Global Counsel

Confiscating Russian assets: a new frontier for sanctions?

Blog post by International Policy Practice Director Jon Garvie, 30 May 2022

In his speech to Davos last week, President Zelensky proposed that frozen Russian assets "should be allocated to a special fund to compensate all the victims of the war", adding that this would set a useful global precedent in deterring future aggressors. Voices in favour of the proposal are gaining force, particularly in the US, on both moral and practical grounds.

The brutality of Putin's war and the gaps in Ukraine's public finances have advanced together. Zelensky has said that a post-war rebuilding will require more than $500 bn, but a separate $5 bn euros per month is needed now to pay state employees and beneficiaries, including soldiers. The IMF has endorsed the latter figure, while acknowledging that monthly international disbursements reached only $3.3 bn euros in March. Both the US and EU are pushing through legislative packages to provide over 30 bn euros each in aid. But that is far short of the scale of a "Marshall Plan" which Zelensky believes Ukraine needs. Meanwhile, the longer Putin bombards the south and east of Ukraine, the more funds will be required in the medium-term.

The $300 bn of frozen Russian central bank reserves (CBR) therefore looks like an increasingly attractive target. Confiscating the money and holding it in some form of "reparations" fund could be presented as both retribution and deterrence. Such a move would be easily explicable and popular in some countries, particularly those suffering from energy price rises and broader inflationary impacts due to the war. However, it would be difficult to execute and could provoke divisions within the G7. It would also be the first time that a third party to a conflict had taken such a step.

The White House apparently believes that it has the legal framework to seize and distribute foreign assets, as well as freeze them. The Trading with the Enemy Act of 1917 (TWEA) and the International Emergency Economic Powers Act of 1977 (IEEPA) were used to freeze German and Iranian assets respectively and IEEPA was then revised by President Bush in 2002 to use Iraqi assets for national "reconstruction". However, there is significant legal debate about whether the President can use these powers to vest Russian assets elsewhere in the absence of direct hostilities between the US and Russia. A bill is going through Congress which would provide more explicit authority to do the latter. But there are concerns that private lawsuits against Russia – targeting those same frozen funds – may begin before it is approved.

The time to act may therefore be short, and the US would need to persuade its G7 allies to act together. Only 6% of Russia's frozen central bank assets are held in the USA and 5% in the UK. Germany holds 16%, France 10% and Japan 9%. It appears that Putin shuffled his portfolio preceding the war (Russian CBR reserves in Germany increased from 11% to 16% in the year to January 2022). Both France and Germany are likely to argue, in private at least, that permanently confiscating Russia's CBR will remove a "bargaining chip" or "off-ramp"; it is here that implicit divisions between US / UK narratives of "defeating" Putin and Franco-German prioritisation of ending the war will come to the fore. Publicising the proposal risks undermining the image of G7 unity which has held to this point.

Notwithstanding further Congressional authority, the move would also be denounced by much of the wider G20. China would argue that compromising the status of CBR undermined the legal validity of the international system – as well as posing risks to financial stability - and would be encouraged to consider the location of its own reserve holdings. It would also incentivise broader decoupling within the financial system, for example through the creation of a rival international payment and settlement system to challenge SWIFT. The US would therefore face a severe diplomatic test in bringing onside the German Presidency, and an even tougher job in convincing emerging markets.

There have been separate discussions both at the G7 and the EU about whether Russian oligarchs might be allowed to buy their way out of sanctions, or whether EU law could be changed so that their assets could be confiscated before any criminal process had run its course. This could also deliver substantial funds for Ukraine and would not have the same legal bar as the confiscation of state assets. But it would still produce a wave of litigation, of which many member states remain wary.

As the G7 leaders' summit on 26-28 June draws closer, the pressure for a major new announcement that funds Ukraine and punishes Russia will continue to build.