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Economic Penalties for Putin's Aggression Threaten To Impoverish the World

Countries insulating themselves against future sanctions may block trade that lifted billions from misery.

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Casualties were inevitable the moment Vladimir Putin sent Russia's army across the border into Ukraine. But after the initial tally in lost and shattered lives, destroyed homes, and depleted wealth, we're likely to discover that we've also lost a world of expanded trade that pulled billions of people out of poverty by removing barriers to free exchange. The walls were already rising because of pandemic restrictions and politicians' thirst for greater control, but the war in Ukraine has accelerated a process that threatens human freedom and prosperity.

Economic sanctions and the retreat of Western businesses in response to the invasion of Ukraine have left Russia largely isolated. But they've also made clear that the integration of the global economy in recent decades wasn't inevitable and is vulnerable to political decision-making.

"The damage sanctions are doing to the Russian economy and the substantial costs to central Europe if Russia cuts off its access to natural gas and oil in response may make governments pursue self-reliance and disentangle themselves from economic connections," warns economist Adam S. Posen in *Foreign Affairs*. He supports sanctioning Russia on ethical and national security grounds but predicts far-reaching consequences. That governments around the globe are likely to take lessons from the sanctions against Russia was emphasized by Putin himself.

"Now everybody knows that any assets could be basically stolen," the Russian dictator seethed in a March 16 speech in response to the seizure of foreign reserves held overseas. He predicted that countries would respond by converting foreign reserves into physical stores of wealth, such as food, land, and gold that aren't vulnerable to international action. There's enormous irony in a national leader who violated rules against rolling tanks into neighboring countries caught off-guard by the confiscation of funds entrusted to other nations, but Putin wasn't alone in predicting strong reactions. Predictably, some even see opportunity in encouraging disengagement with global systems.

"The harsh reality has sobering implications for developing countries vulnerable to sanctions," economic columnist Huang Yongfu noted for China's state-owned CGTN. "In order to secure strategic independence, developing countries should urgently coalesce around and collaborate with emerging countries such as China to develop alternative financial and technological infrastructures that make them sanctions-proof."

It's unlikely that anybody really believes that the Chinese government, which developed a social-credit system for keeping its own citizens in line, would balk at using financial clout to twist arms. But it's probable that actions taken towards Russia make the weaponization of trade and finance seem inevitable and push some governments to seek like-minded partners, or at least alternative systems to which they can turn. That's especially true since the world was already breaking apart.

Posen emphasizes that, starting well before the war, "populists and nationalists have erected barriers to free trade, investment, immigration, and the spread of ideas" and China tussled with the West over trade and security issues, resulting in barriers that corrode globalization.

To this you can add recent supply-chain disruptions largely caused by lockdown orders and other policy reactions to the COVID-19 pandemic. Relying on suppliers and partners across the world has come to seem enormously risky, spurring a return to local manufacturing, even if that means higher costs.

"COVID-19 has disrupted global value chains (GVCs)," four economists noted last year for the Center for Economic Policy Research's VoxEU. "Some observers expect firms to respond by abandoning their pursuit of lower production costs in favour of building stronger resilience in production – by reshoring, nearshoring, and/or diversifying sources of production."

That process has been encouraged in the United States by two consecutive presidents, first Donald Trump and then Joe Biden, wedded to economic nationalism. "When we use taxpayers' dollars to rebuild America, we are going to do it by buying American: buy American products, support American jobs," Biden vowed in the recent State of the Union address. He's unlikely to get much pushback from the public; while support for free trade rose under Trump it has since declined, according to Gallup. More Americans (61 percent) see trade as good for economic growth than see it as a threat (35 percent), but the numbers swing more as a matter of partisan politics than according to principled commitment.

That's a shame because free-trade advocates are correct. While a strong case can be made that free trade is a basic human right involving consensual relations among individuals, it's also a miraculous cure for misery. Over the last half-century or so, economists have rediscovered comparative advantage and that "trade openness is a necessary—even if not sufficient—condition for economic growth and reducing poverty," as Pierre Lemieux wrote for the Cato Institute's *Regulation* in 2020.

"A dramatic increase in developing country participation in trade has coincided with an equally sharp decline in extreme poverty worldwide," agrees the World Bank. Specifically, the organization found, "the global poverty rate, defined as the share of world's population living below the [international poverty line], has dropped from 35.9 percent in 1990 to 10 percent in 2015 – more than a 70 percent reduction."

But that progress ground to a halt in recent years as international commerce slowed. The number of people living below the poverty line ticked back up, while Americans experience economic pain of their own. Higher barriers and long-term reductions in trade can only make things worse.

"If the global economy splinters further and countries retreat, from a productive perspective, to a domestic or regional focus, the implications are quite large," finance reporter Ron Insana comments at CNBC. "Prices for domestically made goods are generally higher that those that are produced abroad. That means a relative shift in inflationary pressures beyond the pandemic-induced price spikes we've already seen."

"With less economic interconnectedness, the world will see lower trend growth and less innovation," concurs Posen, who predicts that the world will fracture into competing economic blocs. "Domestic incumbent companies and industries will have more power to demand special protections."

Economic and financial sanctions may cause Russia pain and add to the cost of invading Ukraine. But as governments around the world raise barriers and try to insulate themselves from future uses of weaponized trade and finance, the result is certain to be a world that is poorer and less free.