TRANSITION COSTS AND SECESSIONS

- CONFERENCE ON ECONOMICS OF CONSTITUTIONAL CHANGE
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SECESSION AS A PROCESS

- NOT AN EVENT
- THERE IS A TRANSITION TO INDEPENDENCE
OUTLINE

1. TRANSITION COSTS IN SECESSIONS
2. WHY THEY ARE IMPORTANT
3. SOURCES OF TRANSITION COSTS
4. BARRIERS TO COOPERATION
5. THE SCOTLAND CASE
OUTLINE

1. TRANSITION COSTS
2. WHY THEY ARE IMPORTANT
3. SOURCES OF TRANSITION COSTS
4. BARRIERS TO COOPERATION
5. THE SCOTLAND CASE: IN BRIEF
6. MINIMIZING COSTS
7. TRANSITION BENEFITS?
8. CONCLUSION
1. TRANSITION COSTS
TRANSITION COSTS

- LOSSES INCURRED IN THE PROCESS THROUGH WHICH A REGION OF A LARGER ENTITY BECOMES A SOVEREIGN STATE
SIZE AND GROWTH

“UNDER FREE TRADE AND GLOBAL MARKETS EVEN RELATIVELY SMALL CULTURAL, LINGUISTIC OR ETHNIC GROUPS CAN BENEFIT FROM FORMING SMALL, HOMOGENEOUS POLITICAL JURISDICTIONS”

ALESINA, SPOLAORE AND WACZIARG, “ECONOMIC INTEGRATION AND POLITICAL DISINTEGRATION”
HOWEVER,

“IN PRACTICE, BORDER CHANGES AND SECESSIONS OR UNIFICATIONS ARE COSTLY AND LENGTHY PROCESSES.”

IBID.
THE TRANSITION

“THERE IS VERY LITTLE INFORMATION ON THE ACTUAL PROCESS OF DISASSOCIATION”

BOOKMAN, THE ECONOMICS OF SECESSION
THE ECONOMIC COSTS AND BENEFITS OF SECESSION WOULD DEPEND MAINLY ON HOW THE PROCESS TOOK PLACE.

YOUNG, THE SECESSION OF QUEBEC AND THE FUTURE OF CANADA
2. WHY TRANSITION COSTS ARE IMPORTANT
TWO SCENARIOS: #1

- Growth is 2% per year
- Could be 3%
- Transition lasts 3 years
- GDP drops 3% for that period
Figure 1: 3% drop in GDP for 3 years
3% GDP growth thereafter

- 2% GDP growth
- 3% GDP growth after transition
TWO SCENARIOS: #2

- GROWTH IS 2% PER YEAR
- COULD BE 2.5%
- TRANSITION LASTS 4 YEARS
- GDP DROPS 5% FOR THAT PERIOD
Figure 2: 5% drop in GDP for 4 years
2.5% GDP growth thereafter

- 2% GDP growth
- 2.5% GDP growth after transition
3. THE COMPOSITION OF TRANSITION COSTS
i. TRANSACTION COSTS

- NEGOTIATION COSTS
- DISENTANGLING THE STATES
  - ARMY, PUBLIC SERVICE, PROGRAMS, PENSIONS, DEBT, ASSETS
- BUILDING NEW INSTITUTIONS
  - FOREIGN SERVICE, SECURITY AGENCIES, REGULATORY AUTHORITIES
TRANSACTION COSTS

QUEBEC-CANADA

- FORTIN - 0.38% OF QUEBEC’S GDP
- GRADY – OVER 1% OF GDP FOR BOTH CANADA AND QUEBEC
ii. FISCAL COSTS

- TO REPLACE TRANSFERS

- ECONOMIC COUNCIL OF CANADA: ABOUT 3% OF QUEBEC’S GDP
FISCAL COSTS

- DEPEND ON THE DIVISION OF THE DEBT
iii. UNCERTAINTY COSTS

- PERVERSIVE
- ALL ACTORS ARE AFFECTED
- EVERYTHING IS RISKIER
UNCERTAINTY COSTS

- ECONOMIC COUNCIL (FINANCIAL MARKETS)
  - POLITICAL RISK ABOUT POLICIES
  - DEFAULT RISK
  - CURRENCY RISK

- 100 BASIS POINTS = 1.5% OF GDP
UNCERTAINTY COSTS

- ROYAL BANK
  - INVESTMENT DOWN 15%

- GRADY: COMPREHENSIVE ESTIMATE
  - CANADA - GDP DOWN 1.9%
  - QUEBEC - GDP DOWN 7.4%
UNCERTAINTY COSTS

- CONTESTABLE
- FEAR-MONGERING
UNCERTAINTY COSTS

BUT (ROYAL BANK):

