

On Sanctionomics and the Externalities of Economic Sanctions

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The issues related to the effects that arose as a result of economic sanctions against Russia due to the start and large-scale deployment of Russia's war against Ukraine are analysed in the paper. It is obvious that the scale of these economic sanctions actualizes the issue of studying their economic consequences both for the country that fell under the sanctions (i.e., Russia) and the countries that imposed these sanctions as well as other countries that did not fully or partially join these sanctions. The area of economics that studies these issues is proposed to be called sanctionomics. Particular attention is paid to the study of the externalities of economic sanctions, which are exogenous in nature, in contrast to market externalities, which are qualified as endogenous. The negative and positive externalities of economic sanctions are considered and it is noted that the former are superior to the latter. © 2022 Bull. Georg. Natl. Acad. Sci.

Russia's war against Ukraine, economic sanctions, sanctionomics, externalities of the economic sanctions, endogenous externalities, exogenous externalities

Shortly after the invasion of Russian troops in Ukraine and the outbreak of Russia's war against Ukraine on February 24, 2022, the US and the EU, as well as other economically developed countries, decided to impose extensive economic sanctions against Russia [1] and Belarus [2].

The history of the introduction of economic sanctions begins in the 5th century BC when they were first recorded, were periodically used in the Middle Ages and have become widespread in our time [3, 4].

Among the problems associated with economic sanctions, the most acute is their effectiveness which is used as a security tool. An analysis of the accumulated experience in assessing the effectiveness of economic sanctions shows that their

positive effects directly depend on how comprehensive they are and how many countries take part in their adoption. It must also be taken into account that autocratic regimes tend to resist sanctions more effectively than democracies [5].

It is in this context that the most interesting is the assessment of the effectiveness of the economic sanctions that were imposed by the West and other developed countries against Russia because of its invasion of Ukraine and the start of the war against Ukraine [6]. In today's globalized world, these economic sanctions directly affect the world economy [7, 8].

Economic sanctions are, by their very nature, tools of the Cold War and they are used against Russia which is waging a Hot War against Ukraine.

Naturally, the question arises as to whether it is possible in principle to stop the Hot War by the methods of the Cold War [9].

Unfortunately, the economic sanctions imposed by the West against Russia are not full-fledged and have many serious “holes.” The most obvious manifestation of such a “hole” is the impossibility of many EU countries to refuse to buy Russian gas [10]. An equally important “hole” in the economic sanctions imposed by the West is that many countries (first of all, Israel and Turkey as well as China and India) did not join these sanctions [11].

Despite this, even these “inferior” sanctions have and will have significant negative consequences for the Russian economy and its military power [12]. Unfortunately, the possibility of a quick suspension of the Hot War by economic sanctions is minimal. These sanctions are designed for the medium term and, to a greater extent, for the long term [13].

Based on this, it becomes obvious that one of the priority tasks for economic science is not just the study and generalization of world experience in the effectiveness of previously imposed economic sanctions but also the research of the negative as well as positive effects of modern large-scale economic sanctions imposed against Russia. For this area of economics, the new term “sanctionomics” is most suitable which is coined by combining two terms – “sanctions” and “economics” [14]. The subject of the study of sanctionomics is the direct and indirect economic consequences that are caused by economic sanctions. Taking into account the economic sanctions imposed against Russia due to its invasion of Ukraine, the study of the problems of sanctionomics is of particular relevance.

Both Russia’s war against Ukraine and the economic sanctions imposed on the Russian Federation have created a geopolitical depression [15] which in turn has further complicated the problems of the global economy, especially those that the world has inherited from the COVID-19 pandemic [16, 17]. In other words, the world is

facing crisis upon crisis [18]. Not surprisingly, global economic uncertainty is clearly on the rise against this backdrop [19].

The economic sanctions imposed by the United States against Russia include a ban on the purchase of Russian oil which caused an increase in oil prices [20]. Although many EU countries continue to buy gas from Russia, it is almost impossible to determine with any greater or lesser accuracy how long the inflation driven by rising prices for oil, natural gas and many other commodities can continue [21].

