community whose national structure is strong enough to permit its people some real control over their own political and economic lives, wise enough to make long-run investments in human resources and decent enough to protect them from tyranny, whether public or private.

The Economic Consequences of Quebec Sovereignty

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Quebec sovereignty has many possible dire economic consequences for Canada and especially Quebec. Few would deny that to date Canada has been an economic success story. Although Canada has a small population, it has the seventh-largest economy in the world. Our standard of living is the second-highest after the United States. Canada is richly endowed with resources and has a diversified industrial economy. Immigrants from all over the world flock to Canada, drawn by our prosperity. Quebec has flourished economically in Canada, and Quebeckers have shared in the bountiful income and wealth generated by the Canadian economy.

We must have been doing something right. Certainly there are ways we can do better, but there are also ways we can do much worse. Separating Quebec from the well-functioning Canadian economy is unquestionably a way to do worse.

Since Quebec separation is looming ever larger on the horizon and it threatens the economic success we have achieved, both Canadians and Quebeckers need to understand fully its economic consequences. Negotiating issues, transition costs and long-run economic impacts must all be considered to gain a proper appreciation of the economic consequences of Quebec sovereignty.

Quebec is an integral part of the Canadian economy. Even if Quebec were to separate, flows of goods and services, capital and labour would have to be maintained in both directions. This would require some accommodation on both sides, but Quebec would be wrong to assume that it has Canada over a barrel with no choice but to negotiate economic association on Quebec's terms.

Sovereignty-association seems to be the preferred option of many Québécois for economic relationships with the rest of Canada. It has the attraction of preserving the continued free circulation of people and goods between Canada and Quebec. The two pillars of sovereignty-association are a customs union and a monetary union. The former has nothing to recommend it, from a Canadian point of view; the latter is dubious at best.

A customs union would not be in Canada's self-interest. It would require Canada to give up control over our external tariffs. It does not make economic sense for Canada to retain duties as high on clothing, textiles and footwear as those now imposed by the federal government for the benefit of Quebec, where more than half of the industry is centred. The textiles and clothing industries, which are the largest and most important of Quebec's "soft" industries, are able to operate only behind high tariff walls and then only after being propped up by protectionist international agreements.

There would be other contentious trade issues from Canada's perspective that would have to be resolved. Quebec's dairy farmers supply almost half of Canada's milk at inflated prices under the shield of supply

management marketing boards. Hydro-Québec, benefitting from a long-term contract, sells Churchill Falls power from Labrador to the United States for a huge profit while paying Newfoundland only a pittance. Neither of these situations would be allowed to continue.

In a Canada without Quebec, the traditional western Canadian support for freer trade and grievances over the treatment of the resource industries would be more influential in the determination of national trade policy. The Ontario–Quebec axis in support of manufacturing would be broken with the departure of Quebec.

A free trade agreement would probably be about as far as Canada would want to go to accommodate Quebec. And this would not be an act of magnanimity. It might be in Canada's interest. Under a free trade agreement, there would probably have to be border control points between Canada and Quebec. Even in the European Economic Community there are still border controls on the flow of goods to enforce rules of origin and commodity taxes. But Quebec–Canada free trade is no foregone conclusion. At the moment, Quebec sells a great deal more to the rest of the country than it buys from the other provinces. That favourable situation might well change in the event of Quebec secession. Most of what Quebec sells to the rest of us could be bought elsewhere — in many cases at considerably lower cost.

If a customs union would not work, a monetary union between Quebec and Canada seems almost as unlikely. It would certainly be hard to sell in the rest of Canada. English Canada could be expected to embrace the idea only reluctantly, if at all, and not to yield much control over monetary policy to a sovereign Quebec. Other provinces would find it very difficult to accept Quebec representation on the central bank if they are excluded. Early reaction suggests that Jacques Parizeau's view of what would constitute a "fair" apportionment of policy influence in a monetary union would be unacceptable.

