



THE COST OF GEOECONOMIC COERCION

Jeffrey Frieden

Governments have good reasons to use tariffs or sanctions for geopolitical purposes but should consider the trade-offs

Governments worldwide increasingly are using economic policies, such as export bans, financial sanctions, and trade tariffs, to achieve noneconomic goals. The benefits of these geoeconomic policies can be significant, accomplishing a geopolitical purpose without threatening, or using, military force—and without the high human and economic costs of war. Perhaps the world should welcome this.

Yet coercive policies can be costly for nations that impose them. As appealing as it may be to use economic policies for coercive purposes, sometimes the benefits are not worth the cost.

Close connection

International politics and international economics have always been closely intertwined. The age of mercantilism that prevailed from the 15th to the early 19th centuries was explicitly organized around the interaction of economic and military prowess. In his 1618 work *A Discourse of the Invention of Ships, Anchors, Compasse &c*, the explorer Sir Walter Raleigh, a theorist and practitioner of English mercantilism, opines, “Whosoever commands the

sea commands the trade; whosoever commands the trade of the world commands the riches of the world, and consequently the world itself.”

Mercantilist policies used military control over shipping routes and colonies to extract resources from trading partners and overseas possessions and used those resources to finance additional military spending. For several hundred years, the major powers’ conflicts and alliances were reflected in both their military and economic relations.

As Britain led the rich countries of Europe away from mercantilism and toward freer trade and financial flows in the early 19th century, the European powers increasingly separated economic policymaking from great-power politics. There were still occasional blockades and embargoes, and economic policies were often used as an instrument of colonial control. But the prevailing ideology and practice tended to keep economic and military policies relatively separate. This era of free trade saw very rapid economic growth by historical standards, which seemed to confirm the wisdom of divorcing economic from diplomatic relations.

However, as countries strove to catch up to Brit-

ain in the late 19th and early 20th centuries, geopolitical contention and a race for colonies brought geoeconomics back to the fore. Colonial powers tightened their control over their empires, Germany carved out a sphere of economic and political interest in central Europe, and the United States cemented its predominance in the Western Hemisphere during a period of rising economic nationalism that has parallels today.

The Cold War reinforced the connection between geopolitics and economics: The Western powers largely sealed off the Soviet Union and its allies from international trade and investment even as Western international economic integration grew dramatically. For their part, the Soviets and their allies, along with China, showed little interest in the world economy.

The end of the Soviet Union and the Cold War, along with the onset of full-scale globalization in the late 1980s and early 1990s, led most governments to conduct their international economic relations with little concern for military or other geopolitical considerations. As China and Vietnam, and later the former Soviet republics and their allies, joined the world economy, it seemed that global acceptance of economic integration had overcome the worst features of great-power politics.

Expectations at the start of the new millennium that international politics and international economics would stay separate have turned out to be wrong. Renewed competition among the major powers has encompassed their economic relations—think Western sanctions on Russia and ongoing trade conflicts between China and the United States. The global pandemic highlighted fears that long and complex supply chains could jeopardize countries' access to essential goods. The full-scale Russian invasion of Ukraine has brought major military conflict to Europe in ways that many considered unthinkable. It is hardly surprising that governments are using economic policies to address the rising geopolitical tensions they face.

Benefits of coercion

Governments have good reasons to use economic policies for geopolitical purposes. Sanctions, embargoes, tariffs, and other such measures can coerce adversaries without the threat or use of force. They can impose costs on target countries and governments, induce powerful groups abroad to pressure their own governments to change course, and persuade allies to collaborate in compelling an adversary to make concessions.

The appeal of geoeconomic policies can be clear, although they may be difficult to measure. Many geopolitical goals are hard to quantify, and hard

even to think of in monetary terms. How much is national security worth? What is the value of isolating an adversary, cementing an alliance, staving off a potential attack, avoiding a disastrous war?

While the benefits of geoeconomic policies may be intangible, many of the costs are more directly economic and amenable to analysis. Policymakers, analysts, and constituents should think about the trade-offs involved, about what a country may be giving up when it imposes sanctions or tariffs for geopolitical purposes. This does not mean that such policies should be avoided—only that both their benefits and their costs should be considered.

Coercion's costs

Coercive economic policies typically impose costs on the country that uses them. Those costs come in many varieties: Some examples follow.