Due to the Russian war against Ukraine, the export of wheat from Ukraine is obviously suspended. For its part, Russia has imposed severe restrictions (for some countries a ban and for others it has established quotas) on the export of wheat. Since before the start of the Ukrainian crisis the joint share of Ukraine and Russia in world wheat exports was 25 percent, the reduction in wheat exports by this share caused an increase in prices for it. In other words, wheat has become an instrument of a “Food War” [22].

The purpose of the economic sanctions imposed against Russia, as we know, is its economic weakening and a reduction of its military power as a result of which Moscow will be forced to abandon the continuation of the war in Ukraine.

Economic sanctions, regardless of the desire of those who impose them, have their side effects which also affect those entities that are not subject to sanctions.

In economics, such side effects are called externalities which are associated with the activities of market entities which are not reflected in prices and which cause costs for third parties (possibly for the whole society as well); that is, those that are outside of a particular market transaction. Externalities, which are both negative and positive, and, as a rule, are unaccounted for the consequences of market activity (for example, environmental pollution by chemical industry enterprises) [23-26].

Externalities are also formed as a result of the adoption of economic sanctions. It is not surprising that the study of the nature of externalities as a result of economic sanctions has recently become more and more relevant [27-30].

The externalities traditionally studied by economic science can be conditionally called “market” ones and on the basis of this they should be called *endogenous*. In contrast, economic sanctions imposed by the state or by a group of states are not market transactions. Therefore, the externalities corresponding to these sanctions are of a “non-market or artificial origin” and should be referred to as *exogenous* externalities.

Let us first consider the negative externalities of the economic sanctions against Russia.

Speaking about the negative externalities of economic sanctions, it should be taken into account that some externalities appeared in relation to the companies of those countries that imposed these sanctions and some externalities affected those countries that did not directly join these sanctions. There are also such externalities that have affected almost the entire world.

The negative externalities of economic sanctions manifested themselves primarily in relation to those companies that were forced to leave the Russian market due to sanctions and, thereby, incur corresponding economic losses. Among them are such well-known brands as McDonald’s, IKEA, Nike, Apple, Zara, Netflix, etc. [31]. It should also be noted here that Visa, Mastercard and American Express have announced the suspension of all operations in Russia [32]. Also, shipping companies that have suspended deliveries to Russia, as well as those ports that are closed to Russian ships, are receiving losses [33]. The same effect of negative externalities exists in relation to air transport and airports [34, 35].

Negative externalities of a similar nature also affected those countries that did not join the economic sanctions against Russia. For example, and not without reason, China fears that its

companies will fall under US sanctions if they cooperate with Russian companies based on the fact that Moscow asked Beijing to provide military and financial assistance [36]. For the same reason, Chinese companies have suspended new purchases of Russian oil for fear of falling under Western sanctions [37].

Restrictions on the purchase of Russian oil and gas, even when not all countries (especially on natural gas) have joined these sanctions, have led to higher international prices for these carbon products. This negatively affects the increase in costs both in industry and for the population [38].

The war in Ukraine and rising energy prices have given a significant boost to the decarbonization process which has recently been increasingly considered in the context of combating climate change [39, 40]. At the same time, significant increases in oil and gas prices could hamper Asia’s decarbonization efforts which is an obvious negative externality caused by economic sanctions to limit the purchase of Russian oil and gas [41].

A noteworthy fact is how Russia, which is directly hurt by economic sanctions, has created a negative externality for itself. In particular, Russia demanded that those European countries that consume Russian gas in a significant part pay for it in Russian currency – in rubles in order to counterbalance to these sanctions. As soon as Poland and Bulgaria refused to pay for Russian gas in RUB, Russia stopped gas supplies to these countries [42]. Thus, Russia has lost guaranteed income in EUR from Poland and Bulgaria in conditions when the vast majority of Russian foreign exchange reserves are blocked due to the economic sanctions. Here, we note that Hungary plans to allow the conversion of RUB for purchasing Russian gas [43].

It is in this context that the decarbonization of the Chinese economy will suffer, at least in the short term. Here, one should also take into account the above-mentioned danger of Chinese companies

falling under US sanctions in the event of their cooperation with Russian companies [44].

One of the obvious manifestations of negative externalities is the above-mentioned “Food War” which has led to an increase in food prices [45]. As a result, the problem of food security has actualized for many countries of the world [46, 47]. Rising food prices, as one would expect, are primarily at risk to the poor [48].