Perhaps the only way that Quebeckers might be able to persuade English Canadians of the need for a monetary union would be to appeal to their pocket-books by trying to convince them that common currency would be necessary if Quebec is to stay strong enough to assume its share of the Canadian-dollar-denominated public debt. The lack of a monetary union would be more troublesome for Quebec than for Canada. The smaller and more open an economy and the less diversified, the less the benefits from a floating exchange rate in fostering adjustment and the higher the costs in increased transaction costs and volatility. The Bank of Canada has already gained the confidence of the international financial community for the stability of the Canadian dollar. Quebec would have to earn such confidence for its new currency. The only short cut to confidence would be to peg the Quebec piastre, or whatever it would be called, to either the Canadian or U.S. dollar. But such a link could hardly bring Quebec the monetary independence it craves.

In the actual division of the $380-billion national debt, Quebec would have the upper hand and Canada would have to make sure it did not get short-changed. The debt is an obligation of the government of Canada; persuading Quebec to assume its one-quarter proportional share, based on population, would not be easy.

Currently, we are getting mixed signals from Quebec on the debt-split issue. Jacques Parizeau, the PQ leader, said in Toronto in December 1990, "We will ... haggle for a few weeks before we come to something like a quarter." But one of the background studies of the Bélanger–Campeau commission argued that Quebec's share of debt should be only 18.5 per cent based on federal assets and

revenues in Quebec. For Quebec, this would make the difference between an almost balanced budget and a huge deficit. In fact, a strong and inflammatory case could certainly be made that, as a long-time net beneficiary of transfer payments, Quebec's equitable share of the national debt should be considerably *larger* than its proportion of the population.

There also seems to be some resistance in Quebec to the idea of replacing federal bonds with Quebec bonds. The preferred option in Quebec is to leave the federal debt as it is and to reimburse the federal government for the interest. This has obvious advantages for Quebec in avoiding an increased risk premium for Quebec government securities. It would also strengthen Quebec's hand in future negotiations as it would give Quebec the option of threatening to withhold payments if the bargaining were not going its way.

A related issue would be the division of national assets. Presumably those federal government assets such as buildings and land that have a fixed location would have to be transferred. A great many federal assets in Quebec were, of course, created for the benefit of the whole country — harbour, canal and navigational facilities, broadcasting and other communications installations, defence industries and CFBs, rail and air systems, to name the most obvious. These could not merely be transferred. Mobile assets would be subject to even more disagreement. Breaking up commercially viable Crown corporations would be controversial and if not done carefully could lead to declines in output and employment.

Almost as tricky as the debt and assets questions would be that of the federal public service, which would have to be cut back sharply if Quebec were to separate. While some public servants in Quebec would be hired by the Quebec government, many others would find themselves out on the street. They would include many of the 25,000 Outaouais residents with federal jobs in the National Capital Region. Unemployment would rise until displaced public servants could find new jobs. Property values in Ottawa could take a real shellacking and Hull could become something of a disaster area. Nor would there be much hope of Canadian assistance in making the abrupt transition; any "foreign aid" that Canada grants to Quebec could not come close to the scale of Ottawa's current largesse towards the province today.

Another likely cost for an independent Quebec would result from the probable end of bilingualism in Canada. Canada has operated as a buffer between French-speaking Quebec and English-speaking North America. An independent Quebec would have to deal directly with the United States without the accustomed support from Canada. French documentation and labelling would no longer be obligatory for suppliers of goods to Canada, eliminating one small non-tariff barrier to trade and one large irritant to some admittedly intolerant English Canadians (no more French to be forced down unwilling Canadian throats with the corn flakes). The Quebec economy would have to bear the full cost of preserving and protecting French on its own, and the specific economic cost would be compounded as many foreign exporters simply wrote off the shrivelled francophone market in North America.

Perhaps the most divisive issue of all, and a costly one, is the territorial boundary of a sovereign Quebec. With the transfer of Hudson's Bay Company lands to the province of Quebec under 1898 and 1912 federal legislation, Quebec's territory has grown since Confederation from 193,000 square miles to 595,000 square miles today. The added territory includes a part of James Bay and its hydro-electric facilities, which have

been central to the development strategy of a succession of Quebec governments. In the not unlikely event that an international arbitration decided that the District of Ungava (as of 1912) should revert to Canada, not only would the power generators be on Canadian soil, that soil would be contiguous with Ontario; hence transmission lines could be built through Ontario without Quebec's permission. Future electric power revenues for Canada would more than offset compensation paid to Quebec for the existing plants. Again, although Quebec has made a claim to much of Labrador, based on its rejection of the 1927 decision of the Judicial Committee of the Privy Council settling the Canada–Newfoundland boundary, reversal of that decision by arbitration is extremely improbable.

