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Using sanctioned Russian assets to rebuild Ukraine will not be easy

by Camino Mortera-Martinez and Zach Meyers

Funding Ukraine's reconstruction with confiscated assets from Russian elites will be legally complex. Seizing Russia's frozen foreign reserves may prove easier.

As the Russian invasion of Ukraine continues, policy-makers are beginning to look at the cost of post-war reconstruction – a figure Ukraine estimates at over $750 billion and the European Investment Bank believes could be as high as €1 trillion. The EU's current support of €6.2 billion pales in comparison. And yet – given that Russia is unlikely to agree to pay for the destruction it has wrought – the EU is expected to bear much of the cost of rebuilding Ukraine, not least as it is a candidate for EU membership.

While European support for Ukraine remains steady (for now), governments are starting to get nervous about growing demands on their budgets. One increasingly salient question is how to justify the bill for reconstruction to European taxpayers, with inflation on the rise, swelling defence expenditure and a looming recession. Come autumn, EU leaders will have to tell their citizens to curb their energy consumption and brace for a further rise in the cost of living. They will be understandably wary of asking their voters for more money to rebuild war-torn Ukraine. So EU capitals and the EU institutions are looking for other ways to cover the bill. One idea making the rounds in Brussels is to confiscate Russian assets which have been frozen under EU sanctions – namely, the assets of sanctioned Russian elites and Russia's foreign reserves held in the EU – sell them, and channel the proceeds to Ukraine. But liquidating Russian assets would only be worthwhile for the EU if it was legal, feasible and sufficiently lucrative.

Take private assets. Article 215 of the Lisbon Treaty allows the EU to impose sanctions on both entities and individuals, including freezing their assets. The EU keeps several lists of sanctioned individuals and organisations whose assets must be frozen – ranging from Russian oligarchs and Syrian mercenaries to members of terrorist organisations. As of April, the EU had frozen approximately €30 billion of Russian and Belarusian boats, real estate, artwork and other assets. But the EU does not have the power to confiscate and liquidate these frozen assets unless they are the proceeds of crime, and many EU countries have investment treaties with Russia which protect Russian investments from arbitrary expropriation. That protection would continue to apply to existing investments, even if member-states terminated the treaties.

That is why the European Commission has come up with a plan to make breaching sanctions a 'euro-crime' – a particularly serious crime with a cross-border dimension, for which the EU sets baseline rules to try to ensure that all member-states criminalise it and apply roughly similar penalties. This would make it easier for the EU and its member-states to confiscate the assets of Russian and Belarusian oligarchs who try to trick the system, for example by diverting

or moving assets from one member-state to another. The Commission's plan is ambitious: at present, only 12 member-states consider the violation of sanctions as a criminal offence. In two EU countries (Spain and Slovakia), breaching sanctions is only an administrative offence. In some member-states, a sanctioned individual who fails to abide by EU restrictive measures can face up to 12 years in jail; in others, they would be able to walk away with a €1,200 fine.

Even if the Commission succeeds in convincing all member-states to start confiscating private Russian and Belarusian assets, it will still be very difficult to use those assets for Ukraine's reconstruction. Because asset-seizing requires unlawful conduct (and not merely an association with Vladimir Putin) confiscation will often require criminal proceedings. The process of expropriating sanctioned private assets will therefore be painstaking and open to legal challenges in many member-states. National prosecutors will need to present evidence of either sanctions breaches or that the assets were the proceeds of crime, and in many cases this will be impossible to prove. Some member-states, like Germany, would need to change their constitutions to allow for confiscated private assets to be used in rebuilding Ukraine. Even if all legal hurdles were crossed, confiscating the assets of Putin's elite would still be a fraught process and – since only a fraction of the €30 billion in frozen assets will probably be seized – insufficiently lucrative to make much of a dent in Ukraine's reconstruction bill.

Russia's foreign reserves are a much bigger prize – the value of reserves frozen by the West is approximately €300 billion – and it may be easier to use them for Ukraine's reconstruction. International law protects foreign reserves to some degree, but there are precedents for freezing another country's foreign reserves in specific cases, as for example when the US stopped the Taliban accessing Afghanistan's foreign reserves last year. When foreign reserves are frozen, governments and private entities are banned from buying or dealing with them, but the reserves themselves are left untouched. Confiscation, on the other hand, goes a significant step further.