With regard to the above noted negative externalities manifested in the form of rising fuel and food prices, each country needs to develop agile fiscal policies based on their specifics [49].

Restrictions on the use of USD by Russia within the framework of the economic sanctions may create a negative externality for the global financial system in which USD occupies a leading position. The fact is that many countries (first of all, China, India and Turkey), which have not joined the noted economic sanctions, will look for new monetary opportunities in trade with Russia [50].

An important issue is sovereign default. Russia has real opportunities to prevent default but if Moscow does not use them, then negative externalities in the form of financial losses of creditors will manifest themselves in the relations of those countries that have imposed these sanctions [51].

It was noted above that Russia’s war against Ukraine created negative externalities for China, which is by no means an exception. In particular, in place of the economic recovery of Europe in the post-pandemic period, its economy received a serious setback [52]. In fact, this negative externality is a problem for the entire post-pandemic world [53].

In addition to the negative externalities of the economic sanctions imposed on Russia, these sanctions create positive externalities as well. In the

example of Georgia, positive externalities manifested themselves first of all in the strengthening of its function as a transport corridor linking Europe and Asia [54]. In particular, Kazakhstan has faced some problems in exporting its crude oil through Russia as a result of the economic sanctions against Russia because of its war against Ukraine. As a result, there is a plan to transport 2-3 million tons of Kazakh oil through the Georgian transport corridor [55]. Based on the new opportunities created by Russia’s war against Ukraine, Georgia, Azerbaijan, Turkey and Kazakhstan agreed to strengthen the transit potential [56].

A positive externality for developing countries may be a change in the approaches of developed countries towards developing countries in order to solve the problems caused by Russia’s war against Ukraine and the economic sanctions imposed on Russia. In particular, these problems are overcoming the food crisis and preventing a possible public debt crisis [57].

There is no doubt that a comparison of the above-mentioned negative and positive externalities indicates a clear superiority of the former. In other words, the immediate consequences of the war for Ukraine and the economic sanctions imposed on Russia, as well as the negative externalities of these sanctions taken together, have a pronounced negative impact not only on the economies of the direct participants in the Ukrainian crisis but also on the entire global economy.

Based on the current situation in the global economy formed as a result of the COVID-19 pandemic and the Ukrainian crisis, a qualitative study of the nature of exogenous externalities, as well as the development of methods for their quantitative assessment, becomes a priority for economic science.

ეკონომიკა

სანქციონომიკის და ეკონომიკური სანქციების ექსტერნალიების შესახებ

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აკადემიის წევრი, ივანე ჯავახიშვილის სახელობის თბილისის სახელმწიფო უნივერსიტეტი,
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სტატიაში შესწავლილია იმ ეფექტებთან დაკავშირებული საკითხები, რომლებიც წარმოიქმნა რუსეთის წინააღმდეგ დაწესებული ეკონომიკური სანქციების შედეგად, და რომლებიც, თავის მხრივ, შემოდებულ იქნა რუსეთ-უკრაინის ფართომასშტაბიანი ომის დაწყების გამო. აშკარაა, რომ ამ ეკონომიკური სანქციების მასშტაბურობა აქტუალურს ხდის მათი ზეგავლენის საკითხის შესწავლას, როგორც იმ ქვეყნის (ანუ, რუსეთის) მიმართ, რომელიც დაექვემდებარა სანქციებს, ისე იმ ქვეყნების მიმართ, რომლებმაც შემოიღეს ეს სანქციები, ასევე იმ ქვეყნების მიმართ, რომლებიც სრულად ან ნაწილობრივ არ შეუერთდნენ სანქციებს. ეკონომიკური მეცნიერების იმ სფეროს, რომელიც შეისწავლის ამ საკითხს შემოთავაზებულია ეწოდოს სანქციონომიკა. განსაკუთრებული ყურადღება დათმობილი აქვს ეკონომიკური სანქციების ექსტერნალიების შესწავლას, რომლებიც თავისი ბუნებით არიან ეგზოგენური, განსხვავებით საბაზრო ექსტერნალიებისა, რომლებიც კვალიფიცირდება როგორც ენდოგენური. განხილულია ეკონომიკური სანქციების უარყოფითი და დადებითი ექსტერნალიები და აღნიშნულია, რომ პირველები უკანასკნელთან შედარებით უფრო მნიშვნელოვანია.

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