

Confiscation of Russian Sovereign Assets: Mission Possible and Overdue

#MakeRussiaPay

Economic argument:
There's no alternative
to Western reserve currencies

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There is consensus that **Russia should pay for damages and losses** it has caused to Ukraine during its unprovoked war of aggression. The documented damages as of March 2023 reached \$411 billion¹. Since then, Russian destruction of the Kakhovka Dam alone has caused almost \$14 billion in additional damages to Ukraine². Moreover, the longer this war continues, the greater will be the losses in the light of Russian “scorched earth tactics” of fighting and deliberate destruction of Ukraine’s economy. Given the primary goal of ensuring Ukraine’s victory, all economic measures must be deployed against Russia now to compel it to cease its aggression and withdraw from Ukraine, as well as to limit its ability to wage war indefinitely. Nevertheless, the Russian Central Bank’s assets (RCB assets) amounting to approximately \$300 billion³ are still kept untouched, with the largest burden of funding Ukraine’s self-defense and recovery efforts currently falling on the shoulders of Ukrainians and Western partners.

Insufficient political will has been shown to make confiscation of Russian state assets happen, despite the fact that this concept has been extensively debated by major international and foreign partners of Ukraine. On November 14, 2022, the UN General Assembly adopted the Resolution ES-11/5⁴ in which it was recognized that the Russian Federation must be held accountable for all violations of international law against Ukraine and bear the legal consequences of its internationally wrongful acts. Such responsibility must include making reparations for all the damages, injuries and losses caused. In June 2022, Canada adopted amendments to the *Special Economic Measures Act* allowing for seizure and transfer of Russian state and private assets, yet the law has not been applied against Russia’s state assets.

1 Ukraine: Rapid Damage and Needs Assessment. February 2022-February 2023. The World Bank, the Government of Ukraine, the European Union, the United Nations. Available at <https://documents1.worldbank.org/curated/en/099184503212328877/pdf/P1801740d1177f03c0ab180057556615497.pdf>

2 Post-disaster needs assessment. 2023 Kakhovka Dam disaster, Ukraine. October 2023. Government of Ukraine and the United Nations. Available at: <https://ukraine.un.org/sites/default/files/2023-10/PDNA%20Final%20and%20Cleared%20-%2016Oct.pdf>

3 Intensive efforts to enable frozen Russian assets to reach Ukraine. Swedish Presidency of the Council of the European Union. April 12, 2023. Available at: <https://swedish-presidency.consilium.europa.eu/en/news/intensive-efforts-to-enable-frozen-russian-assets-to-reach-ukraine/>

4 Resolution adopted by the General Assembly on 14 November 2022. ES-11/5. Furtherance of remedy and reparation for aggression against Ukraine https://www.securitycouncilreport.org/atf/cf/%7B65BF9B-6D27-4E9C-8CD3-CF6E4FF96FF9%7D/a_res_es_11_5.pdf

5 Special Economic Measures Act, S.C. 1992, c. 17. Government of Canada. Assented to 1992-06-04. Available at <https://laws-lois.justice.gc.ca/eng/acts/s-14.5/page-1.html>

On February 16, 2023, the European Parliament called⁶ on the European Commission and the Council of the EU to create a legal basis for confiscation of Russian assets, and on October 17, 2023, the Parliament adopted its position on the draft regulation establishing the Ukraine Facility, which provides clear grounds for confiscation: collective countermeasures and collective self-defense⁷.

Opponents of confiscation raise various legal, economic and political counterarguments. This note, prepared as a part of the #MakeRussiaPay public campaign held by the civil society organizations International Center for Ukrainian Victory, Anti-corruption Action Center, National Interests Advocacy Network ANTS, is focused on answering the question of **why confiscation of Russian RCB assets is legitimate under international law and compelled by political necessity**, based on collective findings of prominent legal experts displayed in their studies and reports. In addition, from the international finance perspective, there is no real alternative to Western reserve currencies. Therefore, the fears that confiscation may trigger the outflow of other countries' reserves are largely overinflated. Nonetheless, in order to minimize any potential financial risks, **G7 and EU should jointly confiscate RCB assets acting as a coalition.**