If Europe seized Russia's foreign reserves, it would want at least a plausible justification under international law for taking this further step. It could, for example, try to present confiscation as a counter-measure intended to persuade Moscow to withdraw from any parts of Ukraine it still occupies and compensate for its damage. Europe could also argue seizures have at least some precedent, even if they are not directly analogous: for example, in 2003, the US confiscated Iraq's foreign reserves to help with rebuilding the country once Saddam Hussein was defeated. Seizing Moscow's foreign reserves would appear most legitimate if an international tribunal like the International Court of Justice awarded reparations to Ukraine and Putin refused to pay – but if that happens, it would probably be many years in the future.

Assuming these legal complexities could be overcome, seizing Russia's foreign reserves could be faster and far more lucrative than trying to liquidate private assets of the Kremlin elite. However, two problems would remain. First, expanding the circumstances when assets or reserves can be expropriated risks encouraging other countries, including those with fewer moral scruples about property rights, to confiscate others' assets. This could put European investments in other parts of the world at greater risk. Second, Europe needs to be careful not to be seen as blatantly disregarding the rule of law and principles of international law. Most Europeans may, by now, have seen through Putin's lies, but this is not necessarily the case elsewhere. Many developing countries are still receptive to Moscow's propaganda – and particularly to the idea that the West has forced Russia to invade Ukraine, and that Europe's sanctions are to blame for the higher food and energy prices and the shortages they are suffering.

European governments would increase the risk of alienating countries susceptible to Russian and Chinese influence if they chose to use Moscow's foreign reserves to rebuild Ukraine without a watertight legal argument (like an international court ruling) to do so. If Europe chose to confiscate Russia's foreign reserves, at a minimum, it would need to lay out clear and predictable principles, to try to assure other countries that their own foreign reserves would only ever be seized in response to similarly severe breaches of international norms.

Russian assets will not suffice to pay for the entirety of Ukraine's reconstruction. Confiscation will be slow and, at times, legally problematic. While they consider whether and how to liquidate sanctioned Russian assets, European leaders should also come up with a narrative to explain to European taxpayers why it is in their long-term interest to help finance Ukraine's reconstruction.

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Beyond European strategic autonomy?

by Luigi Scazzieri

European strategic autonomy in security and defence will remain a controversial subject, but leaving aside labels, the Ukraine war is giving fresh momentum to Europeans' defence efforts.

When EU countries set up what would later become the EU's Common Security and Defence Policy in the late 1990s, the Union's 'capacity for autonomous action' was a stated aim. Despite this long-standing goal, the concept of 'European strategic autonomy' has been ambiguous and divisive. For its proponents, chiefly France, Europeans need strategic autonomy to protect their interests better, in case the US proves unwilling or unable to do so. Conversely, opponents of strategic autonomy, mainly in Europe's eastern member-states, think it a dangerous idea. In their eyes, strategic autonomy risks undermining NATO, wasting finite resources through duplication, and driving a wedge between the US and Europe.

The renewed threat from Russia has underscored how, despite NATO's internal disagreements, there is no viable alternative to the alliance and its integrated command structure when it comes to organising deterrence and defence against Moscow. In particular, Russia's attack on Ukraine has starkly underscored the degree of Europe's reliance on the US for security in both conventional and nuclear terms. The US forces stationed in Europe, which have grown by tens of thousands since Russia's invasion, form the linchpin around which deterrence is structured, and commit America to defending its European allies. Meanwhile, the US's nuclear arsenal serves as the ultimate guarantee of European security in a way that the British and French nuclear arsenals could never do on their own.

Proponents of European strategic autonomy worry about Europe's reliance on the US for security, and see the war as yet another reason why Europeans should redouble their efforts to be able to act alone if necessary. Conversely, for opponents of strategic autonomy, the conflict in Ukraine means that keeping the US committed to Europe's defence is more important than ever, while strategic autonomy seems even less realistic and desirable than before. Most eastern member-states do not trust the big western European countries, especially France and Germany, when it comes to dealing with Russia. The latter are generally seen as too soft on Russia, unwilling to live up to all their promises to support Ukraine, and inclined to doing a deal with Putin that would undermine Ukraine's interests. The perception that Western Europeans are dovish towards Russia has only enhanced the perceived importance of the US as a security guarantor in the eyes of eastern EU countries.

Russia's invasion has also highlighted the UK's important contribution to European security.

London's hawkish stance has earned it praise amongst eastern member-states, further challenging the idea that EU-only strategic autonomy is desirable.