“THE THINGS THAT CANNOT BE MEASURED ACCURATELY IN THE CURRENT DEBATE ARE THE THINGS THAT WILL HAVE THE MOST IMPORTANT INFLUENCE ON THE ECONOMIC CONSEQUENCES OF DISUNITY.”
TRANSITION COSTS

- FIXED – INESCAPABLE

- VARIABLE – DEPEND ON THE POLITICS OF THE TRANSITION
  - COOPERATION OR NOT
4. BARRIERS TO COOPERATION
BARRIERS TO COOPERATION

- THE STRUCTURE OF THE DEBATE
  - NO PRE-COMMITMENT
  - NO CERTAINTY

- POLARIZATION
  - POPULAR SUPPORT FOR HARD BARGAINING
BARRIERS TO COOPERATION

- IS COOPERATION ALWAYS RATIONAL?
  - EXPLORE GAME THEORY
  - 2-PLAYER GAME
TWO PLAYERS

- UNITY – THE ‘CONTINUING’ STATE
- AUTONOMY – HAS DECLARED ITS INTENT TO SECEDE
ONE ISSUE – CURRENCY – FOUR POSSIBLE OUTCOMES

- CUR – CURRENCY UNION WHERE AUTONOMY IS REPRESENTED
- CU – CURRENCY UNION WITHOUT REPRESENTATION
- M - MONETIZATION – JUST USE IT
- SC – SEPARATE CURRENCY OR ANOTHER ONE
AUTONOMY’S PREFERENCES

- CUR > CU > SC > M
UNITY’S PREFERENCES

- M > CU > SC > CUR
“PRISONERS’ DILEMMA”
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SOLUTIONS

- CU – STABLE
- SC – STABLE

TO GET TO COMPROMISE (CU), EACH SIDE HAS TO BE ABLE TO THREATEN TO CHOOSE SC
TWO-PLAYER GAMES

- Often no cooperation without compelling and deterrent threats.
- Threats are credible when they have been acted on in the past.
- Repeated games: punish defection with non-cooperation – ‘Tit-for-Tat’.
5. ECHOES IN THE SCOTLAND DEBATE
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- PRE-NEGOTIATION IS DESIRABLE
5. ECHOES IN THE SCOTLAND DEBATE

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- **THE TRANSITION WILL BE “SMOOTH AND COOPERATIVE”**
- **PRE-NEGOTIATION IS DESIRABLE**
- **STATEMENTS MAY REFLECT “POLITICAL CONSIDERATIONS” (BLUFFS)**
ECHOES IN THE SCOTLAND DEBATE

- THE NO SIDE PREDICTS LARGE TRANSACTION COSTS (FOR SCOTS)
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- PRE-NEGOTIATION IS IMPOSSIBLE
- NO MENTION OF JOINT INTERESTS
- rUK WILL NEGOTIATE FOR rUK ALONE
6. REDUCING TRANSITION COSTS

- PRE-NEGOTIATION
- OUTSIDE ACTORS
- CONVERGENCE TOWARDS TACIT AGREEMENTS (DEBT, BOUNDARY)
REDUCING TRANSITION COSTS

- A MOST IMPORTANT COMMITMENT:

“TO WORK TOGETHER IN THE BEST INTERESTS OF THE PEOPLE OF SCOTLAND AND OF THE REST OF THE UNITED KINGDOM”
7. TRANSITION BENEFITS?

- SOLIDARITY BEHIND LEADERSHIP
TRANSITION BENEFITS?

- EXTRAORDINARY EFFORTS DURING THE TRANSITION
  - CZECH BANKNOTE STAMPING AND DISTRIBUTION
8. CONCLUSION
CONCLUSION

- THE TRANSITION IS CRUCIAL
CONCLUSION

- CO-OPERATION IS NOT INEVITABLE
CONCLUSION

- THERE ARE BARRIERS TO REDUCING TRANSITION COSTS
THE END

- THANK YOU
THANK YOU

COMMENTS AND QUESTIONS ARE WELCOME