The Secession Question

What are the economic costs and benefits of nations breaking apart?

BY TIM SABLIK

It was called a "once in a generation opportunity." Last September, Scottish voters took to the polls to decide the fate of their country's more than 300-year union with England. One side, clad in the blue and white of the Scottish flag, invoked Scotland's unique history and heritage and argued that they would be more prosperous on their own. But many in Scotland and the United Kingdom as a whole implored voters to reject independence, arguing, among other things, that it would be economically disastrous for everyone involved.

The referendum drew a record turnout: 3.6 million people, or nearly 85 percent of eligible voters. In the end, status quo won the day by a margin of 55 to 45. The debate didn't end there, however. This May, the Scottish National Party (SNP), which is the leading proponent of independence, secured 56 of Scotland's 59 seats in Parliament, prompting speculation about another referendum in the not too distant future. And the debate reinvigorated existing secession movements elsewhere. Catalonia, a region in northern Spain, is seeking its own vote on independence, and the Flemish nationalist party surged to power in Belgium following the Scottish referendum.

What prompts some regions to seek separation from their country? Having a distinct regional identity is a crucial component, as most secession movements appeal to cultural and historical differences between the region and the rest of the country. There are a number of catalysts that might inflame those differences. In the past, secessions have been sparked by disputes over religion, politics, or civil rights. But in a 2008 paper, Andrés Rodríguez-Pose and Richard Sandall of the London School of Economics traced the evolution of the arguments made in secession movements and found that they have shifted. "Identity has progressively been relegated in favour of the economy and the promise of an economic dividend as the other main motivating factor," they wrote.

This is certainly true of Scotland, Catalonia, and Flanders, which have focused heavily on economic issues. But can regions become economically better off going it alone?

A Perfect Union?

From a pure economic efficiency standpoint, countries are rarely better off splitting into smaller pieces. As Alberto Alesina of Harvard University and Enrico Spolaore of Tufts

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University noted in their 2003 book *The Size of Nations*, there are several major advantages to being a large country. First, the per capita expenses of public goods with large fixed costs are lower in large nations. Taxes to support infrastructure like roads, schools, and national defense are spread across a bigger population. In the case of national defense, this means larger countries can also more easily support a larger military, arguably allowing them to better defend their territory.

Large nations also typically have bigger, more diverse internal markets. Smaller countries can seek this advantage to some extent by trading with the larger world market. Indeed, Alesina and Spolaore found a correlation between trade liberalization and the fragmentation and downsizing of nations. The early 20th century, which was marked by high protective tariffs and other trade barriers, was also a period in which countries maintained large empires. In a restrictive trade regime, it is advantageous to be a large nation or have multiple colonies with which to trade freely. Coincidentally or not, as countries have relaxed trade barriers, the number of nations has grown. In 1948, there were 74 countries; today, the United Nations recognizes 193. "As trade becomes more liberalized, small regions are able to seek independence at lower cost," wrote Alesina and Spolaore.

Still, small nations face costs to trade that larger countries can avoid. Even relatively open international borders impose some frictions. For example, researchers have found that even in the case of the very open trade relationship between the United States and Canada, internal trade remains preferred by market participants in both countries. Without internal trade barriers, a large country has efficient access to large domestic markets, avoiding trade frictions.

Furthermore, larger nations can support more diverse markets. To compete in international markets, small nations often specialize in a small number of goods or services. This lack of diversification can leave their economies more vulnerable to macroeconomic shocks, as witnessed during the financial crisis of 2007-2008 by the troubles in small economies like Iceland and Ireland.

With more diverse economies, larger countries are also better equipped to share risk among their territories. If certain regions of the country suffer greater losses than the nation as a whole during an economic crisis, the government can transfer tax revenues from more prosperous areas to provide aid. Even in non-crisis times, large countries are better equipped than small ones to smooth income across the country by transferring tax revenue from wealthy regions to help boost development in poorer regions.

But size has downsides as well. According to research on the political economy of secession, larger nations are more likely to have regions that strongly disagree about public policy. As a result, decisions intended to improve the welfare of the country as a whole, such as economic transfers, can benefit some regions at the expense of others.

"That creates the beginning of political resentment," says Ángel Ubide, a senior fellow at the Peterson Institute for International Economics.

In 2012, on September 11, Catalonia's national day, hundreds of thousands of people gathered in Catalonia's capital, Barcelona, to demand independence from Spain.