All intermediary scenarios proposed by Ukraine's partners, such as the transfer of proceeds from blocked assets, amounting to several billion dollars or euros annually, taxes from such proceeds (e.g. the case of Belgium), imposition of specific tax on companies benefiting from Russian assets etc., are welcome first steps, but cannot be the end goal. Given the scale of damage, they should be considered only as supplementing and not substituting full confiscation. Otherwise, G7 and EU partners will need to collect funds for Ukraine amounting to tens of billions of dollars or euros annually for many years to come, which is hardly a realistic nor an attractive long-term posture for the West to adopt toward Russia.

6 European Parliament resolution of 16 February 2023 on one year of Russia's invasion and war of aggression against Ukraine (2023/2558(RSP)). Thursday, 16 February 2023. Strasbourg. Available at: https://www.europarl.europa.eu/doceo/document/TA-9-2023-0056_EN.html

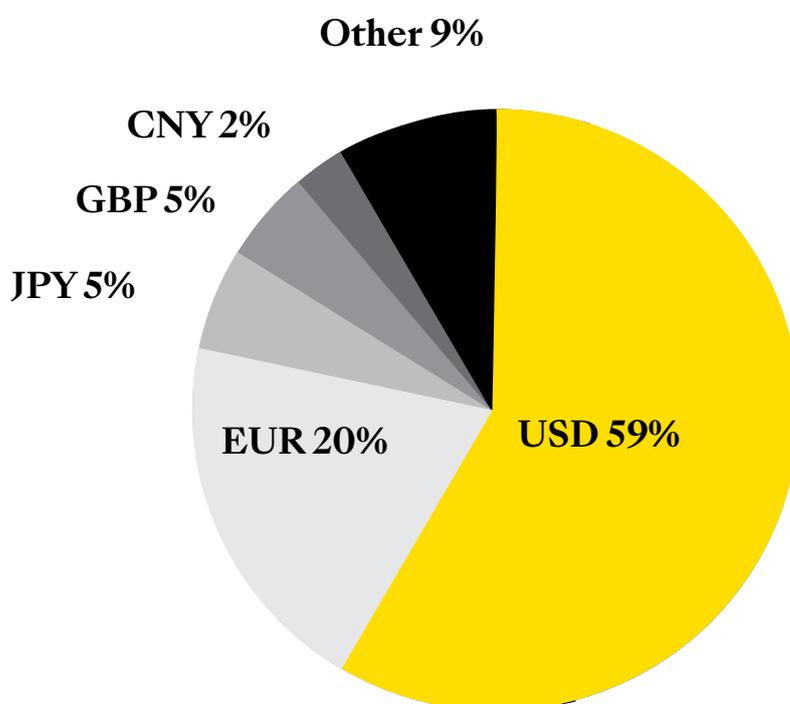
7 Establishing the Ukraine Facility. Amendments adopted by the European Parliament on 17 October 2023 on the proposal for a regulation of the European Parliament and of the Council on establishing the Ukraine Facility (COM(2023)0338 – C9-0210/2023 – 2023/0200(COD))

Economic argument: there's no alternative to Western reserve currencies

Economic block was prepared by Maksym Kuzhdin, research intern, and Roman Sulzhyk, Supervisory Board Member at the Center for Economic Strategy

The potential destabilization of the Western financial systems is used by the representatives of the central banks and finance ministries of the Western countries as one of the main arguments against the seizing of the RCB assets. Yet, these fears are largely unfounded. Such prominent economists as former US Secretary of the Treasury Larry Summers, and former President of the World Bank Robert Zoellick arrived to the same conclusion⁸.

SHARE OF CURRENCY IN GLOBAL RESERVES



Source: Currency Composition of Official Foreign Exchange Reserves, IMF

Just like there is no alternative to Western capital markets, there is no alternative to US, EU and Japanese currencies as reserve currencies for the world. The IMF data for the second quarter of 2023 shows that 59% of the world's foreign reserves are held in US dollar, 19.8% in euro, 5.5% in Japanese yen, and 4.9% in British pound⁹, amounting in total to 89.2% of all reserves.

