Stopping Russian imperialism

Joe McGarrity

After Russia invaded the Ukraine, the U.S. and its allies retaliated with economic sanctions. The allies halted most trade with Russia, although they still accept energy imports. The allies cut many Russian banks off from an international banking clearing house, making it difficult for Russia to engage in international finance. Western companies, such as Shell Oil, halted their investments in Russian projects. The allies also punished rich Russian oligarchs by seizing some of their property and by kicking their children out of western universities.

Taken together, these sanctions have hurt the Russian economy. Its stock market was falling so quickly that the Russian government halted stock trades. According to Yahoo Finance, the value of the ruble (its currency) has dropped 54.6 percent from its 52-week high. A key Russian interest rate has doubled and is now over 20 percent. Russia's economic condition should continue to worsen. On March 1, the Wall Street Journal reported estimates that suggested Russia's GDP will decrease by 10%.

Each of these statistics tells us something about the Russian economy and how effective the sanctions have been – or are expected to be. First, the stock market is a leading economic indicator. That is, it often can tell us where an economy is going. Stocks, after all, are ownership stakes in companies, and companies often pay out their profits to shareholders in the form of dividends. When a company is expected to become more profitable, investors who want a claim on these profits bid up its stock price. In contrast, when a company is expected to be less profitable, people aren't willing to pay nearly as much for shares of this stock since they believe their future dividend payments will be lower. Russia's plunging stock market reflects investors' belief that Russian companies will be far less profitable now that the sanctions are in place.

Second, the plummeting value of rubles indicates that few people want them. The reason is obvious: since the allies aren't buying many Russian goods, they do not need rubles. With so few people bidding for rubles, those that want them can get them cheap. Also, people with rubles see the plunging value of the currency and they want to unload their rubles. To do so, they have had to accept lower and lower payments.

Third, Russia's high interest rate suggests investments in Russia are risky. The main risk investors fear is default risk. As its economy takes a sharp turn for the worse, Russian companies may not generate enough revenue to pay their debt obligations. Even worse, the government may run out of money and default on its loans.

Finally, if Russian GDP does drop by 10 percent as predicted, the country will have 10 percent less output that it can devote toward future invasions. With a smaller economy, Russia will find it more difficult to gather enough resources to mount another invasion. This would be the most important effect of the sanctions.

Given the real damage the sanctions have done to the Russian economy and to its war-making ability, the allies should take the next step. The allies should stop all trade with Russia. They should even stop importing Russian oil and natural gas. I have no doubt that this will cause some economic pain to countries in Europe. But the U.S. can expand its own energy output and pressure countries like Saudi Arabia to do the same. Even then, some western economies will suffer hardship because of the higher energy prices. But this hardship is nothing compared to the hardship they will face if Russia decides to invade more European countries. By limiting Russia's ability to wage war, a complete trade embargo may prevent a war.

Joseph McGarrity is a Professor in Economics at the University of Central Arkansas. He received his Ph. D from George Mason University. He has won the College of Business Teaching Excellence Award, its Research Excellence Award, and was a finalist for the university-wide Teaching Excellence Award. He has published 26 journal articles. His research has appeared in the Journal of Law and Economics, Economic Inquiry, the Southern Economic Journal and Public Choice.