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Taxing Their Patience

When a region has a strong independent identity and a higher average income relative to the rest of the country, resentment over wealth transfers can prompt residents to question whether they might do better on their own. In a 1987 *American Economic Review* article, the late economists James Buchanan and Roger Faith reasoned that just as individuals might "vote with their feet" and exit a country to escape unfavorable tax treatment, so might entire regions or political groups threaten secession if they believe they can achieve a more equitable tax treatment through a government that is closer to home.

This is a key argument in the debate between Catalonia and Spain. Catalonia's per capita gross domestic product is higher than Spain's as a whole and the region accounts for more than a quarter of all Spanish exports. In the aftermath of the financial crisis of 2007-2008, Catalonia's government argued that it was contributing more in tax revenue to the national government than it received in benefits, with the difference going to support poorer regions of the country.

"That led to the slogan, 'Spain steals from us,' and from there, 'we would better off alone,'" says Ubide. He notes that in most cases, the political platforms of regional parties are built around achieving gains for their regions from the center. Eventually, the parties reach the end of the road in terms of

Independence Votes Since World War II

Did not lead to independence		Led to independence
	1957	Guinea
	1961	Samoa, Jamaica
	1962	Algeria
	1964	Rhodesia, Malta
Comoros (one island)	1974	Comoros (three islands)
Aruba	1977	Djibouti
	1979	Saint Vincent and the Grenadines
Quebec	1980	
New Caledonia	1987	
	1990	Slovenia
	1991	Armenia, Azerbaijan, Croatia, Estonia, Georgia, Latvia, Lithuania, Macedonia, Turkmenistan, Ukraine, Uzbekistan
Montenegro	1992	Bosnia and Herzegovina
	1993	Eritrea
Quebec, Bermuda	1995	
Nevis	1998	
	1999	East Timor
	2006	Montenegro
	2011	South Sudan
Scotland	2014	

NOTES:
Jamaica: Voted to withdraw from West Indies Federation; became fully independent on its own in 1962.
Rhodesia: Unilaterally declared independence in 1965 but was not fully recognized internationally until 1980, when it became Zimbabwe.
Comoros: Although 95 percent of all voters supported independence, a majority on the island of Mayotte voted against it. In July 1975, the parliament declared the independence of the three remaining islands; Mayotte remains an overseas department of France.
Aruba: Although 95 percent of valid votes favored independence, in 1990 the transition process was postponed indefinitely at Aruba's request.
Nevis: 62 percent voted to secede from St. Kitts and Nevis, short of the necessary two-thirds.
Djibouti: 99.8 percent of voters chose independence over remaining a French territory; fraud accusations marred two prior referendums, in 1958 and 1967, which came out in favor of the territory remaining French.
SOURCE: Pew Research Center

what the center will allow. "Then, either the center makes the road longer or the region decides to leave," he says. On Catalonia's national day in September 2012, hundreds of thousands of people demonstrated in favor of leaving.

The financial crisis also exacerbated regional income differences in Belgium between the wealthy region of Flanders and the less-prosperous Wallonia. The New Flemish Alliance made large electoral gains in the Belgium government last year and has pledged to take steps toward dissolving the current union.

Such disagreements don't always result in secession, though. Buchanan and Faith noted that regions can use the threat of secession to exert pressure on the rest of the country and obtain concessions on tax treatment. This may place a cap on the tax level countries can impose on wealthy regions in particular, since they would not want to risk damaging their own economy by letting those regions go.

On the other hand, such concessions can generate secession pressures from other regions. In a 1997 *Quarterly Journal of Economics* article, Patrick Bolton of Columbia University and Gérard Roland of the University of California, Berkeley pointed to Belgium as an example of this dynamic: "Less redistributive policies may prevent the more right-wing Flanders from separation, but these may induce a revival of separatism in the more left-wing Wallonia."

Resource Control

Besides gaining control over their taxation, regions can gain economically from secession by assuming control of valuable natural resources.

Proponents of Scottish independence argue that their case for economic self-sufficiency is bolstered by the estimated 15-24 billion barrels of oil and gas in the North Sea off the Scottish coast. In fact, Paul Collier and Anke Hoeffler of Oxford University linked the rise of the modern Scottish secession movement to the discovery of that oil in the 1960s. When oil prices rose sharply in the 1970s, the United Kingdom government imposed a tax on most of the increase in oil revenues. The Scottish National Party enjoyed its greatest success up to that point in the 1974 election under the rallying cry "It's Scotland's Oil." Oil also figured prominently in the 2014 referendum, with Scottish nationalists again arguing that revenue from that resource belonged to Scotland and would help ensure its economic success as an independent nation.