There would be nothing like a territorial dispute with a very costly outcome for Quebec to turn negotiations over sovereignty sour. This would almost guarantee an acrimonious, expensive and mutually destructive split.

The costs incidental to bitterness are seldom considered. The consensus among Quebec economists and businessmen as reflected in the Bélanger–Campeau report is that in the long run there are no economic costs of sovereignty and that the short-run transitional costs can be minimized if both sides to the split are rational. This consensus is based more on wishful thinking than on facts.

The process of separation would be very costly. A strong central government in the rest of Canada and a Quebec government with sound economic policies would be necessary to control the damage. Even so, economic disruptions and hardship would be great. Many people would move from Quebec to Canada, adding to the flow of 200,000 anglophones who have left Montreal over the last fifteen years. Confidence in the Canadian and

Quebec economies would be shaken. Capital would flee Quebec and become nervous in the rest of the country until reined in by high interest rates. Stock markets would dip and maybe even crash. In some sectors, business investment plans would be shelved pending the resolution of the uncertainty. There would probably be at least a mild recession in Canada and probably a worse one in Quebec. And this assumes that the present economy would have had a chance to recover fully from the current recession.

In English Canada, in addition to the dangers of Balkanization, we would have to be very careful to guard against a nationalist backlash that could result in the introduction of interventionist and protectionist policies and an increase in fiscal deficits. These could transform the short-term economic costs of Quebec independence into long-run permanent losses. For its part and to its credit, Quebec seems to be committed to pursuing market-oriented and fiscally responsible policies regardless of the resolution of the current crisis. Quebec has been one of the biggest boosters of the Canada–United States Free Trade Agreement and is supportive of a trilateral pact with Mexico. Such outward-looking economic policies might strengthen its hand to weather the economic storms of separation; but those storms would not be short-lived.

Once through the transition period, both Quebec and Canada would continue to be hurt. It would take a long time to make up for the investment lost during the transition phase. Investment loss stemming from plant location decisions might never be made up. In addition, there would be the dead-weight loss from the time and effort that the best brains and talents in the country would have to spend reorganizing and sorting out our affairs. This time and effort would be much better put to

use working to improve our international competitiveness and other pressing domestic problems.

In the longer run, Quebec would probably continue to be much harder hit than the rest of Canada. For one thing, Quebec might have difficulty negotiating its own favourable free trade agreement with the United States given the much higher degree of government intervention in the economy in Quebec than in the United States and the rest of Canada. In any event, the external position of Quebec would be weak, and structural adjustment policies of the type that the World Bank likes to impose to overextended developing countries would be required to strengthen the current account. Consequent social security cut-backs could be necessary to stabilize the finances of a new state of Quebec.

The Quebec economy would exhibit several weaknesses, exacerbated by independence, and these should not be ignored. On the fiscal front, Quebec would lose the benefit of net fiscal transfers from the federal government. According to André Raynauld in a recent study for the Conseil du Patronat du Québec, the federal government spent $27 billion more in Quebec than it received in taxes between 1981 and 1988 after correcting for the deficit and public debt charges. The budgetary deficit of the Quebec government would increase to well over $10 billion if Quebec were to take over the existing federal structure of revenues and expenditures.

Public debt as a proportion of GDP would rise from 29.0 per cent of GDP in 1990–91 to a dangerously high 98.5 per cent if Quebec's almost $110-billion share of federal gross debt based on population were factored in. Quebec would have a larger gross public debt than any of the seven largest industrialized countries except for Italy. Of the smaller OECD countries, only Belgium and Ireland would have higher gross debt. A sovereign Quebec would definitely be a country with high public debt — critically high if proportional refunding of previous net transfer payments were factored in. International and domestic lenders could be expected to exact an interest premium from the Quebec government to compensate for the greater risk of lending to a high-debt sovereign Quebec, as indeed they are already doing in anticipation of possible sovereignty.

If Quebec were to lose the benefit of federal fiscal transfers (and even repay some) and to assume its full quarter share of the federal debt, taxes would have nowhere to go but up. Fiscal belt-tightening would become the order of the day as structural adjustment policies were adopted to redress Quebec's weak external position. Without question, this would compound any shocks to the Quebec economy that might result from free trade negotiations with the U.S.