All this means that the debate around European strategic autonomy is set to remain contentious. But if one looks past the rhetoric, the reality is that Europeans have been making slow but steady progress in being able to look after their own security better – however they wish to label these efforts. The EU has taken on an increasingly large role in security in the past five years. This shift was prompted by conflicts and instability amongst Europe's neighbours and by President Trump questioning the US commitment to NATO. At the same time, Brexit removed the UK's veto on greater defence co-operation. The Union has launched the European Defence Fund to help finance co-operative research in defence. The EU also activated Permanent Structured Co-operation, a framework within which nearly all EU states are working together on a range of defence projects, such as upgrading infrastructure to ease physical and regulatory obstacles to moving military forces quickly across Europe. The aim of the EU's Strategic Compass, a strategy document approved by all member-states in in March this year, is to "enhance the EU's strategic autonomy". The Compass contains proposals to strengthen joint development of military capabilities, counter hybrid and cyber threats, and assist partners. It also led to member-states agreeing to set up a 5,000-strong rapid intervention force, which implies that they would have a larger pool of interoperable forces available to deploy.

The conflict in Ukraine is pushing Europeans to take defence more seriously. Since the start of the war, EU countries have announced around €200 billion of defence spending increases. Most notably Germany has promised to raise its defence budget to 2 per cent of GDP (after years of stalling) and agreed a €100 billion ad-hoc fund to help reach that goal. The Union is leading in helping member-states to deal with the economic consequences of the conflict, especially in weaning themselves off Russian hydrocarbons. The EU is also involved in supporting Ukraine militarily: the decision to allocate €2.5 billion to finance the provision of military assistance to Kyiv through the recently launched European Peace Facility is a step change in European support for partners, and has set a precedent that is likely to be repeated in the future. The European Commission wants to co-ordinate efforts to replenish stocks of weapons given to Ukraine. The Commission has also tabled proposals to foster joint procurement and maintenance of military equipment, to generate economies of scale, by allowing member-states to form groupings that would be exempt from VAT, and by contributing EU funds to these efforts.

Time will tell whether Europeans' newfound seriousness on defence will amount to much. Diverging national and industrial interests may torpedo the EU's new defence initiatives, as they have done before. And announcements of additional spending by member-states are not the same thing as better capabilities. Some governments may not stump up all the money they promised; the real value of that cash will decrease if inflation remains high; and spending increases may be diluted across years. Still, there are reasons to be optimistic. First, even if the EU's efforts to increase co-operation by providing financial incentives are not very successful, the aggregate increase in member-states' defence spending should ease resource constraints, provide more room for co-operative projects that generate economies of scale, and lead to stronger European military capabilities in the medium term. Second, the financial sweeteners on offer are substantial, and the US says it backs the EU's defence efforts, so long as these lead to concrete results in terms of improved European capabilities. The chances of success will be greater if leaders do not use the term 'strategic autonomy' – France now prefers to talk of 'European sovereignty' – and if EU defence initiatives are as open as possible to the participation of non-EU NATO allies.

The external pressure on Europeans to take defence more seriously is unlikely to decrease. On the one hand, Russia's invasion will exacerbate challenges for Euro-Atlantic security well beyond Eastern Europe, with potential food shortages and economic challenges in much of Europe's neighbourhood. On the other, the war has not undermined Washington's bipartisan wish to focus on countering China's rise. If Trump or another 'America-first' Republican became president in 2025, America's commitment to European security could not be taken for granted, and US foreign policy could often clash with that of many EU members, undermining European security. Regardless of the outcome of the next US election, the US is likely to devote fewer resources to European security in the future, and to demand that Europeans take up a larger share of the burden of deterring Russia and stabilising their own neighbourhood. Europeans would be wise to prepare for that now.

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The US could cope with deglobalisation. Europe couldn't

by John Springford

True 'deglobalisation' – disintegration of the global economy – would be triggered by a political event, like China invading Taiwan. That would be a big problem for Europe's economy.

Foreign policy analysts sometimes indulge in grand narratives that have little basis in data. Talk of 'deglobalisation' is one such narrative, and has been on the rise since 2016. On some measures global economic integration has stalled, while on others, it continues to grow. A 1930s-style collapse in trade and international investment did not happen after the global financial crisis in 2008 – or after Donald Trump's election victory. However, the risks of outright deglobalisation have clearly risen after Vladimir Putin's invasion of Ukraine and Xi Jinping's decision to strengthen ties with Russia (if more in word than deed). If Xi decides to invade Taiwan, and the US and its allies impose sanctions on China in response, international trade and investment would fall substantially. Europe's economy is far more vulnerable to such disintegration than that of the US.

Global goods trade remained high after Trump took office, fell rapidly during the pandemic, and then recovered (unlike the 1930s, when it fell precipitously to a lower level and stayed there). Global services trade has been steadily growing since the financial crisis. After 2009, global cross-border lending stagnated: slower trade growth meant less international credit was needed to facilitate it. But foreign direct investment – investment in companies, buildings and machinery – continued to rise, especially in emerging economies. So too did migration flows. But if China, Russia and the West separate into two opposing political and economic blocs, true deglobalisation would ensue.

