that sovereignty would have no impact on the Quebec economy, the Parti Québécois cites the Toronto Dominion Bank's study incorrectly:

In a confidential study reported in the newspapers in March 1990, the Toronto-Dominion Bank (U.S. Division) concluded that regardless of the resolution of the constitutional issue, there will not be any economic uncertainty that will be harmful to Quebec in the short or long term (PQ, 1990, p.26, my translation).

But the study itself, which was written during the debate over the Meech Lake accord, does not say that sovereignty will have no harmful economic impact. Instead, the study says that "in the near term and long term...it is very unlikely that discussion about the Accord will have any effect on business confidence" (1990, p.2). The bank's study concluded

only that discussions about the accord will not have any effect on business confidence; but the Parti Québécois incorrectly inferred that there would not be any effect from constitutional changes, including accession to sovereignty. This misinterpretation is an attempt by the Parti Québécois to gain greater credibility for its own views by putting them in the mouth of a respected financial institution.

In fact, the Toronto Dominion Bank study has nothing to say on the economic viability of a sovereign Québec. It does, however, provide a useful discussion of Canadian constitutional developments and the Meech Lake accord for its intended audience of American readers.

#### *Merrill Lynch*

Concerning the critical issue of the likely credit rating of a sovereign Quebec, the Parti Québécois cites Merrill Lynch as saying, "Given the economic strengths of the Province, one can argue that a 'sovereign' rating on Quebec would not be much different than its rating as a province" (1990, p.27). The Parti Québécois cites its source accurately, but it does not state that its source is a one-page comment prepared by an analyst, not a more detailed study of the financial viability of an independent Quebec.

The entire text on the Quebec economy takes just one paragraph, following three paragraphs of comments on the political implications of a failed Meech Lake accord:

*If separate, how sound economically?* The gross domestic product of Quebec in 1988 was U.S. \$120 billion. If it were an independent country, its GDP would exceed that of Denmark [\$101 billion] and Austria [\$117 billion] and fall slightly short of that of Belgium [\$138 billion]. Since English language-only speakers represent a tiny 6.7 per cent of the total Quebec population, it is difficult to argue that there would be a damaging exodus of the English community. Many of the dissatisfied English have already departed for Ontario, having done so during the raucous 1970s. Québec's 6.5 million inhabitants represent about 25 % of Canada's population. The policies of the Bourassa government have been favourable to development. The economic growth over the last four years has been relatively balanced, adding diversification to the economy. Finally, the economic arguments advanced in the early 1980s suggested that the economic benefits are in close parity with the federal taxes paid. *Given the*

*economic strengths of the Province, one can argue that a sovereign rating on Québec would not be much different than its rating as a province.* (Taylor, 1990)

Note that the fiscal balance studies discussed above do not, as claimed in the comment, suggest that the economic benefits to Québec are in close parity with federal taxes paid. Also Merrill Lynch says that the policies of the Bourassa government have been favourable to development. It does not say anything about how a Parti Québécois government is likely to be perceived by the financial community. It is also worth noting that Merrill Lynch is the lead underwriter for Quebec Hydro and that its interest in selling hydro bonds could cloud its objectivity in evaluating the likely international credit rating of a sovereign Quebec.

### *Bank of Montreal*

A paper prepared by a Bank of Montreal employee (Close, 1989) has also been cited by the Parti Québécois to lend credibility to the view that Quebec sovereignty would not undermine investment (PQ, 1990, p.26). This study, which was prepared by a political scientist and for which neither the Bank of Montreal's Economics Department nor the bank takes any responsibility, provides an interesting discussion of the political forces shaping the North American economy in general and Quebec in particular. The section dealing with Quebec, which accounts for less than a quarter of the paper, focuses on the development of the new class of Quebec entrepreneurs and Quebec's economic development policies. It does not contain any economic analysis of the viability of a sovereign Quebec.

The passage which has attracted the most attention from sovereigntists is the following:

Confederation or a separate state, however, is not the critical issue from an investment point of view. This is because Quebeckers are unlikely to vote for a separate state if it would endanger their standard of living; nor would the increasingly nationalistic business class lead Quebec out of Confederation if it would damage the newly emergent vibrant Quebec economy. The non-event of Norway's separation from Sweden in 1905 is perhaps the appropriate historic analogy for any legal separation of Quebec from the rest of Canada. (Close, 1989, p.4)

This passage says that Quebeckers are unlikely to separate if separation would damage the Quebec economy or reduce living standards. Thus, confederation versus separatism is not the key issue from an investment point of view. This is a political judgement about what Quebeckers are likely to do—not an economic one about the consequences of sovereignty. It says nothing about the implications for investment if sovereignty becomes economically damaging and if Quebeckers decide to ignore their economic self-interest and separate for reasons of national pride.

