Confiscating Russian sovereign assets to fund Ukraine's reconstruction: Mission impossible?

The Russian invasion has caused huge destruction of life and property in Ukraine. Reconstruction will be a long and costly process, and the EU and others are already marshalling funds for this effort. Some EU leaders have expressed support for using frozen Russian central bank (RCB) funds towards reconstruction, but it is unclear if this will actually happen. There are recent examples of sovereign assets being confiscated and used to compensate victims of injustice, but the confiscation of Russia's sovereign funds raises complex legal and political issues that are unlikely to be resolved quickly or easily.

Reconstruction costs and funding sources
The European Union is already engaged in efforts to prepare the reconstruction of Ukraine. The estimated costs are huge. On 18 May 2022, a European Commission communication announced plans to establish a Ukraine reconstruction platform. This would become the ‘strategic governance body’, led jointly by Ukraine’s National Recovery Council, the Commission and international partners. It would channel and coordinate financial support for reconstruction, in the form of the ‘RebuildUkraine’ facility.

At the ‘Ukraine Recovery’ Conference in Lugano, Switzerland on 4-5 July, Ukrainian prime minister Denys Shmygal stated that total reconstruction costs would amount to around US$750 billion, an estimate shared by the Kyiv School of Economics. The prime minister noted that Ukraine had so far received around US$100 billion for this purpose. The European Parliament strongly supports the provision of macro-financial aid for Ukraine.

Since the 24 February invasion, Ukraine’s Western partners and international organisations have been generous and swift in their financial support. The European Union, World Bank and International Monetary Fund were among the first to provide macro-financial assistance and emergency financing packages to the Ukrainian government. The financial support from the US and the UK to date is one of the largest emergency assistance packages in history.

The possibility of mobilising other, less conventional sources of funding remains open. The Commission communication and Shmygal both noted that the RCB’s substantial holdings abroad could be a source of income for Ukraine's recovery. The US, the EU and other partners moved to freeze these funds within days of the invasion. The funds amount to approximately US$300-500 billion. This figure dwarfs any amount likely to be realised from the seizure of sanctioned oligarchs' assets.

EU response: 'Freeze and seize'
The Commission set up the 'freeze and seize' task force in March 2022, in order to identify and freeze the assets of Russian oligarchs, and to ensure a coordinated approach within the EU and with other G7 partners. A proposed directive on asset recovery and confiscation will enhance the ability of national authorities to identify, freeze, confiscate and manage tainted assets. The focus is on the assets of individuals involved in criminal activities; the proposal does not specifically address the confiscation of Russian sovereign funds. The US has created a similar task force, known as Kleptocapture.

The European Parliament has called for compensation from Russia for war damages, arguing that Russian assets frozen as a result of sanctions ‘should be legally confiscated in accordance with international law’.

Political, strategic and legal obstacles
There are major political and strategic obstacles hampering confiscation of Russian sovereign funds. On the political front, the UN Compensation Commission serves as an interesting precedent. This was set up by the UN Security Council to deal with claims from Kuwait against Iraq, and it awarded US$52 billion in compensation to the victims of Saddam Hussein’s invasion. It is difficult to imagine the UN taking this
approach in this case however. As a permanent member of the Security Council, Russia would be able to veto any such proposal to compensate Ukraine.

In 2018, the Stockholm Chamber of Commerce (SCC) Arbitration Institute ordered Russian state-owned company Gazprom to pay US$2.9 billion in compensation to Ukraine’s Naftogaz, and this was duly paid. This is a not a reliable precedent for a judgment involving far greater amounts awarded directly against the Russian State, however, whose disregard for international law is well established. Early in 2022, the US confiscated US$7 billion from Afghan central bank funds, to be used to compensate the victims of terrorism, including relatives of 9/11 victims, and for humanitarian aid. A significant part of the legal justification for this step was that the US was a direct party to the conflict in Afghanistan; this argument cannot be made in relation to Russia's war on Ukraine.

In law, there is a clear distinction between freezing assets (preventing their use) and confiscating them (removing title from the original owner). Legal analysts note that the principle of sovereign immunity is a formidable obstacle to the confiscation of RCB assets. Any such step could well be overturned by legal challenges, and any failure to comply with due legal process in the matter would be seen as undermining the rules-based order to which the West is committed. A further consideration is that confiscation without a UN Security Council decision could set a precedent that could later be used against the US or its allies. The Economist also points out that seizure of sovereign assets could deter other countries, notably China, from holding substantial assets in the West in future.

Alternative avenues for compensation

These considerations may explain why the EU has not highlighted the possible use of frozen Russian assets among the potential sources for reconstruction, since the Commission’s communication in May. The moral case for seizing RCB assets is compelling, and the amounts involved are substantial. A significant foresight exercise may be needed in order to identify and resolve issues around legal authority and the legal basis, in addition to the problem of enforcing a judgment against Russia. The practical and political obstacles are such that alternative strategies need to be considered. Radoslaw Sikorski (EPP, Poland) Member of the European Parliament has called for legislation to allow victims of Russian terror to claim compensation from Russian state assets.

Philip Zelikow and Simon Johnson suggest that instead of confiscation, frozen assets could be used as a lever to achieve concessions from Russia. When the Russian war on Ukraine finally ends, countries that have imposed sanctions could insist on a condition for unfreezing RCB assets and for ending sanctions: that the Russian government agrees to make reparations to Ukraine. This would not require a Security Council resolution. Russia would face the reality that the loss of frozen assets, offset by a restoration of external economic links, would be preferable to the long-term continuation of the asset freeze coupled with continued economic isolation.

A further option is a tariff on Russian oil exports, with the revenue being allocated to Ukraine. Another is the diversion of payments for Russian oil into escrow accounts, to be released only when an agreement is reached on the lifting of sanctions and the provision of funding to Ukraine. With arrangements like this in place, Ukraine’s rebuilding could proceed, and Russia would ultimately have to bear a significant share of the costs.

The reconstruction of Ukraine is likely to be a generational task, extending far into the future. Efforts to secure compensation from Russia will be pursued vigorously – whether or not this involves the confiscation of currently frozen sovereign assets.