Meanwhile, the EU has been flirting with policies to bring more production onshore (as have the US and China, which is aiming for self-sufficiency in key technologies through its 'dual circulation' policy). Since the UK voted to leave the EU, the balance of power in the Union has shifted towards more trade-sceptic countries, especially France. Gummed-up global supply chains after the pandemic have further encouraged talk of European 'strategic autonomy' in trade and investment. The EU is providing big subsidies for European microchip production, attempting to onshore electric vehicle supply chains, planning to develop home-grown alternatives to US tech and payments giants, and enacting stricter controls on foreign investment into the Union, especially by companies based in autocracies. Russia's weaponisation of gas supply has prompted a scramble to diversify Europe's energy imports.

The EU's economy – like those of the UK, Switzerland, Turkey and other countries in its neighbourhood – faces a sharp recession as retail energy prices climb. Energy rationing might be needed this winter as EU member-states struggle to find alternatives to piped Russian gas. Food prices are also rising rapidly, as well as some commodities that Ukraine and Russia specialise in, such as fertiliser. That comes on top of high inflation in other imported commodities, parts

and finished goods, thanks to pandemic-induced supply chain disruption.

The current energy crisis shows how future trade shocks would play out: first, they lead to higher prices, which then reduce demand and thus economic activity. Inflation encourages investment in domestic production and substitutes, if they can be found. But domestic production and substitutes are less efficient, or they would have been delivered by market forces anyway. That means domestic consumers face continued higher prices for the same goods, forcing them to either reduce their consumption of those goods or cut spending on other things.

The US has suffered from a similar overall inflation rate to the EU (even if inflation took off earlier in America). But it is comparatively self-sufficient in energy, with larger oil and gas stocks. It also has more than twice as much agricultural land as the EU (360 million hectares versus 174 million). At the time of writing, the consensus forecast was a milder recession this year than in Europe.

The US's economy is more robust in the face of deglobalisation in other ways, too. Its top imports are similar to those of the EU – computers, microchips, electrical machinery, oil and refined petroleum, pharmaceuticals, medical devices and metals. But it has larger computing and chip companies than the EU, allowing it to raise domestic production more rapidly if need be. The EU's large manufacturing sector, and its greater reliance on Asia for inputs, makes it more vulnerable to conflict there.

More 'strategic autonomy' in microchips, medical equipment, electric vehicles and digital tech would impose costs on European consumers, but without the environmental benefits that energy independence would bring. Cutting imports of hydrocarbons from Russia will make the EU less vulnerable to blackmail by Putin – and cutting fossil fuel imports more generally will allow a more robust approach to oil and gas exporters, which are mostly autocracies. There are green substitutes for fossil fuel energy, especially in electricity generation and transport, and higher fossil fuel prices will prompt more investment and research and development in earlier-stage technology. Higher energy prices are a good thing, insofar as they price in the costs that fossil fuels impose on society. But the production and consumption of microchips, medical equipment and so forth impose far fewer costs on society than energy does, and governments should seek to keep prices of these goods as low as possible.

That is not to say that governments should ignore dependence on one country for supplies of important goods. Both Europe and the US are vulnerable to a Chinese invasion of Taiwan, because such a large share of advanced microchips are made there. China's dominance in the processing of metals needed for battery production is also a problem. But Europe's strategy should be first to diversify production, especially to companies based in countries that face fewer political risks, and resist the temptation to prioritise onshoring production.

Market forces have an important role to play in dealing with political risks and disruptions. Those who argue, with some reason, that companies are bad at pricing political risks must also explain why governments are better at it. Onshoring imposes large costs on consumers (and taxpayers, if it is subsidised). Those costs may be larger than the supposed benefits of resilience, especially if onshoring substantially raises prices. And the costs of disruption may not be as large as governments assume: supply chains held up reasonably well through the pandemic, considering the huge impact lockdowns and infection had on global production capacity. During the worst of the pandemic, domestic production facilities were just as likely to be closed as foreign ones (although governments could do more to keep their own critical facilities running).

In some sectors, such as food, energy, pharmaceuticals and medical equipment, governments should regulate and stockpile to ensure resilient supply. The case is far weaker for less critical goods and services and the EU should do more to resist lobbying for onshoring subsidies than it has so far, leaving manufacturers to seek low-cost suppliers outside China or build their own plants, if they can do so competitively.