### *First Boston Corporation*

In February a draft study done by First Boston Corporation (1991) on constitutional change in Canada was leaked to the press. This study created some controversy because it included a specific estimate of the risk premium in Quebec bonds and some erroneous estimates of the debt stock. The study was quickly revised and released without the offending estimate of the risk premium and debt stock error. The revised study now only reviews the constitutional debate, including Meech Lake, and the Allaire report, and it lays out the timetable for constitutional discussions. The study still warns that "the ongoing uncertainty probably means a higher premium on Canadian over US long term bonds will prevail for political reasons alone, regardless of economic fundamentals." The key passage in the study reads thus:

As the new phase in the Constitutional debate begins, it introduces new uncertainties. For at least two years to come, a ferment of proposals, rhetoric and divisiveness will continue. What will result is unpredictable at this point, which creates an element of risk for investors. The impact could be greatest on foreign investors who do not have the full information necessary to interpret a complex legal, social and economic process, and who could react with an excess of caution to headline developments.

A key index of the expense to Canada of the ongoing debate is in the spread of Canadian over US long-term bond yields. Of the 200-250 basis point spread that has prevailed for the last year, a portion probably reflects the uncertainty created by the Meech Lake debate. Other factors matter, too. In particular, relatively high Canadian short term rates of interest have driven up the

value of the Canadian dollar, and created the risk of depreciation sometime in the future. (1991, p.1)

### A Quebec currency

While some economists have suggested that Canada might benefit from two or more currencies to combat regional disparities (Mundell, 1961, pp.657-65 and Dudley, 1973, pp.7-18), the consensus has been that the costs of an independent currency in terms of volatility and transaction costs would outweigh the advantages for an economy as small as Quebec's. In a study prepared for the Quebec government in 1979, Bernard Fortin argues that "the *smaller* an economy, the more *open* (in terms of trade and financial links with its partners in the monetary union), and the *less diversified* in its domestic production, the more it will benefit from a monetary union" (B. Fortin, 1979, p.10, as translated in Maxwell and Pestieau, 1980, p.37). This study provided the analytical underpinnings to support the Parti Québécois's preference for a monetary union.

More recently, a paper by David Laidler (1990), "Money after Meech," has had a big impact on the debate in Quebec about possible post-sovereignty currency arrangements. It has provided support from one of Canada's leading monetary economists for the proposition that a separate Quebec currency pegged to the U.S. dollar would be a viable second-best option for Quebec. Laidler argues that the prospect of a breakup of the Canadian monetary system would disturb international capital markets. Since Quebec has a strong interest in maintaining the current monetary system and other economic ties, he argues, Quebec may need to retain a federal government in which it is represented. Laidler sees threats to the Canadian monetary system from several directions. Western populism could endanger the cohesiveness of the Canadian monetary union. The inability of the Bank of Canada to retain its price stability goal in the face of political opposition could make it unattractive for Quebec to continue to participate in the Canadian monetary system. Or the rest of Canada could try to exact too high a price from Quebec for a maintenance of monetary ties. In this case, in Laidler's view, the best option for Quebec would be to establish a separate currency pegged to the U.S. dollar.

Laidler emphasizes the attachment of a responsible Quebec government to price stability and a hard currency. His paper was written before the Quebec business community's dissatisfaction with the Bank of Canada's current monetary policy became apparent in their submissions to the Bélanger-Campeau Commission (see *inter alia* the Chamber of Commerce submission). In fact, arguments have been made before the Bélanger-Campeau Commission for sovereignty—or at least Quebec's input into the conduct of monetary policy—in order to get lower interest rates and a cheaper Canadian dollar, which would improve the competitive position of Quebec industry. Quebec's attachment to a hard currency is probably weaker than Laidler suggests.

Laidler's paper contains a very good discussion of what is important for a currency. He argues that foreign creditors and investors do not really care about Canadian constitutional discord as long as it neither threatens to generate economic instability nor affects confidence in Canada's capacity and willingness to service its present debts. But the prospect that Quebec might introduce a separate currency unnerves international capital markets: it raises questions about the redenomination of Canadian dollar debt and the possible impact on the profitability of investment of market inefficiencies resulting from the breakup of the Canadian monetary union.

For the establishment of a Quebec dollar to have more than a symbolic meaning, Laidler argues, its value would have to be potentially variable against the Canadian dollar. Countries which have GDPs of the same order of magnitude as Quebec, such as Finland, Denmark, Norway, and Austria, all have their own currencies, but none of them are freely floating. To him, this suggests that Quebec might not choose a flexible exchange rate regime.