If Quebec became a sovereign state, there would be a renewed exodus of the head offices of Canadian corporations out of Quebec. Quebec's business and entrepreneurial base would be further eroded. Canadian Crown corporations such as Canadian National Railways, VIA and Air Canada would have no reason to be headquartered in a foreign country. Private firms such as Imasco, Montreal Trustco and Power Corporation that own Canadian financial institutions that are subject to restrictions on foreign ownership would, under existing legislation, be required to move their head offices or divest. Similar restrictions apply to federally regulated telecommunications firms or their holding companies such as BCE Inc., Bell Canada and Teleglobe, airlines such as Air Canada and broadcasting companies such as Astral Inc. Other major firms such as Canadian Pacific, Seagrams Corporation and Alcan and many smaller firms too numerous to name might also decide to move.

However, while a sovereign Quebec would be much worse off than as a Canadian province, it cannot be denied that Quebec would still be a viable economy. It would not be the smallest country in the OECD Measured by GDP in U.S. dollars in 1989, converted at the average exchange rate, Quebec would only be slightly smaller than Austria and larger than Denmark, Finland or Norway. In terms of population Quebec would fit in among the same countries. Quebec's GDP per capita, measured by U.S. dollar purchasing-power parity at $17,207, would place it third among OECD countries — behind the United States and Canada. Yet such an estimate presupposes more favourable outcomes of bilateral negotiation with Canada and of arbitrations than may seriously be anticipated. A sovereign Quebec would have adjustment problems, but they would not be insurmountable if business, labour and government were induced by a crisis environment to work together for the greater good of a newly sovereign Quebec. Quebec Inc. once more into the breach.

The problems for Canada itself, while far less ominous, would not be negligible. The rest of the country would be worse off in the longer run as a result of Quebec separation, but maybe not greatly. Key to the economic well-being of the rest of the country would be the need to resist centrifugal forces and to retain a strong central government capable of managing the Canadian economy. Nevertheless, any reduction in access to the Quebec market would obviously still have some costs. Ontario and the Atlantic provinces would be most affected by any disruption in trade flows because of their greater dependence on trade with Quebec (8 to 9 per cent of manufacturers' shipments from Ontario and the Atlantic provinces go to Quebec). The Prairies and British Columbia would be virtually unaffected (only 3.8

per cent of manufacturers' shipments from the Prairies go to Quebec and only 1.7 per cent from British Columbia).

The sharing of the public debt would be a critical determinant of the long-run impact of the separation of Quebec on the rest of Canada. For the impact to be relatively minor, Canada would, of course, have to make sure that Quebec assumed its full share of the debt; Canada would also have to fight very hard for equitable settlement of boundaries, federal assets, compensation for past net benefits from transfer payments to Quebec and a guaranteed transportation corridor to the Maritimes.

The most serious disadvantage of Quebec separation for the rest of Canada would be the potential loss of international influence and prestige and the weakening of our bargaining position in international negotiations. This could harm our trade and other international economic relations with the United States and other major trading partners. But the significance of our weakened international position should not be overstated. Canada without Quebec would still be the seventh-largest country in the OECD and would retain its status as a member of the G-7 economic summit nations.

On the positive side, Canada would benefit from the end of net fiscal transfers to Quebec from federal government transactions with the Quebec government and residents. With the recipient of almost half of current equalization gone, the cost of fiscal transfer payments to less well-off provinces would be much more affordable for the deficit-strapped federal government. The longer-run economic impact of Quebec sovereignty on the rest of Canada would be conditioned as much by the policy responses of the Canadian government as by the direct impact of the act of separation itself. If Quebec could pull together in adversity, why could the rest of Canada not do likewise?

Beyond doubt, the economic costs of the separation of Quebec would be high. Pointing them out is not to blackmail Quebec. Rather it is to try to warn Quebeckers of the possibly dire economic consequences of their political choices. If successful, such a warning will spare much needless economic pain. If not, we will have to pull together to make the best of a bad situation. If we have to establish economic relations with a sovereign Quebec, we must keep our emotions under control and be guided by self-interest and not spite. An emotional response would only make a bad situation worse. Damage control would be the name of the game.