⁸ The Other Counteroffensive to Save Ukraine. Lawrence H. Summers, Philip Zelikow, and Robert B. Zoellick. Foreign Affairs. June 15, 2023 <https://www.foreignaffairs.com/ukraine/other-counteroffensive-save-ukraine>

⁹ Currency composition of official Foreign Exchange Reserves (COFER). IMF. Available at <https://data.imf.org/?sk=e6a5f467-c14b-4aa8-9f6d-5a09ec4e62a4>

Even authoritarian countries, as defined by The Economist's Democracy Index, which hold almost 40% of the world's foreign exchange reserves, choose the stability of the free world's currencies.

China has tried for over a decade to position renminbi as an alternative, at least in Asia if not the whole world. Yet, it obviously struggles to achieve this goal. Among the main reasons is the country's weaponization of renminbi in the trade wars against the West. Heavy focus on export competitiveness prompted the Chinese government to keep renminbi artificially low, and since 1994 the central bank sets a daily forced exchange rate which can fluctuate within the band of 2%¹⁰. In 2019 after a record devaluation, the country was even designated as a 'currency manipulator' by the United States¹¹, though the designation was dropped in 2020. For investors who look for a stable and predictable reserve currency, such conditions are unattractive.

There is also a problem of China's inability to implement full convertibility of renminbi. The offshore and onshore renminbi differ in regulation and, in some instances, the exchange rate, as the spread at times reaches 1-2%¹².

And then, there's also China's record of being unsafe for private investments, with one of the notable recent incidents being the passing of an "anti-foreign-sanctions law" in 2021 that allows the government to seize foreign-owned assets¹³.

The full-scale Russian invasion of Ukraine made China's position even more vulnerable, despite the expectations of some that after the freezing of Russian assets the reserves of other countries might flock there. Between 2010-2021, investors bought a net of \$558 billion of Chinese bonds, and then from February 2022 through March 2023 they sold \$115 billion¹⁴. Without attractive reserve assets renminbi struggles to compete, and its share in world's reserves as of Q2 2023 dropped to 2.4% down from 2.8% in Q2 2022¹⁵. Five years ago, in Q2 2018, its share was about 1.83%, which further demonstrates the country's struggle to attract investors¹⁶.

10 This is how China controls its currency. CNN Business. Available at <https://edition.cnn.com/2018/10/01/economy/china-currency-yuan-rmb/index.html>

11 Treasury Designates China as a Currency Manipulator. US Treasury. August 5, 2019. Available at <https://home.treasury.gov/news/press-releases/sm751>

12 Renminbi turnover tilts onshore. Frank Packer, Andreas Schrimpf and Vladyslav Sushko. BIS Quarterly Review. December 2019. Available at https://www.bis.org/publ/qtrpdf/r_qt1912w.htm

13 China Asserts Broad Power to Seize Assets in Anti-Sanctions Law. Bloomberg News. June 10, 2021. Available at <https://www.bloomberg.com/news/articles/2021-06-10/chinese-lawmakers-pass-bill-intended-to-fight-u-s-sanctions>

14 Yuan won't be FX reserve currency if no one buys China's bonds. Reuters. May 16, 2023. Available at <https://www.reuters.com/markets/asia/yuan-wont-be-fx-reserve-currency-if-no-one-buys-chinas-bonds-2023-05-16/>

15 Currency composition of official Foreign Exchange Reserves (COFER). IMF. Available at <https://data.imf.org/?sk=e6a5f467-c14b-4aa8-9f6d-5a09ec4e62a4>

16 World Currency Composition of Official Foreign Exchange Reserves. IMF. Available at <https://data.imf.org/regular.aspx?key=41175>

Attempts by other countries to make their currencies reserve have been even more dismal. India has tried to position the rupee as a reserve currency, yet the same convertibility problems and history of governmental interference in the currency market will prevent this from happening in the foreseeable future. India's share of global exports exceeds a little 2%, and thus few countries feel the need to hold rupees. Even the heavily sanctioned Russia, which does not get many options, refuses to accumulate the Indian currency, seeing it as too volatile¹⁷.