Trade and investment policy can help, however. Countries that could help reduce political risks, because they are endowed with commodities, workers or capital, and are unlikely to become enemies, should be first in line in negotiations. North African countries have enormous solar energy potential, which could be connected to the European grid. Many Latin American countries and India are relatively stable, have plenty of commodities or cheap labour, and keen to balance China and the West against one another.

If China invades Taiwan, prompting an economic rupture with the West, the economic consequences would be painful for the US, but worse for Europe. The EU should dial back the more mercantilist elements of its 'strategic autonomy' plans: becoming resilient to globalisation's political risks means taking advantage of its benefits while curbing the downsides – not retreating from it altogether.

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CER in the press

Financial Times
15th July
Luigi Scazzieri, a senior research fellow at the **CER**, said Draghi has left Italy a substantial legacy in the EU Covid recovery programme architecture, which ties the delivery of the next tranches of funds to progress on reforms.

Bloomberg
7th July
"Without widespread adoption, a CBDC [central bank digital currency] will be an expensive failure, and will do little to advance central banks' goals," Zach Meyers of the **CER** said. "The EU shouldn't be distracted by the prospect of a digital euro – which may sound impressive and exciting, but may give Europeans few benefits they can't enjoy already."

The Telegraph
4th July
In a keynote speech [to the **CER**] on Britain's future outside the European Union, Sir Keir Starmer pledged to "make Brexit work" and said he would not seek to join the Single Market or a customs union.

Financial Times
3rd July
Charles Grant, director of the **CER**, said the ministers' statement "shows a hardening of the EU line on the protocol". "The new German government is a few notches tougher on the British than its predecessor," he said. "In recent years it has often been the French who have taken the hardest line among the 27 – but the joint statement shows they are not alone. EU governments now say that the arguments over the protocol are not just about Northern Ireland, they are about the UK's international reputation as a country that respects the rule of law."

Politico
20th June
"The Commission's process [in its antitrust case against Qualcomm] comes across as highly questionable," said Zach Meyers of the **CER**, which counts Qualcomm among its corporate donors. "There will undoubtedly be concerns within the Commission legal service that these problems might have been endemic at the time and could lead to other Commission decisions being vulnerable to appeal."

Financial Times
15th June
John Springford of the **CER** noted there was "some disagreement among economists about the extent to which the TCA [Trade and Co-operation Agreement] has reduced UK trade. But, he added, "all agree that it has made the British economy significantly more closed".

Financial Times
14th June
Charles Grant of the **CER**, said Truss's style had not always gone down well in Brussels and major EU capitals like Paris and Berlin. "They feel as if she treats the diplomatic world like it's the Tory party conference."

ITV News
10th June
John Springford argues that a sizeable gap between the UK and its "*doppelgänger*" economy had opened up before the pandemic struck and that by the end of 2021 most economies had reopened and the worst of the pandemic has passed. "The UK lifted its restrictions about six weeks earlier than a lot of European countries that I compare the UK to and it had a much more successful vaccination drive. You would expect [UK GDP] to have recovered faster but it's is still quite a lot down". The **CER**'s analysis shows that Brexit has cost the UK billions of pounds in lost trade, lost investment and lost tax revenues.

BBC News
2nd June
"You only have to look at the struggle to get the oil embargo," says Ian Bond of the **CER**, referring to the tortured weeks of negotiation that resulted in this week's partial EU embargo on Russian oil.

The New York Times
1st June
"This is a purely political decision to send a message of European unity," Camino Mortera-Martínez of the **CER**, said of deal [to release recovery funds to Poland] announced Wednesday by the European Commission. "Nothing has changed except for the fact that there is war going on."

Recent events

13 July
Discussion on 'EU-US co-operation on public health', Hybrid/Brussels
Speakers: Pierre Delsaux and Gary Disbrow

12 July
Aspen Institute Italia/CER webinar on 'EU-US: What to make of Russia and the competition with China'
Speakers included: Carl Bildt, Heather Conley, Andrey Kortunov and Nathalie Tocci

4 July
CER's 24th birthday party
Keynote speaker: Sir Keir Starmer
Hosted by Adrian O'Neill, Ambassador of Ireland to the UK

23 June
Discussion on 'Ukraine's place - in Europe?', Hybrid/Brussels
Speakers: Natalie Forsyuk, Ivanna Klympush-Tsintsadze, Katarína Mathernová and Mariia Mezentseva

14 June
Dinner on 'The UK-EU energy relationship', London
Speaker: Greg Hands

31 May
Dinner on 'The future of UK finance', London
Speaker: Andrew Bailey

For further information please visit

www.cer.eu