But while control over such resources can make the case for independence more enticing, it also raises a number of uncertainties. One problem is that such resources don't last forever. Oil production in the North Sea seems to have peaked in 1999, and it is currently estimated that the oil will last another 30 to 40 years. Scotland's government has argued that it would invest revenue from the oil in a sovereign wealth fund, similar to Norway's oil fund, to provide a revenue stream after the resource is exhausted. Still, it's not clear how soon they would be able to do that. In the 2013 book *Scottish Independence: Weighing Up the Economics*, former Scottish government economist Gavin McCrone noted that current oil revenue would not fully cover the Scottish government's deficit, meaning spending cuts or tax increases would be needed to set aside any revenue in a fund. All of these calculations also depend on oil prices, which are highly volatile. In the run-up to the 2014 referendum, oil prices were more than $100 a barrel; today, they are a little less than half that.

Additionally, while wealthy or resource-rich regions may calculate that they would be better off on their own, there's no guarantee that the parent state will just let them go. And conflict can dramatically increase the costs of separation.

Rebellion and Resistance

Becoming a newly independent nation is rarely a straightforward process. "Most countries will fight tooth and nail to keep hold of their territory," says James Ker-Lindsay, a senior research fellow at the London School of Economics who studies secession. Orderly referendums like the ones in Quebec and Scotland are more the exception than the rule, he says.

Resistance can usually be expected if the parent country would be made economically worse off by a region leaving, but economics isn't always the motivating factor. Ker-Lindsay notes that when Kosovo unilaterally declared independence from Serbia in 2008, Serbia would have been economically better off letting the territory go. "But even if there are good, rational, economic reasons to divest yourself of a territory, it doesn't always play out that states will sit down and make that rational calculation," he says. States may resist because the seceding region has cultural or historical importance, or because they don't want to set a precedent for allowing further disintegration of their borders.

In either case, when resistance comes in the form of armed conflict, the costs can be devastating. In a 2014 working paper, Rodríguez-Pose and Marko Stermšek of the London School of Economics studied the breakup of Yugoslavia in the 1990s. Unsurprisingly, regions that were able to break away quickly with minimal conflict, such as Slovenia and Macedonia, suffered smaller dips in economic performance than regions that were embroiled in protracted armed conflict, such as Kosovo and Bosnia. And the costs accrue to both sides during a war of secession. For example, in a 1975 paper, Claudia Goldin of Harvard University and Frank Lewis of Queen's University evaluated the costs of the U.S. Civil War by examining, among other things, changes in per capita consumption. According to their estimates, it took the North until 1874 to catch up to its level of per capita consumption in 1860, the year before the war started — and the South did not return to its 1860 level until 1904, nearly four decades after the war's end.

Seceding regions may face opposition from the international community as well. In the 1999 book *The Dynamics of Secession*, Viva Bartkus of the University of Notre Dame noted that the international response to secession can be mixed, as international organizations like the United Nations (U.N.) recognize both the right to self-determination (which favors the seceding entity) and the right to territorial integrity (which favors the parent). On the whole, Bartkus found that international support for territorial integrity is stronger, particularly in cases where the secession is contested. Kosovo, for example, is not recognized by the U.N. as an independent country, despite having the support of key U.N. members like the United States.

In some cases, seceding countries can find themselves cut off from the rest of the world. The Turkish Republic of Northern Cyprus, for example, is a self-declared state recognized only by Turkey. This has greatly limited its ability to

Divided States of America

The United States faced its biggest secession threat during the American Civil War. But there have been cases where states broke away from existing ones while still remaining part of the country. This has only happened successfully four times in America's history, with the creation of Kentucky in 1792, Tennessee in 1796, Maine in 1820, and West Virginia in 1863. There have, however, been hundreds of unsuccessful attempts over the years. Under the Constitution, the division of any state must have the approval of both the state legislature and Congress.

In late 1941, a handful of counties in southern Oregon and Northern California briefly declared themselves the independent state of Jefferson. The movement died out following the attack on Pearl Harbor little more than a week later, but it has enjoyed periodic revivals since then. California, the most populous and third-largest state, has been the subject of hundreds of proposals to break it into multiple states since it first joined the union in 1850. Most recently, venture capitalist Timothy Draper launched a campaign in 2014 to divide it into six states.

And similar movements have occurred at the city level too. In 1969, Norman Mailer campaigned for mayor of New York City on a platform of making the city the 51st state. Residents of San Fernando Valley in the city of Los Angeles failed to secure the votes in a 2001 referendum to secede and form their own city.