Russia itself has attempted to position the ruble as a reserve currency, with no success. It faces the same issues as India, and is now topped up with a major currency crisis and the danger of sanctions for other countries who decide to purchase ruble. Since December 2022, the currency has lost 40% of its value¹⁸, and this does not seem to be the limit.

An honorable mention goes to the potential BRICS currency, which has been rumored for a while, though with no concrete plans. It is unlikely that it will ever gain traction, considering that the updated array of BRICS members often has completely opposite geopolitical interests, little economic interconnectivity aside from bilateral trade with China, and weak incentive to cooperate and give up financial sovereignty to developing rivals.

One might also say that countries worried about their central bank reserves being seized in similar fashion will choose to move them into physical gold rather than keep them in fiat currencies of the US, EU or Japan. This is possible, but we believe that the impact would be very limited. Gold is much more volatile, with a short-term volatility reaching 15-20%¹⁹, has high transaction costs, and lack of quick and free convertibility into other currencies. Whenever gold is traded, it remains physically in the vaults of the Bank of England or Federal Reserve of the United States, and experts point out the already existing difficulties for countries like Russia and Venezuela to use their repatriated gold²⁰.

Even if all authoritarian countries decided to follow suit and repatriate gold, there just isn't enough metal in the world: all central banks in the world combined hold about 36,000 tons of it²¹, which at current prices are worth \$2.14 trillion. The combined reserves of authoritarian countries in foreign currency

17 Exclusive: India, Russia suspend negotiations to settle trade in rupees. Reuters. May 4, 2023. Available at <https://www.reuters.com/markets/currencies/india-russia-suspend-negotiations-settle-trade-rupees-sources-2023-05-04/>

18 Russian ruble buckles under trade sanctions, declining export earnings. Federal Reserve Bank of Dallas. October 10, 2023 <https://www.dallasfed.org/research/economics/2023/1010>

19 CBOE Gold ETF Volatility Index. FRED Economic Data. Available at <https://fred.stlouisfed.org/series/GVZCLS>

20 Gold as International Reserves: A Barbarous Relic No More? Author: Mr. Serkan Arslanalp, Mr. Barry J. Eichengreen, and Chima Simpson-Bell. IMF eLibrary. 27 January 2023. Available at <https://www.elibrary.imf.org/view/journals/001/2023/014/article-A001-en.xml#A001fn05> <https://www.elibrary.imf.org/view/journals/001/2023/014/article-A001-en.xml>

21 World Gold Council. Available at <https://www.gold.org/goldhub/data/how-much-gold>

and gold currently stand at \$5.35 trillion.²² Moreover, the flock of reserves into gold would dramatically increase its value. In that case, authoritarian regimes would end up trapped in golden cages with little prospects of being an active player in global trade and subsequent limitations of international settlements.

How to mitigate potential risks

The opponents of the confiscation often stress that the biggest competitive advantage of the Western currencies is predictability and stability thanks to effective sustainable institutions, which is true. But then they make a false conclusion that in order to maintain this advantage, the West cannot use the funds of the aggressor state to pay for the damages and Ukraine's just self-defense in the largest war of aggression since World War II. However, predictability does not mean inflexibility, but rather that steps made should be grounded and explained. The largest war of conquest gives sufficient evidence for the confiscation to be well-justified.

Realistically, the reserves and investments might only flow between the major reserve currencies in case a G7 country or EU moves alone in the confiscation. In order to minimize such risks or avoid "de-dollarization" or "de-eurozation", G7 and EU should jointly confiscate Russian frozen assets in the coalition.

It is essential to create legal mechanisms to hold Russia accountable with a high enough bar to cross and a set of clear criteria related to the Russian war of aggression. That would send a signal to other countries that the confiscation was not arbitrary, and they should not feel threatened if they do not plan to wage wars of aggression. Moreover, if some authoritarian countries start pulling their reserves out, that might also serve as a signal about their potential preparation for gross violation of international law.

Instead of focusing on the fact that the confiscation will threaten other countries, the West should consider such precedent as one of the safeguards against other wars of aggression in the future.