Costs to economic efficiency. Almost by definition, geoeconomic policies move a country's economy away from its most productive purposes. Restricting imports limits the country's access to goods more efficiently produced elsewhere; restricting exports limits the country's access to profitable foreign markets. Measures that restrict the movement of goods and capital can compromise a country's comparative advantage and reduce its productive efficiency. This was, after all, the argument of pro-trade economists from Adam Smith to David Ricardo and John Maynard Keynes. As Keynes wrote, "The community as a whole cannot hope to gain by making artificially scarce what the country wants."

Governments pursue geoeconomic policies because they are willing to sacrifice aggregate (economic) welfare for geopolitical purposes. Within this objective, there are specific constraints that highlight the trade-offs geoeconomic policy entails.

Costs to specialization. Specialization is central to productivity and economic growth. The division of labor is central to broader economic efficiency and, as Adam Smith wrote, "The division of labor is limited by the extent of the market." Purposely giving up a broader market limits how much a national economy can usefully specialize.

There is a more explicit trade-off. More specialized economic activities are both particularly valuable and particularly vulnerable. They are valuable because specialized production is especially profitable, given its scarcity and specificity. They are vulnerable because the scarcity and specificity of specialized production also make it harder to replace. The more specialized the productive activity, the greater the challenge in doing without it—and the more dangerous it is to rely on it.

Governments will thus try to avoid dependence on the more specialized products of other nations.

Diversifying economic ties provides some protection against economic and geopolitical shocks and helps limit vulnerability. But it can also limit an economy's efficiency and that of its trading partners.

Costs to innovation. Just as artificially limiting a country's market reduces its ability to specialize, it also reduces its incentives to innovate. Producers invest in research and development to gain advantages in markets, and the larger the market and the fiercer the competition, the greater the reason to do so.

On the other hand, export controls that restrict a target economy's access to technology give the target strong reasons to innovate. Nazi Germany developed synthetic rubber and methadone when faced with an Allied blockade that cut it off from natural supplies of rubber and opium. While this may not have been the most efficient use of German resources, it did counteract the impact of the goeconomic policies. More recent evidence shows that sanctioned countries have invested heavily in innovation: Russia, China, and Iran have all responded to sanctions by ramping up research and development to try to replace goods no longer available.

Costs to credibility. A country's good reputation is valuable: It encourages other countries to commit to potentially risky arrangements in trade, finance, and investment. If goeconomic policies such as sanctions and asset freezes violate implicit or explicit contracts, it causes other countries to question whether they can trust commitments with those imposing such policies. As trust erodes, other governments and private companies are less willing to risk economic commitments that might be violated. This can deprive a country of valuable trade, investment, and financial ties—many of which rely on partners' reputation for reliability.

Costs to domestic politics. The costs and benefits of goeconomic policies may not be evenly distributed within the population, which can lead to domestic political conflict. The negative effects of sanctions or export controls, for example, may be severe for businesses that lose important and profitable economic ties. On the other hand, successful goeconomic policies may create particularly profitable opportunities for companies and industries that gain market access or favorable treatment. Domestic businesses that suffer from the imposition of goeconomic policies may resent those that benefit from their success. Such policies may thus be harder to impose, less credible, or more politically controversial. The last thing national leaders want when they pursue what they regard as key geopolitical policies is domestic political backlash—and so they need to pay close attention to the domestic social costs of these policies.

Complete picture

Governments often adopt coercive economic policies in the midst of an immediate geopolitical struggle. The understandable focus on the near-term geopolitical goal—extracting concessions, forestalling harm—can obscure the longer-term economic costs. It may be difficult, in the heat of geopolitical conflict, for policymakers to keep in mind that sanctions can inflict lasting damage to the financial or commercial reputation of the sanctioner, damage that could outweigh the temporary goeconomic advantage gained.

Goeconomic policies may engender desirable behavior in other countries, but they have costs and involve trade-offs. Policymakers, analysts, and citizens need a clear picture of these costs. Goeconomic policies can limit the efficient functioning of the economy, reducing incentives to specialize for maximum national productive efficiency. They can discourage domestic innovation but stimulate such activity by foreign rivals. They limit the activities available to national firms and industries. They can affect a country's reputation for reliability and may damage its long-term economic prospects. And they may harm some industries or groups in the sending nation in favor of others, in ways that may be politically controversial.

Goeconomic policies are a valuable tool of foreign policy whose benefits may be substantial, especially if they help avoid military conflict. There are times, however, when the costs may outweigh the benefits. We need a clear picture of the costs before we can determine whether the net benefits are positive. **F&D**

JEFFRY FRIEDEN is professor of international and public affairs and political science at Columbia University and professor of government emeritus at Harvard University.

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