If a currency already exists, Laidler argues, a floating rate may be preferable to a pegged. But the nuisance costs of having a separate currency and establishing its viability may be too large to justify creating it in the first place. The nuisance costs of maintaining a separate currency increase as the economy becomes more open and its size decrease, while the benefits from a separate flexible rate currency decrease as the economy's openness increases and its size decreases.

Laidler describes how the adjustment mechanism works with fixed and floating exchange rates and how a flexible exchange rate is a better

adjustment tool when an economy is larger and less open. Laidler correctly dismisses the argument that it is possible to use monetary independence and a floating Quebec dollar to promote low unemployment and rapid growth; in fact, all that monetary independence can determine in the long run is the rate of inflation. But he overestimates the attractiveness of the Bank of Canada's strong and credible anti-inflation credentials to a more independent Quebec government.

Highlighted by Laidler are the problems involved in establishing a new currency for Quebec. People must be persuaded to use it. Its use can be encouraged inside Quebec through government decrees, such as requiring taxes to be paid in Quebec dollars or enforcing only contracts denominated in Quebec dollars. Gaining acceptance internationally for a Quebec currency would be more difficult because of the need to overcome concerns that the new government would follow inflationary policies. According to Laidler, Quebec could try to borrow viability for its new dollar by establishing a fixed exchange rate; this strategy would be more likely to succeed if the U.S. dollar were used as the reference rate. If the Canadian dollar were chosen, there would be more suspicion that the Quebec government would pursue inflationary policies and its currency would devalue.

Nevertheless, Laidler makes a very strong case for the continuation of the existing Canadian monetary union. He believes that Quebec will accept the case. First, the maintenance of the current Canadian financial system with widespread branching, which does much to promote capital mobility and to give the system stability, requires the continued existence of some system-wide and politically responsible regulatory authority. Second, the maintenance of a common currency would keep the burden of adjustment to shocks to the Quebec economy from elsewhere in Canada focused on the local labour market. A common labour market is a useful supplement to a currency union which goes together with a common market for goods and services, but it requires a common political authority. Laidler accepts that this political authority might be a radically redesigned and less centralized government—a Confederation, of which Quebec would be a member. He argues that the maintenance of a common Canadian currency for a common Canadian labour and goods market would make it possible to negotiate other aspects of Confederation without the threat of a foreign exchange crisis.

### Financing government deficits and debt

The division of the federal government debt is an important issue which would have to be addressed in any negotiations over sovereignty. Though there has not been any rigorous analysis of the economic impact of this issue, some interesting views have been expressed and the issue is so important that it cannot be ignored.

First, Grant Reuber (1990, p.B4) argued that Quebec would have a substantial bargaining advantage in resolving this issue since Canada's public debt is an obligation of the government of Canada. Given this substantial bargaining advantage for Quebec, separation would almost certainly result in the rest of Canada being left with a disproportionate share of today's federal debt compared with the revenue base remaining to service it. Douglas Purvis (1990) responded by calling the federal government debt "the bonds that tie" and by suggesting that it adds a greater degree of mutual interest than was present a decade ago. In his view, there are two reasons for this. First, Quebec will continue to be dependent on foreign capital and cannot afford to wench on its current obligations; second, Quebec will need to preserve strong economic ties with the rest of Canada.

More recently, Jacques Parizeau has reassured English Canadians that even a Parti Québécois government would not seek to avoid its share of the debt. In a speech to the Empire and Canadian Clubs in Toronto, he said the following:

What share? There are really two criteria to use: population and gross domestic product. We will, I suppose, haggle for a few weeks before we come to something like a quarter. (Parizeau, 1990, pp.9-10)

Marcel Côté has argued in a pair of interesting papers (1990a,b) that Quebec could not assume its \$100 billion or so share of the federal debt overnight. He notes that the national debt is not a passive debt—half of it is short-term and the other half has a maturity of only seven years. While he thinks that the Quebec government can in theory support such a level of debt, it will take five to ten years to develop a market for \$100 billion of Quebec debt. So, he argues, the old debt will remain a common debt, with Quebec obliged to send regular debt servicing payments to Ottawa. Jacques Parizeau shares this view (1990, p.9-10). Nevertheless,

Côté argues that there would be a \$1 billion or so risk premium per year associated with financing the cost of the debt.

Côté also raises some question about the ability of the Quebec government to finance its share of the federal deficit. If the Quebec government deficit were to increase from \$2 billion to \$10 billion (4 to 5 percent of Quebec GDP), there would be no market for such a huge annual increase in the level of debt and it would take years to develop one.