The driving forces behind these movements are often similar to the ones that motivate secession at the country level. Disaffected residents argue that their tax dollars are misspent or that local or state governments are not responsive to their needs. Differences in culture also play a major role. But these movements face many of the same challenges as country-level secessions. For example, the recent proposal to split California into six states raised questions about how public debt and services would be apportioned. Water is currently distributed across the state; splitting the state into six pieces would create the challenge of somehow dividing that infrastructure across new state lines. Economic disparities between different regions could be exacerbated as well. Critics of Draper's California proposal contended that it would have created both some of the wealthiest and some of the poorest states in America.

Proponents of splitting states or cities do avoid some of the headaches involved in splitting countries, though. The new entities would retain the same currency, language, and national laws, which would likely make trade between newly split states somewhat easier than between newly separated countries. But given that partitioning states requires both local and congressional support to succeed, it is likely to occur as infrequently as national secessions.

— Tim Sablik

trade with other countries, and it relies heavily on Turkey for economic support.

For secession to have the best chance of success, it takes consent on both sides. "And that very rarely happens," says Ker-Lindsay. Although the United Kingdom agreed to allow a vote on Scottish secession, Spain has thus far ruled any similar referendum in Catalonia unconstitutional. The separation of Czechoslovakia in 1993 is often held up as the best example of consent. Called the "Velvet Divorce," the secession was handled quickly and peacefully. But it's unclear what lessons from that event apply to today's movements. It was decided by leading politicians on both sides rather than popular referendum, which made it easier to reach agreement.

Separation Anxiety

Even when countries agree to part ways, there are still a number of difficult questions to resolve. How will the debt be split between the seceding entity and the parent? How will public assets like roads, communications infrastructure, or military facilities be divided? What monetary system will the seceding country follow? Will the parent allow it to keep the same currency or will it have to establish its own?

Negotiating the answers to these questions takes time, and that adds to the costs of secession in the form of uncertainty. In a 2013 paper, Robert Young of the University of Western Ontario noted that uncertainty is both the most important transition cost in secession and the hardest to predict. Without knowing how debt will be apportioned or what the monetary regime of the new state will be, businesses and individuals can't make contracts for the future. If the seceding state's participation in international organizations like the European Union is in doubt, then businesses and foreign investors might choose to pull out of the country.

"The size of these transition costs is a political question," says Young. Many of these issues could be resolved ahead of time to reduce uncertainty, Young explains, but opponents of separation have an incentive to maintain uncertainty in order to bolster their cause. In Quebec, he says, opponents argued that secession meant "taking a great big leap into the unknown." Similar arguments were made by opponents of Scottish secession.

And secession votes can raise uncertainty costs even when they are not successful. Quebec's 1995 referendum to secede from Canada failed by a margin of less than 55,000 votes. The wake of that close decision left the specter of future votes, imposing costs on capital in the region. In a 2005 paper in the *Journal of International Financial Management and Accounting*, Roger Graham of Oregon State University and Cameron and Janet Morrill of the University of Manitoba found that Quebec firms were undervalued relative to other firms in Canada, in part due to uncertainty of future independence votes. Others have also attributed the loss of several business headquarters in Quebec over the last two decades to this uncertainty.

"The point I always make to those advocating independence is: You are gambling your savings on a lottery," says Ubide.

Hitting the Jackpot?

Given the potential transition costs, regions need to be relatively sure they will see a return to independence, says Young. "If the transition costs are high, it can take you an awfully long time to make up the losses from the transition period," he says. "If you take a loss of say 5 to 10 percent of GDP for a few years, you had better get a very serious accelerated growth path to make it up."

Do seceding countries enjoy faster economic growth once untethered from the weight of their parents? There is limited evidence, in large part due to the rarity of these events. But according to the 2014 study by Rodríguez-Pose and Stermšek, there doesn't appear to be an "independence dividend." Even when regions in the former Yugoslavia were able to transition to independence fairly quickly and amicably, the authors found that those countries largely continued along the same growth path they had before becoming independent. Moreover, they still suffered significant economic losses immediately following their independence.

Likewise, it is unclear that downsizing necessarily boosts growth chances. In a 2006 National Bureau of Economic Research working paper, Andrew Rose of the University of California, Berkeley studied a panel of more than 200 countries over 40 years. He found no strong evidence of size affecting economic well-being. And while there are plenty of examples of successful small countries, such as Luxembourg, Norway, and Singapore, many economists argue that institutions matter more than size.

"It all depends," says Ubide, "on what you do with your economy once you are out." **EF**

Readings

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