The Staggering Price of Quebec Independence

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Living in Montreal for 25 years has helped me understand why many Quebeckers desire independence. Quebec's society is obviously "distinct," whether one considers the language and music or the political mentality and general lifestyle. The case for independence usually comes down to that famous phrase from the Quiet Revolution – Quebeckers want to be *maîtres chez nous.*

But everything comes with a price, and there are too many politicians today who pretend that Quebec independence would be costless. Many economic issues matter, from tariffs and passports to banking and railway regulation. I focus here on three of the biggest ones – public debt, fiscal transfers and monetary policy.

Quebec's net debt in 2013 was $175-billion, equivalent to 49 per cent of provincial gross domestic product (GDP). Before separating, Quebec would need to negotiate with Canada about assuming its share of federal debt (and assets). It's a safe guess that with 23 per cent of Canada's population, Quebec would end up assuming a similar amount of federal debt: $154-billion. This would increase its debt-to-GDP ratio to 92 per cent. At that point, Quebec would be more indebted than France, Spain and the United States, and just below the level in Italy. That's a lot of debt.

An equal increase in debt and assets would strain the government's annual budget. Many of Quebec's new assets would not generate much revenue (such as national parks and infrastructure); but every dollar of the newly acquired debt would require annual interest payments. With a current average interest rate on federal debt of about 4 per cent, Quebec would need to increase its annual debt-service payments by about $6-billion.

Now consider fiscal transfers. Quebeckers naturally pay GST and income taxes to Ottawa. In return, they benefit from federal programs, such as Employment Insurance and Old Age Security. But because the Quebec population is older than average and experiences higher-than-average unemployment, Quebeckers are net beneficiaries from these programs.

Some might argue that the Quebec government could simply replace the benefits previously provided by Ottawa, and it could. But where would it find the money? Because of its lower-than-average per-capita income, Quebec's tax base is relatively small, and it is exactly this fact that generates the large equalization receipts from Ottawa every year. This coming year, these payments will be about $9.3-billion, or 13 per cent of Quebec's total government revenues. With separation, this financial inflow would stop suddenly; in its place would be an enormous budgetary hole for the Quebec government.

With higher debt-servicing costs and no federal inflows, the government of an independent Quebec would be forced to implement large tax increases or large cuts in spending – just to

maintain its current budget situation. A third option would be to increase its debt even further, but with an adjusted debt-to-GDP ratio of 92 per cent, this option would be very limited.

When it comes to monetary policy, Quebec would have to choose between two bad alternatives.

It could continue using the Canadian dollar, but it would then have no monetary policy with which to stabilize its economy – and it is delusional to think that an independent Quebec would play any role whatsoever in setting the Bank of Canada's policy. Having no monetary policy would be especially bad in the absence of the fiscal transfers from Ottawa, because they tend to moderate Quebec's business-cycle downturns. This is the Greek option, and it's not attractive.

The other option would be to create a Quebec central bank and a new currency. The downside of this option, especially at the outset, would be the market's reaction. If Quebec introduced a new currency at par with the Canadian dollar, uncertainty and market pessimism would likely create a large depreciation, thus increasing the price of all imports. In addition, the cost of servicing all private and public debts denominated in Canadian dollars would skyrocket. This option is also unattractive.

So where does this leave us? An independent Quebec would certainly not be a poor country. But at least for a while, and probably for a long while, it would be poorer than it is now.

Of course, many Quebeckers seek independence for reasons quite unrelated to economics, and there's nothing wrong with that. But it would be nice if the politicians recognized some of the economic costs involved, and led Quebeckers to ask themselves what price they're really prepared to pay.

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