Another important aspect of the deficit and debt has arisen in the debate on Quebec sovereignty. The disequilibrium in the federal budget has been one of the Quebec business communities' main sources of dissatisfaction and frustration with Canadian federalism (Chambre de Commerce du Québec, 1990, p.11). Rightly or wrongly, it affirms the idea among businesspeople that Canadian federalism has been an economic failure and that a sovereign Quebec could perhaps do better.

### Uncertainty

The Association des Economistes Québécois brief to the Bélanger-Campeau Commission emphasizes that the process on which Quebec and Canada are now embarked involves much uncertainty and certain important economic risks (1990, p.20). Since the consequences of this process on economic activity in Quebec and Canada depend enormously on the political dynamic and political currents, the brief cautions decision-makers to act with prudence. While no quantitative estimates are provided of the likely impact on the economy, two illustrative scenarios are sketched out to show the importance of the process. In the first scenario, the transmission of powers takes place in serenity; in the second, it takes place in an atmosphere of rancour and discord. In the first, the Quebec and Canadian government work together to reduce the deficit by eliminating duplication. There is a smooth transition to new monetary arrangements. Interest rates come down. The climate for investment improves. In the second, there is fighting over all aspects of the transfer of powers, including the new monetary regime. Investors become upset, triggering an exchange crisis. Interest rates have to be raised to support the two new currencies, probably after devaluations. The climate of uncertainty has a negative impact on the investment and economic activity.

While no quantitative information is available on the impact of uncertainty in the current situation, André Raynauld (1990, pp. 45-47) provides some data on the movement of head offices out of and into Quebec and on immigration during the 1980 referendum period. Based on an earlier study, he reports the following movements of head offices:

	<i>Out</i>	<i>In</i>	<i>Balance</i>
1979	282	79	-203
1980	183	68	-115
1981	164	91	-73
Total	629	238	-391

Raynauld observes that, while political uncertainty was not the only factor behind the movement of head offices out of Quebec, it is significant that the outflow decreased and the inflow increased after the referendum.

Raynauld presents the following figures on net immigration from Quebec:

1966-71	-10,566
1971-76	-3,323
1976-81	-17,063
1981-86	-2,573
1986-89	+18,723

The data show, according to Raynauld, that immigration flows are extremely sensitive to political developments. He cites the fivefold increase in net outmigration from 1976 to 1981 following the election of the Parti Québécois and the 1980 referendum, and, afterwards, the dramatic decline in net outmigration and ultimate reversal.

In its brief to the Bélanger-Campeau Commission, the Quebec Chamber of Commerce also provides some interesting data on investment trends during the 1980 referendum period. Investment per capita in Quebec fell from 102 percent of that in Ontario in 1979 to only 90 percent in 1981, before rebounding to 97 percent in 1984. The Chamber notes that, while there were several factors that contributed to the fall in investment, it would be difficult to argue that political uncertainty surrounding the 1980 referendum had nothing to do with the fall (1990, p.7).

## Conclusion

The only strong conclusion that can be drawn from the survey of the pre-Bélanger-Campeau literature presented in this chapter is that there is still a scarcity of up-to-date hard analysis on the costs and benefits of Confederation and on the economic impact of Quebec sovereignty. Most of the serious studies were done in the late 1970s when the election of a Parti Québécois government and the prospects of a referendum on sovereignty-association focused attention on the issue. These were the studies done by the Canadian Unity Information Office and the C.D. Howe Institute's Accent Quebec Program. The empirical information and many of the conclusions contained in these studies are now largely out-of-date. The more recent studies have been completed quickly and are not as rigorous. Good economic studies of all aspects of the economic consequences of Quebec sovereignty are desperately needed so that important decisions about the future of the country will not have to be made without an adequate understanding of the facts. As we will see in the next chapter, the Bélanger-Campeau economic studies provide some useful additional information, albeit from a largely sovereigntist perspective, but the need for further objective analysis still remains urgent.

## Chapter 3

### The Bélanger-Campeau's Sovereigntist Economic Studies

#### Introduction

THIS CHAPTER PROVIDES A CRITIQUE and summary of the background economic studies prepared for the Bélanger-Campeau Commission by outside experts, the secretariat of the commission, and the Ministry of Finance (Commission sur l'avenir politique et constitutionnel du Québec, 1991b). The authors of the studies include some of Quebec's most distinguished economists. The nine studies considered deal with trade relations, public finances, labour markets, macroeconomic policy coordination, and monetary options.

It is important to consider these studies in detail because of their key role in shaping the opinion of the Quebec elite on the economic consequences of sovereignty. Because the studies have not been translated into English and have only been published in limited quantities, they have not received wide dissemination outside of Quebec, even among economists. English Canadians need to be familiar with the main arguments made in these studies if they are to be informed participants