

Russian Immobilized Reserves: Position Paper for the Round Table Discussion of the Committee on Foreign Affairs, House of Representatives of the Netherlands, 27 June 2024

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1. The EU's interest in funding Ukraine

The EU has a unique interest in Ukraine's continued ability to defend itself, which in turn depends on the Ukrainian government's ability to keep delivering public services and ensure economic and financial stability. As such, the EU must view itself as the financier of last resort of Ukraine's continued fiscal capacity for as long as the war goes on. Contrary to initial hopes and for the foreseeable future, this means financing wartime expenditure rather than postwar reconstruction costs, the latter being a matter for a yet undetermined future.

In economic terms, Ukraine's defense represents a superlatively valuable investment in European security, and therefore worth funding by the EU at scale without time limit, assuming reasonable conditionality is observed.

To the extent practical, the EU should of course seek sharing the burden of that responsibility with other supporters of Ukraine. But it must also acknowledge that its security interest in Ukraine's defense surpasses that of all other significant partners. Thus, the EU should ultimately not view co-funding by others, including the United States, as a precondition for its own assistance to Ukraine.

The cost of such funding for the EU will remain modest and emphatically affordable under any assumption other than of massive escalation from the current levels of conflict intensity. In 2023 that cost has been around 0.1 percent of EU GDP, and it is set to remain around that level in 2024. It could increase significantly from that current level without becoming problematically burdensome for the EU, its member states, and their citizens.

2. Distinguishing the immobilized reserves from Euroclear's windfall profits made on them

Policymakers must sharply distinguish between the immobilized reserves,¹ which belong to the Bank of Russia, and the windfall profits that Euroclear makes on them,² which belong to Euroclear. This distinction is unequivocal, because the specific contractual conditions of Euroclear's relationship with all its account holders make it unambiguous that cash balances left at Euroclear Bank are not remunerated. As a consequence, the legal and other challenges associated with scenarios of appropriation of the immobilized reserves are fundamentally different from those related to appropriation of Euroclear's windfall profits. It is misleading and inaccurate to present the latter as a form of mild or watered-down version of the former, as has occasionally been the case in some of the media coverage and analysis.

3. Use of Euroclear's windfall profits

Council Regulation (EU) 2024/1469 of 21 May 2024, adopted by unanimity of all member states, has created a financial contribution due by EU-based central securities depositories, primarily Euroclear, which results in the transfer to the EU of 99.7 percent of their net windfall profits made on the cash portion of the Bank of Russia's immobilized reserves.

Since Euroclear is located in the EU, this forced transfer of property does not raise any issue in terms of compliance with international law, even though it may be viewed as innovative within

the confines of the EU legal order where taxation is generally the preserve of member states. There is no indication that Euroclear or its shareholders would challenge it, however.

The mid-June G7 Summit in Italy has announced an intent to execute a transaction by which G7 and EU countries would collectively lend around \$50 billion to Ukraine and expect to be reimbursed by future proceeds of the EU contribution from Euroclear's windfall profits. If properly structured, this transaction will further frontload financial resources for Ukraine and provide a signal of common purpose of the participating jurisdictions. Key features of the transaction, however, remain to be negotiated, making it impossible to pass firm judgment at this point on its benefits and costs to the EU and its member states.

4. Considerations about the Bank of Russia's immobilized reserves

The outright confiscation of the immobilized reserves would be unprecedented.³ The understanding that central banks can count on continued property of their reserves, even if placed abroad, is a foundational element of the global monetary order. It has not been broken by the immobilization actions taken in February 2022, because those actions have not modified the property status of any reserves. Confiscation would have structural consequences for the global monetary order, aside from any discussion of its compatibility with international law – and irrespective of any reaction to it by Russia itself, which no attempt is made here to predict.

The REPO Act of April 2024 gives the U.S. President authority, with expiry after five years (i.e. in 2029), to confiscate those immobilized Russian reserves held in the United States, which have been reported not to exceed single-digit billions of dollars. It appears unlikely (though not impossible) that a U.S. President would exercise that authority unilaterally or without the EU acting similarly and simultaneously. The choice of whether or not to confiscate the reserves thus belongs primarily to the EU.

Alternative designs such as issuing securities backed by the immobilized reserves, or by Ukraine's war damages claims on Russia which might be set off against immobilized reserves, raise similar problems as outright confiscation in terms of impact on the global monetary system and compliance with international law.

The EU must consider the related trade-offs in their global context. Most of the world's population lives in countries that have not been directly involved in the Russia-Ukraine conflict through either warfare or sanctions. Those that have not signed the June 2024 Ukraine peace summit declaration represent 37 percent of global GDP (53 percent at purchasing power parity).⁴ Policymakers in these countries tend to view confiscation as a dangerous option that would adversely impact their interest, irrespectively of diplomatic or strategic considerations.

5. Conclusions

The immobilization of the Bank of Russia's reserves held in the EU has successfully prevented Russia from using them as resources for its war effort. Moving from there to confiscation would not further decrease those resources. As for Ukraine's war effort, it can and should be properly financed by the EU itself, jointly with other countries to the extent practical.

EU actions so far, including the appropriation of Euroclear's windfall profits, have been unambiguously aligned with the EU's strategic interest in the preservation of the global rules-based order which Russia has disrupted through its aggression of Ukraine. The EU has the means to maintain that stance of strategic consistency, and should keep doing so.⁵

Notes

¹ The immobilization of the Bank of Russia's reserves held in their respective jurisdictions was announced by the EU near-simultaneously with Andorra, Australia, Canada, Iceland, Liechtenstein, Monaco, Japan, New Zealand, Norway, San Marino, Singapore, South Korea, Switzerland, Taiwan, the UK, the US, and a few other jurisdictions in the days following Russia's full-scale invasion of Ukraine on 24 February 2022. The level of public transparency on the location of foreign reserves is notoriously low. From various available disclosures, however, it can be estimated that the total reserves of the Bank of Russia immobilized in the G7 countries, rest of EU, Australia and Switzerland add up to around €270 billion, of which around €180 billion (two-thirds) are at Euroclear, and the last third (€90 billion) is distributed between three buckets: EU ex Euroclear; Japan; and all other jurisdictions (Australia, Canada, Switzerland, US, and UK). The €180 billion at Euroclear were initially held as securities, but nearly all of these have come to maturity after more than two years since immobilization and are thus held as cash. All these cumpens must be viewed as indications of orders of magnitude rather than precise quantities.

² Euroclear typically invest cash deposits on a highly liquid, low-risk basis, implying interest rates equal or close to the reserve remuneration rate of the relevant central bank(s). The corresponding revenue is a windfall profit because, as highlighted, Euroclear's ordinary business model does not foresee account holders keeping significant cash deposits at Euroclear Bank, as the Bank of Russia does as a consequence of the forced immobilization of its reserves. At 3.75 percent (ECB deposit facility rate as of mid-June 2024), €180 billion in cash would generate windfall pre-tax profits of €6.75 Billion on a full-year basis. The applicable Belgian corporate income tax rate is 25 percent.

³ The immobilization action of late February 2022 was unprecedented in its scale but not in its nature. By contrast, there appears to be no applicable precedent of confiscation of foreign reserves outside of a state of war and without a legitimizing decision from the UN Security Council.

⁴ Using the International Monetary Fund's World Economic Outlook dataset of GDP estimates for 2024, and the list of signatories of the joint communiqué of the Peace Conference in Switzerland as publicized by the Swiss authorities as of 17 June 2024.

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